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FINANCIAL TIMES WEEKLY REVIEW OF THE INVESTMENT INDUSTRY

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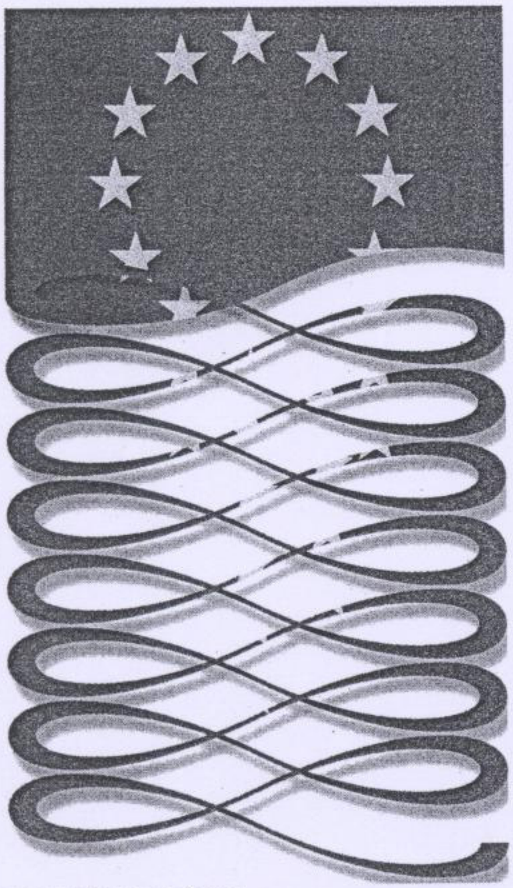
'You can be misled into thinking they have a skillset when they haven't'
Robin Bowie, the founder and chairman of Dexion Capital, shares his insights into the hedge fund industry
Face to Face, Page 4

Credit crunch predicted for Europe

ADM Capital sets up $700m fund that aims to profit from 'imminent crisis'

By Phil Davis



One of the pioneers of the Asian distressed debt market is turning its sights on Europe, predicting a credit crunch that could lead to Europe experiencing a meltdown approaching the scale of Asia in 1997.

ADM Capital, a Hong Kong-based hedge fund that successfully exploited the turmoil in Asian capital markets in the 1990s, has launched a $700m fund that aims to profit from what it believes is an imminent crisis in European capital markets. It has hired Mark Baker, a Goldman Sachs banker, and Anthony Stalker, a former managing director of Merrill Lynch, to spearhead the effort.

The move follows that of Lone Star, a Dallas-based fund that has expanded its presence in Europe and bought up distressed assets in Germany.

Two months ago, Lehman Brothers decided to relocate a senior distressed debt banker, Guy Moar, to Europe to take advantage of what it believes is a corporate sector that has taken on too much debt.

ADM, which has $1.5bn in assets under management, said it saw similarities to Asia in 1997 when large-scale lending had taken place without proper understanding of credit and the capital markets.

Denys Firth, director of ADM, said: "My sense is sometime during the third and fourth quarters of this year we will see a major volatility in spreads. It doesn't take a lot to see that volatility in equity markets will spill over to bond markets.

"There are lots of new lenders in Europe and we can see an Asia-type scenario. The easy money lent to companies might come back to haunt the market.

"Funds are willing to take a piece of all syndicated loans now – about 40 per cent of them in all. This used to be all owned by banks. You have to wonder what is the funds' holding power if things go wrong. If rates go up and growth continues to slow we could see a preponderance of sellers."

ADM sees opportunities in mainstream economies such as Germany and Italy, but also in emerging Europe. It is particularly interested in Greece, Bulgaria and Israel.

Mr Baker, head of the London office, said: "Many banks in these areas are like deer caught in the headlights. They don't know how to exit their loans so we will do a lot of handholding and explain there is a secondary market where they can sell their exposure."

Mr Moar said his switch from Asia stemmed from the reduction in attractive opportunities there. "They had a very deep crisis so not much leverage has been built up again. The few deals that come along tend to be very crowded.

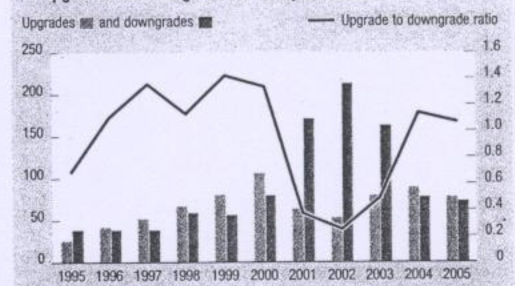
"Transactions in Europe are more aggressively levered so carry with them a higher degree of risk, which is what we're looking for."

Rich pickings were available in Germany and Italy, Mr Moar said, citing reports of large non-performing loans in those countries. But he was wary of predicting when any credit contraction would occur. "It's coming but I can't put a timeframe on it," Mr Moar said.

Others were more optimistic about the strength of European companies. Alan Brown, head of investment at State Street Global Advisors, said: "The idea of a credit crunch is too strong. Spreads will widen but corporate balance sheets in Europe are very healthy. There is tightening of monetary policy all round the world but banks are still ready to lend and corporate cash as a percentage of gross domestic product is high."

Mr Brown said the rise in use of credit default swaps had helped to smooth capital markets by giving investors a hedging mechanism against rising yields.

Upgrade-to-downgrade ratio and counts of upgrade and downgrade for European issuers



Source: Moody's Investor Service

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