Strategically Speaking **Astellon Capital Partners**

Events, dear boy, events

MARTIN STEWARD

Responding to a reporter's question about what he most feared could blow his government off-course, the British prime minister Harold Macmillan is supposed to have said: "Events, dear boy, events."

Bernd Ondruch of Astellon Capital Partners can relate to that. As a banker in the 1990s he knew he wanted to start his own business one day. By the time he joined the buy-side in 2007, he reckoned he was within three years of doing so. Then events got in the way.

As the recovery from the financial crisis took hold, he and Astellon co-founder Christian Vogel-Claussen returned to their plans. By April 2011, they had secured $50m (€46m) for their fund and were setting up a Luxembourg SICAV ready for a September launch. Then events intervened again: June saw Greece secure its first bail-out, while Communists stormed the Acropolis.

One of Astellon's largest investors was not comfortable incurring Deutsche Bank credit risk for the few days it took to clear the purchase of SICAV units, and it took another six weeks to structure a certificate that could be cleared through Clearstream. Astellon finally started trading in mid-December.

The irony, of course, was that the same events that delayed Astellon's launch were perfect for its event-driven long/short strategy, which seeks out value that can be unlocked by corporate-activity catalysts. "Everyone thought we were launching at the worst possible time but, in fact, it meant there was still a very rich opportunity set, particularly in the real estate and credit sectors," says Ondruch.

Nonetheless, Astellon was launched to exploit an opportunity that is as much structural as short-term. Its focus is German-speaking Europe, typically 70% of its portfolio. And as co-head of financial institutions at Morgan Stanley, Ondruch saw time and again how difficult it was for his clients to get local investors in these markets interested in the corporate events they were underwriting. They would take the CEO to meet one or two big institutions before catching the plane to London.

"In the UK, Standard Life, Legal & General and a whole bunch of others step in to lead the pricing," he observes. "I learned that we have a non-crowded market rich in event-driven opportunities, and yet there are no local opinion-leaders playing a key role. The catalyst for change on one of the first big thematic opportunities we addressed, in German real estate, was a Dutch pension fund."

Buy-siders from London, New York or Silicon Valley bring industry expertise that the local market doesn't have, he concedes, but Astellon, embedded in international finance in London but also well-recognised in German-speaking markets, occupies a specific niche. The evidence is corporate access out of all proportion to Astellon's size.

While the fund launched into an abundance of opportunity, the ongoing euro-zone crisis and Astellon's tight risk-management mandate – drawdowns must never exceed 5% – led to a first year of very low net market exposure and a strategy geared towards the sluggish European economy. Consolidation in the real estate and cable sectors were key themes, often pursued via secured debt rather than equity; the short book held positions in over-leveraged, cash flow-negative businesses – bets that held their own, even thought the market ended 2012 up almost 30%.

But the firm really made its local and sectoral knowledge count in the banking sector, where, during 2011-12, rich pickings were still available in the old-style tier-1 capital that Ondruch helped arrange in his Morgan Stanley days.

Among these were bonds issued by Eurohypo, the dominant commercial real estate lender acquired by Commerzbank in 2005. When Eurohypo refinanced via Pfanbriedfe and tier-1 bonds, coupons were linked to its balance-sheet profits; but because Commerzbank and Eurohypo had entered into a profit-and-loss transfer agreement Eurohypo's P&L was always zero. Commerzbank voluntarily paid the coupons to keep bond markets onside – until it decided to stop under the stresses of 2008.

The bonds crashed to 20 cents. As a small group of investors sued Commerzbank, Ondruch and his team looked into their case, decided it was strong, started buying the bonds, and followed proceedings all the way to Germany's Commercial Supreme Court in Karlsruhe.

"I went to the court hearing and the only other people there were the plaintiffs, Commerzbank's legal team and a class of law students from the University of Cologne," Ondruch recalls. "It was clear how the court was leaning and in the afternoon it published its decision, in German."

Commerzbank had to pay all the coupons plus 5% penalty interest, and guarantee future payments – effectively turning a subsidiary's subordinated hybrid into a senior claim against the parent. The bonds rocketed back to par.

"There were a number of similar situations, including Postbank and Hypo Realestate, which were unique to Germany," Ondruch recalls.

Three years into the euro-zone recovery, has Astellon allowed net exposure to breathe a bit more? There was an exception during the winter of 2013-14, when a big market rotation out of mid-caps into mega-caps left its index-future portfolio hedges ineffective and the only way to stay within risk tolerances was to cut back some high-conviction longs, but more recently net exposure has crept back above 40% as confidence in Europe's M&A cycle has grown. The sort of consolidation real estate and cable saw three years ago started to show up in healthcare through 2014, and Ondruch expects it to become a more fertile source of corporate events this year.

"Sabadell bidding for TSB is surely a sign of things to come," he says. "Cross-border M&A in banking would have been unthinkable even a couple of years ago. We see a lot of potential for consolidation in fintech, and another sector we are very excited about is chemicals."

Against a short book of big German chemicals groups vulnerable to Asian competition, Astellon has identified names that have restructured to create higher margins and growth, and less cyclicality; or that could be acquisition targets; or both. Clariant, for example, started trimming fat eight years ago, made an earnings-accretive acquisition of Sud-Chemie in 2011, and is poised to translate top-line growth into free cash flow.

"The market remains very cynical, so there is value to be had, but it is also a prime candidate for acquisition," Ondruch says.

What about corporate events at Astellon itself? Now at $700m from an international client base, might it expand its mandate? It's no surprise to find Ondruch dismissing the idea; he likes his niche and it's just getting interesting. But he also emphasises his firm's global outlook. In fintech, the portfolio's main holding is based in Munich, but analysing the theme has taken the team to 11 countries; when the fund takes positions outside German-speaking Europe it is often to exploit opportunities uncovered by this kind of research.

"Germany and Switzerland are so embedded in global trade that expertise in these markets helps us to keep our finger on the pulse of what's happening worldwide," as Ondruch puts it.

That also continues to feed top-down views that inform portfolio exposure and hedges. It's a symbiotic relationship, enabling Astellon to exploit local corporate activity while limiting the risks posed by global financial and economic ups and downs. Or, as someone may once have said: "Events, dear boy, events."

BERND ONDRUCH
- 2011: Co-founder, CIO and managing partner, Astellon Capital Partners
- 2007-2011: Managing director, Amber Capital
- 1999-2007: Managing director, co-head of the financial institutions investment banking practice for Germany, Austria and CEE, Morgan Stanley

Astellon Capital Partners
- Established: 2011
- European event-driven value-investing; focus on German-speaking countries
- Assets under management: $700m
- Investors: 30% insurance and pensions; 25% wealth managers; 23% family foundations; 13% banks; 9% HNWI