FUNDRAISING

The south warms up

Fundraising in southern Europe is picking up, with managers that have successfully deployed initial funds now planning successors. **Claire Coe Smith** examines the landscape

When Spanish credit firm Incus Capital closed its third fund on €500 million at the end of 2018, it signalled the start of an anticipated flurry of fundraising by private debt firms coming of age in southern Europe.

Madrid-based Incus raised its €130 million first fund in 2012 and a second worth €270 million in 2016. It was able to reach a first and final close on its third fund six months after fully committing its second and well ahead of the investment period ending. It secured half its money from European investors and the remainder from the US and Canada.

Incus lends across Spain, Portugal, Italy and France and has already deployed €150 million of the capital raised for Fund III. Andrew Newton, managing partner, says: "In general, we work in the sponsorless part of the market, and we have certainly found in the last few years that there are a number of companies that are very comfortable with alternative debt as a strategy. We see increased flows across Spain, Portugal and Italy as those non-sponsored borrowers become more educated and accepting of alternative credit as a product."

While many pan-European private lenders are active in southern Europe, there is a growing body of local credit funds playing in the lower end of the mid-market and now fundraising for second and third funds.

Trea Direct Lending is another Spanish firm currently fundraising, having gathered €70 million for its first fund in 2017, with a focus on sponsorless deals in Spain. Trea finances Spanish SMEs with mainly senior and senior convertible debt; ticket sizes typically range from €5 million to €25 million. It has already raised €160 million against a target of €200 million for its second fund and has done three out of an anticipated 15 deals from the vehicle, after completing seven deals out of Fund I.

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Andrew Newton

Managing partner Ignacio Diez Torca says: "In Spain, the investor base is very limited because the number of institutional investors is quite small, so the potential to raise capital here is small. We are attracting a lot of interest from private banks now, because what we do is much less risky than unitranche with the same returns, and we are also beginning to attract international investors."

LPS ARE DIVERSIFYING

He adds that LPs are keen to diversify into new regions, and southern Europe is hot, but the challenge is the size of the deals. "All the managers that do sponsorless deals are country-specific, because they have to be. We are finding 10 or 20 investors who will look at country-specific funds, but still it's too small. We already have two foreign investors, but it isn't easy – they love the product but it is risky."

In Italy there is a similar wave of fundraising anticipated, with the private debt team at Italian investment bank Equita in the market for a second fund, targeting €200 million with a €250 million hard-cap. Equita raised €100 million for its first fund launched in 2016 and Paolo Pendenza, head of the Equita team, says activity has taken off since the start of 2018.

"The private debt players that are currently active in Italy were all born at more or less the same time," says Pendenza, "and so we are all going back into the market at the same time to raise second funds. I expect 2019 to be characterised by fundraising activity and an increase in capital deployed as the market continues to progress."

The first fund's investors were all Italian institutions, including fund of funds Fondo Italiano d'Investimento, which backed several private debt players. "It will be interesting to see what those funds are

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capable of raising for fund two, based very much on their track record and depending to some extent on whether Fondo Italiano will also be in a position to invest," says Pendenza. "They played a fundamental role in the first round of fundraising, and the market would suffer if they were missing in the next round."

Equita is looking to expand its investor base outside of Italy this time around, and is also in the process of registering its own management company with the Bank of Italy, so it cannot officially launch the second fund until that process is completed in the summer. The new fund will focus on unitranche and subordinated bonds issued by Italian SMEs, with ticket sizes of around €15 million. Most of the firm's deals are private-equity backed, often adding a layer of intermediate capital beyond what the banks are able to offer.

Pendenza says: "What is characterising our market at the moment, as compared to other markets, is that we tend to lend on lower leverage and better contractual terms. We can still agree solid structures, which will make a difference if we move towards a softening market.

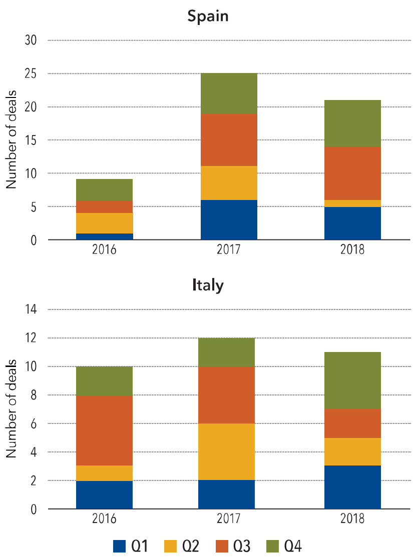
"There is now a real appreciation of the new instrument available from alternative lenders, which took some time to find a space and gain appreciation in the market. But 2018 was very active for private equity in Italy, and so that helped in terms of deployment. This is still a young market, so there is room to gain market share."

"THEY [FONDO ITALIANO] PLAYED A FUNDAMENTAL ROLE IN THE FIRST ROUND OF FUNDRAISING, AND THE MARKET WOULD SUFFER IF THEY WERE MISSING IN THE NEXT ROUND"

Paolo Pendenza

BULLISH MOOD

Direct lending deals in Spain and Italy have increased since the end of 2016



Source: Deloitte

BANK BUDDIES

Across southern Europe, the economies are characterised by a diversified bench of family-owned businesses and banks that are actively lending, unlike in other European regions where their influence is waning. Many private debt funds have chosen not to compete, but instead to work alongside the banks.

Alfonso Erhardt is founding partner at Oquendo Capital, one of Spain's oldest private debt managers, which entered the market in 2007. "In Spain, the banks are extremely active in lower mid-market situations," he says. "So if you are a bank replacement lender doing unitranche it is difficult to get market share. The banks need the lower mid-market to keep their lending activities going."

For his firm, that has created two opportunities: providing mezzanine debt when businesses require a larger figure than the banks can reach; and, on the senior side, being able to layer on another tranche where banks need part of the risk off their balance sheet.

"We partner alongside the bank, to help them offer better terms and flexibility to clients," says Erhardt. "We are not competing with them. In fact, the market is much bigger where the banks are present, because they get access to the best deals."

There has also been huge consolidation in the Spanish banking industry in recent years. The acquisition by Santander of Banco Popular in 2017 put an estimated 80 percent of Spanish business financing in the hands of five banks, where more than 150 were active less than a decade ago.

"There has been a huge concentration in a short space of time," says Torca. "All the banks have been through a huge consolidation of credit, so that's where the opportunity lies – being an alternative financier in a market that doesn't have alternative financiers."

As business owners and sponsors alike wake up to the opportunities on offer outside the banking sector, funds are witnessing an uptick in demand and fundraising looks set to take off in the coming months.