HEDGENORDIC

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SPECIAL REPORT
PRIVATE MARKETS

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HEDGENORDIC

INTRODUCTION

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals from the sell and buy side from all tiers.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, indepth reports on "hot topics".

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables and seminars.

PUBLICATION PLAN 2021:

September: Quant Strategies
October: Value / Quality Investing
November: Alternative Fixed Income
December: ESG in Alternatives

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Editor´s Note...

Between Plain Vanilla and Exotic

One of the perks in my line of work is I get to talk to a lot of different people in various corners and positions of our industry. The group of people I get the best feel from on what is really going on is from marketing and especially sales people (who sometimes have much more flamboyant job titles).

It gets all the more interesting if you have sales people from very large organizations that have everything, literally everything in their offering, reaching from the plain vanilla, long-only products to extremely niched boutique offerings. Simple questions as "so, what are investors buying, or where are you seeing redemptions?" give an immediate insight and feel for trends and shifts in sentiments in allocators' behaviors.

Going into 2021, the most frequent response to that question, more often than not, was something relating to private markets. So, coming towards the end of the first half of the year, we at HedgeNordic wanted to dive in and see how the different segments of private markets navigated the new year and look closer at some of the offerings that are getting investors excited.

Our daily lives, as well as financial markets and private businesses are, of course, still in a tight grip of the Covid-19 pandemic. Not surprisingly then, fundraising fell sharply in the second quarter of 2020, at the height of uncertainty, before rebounding in the fourth quarter as confidence returned and LPs and GPs alike adjusted processes to accommodate the remote environment. The decline in private markets fundraising was broad based across all regions. While North America and Europe each experienced their first respective drop in fundraising since 2014, Asia had its third straight year of decline. In North America, overall private markets fundraising decreased by 21.3 percent to $508 billion, driven primarily by a decline in private equity. Europe had the most moderate fundraising decline (down just 8.5 percent), though 25 percent declines across natural resources and infrastructure and private debt fundraising dragged down overall totals in the region.

Despite last year's volatility in fundraising, private markets AUM grew by 5.1 percent, reaching $7.3 trillion, according to a paper by McKinsey from April 2021, reporting another all-time high. AUM increased in most private asset classes, but PE was the biggest driver, growing 6 percent to $4.5 trillion, about 61 percent of total private markets assets. Growth in the Asian private markets has continued to outpace other regions, and Asia now accounts for a greater share of AUM in VC and growth than North America. European markets saw slow growth in the first half of 2020, with a slight uptick in private equity. In North America, AUM growth was driven primarily by private equity and private debt, while real estate and infrastructure lagged behind.

Real estate in particular was hit hard by the pandemic, though the degree of recovery within the asset class remains unclear as the public-health crisis continues. Fundraising and deal making fell sharply, as owners avoided selling at newly depressed (and uncertain) prices. Rapid changes in how the world lives, works, plays, and shops affected all real estate asset classes. Office and retail saw the most pronounced changes—some of which seem likely to endure—which are causing investors and owners to rethink valuation and value-creation strategies alike.

In some respects, the private equity industry in the first months of 2021 strongly resembles what we had seen a year earlier: robust fundraising, rising deal volume, elevated multiples. But for the institutions that populate the industry, transformation has come faster than ever, accelerating old trends and spawning new ones.

There are of course more exotic corners in the private markets area. While most investors are familiar with private equity, venture capital and private debt, these more exotic asset classes might offer additional diversification, and potentially higher and less volatile returns. Investors need to choose carefully because these exotic areas have provided a wide range of returns, and some of them have performed poorly for many years. Such funds can focus on some very niched and illiquid areas, ranging from royalties, whisky and wines, historic documents, art, coins and stamps and cars, just to mention a few.

In this special report then, Flexstone Partners turn to "Small and Mid-Cap Private Equity and Optimising the Return Drivers," Marcel Rafart from Galdana Ventures explains why "top managers remain hard to get access" to in VC, while Hans Stegeman, Chief Investment Strategist at Triodos Investment Management, highlights "the role of private markets in Impact Investing and Transitioning Towards a Sustainable Economy."

Schroders tells us of their effort in "Democratising Small and Mid-Cap Global Private Equity" and Emmanuel Leblanc from Allianz Global Investors talks about "Finding Compelling Risk/Reward in Private Debt." In an interview with specialists from UBP, we discuss "Private Debt and Investing in the Real Economy."

In an editorial, we are showcasing how "Nordic Institutions are Embracing Private Markets" and as examples look at "Alecta's Hunger for Private Businesses" and Velliv's Christoph Junge tells us how private markets are "Beautiful in Their Own Way."

Finnish asset manager Evli tell us of their journey to a "One-Stop-Shop for Private Assets" in their fund of fund approach, and, finally, turning to one of the described exotics, one Danish manager seems to bridge the impossible in "Super Cars. Sober Investing."

Enjoy the read ahead of what is hopefully a lovely summer!

KAMRAN GHALITSCHI

CEO & PUBLISHER HEDGENORDIC

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Alecta’s Hunger for Private Businesses

By Eugeniu Guzun - HedgeNordic

Marcus Lüttgen, Portfolio Manager - Alecta

Many up-and-coming companies with great prospects are no longer racing to list their shares on public markets. Despite the extra challenges coming with private asset investing, institutional investors increasingly recognize the diversification and return benefits of investing in private companies. Swedish pension provider Alecta now has about $1 billion allocated to unlisted equities. Four years ago, this number stood at zero.

“The main benefit of investing in unlisted companies is the shareholder value creation and growth opportunities some companies can provide,” Marcus Lüttgen, portfolio manager at Alecta, highlights the benefits of investing in private companies. “By also having the opportunity to invest in unlisted companies, Alecta can gain access to some attractive investment opportunities among unlisted companies and does that as a strong financial partner with a long-term investment horizon.”

“Currently, between 1-2 percent of the total equities portfolio or almost $1 billion are allocated to unlisted equities,” Lüttgen tells HedgeNordic. “There are a lot of interesting, big companies away from the stock exchange and we have appetite for more,” the portfolio manager told Swedish business daily Dagens Industri earlier this year. Many private companies today no longer feel the need to go public to raise money via an initial public offering, with this private-for-longer trend benefiting investors who can invest in these companies at a faster stage of growth.

“Some private companies are strong and mature but at the same time in an earlier or more dynamic stage of their growth cycle or company development,” Lüttgen highlights one advantage of investing in private companies over public ones. “The private equity space has grown a lot with larger companies that are developed during an extended period with private ownership,” the portfolio manager discusses the private-for-longer trend. “Therefore, the number of relevant investment opportunities in the private space is also rising” for large institutional investors such as Alecta.

CURRENT PORTFOLIO

“We communicate what kind of investment candidates we are looking for, very high-quality businesses that are providing outstanding customer value and a proven, scalable platform for further development and growth,” Lüttgen describes Alecta’s selection approach in the unlisted space. Alecta has so far made four investments in unlisted companies.

"The main benefit of investing in unlisted companies is the shareholder value creation and growth opportunities some companies can provide."

"The veterinary chain IVC Evidensia, pest control company Anticimex and online pharmacy Apotea are such examples of highly successful privately-held companies that we recently have invested into as a co-investor," Lüttgen tells HedgeNordic. Most recently, Alecta has also invested SEK 300 million in music rights tech company Epidemic Sound.

"We follow a careful process to evaluate the potential for each company we choose to invest in," Lüttgen and his colleague Leif Törnvall, who are both responsible for the investment, commented in connection to Alecta's investment in Epidemic Sound. "Epidemic Sound meets many of the criteria we are looking for – they are a global market leader in their industry, have a strong corporate management, great growth potential and an ability to scale up their business profitably," they added. "Alecta is a long-term investor and we believe that Epidemic Sound and the company's management will create value for our customers at a level above the rest of the stock market for many years to come."

"Through the investment in Epidemic Sound, we continue to build up a portfolio of holdings in unlisted companies with great growth potential," Hans Sterte, the chief investment officer of Alecta, commented on the investment in Epidemic Sound. "In recent years, we have made investments in Anticimex, Apotea and IVC Evidensia and are looking for more attractive investments in this area," asserted the CIO. Elaborating on Alecta's approach to investing in private companies, Sterte says that "for unlisted companies, Alecta acts as an independent financial partner, which has the ability to follow as an investor for a long time."

Although Alecta has primarily invested in unlisted companies based in Sweden, the portfolio management team is looking at a much broader list of predominantly European companies to build its unlisted equity portfolio. And Alecta is looking for more large-sized investments in unlisted equity in Europe. "We want the unlisted investments to have a relevant size for the portfolio," Lüttgen recently told Dagens Industri. "This means that investments in new companies of less than SEK 500 million will become unusual."

ILLIQUIDITY PREMIUM

"The lack of liquidity and the complexities of executing transactions in the unlisted space are examples of disadvantages compared to listed companies," Lüttgen tells HedgeNordic about the downsides of investing in private companies. Even so, investors' increasing allocations to private assets enable them to pick up an illiquid premium or even a premium stemming from the complexity of private investments, which translate into higher expected returns over publicly traded assets of broadly similar quality. "When liquidity is high in many markets, we can get a relative premium for investments in unlisted companies with less liquidity," says Lüttgen.

However, private equity is not the only asset class rewarding investors for illiquidity and complexity. Many other alternative asset classes can offer better returns than publicly traded assets to compensate investors for tying up their capital. For long-term-oriented investors such as Alecta, the illiquidity of its investments in private assets may not matter too much as long as the lack of liquidity is adequately compensated for. "We are looking for that premium in all asset classes in our portfolio, not just equity," concludes Lüttgen.

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Christoph Junge, Head of Alternatives – Velliv

Beautiful in Their Own Way

By Eugeniu Guzun – HedgeNordic

"For us, institutions and pension funds with a very long investment horizon, it is a natural fit to invest in long duration assets and take on some liquidity risk to get higher returns in return."

Faced with an ultra-low and "lower for longer" interest rate environment, institutional investors have increasingly turned to private markets to offset their lower-yielding bond portfolios. "This is a very prominent explanation and it is very often highlighted that institutions are going for private markets due to the interest rate levels," says Christoph Junge, Head of Alternatives at Danish pension provider Velliv. But he believes that that is only part of the explanation for why the private assets space has become an increasingly attractive market for institutional investors. The more mature operational processes within private markets have equally facilitated investment in the space.

"Institutions have been investing in private equity or real estate for at least the last 20, 30 years," Junge tells HedgeNordic. "Some asset classes have been becoming more mature during the last ten to 20 years. Many alternative asset classes were not mature enough and the deal volumes were not what they are today," he continues. "The energy transition with a lot of projects coming to the market during the last ten years certainly helped drive investor interest towards private markets." With these asset classes becoming more mature and the private assets space becoming ever larger, allocating capital to the space is a no brainer for long-term oriented investors. "For us, institutions and pension funds with a very long

"The role of the private assets space in a portfolio really depends on the asset class we are speaking."

investment horizon, it is a natural fit to invest in long duration assets and take on some liquidity risk to get higher returns in return."

HETEROGENOUS SPACE AND ROLES

The private assets space is highly heterogenous, and each alternative asset class from this space is heterogenous in its own way. Velliv, the third largest pension company in Denmark, is allocating about one tenth of its DKK 280 billion under management to a range of alternatives, including private equity, alternative credit, infrastructure, timberland and liquid alternatives. "Private equity and private debt are the largest building blocks and then comes infrastructure and then a smaller allocation to timberland and liquid alts," says Junge.

Each alternative asset class plays a different role in Velliv's portfolio. "The role of the private assets space in a portfolio really depends on the asset class we are speaking," Junge tells HedgeNordic. "Investing in private equity, for instance, is all about having higher returns than on public equities," says Velliv's Head of Alternatives. "There are only minor diversification benefits from private equity as it is the same macro factors driving returns in both listed and unlisted markets. But given that the majority of companies in the world are not listed, you get a much broader investment universe by investing in private equity," says Junge. "The markets are also less efficient, so you'll have better possibilities to create value or alpha," he continues. "Investing in public equities is like taking the passenger seat in the car. When investing in private markets, you literally take the driver's seat because you (or the manager) normally buy into controlling stakes, or even a hundred percent of the companies."

"Private credit is also about higher returns than the liquid counterparts," continues Junge. "In infrastructure, on the other hand, we are targeting stable returns," says the Head of Alternatives. "We are not aiming for returns in the range of 15 to 20 percent from infrastructure investments. That is not why we are investing in infrastructure," he highlights. "It is stability and inflation hedge that is relevant for infrastructure investments as they add stability to our portfolio," says Junge. "Then there is all the liquid alternatives space where we expect to get some crisis alpha. Each alternative asset class, therefore, is attractive in its own way."

OUTSOURCED INVESTMENTS

With a team of five focused on alternative investments, Velliv delegates the majority of their alternative investments to external managers. "We tend to say that we are specialists in selecting specialists, so that is our philosophy," argues Junge. "This is what we are good at and honestly, I don't think that we are better in sourcing deals in the U.S. or in Australia than people with boots on the ground who have an established network in these parts of the world," he continues. "Last but not least, of course, we get much better diversification by investing in alternative investments through funds. It takes some quite big tickets to invest directly."

Velliv cooperates with BlackRock and Nuveen for private equity investments outside Denmark. "We are only taking care of private equity in Denmark and BlackRock is covering Europe and Asia Pacific and Churchill Asset Management, an investment-specialist affiliate of Nuveen, is covering North America," explains Junge. "We have set up a fund of one with each of these, where they allocate two thirds to primary investments and one third to co-investments," he continues. "Co-investment is an important building block to bring down the overall fee load."

The manager selection process "starts with the investment strategy, analyzing whether it is a good fit for what we need," explains Junge. "But then we are focusing on the team in terms of both size and location," he continues. "We prefer boots on the ground, as we believe it is key to be present in the local markets to be able to source the best deals." Junge and his team at Velliv also "want to see a replicable and clearly-defined investment process or investment strategy, which is following a fixed playbook or framework." Last but not least, the team scrutinizes the track record. "The returns speak for themselves. We would like to see more consistent returns instead of one or two really high-flying deals leading in the front and then a couple of write-offs," says Junge.

FUTURE ALLOCATIONS

"I like the private assets space and see a lot of compelling things in the asset class, but then there are, of course, other aspects we need to take into consideration," Junge tells HedgeNordic. "It is a more expensive asset class as you can get listed equities nearly for free, and then there is illiquidity risk, so it has to be a balanced approach," he continues. Velliv, therefore, does not plan to significantly increase the percentage allocation to alternatives. "Our portfolio construction team is doing the asset allocation, but as things stand today, we are not going to change the percentage allocation," says Junge. "But given that we are having more inflows than outflows, it is natural that our dollar amount invested in this asset class will grow over the next years."

One-Stop-Shop for Private Assets

By Eugeniu Guzun - HedgeNordic


Ville Toivakainen, Portfolio Manager – Evli

Institutional investors have an insatiable appetite for private assets, but there is no easy passive way of getting exposure to this growing market. For smaller investors facing difficulties accessing this market either due to insufficient monetary resources or technical expertise, Finnish asset manager Evli has built a full range of one-stop solutions to accessing alternative asset classes such as private equity, private credit, infrastructure, and timberland.

Although Evli makes direct investments in real estate and later-stage venture capital, the asset manager mostly relies on a fund-of-funds approach to invest in private equity, private credit, infrastructure and timberland. "The fund-of-funds approach goes back to the locality of investment activities," argues Ben Wärn, portfolio manager responsible for two private equity funds of funds at Evli. "We want to provide a global platform through our fund-of-funds strategy," he continues. "In golf terms, this approach should land investors in the middle of the fairway with diversified portfolios across sizes, geographies, and industries," emphasizes Wärn. "To have a direct strategy on a global scale, one would require huge resources, we mitigate this by choosing a range of GPs that provide us indirectly with those resources."

"We want to achieve diversified portfolios with our fund-of-funds structure," agrees Ville Toivakainen, who joined Evli in September of last year to be responsible for private debt. "Getting the necessary diversification benefits through one single underlying manager would be close to impossible, so we pool together different kinds of investment strategies within each asset class," he explains. "We want to offer investors a pool of managers in one fund that will serve as a core investment for a given alternative asset class," says Toivakainen. "Especially in credit, you want to have that diversification. Diversification is the only free lunch you can have."

"Investors should get sufficiently broad and diversified, but also balanced exposure to a given asset class," explains Richard Wanamo, who joined Evli in November 2019 to lead Evli's infrastructure funds. "That means we need to diversify on different metrics, across different GPs, different geographies, different sectors and different value-creation strategies," he continues. "Industry data shows that funds of funds typically exhibit a much narrower band of outcomes and lower discrepancy in returns. The risk on a fund-of-fund level is much smaller than if you invest in a direct fund."

> "We want to offer investors a pool of managers in one fund that will serve as a core investment for a given alternative asset class."
> – Ville Toivakainen

Richard Wanamo, Portfolio Manager – Evli

“Funds of funds typically exhibit a much narrower band of outcomes and lower discrepancy in returns.”

– Richard Wanamo

FULL BOUQUET

Evli seeks to build well-diversified funds-of-funds in each alternative asset class, but because each asset class plays a different role within a portfolio allocation, Evli’s entire alternative product offering represents a full bouquet of diversification. “Every asset class has its role in terms of diversification and return expectations,” argues Wärn. “It is hard to generalize, but we have built a platform that provides investors with all components they need for their own asset allocation needs on the private assets side,” he continues. “In private equity, investors mostly treasure the capital appreciation aspect,” explains Wärn.

Wanamo argues that “infrastructure investors are looking for the very low correlation to other asset classes.” According to Wanamo, “infrastructure is a very strong diversifier in investor portfolios and offers strong downside protection.” Infrastructure investments also feature a bond-like yield component. “An additional benefit revolves around the stable cash yields from a real, tangible assets-type of defensive asset class,” explains Wanamo.

Ben Wärn, Portfolio Manager – Evli

“From the private debt point of view, just like all the credit investments, investors get stable cash flows,” explains Toivakainen. “From a risk point of view, you are in a different part of the capital structure, typically very senior in the capital structure,” he continues. “Private debt investments have different risk components and that brings some additional diversification for the total portfolio,” says Toivakainen. “Each of these private assets brings something new for the total portfolio, which is why it is very important that clients have all these components in the portfolio to get all these different angles of diversification.”

“Every asset class has its role in terms of diversification and return expectations. We have built a platform that provides investors with all components they need for their own asset allocation needs on the private assets side.”

– By Ben Wärn

MANAGER SELECTION AND ESG

"Because our funds are the cornerstone or only exposure investors have to an asset class, manager selection is very important," argues Wanamo. "It is important that we pick the ones that can create alpha," he continues. "As a fund-of-funds manager, for us, it is all about manager selection to actually recognize the managers who are providing alpha," agrees Wärn. "Not every single private assets manager is going to provide you alpha, so you need to identify the best managers that offer the best alpha creation potential."

"For the manager selection process, we spend lots of time analyzing both quantitative and qualitative aspects," explains Toivakainen. "And, of course, ESG is something that lies between those two. It is a very integrated part of the whole process," he emphasizes. The track record is one of the key aspects analyzed in the selection process. "Given that we want to have some historical track record, we do not invest in startup funds or first-time funds," says Toivakainen. "We have our networks and we know the GP universe, so before we were ready to invest, we typically have known the manager for several years already," elaborates Wanamo. "That is the only way to keep track of the consistency of their strategy."

"Then we spent lots of time analyzing the individual investments within each of the portfolios to understand the reasoning behind the investments," continues Toivakainen. Wärn also points out "the repeatability of the performance and strategy" as another key aspect to consider. "To understand whether a current team can repeat the past performance, we need to understand where it comes from. Is it the contribution from the GP, is it luck, or is it a favorable market environment with inflated prices?" asks Wärn. "Since most of us have done direct investments ourselves, we go down to the bottom of the actual underlying investments to understand the DNA of the GP," he adds. "We have several hundred fund managers coming through every year and we do a couple of commitments a year, so our biggest job is to say no."

Understanding an underlying manager's ESG practices is an integrated part of Evli team's selection process. "The ESG assessment process starts from the initial discussions we have with the managers right up until we get the final payment from that fund," explains Toivakainen. The whole process involves "making sure that the managers are doing the right things so that we do the right thing," according to Toivakainen. "If there are some concerns, we have active dialogues with the managers to find solutions and provide them ideas on how to improve their processes until we get comfortable to invest."

Both investors and managers have made substantial progress in recent years towards embracing ESG. "When I started 15 years ago, ESG wasn't a thing at all, so you had to explain to GPs what it is all about," says Wanamo. "But it has become much better. Very small and startup GPs find it more difficult to embrace ESG in a minacious way," he elaborates. "Most veteran GPs may already have dedicated ESG resources, have clear systems and KPIs for the portfolio companies on what they track in terms of emissions or worker incidents or whatever it is that that is relevant for that company and sector."

SOLVING THE COMMITMENT CHALLENGE

One of the most frequent challenges faced by institutional investors when allocating to private assets is the sizing and timing of their fund commitments. With investors often maintaining a target allocation with a broader investment program, the success in achieving that target depends on a range of nuances, including difficult-to-predict future cash flows, overall fund performance, and the timing of capital calls and distributions. "One of the biggest, if not the biggest challenge, that investors face is that they do not have any educated guesses or analysis saying how much to commit over time to reach a target allocation," says Toivakainen.

Evli has developed a tool allowing investors to estimate the pattern of cash flows for planning purposes. "The introduction of the cash flow modeling for planning purposes has been resonating extremely well with our clients," says Wärn. "Finally, they get some visibility in terms of how they should act," he adds. "This toolbox has been really helpful for the expansion of our platform," which now oversees close to €1.3 billion.

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Private Debt and Investing in the Real Economy

By Hamlin Lovell – HedgeNordic

Nina Jahanbin, Head of Nordics – Union Bancaire Privée (UBP)

Francesco Filia, CEO and CIO – Fasanara Capital

We caught up with Nina Jahanbin, Head of Nordics at Union Bancaire Privée (UBP), Colin Green, Head of Private Debt at UBP, and Francesco Filia, CIO and CEO of Fasanara Capital.

Private debt assets under management have more than doubled over the past decade to USD 848 billion (including dry powder) as at the end of 2020 and are forecast to grow by 11.4% annually to USD 1.46 trillion by the end of 2025, according to Preqin, the financial data provider. Private debt allocations are growing, and have reached 12% of consultant-led allocations, according to Private Credit Fund Intelligence.

Private credit not only offers a yield pickup – and, sometimes, stronger covenants and collateralisation – but also makes a strong contribution to the real economy by helping to plug market gaps in areas such as financing smaller companies or social and affordable housing. These are also growth markets where substantial capital can be deployed in scalable strategies.

FACTORING

European factoring – i.e. buying invoices at a discount from suppliers in the real economy – is worth EUR 1.8 trillion or 11% of EU GDP, representing a key source of financing from 260,000 private companies (Source: FCI, 2020). For over seven years, Fasanara Capital has been pursuing a direct, super-diversified, non-recourse factoring strategy that uses fintech to originate and underwrite invoices and other types of trade receivables. Returns in recent years of around 6% gross in euros carry virtually no duration risk, as a portfolio turnover of 4–5 times per year means that the average duration of deals is just a few months. The credit risk is effectively investment grade: although Fasanara sources the invoices from small companies that may not have any credit rating, the debtors are much larger and investment grade, including giant multinationals.

Default risk is relatively low, with historical losses due to defaults on the overall European factoring market being below 1%. "We aim to minimise losses through the use of fintech to help carry out due diligence, which includes AML, KYC, financial statements, and verification, to minimise the risk of fabricated invoices or multiple advances on the same invoice. So far, investment-grade mandates have shown zero losses, partly because deals in this segment have significant over-collateralisation and additional recourse or guarantees. The strategy is also highly diversified, with a typical portfolio comprising over 10,000 debtors, 5,000 suppliers, 70 originators, 30 sectors and 50 countries. With the exceptions of the fintech-friendly UK, US and Germany, country weights are capped at 10%, while emerging and frontier markets are a small part of the portfolio," says Francesco Filia, CIO and CEO of Fasanara Capital.

Factoring is not immune to yield-compression pressures. Returns in euros on the Fasanara strategy have come down from 9–11% in 2015–2017, to a range of 5–6% in 2019 and 2020 as more capital

> "In a context of negative yields and expensive valuations, investors have been looking for alternative income and diversification away from traditional credit and rate exposures."
>
> – Nina Jahanbin

"Increasing the stock of available housing is really high impact; it's the S in ESG."
– Colin Greene


Colin Greene, Head of Private Debt – Union Bancaire Privée (UBP)

has flowed into the strategy and technology has improved efficiency. "2020 was something of a special case because two risk mitigants reduced returns. Prudentially holding more cash than usual resulted in higher-than-normal drag, while a higher recourse to credit insurance also reduced returns on some deals. Going forward, the strategy is to seek full deployment of assets in 2021, which currently stand at EUR 1.5 billion. We expect stable yields for at least five years, but also expect that technology will eventually bring in efficiencies that reduce yields," says Filia.

The investor base includes insurance companies, banks, family offices and the European Investment Fund (EIF), which is invested in the strategy as a cornerstone investor in a separate, closed-end fund, vehicle that runs pari passu. The EIF had been pursuing ESG and impact investing as part of its mandate for many years before these became more widely fashionable. Fasanara's ESG policies include some upstream sectorial exclusions as they are signatories to the UNPRI, TCFD and CA100+, with funds complying with Article 8 of the EU SFDR and avoiding predatory or distressed lending.

"The strategy has generated a lot of interest from the Nordic investor base, especially because of its impact on the real economy. In a context of negative yields and expensive valuations, investors have been looking for alternative income and diversification away from traditional credit and rate exposures. Unlike structured or private credit, Fasanara's factoring funds can provide significant, uncorrelated, reliable income with relatively low risk and accessible liquidity.

In short, Fasanara has managed to digitalise and disintermediate an established banking trade that is now opening up for institutional investors, exploiting fintech, e-commerce and e-invoicing secular trends." says Nina Jahanbin, Head of Nordics at UBP.

SOCIAL AND AFFORDABLE HOUSING

Factoring is reasonably liquid and investors who can accommodate multi-year liquidity of six or more years may get slightly higher returns – a target of 6–7% – from private debt that is used to finance social and affordable housing, student housing, and care homes.

"The shortage of social and affordable housing has grown over the past 10–20 years as house prices have risen much faster than wages," says Colin Greene, Head of Private Debt at UBP. For instance, since 2000 the UK House Price Index is up 182%, compared with an around 85% rise in average weekly earnings according to the UK's Office for National Statistics (ONS). To put it another way, the ratio of median house prices to median pre-tax earnings has reached an all-time high of 8 times in 2018, up from 5.1 times in 2002, according to the ONS.

"Increasing the stock of available housing is really high impact; it's the S in ESG. The National Housing Federation estimates that 3.8 million people in England are in need of social housing, while the Children's Commissioner for England has found that 124,000 children are living in temporary accommodation. Government policy in England is to build 300,000 new homes per year, but over the past decade only between 125,000 and 244,000 were built per year, according to the House of Commons Library Briefing Paper, Tackling the under-supply of housing in England," says Greene.

Not only is there an undersupply of housing, but new housing must help with decarbonisation. "Some 22% of UK carbon emissions come from heating houses. The strategy therefore pays careful attention to energy efficiency, insulation and heating in light of revised building standards," says Greene.

HIGH VOLUME OF FINANCING REQUIRED

The social need to address the undersupply of housing is facing headwinds from the cost of addressing legacy problems in the existing housing stock. In May 2021, the Financial Times reported that, according to four of England's largest housing associations (Clarion Housing Group, L&Q, Network Homes and Peabody), fire safety remediation work following the Grenfell Tower fire could reduce construction of new affordable homes. L&Q separately said in March 2021 that its own housebuilding target could be cut by 70%.

Meanwhile, the costs of retrofitting housing to meet decarbonisation targets are mounting. Inside Housing estimates the cost of retrofitting all social homes in the UK to zero carbon could reach GBP 100 billion, although there may be grants to fund or part-fund legacy costs. Even so, a very high volume of financing will be required to meet housing needs in an energy efficient manner, so there is room for many funding types, including private debt.

COVID-19 HAS EXACERBATED THE HOUSING NEED

COVID-19 constrained the housing supply in 2020. Moreover, while many individuals lost out economically, many others had their incomes underpinned by furlough schemes. Unlike during and following the global financial crisis when house prices fell, UK house prices in February 2021 were up 8.6% year on year. This is not just a UK phenomenon: the Financial Times reports that in Q1 2021 house prices across the 37 economies of the OECD accelerated at the fastest rate since 1990.

Despite the need for more housing, financing is constrained. "The balance of bank lending to construction firms in the UK has been trending down for eight years," says Greene. Private debt can fill some of this gap.

UBP's private debt strategies focus on two main segments: affordable housing, and those sectors for which there is strong institutional demand, including student housing and care homes. There is a common thread to these, "student housing is relevant to the broader housing shortage, since housing students in purpose-built properties helps to reduce pressure on the housing stock by releasing more homes for families," says Greene. "We see this as a hugely scalable 10-year investment theme," he concludes.

Benjamin Alt, Head of Global Private Equity Portfolios – Schroders Capital

Democratising Small and Mid-Cap Global Private Equity

By Hamlin Lovell – HedgeNordic

Schroder GAIA II – Specialist Private Equity is a highly differentiated strategy, offering access to small and mid-cap deals, in selected growth oriented industrial sectors, managed by restricted access smaller private equity managers globally, with Asian exposure to China and India. The semi-liquid, open-ended, evergreen vehicle structure is also distinctive in offering potential liquidity while avoiding capital calls and distributions, and requiring a minimum investment of only USD 50,000.

PROFITABLE COMPANIES AND COMPETITIVE VALUATIONS

Schroder Adveq, part of Schroders Capital - which is the umbrella for all private assets products and solutions within the global asset manager Schroders - invests along the whole lifecycle of businesses including venture capital strategies investing pre-profit with longer time horizons to mature profitable companies. Schroder GAIA II - Specialist Private Equity fund invests predominantly in profitable companies, which are often bought from families and founders. While most asset class valuations – including large cap private equity – have expanded in recent years, especially small-cap private equity deal multiples have been remarkably stable for over a decade, fluctuating around 8 times EV/EBITDA. Less capital is chasing these opportunities and leverage parameters place a ceiling on valuations: "Larger funds were able to raise billions from larger investors but smaller PE funds in Europe are pretty consistently raising overall around EUR 10-12 billion per year in total. Small funds soon become mid and then large funds so turnover is high. Leverage and acquisition

"We were one of the early backers of several larger buyout firms like Sweden's EQT, which is a fantastic firm, but is now well above our core target size."

finance multiples in small cap are 3-4x EBITDA so managers who want to maintain a 50/50 debt to equity ratio cannot pay more than 8x EBITDA. At the larger end leverage is reaching higher levels often in the range of 8-10x allowing managers to pay 14-16x," explains Benjamin Alt, Head of Global Private Equity Portfolios at Schroders Capital.

ACCESSING SMALLER PRIVATE EQUITY MANAGERS AND COMPANIES GLOBALLY

Smaller firms are generally accessed through smaller managers: "we were one of the early backers of several larger buyout firms like Sweden's EQT, which is a fantastic firm, but is now well above our core target size. Investors do not need us to access the largest 25 private equity funds in Europe. We cover 800 smaller funds in Europe, 1,500 in the US, and more than 5,000 in India and China. One of our smallest ever private equity manager was Sweden's Ceder Capital, which raised EUR 35 million for their first fund. Today our smaller funds are ranging closer to EUR 100 or EUR 200 million, and we define "small" up to EUR 500 million and mid up to EUR 2 billion. In terms of company enterprise values, small is an up to EUR 100 million and mid is between EUR 100 and EUR 500 million," says Alt.

CHINA AND INDIA

He is especially excited about growth in Asia: "We have been active in Asia for over 15 years, first in China and then India. We are also looking at South East Asia and do not include more developed markets such as Japan and Australia in our Asia bucket. We were one of the first foreign private equity managers to build a joint venture in China that allows us to also access RMB funds. In five years, China could easily be the largest private equity market in the world, given its economic growth rates and fast developing private equity market. In 2020 it was a great diversifier, roaring back in March, April and May when Europe was at a standstill. India has huge potential as it is several years behind China in terms of private equity market development".

GROWTH AND RECOVERY SECTORS

"In Asia we do not invest in suppliers to Western corporates we rather focus on local demand that is driven by a fast growing middle class. Globally we focus on five verticals: healthcare, technology, consumer, business services and industrials, and are active from venture / growth to mature buyouts. We allocate to very specialized managers who help companies to grow through active transformation like consolidation, international rollouts and professionalization. After a period of focusing mainly on less cyclical business given where we were in the cycle some more cyclical business can be interesting targets over the coming months. Companies in sectors that really suffered during Covid pandemic can now come out much stronger.

SEMI-LIQUID STRUCTURE

The private equity business within Schroders Capital (formerly known as Schroder Adveq) is for the first time offering an evergreen structure, with no distributions and capital calls (though the underlying investment funds which will make up the minority alongside the direct / co-investments nearly all have a traditional structure of capital calls and distributions). "This has been enabled by the Schroders acquisition, which provides the necessary expertise and strong overall platform. We also need a strong pipeline of dealflow: globally we always have 50-70 deals in the due diligence stage, so that we can swiftly deploy inflows," says Alt.

The normal life cycle for a private equity funds is about ten to twelve years allowing for buying, developing and selling companies within an average holding period of approximately five years, but the fund offers potential for calendar quarterly redemptions up to 5% of the net asset value, dealing with the fund itself and at NAV. Redemptions are not guaranteed, but there are several features that reduce the risk of the fund being unable to meet either capital calls or redemptions or both, even under a 2008 scenario stress test. "It typically holds cash of 10-20%, which could cover two to four calendar quarters of redemptions. On top there is a credit facility of around 20% of NAV provided by Schroders, which is available to fund underlying capital calls through a period of low distributions. The fund can suspend redemptions for four consecutive quarters. If there are still redemption pressures, the secondary market, which has grown enormously over the past decade, could also be used to create liquidity," says Alt. "We saw very few redemptions in 2020 and have been raising 15 -30 million per month recently".

Johan Strömberg, Director, Private Asset Sales – Schroders

"We were one of the first foreign private equity managers to build a joint venture in China that allows us to also access RMB funds."

PRIMARIES, SECONDARIES, CO-INVESTMENTS AND FEES

"The semi-liquid structure does not compromise our strategy, which is a fully fledged PE fund, including private equity funds, secondaries and direct / co-investments," says Johan Strömberg, Director Private Assets. "The cash weighting of 10-20% does imply some cash drag which we estimate at about 1% per year, but in traditional private equity structures, fees are charged on committed capital in the first years of deploying the fund. Our investors get exposure to a globally diversified portfolio that has a paid-in level of around 75% from day one," says Alt.

Fees for smaller PE managers tend to be sticky around 2% management fee and 20% carry above a hurdle of 8%. "It is hard to go below 2% at the smaller end, and managers will not get rich on management fees," says Alt. Direct / co-investments are nearly all alongside existing managers and pay no fees in about 90% of cases historically (some GP led transactions might have fees, those are typically below 1% and carry only applies above hard hurdles based on capital multiples of 2-3x net to investors).

PERFORMANCE

But net returns are what count and Schroder Adveq's IRRs have ranged between 15% and 31% every year since 2010, with 2020 being one of the best year in the firm's history in terms of total investment result. Benchmarking performance is not a straightforward exercise, given the mix of primaries, secondaries and co-investments, the diversified geographic split, differences between vintages, and some funds not publishing performance data. "Nonetheless, our analysis of Preqin data shows that with our multi strategy funds we consistently rank within the top five providers that launched more than five funds since 2006. Based on our analyses more than 80% of our funds are first or second quartile compared to their peers," says Alt.

EXAMPLES OF CO-INVESTMENTS

The business has had a spectacular success with Chinese fashion designer and toy company, POP MART, which has been strongly growing its revenues over the last couple of years and has accomplished a very successful IPO in December 2020. Other winning investments have included firms bought from founders, such as German digital transformation agency,]Init[, which was founded in 1995 and serves SMEs and Governments. "It has benefitted tremendously from Covid accelerating the digitization trend and helping both SMEs and authorities to digitalize their processes," says Alt. Healthcare has also generated impressive growth: UK generic pharmaceuticals firm Essential Pharma, which was founded in the 1980s, has grown far above market growth thanks to a niche strategy of focusing on low volume, clinically important drugs.

ESG

"We were one of the first private equity firms to sign up to the UNPRI, in 2010, and has a structured ESG process with senior people on our ESG committee. ESG plays a role for every investment. Sustainability goes hand in hand with the big megatrends of demographics, digitalization and environmental topics. As well as avoiding corruption, environmental risk, and ensuring workforce quality and safety, we are proactively helping to improve companies," says Alt. "We are one of the first investors in Summa Equity in Sweden, which clearly is a leader in sustainable private equity, only investing in firms with a sustainability angle or trend," says Private Assets Director, Johan Stromberg.

"Our biggest project is moving ESG from a qualitative to a more quantitatively driven approach, with realistic, measurable, digestible and relevant key performance indicators. We hope for some standardization in the industry over the next years. The goals must be that the majority of underlying companies are able to report on KPIs that help to improve the businesses in terms of better ESG," says Alt.

Stromberg sums up: "Sweden is a highly sophisticated PE market with one of the world's best GPs in EQT. We need to bring something different to the market. We are offering well diversified access to the more complex end of the PE market, with liquidity in between pure play private equity and a hedge fund. This is complementary for institutions and intermediaries".

Venture Capital: The Access Class – Top Managers Remain Hard to Get Access to

Marcel Rafart, Founder and Chairman – Galdana Ventures

By Pirkko Juntunen – HedgeNordic

In the world of institutional investors, the largest pension funds and sovereign wealth funds are often likened to the most popular kid in school that everyone wants to be friends with. This status does not get them far with the top 1% performing venture capital managers, or the VC aristocracy as some call them, who can pick their own play mates.

This is not to say that institutional investors are not welcome, but they will face a hard battle to get into these managers and trying to build a team to rival them would be a huge financial commitment without guaranteed success. Building up such a team will take no less than 3-5 years and even then it is unlikely they will ever come close to the success of the top VC managers.

These top 1% of VC managers often see demand outstripping capacity three or four times each time they launch a fund. Even if the sector is growing, access remains hard as the best tend to have preferential access to funds favouring existing and early investors, leaving only 1-10% to new investors, which is decided on a discretionary basis by the GPs.

Marcel Rafart, founder of Galdana Ventures, an investment advisory firm based in Barcelona-, which provides its services to the Altamar Private Equity VC fund of funds (Galdana Ventures I, II and III, "Galdana Funds"), focused on tech companies and amounting to €900 millions, said a very small proportion of VC managers have a solid track record spanning decades. "Out of some 5000 managers in the VC space globally,

> "VC has no leverage and its roots are in innovation, the future and growth."

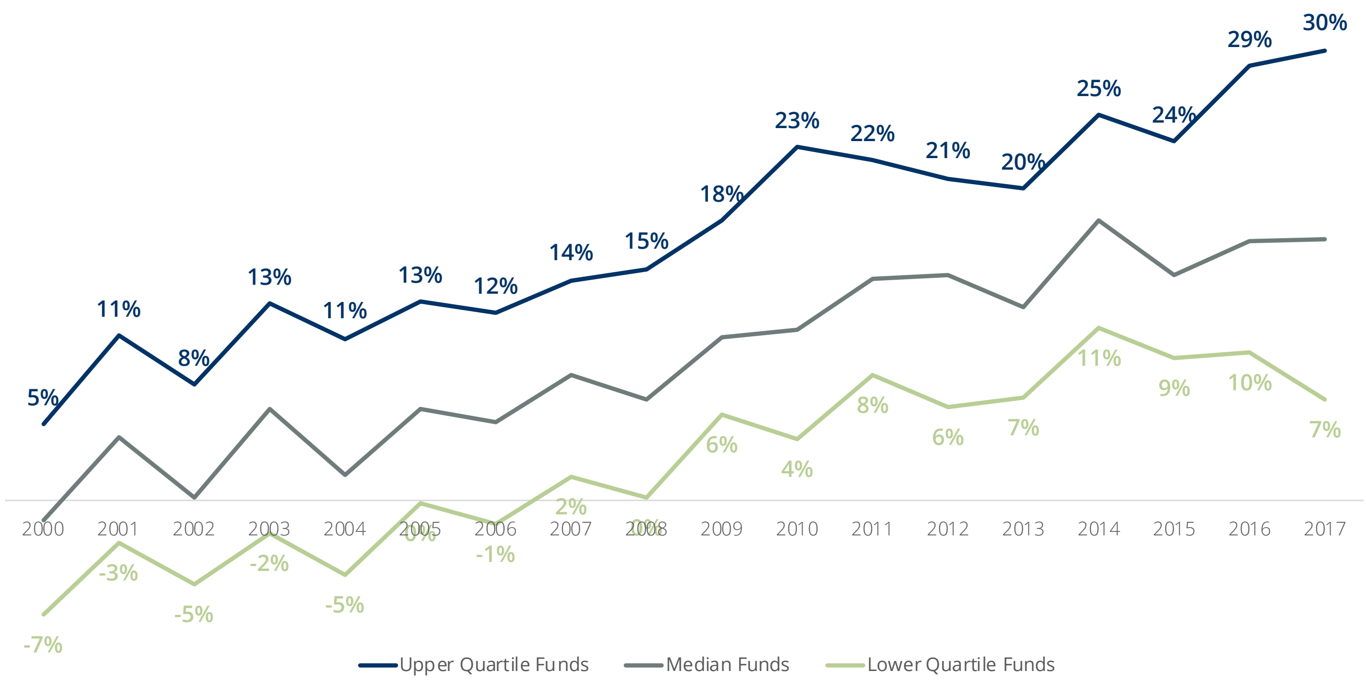
only 50-70, or just over 1%, have this exceptional track record. They have a structural competitive advantage in terms of preferential deal-flow and as a result they can achieve fantastic results i.e. substantially better than the rest," he said.

"Just having the suit and the capital does not give you access. VC has no leverage and its roots are in innovation, the future and growth, unlike buyouts that originated from financial engineering. The whole tech innovation space is very different and requires very different skills – you have to be into technology and part of the ecosystem for it to work, not just bringing in the dollars. These top VC managers are not your typical fund managers. There´s a distinct difference in the way they go about their business, forge relationships and even in how they dress. To appreciate this is key," Rafart explained.

Galdana Ventures, itself founded by seasoned entrepreneurs, concentrates its efforts to gain acceptance by the 50-70 players worldwide because of the risk return profile being so attractive. "Risk is lower than you might expect given the returns obtained. You only get this when you have an imperfect industry, and in a way, VC is exactly that. Because a very small group of players dominate the deal-flow they can obtain superior returns. There is an information asymmetry within the VC universe which favours a very small number of players," Rafart explained.

Rafart and his team of 8 are all tech veterans, so the focus on tech innovation that will change our lives in the future the way the internet and the mobile phone have done, is not a surprise.

The figure shows IRR per vintage and quartile



Source: Cambridge Associates (data reported as of 30-Sep-2020). Search criteria: ii) venture capital and growth equity funds; ii) all geographies included; iii) IRR in USD currency

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> "Risk is lower than you might expect given the returns obtained. You only get this when you have an imperfect industry, and in a way, VC is exactly that."

"The digital revolution is changing the world in such a way and at such a speed that technology needs to be part of any well-diversified portfolio," Rafart argued, adding that VC managers and founders of successful tech companies see the public markets as the end of their journey, where they can sell their shares at a very high multiple compared to when they began their journey years before, when their valuation was much lower.

This large difference between the valuation at the private phase vs the public phase makes the asset highly resilient to the volatility of the public markets, since a great gain has already been obtained for the existing investors.

"We encourage investing in VC if you can access the top managers . The biggest challenge is access. The Galdana Funds are able to provide access to most of the 1% top managers worldwide, even to new investors. In addition, the Galdana Funds' portfolios are diversified across geographies, stages, vintages and sectors.

Rafart said that VC managers have been professional and disciplined in dealing with excess demand and while this demand is increasing they remain focused on their principles of only taking a fund to a size where the capital can successfully be deployed to continue delivering for their LPs.

Institutional investors are notoriously cost conscious but for the top 1% of VC managers there is no pressure on fees given that demand outstrips availability several-fold.

"VCs have not tended to take advantage of the excess demand in a way that perhaps managers of other classes did in the past. As an example, in 50-70 managers there is maybe five partners per manager. This is only 250-350 in total, and over the

“In the past the excess capital also affected the level of transparency, but things are slowly changing in a positive way."

years we´ve been fortunate enough to get to know them and how they tick – not only professionally but also at a personal level. They have been very successful over the past 20-25 years, so 100% of the partners are very wealthy but also 100% of them are incredibly ambitious and curious from an intellectual perspective which creates a different mindset and integrity,” Rafart said.

“They love what they do and love to discover and invest in companies that will change our lives. Their focus is the searching for the amazing founders with great companies, not the amount of money the funds will make them. When meeting these managers very little time and focus is on fees but all about content. They are passionate and want to be part of the revolution and the reason the Galdana Funds have been accepted into these managers is because the Galdana Ventures team shares their passion.

“In the past the excess capital also affected the level of transparency, but things are slowly changing in a positive way. The pressure is now increasing to comply to the level of transparency that more sophisticated and institutional investors require. This also applies to ESG policies where VC has been late to the table compared to many other asset classes but the progress we have seen over the last few years is encouraging and could well catch up with other asset classes in the coming years,” Rafart said.

As VC companies get better equipped to handle institutional capital in terms of transparency and ESG policies, the access issue will remain. However, Rafart maintains that as the digital revolution is also growing and picking up speed there is still room for growth among the top tier of VC mangers; so, it is not too late.

“If you ranked by market capitalization the top 10 companies in the world, 20 years ago this was the domain of US industry with only two tech companies in the top 10 (Microsoft and Intel) today, the slots are filled by tech companies (8 out of 10) including two Chinese (Tencent and Alibaba). China is no longer the copy-cat of the world. Innovation in China is exploding and in some sectors such as Artificial Intelligence, China is ahead of the West,” he said.

As these new tech companies become increasingly dispersed globally, access becomes even more complex and takes more time and resources to develop close relationships. However, Rafart said that the impact of the digital revolution on the economy and society is only growing so future potential remains. “VC specialises in these future giants while they are still very small or medium-sized but with great potential for growth. The top VC managers are surfing on a positive wave and will continue to grow between 10-15% per year,” he predicted.

Rafart singled out the Nordic region as one of the best hubs and fertile grounds for tech innovation, likening it to Israel in this respect with a small population but a high number of enormously successful tech companies such as Spotify, Klarna and Rovio to name a few. “The most important thing for young people is to see that an idea can become a success, not just locally but globally. The success stories are fantastic examples and what the Nordics have done is to be open minded and feed the ambition of future entrepreneurs, which of course is great for the broader economy, creating a virtuous cycle,” Rafart said.

The pandemic in 2020 put a stop to what most of us viewed as normal life and the tragedy that ensued will not be easily forgotten. We all got used to working from home and endless video-conference calls. Rafart said that during a normal year at least 50% of his and his team’s time is spent travelling. He also noted that the industry was perhaps in the best position to adapt to this new normal, making use of the latest technology to stay in touch and work from home. “The managers moved rapidly into remote operations and a significant proportion of activity will remain remote because people have understood the value of these new tools and the flexibility they offer even if we do want to get back into face-to-face meetings too. Also, as was the case with investors in innovative tech companies such as Zoom, there was also good news with increased IPOs and M&A activity, despite the dire global situation,” he said.

When asked about what innovation we might see in the coming decade that will change our lives as fundamentally, as the internet or mobile phones did, Rafart said it will not be just one thing but a plethora of innovations we cannot even imagine. He remembers a time when mobile phone penetration was 0.5% and estimates by those bidding for contracts forecast 15% penetration in twenty years, which was perceived as very aggressive. The benefit of hindsight tells us it quickly reached beyond 100%.

Rafart is sure that self-driving ‘anything’ will be the norm, whether it is cars, buses or trucks. He also said that people today underestimate the way we will use these innovations. Looking at the earlier example of mobile phones, the ‘phone’ part is only a very small part of how we use the device compared to how we used a land-line telephone.

“Innovations and technology will continue to develop but it is hard to predict what will take off and how it will impact our lives. I am sure it will be much quicker than expected over the next few years and the hurdles will be of regulatory nature rather than technological” he said, concluding that this is not science fiction. For investors like Rafart, and the entrepreneurs who surround them, this future is much more exciting.

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Emmanuel Leblanc, Head of Private Markets – Allianz Global Investors

Finding Compelling Risk/Reward in Private Debt

By Hamlin Lovell – HedgeNordic

Allianz Global Investors has been expanding its private markets footprint for over a decade and is now one of the largest players in the space. Some EUR 81 billion or 14% of assets of EUR 582 billion is in alternatives (as of December 2020), of which 94% is in private markets. The offering includes infrastructure debt and equity, including renewables, and private equity as well as private debt, which includes direct lending. The latest strategy launches have been trade finance, impact investing, and two multi-manager products focused on external managers: a fund of private debt funds (which was profiled by HedgeNordic in 2020) and a fund of private equity funds.

“We have expanded into areas where our local presence, knowledge, network and investor base are aligned. We are open minded about new strategies and would only be likely to avoid niche markets that cannot be scaled up,” says Emmanuel Deblanc, Head of Private Markets, Allianz Global Investors.

> "We are open minded about new strategies and would only be likely to avoid niche markets that cannot be scaled up.”

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Allianz is exposed to nearly all strategies it offers externally to a greater or lesser extent. "Internal and external clients naturally need to be treated fairly. Larger or earlier investors may get better terms on fees, whether they are Allianz or third parties. Investment vehicles can be comingled and pooled or could dedicated to single investors for larger allocations," says Deblanc. The client base is institutional and includes substantial allocations from insurance companies and pension funds, where credit ratings and transparency can be important under Solvency II.

Private credit spans a wide spectrum of risk and reward, with return targets ranging from about 1% to 15%, and credit ratings including investment grade, non-investment grade and some non-rated exposures. It includes strategies where few if any borrowers have credit ratings, though equivalent ratings can be mapped, based on metrics such as leverage multiples. Portfolio transparency also aims to offer look through reporting, which can be useful for obtaining lower Solvency II capital charges. "Whether investors could use the portfolio reporting and mapped credit ratings for Solvency II purposes would depend on their internal models," says Deblanc.

Allianz has exposure to developed markets mainly in the US and Europe, and also emerging markets including infrastructure debt in Latin America, and blended finance deals in Africa in conjunction with development finance institutions. Currently, Asian private credit, which combines some developed markets such as Australia and some emerging markets such as India, may offer the most compelling value in either developed or emerging markets - in absolute and relative terms.

YIELD PICKUP

In absolute terms, Asia (excluding China) can generate gross yields of 9% in senior secured lending while direct lending can go as high as 15% (the net return targets are about 20% below this after typical management and performance fees). This is in USD after some deals in Australian Dollar, New Zealand Dollar or Indian Rupee have been hedged back. In relative terms, this represents a yield pickup of between 250 and 450 basis points over broadly comparable risks in the US and Europe. (The mapped credit ratings are 'BB' equivalent for the senior secured strategy and 'B' equivalent for direct lending). The legal risk framework is similar. Private credit covenants are generally stronger than in public markets, including in Asia. Legal documentation is predominantly in English law, and other legal systems, such as Singapore, Hong Kong, Australia, and India, which are based on English law. "Finance security can use local law and Allianz has a strong influence on terms and packages," says Deblanc.

> "Asia's stronger economic growth allows the strategy to deleverage, and also makes credit attractive to entrepreneurs who want to avoid the dilution that could be entailed in public or private equity."

CLEAN EBITDA GROWTH AND STRONG GOVERNANCE

On a risk-adjusted basis, the yield pickup might even be more attractive because the metrics used to calculate leverage multiples can be much cleaner. "EBITDA adjustments, which can mean true leverage is much higher than the headline figures, are widespread in the US and Europe, but are much rarer in Asia where definitions are much tighter," says Deblanc. Therefore, typical multiples of 3.5 times EBITDA for senior secured lending and 4.5 times EBITDA for direct lending, are meaningful.

And if the starting point for leverage may be lower, it gets better over time. "Asia's stronger economic growth allows the strategy to deleverage, and also makes credit attractive to entrepreneurs who want to avoid the dilution that could be entailed in public or private equity. They would rather not prematurely give up equity when they could make a much more lucrative exit in a few years' time," says Deblanc. (Allianz does occasionally take equity kickers such as warrants on the direct lending side when equity value could be disproportionate relative to its capital).

Though these individuals are independent minded, they will also consent to reasonably intrusive governance rights, such as board observer rights, board seats and cash monitoring on the direct lending side.

RELATIONSHIPS, ORIGINATION, DEFAULTS AND WORKOUTS

This is a relationship-based business where Allianz's team have originated 75% of their own dealflow, mainly from founders though there can be some financial sponsors. Most deals are bilateral though the largest ones are sometimes syndicated with other institutions or banks. The uses of finance include growth, acquisition and refinancing, with an approximately even split amongst the three: for senior secured and direct lending, the splits are: 41/32/27 and for direct lending they are 34/37/29, respectively. The senior secured lending strategy would not lend to the same borrowers as the direct lending strategy, as that could create a potential conflict.

Whereas some Allianz strategies, such as senior investment grade debt, have a zero loss underwriting philosophy, and have had no defaults for over a decade, Asian private credit has historically seen some occasional defaults and small losses. Of 88 deals that the team invested in since 2010, five had restructuring issues, with the worst return was an IRR of minus 5%. The reasons for losses have tended to be negative sector dynamics such as a new competitor driving down margins. There has not been any fraud.

GROWTH SECTORS AND ESG

The sector focus on software, data centres, healthcare, education, packaging, pharmaceuticals, real estate, food/food retail, telecom, and waste management is essentially investing in secular growth and defensive sectors, which are often asset heavy and have strong cashflows. The strategy avoids cyclical sectors such as apparel, autos OEMS and suppliers, consumer durables, travel and leisure, retail, and shipping.

"ESG is also influencing sector choices, as some deals are driven by energy transition and renewables. For instance, most new generation in India comes from renewables, which also requires reinforcement of networks to handle intermittency," says Deblanc. European investors have growing ESG reporting needs, such as carbon footprints and SFDR (Sustainable Finance Disclosure Requirement), which is being phased in between now and 2023, and Deblanc is confident that their borrowers will provide enough transparency: "medium sized companies in Asia should increasingly be willing to disclose enough data because they need to do this to access finance".

YIELD COMPRESSION?

"The covid crisis initially increased yields, between March and October 2020. Yields have now reverted to pre-Covid levels, especially in more mature markets such as Australia and New Zealand, but we do not see signs of further yield compression," observes Deblanc in May 2021. There are structural reasons for yields in the Asia Pacific region remaining higher, at least outside China, where Allianz do not see the same supply/demand imbalances.

On the demand side, high growth generates a strong demand for credit. On the supply side, Asian public markets cater mainly for larger borrowers; Asia is under-banked and does not have the structured credit collateralised loan obligations (CLOs) or Business Development Companies (BDCs) and various other vehicles that provide credit for smaller companies in the US and parts of Europe. There may also be a complexity premium: "Asia has many different countries and geographies and is not a homogeneous market like the US," says Deblanc.

For more information on Allianz Global Investors private markets capabilities visit **nordic.allianzgi.com**

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Small and Mid-Cap Private Equity:

OPTIMISING THE RETURN DRIVERS

David Arcauz, CFA, Managing Partner - Flexstone Partners

Eric Deram, Managing Partner - Flexstone Partners

By Hamlin Lovell – HedgeNordic

Small and mid-cap private equity, a segment which Flexstone broadly define as funds between USD 150 million and USD 1,5billion, and companies with enterprise values between USD 50 and 500 million, has outperformed large cap private equity over various cycles. Median net returns have shown an IRR 15% for small, against 12.2% for mid and 13.4% for large fund sizes, based on Preqin data as of Q2 2020.

The key return drivers for profitable investments are essentially the same for private equity of all sizes. Valuation multiple expansion as firms grow or move to public markets; leverage followed by deleveraging; and operational and revenue growth. However, the relative importance of the three drivers varies with the size of deals.

VALUATION

Valuation multiple expansion has made the biggest contribution in larger deals, which are now changing hands at 13x EBITDA versus 8-9x for medium sized deals, according to Pitchbook data.

“We run co-investment funds that have delivered attractive net returns to our investors."

"Leverage levels tend to be back to pre-crisis levels, but our portfolios on average have leverage levels of 3.5-4.0 times, one or two turns below the wider market average."

LEVERAGE

Leverage has also been more important for larger private equity deals, since they can sustain higher leverage levels: an average of c.5.5 times EBITDA against c.5 times for mid and c.4.5 times for small, using S&P Global Market Intelligence data. However, these headline averages bely wide variations between industrial sectors. "More resilient, asset light sectors can support higher leverage levels whilst more cyclical businesses usually command 1 to 3 turns less leverage," says David Arcauz, Managing Partner at Flexstone Partners, who heads the European investment team and is a member of the Global Advisory Investment Committee. There are also substantial variations between funds: "leverage levels tend to be back to pre-crisis levels, but our portfolios on average have leverage levels of 3.5-4.0 times, one or two turns below the wider market average," says Arcauz.

Growth in the top and bottom lines has been more relevant for smaller funds and deals, partly because they are less leveraged. "Using less leverage means businesses have more capacity to reinvest in growth and weather difficult market conditions, helping them to be more flexible," says Arcauz. "We think that operational value creation is a true repeatable skill, a real "savoir faire". It is less market dependent than leverage, which has become more of a commodity with the emergence of private debt funds to complement traditional sources of debt like banks. Financial arbitrage works well when a rising tide lifts all boats but when the tide goes out you see who is not wearing swimming trunks. Market timing is also risky because very few people can call the top or bottom of the market," says Eric Deram, Managing Partner at Flexstone Partners in Geneva who serves on the Global Advisory Investment Committee.

SECTOR SPECIALISTS

Additional outperformance can come from sector specialists, which have outperformed generalist managers by 4.7% per year, according to data from Cambridge Associates and Pitchbook. "Sector specialists are a growing trend and the US market is 5-7 years ahead of Europe. Currently, a growing portion of the market is allocated to sector specialists, and we expect this trend to grow further over the coming years. Smaller firms with deep specialist expertise in sectors also develop more differentiated strategies, rather than relying on outsourced resources to define and implement their business plans," says Arcauz.

FEES

Fees are also important for returns. Fees are generally higher on private equity than on liquid investments, but the weighted average fee that investors could pay is frequently lower than the headline figure, mainly because strategies like secondaries and co-investments have a lower fee intensity profile. The weighted average fee is also coming down as co-investments make up a growing share of the mix. co-investments represent 30 to 40% of primary volume, according to: "Investing outside the box: Evidence from alternative vehicles in private equity. Josh Lerner, et al – May 2019, Global Private Equity Barometer, Coller Research Institute, winter 2019 – 2020"

The co-investment market has become deeper and more sophisticated, which allows for dedicated co-investment funds. Even after co-investment managers charge their fees, the overall cost ratio could be significantly lower and reduce the impact on net returns. "We run co-investment funds that have delivered attractive net returns to our investors. You need a substantial primary investing program to access and select dealflow. The majority of our clients have opted for a portfolio construction mixing primaries, secondaries and coinvestments," says Arcauz.

MINIMISING LOSSES

The discussion around performance attribution drivers often seems to assume that all of the drivers are positive, but it is also important to minimize losses. Since 2008, Flexstone has only lost a handful of investments out of the 104 co-investment deals realised, generating a very low capital loss ratio. "Our realized loss ratio is much lower than industry averages of 12-15%. We have a very cautious selection approach and only work with fund managers that we know and trust. We are very selective in co-investing with first time funds as a result," says Deram.

RETURN OUTLOOK

Whether historical returns can be maintained is debatable. Some economists fear that the economy may be heading for a climate of stagflation: faster inflation with slow growth. Even under this scenario, Flexstone are confident that leading private equity managers should be able to keep generating a premium over public markets from active management and alpha generation. "Around 80-90% of small and mid-cap companies in Europe are still in private hands. In a more challenging economic environment, cash rich private equity firms may also be well positioned to consolidate through buy and build strategies as observed in Q1 2021 (70% of the deals closed in Europe were add-ons according to Preqin). Private equity can weather the storm, just as it did after the previous crisis like the GFC," argues Arcauz.

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Impact Investing and Transitioning Towards a Sustainable Economy

THE ROLE OF PRIVATE MARKETS

By Hamlin Lovell – HedgeNordic

Hans Stegeman
Chief Investment Strategist
Triodos Investment Management

There are different opinions about the speed, strength and persistence of the economic recovery, but very few economists entertain the possibility of an end to economic growth. "We are one of very few financial institutions who even talk about the possibility of less economic growth or zero economic growth. Impact and sustainability have to come first and it is currently very hard to grow the economy within our planetary boundaries, based on current technology. John Kerry recently said that the US pledge depended on about 50% unproven technology. We are therefore agnostic on what economic growth outcome turns out to be consistent with sustainable impact investing, and the outcome might even be negative growth if technology does not progress enough," says Hans Stegeman, Chief Investment Strategist at Triodos Investment Management, which runs EUR 5.4 billion in impact investing strategies in public and private markets, all of which are expected to be classified as "Article 9" or "dark green" under SFDR.

The pathway of sustainable growth is difficult to predict partly because governments and companies are still a long way from the right policies. There were high hopes that the Covid crisis would lead to a reset towards greener economics but this has been disappointing. Of course, the lockdowns produced a temporary reduction in carbon emissions, but the Covid rescue and stimulus was more backward looking than forward looking. "Most of the government intervention and public spending was saving the old economy such as airlines and other unsustainable industries. Only a tiny part was spent on the broader agenda of the real reset. Voters are expressing a preference for more radical change in a few countries such as New Zealand, Scotland, and Finland, but in general policy has not moved the economy to a sustainable path. It is true that governments and companies are making announcements about targets for the UN Sustainable Development Goals (SDGs). However, in many cases that are just re-labelling and reporting what they already do, and not making additional commitments," explains Stegeman.

> "We are one of very few financial institutions who even talk about the possibility of less economic growth or zero economic growth."

Covid has also had adverse effects by delaying the probable timeline for achieving the SDGs. "For instance, the pandemic has increased inequality between and within countries, which makes it more difficult to attain the goal of financial inclusion," says Stegeman.

Where policy has radically changed is the size of monetary and fiscal stimulus, which has been far greater than after the great financial crisis. This, combined with economies adapting to the lockdowns, has made them more resilient at least in the short term: "advanced economies are in good shape with relatively low unemployment. For the first time in many years, we see some risk of higher inflation. Part of this is a temporary response to supply chains and commodity prices, but we also see a risk of longer term – if not permanent – inflation, partly because central banks now have a broader mandate beyond price stability. Short term we see a roaring 2021 with pent up spending demand boosting growth and inflation. Longer term, we still see low structural productivity growth and high debt keeping structural economic growth lower".

"Regardless of economic growth, we expect that impact investing can generate positive returns from an acceleration of the climate transition". Impact and transition investing needs to look at private as well as public markets.

PRIVATE MARKETS

With government debt and corporate leverage already high, private debt can complement public or private equity as a way to raise funds for instance through green bonds or social bonds. Private equity firms have over two trillion dollars of dry powder, which can be used to encourage firms to transition their business models. There are far more private than public companies: "in 2019 alone, European private equity investment was directed to about 7,900 companies, 84% of which were SMEs," says Triodos IM paper, "Investing in Radical Change". Companies that are too small for public markets could be needed to access small scale local food production, distribution and recycling solutions.

There will be different levels of risk appetite at each stage of transition, requiring different forms of

> "We are explaining to clients that our vision of sustainability is broader than the current EU taxonomy, and we would like to see the taxonomy broadened out."

funding. For instance, "private capital is also often needed to provide project finance, for projects such as solar panels, solar parks and wind parks," says Stegeman.

REFORESTATION, NATURE-BASED SOLUTIONS AND BIODIVERSITY

Searching for transition solutions has led Triodos IM to innovative, flexible and open-minded private companies. "Private companies will play an important role in reforestation, and nature-based solutions. We also find that smaller companies are more open to dialogue around the social and ecological impact of their activities. In contrast, shareholders are trying to make Shell more sustainable for the fifth time. Private companies can also be more innovative, in areas such as energy, agriculture and food. It is almost impossible to currently find companies that help biodiversity on a large scale," says Stegeman.

HOLISTIC IMPACT INVESTING

Investing across public and private markets maximises the opportunities for addressing different dimensions of impact, through companies of all sizes, in different geographies including emerging and frontier markets that often lack developed public capital markets. Investors need to look at sustainability holistically from many frameworks. "we do not want to single out one or a few of the UN SDGs, because they are all interconnected. Most investors are reductionists but they need to see the big picture. Solar panel projects have their own lifecycle of emissions. Microfinance, which promotes financial inclusion, could have an impact on climate change".

BEYOND CLIMATE

For instance, environmental concerns only start with climate: "carbon is a relatively easy topic to calculate budgets for and mitigate. Biodiversity is much more complex in terms of measuring costs, damage, tipping points. Therefore, we exclude companies that contribute to loss of biodiversity through activities such as deforestation or producing palm oil. We also engage with companies on deforestation and reforestation, though this is also difficult. Longer term we expect companies to be more transparent about what they do with offsets, as a basis for building a bigger market for investing in biodiversity solutions. A lot of capital could be spent on that, restructuring and rebuilding to make returns".

The first phase of the EU taxonomy is arguably too climate-centric in focusing on the first two of the six environmental objectives: climate adaptation and climate mitigation. "We are explaining to clients that our vision of sustainability is broader than the current EU taxonomy, and we would like to see the taxonomy broadened out. This would also encourage more transparent company reporting. Our discussions with the EU are focused on more transparency, including disclosure of unsustainable activities that should be phased out," says Stegeman. Eventually, the next four environmental objectives should be added to the taxonomy: sustainable use of water and marine sources; circular economy; pollution prevention, and healthy ecosystem, which includes biodiversity.

FORWARD-LOOKING BENCHMARKING

Benchmarking is another area of focus for regulators. Even within a climate-centric framework, non-financial benchmarking and reporting needs to become more forward-looking: "it is not sufficient for asset managers to say their fund has lower carbon emissions than a benchmark, because this is relative and backward looking. Beating a benchmark is not enough when the world is unsustainable – we need to think in absolute terms. We also need to use forward looking measures, compared to the Paris agreement targets out to 2050," says Stegeman.

The Irish Limited Partnership:

A FLEXIBLE STRUCTURE FOR PRIVATE MARKETS

By Hamlin Lovell – HedgeNordic

The long-awaited Irish Limited Partnership (ILP) investment vehicle structure is attracting strong interest from clients at Royal Bank of Canada (RBC) managing private equity, private debt, infrastructure, real estate, and impact and ESG strategies.

"Ireland has historically been a big player in UCITS and liquid alternatives including hedge funds but with the ILP in place, this could be a real game-changer putting Ireland on the map for both asset owners and asset managers. We are seeing a lot of interest from managers in North America, the US and the Nordics. Historically, Nordic managers preferred domestic

"When Nordic asset managers want to raise assets from North America it may be more attractive to use an Irish structure."


Dirk Holz
Head of Private Capital Services, Product Management
RBC Investor & Treasury Services

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"Ireland has historically been a big player in UCITS and liquid alternatives including hedge funds but with the ILP in place, this could be a real game-changer putting Ireland on the map for both asset owners and asset managers."

Scandinavian structures, and the Channel Islands – Jersey and Guernsey – and over the years leveraged Luxembourg AIFMD structures. Now Ireland is a complementary option," says Dirk Holz, Director, Head of Private Capital Services at RBC Investor & Treasury Services.

Key features of the structure will put Ireland on a level playing field with other leading domiciles. An umbrella feature allows for economies of scale through common costs being shared across vehicles. Segregation ensures that liabilities do not spread between cells or sub-funds, and investors should have limited liability. It can also house multi-manager or fund of funds strategies. The ILP is tax transparent and tax neutral, meaning taxes are paid by the end investors and not levied at the vehicle level. It can provide US tax reporting, and is flexible enough to accommodate new and innovative asset classes and strategies, such as carbon capture in the impact space. ILP can cater for unlimited numbers of limited partners. It avails of the AIFM marketing passport to expedite distribution throughout the European Economic Area (the EU plus Norway, Iceland and Liechtenstein). Irish funds in general are also distributed in dozens of countries outside the EU, including the UK.

Ireland has a long history of servicing alternative funds domiciled elsewhere, using well-established leading service providers including RBC. "There are some smaller nuances to service an LP but it is generally straightforward," says Holz.

Another advantage of the ILP is Ireland's common law legal system which is based on English law, and therefore aligns more seamlessly with English language and culture. These differentiators will appeal to managers and investors in parts of the Anglo-Saxon world, including North America, where RBC is headquartered. "When Nordic asset managers want to raise assets from North America it may be more attractive to use an Irish structure," says Holz.

"We service most Canadian pension funds, who were early adopters of real estate, infrastructure, private equity and private debt investments," he adds.

Private assets have historically and primarily been distributed to institutions and wealth managers, but an important new development is distribution to retail investors. "Over the past 12-18 months we have seen a lot of big US and Nordic asset managers starting to approach retail investors. This is a significant trend, which is likely to provide a new investor base for private investment funds going forward," says Holz. The flexibility of an ILP means it can be structured as a Retail Investor Alternative Investment Fund (RIAIF), marketed to retail investors, or a Qualified Investor Alternative Investment Fund (QIAIF), which can only be marketed to qualified investors.

COMPLEMENTARY

The ILP is not necessarily competing with other domiciles in all cases – in some instances, it could be complementary: "some managers may set up an ILP running parallel to, or as a feeder for funds in other domiciles," points out Holz.

GROWTH PROSPECTS TO BE DETERMINED

There is optimism for growth with local industry association, Irish Funds, projecting that the ILP will bring EUR 20 billion of capital raised in private assets. Holz remains open-minded about what choices are made by managers and investors. "It is too early to predict how big a success ILP will be and it might take a few years to test its popularity, judging by the experience of Luxembourg, where RBC also operates. Luxembourg was quick to set up private asset vehicles after AIFMD in 2013, and 3-4 years ago it set up the SCS Limited Partnership structure, which has gained interest globally from Nordic and US managers. So far only a handful of ILPs have launched. We saw the same with the Luxembourg SCS." Another accelerator is the fact that ILP can use a fast-track Central Bank of Ireland approval process, speeding up time to market.

STRUCTURES AND COSTS FOR LARGER AND SMALLER MANAGERS

The ILP can also work with self-managed structures and platforms. "Larger managers running at least 500 -1,000 million euros in assets might also set up their own management company, while smaller ones could use a third-party management company platform," says Holz.

The Nordic region is home to some smaller private equity and venture capital managers running only tens of millions, and the ILP structure might not appeal to some of the smallest alternative asset managers: "the costs related to an ILP likely make sense for assets of at least USD 150 to 200 million. This is a regulated structure with full AIFMD, depositary oversight, and other reporting requirements," says Holz.

"Early indications show that costs and pricing will be quite similar to Luxembourg AIFMD vehicles," he adds.

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McLaren 765 LT

Super Cars. Sober Investing.

By Kamran Ghalitschi – HedgeNordic

Special Cars Invest's presentation and website are certainly appealing to the eye, including pictures and descriptions of some of the most beautiful and spectacular cars. But while the team around founder Theis Gerner Stanek Strand, CEO Ulrik Larsen and asset management veteran Frederik Mørkeberg are true car buffs and petrol heads, they are as sober as a Volkswagen Golf Rabbit when it comes to their fund and their pursuit of investment returns.

"Who wouldn't like to own a 1973 Porsche 911 Carrera RSR, or a 1988 Lamborghini Countach? Perhaps a 1992 Ferrari F40 or the historic 250 GT Berlinetta as well? All beautiful, fantastic cars, but as investment objects, we don't find the risk reward particularly compelling; there are many pitfalls when investing in vintage cars. What is the history of the car, how has the maintenance been, has it been damaged and if restored, has it been done accordingly or has there been cut any corners? The costs of documentation quickly escalates which weighs on the returns on the invested capital (ROIC) – and ROIC is a key focus for us" explains Frederik Mørkeberg.

The team, therefore, focuses exclusively on brand new supercars. A supercar is a car that the manufacturers have built to the very best specifications, and for which no compromises have been made. They are extremely expensive to develop, are often hand-built and only a few examples are made.

Supercars appeal to a narrow, but extremely wealthy customer segment and are much less sensitive to economic fluctuations than shares and real estate, for example.

THE FEWER PEOPLE TOUCHED THE CAR, THE MORE IT IS WORTH

There are funds that invest in vintage cars, or those with a specific pedigree, historical relevance, or of prominent owners. "A 1973 Porsche RSR is an exceptional car. But when you go to inspect it, you may find out this one has a '75 chassis or a '72 engine and it all gets messy. Gathering all the right documentation is an enormous hassle and there is

"Our focus is on optimizing the return on our investors' capital, and short-term prospects cannot put at risk long-term relationships with the manufacturers, for example."

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large risk to buy a vehicle under the wrong premises. With a car just out of the factory, there are no such issues, headaches and risks", portfolio manager Theis Gerner Stanek Strand explains.

In the spring of 2020, just as Covid was starting to impact the world, Frederik Mørkeberg was starting to structure the legal setup of the to-be-founded fund. "Talking to seed investors, the question we were repeatedly getting was "are you really sure you can get your hands on the cars?" It became obvious we may have a perception problem in this field. While individually we have a track record to show, as a fund and manager, we are new," he recalls.

The opportunity arose to partner with Selected Car Group, which was founded by fellow Dane Torben Østergaard-Nielsen, who is widely recognized for having one of the most complete car collections in Europe. Part of the group is Selected Car Investment, which already has funds for vintage car investments and therefore makes a nice compliment to their own investment vehicle. "It all turned out to be a perfect fit," Mørkeberg says.

The hardest part in this segment is sourcing the cars, and that Mørkeberg believes is one of the key strong points giving his team a competitive edge over peers and a high hurdle for new players to overcome. Especially Stanek Strand can fall back on many years of building relationships with manufacturers and dealers in Italy, Germany and the UK. "I probably travel to Germany 80-100 times a year to polish relationships with manufacturers and dealers," he reveals.

"We only own some cars for a short period, others longer, and some for several years. What's important is to ensure that short-term profit is not made at the expense of long-term prospects. Our focus is on optimizing the return on our investors' capital, and short-term prospects cannot put at risk long-term relationships with the manufacturers, for example."

But indeed, the biggest source of disagreement among the team is the timing to sell the cars. A Ferrari F40, for instance, came to market in 1987 at

"There is this sweet spot period when there is a "must-have" urge in the market and sometimes we'd like to hold on longer, but you want to be feeding the ducks when they are quacking."

Theis Gerner Stank Strand

Frederik Mørkeberg

around $1.5 million and peaked at probably $6 million in 1992. Today they trade for less than a million and a half dollars again. In addition, there may be minimum holding periods agreed with the manufactures as they are keen to have their cars spread around the globe. "They don't want 20 cars of their series of 25 standing in the desert in Dubai."

"There is this sweet spot period when there is a "must-have" urge in the market and sometimes we'd like to hold on longer, but you want to be feeding the ducks when they are quacking," says Mørkeberg.

Once having decided to sell, there is no shortage of buyers, be it at auction, from collectors and collections or simply individuals who "have to have that car."

The portfolio currently holds three mouthwatering positions: McLaren 765LT, an Aston Martin Valhalla and a Bugatti pur Sport, which were all purchased in the last year.

The cars are kept in one of Selected Car Group's facility, and the cost for maintaining the cars may be lower than for your family stage coach. "The insurance, for instance, amounts for approximately 0.3% of NAV, the infamously high Danish taxes on cars don't kick in until the number plates go on and with Bugatti for instance, the car purchase includes a maintenance agreement."

As the team is growing assets under management from humble beginnings, being able to allocate invested capital despite the thin market seems of no great concern: "We have a pretty good understanding of which cars will be coming to the market over the next 18-24 months that we would like to add to the portfolio."

The fund is set up as a Danish alternative investment fund, in an all-Danish structure with a €100.000 minimum ticket size with a 2+20 fee structure. Sadly, there are no fringe benefits included for investors such as getting one of the cars for a long weekend. I checked.

Nordic Institutions Embracing Private Markets

By Hamlin Lovell – HedgeNordic

Historically, US pension funds had larger allocations to alternatives but Europe may be catching up: as of 2018, European pension funds had 27% in alternatives, almost matching the 31% seen in the US, according to the 2020 report on pension funds by the Association of the Luxembourg Fund Industry (Alfi) and published by PwC Luxembourg. (The percentage allocations were much lower in Asia at 8% and Latin America at 5%).

Within Europe, the largest allocations to alternatives were seen in Germany at 40.6%, Switzerland at 35.3% and the UK at 31.9%, but preferences for different types of alternatives vary between countries - with more appetite for venture capital seen in the Nordics.

These figures are also a moving target. The Swedish Government AP funds can now invest up to 40% in illiquid asset classes, which should eventually give them some of the largest weights. The ALFI report found that European pension funds in general were allocating more to real estate, private equity, private debt, infrastructure, as well as forestry and farmland.

Many insurers in the Nordics have been steadily growing their allocations to alternatives for a number of years. Numerous Nordic pension funds, banks, and funds of funds, are regularly announcing and tendering mandates to invest in these areas. Some of them run programmes allocating to different vintages every year.

> "The Swedish Government AP funds can now invest up to 40% in illiquid asset classes, which should eventually give them some of the largest weights."

MULTIPLE MANDATES UP FOR GRABS

For instance, Danske Bank and its Danica Pension are investing in private equity, infrastructure and private debt, via funds and co-investments. Commitments are around EUR 100 million per fund. The firm invests across private equity buyouts and in private debt the focus is on mezzanine, direct lending, distressed debt, infrastructure debt, fund of funds and special situations.

Denmark's DKK 110 billion Lærernes Pension public pension fund, for doctors, is adding to a wide variety of alternatives, according to Preqin. In private equity

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"The European Investment Fund (EIF) is Europe's largest investor in venture capital, but Nordic pension funds are also very big players making up 16% of European venture capital fundraising since 2013."

it is looking for European buyout funds. In real estate it seeks investments in the Nordics and in North America. Its infrastructure programme will include renewable energy and digital infrastructure in Europe, while forestry looks further afield to Australasia (Australia and New Zealand) and North America. Its private debt programme looks at distressed and sustainable debt, in West Europe and North America. Ticket sizes are usually between USD 30 million and USD 60 million.

In Finland, public pension fund Keva runs over EUR 50 billion and its planned additions to alternatives allocations run the gamut from buyout, distressed debt, funds of funds, mezzanine, secondaries, special situations and venture capital, to real estate fund managers, direct hedge funds and funds of hedge funds, infrastructure and private debt.

MULTI-MANAGERS, COLLABORATION AND CLUB DEALS

The largest pension funds will often invest directly into private markets funds while smaller ones – as well as private banks and high net worth individuals - are more likely to outsource to multi-manager groups. The region has private funds of funds managers, such as Coeli Asset Management in Sweden, eQ Asset Management in Finland, Cubera Private Equity in Norway, and Saga Private Equity in Denmark, which are all seeking private equity funds, including growth and buyout funds.

Some investors are joining forces either to set up their own specialized asset managers, or to make larger investments. Danish pension funds, PKA and PenSam, set up joint venture, AIP, to invest in infrastructure, and have in 2020 been joined by Storebrand Asset Management of Norway. The trio are investing into an energy transition fund that could manage up to EUR 4 billion. Five Danish allocators - Laegernes Pension Fund, P+, MP Pension, the Lars Larsen Group, and Novo Holdings - formed the Danish Investment Club, managed by Advantage Investment Partners, and have committed DKK 3.11 billion (USD 500 million) to ISQ Global Infrastructure Fund III.

Cooperation across borders has also been seen with Lærernes Pension and Pension Danmark of Denmark, joining KLP of Norway, to invest in Copenhagen Infrastructure New Markets Fund. KLP has also joined up with Sweden's Folksam to invest EUR 1.2 billion in Brunswick Real Estate Capital III, a senior debt fund that targets sustainable investments in commercial property in growth regions.

VENTURE CAPITAL

In the Nordics there is a strong appetite for alternatives right across the risk spectrum, and government sponsored funds are sometimes invested in more early stage, venture capital strategies, in the spirit of public/private partnerships.

The European Investment Fund (EIF) is Europe's largest investor in venture capital, but Nordic pension funds are also very big players making up 16% of European venture capital fundraising since 2013, according to "The state of European Tech" 2019 report by Atomico. This is quite impressive when the four Nordic countries' population of 27 million is only about 5% of the EU population of 445 million. Nordic pension funds have a far greater appetite for venture capital than do those in Germany, Austria and Switzerland. Sweden's AP6, which is dedicated to unlisted companies, has helped to seed VC funds such as Cerandum, and also makes direct coinvestments.

GREEN AND CLEAN

Green investments are naturally becoming an important theme for earlier stage funds. The Antler Nordic fund has just raised USD 36 million for its first venture capital fund, devoted to sustainable technology companies. The investors included Norwegian wealth manager Kistefos, as well as two government investors: the Danish state fund Vækstfonden, and the Norwegian state fund Investinor. Another Norwegian government body, Norfund, has committed to Openspace Ventures III, focused on B2B and B2C in South East Asia. Elsewhere in Denmark, The Danish Government's Green Future Fund has allocated to the 2150 Tech Sustainability Fund, which was co-founded by former Facebook executive, Christian Hernandez, and was incubated by Danish real estate company, NREP.

Nordic allocators want to be at the leading edge of technology in general and of course green and clean tech in particular – and they are investing across the range of alternatives, from infrastructure debt in renewable energy often with a low single digit return target to venture capital targeting returns above 20%.

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