EXPERT Q&A

Asset-backed lending has huge potential – all the more so if you can distinguish yourself from the well-trodden path. Paul Burdell, co-founder and chief executive of LCM Partners, explains the benefits of adopting a niche approach

Granular ABL: A market full of opportunity

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Q Asset-backed lending has gained significant attention within private credit. Why do you think that is, and what areas do you target?

One of the big drivers of asset-backed lending is the superior returns it offers to public fixed income. Moreover, you're less concerned about any illiquidity if you're matching your liabilities by holding a good quality, three- to five-year asset-backed loan or lease that's amortising. The realisation that opportunity exists in buying these credits to hold rather than to trade is why so many fixed income investors have moved over to private credit in search of superior yields.

The asset class also has strong defensive characteristics. Across the private credit spectrum, the starting point is always the quality of the underlying borrower. But with ABL you have security over the underlying asset and further credit enhancements can be built into the structuring of the investments. It's true there can be additional complexity but there is a reason why asset-backed investments have tended to have lower default rates and higher recovery rates than traditional corporate SME lending. Finally, for any investor looking to diversify away from EBITDA-based lending with a strategy that can offer a similar risk-return profile, asset-backed lending is an obvious place to start.

In terms of our approach, banks see the way that private credit is advancing, and that concerns them because they risk losing their higher-yielding customers. We are slightly different from other market participants because we work with the banks and so we are not seen as a competitor but as a complement to them. We see a lot of value in these partnerships.

We have strong relationships with more than 110 banks across Europe and have worked in partnership with banks for over 25 years. This gives us a unique vantage point, and because we target granular assets as a point of differentiation, we are working with a very well diversified pool of countless underlying customers. We are not trying to deploy billions into a small number of transactions like some of the larger funds.

Q How big is the market?

Recent estimates indicate the global asset-backed market is currently worth about $6 trillion and that it will grow to circa $9 trillion by 2029, and I'm excluding consumer lending and the residential mortgage market from these figures. We're European-focused and target segments of the leasing and real estate finance markets, but the size of the opportunity set is not a limiting factor. The European leasing market alone is still worth over €400 billion, for example.

Instead, the challenge for us is working out who we want to partner with. We are highly selective, targeting high quality origination partners with long track records who want to work with us exclusively. Then, the devil is in the detail of structuring these partnerships so long-term incentives are aligned.

Q How can managers most effectively originate investments?

Asset-backed lending comprises a very wide range of asset types. It can be anything from renewables equipment financing through to SRTs, invoice discounting, royalties and much more. In many cases, these can be complex assets to manage and as such there's a real need for experience and specialist asset class knowledge.

Fortunately, we benefit from over 25 years of experience operating at the more granular end of the European SME loan and lease markets. We've developed a deep understanding of the industry, established long-standing relationships with key originators and gained broad operational experience, as well as considerable data and insight into customer behaviour. That's what gives us conviction in our approach, and why we believe we have an edge over others in our target markets.

> *"We are highly selective, targeting high quality origination partners with long track records who want to work with us exclusively"*

Q What skills and tools do you need when managing a granular ABL strategy?

We are targeting prime borrowers looking for financing for business-critical assets with liquid secondary markets. We end up in the less well-trodden parts of the market where there are fewer competitors because our typical transaction size is sub-£10 million ($12.1 million; €11.8 million). These smaller ticket investments are operationally challenging to manage, so we are a firm believer that good systems and infrastructure are prerequisites for success.

Our partnership financing agricultural assets in the UK is a good example. The opportunity exists because the banks have retrenched from the sector and are focusing on the larger farmers and landowners who require loans in excess of £1 million. Along with this, the banks are quite rigid in their approach, often only lending against land at conversative LTVs. Conversely, our average lend is around £125,000 and we're lending against both equipment and land.

We can also respond to financing requests on a much timelier basis. The underlying borrowers value our flexibility and are willing to pay a premium for it. However, when your loan book increases to in excess of £100 million, as this one has, it's imperative you have the right infrastructure in place.

Q What are the main risks in your strategy, and how do you manage those?

We're operating at the conservative end of the asset-backed market. We're funding smaller-ticket hard assets. Using the agricultural example again, there is plenty of liquidity in the second-hand tractor market. Moreover, if there are instances where we have to repossess the underlying asset, we benefit from the work-out expertise of our in-house servicer, which has approximately 2,000 people in 10 markets across Europe.

Along with this, we're not taking residual value risk. In our asset finance partnerships, we're focusing on financing leases that typically amortise over a three to five-year period. If there is a bullet repayment at the end of the initial lease it's because the underlying collateral is a long-life asset and we've got confidence that there is good liquidity in the secondary market. While we partner with originators, we haven't taken an equity stake in any of them. Our intention really is to be quite dull, but we think there's real value in generating the stable returns that asset-backed lending can offer.

Q How do you see the future developing, and where do you see the opportunity set?

For us it will be a case of doing more of the same. While we operate in relatively niche segments of the ABL market, the opportunity set is large and growing. And the fact that there is complexity in providing smaller-ticket financing gives us greater conviction in the sustainability of the returns. We also think it's challenging to try to cover all bases, or to be opportunistic. The nature of the underlying collateral means you typically need specialist knowledge and operational know-how. So, while it might sound a bit boring, we're happy to stick to our knitting. ■