PREQIN QUARTERLY UPDATE: PRIVATE DEBT Q3 2017

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

Content includes:

Fundraising
Funds in Market
Institutional Investors
Dry Powder
Fund Performance

preqin
alternative assets. intelligent data.

FOREWORD - Ryan Flanders, Preqin

The aggregate capital raised ($69bn) by private debt funds closed in the first three quarters of 2017 is well ahead of the same period in 2016, although the number of funds closed (94) so far in 2017 is well below the numbers seen in recent years.

Twenty-four private debt funds closed in Q3 2017, securing an aggregate $23bn in global capital commitments, with this figure expected to rise as more data becomes available. The average size of funds closed in the quarter has reached $958mn, more than double that of Q3 2016 ($400mn). There are currently 334 private debt funds in market targeting an aggregate $148bn, up from the $137bn in capital sought by 310 funds at the beginning of 2016's record-breaking fourth quarter.

Direct lenders once again closed the most funds, and secured the most capital among private debt fund types, raising a combined $10bn across 10 funds. Over the past four quarters, direct lending funds have secured $43bn via 70 funds, constituting a third of total private debt capital raised ($125bn) and nearly half of funds closed (152) in the period.

Private debt dry powder levels have continued to rise, reaching $214bn in available capital as at September 2017, just $2bn shy of the record high in December 2015. Despite the typical concerns about fund managers' ability to deploy existing reserves, managers are continuing to put capital to work in sponsored transactions, and private debt dry powder as a proportion of buyout dry powder is at its lowest level (36%) since 2011.

We hope that you find this report useful and welcome your feedback. For more information, please visit www.preqin.com or contact info@preqin.com.

FUNDRAISING

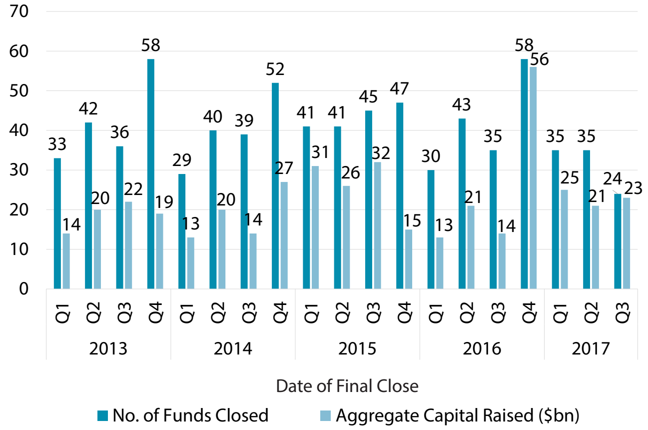
Twenty-four private debt funds reached a final close in Q3 2017, raising an aggregate $23bn in capital (Fig. 1). While fewer funds reached a final close this quarter than in Q3 2016, the average fund size more than doubled compared to those closed in the same period last year ($958mn vs. $400mn). Since Q1 2013, an average of 40 funds have secured around $22bn in aggregate capital each quarter, with an average fund size of $557mn.

Direct lending funds account for both 44% of private debt vehicles closed in Q3 and 44% of capital commitments, the greatest proportions of all fund types (Fig. 2). Five special situations vehicles reached a final close after securing $4.8bn, and four distressed debt vehicles raised $4.7bn. Although direct lending vehicles account for the most funds and capital raised in Q3, the average size of distressed debt vehicles closed is larger than direct lending funds by $260mn.

Twelve North America-focused private debt vehicles reached a final close in Q3 2017, securing almost $11bn in capital, a greater amount than any other region (Fig. 3). Seven Europe-focused funds raised a total of $6.9bn, while five funds targeting Asia & Rest of World raised $5.3bn.

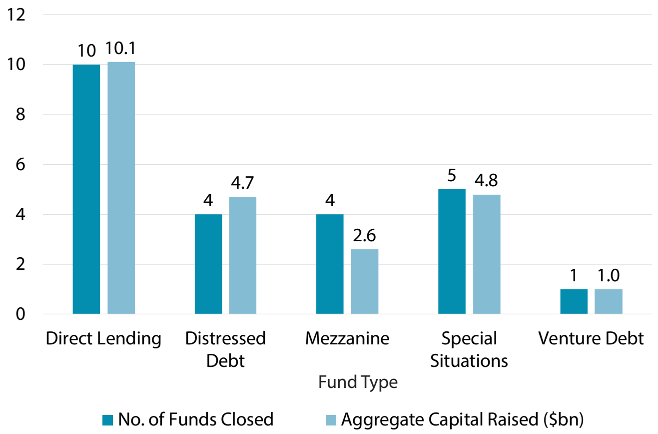
Senior Loan Fund, managed by Bluebay Asset Management, was the largest fund to close in Q3; with $3.4bn in capital commitments, it greatly exceeded its $1.8bn target (Fig. 4). The fund is $1bn larger than Castlelake V, which secured $2.4bn at its final close in July 2017. Europe-focused Senior Loan Fund and North America-focused Castlelake V will target direct lending and distressed debt opportunities respectively.

Fig. 1: Private Debt Fundraising, Q1 2013 - Q3 2017



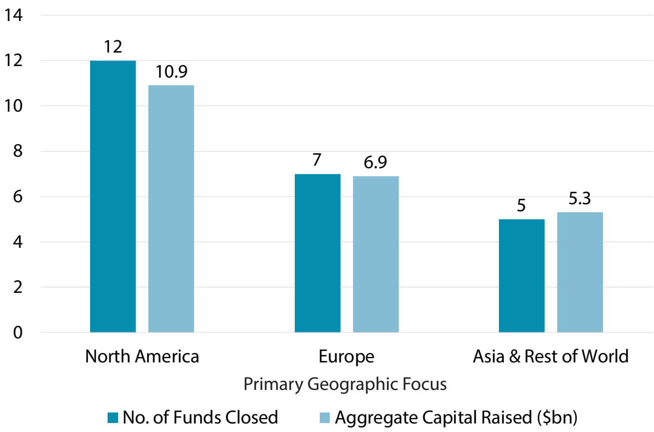
Source: Preqin Private Debt Online

Fig. 2: Private Debt Fundraising in Q3 2017 by Fund Type



Source: Preqin Private Debt Online

Fig. 3: Private Debt Fundraising in Q3 2017 by Primary Geographic Focus



Source: Preqin Private Debt Online

Fig. 4: Five Largest Private Debt Funds Closed in Q3 2017

Fund	Firm	Fund Size (mn)	Type	Geographic Focus
Senior Loan Fund	Bluebay Asset Management	2,900 EUR	Direct Lending	Europe
Castlelake V	Castlelake	2,400 USD	Distressed Debt	North America
CITIC PE Multi-Strategy Fund	CITIC Private Equity Funds Management	13,300 CNY	Mezzanine	Asia
Hayfin Special Opportunities Fund II	Hayfin Capital Management	1,700 EUR	Special Situations	Europe
SSG Capital Partners IV	SSG Capital Management	1,700 USD	Special Situations	Asia

Source: Preqin Private Debt Online

FUNDS IN MARKET

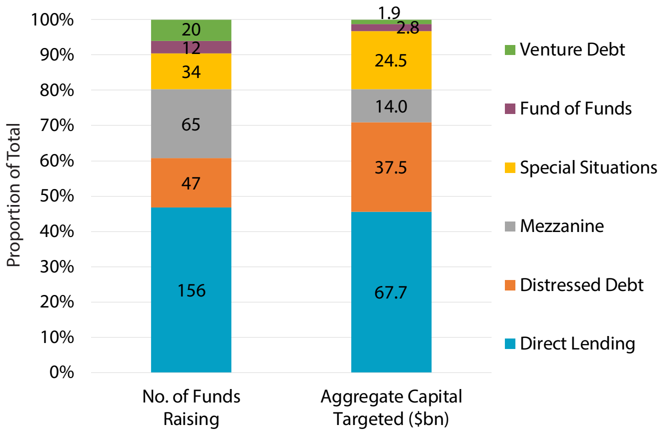
Direct lending vehicles continue to represent the largest proportion (47%) of funds on the road and aggregate capital targeted (46%), with 156 vehicles seeking a total of $68bn as at the start of Q4 2017 (Fig. 5). Distressed debt vehicles account for 14% of funds on the road and a quarter ($38bn) of targeted capital, while mezzanine funds are seeking less than half ($14bn) this amount, but represent for 19% of funds currently raising.

Compared to Q3 2016, there are a greater number of Europe-, Asia- and Rest of World-focused funds targeting larger amounts of capital in Q3 2017 (Fig. 6). While there are also significantly more North America-focused funds currently raising (174 in Q3 2017 vs. 135 in Q3 2016), the total capital sought by these funds has held relatively steady from a year prior.

The largest proportion (43%) of private debt funds currently in market have been on the road for one year or less, while 34% have been on the road for 13-24 months (Fig. 7). Twenty-three percent of funds currently raising have been on the road for two years or more, a slight decrease from 25% of funds in market in Q3 2016.

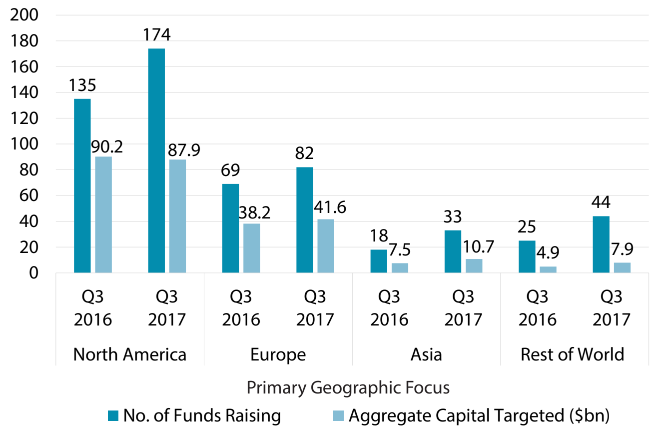
3G Special Situations Fund V is the largest private debt fund in market as at the start of Q4 2017 with a target size of $10bn, followed by two third-series distressed debt vehicles from GSO Capital Partners and Apollo Global Management, targeting $6.5bn and $4.0bn respectively (Fig. 8). Direct lending funds round out the top five: HPS Specialty Loan Fund (IV) 2016 is seeking $3.5bn for opportunities in North America; and Park Square Capital Partners' joint venture with Sumitomo Mitsui Banking Corporation, Park Square Capital SMBC JV ($3.4bn), will focus on investments in Europe.

Fig. 5: Private Debt Funds in Market by Fund Type



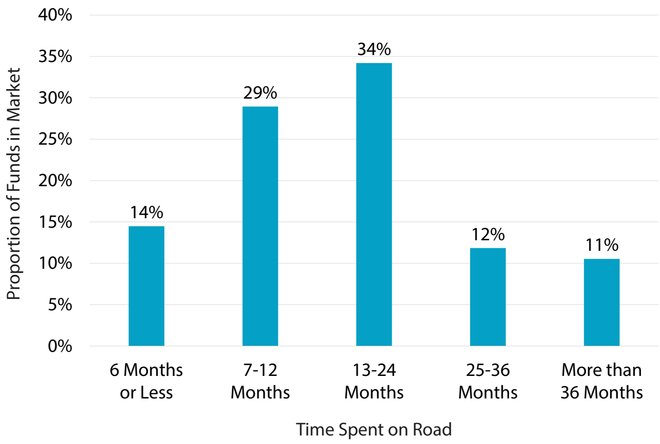
Source: Preqin Private Debt Online

Fig. 6: Private Debt Funds in Market by Primary Geographic Focus, Q3 2016 vs. Q3 2017



Source: Preqin Private Debt Online

Fig. 7: Time Spent on the Road by Private Debt Funds in Market



Source: Preqin Private Debt Online

Fig. 8: Five Largest Private Debt Funds in Market

Fund	Firm	Target Size (mn)	Type	Geographic Focus
3G Special Situations Fund V	3G Capital	10,000 USD	Special Situations	North America
GSO Capital Solutions Fund III	GSO Capital Partners	6,500 USD	Distressed Debt	North America
Apollo European Principal Finance Fund III	Apollo Global Management	4,000 USD	Distressed Debt	Europe
HPS Specialty Loan Fund (IV) 2016	HPS Investment Partners	3,500 USD	Direct Lending	North America
Park Square Capital SMBC JV	Park Square Capital Partners	3,000 EUR	Direct Lending	Europe

Source: Preqin Private Debt Online

INSTITUTIONAL INVESTORS

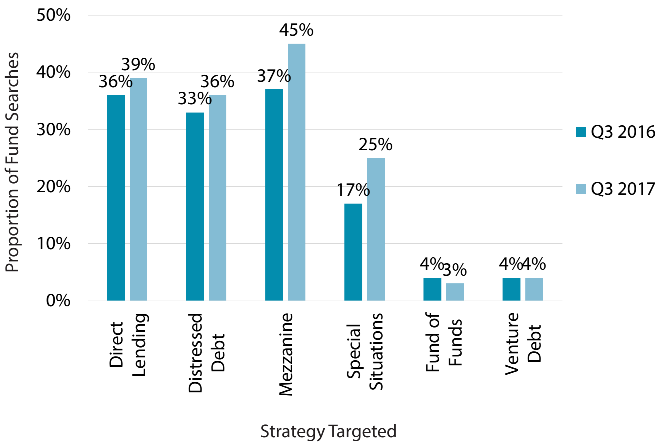
Preqin currently tracks more than 2,900 active private debt investors globally on **Private Debt Online**, which features detailed allocation and investment plans. The 10 largest investors currently allocate a combined $81bn to the asset class, which equates to almost a third (30%) of the total capital allocated to the industry. Half of these investors are North America based, while the remainder are located in Europe, Africa and South America.

For the second consecutive year, the largest proportion (45%) of active private debt investors plan to invest in mezzanine strategies over the next 12 months (Fig. 9). Mezzanine and special situations have seen the largest growth in demand among private debt strategies from Q3 2016 to Q3 2017. The proportion of investors targeting direct lending and distressed debt strategies has also increased in the same period.

Europe and North America remain the most targeted regions among private debt investors, with 49% and 47% of investors seeking opportunities in these regions respectively (Fig. 10). Appetite for Asia has grown over the past year: 22% of investors are targeting opportunities in this region in Q3 2017, compared to just 16% in Q3 2016.

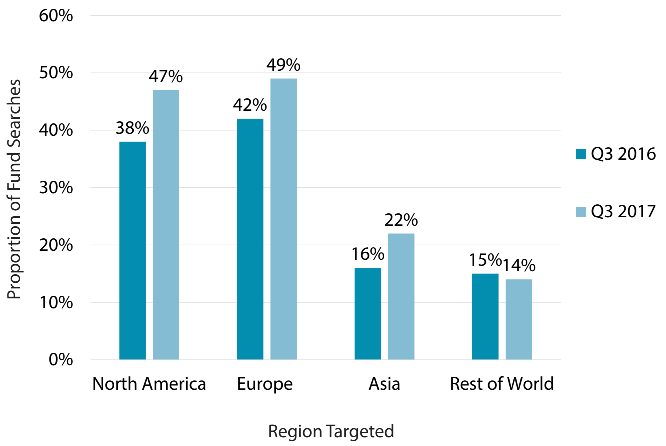
Investors' plans for their private debt portfolios remain diverse: more than half (53%) of investors plan to commit less than $50mn to private debt over the next 12 months, while 35% will allocate between $50mn and $499mn (Fig. 11). Twelve percent of investors are planning to commit $500mn or more to the asset class in the year ahead, including 6% with plans to invest at least $1bn.

Fig. 9: Strategies Targeted by Private Debt Investors in the Next 12 Months, Q3 2016 vs. Q3 2017



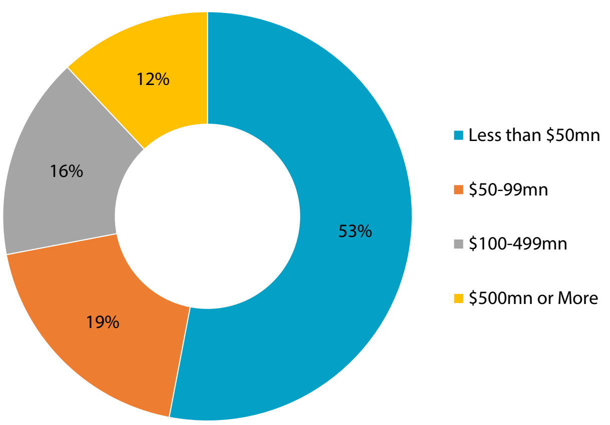
Source: Preqin Private Debt Online

Fig. 10: Regions Targeted by Private Debt Investors in the Next 12 Months, Q3 2016 vs. Q3 2017



Source: Preqin Private Debt Online

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



Source: Preqin Private Debt Online

Fig. 12: Five Largest Investors by Current Allocation to Private Debt

Investor	Type	Current Allocation ($bn)
TIAA	Private Sector Pension Fund	25.9
Partners Group	Private Equity Fund of Funds Manager	11.6
CPP Investment Board	Public Pension Fund	9.5
Netherlands Development Finance Company (FMO)	Government Agency	7.7
California Public Employees' Retirement System (CalPERS)	Public Pension Fund	5.0

Source: Preqin Private Debt Online

DRY POWDER

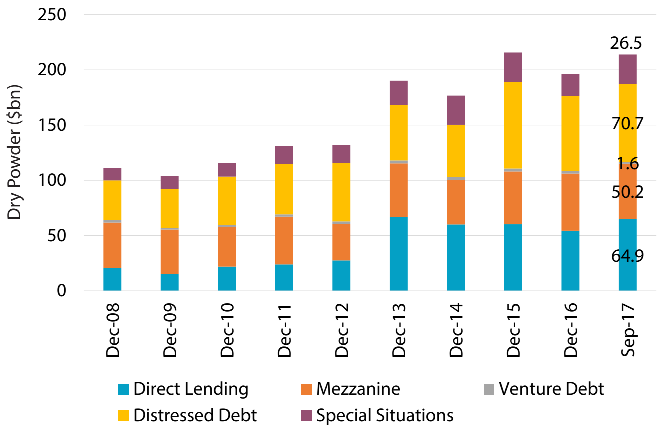
As at September 2017, private debt managers hold an estimated $214bn in dry powder, up $18bn since December 2016 (Fig. 13). Distressed debt funds continue to hold the largest amount of dry powder ($71bn) of any private debt strategy, followed closely by direct lending ($65bn) and mezzanine ($50bn).

North America-focused funds account for over two-thirds of the total private debt dry powder available, with $143bn in capital available as at September 2017, up $10bn since December 2016 (Fig. 14). Dry powder levels also increased in the same period for Europe-focused (by 10%), Asia-focused (25%) and Rest of World-focused (37%) funds.

Fig. 15 displays total private debt dry powder against that of buyout funds, providing context for the substantial growth of the private debt market in recent years. Aggregate dry powder for all private debt strategies has grown by $18bn since December 2016, and is less than $2bn away from surpassing December 2015 levels ($215bn). However, the value of private debt dry powder as a proportion (36%) of total buyout dry powder remains at its lowest level since December 2011.

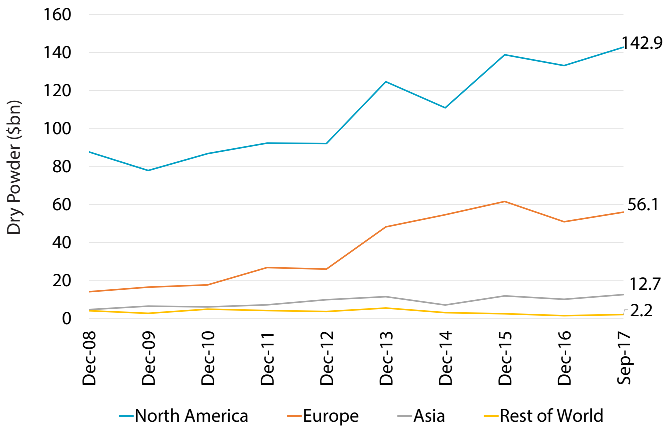
Oaktree Capital Management continues to hold the largest amount of available capital ($13.2bn) among private debt managers, followed by GSO Capital Partners ($11.6bn) and Goldman Sachs Merchant Banking Division ($8.2bn), as seen in Fig. 16.

Fig. 13: Private Debt Dry Powder by Fund Type, 2008 - 2017



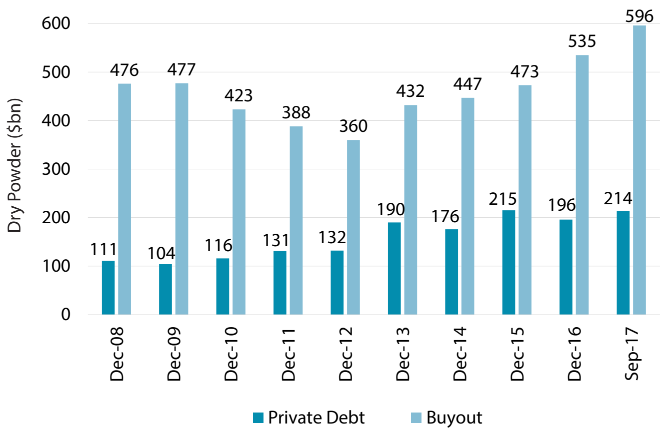
Source: Preqin Private Debt Online

Fig. 14: Private Debt Dry Powder by Primary Geographic Focus, 2008 - 2017



Source: Preqin Private Debt Online

Fig. 15: Dry Powder: Private Debt vs. Buyout, 2008 - 2017



Source: Preqin Private Debt Online

Fig. 16: 10 Largest Private Debt Fund Managers by Estimated Dry Powder

Firm	Headquarters	Estimated Dry Powder ($bn)
Oaktree Capital Management	US	13.2
GSO Capital Partners	US	11.6
Goldman Sachs Merchant Banking Division	US	8.2
Centerbridge Capital Partners	US	7.0
Cerberus Capital Management	US	6.5
HPS Investment Partners	US	6.1
Intermediate Capital Group	UK	5.2
Hayfin Capital Management	UK	5.2
Ares Management	US	4.9
Apollo Global Management	US	4.4

Source: Preqin Private Debt Online

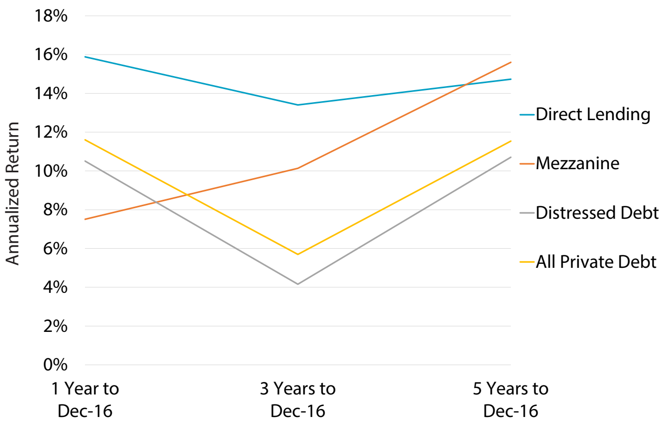
FUND PERFORMANCE

Direct lending strategies have the highest horizon IRRs across the one- and three-year periods to December 2016, while mezzanine funds returned 87bps more in the five years to December 2016 (Fig. 17). The outsized returns of direct lending compared to the private debt asset class as a whole have clearly helped fuel the uptick in fundraising, as investors hope to capture similar performances in the future. The prospect of mid to low double-digit returns while maintaining a higher position in the capital structure than both mezzanine and distressed debt providers remains attractive moving into the end of 2017.

Among the private debt funds of vintage 2007 and onwards, funds of vintage 2008 have the highest median net IRR (+13.3%). However, funds of vintage 2009 have the highest top quartile boundary (+17.9%), which is 140bps higher than that of 2008 vintage funds (+16.5%, Fig. 18).

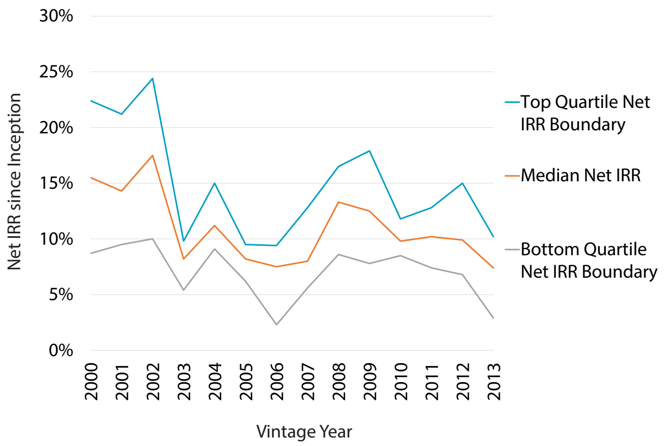
Private debt dry powder levels have remained near all-time highs in recent years: as at September 2017 there is $214bn in available capital – only $1bn less than the record high of $215bn in December 2015. Fig. 19 illustrates the relationships of called-up to committed capital, distributed to paid-in capital and residual value to paid-in capital, adding context to the picture of capital flows across the industry. The ratio of distributed to paid-in capital drops sharply after 2010 vintage funds (84.3%) through to the most recent vintages. Inversely, the proportion of residual value to paid-in capital flips from 49.2% for 2010 vintage funds to levels in excess of 100% starting for vintage 2015 funds. The relationship between residual value and distributions is essentially a function of fund maturity and vintage, with earlier distributions seen in private debt funds versus other alternative strategies.

Fig. 17: Private Debt: Horizon IRRs by Fund Type



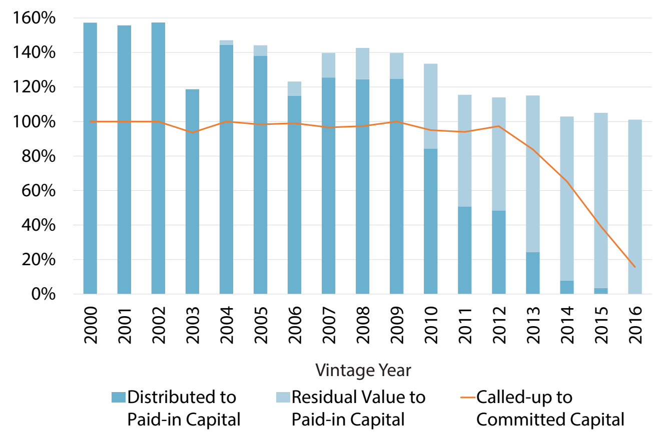
Source: Preqin Private Debt Online

Fig. 18: Private Debt: Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin Private Debt Online

Fig. 19: Private Debt: Median Called-up, Distributed and Residual Value Ratios by Vintage Year



Source: Preqin Private Debt Online

RESEARCH CENTER PREMIUM

All of the free research reports, newsletters, statistics and tools Preqin offers can be found in one place: Preqin's Research Center Premium. This free service provides access to analysis of the latest trends in alternative assets, as well as benchmarking tools, useful presentation slide decks from recent conferences and much more.

For more information, or to sign up, please visit:

www.preqin.com/rcp