SPECIALIST SECTORS

Experts in industry

The private debt landscape has broadened over the past decade, with many players increasing their expertise in specific sectors or strategies. **Vicky Meek** takes the pulse of four key segments

RETAIL

While retail may have been a hot sector for private equity pre-crisis – with roll-outs of niche stores such as Pets at Home, Wiggle, Hobbs and Phase Eight – activity is rather more lukewarm these days, given the many headwinds facing the industry in the US and Europe. As an investment theme for direct lending, it hasn't featured highly, given the high fixed costs involved, such as rent.

Yet it could become an interesting area, particularly in the UK, where distressed debt players have watched with interest as retailers such as New Look, Maplins, House of Fraser and global brands like Toys R Us hit the headlines for all the wrong reasons.

"Retail in the UK, in particular, showed some weakness in 2017, and that will continue into 2018," says Ran Landmann, CVC Credit Partners managing director. "That is the result of a confluence of factors, ranging from foreign exchange volatility, falling consumer confidence, Brexit and, of course, structural issues related to the rise of online shopping."

"Some sponsors will start looking at some of the stressed retailers as an opportunity, and that could provide some private debt opportunities," says Andrew Lynn, partner at Catalyst Corporate Finance. "But we will also see private equity owners move along their portfolios of retail businesses, and some of these may have reduced in value, which could offer some distressed dealflow. The funds remain cautious about this sector, but they will look at it; the banks, meanwhile, often can't take retail opportunities to their investment committees."

HEALTHCARE

Underpinned by the long-term fundamental of ageing populations, healthcare is an attractive sector for many private debt funds. In the UK and Europe, the main opportunity is centred around the care home sector.

"Most people think of the care homes as being the large players," says Duncan Riefler, senior advisor at Arbour Partners. "Yet it remains highly fragmented. There are a lot of mom-and-pop shops, and the owners of many of these are now looking to retire, while the large players continue to dispose of assets that don't fit their portfolios. There's lots of scope to roll up portfolios and make improvements. Many of these situations would be suitable for direct lending – as long as the capital structure is right."

Niches within the care home sector continue to be of interest, adds Lynn. "Long-term, private pay areas of care remain popular among private debt players, such as adult specialist care," he says.

In the US, the opportunity set is broader. "Healthcare is one of the most active sectors for private equity and us as lenders, as ageing populations have driven increased demand for products and services," says John Finnerty, senior managing director at NXT Capital.

He points to two main areas where private debt funds have been active. "Services and practice management, such as doctor surgeries, dermatologists and physiotherapists, have provided strong dealflow – they are highly fragmented and so there is a consolidation trend happening," he says. "The other area is around facilities, urgent care and hospices, where sponsors have been very active." Twin Brook Capital Partners has also been active in this space. *PDI* has reported that the firm has deployed more than $1 billion across 42 transactions in the healthcare space between 2014 and 2017.

INFRASTRUCTURE DEBT

With estimates suggesting an annual financing gap of $1.5 billion a year to fund vital infrastructure projects and improvements in OECD countries, the opportunity for infrastructure debt funds should be significant. And it's not just mega-projects that will require finance over the years to come.

Renewable energy has become one of the mainstays of the infrastructure finance funds, as the cost of solar and wind technologies have fallen considerably over the last decade – so much so that government subsidies in the form of feed-in tariffs are often no longer essential to make these projects competitive.

"Offshore wind in the UK and north-west Europe are clear opportunities in today's market for both new financings and refinancings," says Darryl Murphy, head of infrastructure debt at Aviva. "Southern Europe has also become an attractive space, as Spain, Italy and, to some degree, Portugal offer attractive renewable projects."

And as these renewable energy sources come on line, there is a need to improve power grid stability, providing further opportunity.

"There is an increasing focus on areas such as energy storage and finding ways to deal with peak usage as smaller, flexible power generation plants come into use," says David Cooper, head of EMEA infrastructure debt at IFM Investors. "These can plug the gaps in wind and sun generation."

The products being offered to investors are also shifting as the market develops. "A lot of infrastructure debt capital has already been raised for the senior end, which tends to focus on core assets," says Tavneet Bakshi, partner at placement agent First Avenue. "However, we are increasingly seeing opportunities for managers to raise capital for junior, subordinated positions. These tend to be structured lending opportunities backed by assets and are often more in special situations, so are higher returning investments."

ASSET-BASED LENDING

Once the preserve of banks, US-owned groups and smaller independents, the asset-based lending market has changed in recent years as new players have entered the space, some of them providing ABL as part of a more holistic funding package.

TPG's first European direct lending fund, raised in 2016, has the capacity to provide ABL, and ICG has hired ABL expertise to develop its capability in this area. This not only provides more flexible solutions for borrowers, it also offers the potential to boost returns to investors.

"ABL is an attractive area, where LPs see they can achieve meaningful returns in the mid-market, especially when compared to the plain vanilla direct lending space, where returns have been compressed by a high level of competition," says Bakshi.

The market is also developing rapidly in other areas. The rise of online platforms and fintech players offering ABL products to borrowers is starting to shake up the industry at the smaller end, with decisions reached using algorithms.

Specialist lenders are emerging, too, with ABL offered across esoteric assets, such as fine art and jewellery. It's clearly a dynamic space. And it's one increasingly finding traction with investors, many of which have their eyes focused on where we are in the credit cycle.

"Asset-based lending has become a more popular strategy over recent years, with appropriate structures, including draw downs, being used by GPs," says Bakshi. "This is also an attractive space at this point in the cycle. Investors are cautious and so are seeking out credit investments that are backed by hard assets." ■