

THE LAST WORD

ESO CAPITAL

'It's strange - business goes on as normal'



Speculation is rife about the ending of the cycle and what political developments may be coming round the corner. **Alex Schmid** of ESO Capital is staying focused on doing deals others overlook

Q Where are we in the credit cycle, and how do you view market conditions?

We're in the early days of the credit cycle coming to an end. It's strange because business goes on as normal, but I do think things will become trickier. What will the UK look like post-Brexit and what about the US presidential election? One or two years ago, we thought there would be yield expansion in the US through higher interest rates, but that's not happening. But there are still good opportunities out there and I think firms with niche strategies can be nimbler at finding them.

We have regular discussions with investors and the perception of Europe is better than you'd think. In terms of credit investing, it's seen as more of an open playing field than the US as there are fewer managers with niche strategies. There is not much distress, and Europe never delivers distress in the volume people expect. But it would be interesting if portfolios take a wobble as that could

lead to a bit of a distressed market. Overall, we don't see a lot of growth ahead but we don't see heavy storm clouds either. If you underwrite deals well, you may still have one or two hiccups but you should be fine. Risks need to be managed carefully. What if Germany goes 1 or 2 percent negative? German businesses are managed for cash and you can get to negative equity very quickly. Are you able to hold a loan when there's zero or negative growth? Do you have the resources to see it through?

Q Describe the kind of situations you are typically involved in?

We like deals, platforms and situations where having a narrow mindset doesn't allow you to grasp the opportunity fully. There are so many cashflow-type deals done at 3-4x leverage, and you're in a box if you're that type of investor. LPs can find us a difficult business to understand because we don't operate within standard boxes. We think through value in all aspects and customise a structure that allows a company to take advantage of an opportunity.

It's very rarely that you can come up with the right answer for a company straightaway; being a true partner on a deal means there is a lot of back and forth to make sure it works for both sides. You

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could have a small company that is trying to go deal by deal and that can have certain constraints.

For example, we backed PlaceFirst, a developer of built-to-rent housing in the north of England. They would go out and find capital for a deal and then the next one and then the next one. And these deals were tiny, around £5 million (\$6 million; €7 million) each. If you can provide capital for 10 of these deals then it becomes more of an institutional approach. We have partnered with PlaceFirst to provide them with long-term capital, which enables them to source better deal opportunities through security of funding. We also take a stake in the operating company, which provides important alignment of interest, delivering superior returns.

Q What are your investors typically looking for?

They want a higher return with a bit more risk but not much more. And they are willing to take process risk rather than asset risk. We focus on protecting against the downside, so if a deal were to go sideways, we would be able to put our extensive workout expertise to use. It's hard to find that kind of resource. There are a number of new funds in the market that have not done workouts before. Some will figure it out and some won't. Experience through market cycles is key. ■

**WHAT DO YOU THINK?
HAVE YOUR SAY**
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