

E X P E R T Q & A

Asset-based finance offers different risk and return profiles that make it appealing to a broad investor base, says John Wright, a partner and global head of credit at Bain Capital



A diverse and growing opportunity set

Q What are the most attractive parts of the asset-based finance market today, and why?

The places where we have found the most interesting opportunities in asset-based finance fall into a few buckets.

The first area is real estate, where we see a broad and diverse opportunity set. Commercial real estate lending, in particular, is compelling as banks have stepped back in recent years. With less competition, we're seeing opportunities to lend to refurbished or transitional properties at a relatively conservative loan-to-value, while still achieving strong yields.

Beyond that, there are several residential-related themes that we like.

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That includes locked-in mortgage borrowers in the US with home equity that are finding different ways to finance either home improvements or personal financial needs. There are some interesting lending opportunities there.

Then peripherally to real estate, we have financed parking garages, and we like certain land banking investments. The real estate sector overall continues to offer a lot of opportunity.

Other areas worth highlighting include aviation, where we have strong conviction in the long-term demand trends and an undersupply of aircraft.

In addition, we have found attractive risk-transfer investments backed by corporate debt. We're also focused on digital infrastructure, where we expect significant supply and need for financing. Finally, and more episodically, is the royalties space. We have completed several music royalty transactions.

One of the advantages with asset-based finance is that the opportunity set keeps growing. We have been investing behind many of these thematic opportunities for over a decade, but we continue to see the strategy grow in both volume and diversity. If you can understand the underlying asset and the structure around it, you can create compelling opportunities for different risk and yield appetites.

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Q What are LPs looking for when it comes to differentiated asset-based finance strategies?

As with other strategies, we have found LPs are particularly engaged when there is a high degree of conviction and alignment. We only pursue strategies we are excited to put our own capital behind, and asset-based finance is no different.

Asset-based finance is also resonating because many investors see it as a natural extension of private credit. They like the combination of contractual cashflows and downside protection, and they value returns having a low correlation to public markets.

What’s distinctive about asset-based finance, though, is the breadth of the risk/return spectrum. Some investors favour the high-quality, investment grade-like portfolios where the goal is incremental spread or yield. Others are looking for higher total returns.

For us, the priority is to build a strategy that offers both a complete solution to borrowers and can be a home for a range of yield profiles for investors.



Q Where have you seen the most interesting deal activity? Can you give examples of recent transactions?

Our deal activity follows the themes I have outlined. There is a lot happening in both commercial and residential real estate. Within digital infrastructure, we continue to find a lot of interesting transactions involving data centres and fibre, where there is a strong financing need. The ability to lend with a hyperscaler’s credit risk behind you is compelling.

Within music royalties, there are two themes driving deal activity. One is an aggregation strategy where you are buying rights and building a library

that has a higher value than individual rights. Another is if you are investing alongside a partner that has the ability to drive more usage of the library that you own, which then becomes more valuable.

Last year, Bain Capital’s Special Situations’ team announced a \$1.2 billion joint venture with Warner Music Group to acquire music catalogues, for example, combining Warner Music’s industry expertise with our capital to invest in recorded music and publishing rights. Together, we can source and acquire deals, with Warner Music managing all the aspects of marketing, distribution and administration.

We also announced a joint venture with SMBC’s European leveraged

finance business last year to invest in secured credit to corporate borrowers. Under that deal, the goal is to provide up to €1.5 billion in lending across Europe and the UK, combining SMBC’s pan-European origination and structuring platform with our underwriting and asset management capabilities.

Q How can managers best leverage their capabilities to complete due diligence on asset-based finance opportunities and build compelling investment cases?

There are two drivers to sourcing asset-based finance opportunities and building the investment cases.

First, you need access to a breadth of insights. We have a very large team across the broader Bain Capital business and that comes with a high degree of co-ordination and collaboration. It means opportunities that come into any part of the business find their way to the right home.

Recent opportunities in asset-based finance have been originated and executed by teams within credit, special situations and insurance. These three business units are highly collaborative, and our success is the result of the partnership culture at Bain Capital.

The second piece is having a large team that can process and analyse the information to understand the underlying assets and cashflows, as well as the structures around them. That is critically important.

We have purposefully designed our strategy to size the amount of capital to the opportunities that we like, rather than pursuing deals just because we have access to capital. That means we are choosing only to go into the sub-sectors that we believe are attractive.

When it comes to performing due diligence on underlying assets, one thing that makes it more complex is the granularity of data that needs to be analysed. That creates complexity in monitoring too, so it is really important to have a technology-enhanced operation to track the underlying assets or loans and the cashflows they are generating.

The last challenge comes from the diversity of the opportunity set. We are talking about everything from music royalties to digital infrastructure, so you really need deep industry knowledge and experience to evaluate and select the most attractive investments.

Q Why is now a good time to launch an asset-based finance strategy?

We have discussed how the opportunity set continues to grow in both volume and diversity. As it grows, it presents interesting yield opportunities

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and we are excited about the deals we are seeing.

There are several drivers of that growth, including the evolution of capital markets, but also the fact that borrowers are interested in exploring different avenues to finance assets and portfolios. Borrowers do not necessarily want to be beholden to a single lender or market; they want multiple ways to finance assets.

Like in public markets, the structuring of risk with securitisation technology creates the ability to customise risk and return profiles to meet investor demand. On a blended basis, the combined solution leads to an efficient borrowing cost to the borrower or asset owner.

From an investor demand perspective, investors like asset-based finance because it generates an attractive yield and does so in a way that is typically short duration and cash-flowing. It also works well in a portfolio because it does not contain the same market beta

and its correlation with other credit assets is low.

As we look at the competitive landscape, with new entrants coming in, I would draw an analogy to our direct lending business. That has been a highly competitive space for quite some time and has grown significantly, but there is a market segmentation dynamic where the largest pools of capital are going after the largest deals and competing with capital markets. That is not our strategy, we have stayed in the core mid-market where we continue to find compelling yields and spreads.

In asset-based finance, each subcategory has different dynamics, with different players pursuing different types of transactions. Because of that diversity, there remains a lot of opportunity even as more competitors move in.

Q How do you see the asset-based finance opportunity evolving over time?

One sector that we haven't talked about is consumer, which is typically one of the largest sectors of asset-based finance. It's a sector we have been less active in than some of our peers, and is subject to headline risk, like the recent possibility of a cap on credit card rates or the evolution of “buy now, pay later” loans.

More broadly, we view asset-based finance as an extension of private structured credit, where we have been investing for decades. We will continue to focus on opportunities where we believe we can achieve compelling risk-adjusted returns, and we will size our business in a way that allows us to remain selective and deliver for our investors.

Asset-based finance as a standalone strategy, both total return-focused and high-quality focused, is increasingly interesting to investors. It can also serve as a valuable component of a multi-asset credit strategy, and we expect that demand to continue for some time to come. ■