KEYNOTE INTERVIEW: **LCM PARTNERS**

In the business of good ideas

LCM Partner's **Paul Burdell** has seen and done a lot over his 30-something years in financial markets, not limited to pioneering the secondary market for bad consumer debt in the UK

Burdell is a fan of good ideas. He talks about good ideas in relation to almost everything and his business in particular. He came across investors making incredible returns from buying and collecting on bad consumer loans in the US in the 1990s and decided to replicate the model in Europe.

Almost 20 years on he says that when seeking business with banks selling assets the best approach is to bring them a "good idea". The bank mulls it over, perhaps the deal is tweaked or goes in a whole new direction, he says, but the counterparty remembers that you came in with a good idea and that improves your ability to come away with the business.

"Good ideas always get rewarded and most people don't think about the people they are buying from. It is one of our strengths that we understand banks and we understand credit," says Burdell.

There was no secondary market in Europe for bad credit assets when Burdell first began approaching banks and credit card companies to buy impaired assets in 1998. The leaders in charge cards, credit cards and consumer finance, in the form of American Express, Barclaycard and Lombard respectively, had never sold a single non-performing loan (NPL) when LCM (or Link Financial as it was then) approached them with this particular good idea.

Fast forward to 2015 and European NPLs are considered one of the most exciting investment opportunities globally.

The market then, has transformed, but so too has Burdell's firm. LCM Partners' business model had to pivot in the wake of the 2008 global financial crisis. The firm was originally a balance sheet buyer of assets. It did not manage capital for third parties but that was about to change.

Burdell with his partner and co-founder Selina Burdell built the business from scratch, initially with their own capital and investment from friends. In 2000, they sold 49 percent of the business to 3i and Prudential. Down the line as the business grew, alternative asset manager Cheyne Capital and investment bank Morgan Stanley turbo charged the firm's growth once more by injecting fresh equity in 2005, allowing 3i and Prudential to exit.

The firm launched in the UK and expanded into Spain in 2004. In 2006, LCM Partners started buying assets in Italy before moving into the German market in 2007 and Ireland in 2008.

THEN THE WORLD CHANGED.

Lehman Brothers fell and just as the greatest European distressed buying opportunity began to shape up, LCM Partners found itself capital constrained.

"Our assets were performing well but our business model wasn't," says Burdell. "We found ourselves in the greatest NPL bull market in history and we were out of bullets."

Burdell saw that balance sheet investment as a model was going to have limited potential in the capital constrained period following the crisis and so expanded an existing third-party relationship with a large European pension fund. The firm teamed up with Insight Investment as joint-venture (JV) partner for its first fund, Consumer Debt Recovery Fund I (CDRFI), a €120 million vehicle.

With capital in the bank LCM Partners got busy deploying and came back with a second JV fund, CDRF II, in 2012. Despite demand of roughly €800 million, the second vehicle was capped at €320 million, and on the back of this success, Burdell decided to launch the next fund independently and invite in other third-party investors. Which brings us to 2014 when LCM Partners bought out the remaining corporate shareholders and began marketing the first fund under its own brand, a full 16 years after the firm was first established.

"WE PIONEERED THE CONCEPT OF TREATING 'DEBTORS' AS 'CUSTOMERS' AND THAT WAS VERY IMPORTANT"
Paul Burdell

LCM Partners Credit Opportunities Fund has a target of €1.5 billion. That total includes two existing separately-managed accounts under which the firm manages €650 million. Both investors have already taken advantage of options to increase their commitments, which are invested on a pro rata basis alongside the commingled fund. Burdell says he expects the first close for the commingled vehicle by the end of this year or early 2016.

As well as branching out across Europe, LCM has also broadened its strategy over the years to include purchases of performing assets. And while consumer debt is where it all started, LCM has expanded its portfolio to a wide range of loan instruments from the retail side through to small to medium-sized enterprise credit. And that investor access to a pan-European, pan-credit instrument approach which includes performing and non-performing assets is what makes LCM Partners stand out today, Burdell notes.

REPUTATION

It's hard to underestimate the importance of reputation when dealing with distressed debt. So-called vulture funds are accused of treating creditors badly and doing everything to increase returns. For Burdell, though, that kind of approach is anathema to his "good idea" style of investing.

"We pioneered the concept of treating 'debtors' as 'customers' and that was very important," he says.

Strong governance and being a stickler for best practice is essential in the NPL arena, Burdell adds. And on that front, LCM Partners' relationship with its sister company, Link Financial, is key. Link is completely separate from LCM Partners with the relationship dictated by a servicing contract that requires the best standards and cost efficiency from Link in conjunction with strong performance.

That emphasis on governance has benefited LCM. As regulators have shown that they will hold banks responsible for the treatment of customers even after a loan is sold on, the sellers of those assets are incredibly careful about who they will sell to, to the advantage of LCM.

"One of the largest and most sophisticated sellers is a US-owned credit card issuer who, because of the pressure they were under from regulators back home, actually reduced their panel from around 15-16 buyers down to four or five. What that means is that the drawbridge has gone up," explains Burdell, adding that many sellers have reacted to tougher regulation in the same way.

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Some argue that workout managers should not own servicers as there are conflicts of interest. LCM is clear that to get the best outcome and deliver investor returns, it must keep control of the assets as master servicer and by using Link Financial on an arm's length basis it can achieve both aims.

"Conflicts are only conflicts if they are not transparent," argues Burdell. "The conflicts arise in fees where in theory you could charge whatever you wanted but what we've done is get an independent third party, Deloitte, to annually review the fees paid."

And the huge distressed firms that have scooped up the largest NPL portfolios in Europe agree. Apollo Global Management has gone as far as acquiring two servicing businesses, Lapithus and Altamira.

BIG GUNS

Burdell says that he admires what the very large US NPL investors have been doing in Europe but emphasises that they are in a completely different section of the market.

Managers like Apollo, Cerberus, Fortress, PIMCO and Oaktree have multibillion-dollar vehicles and are seeking to buy €1 billion-plus transactions. They face stiff competition for each widely auctioned portfolio.

In a completely distinct area of the market, LCM Partners are seeking to deploy around €500 million a year. Over the course of 2015, up to late October when *PDI* sat down with Burdell, the firm had invested around €560 million, comfortably making its target. Other distressed investors have told *PDI* this year that it's been a difficult market compared with 2014.

Burdell says LCM hasn't found that, pointing to its track record. The firm has picked up a total of €1.25 billion of loans at prices ranging from just 10 percent of face value for NPLs right up towards par value for re-performing and performing assets.

"CONFLICTS ARE ONLY CONFLICTS IF THEY ARE NOT TRANSPARENT"
Paul Burdell

Burdell and his team win mandates by staying on top of what their sellers need. Banking regulation is in flux and lenders need solutions to help them meet the new capital adequacy rules. And after 17 years of talking to banks and consumer lenders, LCM Partners has a direct line into these institutions to pitch ideas.

Of the capital deployed by the new fund, around 45-50 percent is in performing assets, particularly leasing and car loans. The other 50-55 percent is a mixture of non-performing and re-performing assets. The new fund is targeting net IRR 10-plus percent and is currently on target for 13 percent.

Net returns from the 2012 fund are tracking a few points higher than that, says Burdell. The original 2010 vehicle really blew things out of the water, though. That fund was sold in the secondary market earlier this year. Most of the non-performing assets were sold on as re-performing loans and the portfolio produced 1.6x cash and unleveraged annualised net returns to investors a roughly 17 percent over less than five years. The vehicle had also returned 80 percent of investor cash through monthly distributions prior to exit, he adds.

And while downturns are always a boon for distressed investors, Burdell points to the firm's broad mandate and pan-European approach. "We make money in good markets and bad," he says.

Burdell and his team continue to focus on generating good ideas. And thus far, those lightbulbs have returned investor cash with tasty returns sprinkled on top. ■