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Owning up to Europe’s distressed opportunity

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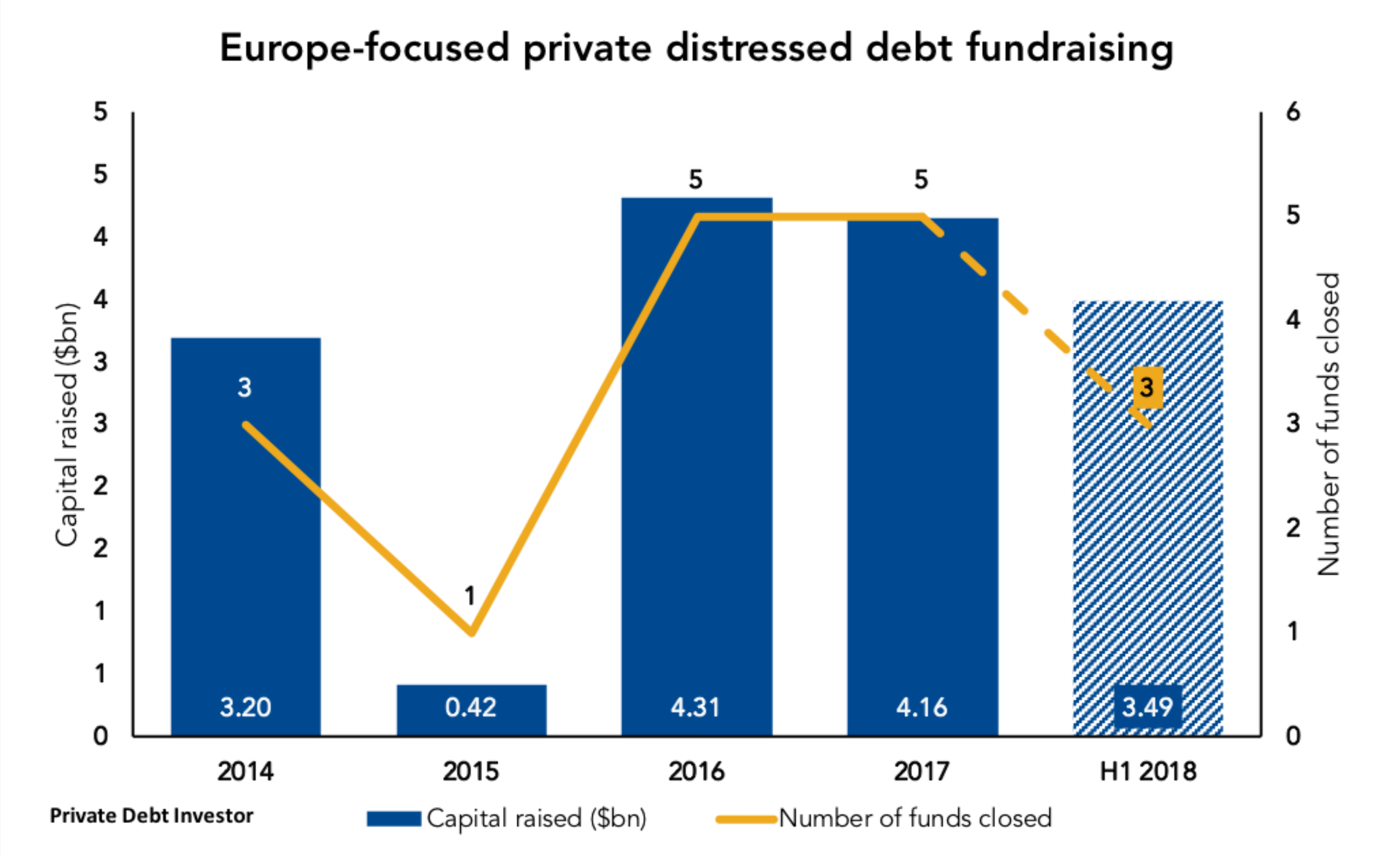

Under increasing pressure, banks are starting to offload troubled assets – with Italy leading the way.

Like a small child who keeps a broken toy in a clenched fist to hide it from a parent, many European banks have been reluctant to own up to the true value of distressed loans.

However, regulatory pressures and improvements in their own balance sheets have persuaded many of those banks, that had previously been reluctant, to acknowledge severe write-downs in loans – a precursor to selling them on to distressed investors.

This has injected new life into the distressed market, despite Europe’s emergence from recession and ensuing acceleration in economic growth, which has resulted in low levels of default in high-yield bonds. As we can see from the attached chart, Europe-focused distressed debt fundraising is on the up.

Aside from non-performing bank loans, distressed fund managers also see opportunities in other distressed assets, including companies that have good underlying propositions but have been damaged by mistakes made by private equity owners.

“There is a view that distressed is a boom and bust business, and there is no question that there is more opportunity after a crash,” Victor Khosla, New York-based founder and chief investment officer at distressed debt investor SVP Global, told PDI. “But if you do your job well there are always places to go, to look for opportunities that are quite interesting.”

Perhaps the biggest current opportunity is in Italy, say a number of market participants. Last year banks sold €99 billion of loan portfolios, according to professional services firm PwC, of which €42.5 billion was sold by Italian banks in about 50 different transactions. The bulk of this, both in Italy and Europe as a whole, is distressed debt.

Partly this is down to the creation of a more creditor-friendly regime, which has attracted more funds. Moreover, Italy has benefited from the “snowball effect” that has occurred at different times in different national markets: pioneering deals generate price discovery, which piques investor interest, and increases iÅnvestor knowledge about the relevant regulatory and legal issues.