

Lead Left Interview – Niels Bodenheim (Part 2)

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This week we continue our conversation with Niels Bodenheim, senior director of debt research for bfinance. bfinance is an investment consultant that specializes in the implementation of investment strategy, including fund manager research and selection, customized portfolio design, monitoring and fee analysis.

Previously Niels was executive director at Mubadala GE Capital, the commercial finance joint venture owned by the Government of Abu Dhabi's investment vehicle, Mubadala and General Electric. *Second of two parts* – [View part one](#)

The Lead Left: Do you depart from the analytic when you assess broader risks and issues?

Niels Bodenheim: It's educational over several months. Sometimes specifications will be changed and markets will change. Brexit is a good example. How much exposure does the manager have to UK risk? Sometimes the pedigree of the firm is over-weighted. Sometimes expertise in second lien doesn't translate to first lien.

TLL: Are there macro trends that you consider that might outweigh the strategies?

NB: That's a very interesting question – economic vs. product driven trends. The biggest risk is the limited number of investments per fund, for example, 30-40. We think macro risks will be more important in certain sectors, such as consumer verticals in gaming, or restaurants. Healthcare has 40-50 sub-segments. There could be macro changes that affect those more than overall trends especially where managers are overweight in sector exposure

We also help clients think about key factors that are more related to event-driven risks. For example, one client was simply opposed to investing in anything related to tobacco or marijuana.

TLL: What are the top three questions you get asked by investors?

NB: What's the difference between the US and Europe? We address that through a number of white papers. What are the risks? What's the illiquidity premium? What are the right off-shore structures for investors outside the US. Is it a private BDC, for instance? Is it the season-and-sell model? What's the amount of [tax] leakage? It's different from client to client. They can't always compare. Sometimes there are capacity constraints with the US eating up foreign availability even in offshore structures.

TLL: Speaking of US vs. EU, we've done white papers on that topic as well. What are the differences?

NB: You can get very detailed with the documentation differences. How second lien in Europe is last-out, but in the US it's separate. Or whether mezzanine debt is secured (Europe) or not (U.S). How income is generated. Europe is generally higher in upfront fees (closing OID, etc.) In a shorter duration refinancing cycle in Europe, for example, it leads to higher returns because the prepayment fees come into play and the overall yield is enhanced by the higher upfront fees. The coupons are roughly the same, so the higher European fees mean

higher returns. Although the return arbitrage opportunity is relatively limited and terms are constantly changing.

TLL: What about banks in the European market vs. non-banks?

NB: European banks are three times more leveraged than in the US. That still hasn't been addressed. Bank teams are still active in leveraged lending. There's still generally healthy competition. Non-banks still haven't developed as quickly as in the US. There's a huge opportunity for them. Many first-time CEOs are prepping for LBOs or growth capital. But there's no sign of banks losing market share.

Banks and asset managers are forming important partnerships, because bank hold levels are decreasing. In Europe, club transactions are a big element of the direct lending market.

TLL: What's the opportunity as you see it for bfinance in the US?

NB: There is a significant opportunity for bfinance in the US. We have worked for asset owners there who have approached us directly, so opening an office was the logical next step. Investors are increasingly seeking more specialist advice, a more customized approach and stronger governance of decision-making when it comes to implementing their investment strategies. There's also been interest in our business model, which is quite unconventional and helps us to avoid some of the conflicts of interest that "one-stop-shop" investment consultants can face. When it comes to private debt, there's also the fact of our presence of the market: we deployed \$1.5 billion over the last year in direct lending strategies alone, both inside the US and outside.

TLL: Niels, what's been your biggest surprise so far this year?

NB: I suppose it's the amount of dry powder for credit. Looking at the Preqin data, it's still equal to the amount that was available at the end of last year, about \$200 billion. But we see funds coming back to market more quickly.

The deployment cycle is surprisingly fast. Bigger funds are closing in the EU. Then they'll be back soon. Timing is about 12-18 months. But managers will be deploying throughout the fund raising period. Capital is being utilized. We also see investors re-upping. They want to do so with the same strategies, sometimes with the same managers.

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