The SOLO approach that's a partnership

Direct lending does not necessarily mean clashing horns with the banks. **Paul Burdell** of LCM Partners reflects on his firm's partnership with originators that has customer retention as its primary focus

In 2018, London-based fund manager LCM Partners launched a new strategy called Strategic Origination and Lending Opportunities (SOLO), which took it into the direct lending market. The strategy is targeting a final close of €1.2 billion around the middle of this year.

Specialising in areas such as leasing, consumer debt, asset-backed finance and auto loans, LCM has historically acquired performing and non-performing loan portfolios. SOLO targets the same assets but has control over origination and underwriting in partnership with banks and other originators. The strategy targets investments in an unleveraged IRR range from 7-12 percent and will distribute income during the investment period.

PDI caught up with LCM chief executive Paul Burdell to find out more.

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Q What was the background to the launch of SOLO?

We've been involved in the non-corporate lending market for the last 20 years, specialising in areas such as small SME, consumer and asset finance loans. We started with impaired loans that needed rescheduling but had originally been of prime credit quality. These were good customers to start with but then something happened that made repayment difficult. The banks progressed to selling us their own rescheduled loans, and then they sold us their performing loans. It was like a snowball effect.

When we made the purchases of performing loans, we worked with the selling banks and learned about the products and customer base. Our flagship COPS (Credit Opportunities) strategy bought and ran off the loans through our Link Financial servicing platform. So we had these amazing performing loans acquired as special situations but our LPs wanted us to continue investing in them. It seemed very scalable and, rather than the opportunistic approach offered by COPS, they wanted us to regularise the strategy through issuing new credit into these same areas.

SOLO is the culmination of 20 years of development of our tool-kit for investing in credit and of the relationships we've built with banks and other lenders. If you buy a portfolio today, you can be fighting over five basis points. In SOLO, we're on the same side as the originator of the loans. We are partners to them in a critical part of their business and allow them to continue in areas that they otherwise wouldn't be able to play in today. In a fast-moving market, it's all about retaining customers.

It's not really a shift in strategy but a natural evolution. It's the same product, the same markets and the same origination. We're not becoming a challenger bank. We work with the banks and others who want to provide credit to their customers; we take their data and experience and combine it with ours. So we're not seen as competition. Some people try to compete with the originators but we want to be seen as a credible counterparty.

Customer retention is not about writing a cheque; you have to offer something more than that. The banks are under so

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much pressure and you have to help make them more efficient and profitable. We have a long history of working with the banks and we know it's about much more than just the money.

Q What yields are available?
In general the technology-based (fintech) lending platforms and speciality finance providers are targeting mid-to-high single digit returns and we believe a similar range of unleveraged net returns are achievable across the spectrum of opportunities we are looking at in the non-corporate market through our partnership lending model.

While the absolute returns from the asset class are competitive, we think the risk-adjusted returns are compelling given the quality of the underlying assets. As an example, we are providing a financing and servicing solution for a publicly listed investment grade-rated corporate to help fund the sale of products to their underlying customers.

While the financing is being provided to the underlying customer, the credit exposure is to the rated corporate which is providing credit support in the event an underlying customer defaults. The duration of the financing we are providing ranges from 36 to 60 months and the return we are receiving for the transaction is approximately 5 percentage points higher than the yield-to-maturity on the corporate's bonds over the same term.

For an asset type which has experienced annualised loss rates less than 0.5 percent over the last five years, it's an attractive return premium. Moreover, assuming there is not a material deterioration in the financial health of the company, we expect the returns to be sustainable as our servicing proposition firmly embeds us as a core component of our partner's infrastructure and sales process.

Q What stage is fundraising at, and what messages are being received from LPs?
We have raised close to €700 million so far. LPs seem to like the fact that it's not corporate debt, it's not sponsored loans, and it's not large ticket. It's very granular and targeting the prime originators is, in the end, the best mitigant to a downturn in the market. Good borrowers will always pay you back whether it's a good or a bad market.

LPs like the diversification benefits of accessing smaller ticket loan investments. We won't throw off high-teens returns, because we're really quite dull and don't use a lot of leverage. But when we tell investors that they can access a pool of ABS at 150 over LIBOR or we can give them the same raw material but with more control and a net yield of 8-9 percent, that resonates very strongly.

It's completely differentiated and investors don't tend to come across anything else like it. They are all concerned about where we are in the credit curve and are looking for strategies with low correlation and low volatility. We might have 100,000 individual borrowers in a portfolio so there's no concentration risk and we know how to manage the volume to maintain performance. The concept is quite simple in terms of originating a pool of loans with a partner, co-investing with them and then owning the pool of assets. SOLO is building a portfolio of 12 to 15 exclusive relationships with originators each spanning up to 5 years.

In the wider market you get someone leaving a bank and they're an expert in, say, aircraft leasing – and they go out and establish an aircraft leasing fund. But then others also leave their banks and jump into the same thing and suddenly there's a flood of aircraft leasing funds. What we do is based on 20 years of experience as operators. It's also a deep and wide opportunity; the retail and SME market in Europe is worth in excess of €10 trillion so, even if there is competition, it doesn't matter.

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Q What comes next?
It's a very scalable strategy. We will look to replicate it and ramp it up so we think the successor fund will be substantially bigger. The sub corporate market is huge with an endless variety of products and segments to enter so we believe it should be a major growth area for private debt managers.

For those active in the sector, the key to success is sourcing transactions in those pockets of the market with the most attractive, sustainable risk-adjusted returns. In that respect, it helps to have a differentiated offering in the first place and to know what you are doing from experience. ■