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AlbaCore Shuns Herd Behavior to Maximize Credit Returns: Q&A

by Sarah Husband
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David Allen, chief investment officer at AlbaCore Capital, says his company picks misunderstood companies with strong fundamentals, while also focusing on structuring private bespoke credit instruments to achieve good returns, rather than following the consensus.

AlbaCore, launched in November 2016, manages commitments of about 1.8 billion euro ($2.1 billion). Its target areas include credit assets from senior secured loans to preferred equity with good downside protection features. Some comments have been edited and condensed.

David Allen

What's the rationale behind your contrarian investment approach?

We look for mispriced assets or companies in transition. When they move from a wide credit spread to a tight one, or when free cash flow or earnings growth transforms a business over one to three years, we see an opportunity. In many cases, a complicated story can offer good risk-adjusted returns as easier stories are often priced to perfection or turn out to be not so easy in reality.

Can you highlight any particular credit or sectors as examples?

Cable is a sector that we are underweight and that has been rock solid for many years, but we see movement there in the way consumers consume content. Not all outcomes are good for the cable sector as leverage is high and spreads are low.

We have found a few pockets of retail that make sense, such as specialty retail companies that compete effectively versus online and those that are not highly levered and produce free cash flow. Earlier in the year we structured a private security for modular space leader Algeco, which has been benefiting from high utilization rates and pricing. Year to date EBITDA is up 34 percent and spreads have tightened materially. Returns can be attractive in beaten-up sectors if you choose carefully.

What kind of investor are you targeting?

Having managed money for many years for the CPP Investment Board, the senior team has developed a patient long term approach to investing. We also have a strong view that ESG screening can lead to better returns. Our investors are a mix of pension & insurance, endowments, sovereign wealth funds and family offices who share our approach.

Does Brexit have any bearing on your investment style?

We have a few U.K. investments which are in companies that while operating here have global brands or businesses that are not dependent on the local economy as much as others. However, because of the risks around Brexit those credits offer excess returns versus similar investments elsewhere.

How will you cope when the market turns/recession hits?

Change is coming. We don't have a crystal ball about the future, but we are pretty certain that interest rates, default rates and spreads will all be wider at some point over the next few years. We prepare for this now by trying to focus on large, high quality companies with stable free cash flows. We also focus on private opportunities with two to four year potential hold periods versus six to seven years, and preserve dry powder for opportunities that we think will develop over the next few years.

Will recovery rates suffer in the next downturn?

This is a very credit and industry specific question. For some sectors recovery rates for junior debt will be very low, while on secured debt for more stable industries they might be better. We look at each deal idiosyncratically and try to protect ourselves through documentation and leverage ratios plus the size and market position of the companies. In general we like market leading businesses, and not niche players.

Do those who follow consensus trade get it all wrong?

If something is understood to be attractive by the herd then its price will reflect that. At the same time, many higher yielding opportunities become defaults. So we seek things in the middle. These tend to be misunderstood or unpopular companies that will change over 1-3 years. If we can buy companies that are misunderstood and they later become popular on the back of fundamental developments, that's a good model to make nice returns.