

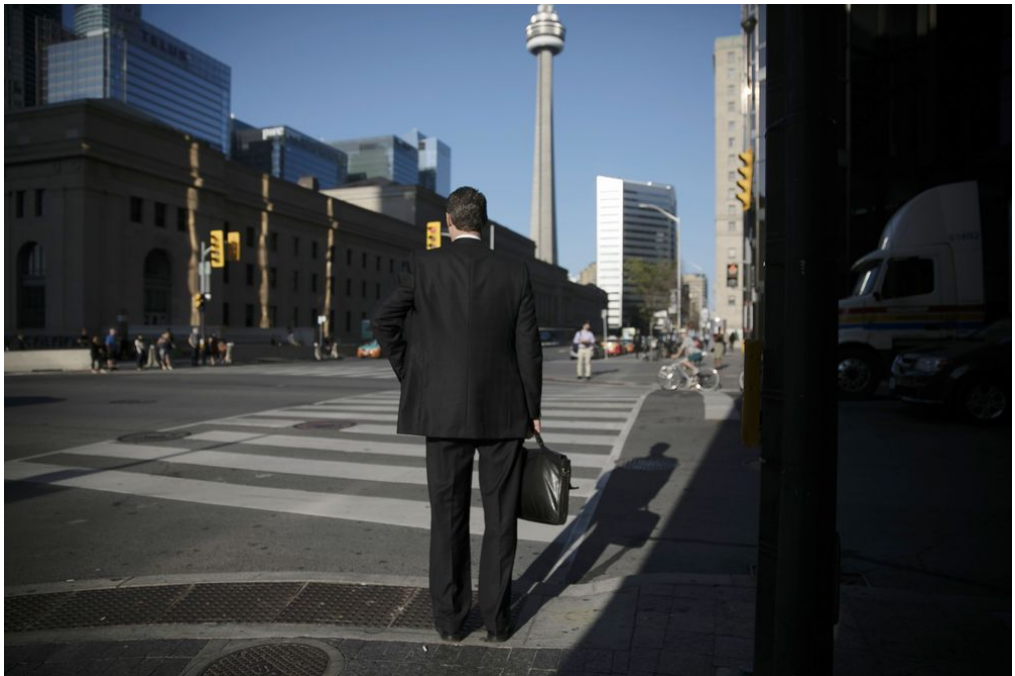
Business

# Fund Brings Convertible Loans to Private Debt, Generates 41%

By [Paula Sambo](#)

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  - ▶ [Duo sells stake in cannabis breathalyzer to start fund company](#)
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A pedestrian waits to cross a street in the financial district of Toronto.  
*Photographer: Brent Lewin/Bloomberg*

A pair of investors is bringing convertible loans to the private debt market, generating outsized returns for investors.

[AIP Asset Management Inc.](#), run by Alex Kanayev and Jay Bala, gained an annualized 41% over the past five years by offering senior secured  
**In this article**

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BLO  
**CANNABIX TECHNOL**  
0.50 CAD ▼ -0.03 -4.81%

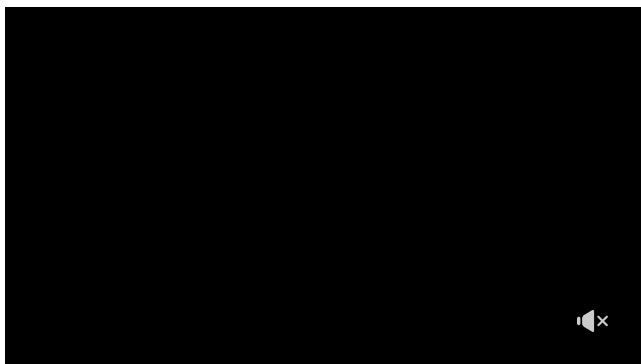
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GC1  
**Gold**  
1,479.50 USD/t oz. ▼ -4.90 -0.33%

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loans to small public companies that can be converted into equity. The strategy won the firm top honors for the best-performing private debt fund over one, three and five years at the Canadian Hedge Funds Awards last week.

ADVERTISING



“Our entire debt is convertible,” Bala, 44, said from his office in Toronto. “If you do your job right and the stock price goes up, you’d never have to pay it back. I just convert. I sell and everything works out.”

AIP has C\$100 million (\$75.9 million) under management and is aiming to reach C\$2 billion in the next five years. It has 10 employees and plans to hire two more.

The market for direct lending -- which largely focuses on companies with less than \$100 million in annual earnings and limited access to bank financing -- has ballooned in recent years as investors seek higher-yielding assets. Fundraising for North America-focused direct lending reached \$22.6 billion this year through the third quarter, according to London-based research firm Preqin. That compares to \$16.2 billion the same period a year ago.

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## Market Need

But convertible loans are still largely the purview of the public markets. AIP's so-called "liquid private debt" also structures the loans as secured debt, putting investors in line to be paid back first if a company files for bankruptcy and giving them a legal claim to certain assets.

"A convertible debt by definition is subordinated, so if things go wrong, you line up behind all the creditors and you get pennies on the dollar. The way we tweaked it is, we are actually senior secured, so if things go wrong, we're first in line to get paid," Bala said. "This is as much about how many losses you mitigate."

That's important as deals can go south quickly in this corner of the market.

Around 8% to 12% of AIP's returns come from the cash coupon, the remainder is equity upside. The average term of a loan is six to 12 months with the ability to renew. Typical loans range from C\$1 million to C\$10 million and about 60% of their loan book is in Canada and 40% in the U.S. AIP also provides loans for companies in distress through turnaround and debtor-in-possession debt.

There are more than 20,000 listed companies with under \$100 million in market value in North America and they have been overlooked by banks and larger investors, according to Kanayev, 54.

"We've started companies from scratch before, so we know what really small owners are looking for," Kanayev said.

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# Cannabis Jumpstart

The duo knows first hand how hard it can be for small companies to find funding. To raise cash for their hedge fund, they tried to start a gold-mining company, buying land in the wilds of northern Canada. “We were drilling holes, everything was going well,” Bala said. The company had a market value of C\$30 million at its peak. “Then gold crashed and burned and the stock price collapsed to 5 cents a share.”

The experience highlighted a glaring hole in the market.

Next, the duo bet on cannabis, but instead of going into production they calculated regulation would be key in Canada’s legal weed market. They bought the intellectual property rights of a marijuana breathalyzer, paying the inventor in shares.

They restructured  the mining company into Cannabix Technologies Inc. and the shares surged in the heady days of the nascent pot market. This time, their timing was perfect. They cashed out their 50% stake when Cannabix’s market value climbed north of C\$300 million. The shares have since tumbled.

“It was a long way of accomplishing a dream,” Bala said. “Most people just walk off when investors are losing money. We didn’t. You learn far more from your mistakes than from your successes.”

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