PEMBERTON

Private debt In France

A LONG-TERM PARTNER FOR COMPANY GROWTH

FRANCE GEOGRAPHICAL SERIES

Introduction

France is an increasingly attractive market for private debt investors thanks to a powerful mixture of structural and temporary factors. The government of President Macron is tackling much needed reform, and private debt investment is growing.

Why invest in France?

France is the joint second largest economy in Europe (along with the UK) and the second largest in the Eurozone, after Germany. GDP reached €606.9bn in Q3 2019, and for the first time since 2004 France should be a leading contributor to Eurozone growth in 2019. French GDP is forecast at 1.3% in 2019 compared with 1.1% for the Eurozone, and 1.2% compared with 1% in 2020[1].

Consumer spending remains the main economic driver, boosted by a €10bn package of tax cuts granted by President Macron. Consumer confidence is at its highest level since September 2007 after nine months of increases, and although unemployment remains above the Eurozone average (8.5% for France in October 2019 compared with 7.5% for the Eurozone[2]) 260,000 jobs have been created since January 2019. The trade balance is still in deficit, with exports growing just 0.3% compared with imports at 1.4%, but the stock market is buoyant, up 26.4% for full-year 2019.

Between the large French multinationals and the mass of small businesses, there is a good number of strong, small and mid-cap companies with regional or global leadership positions. According to the European Commission there are about 136,000 SMEs, employing over 5m people in the country[3].

“We think those companies deserve the resources to develop within and beyond France,” said Geoffroi de Saint Chamas, head of Pemberton’s Paris office.

The private debt sector in France is certainly buoyant. In 2018, a total of €7 billion in private debt financed 147 transactions by French and foreign funds active in France. That was an increase of 16% in the amount invested and 20% in the number of transactions when compared with 2017 (€6bn and 123 deals, respectively) [4].

Private debt funds continued to grow strongly and, together with the arrival of new foreign inflows, this confirms France's attractiveness within the asset class. Alternative credit providers continue to gain market share, delivering sizeable, flexible and customised financing solutions to those companies willing to pay a credit fund premium to secure the flexibility they require to support their ambitious development plans.

Private equity a major driver

A major driver behind this growth – as in many other markets - has been the rise of private equity in France. In 2018, 65% of French private debt deals were backed by a PE sponsor, and many such sponsors now consider private debt and alternative credit funds as well as traditional banks when choosing their preferred financing package. In fact, more than 30% of mid-cap PE deals in France are at least part-funded through private debt, and that figure is increasing – see Figure 1.

Figure 1: # of Private Equity and Private Debt Deals

Country	MergerMarket LTM Dec-19 Private Equity Deals Report	Deloitte DT LTM Jun-19 Private Debt
France	314	103
UK	347	145
DACH	289	46
Benelux	243	32
Italy	153	11
Spain	125	23
Nordics	64	29
Other Europe	374	12
Total Western Europe	**1909**	**401**

Private equity investment in France started later than in the UK but before Germany. It expanded during the early 2000s and has been further boosted since the Financial Crisis as traditional banks have struggled to put capital to work. As a result, in 2018 France accounted for 15% of all buyout activity in Europe[5].

2018 was a record year for PE in France. French PE firms secured €18.7bn of investor commitments, up 13% on 2017. This growth was due in part to a much more investor-friendly environment following the election of President Macron in 2017 who transformed France’s wealth tax and eased taxes on companies, also providing more favourable tax treatment for carried interest. PE investment activity has also been rising, reaching €14.8bn in 2018 (vs. €14.3bn in 2017).

And this positive outlook is set to continue. According to the PwC Private Equity Trend Report, France ranks sixth globally in terms of the countries that are going to become more attractive to PE investment in the next five years, with 52% of respondents naming it in that context.

1. Bloomberg - article by William Horobin, 6 Nov 2019 | 2. Eurostat | 3. European Commission - SBA factsheet
4. France Invest/Deloitte | 5. PwC Private Equity Trend Report 2019

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Relations with the banking sector

The growth in private debt in France has come in spite of a healthy domestic banking system, one of the strongest in Europe if not the world. The country's four main banking groups also traditionally rank in the top 10 of leveraged finance bookrunners in Europe. As a result, French SMEs enjoy relatively good access to finance, with low interest rates and a low level of requests for guarantees.

"All this might hinder private debt providers trying to establish themselves in France, but in practice mid-cap companies often find banks less suitable than they would like. As a result we regularly see situations where companies choose us over a traditional lender," said G. de Saint Chamas.

That flexibility can be seen in private debt providers' willingness to look at fast-growing businesses, and their ability to provide firm commitment in short timeframes – a critical factor in M&A financings.

Private debt providers were initially active in the €15-20m EBITDA range but have moved into the larger mid-caps as the product became more familiar to the French market. Of course the traditional banks remain very active, with a mix of domestic and international bank present in the French market, but it would be a mistake to see the interests of the banks and private debt providers as necessarily opposed.

"We regularly work alongside banks to deliver certain structures that they would struggle to deliver alone," said G. de Saint Chamas.

"For example, some banks are less comfortable with bullet financings. It helps that our Paris team is full of ex-bankers, so we understand what banks can and can't do. That differentiates us from some other private debt funds, whose background is in capital markets and who take a more transactional view."

One feature of Pemberton's financing offering is its involvement in delayed draw capital, which banks have traditionally disliked given the impact on their balance sheet. "But we are happy to provide delayed draw capital if we are happy about the credit," he added.

An evolving legal and regulatory framework

France has not historically offered a particularly friendly legal environment for private debt providers, and at first sight there are still some restrictions on the ability of private debt funds to provide financing to French companies' needs.

Technically, for example, private debt providers cannot make 'loans', so deals are structured as bonds. In practice, however, this makes no difference to the company.

The country remains a borrower-friendly environment. Compared, for example, with the UK it is still challenging for a creditor to enforce securities if a company defaults. Indeed, the Financial Crisis showed how France is not a market for inexperienced investors, a factor that plays to the advantage of locally-established players such as Pemberton, most of whose Paris team have over 20 years in the market.

The French labour market also remains less flexible than other European countries. However, the direction of travel is towards greater flexibility and President Macron's reforms have focused on changes to taxes, benefits, temporary contracts and the cost of unfair dismissal. The intention here is to help companies to be competitive by giving them flexibility, for example to adjust employee compensation, which is important to private debt investors and can prove to be vital for certain businesses.

The good news is that default rates for French SMEs compare well with European peers. According to Euler Hermes Rating, the cumulative three-year default rate for SMEs and midcaps was 3.94% for France, compared with 3.65% for Germany.

Market highlights

Across the asset class globally, 62% of the total invested was single-tranche, with senior debt, other subordinated and mezz making up the balance.

Pemberton is no exception to this pattern. "Our real value comes from our ability to understand the company's business, rather than providing highly levered loans," said G. de Saint Chamas.

Another critical topic in the French market is that CEOs are often key decision-makers in PE-sponsored deals, so it is important for private debt providers to have the experience and credibility to talk to them and develop long-term confidence.

Most of Pemberton's deals are with PE sponsors (see Figure 2), but that does not have to be the case. Family- or founder-owned businesses have also found the flexibility of private debt funding to be appealing.

Another real differentiator is the firm's network. "We have a network of eight offices across Europe, which is extremely valuable for companies looking to expand outside France," explained G. de Saint Chamas.

Pemberton's growing presence

Pemberton has been making investments and providing debt financing in France since 2015. It concentrates on mid-cap companies with annual EBITDA in the range €10m-€75m, and is active right across that range. Deal sizes vary, but in 2019 Pemberton arranged eight transactions, ranging in average €100m including delayed draw tranches.

The firm's French deals extend across a range of sectors. There is no particular sector bias, but a strong focus on leading, highly profitable and rapidly growing businesses, often operating in niche activities.

Over the past years Pemberton has been particularly active in various segments of the healthcare industry, and also in businesses related to the cosmetics, aerospace and telecom industries.

Figure 2: Highlights on certain of Pemberton's private debt deals in France (FY 2019)

Company	Sector	Sponsors	Notes
Maesa	Global beauty brand incubator	Bain Capital	Financing
Photonis	Manufacturer of image intensifier tubes for space, research, defence and commerce	Ardian	Refinancing
Wifirst	Wifi internet provider	Amundi PE and BPI France	Financing
Sterimed	Sterile packaging for the pharmaceutical industry	Sagard	Financing
Euro Techno Com	Distributor of passive and active telecom equipment and supplies	Carlyle	Financing
Sabena Technics	Specialist in aircraft repair and maintenance	Sagard, BPI France and TowerBrook	Financing
CIR	Renovation of historic French heritage buildings	Bridgepoint Development Capital	Refinancing

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

We'd love to hear your opinions. So please feel free to contact our Business Development team on businessdevelopment@pembertonam.com or +44 (0) 20 7993 9300 with any questions or comments.