

# Direct Lending in the Nordics Hits New Record

***Stockholm (HedgeNordic) - Serving as the only local Nordic player in the field of direct lending, the Scandinavian Credit Fund mirrors the opportunities available for a niche player offering short-term loans to smaller companies in the region. Judging from the returns delivered by the fund, those opportunities have been strong showing no sign of abating. Fredrik Sjöstrand (pictured right), CIO of the Scandinavian Credit Fund, shares his views on the industry and the development ahead as retail investors are piling into the strategy en masse.***

HedgeNordic first met with the Scandinavian Credit Fund in September 2016, only nine months after its launch. Sjöstrand and CEO Peter Norman (pictured left), back then, were very optimistic about the prospects for the fund but realised a lot of work had to be done in order to educate the investor community about the asset class and the inherent risks underlying the investment. The fund was off to a good start, well in line with the stated return target of 6-8 percent per year, and inflows were starting to gather pace.

The commitment of building a strong team and infrastructure to support the credit analysis of underlying investments was visible already then. Hans Lundholm, the former head of credit at Handelsbanken, had been hired and, although feeling comfortable with proprietary systems, an additional credit analytics software was in place to have a firm second opinion on the deals analyzed.

Fast forward two years, the Scandinavian Credit Fund has today surpassed SEK 2.3 billion in assets under management, close to 4000 individual clients are investing in the fund across about 90 individual loan deals. Performance has been in line with targets showing a compounded annual return of 7.6 percent and a total return since inception of 21.6 percent. The annualized volatility of the fund has been around 0.7, translating in a Sharpe ratio of above 10.

The team has been expanded further and another DCM originator (debt capital market originator – a person responsible for setting up new loan deals) will be added in January of next year, after which the team of analysts and originators will consist of 6 people, according to Sjöstrand.

## **Adding capacity to avoid dry powder**

“As we are growing in size, it is increasingly important for us to find additional deals where we can put the invested money to work. In this context, we need to secure building out our own capacity and make sure we have the right competences in place to secure new deals without compromising on the underlying credit quality.”

Sjöstrand sees little risk that the market for the deals that the fund invest into has become saturated, there is still significant limitations as for what type of loans the banks can put on their balance sheets and new regulations are not making things easier.

“Our niche is to provide loans in sizes of SEK 20-300 millions with expiries ranging from 1-48 months. Since we focus on local companies in Scandinavia in the small to mid-sized segment, we have built strong relationships on that side and the level of competition is still muted. We essentially see no competition from the major banks although niche banks are starting to dip their toes into our core segment”, Sjöstrand explains.

He sees no signs of yield compression in the space and yields on underlying loans remain at around 10 percent or "significantly higher" and is in line with historical levels for the fund.

"I think for the industry as a whole there might be some yield compression on the back of increased competition, but that relates to segments of the market that we don't participate in", Sjöstrand says.

### **Credit quality in focus**

Sjöstrand highlights the proprietary credit model as one of the keys to finding deals with the right credit quality, it runs in parallel with a Standard & Poors system that was brought in primarily for getting the S&P quality stamp to the process. According to Sjöstrand, the S&P module affirms the quality of the proprietary system.

The fund only invests in senior secured loans meaning that in the case of a lender defaulting, the Scandinavian Credit Fund stands first in line to get money out of what is left in the process. The fund also works with strict so-called covenants, which refers to the terms offered to the lender in terms of payment milestones and similar. The purpose being to secure that the money is paid back in orderly fashion and to minimize the risk of credit losses.

According to Sjöstrand, the fund has only experienced one default since launching, however that was recovered to 75 percent, meaning a minimal impact on the fund's net asset value.

### **Institutional share class in the making**

So far, the Scandinavian Credit Fund has been offered as a retail product only, however that will change beginning of next year, Sjöstrand says.

"We will be filing documents with the Financial Supervisory Authority end of this year to launch a second version of the fund targeting institutions in the first half of 2019. The new fund will be offered under our own AIF-license having lower fees and liquidity terms that support larger tickets."

Sjöstrand says that there are already smaller institutions investing into the fund but that he sees increased interest from larger institutions as well.

"Given the performance and risk characteristics of the fund, institutions that are seeking places to find yield in the current environment are increasingly looking at what we do. As we are the only player focusing on smaller companies in the Nordics, I believe we fill a gap in the space of direct lenders. Barriers of entry are somewhat higher in our particular niche, allowing us to continue to produce returns in line with our stated targets while keeping the credit quality intact", Sjöstrand concludes.