

PREQIN QUARTERLY UPDATE: PRIVATE DEBT Q2 2018

Insight on the quarter from the leading provider of alternative assets data

Content includes:

- Fundraising
- Funds in Market
- Institutional Investors
- Fund Performance
- Dry Powder



FOREWORD - Tom Carr, Preqin

In the second quarter of 2018, 22 private debt funds raised a total of \$25bn, up nearly \$0.6bn compared to Q2 2017 and up \$5.3bn compared to the previous quarter. However, the \$44bn raised by the asset class in the first half of the year trails behind the \$49bn secured in H1 2017, indicating a slight lag for fundraising thus far in 2018. However, there are more private debt funds in market (389) than ever before, and fund managers are eager to capture commitments from a growing pool of institutional investors targeting debt vehicles.

With 55% of private debt investors based in North America, it is unsurprising that the bulk of private debt fund activity in Q2 has occurred in the US and Canada, a trend likely to continue even with upticks in the number of Europe- and Asia-focused vehicles in market at the start of Q3 2018. Further to this, the amount of capital targeted by Europe-focused funds has climbed by \$20bn since the middle of 2017.

While direct lending managers closed the most funds in Q2 – 10 funds raised \$7.8bn – distressed debt managers were able to secure the highest amount of capital at \$14bn, with GSO Capital Solutions Fund III attracting more than \$7bn in capital commitments. Direct lending remains the main story of the fundraising market, however, with nearly half of all funds on the road and aggregate capital sought by fund managers earmarked for direct lending strategies.

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PREQIN'S PRIVATE DEBT DATA

Preqin's award-winning private debt data covers all aspects of the asset class, including fund managers, fund performance, fundraising and institutional investors.

This comprehensive platform is ideal for fund marketers and investor relations professionals focused on private debt and credit funds.

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THE EUROPEAN PRIVATE DEBT MARKET: NAVIGATING THE WATERS WITH A GLOBAL PERSPECTIVE

- Tom Newberry, CVC Credit Partners

Sam Mitchell: How does the European middle market differ from a more mature US market specifically in relation to direct lending deal flow? Where do you think the best opportunities are in 2018/2019?

Tom Newberry: The European private debt market is a much younger market than the US, with roots dating back to the aftermath of the Global Financial Crisis less than a decade ago. Prior to the crisis, senior lending to middle-market companies was provided almost entirely by banks. The crisis drove critical changes in the European market, with banks across the continent shrinking their balance sheets and, in some cases, exiting the market or falling back to focus on their home markets. In addition, regulations such as Basel III have curbed bank demand for holding middle-market credit by increasing loan capital charges and reserve requirements.

This withdrawal of bank capital from the market presented an opportunity for institutional lenders to fill the void. As a result, borrowers have had the chance to become familiar with the advantages of dealing with a non-bank lender, which has spurred steady growth over the past few years. While the overall market size is much smaller than the US, we believe that it will continue to grow based on increased adoption of non-bank lending as a “regular-way” alternative for all types of borrowers.

Since the European middle market is smaller than the US and tends to experience less deal flow, sourcing ability and lender credibility are absolutely critical for success. We really benefit from CVC Capital’s extensive network of 12 European offices and a reputation established over more than 30 years as a partner in Europe.

In terms of opportunity, while the UK has led the way with respect to deal flow, we continue to see a pick-up in deals coming out of Northern European countries,

particularly Germany, Belgium and Holland. These countries have increasingly embraced institutional lending and all enjoy solid creditor regimes. Though German banking disintermediation is taking place at a slower pace than other European countries, the Mittelstand or middle market will, we believe, gradually begin to access new sources of capital to finance growth.

Across Europe, we are seeing the most attractive deal flow from companies with <€30mm of EBITDA. This is the part of the market that is not competing with the syndicated loan or high-yield bond markets, where the supply of capital has driven a decline in lending standards. Lending to these smaller borrowers offers the opportunity to continue to hold on to covenant protections, relatively tight documentation and a reasonable illiquidity premium.

SM: Is CVC Credit Partners industry agnostic? Are there any industries that you tend to avoid and if so, why?

TN: Generally speaking, we do describe ourselves as industry agnostic; however, we tend to shy away from very cyclical businesses and, particularly, commodity-driven businesses. We like to lend into situations where there are operational levers to pull in case of financial difficulty and where the enterprise value of the company can withstand challenges. We are keen to not rely on the macro environment, as reflected in energy prices and the like, changing to get our money back. By contrast, business services companies, while not often asset heavy, have proven to be extremely resilient in both good markets and bad, and they are very attractive borrowers.

SM: If you agree that we are in the final innings of this credit cycle, how are you thinking about the capital structure?

TN: We are not quite ready to call the end of the credit cycle. While late in a recovery,

there is underlying global growth and it is hard to see exactly what will trigger a broad-based recession (although I am certain we WILL see one sometime – probably when least expected). It is also important to keep in mind that any downturn will impact the various countries in Europe in different ways. Accordingly, local insight will be critical when conditions become choppy.

We manage funds focused on first lien, senior secured risk and that will continue to be our primary strategy. While we have flexibility to invest further down the capital structure, it does not feel like the time to take on more risk in order to increase returns. Being in control if something goes wrong is absolutely key to ensure positive outcomes with middle-market borrowers, and that is tough to do if you are a junior lender behind a large senior debt stack.

SM: Margins and terms are tight in the middle market. What are you doing to supplement this? How are you able to source non-sponsored deals?

TN: Spreads are certainly tighter than they have been, and structures are more aggressive than they have historically been. Our answer is to be extremely disciplined with regard to credit selection and really focus on the companies where we are confident that we can return investor capital, even if that sometimes requires compromises on pricing or terms. With many years of experience in global credit markets, we firmly believe that backing quality businesses is the key to preserving capital and generating solid long-term returns.

Some investors are happy to use leverage to augment returns, and we offer them the ability to do that, although it does not inform our credit selection. We will transact with both sponsors and non-sponsor-owned companies and will often get improved pricing where sponsors are not involved. However, the non-sponsor

market in Europe is not as developed as in the US, with deals harder to source consistently, and we are not sure it is a scalable strategy just yet.

SM: What are the advantages of a global platform? Does it provide a sourcing advantage?

TN: We are active in both the European and the US direct lending markets, with teams in both London and New York. Increasingly, we are finding that the ability to transact in multiple currencies or jurisdictions is a real competitive advantage. Right now, we are mandated on a deal for a European company that has significant US cash flows and requires

a USD denominated term loan, and we are preparing to close a loan for a US-based borrower with significant European cash flows, requiring a euro-term loan as part of the financing package. Our ability to provide a full financing solution is unique and really gives us a leg up when competing for attractive deals.

SM: How do you leverage the scale and resources of your private equity business while sourcing sponsored transactions?

TN: We believe that being part of the broader CVC network makes a real difference with both deal sourcing and due diligence. With a network of 12

offices across Europe, developed over 30+ years, CVC Capital is “local” in most of the significant lending markets and we utilize the network to source differentiated deal flow. Perhaps more importantly, the insight that the team at CVC Capital is able to provide on companies, industries, management teams, macro trends etc. is exhaustive and can be instrumental to many of the lending decisions we make. We believe that having more, and better, information drives better investing decisions. The sponsors we interact with appreciate this connection and understand that it can make us a better partner as they look to grow their businesses.

CVC CREDIT PARTNERS

Founded in 2005, CVC Credit Partners is a leading player in global leveraged finance, with over \$18.7bn of assets under management and 55 investment professionals across Europe and in New York. CVC is committed to fundamental bottom-up credit analysis and seeks to deliver attractive returns through varied credit market cycles.

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FUNDRAISING

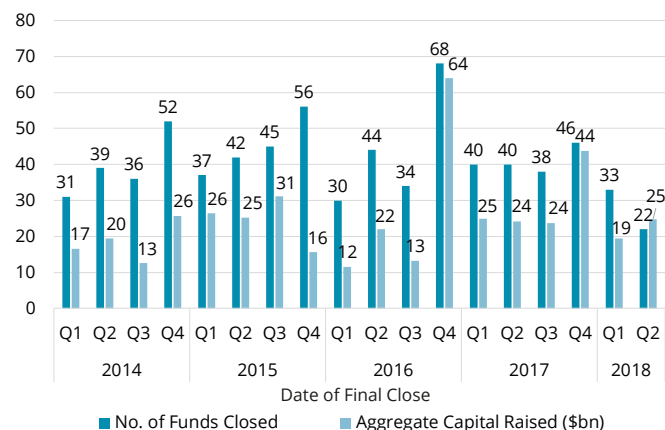
In Q2 2018, 22 private debt funds reached a final close securing an aggregate \$25bn (Fig. 1). This represents a \$0.6bn increase from Q2 2017 and a \$5.3bn increase from Q1 2018, marking the halfway point of 2018 private debt fundraising at \$44bn. This total is slightly behind that of the H1 2017 total of \$49bn, although the Q2 2018 total is expected to rise as more information becomes available. Additionally, the Q2 fundraising total of \$25bn was secured across only 22 funds, whereas the \$24bn raised in Q2 2017 was achieved by 40 private debt vehicles.

North America once again saw the largest share of capital raised and funds closed at \$16bn across 11 funds, followed by Europe-focused funds securing \$7.2bn across seven funds (Fig. 2). There were three Asia-focused funds closed which secured \$2.0bn, while just one Rest of World-focused fund secured \$100mn.

The most funds raised in Q2 in terms of strategy were direct lending vehicles (10 funds secured \$7.8bn), while five distressed debt funds were closed for \$14.2bn, the highest total in the asset class (Fig. 3). Q2 appeared slow for mezzanine vehicles, of which only two reached final closures for a total of \$300mn.

Three of the five largest private debt funds closed in the quarter employ a distressed debt strategy; at the forefront is GSO Capital

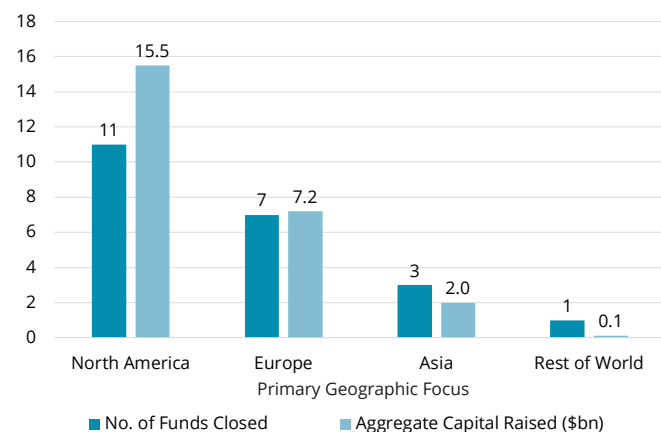
Fig. 1: Global Quarterly Private Debt Fundraising, Q1 2014 - Q2 2018



Source: Preqin

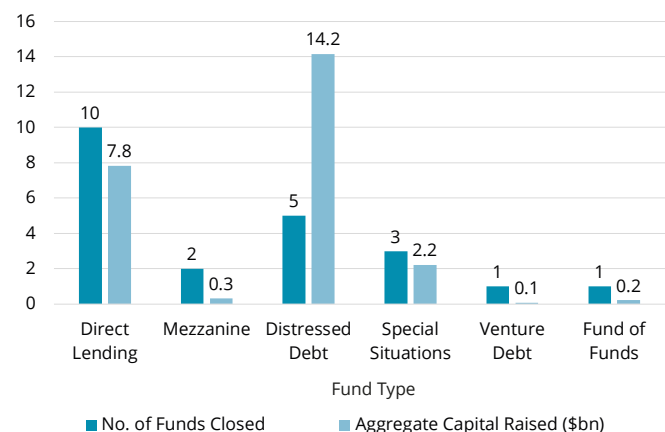
Solutions Fund III which closed on \$7.4bn, representing nearly 30% of private debt capital secured in the quarter and more than double that of the next largest fund, CVI Credit Value Fund IV at \$3.0bn (Fig. 4).

Fig. 2: Private Debt Fundraising in Q2 2018 by Primary Geographic Focus



Source: Preqin

Fig. 3: Private Debt Fundraising in Q2 2018 by Fund Type



Source: Preqin

Fig. 4: Largest Private Debt Funds Closed in Q2 2018

Fund	Firm	Fund Size (mn)	Fund Type	Geographic Focus
GSO Capital Solutions Fund III	GSO Capital Partners	7,356 USD	Distressed Debt	US
CVI Credit Value Fund IV	CarVal Investors	3,000 USD	Distressed Debt	US
Strategic Value Special Situations Fund IV	Strategic Value Partners	2,850 USD	Distressed Debt	Europe, North America
AlbaCore Partners I	AlbaCore Capital	1,458 EUR	Direct Lending	Europe
Summit Partners Credit Fund III	Summit Partners	1,500 USD	Direct Lending	US

Source: Preqin

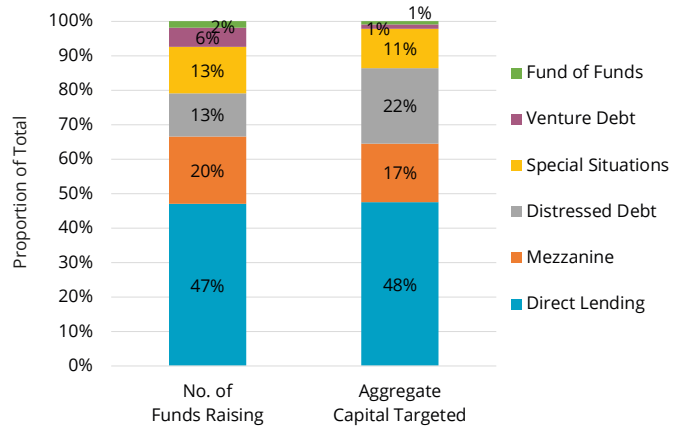
FUNDS IN MARKET

As at the start of Q3 2018 there are 389 private debt funds in market seeking an aggregate \$180bn in capital, up significantly from the 350 funds seeking \$160bn at the start of Q2, as more managers come to market. Direct lending funds account for the largest proportions of both number of funds and aggregate capital targeted (at 47% and 48% respectively) with distressed debt funds targeting the next largest share of capital at 22% (Fig. 5).

The comparison of funds in market by primary geographic focus for the start of Q3 2017 vs. Q3 2018 in Fig. 6 illustrates a dramatic increase across all regions; notably, Rest of World has climbed to 53 funds targeting \$13bn as at the start of Q3 2018. Europe has seen the largest gross increase, however, with aggregate capital targeted up by more than \$20bn.

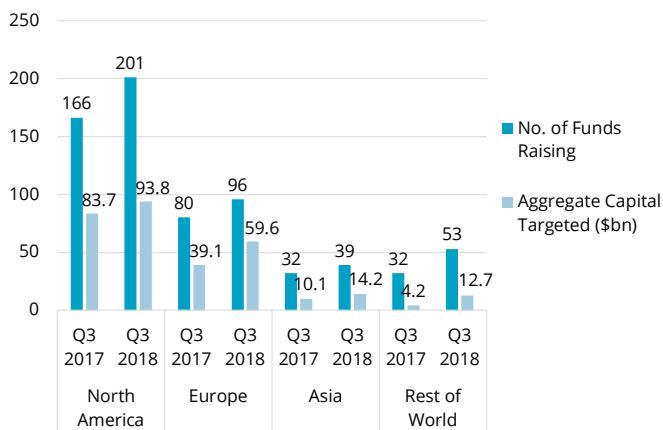
The largest proportion (40%) of funds in market have been on the road for 13-24 months, and the proportion falls off significantly after the two-year mark (Fig. 7), with only 16% of funds in market raising for more than two years. Fig. 8 shows the largest private debt funds in market, led by Goldman Sachs Merchant Banking Division's \$10bn GS Mezzanine Partners VII, a US-focused vehicle.

Fig. 5: Private Debt Funds in Market by Fund Type (As at July 2018)



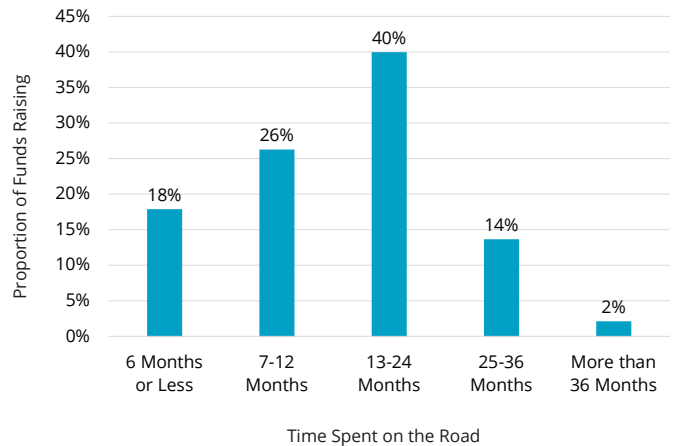
Source: Preqin

Fig. 6: Private Debt Funds in Market by Primary Geographic Focus, Q3 2017 vs. Q3 2018*



Source: Preqin

Fig. 7: Time Spent on the Road by Private Debt Funds in Market (As at July 2018)



Source: Preqin

Fig. 8: Largest Private Debt Funds in Market (As at July 2018)

Fund	Firm	Firm Headquarters	Target Size (mn)	Status	Fund Type	Geographic Focus
GS Mezzanine Partners VII	Goldman Sachs Merchant Banking Division	New York, US	10,000 USD	First Close	Mezzanine	US
Ares Capital Europe IV	Ares Management	Los Angeles, US	4,500 EUR	First Close	Direct Lending	Europe
Fortress Credit Opportunities Fund V	Fortress Investment Group	New York, US	5,000 USD	Raising	Distressed Debt	Europe
GSO Energy Select Opportunities Fund II	GSO Capital Partners	New York, US	5,000 USD	Raising	Distressed Debt	US
ICG Europe Fund VII	Intermediate Capital Group	London, UK	4,000 EUR	First Close	Mezzanine	Europe

Source: Preqin

*As at the beginning of Q3 of each year examined.

CVC

Credit Partners

CVC Credit Partners manages \$18.7bn¹ in assets in the US and Europe and invests across the capital structure, with dedicated vehicles for Performing Credit, Opportunistic Credit, Special Situations and Private Debt

An experienced and global team with a proven track record of identifying value throughout various market cycles

¹As at 31 March 2018. Commitment figure used for Pooled-Closed End Funds and Separately Managed Accounts in ramping phase. Includes warehouse figure for Apidos CLO XXIX. Underlying figures not in U.S. Dollars are converted using a spot rate as at 31 March 2018. Includes Managed Funds, Separately Managed Account Arrangements and CLOs managed by CVC Credit Partners Limited, CVC Credit Partners Investment Management Limited, CVC Credit Partners European Investment Fund Management Limited, CVC Credit Partners European CLO Management LLP and CVC Credit Partners U.S. CLO Management LLC, on a discretionary and non-discretionary basis.



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2018 Winner
Best European
High Yield Fund

2018 Finalist
Manager of the Year

2018 Finalist
Best European
CLO Manager

2018 Finalist
Best European CLO

2018 Finalist
Best European Direct
Lending Fund

INSTITUTIONAL INVESTORS

Preqin currently tracks more than 3,300 active private debt investors globally. Over half (55%) of investors are based in North America, followed by 25% in Europe and 14% in Asia-Pacific. The 10 largest investors allocate a total of \$66bn to the private debt asset class (Fig. 12). StepStone, the Switzerland-based fund of funds manager, currently allocates \$16bn to the asset class, the highest allocation among known investors.

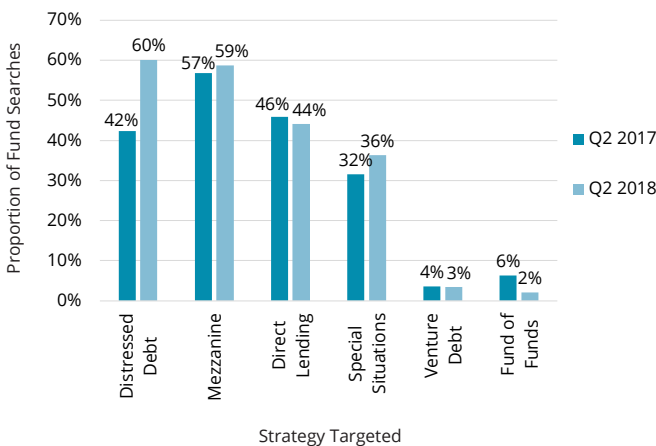
The largest proportion (60%) of investors will seek investment in distressed debt vehicles over the next 12 months, whereas the majority of investors in Q2 2017 favoured mezzanine (Fig. 9). Additionally, the proportion of investors actively seeking distressed debt opportunities has increased by 18 percentage points from the same period in 2017. Mezzanine is still among the top three most targeted strategies, with 59% of investors looking

for mezzanine vehicles in the coming year, followed by direct lending (44%).

Europe and North America remain the most favoured regions among private debt investors, as targeted by 64% and 52% of investors respectively (Fig. 10). However, there has been a slight uptick in investor appetite for opportunities in the Asia-Pacific region over the coming year, growing from 27% of fund searches in Q2 2017 to 30% in Q2 2018.

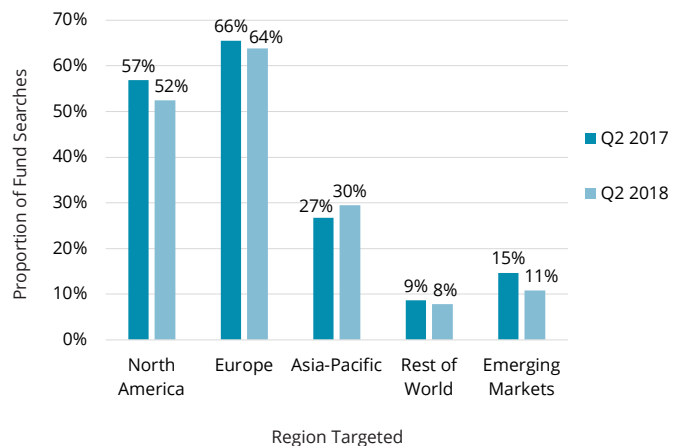
Investors' plans for their private debt portfolios remain diverse: more than half (55%) of investors plan to commit less than \$50mn to private debt vehicles over the next 12 months, while 42% expect to allocate between \$50mn and \$499mn (Fig. 11).

Fig. 9: Strategies Targeted by Private Debt Investors in the Next 12 Months, Q2 2017 vs. Q2 2018



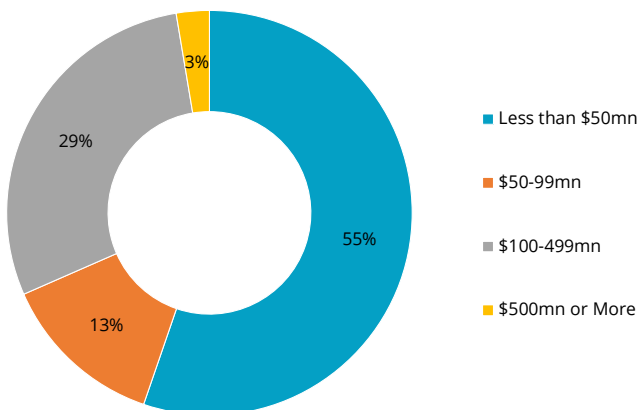
Source: Preqin

Fig. 10: Regions Targeted by Private Debt Investors in the Next 12 Months, Q2 2017 vs. Q2 2018



Source: Preqin

Fig. 11: Amount of Capital Investors Plan to Commit to Private Debt Funds in the Next 12 Months



Source: Preqin

Fig. 12: Largest Investors in Private Debt by Current Allocation

Investor	Type	Current Allocation (\$bn)
StepStone	Private Debt Fund of Funds Manager	16.0
Virginia Retirement System	Public Pension Fund	12.5
African Development Bank	Bank	6.0
Liberty Group	Insurance Company	5.5
Arizona State Retirement System	Public Pension Fund	5.3

Source: Preqin



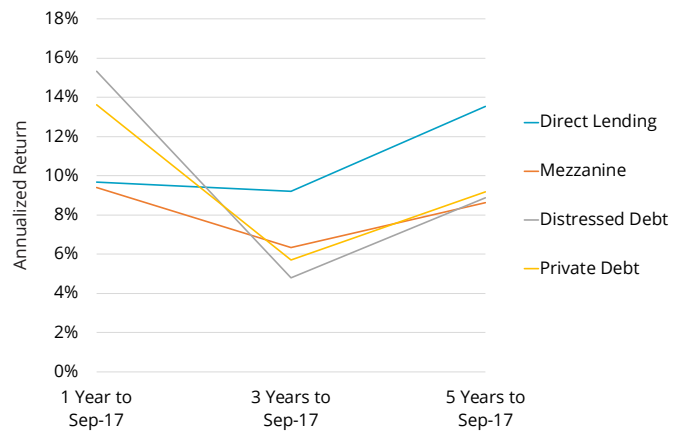
FUND PERFORMANCE

As seen in Fig. 13, distressed debt has outperformed all private debt strategies over the one-year horizon to September 2017 (+15.3%), while direct lending has been the strongest strategy, on average, over the five-year horizon (+13.5%). As the credit cycle is likely to see a shift in the coming years, it is possible distressed debt could continue to see higher fundraising totals and outperformance against other private debt strategies.

Preqin's latest median net IRR data for private debt funds shows vintage 2015 funds posting a top quartile boundary of 16.7% and median net IRR of 11.2%, with a bottom quartile boundary of 8.0% (Fig. 14).

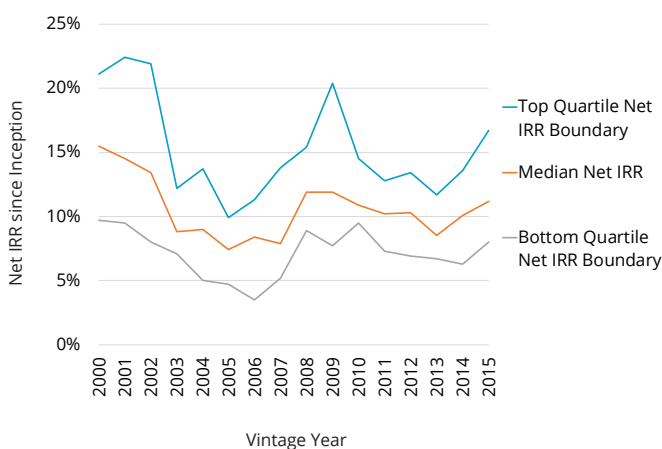
Fig. 15 shows the median called-up, distributed and residual value ratios of private debt funds by vintage year; vintage 2013 funds are edging closer to having all capital called, with 89.7% of capital called up as a proportion of committed capital.

Fig. 13: Private Debt: Horizon Returns by Fund Type



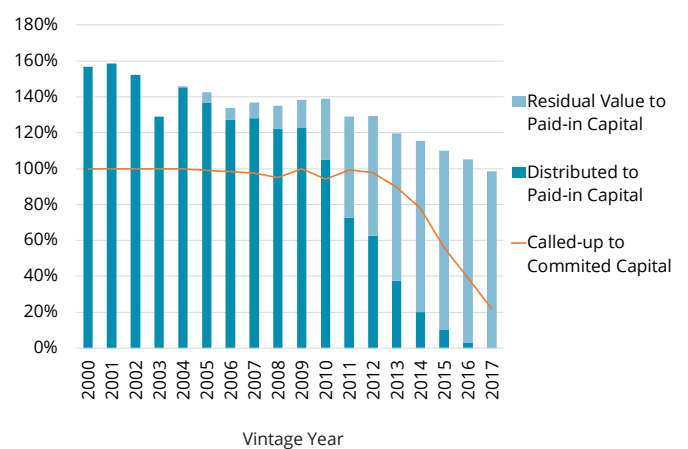
Source: Preqin

Fig. 14: Private Debt: Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin

Fig. 15: Private Debt: Median Called-up, Distributed and Residual Value Ratios by Vintage Year



Source: Preqin

PREQIN'S DATA

Preqin collects performance data from a variety of sources to ensure a high degree of accuracy and confidence. Since inception of its database, Preqin has collected performance figures from institutional investors, which are obtained via Freedom of Information Act (FOIA) requests, as well as listed firm financial reports, public filings, and annual reports.

Preqin also collects a substantial proportion of performance data from fund managers directly. Such contributions are invaluable to the industry for market transparency and benchmarks. Moreover, fund managers are increasingly recognizing the importance of providing the most accurate and most recent data to Preqin, as Preqin subscribers use Preqin Pro to search for new investment opportunities and view performance on a fund level.

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DRY POWDER

With the exception of 2014, capital available to private debt fund managers has increased year on year since 2008 and now stands at a record of \$251bn as of June 2018 (Fig. 16). Direct lending accounts for the highest dry powder reserves at \$90bn, followed by distressed debt at \$76bn. Mezzanine and venture debt are the only strategies that have seen a drop in dry powder since the end of 2017, while special situations' total has grown by \$8bn in the first half of the year to \$35bn.

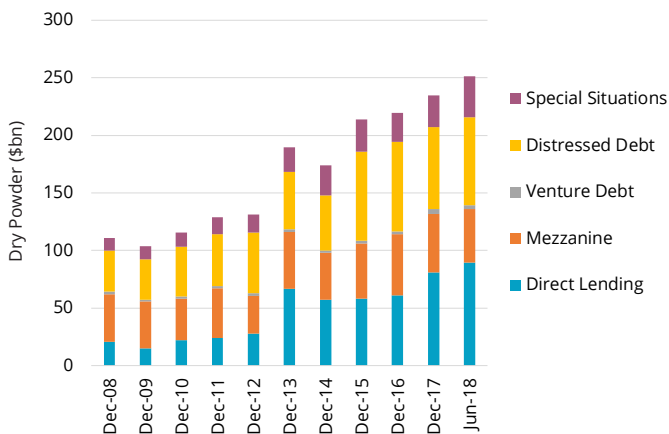
Nearly two-thirds (63%) of private debt dry powder remains in North America-focused funds, after the region saw an increase of \$4.4bn since the start of 2018 (Fig. 17). Europe-focused funds saw a jump of \$12bn in dry powder during the first half of the year, while dry powder in Asia- and Rest of World-focused funds experienced

modest increases of \$1.2bn and \$0.3bn, to \$15bn and \$2.8bn respectively.

As at June 2018, the ratio of total private debt dry powder to that of buyout funds is 0.40, an increase from 0.37 as at the end of 2017. While private debt dry powder has grown \$17bn in the period, buyout dry powder has reduced by \$2bn. At its highest, this ratio was 0.48 in December 2013.

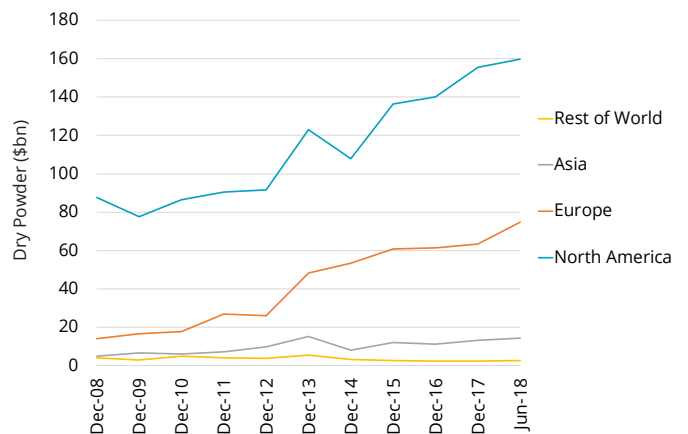
GSO Capital Partners (\$11.3bn), Oaktree Capital Management (\$11.0bn) and Ares Capital Management (\$9.8bn) have all surpassed Intermediate Capital Group (\$8.8bn) in estimated private debt dry powder since Q1 2018 (Fig. 19).

Fig. 16: Private Debt: Dry Powder by Fund Type, 2008 - 2018



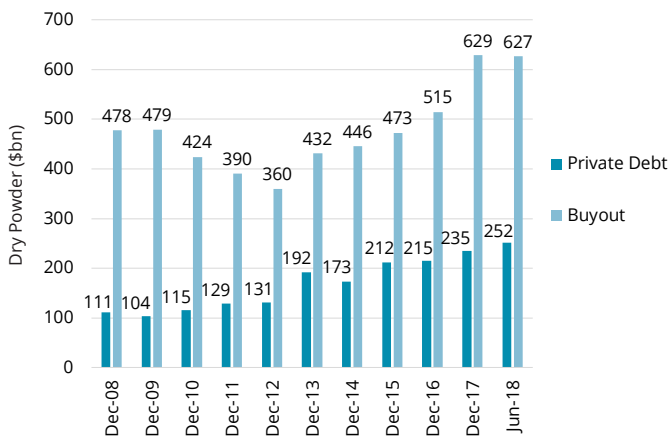
Source: Preqin

Fig. 17: Private Debt: Dry Powder by Primary Geographic Focus, 2008 - 2018



Source: Preqin

Fig. 18: Dry Powder: Private Debt vs. Buyout, 2008 - 2018



Source: Preqin

Fig. 19: Largest Private Debt Fund Managers by Estimated Dry Powder

Firm	Headquarters	Estimated Dry Powder (\$bn)
GSO Capital Partners	US	11.3
Oaktree Capital Management	US	11.0
Ares Management	US	9.8
Intermediate Capital Group	UK	8.8
HPS Investment Partners	US	7.1
Centerbridge Capital Partners	US	4.7
Cerberus Capital Management	US	4.6
Apollo Global Management	US	4.4
KKR	US	3.4
Clearlake Capital Group	US	3.2

Source: Preqin

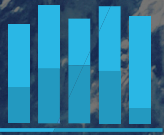


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- **Fund managers:** fundraising, portfolio monitoring and investor relations
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