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A PARADIGM SHIFT FOR EUROPEAN DEBT

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Private debt funds are filling the gap left by bank retrenchment, says Sandrine Richard, Head of private debt at Generali Investments Partners*

How would you describe the current mid-market private debt opportunity across Europe?

The markets that we focus on in France, Germany, Italy and Spain are changing deeply. Starting with covid, then the geopolitical situation, the weaknesses in the global banking system, higher inflation, energy prices and interest rates, we have seen a paradigm shift that has created opportunities and points of attention for debt funds and investors. Investing in private debt implies floating rate notes, so increases in base rates are benefiting investors.

Because it is not listed, private debt aims to offer protection against volatility. Private credit also has a key role in supporting the economy and SMEs, while providing protection via lender-friendly documentation, notably financial covenants, which is even more key in the current environment.

As the banks have stepped back from corporate lending that has enabled private debt funds to fill a gap. Banks do have less capacity to lend and their clients still need access to capital, so there is a good opportunity for us to work not in competition but in collaboration with bank lenders. We need to continue to be selective.

Your private debt fund targets SMEs across Europe. What makes SME borrowers attractive, and how can investors tap into the best businesses in this segment?

The direct private debt fund is targeting SMEs in continental Europe, with the option of more opportunistic investments in the UK. The fund focuses on senior secured debt in the most protected part of the capital structure, given the evolution of the market and the challenging macroeconomic environment.

This fund will invest only in floating notes, protecting investors from the increased rates. With an Article 8 classification under the EU's Sustainable Finance Disclosure Regulation (SFDR), the fund will target companies that are willing to make ESG commitments. The metrics will be bespoke, so that the ESG support can be targeted to the needs of each company. The SME space is attractive from an investor perspective because of the sheer number of opportunities – there are 11.8 million SMEs in our four markets alone, according to European Commission Eurostat data. That volume allows us to be selective, while also providing diversification for investors because these companies are unlikely to be listed. Because the finance for each business is small, these are typically bilateral loans which again reduces the potential for overlaps within investor portfolios.

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Because direct lenders are in dialogue with shareholders and management teams, they can be long-term financial partners in the development of the business. On ESG, that dialogue puts us in a better position to agree and deliver on a collaborative approach.

Lastly, SMEs are attractive because there is less competition in that space from private debt, with fewer players than there are in the upper mid-cap space.

How does the opportunity set vary across geographies? Where are the most attractive places to deploy capital today?

We see opportunities in all four of the markets that we target through our direct private debt fund. We are a little bit more cautious on the UK, because we think the Brexit impact is not yet fully known. In France private debt is now an option considered by all corporates looking for financing of leveraged buyouts or acquisitions. In Germany, unitranche has been very successful in the last 18 months.

Sandrine Richard
Head of private debt at
Generali Investments Partners*

Sandrine brings to Generali Investments over 25 years of investment and business development experience in the European asset management industry.

Sandrine joins from Muzinich, where she steered the European and French senior secured and private debt strategy in senior leadership roles, contributing to launching and managing private debt funds with robust ESG processes. Prior to that, she covered senior roles at AXA AM, including leading the private debt investment team, and at Exane.

Sandrine holds CESGA (Certified ESG Analys), CAIA (Chartered Alternative Investment Analyst) and CFAF (Centre de Formation à l'Analyse Financière) certifications, in addition to having achieved an Independent Administrator Executive Master from EM LYON, and a diploma from the Institut Supérieur de Gestion (ISG) Business School.

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Italian banks are still active but in the last six months we have seen some senior and mezzanine transactions and are starting to see small unitranche deals. The Spanish market is smaller and quite mature in terms of the different financing options, whether that is bank-only, banks and private debt, senior and mezzanine or unitranche. There are lots of options for Spanish borrowers.

How can lenders build a resilient 'all-weather' approach into their European portfolios in the current macroeconomic environment?

The benefit of closed-end funds in private debt is that we have time to invest. Usually we have three years, so we don't have to hurry and can adjust the pace of capital deployment with our understanding of the risk-return ratio. Having that time allows us to be selective, to conduct deep analysis of investment opportunities and negotiate the best documentation for all parties.

Monitoring is also important to that all-weather approach, ensuring we keep in close dialogue with the company to anticipate and respond when performance erodes. Having local investment teams in our markets helps with that selection, analysis and monitoring of investments and reduces risk.

Our investment teams and committees also have expertise outside of private debt, so they can share that knowledge to help us build insights on industries, macros and trends that support our selectivity.

Finally, as an Article 8 fund, how do you support SMEs on their ESG journeys? What are the biggest challenges with this for a manager today?

The ESG philosophy is to help portfolio companies enhance their ESG processes. We strongly believe that if a company has better awareness of their ESG strengths and objectives, that creates additional value for investors by developing businesses which promote certain environmental or social characteristics with a greater capacity to repay their debt at par. In order to do that, we leverage ESG regulation and lean on the support and expertise of the PE firm and management team to integrate ESG into the day-to-day business.

Our contribution starts with an analysis of the non-financial aspects of the company to understand their intentions, based on discussion with the sponsor, management team, our investment team and our ESG team at Generali. That multi-party approach helps define and implement the ESG objectives during the investment phase.

During the period that we hold the portfolio companies, our contribution is to offer analysis from external ESG experts based on a short annual questionnaire that monitors progress and shows what still needs to be done. We also track quantifiable KPIs to ensure compliance with our proprietary sustainability due diligence evaluation.

For SMEs, we believe it is really important that we provide support and leverage our capabilities to help management teams – we are all still at the beginning of this journey and collecting the data is a challenge, as is coordinating all the different requests for data from counterparties around the business. The regulatory environment is not yet completely robust and stable, but as it matures these issues will be overcome.