

**Private Debt
Investor**

Mid-Market Lending

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Rebalancing act

10 trends defining the
mid-market in 2023

PEI

8

Emerging markets in Europe

US direct lenders are seeking to gain an edge with industry knowledge

In the summer of 2022, Tikehau Capital completed its first private debt deal in Turkey, lending to Airties, a leading provider of smart residential wifi that is in the process of relocating its headquarters from Istanbul to Paris. Tikehau Capital's head of private debt, Cécile Lévi, says the firm is also seeing increasing interest in its private credit offering from across Central and Eastern Europe, even though it has yet to lend to the region.

Outside core markets in the UK, France, Benelux and Germany, southern Europe is a particularly attractive emerging opportunity for debt funds. Lévi says: "In Italy there are some really top-class companies and we find that equity sponsors that are focused there and monitoring that market are seeing a lot of strong transactions.

"Spain is a bit more challenging because the banks are extremely active. For deals up to around €120 million, we find the majority go to bank financing, but when the deal is above that, the opportunity set shifts and we see more distribution problems."

Jaime Cano Artero, a partner focused on private debt at Alantra, a Spanish firm with a credit strategy split across corporate lending, real estate and special situations, says banks are slowly losing their grip on financing. Managing €550 million with a focus on

the mid-market in Southern Europe, he sees the opportunity for private credit growing in Spain.

Spanish banks step back

"We started our activity in Spain in 2015 and since then it has been building progressively and continuously year by year," says Cano. "When we started, bank finance represented around 80 percent of total financing, and now that percentage has decreased to more like 60 percent. The banking industry in Spain is very strong and there is a lot of exposure to bank finance, but the consolidation process means there are now only a small number of banks doing the vast majority of financing for SMEs and mid-caps.

"There used to be three or four banks servicing each company and now the banks are reducing their exposure, meaning companies are looking for alternative lenders."

Because banks are stepping back, there are many things they cannot do, such as bullet loans or any kind of corporate lending with a loan term that exceeds five years, says Cano. "More and more small and mid-cap companies in Spain are keen to work with flexible alternative lenders, even though they may be more expensive, because we can provide more solutions and be complementary to the banks.

“They are providing short-term finance, revolving credit and other banking products to companies, but we maintain good relationships with the banks and talk to them every day about ways in which we can be helpful in filling financing gaps and helping them continue their relationships with clients.”

The local banks are even more aggressive in Portugal, but Alantra sees a growing level of interest from borrowers in that market too, while in Italy the firm has recently opened an office and is seeing a high volume of opportunities for both sponsored and sponsorless deals.

Many of these non-core European markets have long been dominated by strong local and regional banks that have come under heightened pressure to scale back corporate lending in the wake of the pandemic. At the same time, pan-European sponsors have sought out deals in less competitive, non-core markets.

Javier Castillo, who is based in Madrid with Kartesia and is responsible for senior opportunities in Iberia, told *Private Debt Investor* in October that the market remained strong: “Both local and international sponsors have remained quite active in this region, with international sponsors increasingly looking into Spain’s middle-market as they diversify away from historically core markets like the UK and France.

“That growing interest, combined with local private equity funds and SMEs increasingly eager to work with private lenders and banks’ reduced capacity to cover the mid-market space, has led to quite a robust level of activity.”

Eastern Europe advances

At Permira Credit, managing director Jens Bauer spends a lot of time focusing on the DACH region and sees growing demand from newer markets. “We have seen some really interesting opportunities with sponsors leaning into newer emerging markets,” he says. “Especially in very resilient sectors like

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JENS BAUER
Permira Credit

infrastructure. For example, Poland is one of the key regions where, with the growth of new technology, we have seen a lot of activity.

“We have also seen activity in other regions like Slovakia and the Czech Republic, where there is frequently more of a discussion around enforceability and legal structure. But those countries are picking up and there is often a structure that lenders can get comfortable with.”

In December, Polish fund manager CVI held a final close on what it claims is the first institutional direct lending fund ever to focus on Central Europe, having pulled together the biggest direct lending team in the region.

CVI partner Marcin Leja says: “The single most important issue for this region is the further retrenchment of bank financing, especially in Poland. The banks have been hit because when interest rates went up the government decided they needed to subsidise mortgage holders and introduce credit vacations, so every mortgage holder can forego payments for four quarters at a cost to the banks. That hit to bank balance sheets immediately hit credit appetite.

“That hit has created much more room for alternative finance and we already see a clear pipeline, which is much more than we can invest in. That is good because it means we can be selective in the deals we do, and we are not chasing deals, but at the same time if we had more money we could invest it.”

Bauer says: “The banks are competitive and have been successful thanks to their strong relationships in those markets, but their competitiveness is similar to where Germany was in 2015, when banks had 80 percent of the market. Today they are doing less than half, and that is driven by the flexibility of the private debt product just fitting better with what sponsors want to do, so there is no reason not to expect other markets to move in a similar direction.” ■