

20
18

Investing in the German Mittelstand

An exklusive interview
with Christopher Grätz,
CEO of kapilendo AG
and Ralf Wohltmann,
director of the pension
fund of the Berlin
Chamber of Dentists



We are a digital lending marketplace. Our platform combines crowd-lending with institutional investors.

Christopher Grätz

*Co-founder and CEO
of kapilendo AG*

Short profile of Christopher Grätz: The CEO and co-founder of kapilendo AG previously held the position of management consultant in the area of Strategy & Operations, Financial Services, at KPMG. Christopher Grätz has a master's degree from the University of St Andrews. He launched his career with a bank clerk qualification from Weberbank AG, a private bank in Berlin.

Investing in the **German Mittelstand**

The pension fund of the Berlin Chamber of Dentists (Versorgungswerk der Zahnärztekammer Berlin, VZB) holds shares in several FinTech start-ups, among them the lending platform kapilendo AG. In addition to its shareholder role, the VZB also engages in loan trading on the kapilendo platform.

Originally, most lending platforms were created as crowd-lending marketplaces for private investors where private backers could grant loans to private entrepreneurs.

With the model having progressed since then, pioneering platforms are now also targeting institutional investors who utilise the loans as an asset class.

Institutional Money has interviewed Christopher Grätz, co-founder and CEO of the lending platform kapilendo AG, and Ralf Wohltmann, director of the pension fund of the Berlin Chamber of Dentists (VZB).

Christopher, could you outline your business model in five sentences?

Christopher Grätz: Our business model focuses on lending. We are a digital lending marketplace. One side of the business consists of the borrowers who approach us about funding. Our assessment of the companies is based on their annual financial statements and other data sources, following the principles of classic credit analysis. In the end, we calculate a rating and notify the company whether or not we can finance their project. If the answer is yes, we specify the interest rate. Should the company accept our credit

offer, we present the project on our platform and produce marketing texts, pictures, films, etc., giving both institutional and private investors the opportunity to invest.

What size are the loans?

Christopher Grätz: In the case of private investors, we handle loans between EUR 100 and EUR 10,000. Institutional investors may, of course, invest larger sums or may fund entire loans on their own. Mostly, institutional investors also restrict themselves to a certain percentage of the total loan amount. Institutional investors thus invest side by side with our retail clients.



Short profile of Ralf Wohltmann: The director of the pension fund of the Berlin Chamber of Dentists is also chair of the supervisory boards of Magna Asset Management, 7orca Asset Management and Aves One. In addition, he sits on the supervisory boards of kapilendo and Engel & Völkers Capital. Mr Wohltmann previously held the position of managing director of the pension fund of the Thuringia State Chamber of Dentists (Versorgungswerk der Landeszahnärztekammer Thüringen) and worked as a consultant at various information and advice offices of the BfA (Federal Insurance Fund for Salaried Employees) where he promoted the establishment of the local advisory network. Ralf Wohltmann has a degree in public administration and studied administrative and pension law in Berlin.

Subordinated loans count towards our risk quota. In terms of risk, they are equivalent to equities. Consequently, the income we generate must be on a par with equities

Ralf Wohltmann

Director of the pension fund of the Berlin Chamber of Dentists

Is both, institutional investment and retail investment, possible over the same platform?

Christopher Grätz: Yes, currently all loans, whether private or institutional, are financed on the same platform. However, increasingly we see loans of a size that cannot be fully placed on the platform. Some institutional investors have signaled that they would like to finance bigger tickets. In the future, one part of the funding structure may be served by the crowd on the platform while another part may run in the background.

Ralf, do you mind that the pension fund of the Berlin Chamber

of Dentists is active on the same platform as private investors?

Ralf Wohltmann: I do not mind that at all, on the contrary, I think it's a positive thing. The due diligence process is the same, whether I invest EUR 100 or EUR 10 million. The platform doesn't always have to go for five or ten million. Occasionally, it can also handle smaller subordinated amounts since the due diligence has already been completed.

Are you reassured by the rating process kapilendo carries out in advance?

Ralf Wohltmann: Reassured is not the right word, the rating process simply makes our pro-

cess easier. Of course we have to understand the process that goes on beforehand. Then we only need to complement it instead of running through the whole rigmarole again.

Right now mid-market direct lending appears to be quite popular in the German-speaking region. Why is that?

Christopher Grätz: Borrowers find that banks rarely issue small tickets any more. On occasion, they may issue money quick and dirty up to EUR 100,000. As soon as tickets are bigger, say EUR 250,000 to EUR 2.5 million, it's too risky for banks to simply wave them through and too

timeconsuming to assess them in detail. Assessing smaller tickets is also too troublesome for alternative lenders, for instance private equity or direct lending funds. At the moment, the segment between EUR 250,000 and 10 million is thus significantly underserved. Demand is substantial, but suppliers are few and far between. This is where we come in. Thanks to more efficient digital processes, we can fund smaller amounts such as EUR 1 million on a profitable basis.

So much on the subject of borrowers ...

Christopher Grätz: Yes, now we come to the other side of the marketplace, the private investors. Private investors want to invest in something transparent, they want to know who the business owner is and what the company does. They are neither interested in another fund or another certificate, nor in term deposits with a 0.5 per cent interest rate. They prefer to pick their fixed-interest product themselves. We offer them the opportunity to invest in a market segment that has not been open to the public in this form before. At the same time they can significantly diversify their investments. Institutional clients, in turn, get access to the small ticket segment without having to spend much time and effort since we take over a large part of this work.

What is it about this investment form that appeals to you? Ultimately, you're also playing at being a bank.

Ralf Wohltmann: All we do is invest money. In the past, we did it through banks. The bank issued promissory notes and we subscribed them. Now that banks are subject to



If a project is not doing well on the platform, we investigate why the crowd is not interested

Ralf Wohltmann

Director of the pension fund of the Berlin Chamber of Dentists

Basel III and equity is tight, they can no longer follow the same pattern. Instead, we do it ourselves via platforms, such as kapilendo. There's no big difference. For us, this is simply an alternative to services the banks don't offer any more.

How high is the direct lending exposure in your pension fund?

Ralf Wohltmann: All in all, it's just under EUR 300 million, around 15 to 18 per cent.

Can you give us a few figures on the pension fund of the Berlin Chamber of Dentists?

Ralf Wohltmann: We have close to EUR 1.7 billion in assets under management, 6,200 active members and 1,200 pensioners. In supervisory terms, we are subject to the German Investment Ordinance; however, not under the German Federal Financial Supervisory Authority (BaFin) but under State supervision. Our actuarial interest rate is currently 3.71 per cent, but will come down to 3.0 per cent at the end of the year.

Do you manage to generate the returns required by your interest rate?

Ralf Wohltmann: For the moment yes, but it's getting more and more difficult.

How do you do the due diligence for this type of SME financing? And how does this work in practice in terms of committees?

Ralf Wohltmann: That depends on whether we choose a co-investment or a fund structure. In the latter case, we just ask for certain criteria to be observed. kapilendo also offers this type of service. In this situation, we do not go through the whole process but outsource it to kapilendo – similar to a fund manager. Where direct lending is concerned, we do the legal due diligence and involve a financial auditor. The scale of the process depends on the respective volume. When we work with kapilendo, they carry out a due diligence and rating process on which we can subsequently base our own due diligence. In these cases, we usually refrain from involving external specialists and rely on our own team.



The way the market is going, smaller-scale funding will increasingly be served via platforms

Christopher Grätz

Co-founder and CEO
of kapilendo AG

Christopher Grätz: We offer both individual investments and portfolio compilations on our platform. What we are seeing now is that, instead of reviewing the individual loans, institutional investors increasingly check us out. In the context of our due diligence, we specify in advance what we will look at, what the processes will be and which players will be involved. That's where trust comes in. The investors give us certain criteria to work by. We offer a modular system that allows them to define their requirements according to their current risk appetite. For instance, there is a choice between subordinated capital or classic loans, perhaps secured by a surety bond. Investors can also choose the term and the industry they prefer. We find the loans that comply with the investors' risk appetite and other criteria they specify.

Do you also act as a portfolio manager?

Christopher Grätz: We operate similar to asset managers; however, we have not yet received our portfolio manage-

ment license as required under the German Banking Act (Kreditwesengesetz, KWG). We are currently in the process of applying for it. At present, our platform 'merely' acts as an agent. We assess companies in compliance with a defined process and prepare the investment decisions. However, in the end it's the investor who decides.

Are you shifting your focus from private to institutional investors?

Christopher Grätz: We are not shifting over completely because we believe that together the two components are stronger. None the less, private investors alone can no longer meet the demand for funding we see. At present, around 80 per cent of our investors are private individuals and 20 per cent institutional and semi-institutional investors. We are moving towards a 50/50 split, which may even develop into a weighting favouring the institutional side. This would support us in serving large volumes. However, we will not exclude private investors since many institutional investors would not work with

us in their absence. Institutional investors prefer to commit when many private investors are involved, in the belief that there is less likelihood of shady business. Private investors, in turn, are happy when institutional investors commit to a project they are involved in. The private crowd views institutional investors as beacons.

Ralf Wohltmann: In this case, the wisdom of the crowd is not entirely wrong. If a project is not doing well on the platform, we investigate why the crowd is not interested. What is it that we see in a more positive light than the crowd? It's a kind of market test. If the crowd funds EUR 1.5 million in 24 hours, the product seems to go down well.

To which Investment Ordinance bucket do such subordinated loans belong? Do you hold the loans in a direct portfolio or are they cast into a certain structure?

Ralf Wohltmann: They fall under no. 9 of the Investment Ordinance and thus included in the total riskratio of 35 per cent. They are definitely subordinated loans, there's no doubt about it. We do not need to cover them but have concentrated our loans in a VZB-owned company which has been set up as a GMBH & Co. KG structure to ensure that we can hold it as an asset on the balance sheet.

You have been quoted in an article as follows: "In the SME funding segment, kapilendo provides the perfect platform on which we can make our own investments accessible to a wider public and jointly realise successful investments." How does this work? Does it go in both directions?

Ralf Wohltmann: Yes, loans are not only originated by kapilendo, there are also loans we suggest to them. In the future, this could become more

frequent since we also have our own loans that need to be funded and prefer to give some part of this to the crowd to keep our volume down. This does not mean that we are giving upon a loan, instead we are sharing the burden with the crowd.

Since late 2016, the VZB has not only traded loans on the platform but has also held a stake in kapilendo AG. How big is your stake?

Ralf Wohltmann: Our initial investment in kapilendo was 15 per cent of the company.

This is not the first time you have taken this approach. You seem to have a penchant for investing in FinTech start-ups – why is that? Do you want to play the role of business angel?

Ralf Wohltmann: Instead of a business angel, we see ourselves as a Series B investor. We prefer it when something is already there. That was not the case for Torca, but we had known the founders for a long time. In the kapilendo case, we invested in a later round. In contrast to many other pension funds, we are also active on the equity side. We have co-founded Magna Asset Management and invested in Engel & Völkers Capital. We have also recently co-founded an asset manager in New York, but I can't go into any details yet.

Are you planning further moves in this direction?

Ralf Wohltmann: Yes, definitely. If it fits into our structure and complies with our objectives. Our participations must offer an added value compared to our other investments. In sum, one can expand and create values together.

How important is it that institutional investors such as the VZB are involved?

Our participations must offer an added value compared to our other investments.

Ralf Wohltmann

Director of the pension fund of the Berlin Chamber of Dentists

Christopher Grätz: In our case, the VZB is involved on both sides. On the equity side, this is crucial for launching the business model on the market. Our product is not yet widely known in the classic SME segment. Compared to bank funding, the total volume provided by lending platforms is as yet rather small. Nevertheless, in this small market, we are among the top three providers. There is still a lot of work to do if we want to become a household name among investors and entrepreneurs who seek funding. This is why it is important to get professional investors on board at an early stage who share the same vision and understand the impact of the business model. Who know that the market is developing towards platforms serving smaller-scale funding. This means that we need the capital now to build up the market.

Which are the key groups among the institutional investors? Who are the first movers?

Christopher Grätz: Banks and insurance companies – the highly regulated investors –

contacted us at a very early stage. However, one needs to find a joint investment vehicle for this and we have decided that we will use a fund solution instead. In this sense, they may have been the first interested parties but they are not the first investors. Apart from that, we have family offices, foundations and pension funds who find it easier to make quick investments and are innovative enough to go through with it.

How much funding have you raised so far?

Christopher Grätz: We set up shop in mid-2015. Since then, we have funded loans worth EUR 30 million via the platform. The majority of this amount was transacted in the last twelve to eighteen months. However, as a start-up, our projected new volumes are set to grow significantly. Growth rates in the last few quarters were all in the three-digit percentage range. We understand that many institutional investors cannot go for tickets below EUR 10, 20, 30 million. But we will be able to handle this in the near future.



*Thanks to our digital processes,
we can finance smaller tickets without
compromising on quality.*

Christopher Grätz
Co-founder and CEO
of kapilendo AG

Investing in SME lending is in keeping with the spirit of the EU capital markets union. You are investing in this type of loans.

What do you think of the capital markets union?

Ralf Wohltmann: We are not interested in the spirit of the capital markets union, our focus is on investment. We want to create long-term values and are required to generate income. After all, we have obligations towards our members. We are looking for ideas we can get involved in, loans that develop and create something of value.

What kind of returns do you generate with your direct lending investments?

Ralf Wohltmann: We receive exactly the same interest rate as any other crowd investor. It is specified on the website at www.kapilendo.de. kapilendo is currently active in the subordinated segment where we make joint investments.

Christopher Grätz: In the subordinated segment, we work with fixed interest and a per-

formancerelated component which is independent of turnover. The fixed interest rate ranges between seven and ten per cent. Together with the profit participation, investors' returns may be as high as 10 to 15 per cent.

Of course, there may be the occasional default to offset. Ultimately, we expect to generate returns between eight and ten per cent.

Can you live with that?

Ralf Wohltmann: Subordinated loans count towards the risk quota. In terms of risk, they are equivalent to equities. Consequently, the income we generate must be on a par with equities. Hence, this is not simply a case of fixed income.

Earlier we mentioned the capital markets union. Do you get any political support in this area, Christopher?

Christopher Grätz: Yes, at present we see a lot of momentum in this space. As yet, we are still in the honeymoon period. For instance, the German Retail Investor Protection Act

offers exemptions. We can raise up to EUR 2.5 million without having to issue a prospectus. The rest of the market is required to produce a prospectus starting at EUR 100,000. However, this is about to change now. In the future, it will be possible to raise up to EUR 8 million without a prospectus. This will allow us to put eight-million Euro funding loans online and make them accessible to investors within a period of 14 days. We are benefiting from the current political climate which supports alternative funding.

However, the honeymoon will not last forever ...

Christopher Grätz: Of course! Once we have the KWG license which we could apply for, we will increasingly move into the professional segment. Our advantages – efficient processes, speed and our digital access – will stand by us, allowing us to organise financing faster and with less red tape.

You complete your due diligence process in 14 days?

Christopher Grätz: We take three to five days from receiving the documents to signing the contract. However, our credit analyst spends as much time on his analysis as big banks do. The banks are often involved in lengthy process-related ping-pong games. They have networks of branches which are partially based on processes and IT systems from the 1980s or 1990s. In 2015, we were lucky enough to set up our processes from scratch – using digital means. Thanks to our processes, we can finance smaller tickets without compromising on quality.



When we work with kapilendo, they carry out a due diligence and rating process on which we can subsequently base our own due diligence.

Ralf Wohltmann

Director of the pension fund of the Berlin Chamber of Dentists

Ralf, how long does it take your side to complete the due diligence and get ready for the investment?

Ralf Wohltmann: Our streamlined committee-based process takes no longer than two weeks. We receive well-edited documents that quickly prepare us for the implementation stage.

And how does this committee process work?

Ralf Wohltmann: Together with our administrative committee, we have set up an operational sub-committee which consists of two dentists and myself. The sub-committee discusses and passes resolutions on small-sized investments. Implementation is relatively straightforward via the GmbH & Co. KG of which I am the managing director. This is the only way it works in the small-scale area. Up to a certain volume, transactions can be decided by the sub-committee. Any bigger volumes are decided by the main administrative committee.

How much does your business model depend on economic growth?

Christopher Grätz: To a certain extent, our business model is buoyed up by economic

growth, especially if the manufacturing industry has full order books and wants to raise operating funds as a matter of urgency. In this case, they don't need the money in six months, which is the classic time frame in which banks operate. They need the funds on the spot to fill their orders. This is where we come in. We also fund areas which are more difficult for banks because there is no tangible collateral, such as machinery or buildings. Accordingly, we see ourselves as complementary to banks and work hand in hand with them. Digitalisation, setting up online shops or process digitalisation are all subjects that are independent of the economic cycle. After all, German SMEs cannot get around digitalisation. It is one of our advantages that we can also work with sureties instead of tangible collateral.

Who provides the sureties?

Christopher Grätz: The business owners. We are the only platform in Germany that offers subordinated mezzanine financing. This works with banks. Banks grant senior loans, we provide subordinated loans – at a higher interest rate to take account of the greater risk. The

banks are happy that kapilendo fills the gap since they would otherwise miss out on a lending opportunity. We also offer classic loans which we can secure by surety. Hence the business owner is personally liable for the credit risk – as is often the case with bank lending.

Ralf, are SMEs a central concern of yours or of the VZB's? What are the hopes you associate with SMEs?

Ralf Wohltmann: It has to do with our options. We are subject to the Investment Ordinance and are not allowed to invest more than one per cent of our assets in a single company. At present, this means that we can invest EUR 16 million in one enterprise. Anything above goes towards the (limited) disposable assets but not towards the actual ratio. We also like the SME segment because it's compatible with our size and volumes.



kapilendo