

Unlocking Opportunities: Kartesia's Approach to Non-Sponsored Lending



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In the lower end of the European mid-market, where Kartesia focuses, the provision of leveraged loans has historically been largely dominated by banks. In the aftermath of the global financial crisis and the ensuing enhanced regulatory oversight, banks' ability, and willingness to hold leveraged loans on their balance sheets has been significantly damped. Regardless of this evolution, Private Equity activity in the lower mid-market has continued to flourish as direct lenders have filled the void in support of financial sponsors, dramatically increasing their market share to over 50% in recent years across Europe.

As a result, most direct lenders' business models are geared towards providing leverage to private equity sponsors, heavily relying on comprehensive diligence by private equity investors and counting on the sponsor's governance and operational support as well as dry powder to support challenged companies.

Whereas sponsor involvement certainly provides comfort to direct lenders, it is undeniable that private equity investors have the incentive to optimise financial leverage and drive down the cost of financing in conjunction with strongly mitigating the rights and security position of lenders. This situation has been exacerbated in recent years as more capital has flowed to direct lending as an alternative asset class. Over the last decade, Kartesia has developed into a leading player in the lower mid-market direct lending landscape in Europe, through our senior and flexible credit and capital solutions mandates. Our goal was and remains to act as a reliable partner to borrowers, including many financial sponsors. We recognise the added value of sponsors, without compromising on independent due diligence and discipline in investing in transactions that provide for appropriate levels of protection and controls at an adequate level of return. We intend to continue to do so.

Where we do see a tangible, still largely untapped growth opportunity is in the non-sponsored market. As only a small portion of lower mid-market companies are sponsor-backed, the addressable market opportunity is clearly multiple times larger.

Furthermore, as sponsor-backed companies have now fully adopted direct lending and with tighter lending conditions from banks set to last, lower mid-market non-sponsored businesses that do not have access to the wider capital markets are bound to turn to direct lenders to achieve strategic goals.

Since the launch of Kartesia, we have performed over half of our investments with non-sponsored companies, making us the number one player by number of deals in the European non-sponsored direct lending space. According to our non-sponsored counterparts, our key differentiators that have allowed us to generate a large non-sponsored deal flow and capitalize on this opportunity are:

- First, a local presence allows Kartesia to be recognized as a local, trusted credit and capital provider across Europe, benefitting from a truly pan-European network combined with agile and rapid centralized decision-making.
- Secondly, our ability to provide deal certainty very early on in a process and our willingness and experience in performing proprietary due diligence combined with the provision of comprehensive flexible, long-term debt & capital solutions have allowed us to gain trust and exclusivity in numerous non-sponsored opportunities.
- Finally, our partnership, growth-oriented approach allows non-sponsored borrowers to partner with a capital provider that can financially support companies to make significant investments, whether to grow organically or through acquisitions. We aim to be a

true catalyst for growth, allowing lower mid-market companies to reach the midcap or upper midcap status with only one financing partner's involvement. As such, we invest tickets as low as EUR 10m that can grow to up to over EUR 150m in one single platform company.

This flexibility enables major value creation as invested companies grow, become better established, diversify their end markets, or increase market shares – typically leading to favourable multiple arbitrage opportunities at exit. As a result of our partnership approach that better aligns interests, our counterparts are less reluctant to accept meaningful controls from Kartesia as a capital provider, including board-level representation irrespective of the lending instrument. This approach has allowed us to remain cautious when it comes to risk-taking while sharing in the overall value creation.

Although non-sponsored lending offers numerous advantages, it's not without its pitfalls. We are often asked how borrowers react in stressful situations. In this respect, in our experience, non-sponsored shareholders have been at least equally inclined to support businesses in downturns compared to private equity firms. That being said, in the event of a stressed situation there is obviously no sponsor to turn to for operational support.

Kartesia's deal teams have therefore built European-wide specific expertise in working out underperforming credits, having managed to generate gains on defaulted assets that far outweigh any losses. Our track record of acting as a responsible, proactive, constructive, and professional partner in challenging times, combined with our ability to support portfolio companies both operationally and financially are key points that are sought out by shareholders and management teams of non-sponsored companies. Conversely, this positioning also benefits our investors as we roll up our sleeves and do what it takes to protect the downside in each investment.

Kartesia is a pan-European, independent, and privately-owned specialist provider of financing solutions, focused on offering customised resources across the capital structure to leading mid-market companies from a wide range of industries, with the view to accelerate their pace of growth. Kartesia manages almost €6bn in assets and is operated by a team of 100 experienced professionals across investment and operating teams led by its four founding Managing Partners. The organisation has offices in Amsterdam, Brussels, London, Luxembourg, Madrid, Milan, Munich, and Paris. For more information visit: www.kartesia.com