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HOW TO LEAD YOUR INVESTMENTS

Private debt market, large opportunity for SMEs and investors

LMF International

In 2015, in Europe, this sector raised 41 billion euros. "SMEs are still too leveraged and too dependent from banks", said Vari (JCI Capital Limited), who added: "There are a wide variety of investment structures available"

Private debt market provides large opportunity for SMEs and private debt funds represent a source of alternative funding for companies that are still too dependent from banks. All information about this market, that is still underdeveloped, illustrated by **Luca Vari, head of Capital Markets, JCI Capital Limited**.

Vari, when the private debt market was born and what are its main characteristics?
In 1951 the Federal Reserve Bank of Richmond noticed that US life assurance companies were investing in a new type of debt: private placement in order to finance SMEs long term needs.
In other words life assurers were investing like banks, and their experiment was not far off to what today we would call 'direct lending'. That was the start of the US private debt market.
Until 2008, European SMEs'financing model was dominated by commercial banks : SMEs' liabilities originated from banks' lending and only a minority part from capital market transactions. After 2008 the combination of a low rate environment and banks deleveraging their balance sheet have made a real difference in the development of the private debt market.
In 2015 the European private debt funds managed to raise 41 billion euros. The SMEs network is the backbone of Italian economy, most of these firms are export oriented and an excellent opportunity for a private debt fund. Finally in 2012, the Decreto Legge D.L. 83/2012 made private debt investments a source of alternative funding. Last year, Italy's government allowed insurance companies to lend directly to businesses. Italy urgently needs to develop capital markets operations to replace banks in the SME capital structure: SMEs that are still too leveraged and too dependent from banks.

What is your role in this market, what do you do and who are your potential clients?
JCI Capital acts as an advisor to small and mid-market firms operating in Southern Europe.
We are currently working with SMEs that require growth financing or that are looking to differentiate their source of funding. We are already dealing with restructuring corporate debt for firms that are involved in pre-bankruptcy procedures. JCI Capital is able to find the right investment partner – whether domestic or international – for every single funding issue, this is our strength.

On a separate note our Asset Management Team will soon be launching a private debt fund focused on Southern Europe, more details to come in the next few months.

What are the main instruments of private debt?
Private debt investments are not easily bucketed into existing asset allocations because they can have characteristics of more than one asset class. Private debt can range from senior to mezzanine to distressed debt.

Given this market environment, there are attractive opportunities for investors in search of higher returns? What strategy do you suggest to adopt?
The wide variety of investment structures available in the private debt space can offer a diversified exposure to investors. European investors are currently looking for a return between 7.00% and 13.00%. This very much depends on investors risk appetite.
Cautious investors that are entering this market for the first time should focus their investment strategy on senior secured lending, which is less risky. Funds with a riskier investment profile could move towards a structure that includes subordinated debt such as mezzanine (with an equity kicker) or distressed debt.

In terms of asset allocation, which role these tools could play?
Direct lending should be taken into consideration when institutional investors build their asset allocation. Diversification in the credit strategy, through single or multiple structures (senior, mezzanine, distressed, real estate, etc.), will for sure stabilise returns.

In your role as arranger, how are seen the Italian companies abroad? What are the foreign investors more interested and why?
What we are seeing is that institutional investors are looking with extreme interest at the Italian SMEs market.
All our small and medium size firms are very well-known in their sector of reference both in Italy and internationally, but their financial structure is still very much dominated by banking debt.
Private debt funds, with their experience and expertise in the global financial markets, could definitely become great partners to our SMEs. Of course our SMEs should do the same and look at the private debt market as an opportunity and not suspiciously.