EXPERT Q&A

Future growth lies in forging closer links with the financial institutions traditionally regarded as private debt's biggest rivals, says Paul Burdell, co-founder and CEO of LCM Partners

Building better relationships with banks

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Q How would you describe the evolution of the private credit and consumer debt markets since you started in 1998?

Twenty-five years ago, in 1998, we saw a US business that was buying consumer non-performing loans from banks and finance companies, yet when we went to three European banks, we found they had never sold their debt before. That was a seminal moment.

The other element we took from the US was that whereas distressed borrowers in Europe had been poorly treated as 'debtors', we decided from the outset to treat them as customers, with dignity and respect. Moreover, we didn't charge them either interest or fees. The banks thought we were crazy, but our returns were exceptional, so we knew we were onto something special.

We existed then – and still do today – to make banks more efficient. We are not traders, we are not a vulture fund, but we are a partner to the banks. We had to educate them, so we spent a lot of time with treasurers, CFOs and COOs, explaining in their language how we could help their back office. Today, this is a multi-billion euro market and, having helped to establish it in the UK, we've replicated the model across Europe.

Over time, as our relationships with the banks deepened, we moved on to acquiring rescheduled loans; typically accounts where the customers are continuing to pay but at a rate below what was originally agreed. Then, in the aftermath of the Global Financial Crisis, some of our competitors started running around with cheque books; prices for NPL portfolios went up significantly and yields dramatically down.

At the same time, banks had portfolios of performing loans they no longer wanted, so we started buying them at better risk-adjusted returns than the NPLs. This meant we gained experience across a whole range of bank product lines from unsecured retail loans through to mortgages and leasing.

Our skills and product expertise have been developed over 25 years in response to the sellers we work with asking us to move into new areas to support them. Our approach is all about developing and growing with the banks. Today, we deal with 110 financial institutions across Europe.

Q You have had experience across the cycles. What changes did you see after the global financial crisis?

Unlike other special situations funds, our flagship investment strategy, Credit Opportunities (COPS), is not viewed as solely a distressed or special-sits fund. What I mean is the non-performing loan portfolios principally exist because customers are affected by a life event.

We buy portfolios from prime banks and their impaired customers were good credits to start with, but something happened – whether it was a redundancy, an illness or another unexpected change in circumstances – that prevented them from repaying their loan as they originally intended.

As life events are common to us all, there are always things for us to buy, which is why we call COPS "a strategy for all seasons". In a strong economic environment, out of 100 people probably two or three will stub their toe and hit hard times, regardless of the macro climate. In a recessionary situation, that figure can easily rise to 10 or more in 100.

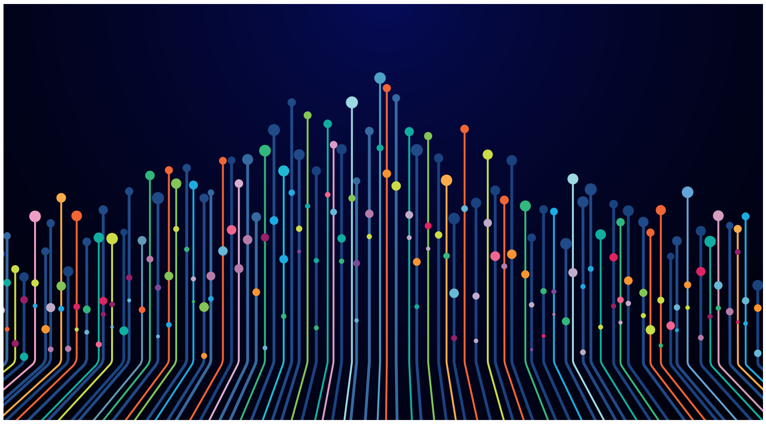
After the GFC, the first thing we saw was more regulation globally. Thanks to the internet, consumers are better educated and empowered, and if they don't like what is happening, they complain to politicians, who tell regulators, who come down hard on financial institutions.

We have always practiced what we preach in terms of customer treatment.

Q PDI is celebrating its 10th birthday this year. What are your predictions for the next decade?

The one thing I can say is that we will continue to innovate as we work with our partner banks, finance companies and captives. Our growth will continue apace as we find more ways to serve our investors over the next 10 years. However, what we are not going to do is grow for growth's sake – the most important thing is to be prudent and conservative because that is how you build a lasting franchise. The focus of our flagship funds will remain unchanged but we will likely expand our investment business into America and Asia where we've already been testing the water.

In terms of strategies, NPLs will always be created since people are always going to stub their toes, and small and medium-sized businesses will always have a requirement for speciality finance. As long as we are able to provide valuable solutions that make a difference for our operating partners, I am confident we will continue to create high-quality deployment opportunities for our investors.



Banks are hyper-sensitive about who they sell their portfolios to. It is no longer just a case of who's writing the biggest cheque, but more importantly, how the customers will be treated. Given that we are considered a safe pair of hands with our long experience of managing consumer and SME loans, we have, in fact, been a beneficiary of the heightened regulatory environment.

Q How have investors changed their appetite and approach to private debt over the past decade?

We recently closed our latest fund, Credit Opportunities 4, at €4.1 billion and feel incredibly lucky because our investors are some of the largest and most sophisticated in private credit globally.

We were the first people to have a private debt strategy that targeted smaller ticket, granular SME and consumer debt in Europe, so having a first-mover advantage was everything. We really benefited from being able to present to investors, who had been investing in larger ticket special sits and distressed real estate funds already, a new strategy that would complement and complete their existing exposures in those areas.

Today, our investor base, apart from one major sovereign wealth fund, is predominantly North American and European. That is likely to change, with more interest now coming from the Middle East and Asia. We have a proven 25-year track record and have never had a down year, and to be fair that's the main thing you need to open the door.

The biggest development of late is that private credit has moved from being a niche product offering to an established building block within sophisticated LP portfolios. Private credit is here to stay.

Q Looking forward, how would you describe the investment opportunities you've identified in your direct lending strategy?

Launched in 2018, SOLO, which stands for Strategic Origination and Lending Opportunities, came about because we bought some performing loan portfolios within Credit Opportunities, and some of our larger LPs wanted more of that.

Going back to our beginning, we used to provide third-party outsourced servicing for a number of fintech businesses. But when we looked at creating a direct lending strategy ourselves, we were concerned that our partner banks might look upon us as a disruptor – or worse – a competitor, which could easily affect our franchise.

When you buy impaired loans from banks, you get to understand their strengths and weaknesses. So, when we created SOLO, it was with the intention of partnering with banks, finance companies and OEMs to help them level the playing field against the disruptors. SOLO also provides white labelled point-of-sale finance: for example, if you were a manufacturer of irrigation equipment or solar panels, and you also wanted to provide point-of-sale finance to help your customers buy your goods.

We provide our origination partners with financing plus operational infrastructure and software. It's a total solution that gives us a competitive advantage. Over the past five years or so, we've had a lot of success with smaller ticket renewables-related investments and going forward, given the huge growth in that sector and investment in sustainable technologies in general, we expect that the vast majority of our transactions will have positive environmental or social attributes.

"The banks thought we were crazy, but our returns were exceptional"

We are now in the market with the latest vintage of the SOLO strategy – SOLO Evolution – which is an SFDR Article 8 product focused on granular asset-backed credit investments that align with the UN Sustainable Development Goals. It has a great future because, thanks to digitalisation and the absolute requirement by banks to drive efficiency through their operations, large gaps in product offerings will appear.

Added to that, there are many alternative credit providers who can't access this space because they don't have the experience, the operating platform, or both. But we do and that's because we have three pillars within our wider business: asset management through LCM Partners, asset servicing through Link Financial and software through our technology business LDMS. Across those three business areas, we now have 1,100 people in 14 offices across nine countries. So, yes, we do have the infrastructure and we do have the track record.

Q You've also built a strategic partnership with Brookfield Asset Management, one of the world's largest alternative investment managers. What opportunities do you think this will create?

A few years back, we saw some changes happening in the market. We already had a strong investor base and no debt on our balance sheet, so we didn't need the capital, but strategically we wanted to partner with a larger organisation. We were looking for someone that shared our approach to people and business and found that Brookfield fitted that description perfectly. They initially acquired 25 percent of the business in 2018 with an option to acquire a further 24.9 percent, which they exercised early in 2021.

What is unique about Brookfield is that we can work with different parts of a diverse, global organisation, but unlike most large asset managers, who can be incredibly territorial, with Brookfield we find that we can collaborate on investment and client-related activities seamlessly – everybody there wants to help us serve our investors and customers. ■