

Bringing Direct Lending to the Nordics

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Stockholm (HedgeNordic) – With investors being drawn from traditional fixed income assets in search for yield, the private debt market has emerged as a fast growing investment option. Within this space, investment strategies focusing on offering loans to private companies, so-called Direct Lending strategies, have emerged as a new asset class. Stockholm-based asset manager Kreditfonden aims to bring Direct Lending to the Nordics through its [Scandinavian Credit Fund 1](#).



"The [Scandinavian Credit Fund 1](#) looks to tap into an opportunity created by the increased regulation imposed on banks following the financial crisis. As banks have become more restrictive in their lending activities to companies, there is huge need for financing offering very attractive yields for those that can provide short and medium term financing options", Fredrik Sjöstrand, founder and CEO of Kreditfonden says (pictured).

Direct lending, as an emerging asset class, has existed for years in the U.S. and has become increasingly popular following the 2008 financial crisis. In recent years, Europe has overtaken North America as the leading fundraiser in direct lending funds with 18.8 billion USD of assets raised in 2015. Between 2012 and 2015 Europe-focused direct lending fundraising increased by a staggering 437 per cent, according to hedge fund data provider Prequin.

"There has been a huge interest for the strategy internationally, especially given the extreme interest rate environment we are in and the strong risk/return characteristics that the strategy has offered historically. However, there has been no obvious way for Scandinavian investors to enter into these type of investments. We are the first to offer the strategy as an easily accessible investment option in the Nordics," Sjöstrand says.

When setting up the [Scandinavian Credit Fund 1](#) in Sweden, Sjöstrand and the team behind Kreditfonden wanted to create an investment vehicle that was offered to the broad public rather than as a closed-end fund targeted towards professional investors only. This was made possible by the AIFM-directive.

"Through setting up the fund as a listed entity on the Nordic Growth Market, NGM, and by offering profit sharing loans in the fund we could address a retail audience in accordance with the AIFM-directive. We will issue new loans on a monthly basis to secure ongoing transactions and also allow investors to buy and sell their loans on a monthly basis. In the end we aim to reach 3 billion SEK in loans outstanding", Sjöstrand says.

Loans will be issued to small and mid-sized companies that are in need of short and medium term financing for different reasons, for example to expand, to restructure, to compensate for seasonality effects or to contribute with bridge financing, i.e. to solidify a company's short-term position until a long-term financing option can be arranged, typically done ahead of an IPO. The duration of loans will range from 1 to 36 months, with shorter-term deals

offering the most attractive levels of yield, according to Sjöstrand.

"It is by being flexible when it comes to the structure and the duration of loan deals that we can create the yield required to meet our return target", Sjöstrand argues.

The fund aims to offer to investors a long-term annual return of 6-8% to a low volatility profile corresponding to a "2" on the KIID risk scale. The average yield on underlying loans is relatively high with levels ranging from 6 to "well above 10%", according to Sjöstrand. However he notes that it is not about entering into financing deals with "counterparties that are questionable from a credit rating perspective".

"We conduct a thorough analysis before entering into a loan deal. This encompasses anything from a regular credit check to getting a feeling for the management of the company, its board of directors, CEO, accountants, product, and markets. It is about having as much information as possible in order to make a proper assessment of the company's ability to repay the loan. The loans are secured which means that we also need to make a proper evaluation of the assets that the borrower has put in as collateral for the loan."

Previously head of trading at Handelsbanken Markets, Fredrik Sjöstrand has a long experience from fixed income and credit trading and has tied the former head of credits of Handelsbanken, Hans Lundholm to the team. Together they will be responsible for evaluating new loan deals and to make sure to avoid entering into deals where companies fail on meeting their obligations.

"By making an investment in the fund you are trusting our team of experienced team of credit analysts to make proper evaluations of the companies entering our portfolio. The inherent risk is that we will have credit events, which is something that will happen eventually. However, over time we believe default risks to be very limited and more than compensated by the yields offered on the loans that are fully repaid."

Since the fund launched in January of this year, performance has been in line with expectations with gains of 3.6 per cent year-to-date as of August. In order to grow the fund further, Kreditfonden is now looking to tap into the distribution networks offered by major financial advisors and insurance companies.

Peter Norman, co-founder and head of business development, says that the challenge short-term is to educate the investor community about direct lending as an asset class and to demonstrate its benefits in a portfolio context.

"Direct lending is an emerging asset class that the broader investment community needs to get acquainted to, however, from a portfolio context it is currently one of the most interesting ones. Given that the strategy shows little or no correlation to traditional assets such as stocks and bonds while offering attractive and stable yields over time, there is a strong case to be made to have it included in any model portfolio", Norman argues.

According to Norman, there has been an ever increasing interest for the fund since the launch, both among private individuals and larger institutions. Although the first version of the fund has been targeted towards non-professional investors offering a minimum investment as low as 100.000 SEK, he sees the possibility of expanding the investor

base to institutions in forthcoming versions of the fund.

"As the name 'Scandinavian Credit Fund 1' suggests, there is a plan to launch additional funds going forward. In the end, this is a product suitable for professional and non-professional investors alike and we foresee great demand among Scandinavian institutions for complementary fixed income investments, of which direct lending should be considered a very interesting option."

This article was written for the HedgeNordic Special Report on Fixed Income Strategies. You can view the entire report, here: <http://hedgenordic.com/wp-content/uploads/2016/09/FI.pdf>

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