Stable returns through resilient Working Capital Finance

Working Capital Finance offers investors short-dated credit exposure with low volatility, stable returns, monthly liquidity, and historically low correlation with other asset classes. Guy Brooks from Pemberton Asset Management explains the rationale behind its growing institutional demand.

By *our editorial team*

Can you give a high-level description of Working Capital Finance ('WCF') and its risk-return profile?
'WCF assets are a form of short-dated corporate credit in the form of payables and receivables to mostly multi-billion-pound companies to help them achieve greater efficiency in their supply chain, which in turn improves relationships, reduces overall costs, and helps to improve profits.

Given their short duration and self-liquidating nature, WCF assets have very stable NAVs. With average tenors below 120 days, they have a natural level of liquidity, and investors can access their investments via a monthly open-ended share class.

Our WCF strategy has continued to provide consistent stable returns since 2019, experiencing zero losses and no defaults. The strategy targets a return of 3-month risk free rate of 200 to 250bps net of fees and has experienced very low volatility with no defaults, even in times of market stress.

The asset class's resilience to downside risks is threefold:

1. **Short-dated:** the nature of payables and receivables to service the needs of large global corporations can provide a natural level of liquidity, even in times of market turmoil.
2. **Floating rate:** as the assets are priced off of 3 months Euribor, there is no duration risk. The cash plus 200 to 250bps return will track interest rate rises and falls.
3. **Low default rates:** WCF performs structurally ahead of its senior unsecured position in the capital structure, benefiting from company

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creditors’ incentive to maintain a business as a going concern, even in stressed situations.’

Where does WCF fit in a private credit portfolio?

‘It’s possible to find investment grade and non-investment grade entities in the WCF market. However, we focus on sub-investment grade names that are often private. Having said that, given that we are an open-ended fund with target returns of 200 to 250bps over the benchmark (RFR), we don’t naturally sit in the private credit world where you typically see long-dated lending with matching lock ups. Therefore, some of our investors would view it as alternative credit, others may argue the case for fitting in a credit or fixed-income bucket of their portfolio.’

Why should investors allocate to WCF?

‘WCF assets offer an attractive, risk-adjusted return profile, delivering diversified, non-correlated returns and low duration. Whilst WCF assets are pari passu with loans and bonds, the default risk is very low, given the preferential treatment that trade receivables and payables receive when companies get into financial difficulty.’

Is there a comparable public credit alternative?

‘As mentioned previously, the strategy has low correlation to all major asset classes, including equities and fixed income. However, the closest might be leveraged loans without the duration and volatility.’

Where are interest and capital coming from?

‘Since the strategy started in 2019, we have seen growing interest across a broad spectrum of investors, including pension funds, insurance companies, family offices, corporate treasurers and private banks. The big move for us over the last year has been the adoption of the asset class from the consultant community. This is really helping to drive interest predominantly from institutional investors and pension funds.’

How have recent market dynamics impacted the supply and demand for WCF?

‘Whilst we are still assessing the impact of tariffs on the trade and working capital finance market, we would anticipate changes to affected companies as they redirect their supply chains. Having said that, the majority of what we finance through WCF solutions is unaffected by recent developments as we finance domestic trade.’

In most cases, each sub-strategy has a short (fund) track record and has not experienced a (significant) downturn. How do you convince investors?

‘Our WCF strategy has now navigated two major market incidents – Covid-19, and the rate and energy price rises triggered by rapidly rising inflation in 2022 and 2023, as well as the invasion of Ukraine. In all cases our strategy has navigated these market shocks without experiencing any defaults or losses, while continuing to deliver our target returns.’

What is the outlook for WCF, also taking into account market competition and regulatory developments?

‘The WCF market is a $ 5 trillion-plus market across the US and Europe and has been in existence for centuries, although largely dominated by the banks until recently. Regulatory pressures are causing the banks to retreat from sub-IG lending, creating a widening financing gap that can be filled by non-bank funding or institutional investors. We believe we are only at the start of the journey of making Working Capital Finance an investible institutional asset class. There are several asset managers now running strategies investing in these products, but there is still less than $ 20 billion total AUM in the market. We believe that we can grow our strategy significantly over the next three to five years.’ ■

Guy Brooks

Managing Director, Head of Capital Raising & Distribution, Working Capital Solutions, Pemberton Asset Management

PHOTO: ARCHIVE PEMBERTON ASSET MANAGEMENT

SUMMARY

Working Capital Finance has historically been a stable performing asset class, even in times of market stress.

The combination of low volatility, stable returns, monthly liquidity and historically low correlation with other asset classes have attracted interest from a wide variety of institutional investors and family offices.

The expected further retreat from the banks from this asset class could trigger growth in the strategy.