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A taste for adventure

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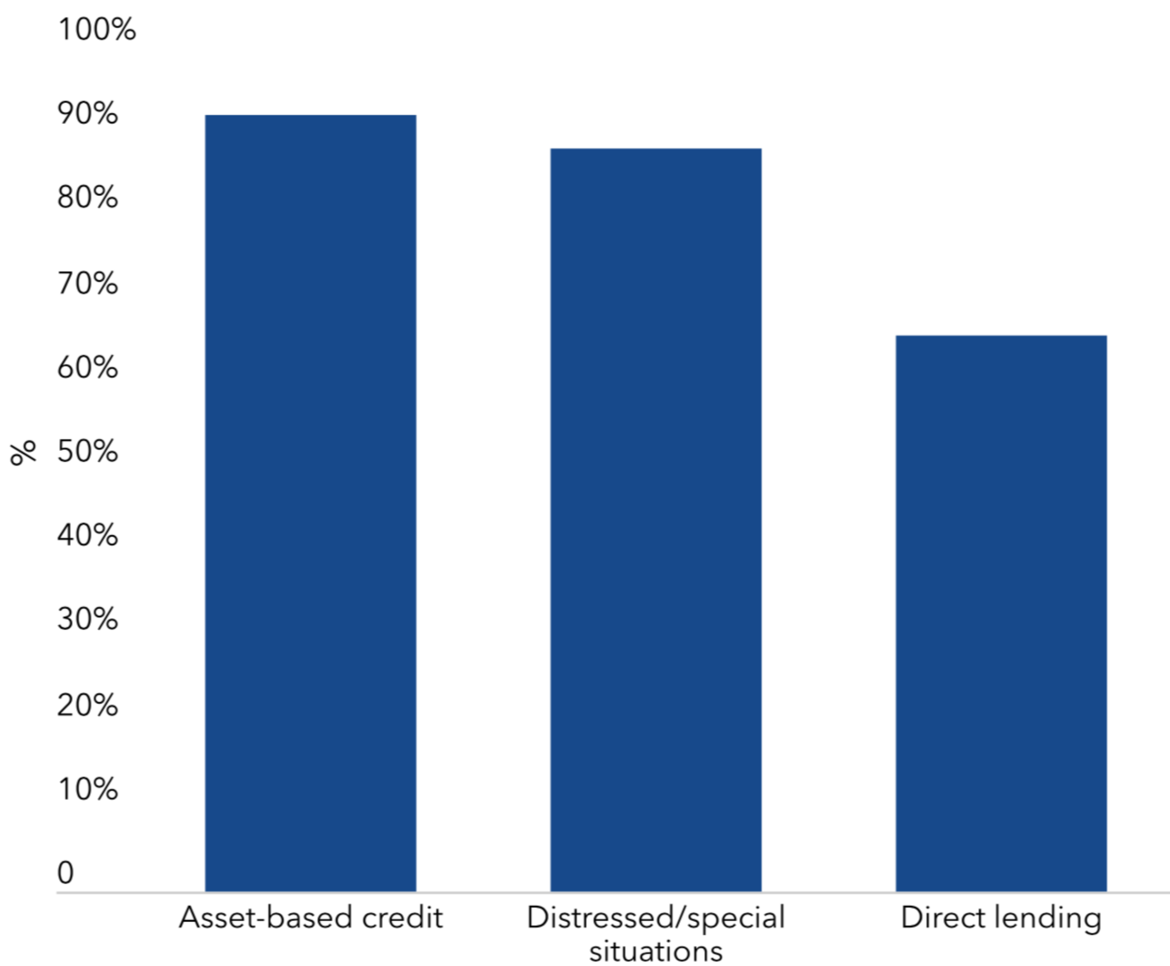
ASSET-BASED APPETITE

A survey by Eaton Partners asked 75 private debt LPs where they plan to invest in 2019



Source: Eaton Partners

Beset by concerns about competition and deal structures, limited partners are tempted to look beyond familiar territory.

It’s not all about direct lending any more. As our accompanying chart from Eaton Partners shows, limited partners have aspirations to spread their wings beyond traditional areas of private debt into more exotic, niche strategies.Those which involve asset-backed lending are especially popular, it seems.

So, what are the attractions? One is that, in a world where pursuing meaningful covenant packages can seem akin to the quest for the holy grail, the asset-backed loan market appears to have stood firm. We hear from those specialising in asset-backed loans that covenants are not only present, but also strict. Even small deviations from business plans can trigger technical breaches, leading in some cases to risk being re-underwritten and new terms agreed.

Chrystalle Anstett, head of private credit at Eaton Partners, sang the praises of the ABL market when she told PDI: “Because there’s not as much competition, there’s less erosion of terms, better pricing and more attractive yields. It’s basically the opposite of what we’re seeing in regular direct lending.” She added that the returns from ABLs are also eye-catching, typically a net return of at least 12-15 percent.

Another factor is correlation – or, rather, a lack of it. Niche markets such as ABL do not tend to behave like other markets, a plus point for investors looking to build diversified portfolios. While mainstream private loans are often considered to have a fairly close correlation with high yield, this is not perceived to be the case for ABL and other niche strategies.

Despite the willingness of limited partners to consider branching out to the periphery of private debt, a mass migration of capital should not be expected. There is the practical issue of where allocations come from for niche strategies. What if there is no appropriate bucket? And then there’s the challenge of effectively evaluating what can be highly complex strategies. Getting to the point of writing checks means having an understanding that goes well beyond just a vague appreciation of good returns and lack of correlation.

Make no mistake though, investors are clearly on the lookout for approaches with a bit of spice. Plain vanilla just doesn’t tickle the taste buds these days.