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Pemberton Perspectives

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Discussing some key investment themes in European private debt

Super Return Private Debt Summit 2016

We attended the one day Private Debt Summit in Berlin on Monday 25th February, and we have the following observations that are relevant to the European Direct Lending market:

Re-intermediation of the Banks

"Banks are very active in the mid-market space and continue to deploy significant amounts of capital"

There was a lot of discussion about the role of banks in the European market and it was probably the first conference where there was an acceptance that the banks are not moving out of the market to the extent originally envisaged. On one panel specifically, four managers were all asked to what extent they believe that they are "better" than the banks, and there was a strong reluctance to commit to such a position. This reaffirms what we at Pemberton are experiencing in the market and from our discussions with our top 10 banking relationships, we know that the banks are very active in the mid-market space and are continuing to deploy significant amounts of capital.

On this point, we tend to agree with the recent commentary from another debt manager, "It is probably too early to tell how much the European market has changed but it certainly seems to be a more gradual transition than initially expected. Banks continue to play a meaningful role in this market, in particular over the last 12 to 18 months. With the recent ECB actions, domestic pressures to lend and the need to generate income again, banks are once more becoming aggressive with their lending. However, behaviours have changed, we see banks having little appetite to underwrite and hold large positions and are thus working more in partnership with experienced institutional investors".

Interestingly, a number of managers at the conference voiced their desire to access the bank-led deals, but with no indication as to how this would be achieved. This is confirmed by recent market information from Marlborough Partners on the UK market league tables for 2015. For Sponsor-backed deals with debt in the range of £20m - £250m, 233 deals were done by the top ten lenders. Eight of the top ten lenders were banks, representing 92% of the 233 deals[1].

This would suggest that the banks are in fact consolidating their position in the UK market, and remain very able and willing to support mid-market transactions.

This validates the Pemberton approach of working in partnership with the banks to support these financings.

Deployment of Capital

"Definite concerns about deployment and how debt managers are going to put money into the market"

As a result of the high bank activity levels highlighted above, there was a definite concern at the conference about deployment of capital and how debt managers are going to put money into the market. Most managers are entirely reliant on the PE sponsor market, a market that was down in volumes by 18% in 2015[2], and we expect will again be down in 2016. The concern seems to be that significant volumes of capital have been raised by the large managers, and there is a limited number of opportunities in which to deploy this capital. We were party to a number of conversations between different managers discussing pricing and terms on the same deals, suggesting that everyone is looking at the same transactions in the market. We spoke to one investor who is very nervous about this development and doesn't see these managers looking to expand their origination channels to offer diversified deal flow. We believe that this will be a strong theme for 2016, especially if the market in the UK closes down in advance of the referendum in June.

Investor Appetite

"Almost all managers reported strong demand from investors"

On the positive side, almost all managers reported strong demand for the asset class from investors, with the expectation that this will continue in 2016. The risk-adjusted returns are still compelling. Even if the illiquidity premium is narrowing given recent market re-pricing, the stronger covenants and better security packages, alongside no mark to market volatility, continue to support investments into the asset class.

[1] Marlborough Partners Quarterly Snapshot Q4 2015.
[2] S&P Capital IQ – LCD European Leveraged Buyout Review Q4 2015

US vs Europe

"No clear consensus"

The relative merits of the two markets were debated over a number of panels, however, there was no clear consensus with the European managers favouring Europe and the US managers sticking to their market. There was obvious concern raised about the current US High Yield developments and whether the expected increased defaults in the energy sector will spread to other parts of the credit market.

Our view remains that the US is currently at a much later stage in the credit cycle and investors should remain cautious especially given forecast future interest rate rises.

Summary

Overall, the conference confirmed a lot that we already knew, namely that working with banks rather than going around them opens up a market segment that other managers are not accessing, and secondly, that investors are increasingly focussing on deployment rates, and that this is going to become an increasing challenge as PE deals continue to shrink. This is why corporate deal flow is and will remain a key part of the Pemberton investment strategy.

These are just a few of our thoughts based on our experiences in the market.

We'd love to hear your views as we revisit some of these themes over the coming months for our Pemberton Perspectives series. So please feel free to contact our Head Of Investor Relations, Mike Anderson on +44 (0)20 7993 9311 or mike.anderson@pembertonam.com with any questions or comments.