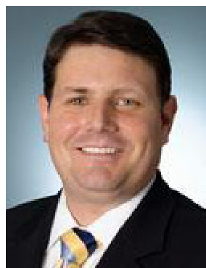
Bloomberg BRIEF
Private Equity
02.29.12
THURSDAY

Q&A

Siguler Guff's James Gereghty: European Distressed Not 'a Bubble Per Se'



James Gereghty, head of distressed investing at fund-of-funds manager Siguler Guff, spoke with Sabrina Willmer about the rush to invest in distressed opportunities in Europe. He said 'localism' is an important quality in a European distressed manager and that a sense of caution remains after 2008, arguing against a bubble.

Q: Are you committing more to European distressed managers than in the past? How much do you expect to commit this year to the strategy? How much did you commit last year?

A: We strategically reduced exposure to European credit during the first half of 2011 and made no new commitments to European distressed strategies during 2011. Interest in European distressed investing has increased over the past 12 to 18 months as the opportunity in the U.S. has cyclically declined and uncertainty has persisted in Europe. We estimate approximately 15 billion euros has either been raised by new dedicated funds or re-allocated from existing pools of capital for investing in European distressed assets, and an additional 15 billion to 20 billion euros is targeted but not yet raised. Although we have not made a dedicated commitment to distressed European credit in the last 12 months, we believe we are approaching more attractive price targets and are ramping up our efforts. It is our opinion, however, that the opportunity should span the next few years.

Q: What type of distressed strategies are appealing to you in this environment and why?

A: We currently like the non-performing loan space and more niche assets such as shipping, healthcare, etc. at the right price. All of these asset types have unique roads to recovery and require specific skills and experience to manage. We believe the current corporate distressed environment is more opportunistic and continue to find good risk adjusted returns, but we are concerned about the level of demand relative to the current flow of opportunities.

Q: What are you looking for in a European distressed manager?

A: Because so much of the targeted investable asset base is in non-performing loans, we believe the restructurings will require a significant measure of localism; i.e. a sensitivity to local laws, legal structures and customs, local market dynamics and preferences, etc. As such, we prefer managers who have illustrated a firm understanding of these attributes and have consistently participated through multiple cycles.

Q: What are your concerns about committing to European distressed funds?

A: Due to the episodic nature of distressed investing, structural considerations are critical. European distressed investing adds a layer of complexity that makes investing with the right manager into the right structure even more important. Timing is everything in distressed investing; not just when to enter, but also managing the exit from the initial investment. In today's environment, banks hold the majority of the European distressed assets, and they are enticed to hold the asset and earn the appropriate reserve level rather than sell at a significant discount to current marks. These banks are afforded this opportunity through the actions of the central banks, particularly the ECB, which are providing liquidity mechanisms. This creates runway for the workouts and/or equity cushion for the banks. In our opinion, the resulting impact is a more measured liquidation of distressed assets. The appropriate structure can help mitigate the fee drag from a slow deployment of capital and remove the incentive to chase deals at prices that do not provide the appropriate risk adjusted return scenarios.

Q: Will Germany's move to pass a law making bankruptcy more like Chapter 11 make distressed investing easier in Europe? Are other countries moving in the same direction?

A: Although the changes to German insolvency laws appear to be friendlier to restructuring activities, akin to Chapter 11 in the U.S., it is difficult to separate the black ink from the interpretation. This makes it very hard to forecast implementation. We must keep in mind that those who will be putting the laws into practice are those whose experiences thus far have been through a very different legal structure, and it will take time to adjust. Significant differences between U.S. and German insolvency practices remain. One such difference is that creditors in Germany cannot be forced into an equity recovery. A significant source of distressed paper in the U.S. is from creditors that are prohibited from holding equity by their governing documents. This stress is relieved by breaking apart creditor groups that would otherwise be treated exactly the same in the U.S. The changes to German insolvency law are a continuation of a process that began in 1999 to modernize the restructuring process and go a long way to improving the attractiveness of investing in German distressed assets. However, we still do not fully know how to interpret the letter of the law. Time will tell.

Q: Are you concerned about a bubble?

A: Although we believe the potential size of the investable market is between 1.5 trillion and 2.5 trillion euros, current demand has outpaced the speed of liquidation. Demand continues to grow as politically driven mechanisms further slow the pace of portfolio and single asset sales. These assets will require restructuring at some point, and the magnitude of the opportunity is tremendous. It is not a matter of "if" but more a matter of "when". We wouldn't characterize the current market as having the specific dynamics of a bubble, per se. Inherent in historical market bubbles is a sense of euphoria and a belief that "it's different this time." From our discussions with numerous market participants, we believe a sense of caution persists as the sting of 2008 remains fresh.

Posted from *Bloomberg Briefs*, April 29, 2012, copyright by Bloomberg L.P. with all rights reserved.
This eprint implies no endorsement, either tacit or expressed, of any company, product, service or investment opportunity.
#C8057 Managed by The YGS Group, 800.290.5460. For more information visit www.theYGSgroup.com/content.