Investors need boots on the ground to target China distress - AVCJ Forum

- Tim Burroughs
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The credit and distress investment opportunity is significant – and expected to grow – but an on-the-ground presence is seen as essential to accessing it, industry participants told the AVCJ China Forum.

“If you take a position it can change rapidly overnight, so you need your finger on the pulse to monitor situations. There is also a bit of the dark arts – it is very hard to restructure things in China. Often the relationship with the founder is so important it has to go with the loan whether distressed or not,” said Marcus Paciocco, managing director at FTI Consulting.

Around $560 billion has been raised for credit strategies globally and 90% of this capital will be deployed in the US and Europe, according to Barry Lau, managing partner at Adamas Asset Management. China accounts for about half of the remaining 10%, which reflects the challenges investors face in addressing the market rather than a limited growth opportunity.

“This is very much seen as a local market, if you are not on the ground it is hard. That is why the market is very nascent in global strategies but it will change. You will have more global players operating here,” Lau said.

Shoreline Capital has been involved in distressed asset investing in China for more than a decade, building up a strong local network in the process. Efforts are underway to penetrate more deeply into the market. The firm plans to open branch offices in 15 provinces – it already has a presence in six – and it has agreements in place with 80 servicers for assistance sourcing deals and enforcing on bad debts.

Xiaolin Zhang, Shoreline’s co-founder and managing partner, estimates the total value of non-performing loans (NPLs) in China’s banking system could amount to RMB2 trillion, but warned that no one really knows the full extent of the problem. “If someone at a bank says they can tell you precisely what their default ratio is, they are lying. New defaults happen every day,” she added.

The labor intensive nature of the industry is a deterrent for some, but investors are increasingly looking to staff up in China – driven not only by the size of the opportunity but also by improvements in China’s enforcement infrastructure.

“It has definitely improved but it depends on where and when, and sometimes it is just about luck,” said FTI’s Paciocco. “We are also seeing more bankruptcies and increasing use of the bankruptcy law. In the past the Bankruptcy Act was a copy and paste of the US act and it wasn’t necessarily used for the right purpose. However, we are seeing a lot more banks going through the courts.”

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