GROWTH LENDING

The hands-on approach

Since its inception **Kreos** has evolved its specialist strategy in step with the wider European private debt market by emphasising the importance of strong sponsor relations

Growth lending is one segment of the European private debt asset class which offers sustained attractive opportunities to managers with the necessary combination of skills and deep experience. The segment generates strong returns thanks to Europe's stream of innovative activity which ensures the continuous creation of companies driven by an ambition to scale internationally. While very attractive, this expansion in multiple markets generates many layers of complexity to challenge a lender – it takes a specialist approach to lend successfully in this space.

This segment has been the focus of Kreos Capital, led by its general partners Ross Ahlgren, Luca Colciago, Aris Constantinides, Simon Hirtzel, Maurizio PetitBon, Raoul Stein and Mårten Vading. The private debt manager closed its fifth and largest fund – Kreos V – in 2016 at €400 million. In less than two years the fund has committed more than €450 million to 75 companies, beating its own forecast rate of deployment and accelerating the raising of its next fund by a year.

"Demand for our product has increased across all stages and sectors we cover," says Hirtzel. "The growth of scalable European technology companies combined with the well-funded equity sponsors we partner with, as well as an increased recognition of the role of growth debt in funding growth, has contributed to our strong deployment. We are in a long-term positive trend where the underlying market is growing."

> "THE GROWTH OF SCALABLE EUROPEAN TECHNOLOGY COMPANIES COMBINED WITH THE WELL-FUNDED EQUITY SPONSORS WE PARTNER WITH, AS WELL AS AN INCREASED RECOGNITION OF THE ROLE OF GROWTH DEBT IN FUNDING GROWTH, HAS CONTRIBUTED TO OUR STRONG DEPLOYMENT"
>
> **Simon Hirtzel**

Founded in 1998 by four of its seven current partners, Kreos was an early mover in the specialist growth debt product space and has evolved along with the ecosystem of high-growth European companies and their sponsors. The firm offers senior secured debt to sponsored pan-European high-growth companies aiming for returns of around 20 percent. These loans also offer a high degree of liquidity due to monthly amortisation offering accelerated distributions to investors. To date the firm has made 450 transactions.

"Nineteen years ago when we first started we made the key decision to focus on well-funded companies that used their resources to target high growth over profitability," says Ahlgren, "and we have continued to evolve and execute on the same strategy. Most banks, particularly since the

2009 financial crisis, turned their backs on this market and focused on profitability, leaving otherwise great companies with few funding options. Our decision to focus on this area has paid off well as not only are we able to obtain the robust debt yields we aim for but we also benefit from having a quickly-amortising senior-secured position in some of Europe's most attractive high-growth companies. Accordingly, we can offer high returns without fund leverage as the value creation comes from the underlying alpha of the assets."

Lending to high-growth companies in the dynamic European environment is underpinned by strong relationships with equity sponsors. Kreos's methodology centres on working closely with Europe's most active and successful equity sponsors which have fuelled Europe's most promising growth companies over many years. It's very much a relationship-driven approach that has been built since the company was set up.

"Our sponsor relationships are one of our major competitive advantages," explains Vading. "These trusted and close working relationships we have built are very symbiotic in nature. Not only do they give us access to pre-vetted dealflow

"OVER THE YEARS OUR EXPERIENCE AND CONTACTS IN LOCAL MARKETS HAVE CREATED A FORMIDABLE BARRIER TO ENTRY FOR NEW ENTRANTS"
Aris Constantinides

but they provide mutual confidence that debt and equity will work together to support the businesses we back through all economic cycles and any tough situations. Aside from funding we bring trust, stability, value-add and flexibility to our companies – which is why we are a preferred partner to both companies and sponsors and are able to generate our target returns."

The benefit of a relationship-based approach is that it allows a lender to follow and grow with the companies it invests in. Even if the initial investment is modest, there are ongoing opportunities to increase commitment as a business grows. By pursuing a strategy of lending to companies early, and continuing to invest as their trusted financial partner, means that companies that are growing and increasingly de-risking their business models can continue to generate yield. In a market of such breadth and diversity as Europe, the ability for a lender to scale across multiple jurisdictions is also key. For its part, Kreos also tries to distinguish itself from other European growth lenders via the range of countries and sectors that it covers.

"We are unique in Europe in offering probably the widest investment range of commitment size from €2 million to €40 million, across most innovation-driven technology and healthcare sectors and across multiple jurisdictions including the UK, German-speaking countries, western Europe, the Nordics and Israel,"

CASE STUDY: **PHARMING**

Kreos led the $40 million debt financing for the NYSE Euronext-listed Dutch pharma company in December 2016 alongside a significant equity round – crucially moving quickly to enable the company to re-acquire the distribution rights to an approved drug in the US. Pharming recognised the opportunity to market the drug itself, but the deal had to be achieved in 3-4 weeks. Following the commitment, Pharming sales grew rapidly and its share price has since increased around 4x. "Pharming is a good example of several key Kreos attributes," says PetitBon.

"First the company came directly to Kreos as we had built a very close relationship to its CEO over several years, since he was CEO of a previous portfolio company. He knew that we were trusted partners and we would be able to react quickly." Given its prior knowledge of the company, strong team support to manage the documentation and due diligence process and its ability to make quick decisions, Kreos was able to execute the financing within three weeks from start to finish.

says Colciago. “We are not aware of any other growth lender that has such a coverage of sectors, geographies and investment range and while we do come across some smaller, niche players in certain markets, none has our breadth of coverage or understanding of the broad set of local ecosystems that we cover. It’s not just the regulatory and legal system that’s different in each country, but the investors are also often different. There are certain firms that are well positioned for investing in their home countries but may be out of their comfort zone when investing outside their local markets”

> “OUR SPONSOR RELATIONSHIPS ARE ONE OF OUR MAJOR COMPETITIVE ADVANTAGES. THESE TRUSTED AND CLOSE WORKING RELATIONSHIPS WE HAVE BUILT ARE VERY SYMBIOTIC IN NATURE”
> **Mårten Vading**

Kreos, which has offices in London, Stockholm and Tel Aviv and a team hailing from 11 different countries, sees its geographic coverage as one of its biggest differentiators. International reach is important because Europe does not follow a unified set of laws, unlike the US. Each country has its own legal system where lenders are treated differently. Security frameworks and insolvency and bankruptcy processes differ by country, so a pan-European lender needs to master the local rules.

“This has been part of our DNA since day one,” says Constantinides, “and over the years our experience and contacts in local markets have created a formidable barrier to entry for new entrants.”

Knowing how to navigate this non-uniform landscape is a key attribute for Kreos. In this context, the firm’s focus has continued to be senior-secured amortising debt in high-growth European sponsored companies. Meanwhile, as the European market has evolved, the company has grown its use-cases to include expansion funding, working capital, acquisitions, refinancings, pre-IPO and pre-M&A as well as post-IPO financings and so broaden its coverage to larger businesses.

“One example of this evolution is Kreos’s commitments to European public companies,” says Stein. “Many European public companies share several similarities with our private investment activity as the IPO is just another major fundraising activity in the company’s lifetime and not an exit in its own right. Most of the original sponsors still hold substantial equity positions in these companies and often the lead partner remains on their board even after they have gone public – so both governance and investor support remain strong.”

There is an additional rationale for these public companies to raise debt as by strengthening their balance sheet they have the financial capacity to meet several milestones which in turn enables them to raise further equity at more attractive valuations. Kreos’s maintains its specialist senior debt strategy aimed at pan-European high-growth businesses has proven resilient over the past two decades over several economic cycles, and will continue to do so.

“We are very excited about the outlook for our business,” says PetitBon. “The pan-European high-growth ecosystem is fundamentally very healthy with significant equity investment forecast in its underlying companies over the coming years. This gives us an excellent environment in which we will continue to grow and expand our model.” ■

CASE STUDY: **MISTER SPEX**

Kreos started by providing the German online retailer of eyewear with an initial facility of €4 million in 2013 when the company’s revenues were only €45 million, but the strong support of top-tier equity investors including Scottish Equity Partners and a capable management team pointed to a promising growth outlook. Kreos has since committed more than €30 million from its last two funds with the potential to lend even further as the business continues to develop. Mister Spex now has over €100 million in revenues today.