AllianzGI’s Private Debt Multi-Manager Strategy

Stockholm (HedgeNordic) – Allianz Group has been building out its alternatives capabilities for over 10 years. More than 20% of AUM of the Allianz Group insurance portfolio of EUR 795 billion is in alternatives strategies. Allianz Global Investors (AllianzGI) manages EUR 77 billion of alternatives strategies, which cater for both proprietary capital and third party investors. Strategies such as infrastructure equity and private debt, where Allianz partners with external GPs, have been opened to external partners to invest alongside Allianz with all the benefits that come from investing with one of the largest global investors in alternative asset classes. In private debt funds alone, Allianz is committing around $5 billion per year, which is approximately 2.5% of the global asset raising of $200 billion per year.

“The feedback from external clients has been very positive. Our co-investment programs are cost-effective ways for clients to gain access to best in class managers and direct co-investments, while benefitting from diversification and strong alignment of interest with one of the largest global investors in alternative asset classes. Our two Infrastructure Equity strategies, a direct core European strategy and a global diversified strategy, have been oversubscribed, which is strong and positive signal from our clients.” – Erik Rosenvärd, Head of Nordics at Allianz Global Investors.

Erik Rosenvärd, Head of Nordics – AllianzGI

“Yield pick-up and creditor protection are the two main reasons to invest in private debt. In addition, our scale and capabilities as a long-term investor puts us at a unique position to invest in the asset class”, says Sebastian Schroff, Global Head of Private Debt at Allianz & Lead Portfolio Manager for the AllianzGI Multi-Manager Private Debt program, who is based in Munich, Germany.

Yield Pickup

Allianz is focused on financing mid-market companies, defined as those with EBITDA between EUR 10 and EUR 100 million. Comparing private debt yields with a headline leveraged loan index might overstate the yield premium, since the indices are dominated by large cap loans that yield less than mid-market debt in public markets. “Within the mid-market space, senior private lending offers a yield pickup of 200-300 basis points versus the leveraged loan market”, says Schroff. Of course, this varies according to factors including how leveraged companies are. “Adjusting for leverage, the yield pickup is 50-100 basis points per turn of leverage”, he adds.

Illiquidity and Complexity Premia

The reasons for the extra yield include an illiquidity premium for locking up capital for multi-year periods and a complexity premium for the variety of documentation and situations. It is not straightforward to split the yield pickup between illiquidity and complexity, but Schroff believes that complexity is certainly relevant: “complex and tailored financing solutions, typically agreed with one party in a short period of time, are an important part of the strategy”.

Yield Compression

Private debt is not immune from the general yield compression trend seen throughout credit markets. As more capital flows into the space and more asset managers launch funds there is more competition for some deals. Equally, “banks are still retrenching, so the growth of private debt fills the gaps in bank finance. And private credit has plenty of room to grow. Private credit is still only one third of the size of private equity, and is often financing private equity backed transactions”, says Schroff.

Sponsored Versus Non-Sponsored Deals

Given that many parts of sponsored lending segments have become crowded, Allianz has focused on diversifying into niches such as non-sponsored transactions. The weighting between sponsored and non-sponsored does however vary between the US and Europe. “The European market is still dominated by sponsored transactions, but the US also has a stronger non-sponsored market, which can offer more attractive pricing combined with strong downside protection if underwritten properly. Although leverage multiples have increased, we are still able to get comfort from equity cushions to provide protection in a downside scenario alongside strong workout capabilities of the GPs we work with”, says Schroff.

A separate phenomenon is the growing number of private equity managers launching private debt funds. “We are monitoring these funds, but our portfolio is strongly tilted to managers who have always had private credit as their core business. Downside protection is our core objective and hence historical track record and proven workout capabilities across business cycles are major selection criteria”, he explains.

Vintage Variations

Workouts become critical when defaults emerge. In common with private equity, returns on private debt vary a great deal by vintage, and have historically been highest after crises. Allianz has invested in private debt funds since before the GFC. Realized fund IRRs have been in a range of 6% to 16% since inception in 2007. "The best vintages benefitted from a dislocation in financing markets after the GFC, and then delivered the highest IRRs and multiples. But even the most challenging pre-GFC vintages that went into the crisis largely invested still had positive returns and strong multiples", he recalls.

Downside Protection

Sebastian Schrod, Global Head of Private Debt -AllianzGI

"Most important in private debt is to structure transactions well and be able to drive recoveries in challenging situations. The ability to recover money is strongly linked to being able to step in early. We insist on strong downside protection and do not like lenders to compromise on covenants. As a result, we have generated annualized loss rates significantly below traded comparables such as high yield or leveraged loan markets", he points out.

Allianz prefers countries that offer strong creditor rights: "for example, the US market benefits from strong creditor protection. In Europe, the Nordics tend to have strong creditor rights and in Asia, Australia is a positive example", says Schroff. In addition, less cyclical sectors such as healthcare and IT are preferred. Moreover, particularly in more challenging market environments, smart structuring is essential to preserve capital.

Downside protection is not purely obtained through investing in senior direct lending strategies. For example, more opportunistic and countercyclical special situations strategies can help to create a resilient private debt portfolio because they particularly benefit during credit market setbacks. Alongside the Allianz insurance portfolios, two strategies are available for partners: The "diversified" strategy, which invests the majority in senior loans, and a more "opportunistic" strategy which is more evenly weighted between senior, subordinated and special situations. In each segment, the focus is on allocating to managers who are very much specialized in their respective segments.

Opportunistic and Diversified Strategy

The 2020 vintage is targeting returns in the middle of the historical range, of 8-11% for the opportunistic strategy and 5-8% for the diversified strategy. "We have historically outperformed these targets, but the past ten years included the post-crisis period that was characterized by a benign global economy and low default rates. In our underwriting, we are always conservative and price in a full-blown economic cycle to ensure that our return expectations also hold throughout a downturn".

Covid-19 Crisis Impact

The Covid-19 shock is arguably such a test for private debt, though the impact on yields has ultimately been much smaller than the GFC. "Immediately after the pandemic shock, we saw much less deal-flow and a significant repricing as well. Shortly after, liquidity – strongly supported by central bank measures – returned and pricing is now largely back to pre-Covid levels. Leverage levels are however somewhat more conservative, so the spread per turn of leverage is higher than pre-Covid, which is a positive development. In terms of defaults and recoveries it is still too early for quantifications. The ability to drive workouts and restructurings will be essential and make the difference between good and bad results. For disciplined market players and solid portfolios, the next years will likely offer attractive opportunities in private markets".

Relationship and Scale Benefits

"Our general approach to private debt is to build scalable long-term relationships with GPs, which often date back 10 years or more. We manage a portfolio of private debt funds of total commitments of $20 billion and write tickets of typically $300 million to $1 billion to individual funds, which makes us a very large investor. Our partners appreciate our stability to invest consistently and the ability to scale up investments together is always mutually beneficial. This almost always results in recurring investments with our partners, as long as our performance expectations are met", says Schroff. "The fact that we are one of the largest investors globally in private debt brings many advantages, such as improved economics and the ability to actively steer our investments via fund advisory boards", he adds.

Co-Investments

"Access to co-investments is another benefit from being a large and experienced investor. Around 10-20% of the Allianz private debt program investments are done via co-investments. These allocations are usually free of management and performance fees. When doing co-investments, we again focus very much on downside protection by avoiding concentration risk: For example, we currently have a very diversified portfolio of more than 50 co-investments. As a result of this broad diversification our co-investments are very stable and resilient. We only co-invest alongside funds we are also invested in, to ensure alignment of interest. We do co-investments across the various segments of our private debt portfolio, but they are strongly tilted towards more conservative performing credit strategies", explains Schroff.

ESG

Allianz actively drives sustainable investments across asset classes. For example, Allianz is a founding member and chairs the UN-convened Net Zero Assets owners' alliance that represents more than $5 trillion of assets and works towards transitioning portfolios to net-zero greenhouse gas emission. This active approach is also applied to private debt investments. "There is an active dialogue and active engagement with GPs on their ESG approach, policy and objectives. Whenever we see shortcomings with one of our GPs, we engage in detail to drive improvements. Given that we are always a very sizeable investor, we do have the ability to really make a difference and we actively use it", says Schroff.

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This article featured in HedgeNordic's report Alternative Fixed Income Strategies.

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