Investec

Investec Alternative Investment Management (IAIM)

# Investing for *long term* growth

OUT OF THE ORDINARY

INVESTEC DIRECT LENDING - AUTUMN NEWSLETTER 2024

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# Dear *Investors,*

I hope this letter finds you well and that you are enjoying real momentum in your business as we close in on the festive season and year end. The European private debt market continues to demonstrate growth and resilience. Global Direct Lending fundraising reached $54bn in the first half of the year, up 13% from 2023.[1] This increase in fundraising volumes - coupled with the successful first close of our second fund, PDF II - makes it a timely point for an intra-year update to supplement our annual report, which will be out next year.

In addition to increased fundraising, deal making has also progressively increased across the year in private credit as M&A, slowly but surely, calibrates to the higher interest-rate environment.

With interest rates on a downward trend (three-year swaps are at 2.10% [EUR]), record hold periods for PE managers and LPs applying pressure for capital recycling, we believe there are now positive structural tailwinds to support continued increases in M&A.[2] These trends are a key tonic for the heightened competition in private credit this year.

Despite the geopolitical and wider market challenges, we remain steadfast in our commitment to disciplined investment into the lower mid-market. We continue to source new investment opportunities and to support the growth of our 140+ existing borrowers. We are pleased that we have successfully completed 25 unique transactions up to the end of June, in line with 2023 levels by deal count and inclusive of 12 new borrowers.

We have been busy investing in our platform for long-term growth, launching a new Private Credit Management team with the responsibility of driving growth and enhancing oversight across the existing portfolio.

Furthermore, we have also been investing in sustainability with the appointment of Alicia Forry as Head of ESG and, in quick succession, a new partnership with Holtara – a sustainability and ESG services expert – to ensure we remain on target to deliver our net zero commitments by 2050. Overall, we are experiencing increased momentum in both the fundraising and investment spheres of our business.

> We continue to actively invest for the long-term, furthering our position as a key access point for investors to the European lower mid-market.

With best wishes

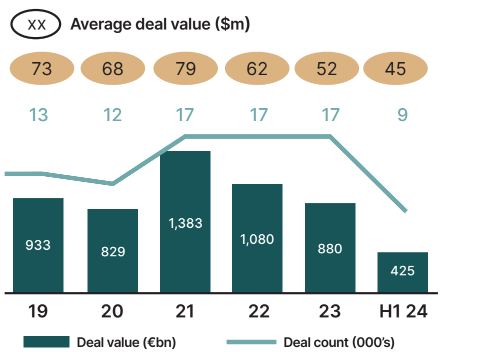
Callum Bell
Head of Direct Lending

# Market review
# *Looking back*

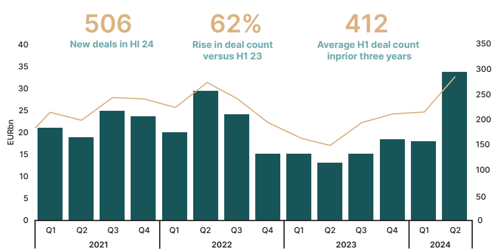
The investment environment in the first half of the year remained relatively constrained due to slow M&A activity, particularly that involving private equity sponsors. As the chart below shows, activity remains broadly in line with the lower levels experienced in 2023, with the effects of higher base rates contributing to a period of relative calm in deal activity.

Direct-lending deal volume on the other hand totalled €52bn for the first half of the year, representing a year-on-year increase of 85%, according to Debtwire's H1 24 European Direct Lender Rankings report. This was largely driven by very high levels of activity in Q2 of 2024, indicative of increasing confidence which has been buoyed by the peak and subsequent fall in inflation and base rates across Europe and the UK. This will provide some welcome relief not only for corporate borrowers but also private equity sponsors seeking a cheaper and more constructive lending environment to underpin and drive M&A activity. With record dry powder levels and long portfolio holding periods, there are now compelling structural drivers to facilitate transactions.

**European M&A activity**[3]

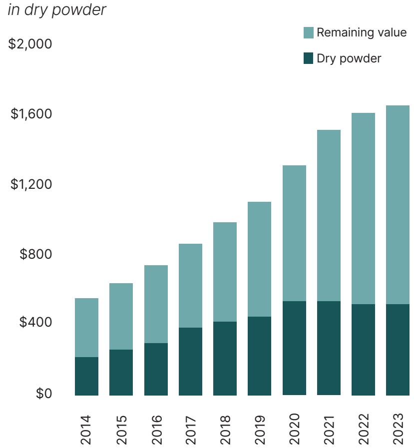



**European direct lending volume**[4]




**Private debt institutional fund AUM and dry powder ($B)**[5]

*Institutional AUM exceeds $1.6 trillion with $520.2 billion in dry powder*




Another key development across the year was the bounceback of the broad syndicated loan market with issuance topping €100bn in the first half.[6] This has led to enhanced competition and inevitable margin compression in the larger-cap space.

The attractiveness of the lower mid-market (LMM) segment, where we focus, has become clear across this period as volumes have been relatively less impacted - as an example, our introductions have increased ~8% year-on-year to 320 for the first half of the year. Further the segment remains insulated from the competitive forces that larger players have been exposed to as they go head-to-head with a rejuvenated syndicated loans market. Overall, margins and terms in the LMM have been materially less impacted. The need for established local networks (and investment teams with the scale and discipline to access this underserved market segment) have proven tangible barriers to entry for larger managers more focused on deploying significant dry powder in short order.

> Investec committed over €450m across 25 investments for the first half of the year (PY FY €910m across 53 investments - 8% growth year on year.



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# Market review
# *Looking forward*

During the second half of 2024, global markets have and will continue to be attentive to interest-rate dynamics, with more central banks transitioning towards policy easing and reducing base rates. The European Central Bank (ECB) recently cut its deposit rate for a third time to 3.25% and the Bank of England made a second 25-basis-point cut to 4.75%. The forward three-year swap[2] rates, which private equity funds typically use to hedge their lending, are currently 2.10% (EUR) and 4.05% (GBP), down significantly from higher levels of 3.25% (EUR) and 4.65% (GBP) only one year ago.

> We will continue to work closely with our borrowers to understand their individual needs and create bespoke solutions to support their growth objectives.

For the private debt market, we envisage the headwinds experienced over the previous two years gradually shifting to more supportive tailwinds as inflation and base rates reduce; we are seeing this already in pipeline activity. In turn, an increase in M&A activity will improve the current credit supply/demand imbalance supporting improved pricing and terms. From a timing point of view, the second half of 2024 and the start of 2025 should provide stronger deal flow and improved conversion rates as increased investment certainty and confidence filters through the investor and borrower community.

Outside of investing, it is worth noting there is increased focus on the industry from a regulatory perspective. AIFMD 2.0 was published in March this year, which will have some implications for credit managers as they prepare for a go-live date in April 2026. An increase in regulation is not unexpected, and we believe this favours managers of scale like Investec who are well placed to effectively navigate and manage new requirements.

Our overall outlook is positive as the market pendulum moves back to more growth orientation. Direct Lending has weathered the cycle well, underpinned by secular growth in the wider private credit markets. We believe established and disciplined managers like Investec, who have continued to invest through this cycle and for the long term, will capitalise on the underlying growth and market consolidation that is increasingly evident.

# medavis
# *Case study*

In 2022, Bregal Unternehmerkapital ("Bregal" or "Sponsor") took a majority interest in Karlsruhe-based medavis GmbH ("medavis"), a leading healthcare software provider for radiological information systems (RIS). medavis' software is indispensable for radiological practices and clinical departments in Germany, Austria and Switzerland, where it is used in workflow optimisation, process integration and networking. For 25 years, medavis has offered tailored software solutions focused on imaging techniques to doctors, specialist medical personnel and patients.

> medavis exhibits strong credit characteristics with high customer loyalty as its customisable software solution is deeply integrated into its customer's day-to-day operations.

## Attractive credit profile

medavis exhibits strong credit characteristics with high customer loyalty as its customisable software solution is deeply integrated into its customers' day-to-day operations. The strength of its product offering has resulted in medavis outgrowing its competitors and building a market share of around 20% in a sector that has been resilient in all economic cycles.

## Investec solution

Our investment team has a long-standing, trusted relationship with the sponsor, having previously partnered on multiple transactions. We were therefore well positioned to support Bregal during a time-sensitive, confidential process.

Our ability to leverage our in-house sector expertise in financing software assets, as well as in-depth knowledge of this niche segment across the wider Investec platform, allowed us to move efficiently through our due diligence process. Our speed of execution, which was facilitated by the mutual understanding of each other's processes, was key in this transaction and provided the sponsor financing certainty and consequently a competitive edge to secure this sought-after asset.

Investec provided the sponsor a tailored debt package on a bilateral basis which has allowed the sponsor and management team to execute their strategic ambitions, including financing their buy-and-build strategy.

Our partnership approach has continued to support the growth of medavis. In 2023 and 2024 the firm completed four credit-enhancing add-on acquisitions in EpiNet, Digithurst, InformMe and MedDream. Investec helped to finance this growth, enhancing medavis' product offering and international expansion.

## Investec differentiators

- Long standing partnership with the sponsor
- Deep sector knowledge across the Investec platform
- Ability to move quickly
- Provided one-stop financing solution inclusive of term lending, delayed draw and revolving facilities

# Leveraging our *in-house sector* expertise

# *Sustainability, impact and people*

## Sustainability

We significantly evolved our Direct Lending sustainability strategy during the first half of 2024. With the introduction of our new Head of ESG, Alicia Forry, the team is further embedding processes to identify ESG-related risks and opportunities throughout the pipeline of potential investments and across the portfolio.

**The key principles underpinning our responsible lending framework include:**

- Sector-based risk ratings
- Double materiality analysis
- Alignment to industry frameworks (UN SDGs & SASB)
- The recognition of the importance of deal-specific insights

We have refined our approach to sustainability-linked financing, providing more ways for borrowers to align their financing with their sustainability objectives. We also undertook an extensive exercise to enhance our understanding of the positive impacts the companies we lend to have on society and the environment.

To support these initiatives, we are pleased to announce the appointment of our ESG data and advisory services partner, Holtara, who have been at the forefront of developing successful ESG programs for investors, managers and companies for over 15 years. Together we can develop valuable insights from our portfolio which can be used to help borrowers throughout their sustainability journeys. We will leverage Holtara's insights to strengthen our own capabilities and to offer a range of sustainability advisory services to our borrowers.

In addition to these significant strategic milestones, we continue to source sustainable investments and are pleased to have been chosen as the sole lender supporting Beech Tree Private Equity's investment in Sustainable Energy First, a leading UK energy and sustainability service provider and B Corp. This transaction is a good example of our commitment to supporting companies that deliver more sustainable outcomes for the planet and for society.

## Charitable giving

As part of our commitment to making a positive impact in our communities, the Direct Lending team is proud to support a number of charitable causes that align with our values and goals. In our 2023 annual report, we announced that following a robust selection process, we had identified two charities that we would support going into 2024: the Campaign Against Living Miserably (CALM) and The Felix Project. In the first half of 2024 we have hosted a number of events and fundraising

workshops and look forward to supporting these important charities throughout the rest of the year.

We also encourage our employees to volunteer their time and skills to help these organisations and other local initiatives. Some of the activities we participated in as a team over the first half of the year included cooking hot meals and preparing


Some of the activities our team participated in over the first half of the year included volunteering for the Felix Project and refurbishing the Slade Gardens Adventure Playground.

Mike Miller

Alicia Forry

food packages for underprivileged schools and care homes with The Felix Project and refurbishing the Slade Gardens Adventure Playground with London Play Design. We were incredibly proud to support three of our Direct Lending team members who ran the London Marathon in April to raise money for Future Dreams, the breast cancer support charity. We believe that giving back to our society is not only a moral duty, but also a way to enrich our culture and foster teamwork.

## Our people

Our people are our most valuable asset, and we are committed to supporting the team's overall wellbeing and individual career development ambitions. During the first half of 2024 we continued to invest in our platform and strengthened our team by adding a Head of Private Credit Management; a Head of ESG; and a senior origination hire to lead our asset-based lending strategy in the Benelux region. Our Direct Lending team now stands at 54 individuals across our primary offices in London, Dublin, Zurich and Amsterdam. In celebration of the 10th anniversary of our Benelux franchise we also upgraded our office in Amsterdam Zuid and look forward to capturing the growth opportunities that we see in Europe.

An important way in which we continue to support our people is through our dedicated Diversity & Inclusion ("D&I") committee. During the first half of 2024 we held a series of roundtable events to foster an open dialogue on the topics of culture and inclusivity and developed action plans based on these learnings.

# *2024 H1* in numbers

€3.5bn

Investec Direct Lending AuM

140+

Borrowers

54

Members in the
Direct Lending Team

€450m

Total capital committed (PY full year €910m)

<3.5x

Average portfolio average leverage

30:70

Female: Male

70+

Sponsors

# *Get in touch*

**Callum Bell**
Head of Direct Lending
callum.bell@investec.com

**Helen Lucas**
Co-Head of UK Origination
helen.lucas@investec.com

**Greg Betz**
Co-head of UK Origination
greg.betz@investec.com

**Alexandre Neiss**
Head of Benelux Origination
alexandre.neiss@investec.com

**Kai Stengel**
Head of DACH Origination
kai.stengel@investec.com

**Alicia Forry**
Head of ESG
alicia.forry@investec.com

**Megan Sachs**
Portfolio Manager
megan.sachs@investec.com

**Lois Moore**
Investment Specialist
lois.moore@investec.com

**Maria Collins**
Investor Relations
maria.collins@investec.co.uk

**investec.com/iaim**

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## About Investec Direct Lending:

Investec Direct Lending is a lower mid-market private debt manager. It has more than 14 years of experience originating, investing and managing private debt assets. Since inception, it has originated more than €9.5 billion in loans across 330+ investments over that period. Its focus is on providing private credit solutions to lower mid-market corporate borrowers in Europe – an underserved group that provides strong risk-adjusted return opportunities for investors.

The team of more than 50 professionals has in-depth expertise in its specialist market - concentrating on senior, unitranche and integrated asset-based lending solutions. The team has a strong track record of credit selection, delivering superior risk-adjusted returns combined with low historical loss rates.

## About Investec Alternative Investment Management:

Investec Alternative Investment Management ('IAIM') is the asset management business of Investec. It leverages the organisation's origination and proprietary deal flow capabilities to deliver private market investment solutions.

Investors have immediate and scalable access to a proprietary source of investments - benefitting from Investec's flexible lending mandate and proven investment teams that focus on capital preservation. This enables IAIM to deliver superior risk-adjusted returns.

IAIM is a 100% owned subsidiary of Investec Bank plc.

## About Investec Bank plc:

Investec Bank plc ('Investec') is the banking subsidiary of Investec plc. Investec plc is a FTSE-250 listed company which holds the Investec Group's non-Southern African businesses under a dual listed company structure. Investec partners with private, institutional and corporate clients, offering banking and investment services in the UK, Europe and certain other countries.

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