Viewpoint

Private Debt – Active Engagement in Challenging Times

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Sandrine Richard, CAIA, Co-Head of European Senior Secured

Prior to joining Muzinich, Sandrine was at AXA IM for 10 years where she worked in the Fixed Income department, the leveraged loan division and co-founded the Private Debt expertise. Prior to AXA IM, Sandrine was an equities sell-side analyst for 7 years, 3 of which at Exane. She graduated from ISG (business school), from SFAF (French financial analysts association) and she holds the CAIA designation.

The Covid-19 pandemic presents a unique challenge to the financial system. We believe Private Debt strategies, as long-term investors, have an important role to play in supporting the real economy during these difficult times, by understanding the threats and the opportunities facing our portfolio companies and helping them to financially structure these in the long term.

In these turbulent times, our local investment teams are actively monitoring our many portfolio companies and assessing the impact of the crisis. We have reached out to the management teams and sponsors of these portfolio companies over the past few weeks to review how the Covid-19 outbreak has impacted their businesses and offer our support.

As a result of the outbreak, we believe all companies will be affected, some will suffer only temporary challenges, but other companies will fare the crisis less favourably. Many of the managers and sponsors we have spoken to have a positive and pragmatic approach in dealing with the crisis. Their top priorities so far have been to protect the health of the workforce and clients, capture opportunities borne from demand dislocation and liquidity preservation.

As revenues and business activity are slowing or have come to a halt, liquidity for portfolio companies is key. Fixed charges, exceptional expenses related to a change of a company's activity profile, increases of breakeven level and working capital needs have all been common topics throughout our discussions. Managers have quickly worked to address these issues by limiting cash out, increasing short-term financing lines available and, when possible, adapting their business model.

Looking Ahead: The Role of Private Debt Strategies

As a result of the coronavirus pandemic, Governments and Central Banks around the world have put in place unprecedented stimulus packages to help maintain a certain level of economic activity, support businesses and limit the risk of default. In this unprecedented scenario, Private Debt strategies are actively engaging with portfolio companies in different ways. These include the issuance of several waiver requests related to deferred interest and debt amortisation payments, laxing of financial covenants and extensions to the deadline of certified accounts disclosures to support companies' liquidity. In a similar way to banks, and on a case by case basis, Private Debt strategies have provided additional funding to portfolio companies by way of varied levels of securities packages and risk remuneration.

As economies begin to slowly re-open, we do not know how long it will take for them to recover. We believe the available financing capacity of the financial system could potentially reach its saturation level as businesses make extensive use of the bank lines drawdown and guaranteed loans facilities.

These evolving dynamics will likely accelerate the structural shift in the European lending landscape and alternative financings will help to transform liquidity needs into solvability requirements.

We believe Private Debt strategies have a long-term role to play, to offer tailor-made, long-term financing solutions, support debt expansion capex and refinancing debt. With over $112bn of dry power[1], we believe Private Debt strategies are in a good position to fill the gap for longer-term financing.

Each economic downturn creates opportunities and challenges. As more companies look at Private Debt strategies as an alternative source of financing, the Muzinich investment team is actively seeking new investment opportunities. We believe the long-term value of investments will be a result of the strong fundamentals of the underlying companies, and the price should reflect the risk taken.

1. Source: Preqin as of December 2019.

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