DIVERSITY AND CREDIT CYCLES: WHAT IS THE BEST STRATEGY TO INVEST IN EUROPEAN PRIVATE DEBT?

- Thierry Vallière, **Amundi**

Disintermediation is clearly gaining traction in Europe, and investors, looking for promising opportunities, are now favouring the private debt market. If, indeed, the European market offers assets that can justifiably attract investors, it nonetheless remains quite different from its US counterpart. Ignoring or underestimating European specificities might not only lead investors to miss out on some of the best investment opportunities, but it could also generate additional risks, warns Thierry Vallière, Global Head of Private Debt Group at Amundi.

Tom Carr: The European private debt market has recently been driven towards disintermediation. Is it going to resemble the US market?
Thierry Vallière: Disintermediation is deeply rooted in the US mindset and represents between 75% and 80% of funding volumes of the US market. This is mainly due to the way the US banking system works, with leaner balance sheets and looser regulations. So, historically, US banks have transferred part of their risks to institutional and retail investors.

In Europe, on the contrary, banks have more substantial balance sheets and retail customers cannot directly buy disintermediated debt. Disintermediation is nonetheless gaining ground and now amounts to 20-25% of all funding. European issuers want to diversify their funding sources and arrangements, while investors are looking for increased yield and diversification. The trend is also supported by new regulations. So it should be a long-term trend.

All in all, and even though the European private debt market is not as deep and mature as in the US, it has expanded significantly over the last 10 years.

TC: Can managers approach the European private debt market in the same way they would approach the US market?
TV: Maturity and depth are not the only differences between both markets. The US market is a relatively homogeneous one, with a single fiscal law, unified creditors rights and common insolvency proceedings – which favour creditors. The EU may show signs of harmonization and integration, but each member state currently still has its own banking regulation, fiscal law and insolvency proceedings. The latter offer more protection in the UK and the Netherlands than in Italy, for instance.

Banking systems are also very different, from one country to the other. France has several major integrated banking networks, while Germany and Italy boast a myriad of local and regional banks. Companies are not the same either. US corporations can access a market of 325 million people, while European companies are probably more diversified, both within and outside of the EU.

So owing to the diversity of the European landscape, managers need deep local roots and intimate knowledge of European states and of their local players.

TC: Taking into account this high level of complexity, can Europe become a strategic market for private debt?
TV: European private debt is a fast-expanding market that can no longer be ignored in strategic diversified allocations. It offers numerous and diverse investment opportunities, thanks to a diversified economic landscape. Relative values are therefore up for grabs. Time-to-market should not be neglected either. And the timing is right: the market is growing fast, it is far from being mature and there are many opportunities to seize.

However, there is not a direct correlation between capital raised and investment opportunity. In 2008, the investment opportunity set was great, but you could not get capital from investors. Now, you can get the capital, but with the overall excess liquidity in the market, can you spend it wisely? Managers need to remain very disciplined and rigorous to find the appropriate risk-adjusted return transactions.

> ***"European private debt is a fast expanding market that can no longer be ignored***

TC: How can you identify these opportunities?
TV: You need strong local roots to address the European private debt market. And that is the strength of Amundi, with our subsidiaries and partnerships in many countries. You need to cope with the specificities of banking systems, and we can rely on our local networks. We also take into account the components of each country's economic fabric. We typically invest in companies with turnovers ranging from €75mn to €1bn, and €300-500mn sweet spots.

There are, for instance, many such exporting companies in Germany. They make up the famous "Mittlestand", one of the country's economic pillars. Their business profiles are interesting, but institutional investors usually cannot afford to provide the same level of competitive funding as banks or savings banks. Italian companies are often family owned, and usually use short-term funding through local players. France has a different model with five healthy banking players. It offers many opportunities and

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France is actually Europe's second most disintermediated market, after the UK.

These examples help to understand why investors need the support of players who are closely acquainted with European specificities.

TC: So the ability to arbitrate is at the heart of your investment strategies?
TV: We arbitrate between countries, indeed, but also between assets. Our size gives us privileged access to an abundant deal flow. As a matter of fact, deals are often directly offered to us before being offered to smaller players.

However, our sourcing capabilities, which are increasingly crucial as more and more players enter the field, do not mean we are not highly selective. On average, we have access to close to 450 operations every year, but our hit ratio is only 5% or 6%. Last year we spent €660mn on 23 operations. Almost half of those were carried out outside France.

And compared to pure private debt players, we are also able to ponder the relative value of each asset, in relation to Amundi's other fields of expertise, such as fixed income. Thanks to the scope of our activities, we are not under any pressure to invest, and we prefer to wait for the right deal, rather than select assets by default.

TC: Can selectivity act as a hedge in case of a turnaround in the credit cycle?
TV: Managers currently operate in the most changing and challenging environment ever. It is marked by unconventional monetary policies which have negative consequences for most asset classes.
In addition, interest rates are progressively rising again as the European QE is being alleviated. If money becomes more expensive, default rates could increase among less robust players and on transactions undertaken with a slippage in risk management.

So we have decided conservatism was the way to go. We invest in the most secure and senior part of capital structures, as it will be hit last in case of a cycle turnaround. This is what we do for all private debt assets, be they corporate, LBOs or real estate. We also favour floating rate structures, as they will desensitize us, should rates be on the rise.

Finally, Amundi has shown its ability to strive through credit cycles, while some other asset managers have yet to experience one full cycle.

TC: Does that mean there is only one strategy to approach the European private debt market?
TV: Protecting ourselves against a possible cycle turnaround does not mean we cannot build diversified investment strategies. Some of the portfolios we have built are centred on mid-caps, while others are more liquid and favour large caps and LBO operations. The latter nicely complement traditional high-yield strategies.

We also offer targeted strategies, for commercial real estate, or others which are innovation driven, for Italian food products for instance.

However diverse they may be, all of these strategies have one thing in common: they are built on our local presence with pan-European scope and strict risk management.

AMUNDI ASSET MANAGEMENT
Amundi is Europe's largest asset manager by assets under management and ranks in the top 10[1] globally. Following the integration of Pioneer Investments, it now manages over €1.4tn of assets[2] across six investment hubs based in 37 countries. At the end of 2016, Amundi launched a platform dedicated to real and alternative assets to provide easier access to unlisted investments. Bringing together capabilities in real estate, private debt, private equity, and infrastructure (green energy), this platform has a headcount of 200 people for AUM of €40.8bn[2], and offers solutions through funds, club deals and multi-management, including two innovative and ambitious partnerships with EDF and CEA. As part of this new platform, the Private Debt division manages €23.6bn and has a dedicated team of experienced professionals in corporate financing who leverage Amundi's extensive Fixed Income capabilities: No.[1] European bond manager with €800+bn of assets and 150 dedicated professionals, including 19 in-house research experts and 18 sector analysts[2]. The private debt division is intended to participate in the financing of companies and their projects (LBOs, investments, external growth, etc.).

THIERRY VALLIERE
Thierry Valliere is Global Head of Private Debt Group. He oversees all private debt activities and is co-chairman of the Investment Committee for the asset class.

Thierry joined Amundi in 2015 from Printemps, the leading French department store and real estate group, where he was deputy CFO. Prior Printemps, Thierry was an Executive Director at the investment bank Rothschild & Cie, where he was involved in M&A situations, debt advisory and restructuring in Europe until 2010.

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[1]Source IPE "Top 400 asset managers" published in June 2017 and based on AUM as of end December 2016.
[2]Figures as of 31 December 2017. Source: Amundi Asset Management