Private debt: an essential avenue to European growth and competitiveness

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Against an agitated geopolitical backdrop and a shift of paradigm in major global equilibria, private debt offers an opportunity to finance French and other European companies in a quest for more robust sovereignty, firmer resilience, and enhanced competitiveness in Europe. Private debt lends itself especially well to the sectors of defence, digital technology, and industrial and energy sovereignty.

SMID[1] PRIVATE DEBT: AN OPPORTUNITY TO SUPPORT SUSTAINABLE GROWTH AND EUROPEAN SOVEREIGNTY

The SMID strategy, which targets larger small caps or smaller, unlisted mid-caps, is especially well suited to these challenges. It targets companies that are smaller but also more local than large caps, whose geographical footprint is broader but whose impact on the local economic is accordingly more diluted.
Moreover, SMID investment helps investors stick to their ambitious sustainability strategies, which is now more challenging outside of Europe. For, unitranche[2] SMID financing gives us the necessary influence on these companies' sustainability policies, while currently offering returns of about 8%/9%.

This comes with better control of risks, thanks to the bilateral relationship between lender and borrower, as well as the possibility of investing in thematics that will make Europe more competitive in tomorrow's multi-polar world.

INFRASTRUCTURE DEBT: A PREREQUISITE FOR SUSTAINABLE GROWTH

Infrastructure debt is also at the forefront of this way of thinking. For, no sustained growth is possible without solid infrastructures. With new investments in Europe, a few themes are now emerging as an essential

[1] SMID: financing of between €10 billion and €50 million euros.
[2] Unitranche is senior secured debt offering the same guarantees as senior debt but is generally held by a sole lender (a debt fund).

foundation of Europe's future competitiveness, such as digital technologies and energy. These two segments are prerequisites for European companies' growth.
Both energy sovereignty and the quality of Europe's digital networks are therefore major challenges.
In addition to major infrastructure projects, Europe's resilience will also depend on its ability to build granular networks that cover its entire geographical area.
Senior debt has long been present on this market but has focused mainly on large caps[3] and has therefore not addressed the full range of financing needs of these transitions.
Junior small cap infrastructure debt also helps meet this objective by filling the gap in local financing. Moreover, it offers yields of about 8%/10% for secured junior debt and at a low Solvency II cost. We regard it as an important pipeline and are confident that it has much to offer in terms of balancing returns with risk and making a contribution to European independence and sovereignty

SECURITISATION: TOO OFTEN OVERLOOKED IN PROMOTING FREER CIRCULATION OF EUROPEAN SAVINGS AND FOR FINANCING TOMORROW'S TRANSITIONS AND CHALLENGES

Securitisation is one of the least-used vehicles in private credit. And yet, it has recently been much-discussed, including in the Draghi report on reforming and restarting sustainable growth. Securitisation is now 10 times more common in the US than in Europe, due to European regulations that are now being regarded as unjustifiably disadvantageous. Securitisation is one factor behind the efficiency of the US economy.
In contrast to other regions, securitisation has been scorned in Europe over the past 15 years, but is now worth rehabilitating, as it could help enhance Europe's competitiveness.
The first step is to gain some perspective on credit performances: while US subprime has suffered inacceptable losses, CLOs (i.e., securitisations of leveraged loans) were hit mainly by price volatility. We now see that default and loss rates (in real terms, observed historically) in this market segment have been very low for 25 years, even lower than on corporate bonds of equivalent rating. And, of course, lack of investor interest has driven yields higher than on conventional credit instruments.
It is worth pointing out that securitisation is more of a technique than an asset class. It can be used for various underlyings but we're not talking about turning lead into gold (or gold into lead, for that matter). Rather, one must simply carefully choose the underlying loans and use securitisation wisely to finance the European Union's many needs in the current geopolitical and economic environment. Not to mention the fact that CLOs are now the main source of financing for leveraged loans and, hence private equity funds.

In conclusion, private debt is a multifaceted object. Its main manifestation is in large cap direct lending[4], but there are many other strategies offering attractive risk/return profiles, from diversification to opportunities for contributing to enhancing European sovereignty and competitiveness beyond the more traditional private debt segments.

DID YOU KNOW?

Securitisation is a technique and not just a product, as was highlighted recently in the Draghi report. Moreover, various regulators believe that it has been unjustifiably penalised. While securitisation in the US suffered massive losses from the subprime crisis of 2008, CLOs[5] have experienced almost no losses over the past 25 years and even feature a better default track-record than corporate bonds.

[5] A collateralized loan obligation (CLO) on the syndication market is a securitisation vehicle that encompasses a portfolio of leveraged syndicated loans.

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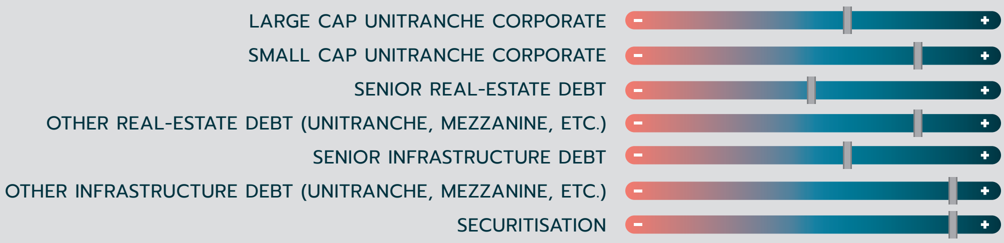

Despite the recent pull back in interest rates, private debt currently offers yields of about 8%/9%, as credit spreads narrowed only slightly after widening in in recent years, particularly in the least busy segments. Mezzanine[6] or unitranche exposure helps align interests with those of borrowers and sponsors, procures returns that, in our view, properly remunerate risk, and provides a diversified sourcing of transactions. Securitisation of junior real-estate debt remains one of the sectors most overlooked by investors and could therefore offer worthwhile entry points and IRRs.

[6] Mezzanine debt is a subordinated financing vehicle that combines elements of both equity and debt and that ranks below senior debt but ahead of shareholders in the event of default.

[3] In private debt, the large cap segment is generally considered to be financings granted to companies having EBITDA greater than €75-100 million.
[4] Direct loans to large companies.