Ghose aims to double Investcorp debt fund

INVESTCORP, THE Bahraini investment house, wants to more than double its leveraged credit portfolio to $25bn, after buying the global debt business from 3i.

Jeremy Ghose, one of the most experienced investors in Europe's leveraged loan market, began work at Investcorp earlier this month, after moving the business, formerly 3i Debt Management, in a deal struck last year.

3i decided last year to change its strategy to one of proprietary investment management, aping Berkshire Hathaway, rather than raising funds from external investors.

That meant Ghose's credit business, which manages $11.5bn for about 400 investors worldwide, no longer fitted at 3i. Ninety-five percent of the money it managed was for external parties.

To preserve the stability of the business, rather than holding a public auction, 3i let Ghose find a new home for it himself, through negotiations last summer that were kept very private.

Had news of the sale leaked, 3i would have had to make a public announcement, as it is a listed company, and that could have unsettled both the group's investors and staff.

The privately negotiated sale echoed the one Ghose conducted when Mizuho sold the business to 3i in 2010.

"As a business, we are working within a framework that provides us with global distribution," said Ghose, now head of Investcorp Credit Management in London. "Investcorp's model is very much a fund management model."

Investcorp brought a long track record — it has been in business since 1982 — operations in London and New York, like the 3i credit team's, and access to substantial capital.

Investcorp's shareholders include Mubadala, the Kuwait Investment Authority, Qatar Investment Authority and the Kingdom of Bahrain.

Investcorp has three other business lines: mid-market private equity, real estate and alternative solutions, a hedge fund business. Credit is now a fourth leg.

Margins under pressure

With the team's 40 funds and 50 staff, getting the regulatory approvals to start operating at Investcorp took five months, but that was completed earlier this month and the team moved to Investcorp's Mayfair office in early March.

The group arrives at a time when leveraged debt markets are skewed in borrowers' favour. The primary market is dominated by a succession of repricing deals, in which borrowers return to the market to reprice their loans at lower margins, and sometimes more aggressive terms.

The economic outlook is also far from bright — at least in Europe. Company valuations are high, relative to prospects for GDP growth, and politics are worrying, with populist leaders on the march in countries such as France.

All this is keeping a lid on mergers and acquisitions by both companies and private equity firms. Chinese appetite for European companies has also ebbed because of exchange controls.

"PE funds, who are the real drivers of this market in Europe, are struggling to compete because of the valuations," said Ghose. "In my 32 years of working in the leveraged financed world, I cannot remember a similar period when PE dry powder has been at such a high level."

But he added: "The private equity sector has weathered storms before and I remain confident that they will do so again."

Ghose senses more economic dynamism in the US, at least in the short term. "Many have argued that the US economic environment will be resilient in the near term," he said. "Regulators have cleaned up the banking sector and banks have, in turn, raised balance sheet capital. What the Trump administration does with China is a different matter, but he is perceived by many as a pro-business leader."

Ironically, one bright spot for leveraged lenders comes from regulation.

US regulators' controls on leverage in buyouts, with an unwritten rule that leverage should not normally exceed six times Ebitda, have been embraced by the European Central Bank. "This has been good news for debt investors," Ghose said. Acquisition multiples remain high, but private equity firms simply have to put in more of the money as equity.

"Pre-Lehman, we had an average of 20%-22% equity below us [as a senior lender]," he said. "Now it's more like 45%. We are better protected today and interest and cash flow coverage ratios remain strong. The Ebitda of businesses has got to halve before senior secured bets become impaired."

Looking further afield

The credit team's new home at Investcorp will allow it to explore different ways of doing business and new products and places to invest in.

"We are committed to targeting an increase to $25bn AUM as a credit management business," said Ghose. "Today, we are principally CLO-centric. Globally, we are regarded one of the best in class in the CLO world."

CLOs suit the Investcorp business well, as it is sticky capital. "It's 10 to 12 year locked-up capital," said Ghose. "And, with version 2.0 CLOs, when we come to the end of the reinvestment period, we have the option to refinance them, further elongating the investment period."

CLOs will continue to be central for Investcorp Credit Management, but it will also build the non-CLO side of the business.

"The CLO market has been functioning well, but no business such as ours would want to end up with all their eggs in one basket," said Ghose. "After 2008-9, the CLO market was shut for a number of years."

Ghose said the group had received reverse enquiries from investors interested in separately managed accounts.

It is also considering other asset classes, including direct lending in Europe and the US and structured credit.

Direct lending — usually meaning lending to smaller companies in deals negotiated between just one or two funds and the borrower — has not enticed Ghose yet, but he is waiting for the right opportunity when the credit cycle turns (*see direct lending story on page 1*).

Ghose: regulation of leveraged lending "has been good news for debt investors"

Investcorp is likely to be involved in the higher end of the mid-market. It expects to work with banks on direct loan deals. Companies can go straight to investors, but often they want to work with their main bank. "It would worry us if we didn't see a relationship bank joining," said Ghose. "That can be a red flag."

About 80% to 85% of the companies using direct lending in Europe are estimated to be private equity-owned, against about half in the US. Partly that is because private equity ownership tends to give companies more indebted balance sheets, and access to more sophisticated financial products.

But lenders also feel comfortable lending to sponsor-owned businesses — in contrast to the usual assumption that PE firms will walk away from failing companies they own.

"What we have found in our long track record is that if something goes wrong, and you are sitting across the table from a PE guy who put up, say, $40m, then he's more likely to put up another $10m," said Ghose. "If the owner is not a sponsor, there's often no one there who can put up any cash. So we have stuck with the PE community. These are the players we know and want to stay close to."

Investcorp will also broaden its net to other parts of the world. India, where the banks are under stress but economic growth is 7% to 8%, needs foreign capital and could be worth exploring. ■