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Structured Finance: The Last Word with EFA Group

Published: **01 April 2016**
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Xavier de Nazelle, EFA's head of corporate and asset-based finance, talks about his firm's new strategy and how investors are responding to it.

Singapore-headquartered EFA Group recently launched plans to expand its focus on trade finance to include asset-backed term loans to industries tied to the real economy. The new direct lending strategy comes as EFA Real Economy Income Trust (EFA RET), which is targeting $300 million-$500 million from investors, reached a first close of $50 million. The fund is seeking net returns of 10-12 percent.

Q What is the difference between your trade finance funds and EFA RET?

EFA RET is a direct lending vehicle which provides senior secured loans of $2 million-$20 million to mid-market companies across the real economy supply chain. It's an evolution of our trade finance funds [through which] we provide close to $2 billion annually in short-term revolving transactional loans to over 100 companies. Our investors continue to seek uncorrelated, non-directional yield and our borrowers increasingly look to alternative sources of financing for small projects that fall under banks' radars.

Before launching RET, we had done over a dozen direct lending deals totalling approximately $100 million on a deal-by-deal basis. The capital came from partners, external investors, family offices and high net worth individuals through networking and existing relationships.

Q How do you see the Asian market?

Asia is particularly interesting. The private debt market in Asia is not as well served as, for example, the US or Europe, meaning that there isn't as much dry powder available in the region. I think there's about $100 billion of dry powder in private debt globally, of which less than $1 billion is dedicated to Asia.

Despite a more liquid banking market, a less crowded space for alternative financiers means you can really find opportunities with attractive risk-adjusted returns. In Europe and the US, the increasing density of alternative financiers drives down return yet drives up risk, forcing managers to look at deferred upside instruments, more junior positions, or more stressed borrowers to achieve their target returns.

Q How do you evaluate deals?

We have a unique and competitive edge at EFA. To start with, most of our dealflow originates from our longstanding trade finance borrowers. These are borrowers that have, on average, a four-year track record with us. They are companies and business models that we are close to and understand well.

Q What are the major difficulties in fund-raising?

The direct lending world is very broad. This does not always make it easy to clearly identify where asset managers sit within the industry, and which part of the capital structure they focus on.

We focus on amortising, senior secured lending facilities to the middle-market segment and, given the sectors and regions we target, as well as our speed and flexibility, are able to generate attractive returns.

Similar or higher returns are achievable elsewhere, but in regions like Europe or the US, which have lower overall growth and a much denser population of asset managers focusing on direct lending, this usually comes by working with leverage, deferred upside instruments, more junior positions, and/or more stressed borrowers.

Q Do you see banks as competitors?

We don't, given their sheer size and the fact that they can provide a much wider range of services than we can. There is always going to be a need for banks, and they will continue to provide for the vast majority of the liquidity in the system.

Banks regularly refer some of their borrowers to us when they are unable to finance certain of their specific transactions, typically when these deals are too small and do not fit the banking mandates. They prefer to see their borrowers come to us than to another bank.

Q Is it difficult to survive in the market that's dominated by a few blue chip asset managers?

While [the industry is] dominated by first class, top-tier, blue chip asset managers, we still focus on a different section of the market.

You will not see the larger asset managers going into $2 million-$20 million transactions, they do $50 million or above. And you don't see them yet in trade finance given the specific operational expertise required and the highly labour-intensive characteristic of the asset class. As a pioneer of trade finance as an asset class, particularly in Asia, we enjoy a similar level of recognition in our own sector. When faced with large deals, we have enjoyed working with the blue chip asset managers.

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