EQT CREDIT

Calling on experience

Supported by a large network of industrial advisors, EQT Credit brings added value to its three strategies. **Andrew Konopelski, Cyril Tergiman** and **Paul Johnson**, at investment advisor EQT Partners, explain more about the firm's approach to the market

"The banks have got huge resources but you can do all the reading of sector analysts' reports that you want – nothing beats sitting next to someone who has run the type of business you are looking at."

Cyril Tergiman, a partner at EQT Credit, is describing the due diligence process and the advantage that EQT as a firm has in being able to draw on a group of approximately 250 industrial advisors – established business leaders with experience from different industries and regions from around the world. This network is a major selling point of all EQT's investment strategies which began with private equity and then segued into infrastructure and subsequently – in 2008 – into credit.

Tergiman knows all about the banking resource he refers to above. He, Andrew Konopelski, a partner and head of EQT Credit at investment advisor EQT Partners, and Paul de Rome, a partner and CIO of EQT Credit, were formerly in the leveraged finance team at Citi before seeing an opportunity to move into the European private credit market – just as it was beginning to gain some traction – with the aim of exploiting EQT's alternative asset experience, its investor base, its network of local offices and its knowledge.

And it's that knowledge base that the experts within EQT's proprietary industrial advisory network contribute materially to. "The advisors are a resource for the whole of EQT," says Paul Johnson, a portfolio manager with responsibility for EQT Credit's senior debt strategies.

SMARTER TOGETHER

"We use them on the due diligence angle, where they can bring us up to speed quickly," Paul adds. "They attend management presentations and it's great to have an industrialist on your side as they can

Paul Johnson, portfolio manager

dig down to a level of granularity that is typically beyond financiers and they can provide valuable insights on the downside. They've also seen everything before and might know about aspects of the industry you've never come across or that may seem irrelevant or unimportant."

Johnson adds with a wry smile that he and his colleagues "enjoy the debates about what can go wrong". On the face of it, not much has gone wrong so far for EQT Credit. With a key eye on downside risk, Konopelski says the approach allows EQT to be better credit pickers with negligible loss rates in the portfolio companies..

Back in 2008, a 'downside' was just around the corner, waiting to become a major part of history. It was "an interesting time", Konopelski recalls with understatement, with the launch of EQT Credit coming just before the collapse of Lehman Brothers. Once the crisis had hit, it was perversely an encouraging time for private debt providers as the banks retreated to the side-lines to nurse their wounds and vacated a financing gap to be filled by others.

CARVE-OUT

Initially the investments were made on the basis of a carve-out from EQT's fifth private equity fund, which managed €4.25 billion and was launched in 2006. It then went on to establish its first Credit Fund in 2010 on €320 million with the broad aim of tapping into post-crisis opportunities and the specific mandate of seeking medium-term investments in operationally-sound companies facing challenges created by excess leverage levels or the need for additional capital. The EQT Credit Fund II was established in 2013 with €845 million under management.

'PAID WELL FOR RISK'

Two other strategies have followed. The first was Senior Debt, a strategy spearheaded by former Credit Suisse leveraged finance director Paul Johnson and which seeks investment opportunities in floating rate loans and notes of strongly performing European companies.

Explaining the background to the launch of the senior debt strategy, Johnson says: "Post-crisis, people were getting paid well for risk. So we focused on that. Many investors had only had exposure to leveraged loans through CLOs before. EQT Credit focuses on a higher level of due diligence."

In the current market, senior debt invested in leveraged loans typically yields around LIBOR plus 5 percent. "In a low interest rate environment, we find this an interesting opportunity, especially if the due diligence is done in a sensible way," asserts Johnson. "In the last 18 months we've found this approach really plugs a gap in the investment market."

Following senior debt came the third strand, focused on mid-market direct lending. In April this year, EQT's Mid-Market Credit strategy was created with €530 million under management. This strategy focuses on flexible long-term debt capital solutions to medium-sized European businesses.

Andrew Konopelski, partner and head of credit

EMERGING OPPORTUNITY

Tergiman says the private debt opportunity is emerging in spite of the low financing costs that borrowers have become accustomed to. "Many corporates have been borrowing at 200bps and that's what they're used to. Essentially, they have benefited from mispriced risk. But there may come a time where they're under a bit of stress or they need to make a big acquisition and that's where we can come in."

With three strategic approaches now within the EQT Credit stable, the firm is fulfilling its initial objective to have a suite of credit products. The three executives have already explained the vital role of the firm's industrial advisors – but what else gave them the confidence to change careers and pursue a different path?

"Traditional lenders were paralysed," reflects Tergiman. "There was no liquidity in 2008/09 and beyond but there was a need for financing. We felt that Europe

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simply had to change [in terms of who would provide the finance] because the regulators didn't want systemic risk and we were sure that the private market would take up the slack."

COMPETITIVE ENVIRONMENT

At the time Tergiman and Konopelski made their move, they also sensed that the competitive environment was accommodating. Pre-crisis, most debt financing in Europe had come from US-based organisations. In the new environment, very few managers had a European footprint. With its nine offices across the continent, EQT was well placed to be a trusted source of capital. "People care about local attachment here," says Tergiman.

Although Europe's private debt market has undoubtedly become more populated than it was when EQT Credit was taking its first steps, Johnson says that when looking at a possible investment opportunity, the firm typically finds itself up against no more than four or five other fund managers. Moreover, deal flow is healthy – he says that the firm has seen more than 300 possible deals during the last year in mid-market credit.

The three executives are keen to stress what they see as key attributes of EQT's approach: speed, flexibility and creativity. Private debt is often not the cheapest source of finance, but it may well offer the best solution in situations where the borrower has certain requirements.

"EQT can help when someone needs something a little unorthodox," says Tergiman. "Maybe the company needs to extend its maturities but has a potential issue with its lender and needs to bring in new money. Perhaps it's a big company, things are not going well, and the lender tells it to sell the jewel in the crown. But maybe EQT can ring-fence it and leverage that entity. It comes down to creativity and also having the personality and conviction to get something done."

By way of a specific example, Tergiman refers to a deal the firm did in Finland. The country is not one where you would expect private debt to resonate with borrowers, since the banking community has remained dominant post-crisis. But in this case, he says, "the sponsor was prepared to pay a premium as it wanted to drive the return through a roll-up strategy and, if it's dealing with an amorphous banking committee that doesn't react quickly, then it's potentially losing return."

CALCULATION

This puts in sharp focus the kind of calculation that sponsors have to make when it comes to assessing whether using private credit is right for them. "You have to deliver value and be conscious of the cost of debt versus the value it delivers," says Konopelski. "That's why we don't just peddle wares, we offer a creative solution."

"The ethos we developed from the beginning was around flexibility and creativity and that permeates EQT's direct lending approach," adds Tergiman.

It's a message that all three believe is now being digested by borrowers. "The sponsor acceptance of private debt is growing daily," says Johnson. "Not just direct lending but the whole market. For large cap sponsors it's about what you can give me on a speed and certainty basis."

Cyril Tergiman, partner

Borrowers are not the only ones getting the message. So too are limited partner investors, although patience has been required since the private credit 'bucket' within institutional portfolios has only recently emerged. Previously, private credit fell uncomfortably between the alternatives and fixed income allocations which both struggled to engage with a form of investment that had some characteristics alien to both.

MARKET SENTIMENT

Tergiman makes the point that, amid adverse regulation for the banks, acceptance of private debt fund managers will continue to grow. However, he suggests that more uncertainty and volatility in future is the "elephant in the room". For a while now, market conditions have been supportive of the asset class's growth – but what if that changes? "The market is supportive of people who know how to deal with that uncertainty," says Tergiman.

With three well-established different strategies, EQT Credit can arguably afford to be optimistic that the strategies and the market will endure. ■