Preqin Special Report: Distressed Private Equity

October 2011

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... and Much More!

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Foreword

Distressed private equity has become an increasingly prominent part of the overall private equity industry. Funds targeting the sector accounted for 10% of all private equity fundraising in both 2010 and January-August 2011, up from just 3% in 2006, illustrating the increasing appetite shown by institutional investors for these vehicles.

Preqin groups three types of private equity fund under the umbrella term, ‘distressed private equity’: distressed debt, turnaround and special situations.

Distressed debt involves purchasing debt securities that are trading at a distressed level, in anticipation that those securities will have a higher market valuation and generate profit at a future selling point, or taking a position to potentially gain control of an asset.

Turnaround investments focus on purchasing equity in companies that are in distress, and aiming to subsequently restore the company to profitability.

Special situations investments focus on event-driven or complex situations, where a fund manager may be able to exploit pricing inefficiencies due to an expected or actual significant event.

The protracted recovery of the Western economies from the global downturn, as well as other factors such as the European sovereign debt crisis, means that distressed private equity funds will continue to have a significant role to play in the private equity industry in the coming years.

Preqin calculates 151 distressed private equity firms have an aggregate $55bn in dry powder at their disposal, and competition for deals is expected to intensify given the record number of vehicles currently on the fundraising trail: for the fourth consecutive year, the number of distressed private equity funds on the road has increased. As of September 2011, the figure stood at a record 62 funds seeking an aggregate $62.6bn.

Institutional investors still recognize the value of including exposure to distressed private equity in their investment portfolios. In the compilation of this report, we conducted in-depth interviews with over 50 prominent LPs from around the world which have expressed an interest in distressed private equity funds to find out about their plans for investment in the sector. The results of this study can be found on page 5.

In addition to the results of our investor study, we are pleased to include an exclusive interview with Howard Marks from leading firm Oaktree Capital Management which provides further perspectives on the key trends affecting the industry.

We hope you find the Preqin Special Report: Distressed Private Equity a useful and interesting guide. With teams in New York, London and Singapore, our real-time global private equity coverage is the most pertinent and comprehensive available. If you would like more information or have any feedback, please feel free to contact us at any of our offices.

Richard Stus
Manager - GP Data

Expert Comment: Howard Marks, Oaktree Capital Management

We spoke to Howard Marks, Chairman of Oaktree Capital Management, about the current opportunities in the distressed debt market. Founded in 1995, the firm is involved in less effificient markets and alternative investments and currently has around 600 employees based in offices across the globe.

Our latest LP survey shows that appetite for distressed debt is second behind that for mid-market buyouts. Are you finding it easy to attract investment at the moment?

We're certainly reaching our goals on our funds, but then we're raising smaller funds now. We raised a very large fund in 2008 and we've been raising smaller ones ever since. It's easier to raise smaller funds of course, and we're encountering good demand for them.

Are there enough economically viable deals in the market at this time?

While there are certainly enough for moderately sized funds, I wouldn't want to have peak assets right now. But yes, there's a reasonable supply of deals in the market.

What are returns levels like at the current time?

Distressed debt has had returns all over the lot over the last 10 years. Our '08 fund is showing the returns it is because it was invested when opportunities were at a peak. If we have another upsurge in opportunity we might get back to those levels, if we don't, we won't. It's not something we can predict.

What are general market conditions like at the moment?

We're not seeing a lot of defaults, distress or highly motivated sellers. In such a climate we don't get huge buying opportunities. So the operative question is "what happens ahead?"

We believe the opportunities will improve, but how far that pendulum will swing, we don't know.

Ultimately, the easier it is for companies to raise money, the easier it is for them to avoid distress. The capital markets became quite generous in 2009, '10 and the first half of '11. If they continued to be generous then we wouldn't find great opportunities. But the capital markets have been getting jittery in the past three months, and as they do so our opportunities improve.

LP Attitudes to Distressed Private Equity

Since the financial crisis, distressed private equity has become an increasingly popular investment strategy, with institutional investors looking to gain exposure to companies in financial distress as a result of the difficult economic climate.

The latest Preqin Investor Outlook: Private Equity has shown that there is still significant interest in distressed private equity. According to the report, 21% of institutional investors view distressed private equity funds as presenting good investment opportunities in the current market and 23% of LPs are looking to invest in these funds in the coming year. Distressed private equity thus represents the second most popular fund type amongst investors, after small to mid-market buyout funds.

Investor Intelligence, which profiles over 4,000 investors in private equity, currently tracks 956 LPs with an interest in distressed private equity funds. We recently interviewed 50 LPs from around the world that have an interest in distressed private equity funds in order to find out about their plans for investment in the sector.

Current Attitudes

There have undoubtedly been plenty of distressed private equity funds for LPs to invest in following the financial crisis and our recent study shows that there is still significant investor interest in the fund type. 35% of LPs we spoke to indicated that their opinion towards distressed private equity has become more positive since the financial downturn and a further 41% said their opinion has remained the same.

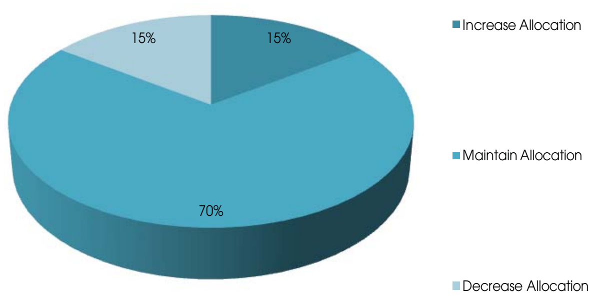
14% of investors we spoke to have become more negative towards distressed private equity. One prominent US investor we spoke to commented: “There is now less fear in the market and investors are being more selective. There are still a lot of good potential deals but we are past the fire sales of 2009.”

We asked investors why they invest in distressed private equity funds, and the responses were mixed. Some investors feel distressed private equity offers good risk-adjusted returns; others feel that there are good pricing opportunities in the distressed private equity market. A number of LPs we spoke to told us they invest in distressed funds in order to diversify their portfolios. An Australian superannuation scheme told us it is attracted to distressed private equity as distressed funds offer “a shorter J-curve, potentially a better fee structure and a good investing environment at the moment,” while a Netherlands-based asset manager stated that “if fund managers can prove they know the trick then it [distressed private equity] can be very profitable.”

As Fig. 1 shows, 85% of LPs that have a specific allocation to distressed private equity are looking to either maintain or increase their allocations in the longer term. One UK-based pension fund aims to increase its allocation to distressed private equity because it feels there are “better opportunities due to the amount of leverage used over the last five years.”

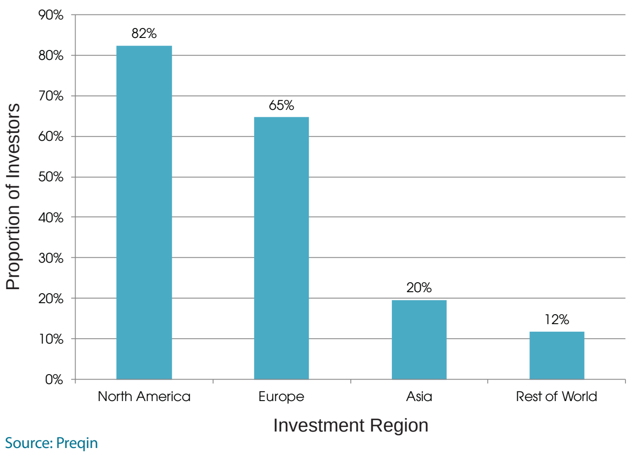
15% of the LPs we spoke to are aiming to decrease their allocations to distressed private equity in the long term. One public pension fund intends to decrease its allocation as it feels that “the number of distressed opportunities will just decrease in the next few years.” A UK private pension fund stated: “Large distressed commitments made in 2010 and 2011 will ultimately

Fig. 1: Investors’ Intentions for Their Distressed Private Equity Allocations in the Longer Term



Source: Preqin

Fig. 2: Regions Viewed by Investors in Distressed PE as Presenting Good Opportunities for Distressed Private Equity Investment



Source: Preqin

run off, and while we will continue to look at distressed private equity and make further commitments, on a net basis they will probably decline.”

Geographical Preferences

As shown in Fig. 2, 82% of LPs we interviewed have a preference for distressed private equity funds targeting North America. One French public pension fund we spoke to invests in distressed private equity vehicles focused on the US because it sees the market as “more mature, efficient and with good investment teams.”

A number of investors also have an appetite for distressed private equity in Europe, which was named as a preference by 65% of LPs. It is interesting to note that several LPs we interviewed are looking to move away from US-focused distressed private equity investments towards opportunities in Europe. One large US public pension fund noted: “[There are] more distressed companies in Europe because of gloom hanging over the EU... [there are] better opportunities to invest there".

Fewer LPs named Asia (20%) and Rest of World (12%) as attractive regions for making distressed private equity investments. One investor we spoke to is deterred from making distressed investments in the regions, stating that: "[There are] fewer distressed debt opportunities and a lack of available managers investing in those areas."

First-Time Funds

LPs appear to be cautious about investing in first-time distressed private equity funds. As Fig. 3 shows, more than half (51%) of LPs said they would not invest in first-time distressed private equity funds. One European pension fund commented: "We would not invest in a first-time distressed debt fund raised by an emerging manager, but would invest in a first-time distressed debt fund if raised by an experienced manager, such as one that has previously raised buyout funds."

39% of LPs would invest or would consider investments in first-time distressed funds, and a further 10% would invest with spin-off teams. One US-based investor, for example, is willing to invest in first-time distressed private equity funds but only with managers which "have the experience, people and talent to produce higher returns."

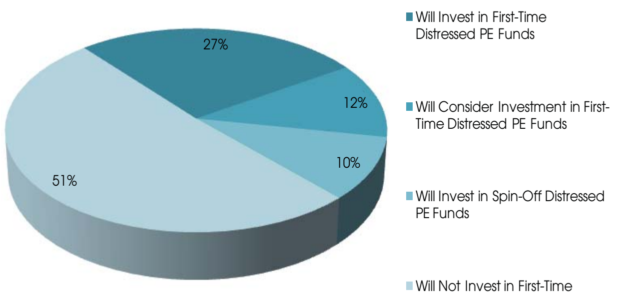
Future Plans

Investors remain positive about the distressed private equity market and expect to continue making new commitments to these funds going forward. As Fig. 4 shows, 29% of respondents plan to make their next commitment to a distressed private equity fund before the end of 2011 and a further 21% will make a new commitment in 2012. It is important to note that more than a third (38%) of LPs we interviewed are looking to commit to the fund type on opportunistic basis.

The majority of investors we spoke to are set to maintain or increase their level of activity in the distressed private equity space, with almost half (49%) of LPs planning to commit the same amount of capital to the fund type in 2011 as they did in 2010. A significant 26% of LPs intend to commit more capital to distressed private equity overall in 2011 in comparison to 2010, and 4% told us they did not make new commitments to distressed private equity funds in 2010 but will be active in 2011.

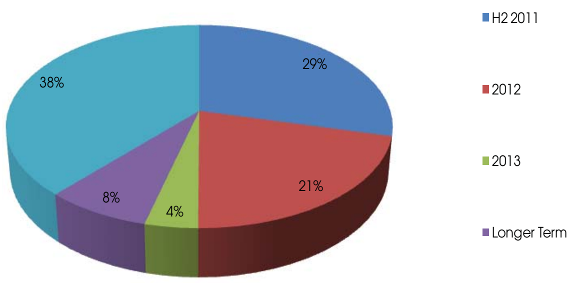
A European LP we spoke to, for example, includes distressed private equity as part of its overall strategy and is aiming to commit the same amount in 2011 as it has done in the previous years: "We commit on average to one to two new distressed funds per year." Another UK pension fund is very positive about the current distressed market and anticipates committing more capital to distressed private equity this year than in 2010. It intends to invest more in 2011 for "macro reasons and the market outlook, particularly in Europe."

Fig. 3: Proportion of Investors in Distressed PE That Will Consider Investing in First-Time Distressed Private Equity Funds



Source: Preqin

Fig. 4: Investors' Timeframes for Next Commitment to Distressed Private Equity Funds



Source: Preqin

Data Source:

Preqin Investor Intelligence is the industry's leading source for profiles of institutional investors in private equity funds. Investor Intelligence contains over 4,000 detailed profiles for all types of institutions from all regions worldwide, all updated as a result of direct communication with our large team of multi-lingual analysts to ensure all profiles are accurate and contain exclusive, extensive intelligence.

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The Role of Distressed Private Equity

The Role of Distressed Private Equity

Since the pioneering distressed private equity funds launched in the 1980s, vehicles investing in securities of companies facing financial distress or bankruptcy have made a relatively small, but vital, contribution to the private equity marketplace.

While the returns of more traditional private equity fund types such as buyout and venture capital are generally positively correlated to economic growth, the reverse is true for distressed private equity funds; the constriction of the credit markets and slowdown in economic growth in general has equated to an abundance of viable distressed private equity investment opportunities for fund managers.

Two economic events that produced favourable market conditions for distressed private equity firms in the last decade are evident in Fig. 5. Capital raised by distressed private equity funds annually as a proportion of overall private equity fundraising doubled in 2002 from the previous year, with 23 funds raising $10.8bn, due to investors looking to take advantage of the technology bubble crisis. More recently, the long-lasting effects, and opportunities, resulting from the credit crisis is shown from 2008 onwards. In 2010, distressed private equity funds amassed $26.5bn, equating to 10% of the capital raised that year. In the period January to August 2011, distressed private equity fundraising again accounted for 10% of overall private equity capital raised.

Investor Sentiment

The growth of in the proportion of overall capital of fundraising accounted for by distressed private equity fund managers in recent years reflects the positive LP attitude towards distressed private equity investments since the financial crisis of 2008.

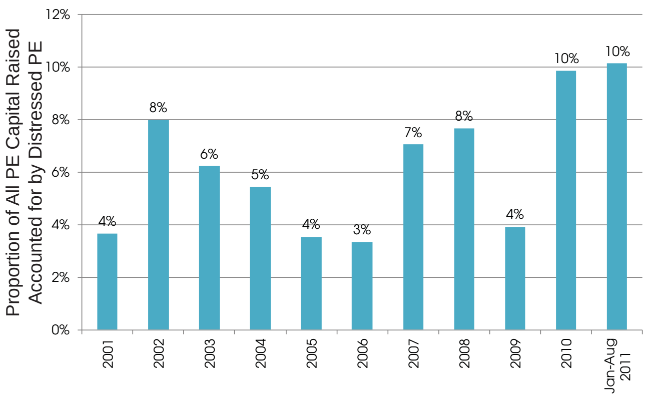
Preqin Investor Outlook: Private Equity H2 2011, based on a June 2011 survey of LPs, reveals there is still significant LP interest in distressed private equity. Distressed private equity represented the second most desirable fund type amongst LPs, after small to mid-market buyout funds. 21% of the investors interviewed stated that distressed private equity funds provide the best investment opportunities at present, and 23% said they would be looking to invest in distressed private equity funds over the following 12 months.

Globalization of Distressed Private Equity Market

Due to often complex and varied nature of the investments and the significant impact of local laws and regulations, private equity firms and investors have preferred to focus on distressed debt and restructuring opportunities in the established North American market. As shown in Fig. 6, the proportion of total capital raised annually that was raised by North America-focused funds rarely fell below 80% in the last decade; however, there is also evidence that geographic diversification can be achieved in a distressed private equity portfolio, especially in recent years.

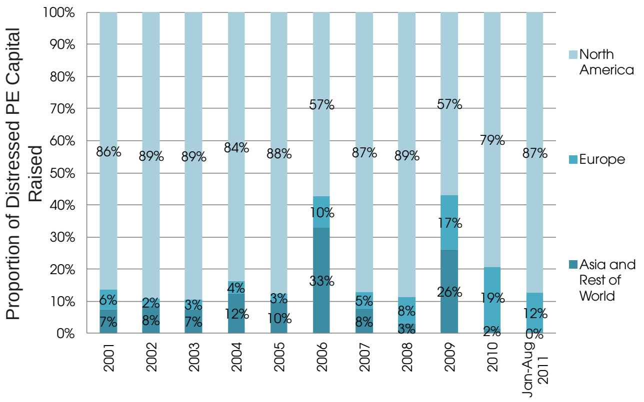
In 2009, non-North America-focused funds accounted for 43% of the aggregate capital raised, with Europe and Asia and Rest of World funds contributing $2.0bn and $3.1bn respectively. Significant funds that focus on regions outside of North America include the $3bn Avenue Asia Special Situations Fund IV, raised by Avenue Capital Group in 2006, which accounted for half of the capital raised by Asia and Rest of World-focused funds that year.

Fig. 5: Annual Proportion of Private Equity Capital Raised by Distressed Private Equity Fund Managers



Source: Preqin

Fig. 6: Breakdown of Distressed Private Equity Capital Raised by Primary Regional Focus



Source: Preqin

Outlook

The countercyclical nature of distressed private equity investments, compared both to more traditional private equity sectors and to the economy as a whole, means that funds of this type add significant diversification to investors' private equity portfolios. Distressed private equity funds will thus continue to have an important role to play in the future, providing returns at different points in the economic cycle to buyout and venture funds.

North America will remain the region of focus for the majority of distressed private equity funds over the medium term, meaning competition for mispriced debt and suitable restructuring opportunities in the region is likely to intensify if economic conditions improve. However, the sovereign debt crisis in Europe is likely to cause the pipeline of distressed opportunities in the developed economies of the world to continue to flow.

Review of Distressed Private Equity Fundraising 2004 - August 2011

Fig. 7 shows distressed private equity fundraising increased year on year between 2004 and 2008, reaching a peak of $52.1bn raised by 39 funds in 2008. The lack of investor confidence in the wake of the financial downturn meant that, along with the rest of the private equity industry, distressed private equity fundraising was not able to reach the same levels in 2009.

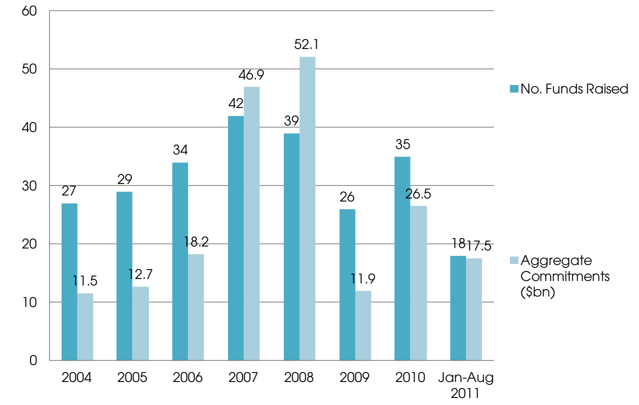
However, 2010 saw a strong recovery in distressed fundraising, demonstrating investor appetite for this area of the market when economic conditions are tough. Over the course of the year, 35 funds closed with aggregate commitments of $26.5bn. Fundraising was also relatively robust in the period January to August 2011, with 18 funds reaching a final close on an aggregate $17.5bn.

Fig. 8 shows that distressed private equity funds which closed after the onset of the financial crisis spent a longer period of time in market than those that closed prior the crisis. Nearly three-quarters of distressed funds that closed in 2004-2008 spent less than one year in market, whereas the figure falls to 33% for funds closed in 2009 to August 2011, with the remaining 67% spending up to two years on the road. However, on average, distressed private equity funds that closed in 2009 to August 2011 spent less time in market than other types of private equity fund closing in the same period. Distressed private equity funds spent an average of 15 months on the road, as opposed to 18 months for all other fund types.

Further evidence of the challenging fundraising conditions endured by distressed private equity fund managers can be seen in Fig. 9, with 50% and 46% of funds closing below target in 2009 and 2010 respectively. However, fundraising conditions do appear to be improving, with 67% of funds closed this year having achieved or exceeded fundraising targets.

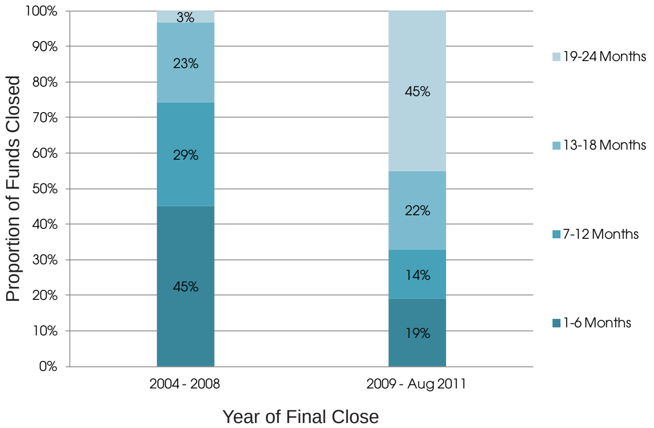
The table overleaf (Fig. 10) shows that eight of the 10 largest distressed private equity funds ever to close completed the fundraising process in 2007 or 2008, contributing to those years being the strongest to date for distressed private equity fundraising in terms of capital raised. Two of the largest distressed private equity funds that feature in the table are managed by Oaktree Capital Management, including the largest distressed private equity vehicle ever to close: OCM Opportunities Fund VIIB.

Fig. 7: Annual Distressed Private Equity Fundraising, 2004 - August 2011



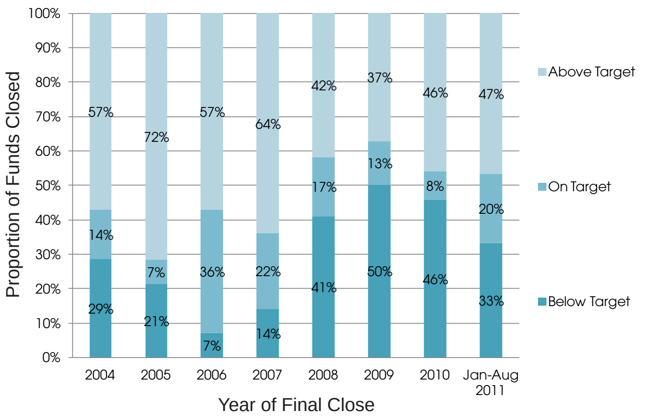
Source: Preqin

Fig. 8: Breakdown of Time Spent on the Road by Distressed Private Equity Funds



Source: Preqin

Fig. 9: Annual Breakdown of Final Close Size Relative to Initial Target, Distressed Private Equity Funds Closed 2004 - August 2011



Source: Preqin

Fig. 10: Top 10 Distressed Private Equity Funds Raised All Time by Final Close Size

Fund	Fund Manager	Fund Type	Final Close Size (mn)	Year Closed	Manager Location	Fund Focus
OCM Opportunities Fund VIIB	Oaktree Capital Management	Distressed Debt	7,900 USD	2008	US	US
Cerberus Institutional Partners (Series Four)	Cerberus Capital Management	Distressed Debt	7,500 USD	2007	US	US
Avenue Special Situations V	Avenue Capital Group	Distressed Debt	6,000 USD	2008	US	US
CarVal Global Value Fund	CarVal Investors	Distressed Debt	5,750 USD	2007	US	US
Sun Capital Partners V	Sun Capital Partners	Turnaround	5,000 USD	2007	US	US
MatlinPatterson Global Opportunities III	MatlinPatterson Global Advisors	Distressed Debt	5,000 USD	2007	US	US
TPG Financial Partners	TPG	Turnaround	4,500 USD	2008	US	US
OCM Opportunities Fund VIII	Oaktree Capital Management	Distressed Debt	4,400 USD	2010	US	US
Centerbridge Capital Partners II	Centerbridge Capital Partners	Distressed Debt	4,400 USD	2011	US	US
WLR Recovery Fund IV	WL Ross & Co	Distressed Debt	4,000 USD	2008	US	US

Source: Preqin

Distressed Private Equity Regional Fundraising 2004 - August 2011

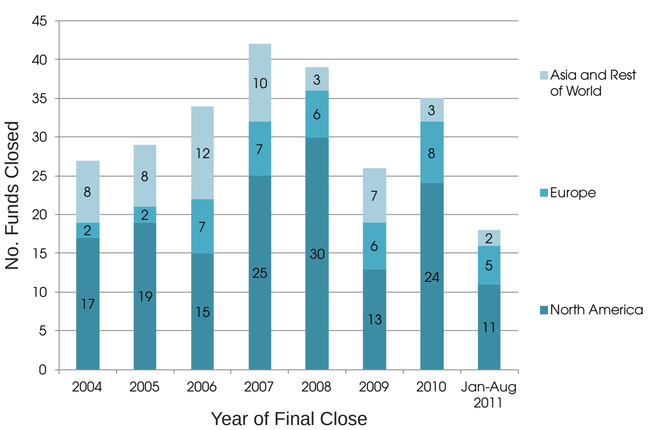
During the period 2004 to August 2011, 250 distressed private equity funds reached a final close, raising a total of $197.3bn in investor commitments. The majority of the capital (82%) was raised by funds primarily focused on investment within North America. The remaining capital raised in the period was split evenly between Europe-focused and Asia and Rest of World-focused vehicles, both raising 9% of aggregate capital raised.

Figs. 11 and 12 show the regional breakdown of distressed private equity fundraising from 2004 to August 2011 by number of funds and aggregate capital raised respectively. Across the period, 154 primarily North America-focused funds, 53 Asia and Rest of World-focused funds, and 43 Europe-focused funds completed their fundraising campaigns. North American fundraising accounts for the largest proportion of distressed private equity fundraising year on year, and peaked in 2008, with 30 funds raising $46.2bn in aggregate capital, equating to 77% of the capital raised that year. Europe-focused funds reached their highest level of fundraising in 2010, with eight vehicles closing on an aggregate $5.1bn in committed capital. Asia and Rest of World funds raised $17.4bn through 53 vehicles holding a final close from 2004 to August 2011, with annual distressed private equity fundraising in the region peaking in 2006 at $6bn in committed capital raised by 12 vehicles.

A breakdown of Asia and Rest of World fundraising shows that Asia-focused funds accounted for the majority, raising $12.6bn in aggregate capital through 40 vehicles. Middle East and Israel-focused funds raised $688mn in committed capital from five vehicles holding a final close, and four funds diversified by region within Asia and Rest of World raised an aggregate $3.8bn. Three Australasia-focused funds raised $259mn, and the Africa International Financial Holdings fund raised $115mn, which was the only Africa-focused distressed private equity fund closure.

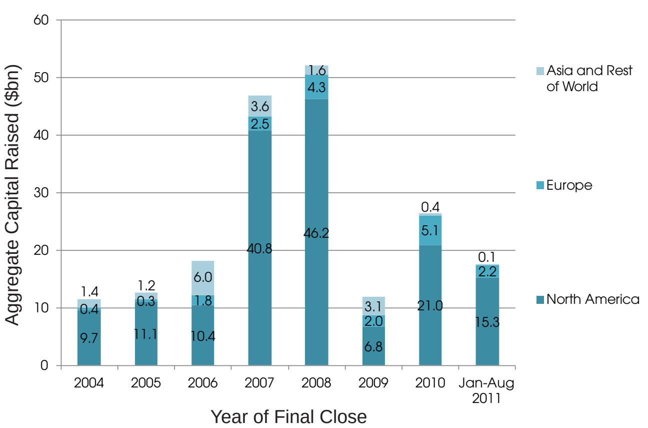
In 2008, Oaktree Capital Management closed both the largest North American-focused and the largest European-focused distressed private equity funds. OCM Opportunities Fund VIIB, a distressed debt fund focusing on investment in the US, closed in May 2008 on $10.9bn in capital commitments; however as the fund's investment period neared an end in January 2010, the firm returned an un-invested $3bn to limited partners. The largest European-focused fund to close is the OCM European Principal Opportunities Fund II. The fund focuses on special situations investments and closed on €1.8bn in July 2008. Avenue Capital Group closed the largest Asia and Rest of World-focused fund during the period 2004 to August 2011, Avenue Asia Special Situations Fund IV, in September 2006. The fund closed on $3bn and is a distressed debt fund concentrating investments within China, India, Philippines and Thailand.

Fig. 11: Number of Distressed Private Equity Funds Closed by Primary Geographic Focus, 2004 - August 2011



Source: Preqin

Fig. 12: Aggregate Capital Raised by Distressed Private Equity Funds by Primary Geographic Focus, 2004 - August 2011



Source: Preqin

Data Source:

Preqin Funds in Market is the industry's leading source of intelligence on private equity fundraising.

This constantly updated resource includes details for all funds of all types being raised worldwide, with key information on target sizes, interim closes, placement agents, lawyers, investors, plus much more all included.

For more information, or to arrange a demo, please visit: www.preqin.com/fim

Distressed Private Equity Fundraising Market by Fund Type

Preqin has categorized distressed private equity investments into three constituent strategy types: distressed debt, turnaround and special situations. A large proportion of distressed private equity fund managers will seek exposure to more than one of the three types, but for the purposes of this analysis, distressed private equity funds have been categorized based on their primary investment focus.

Distressed Debt Funds

Distressed debt funds purchase debt securities that are trading at a distressed level, in anticipation that those securities will have a higher market valuation and generate profit at a future selling point, or take a position to potentially gain control of an asset.

Fig. 13 shows that 122 distressed debt funds have closed between 2004 and August 2011, raising a total of $146.6bn. The aggregate fundraising total increased year on year from 2004 until 2008, when 22 distressed debt funds closed having garnered a record $38bn in commitments. Capital raised by funds closing in 2009 fell by 83% to $6.4bn. Fundraising improved the following year, with the closing of an additional 19 funds on an aggregate $23.4bn. 2011 has also shown promising signs, with the sixth largest distressed debt fund ever raised, Centerbridge Capital Partners II, closing on $4.4bn in August. The fund invests in US-based distressed asset transactions and traditional buyouts.

Distressed debt funds account for 74% of total distressed private equity capital raised from 2004 to August 2011. Special situations and turnaround vehicles have raised 17% and 9% respectively.

Special Situation Funds

Special situations vehicles are those that invest in a broad range of unusual transactions, including equity-linked debt, project finance, one-time opportunities resulting from changing industry trends or government regulations, and leasing.

From 2004 until August 2011, 85 special situations funds closed garnering an aggregate $34.2bn. The highest number of fund closes came in 2007, with 17 special situations vehicles raising $9bn in aggregate capital. Funds closed in 2008 had the largest average fund size ($811mn). The two funds to close in the period January to August 2011 were Altamont Capital Partners Fund I, which raised $500mn to invest in US middle market firms, and Avendus Special Situation Fund II, which raised $40mn to invest in India.

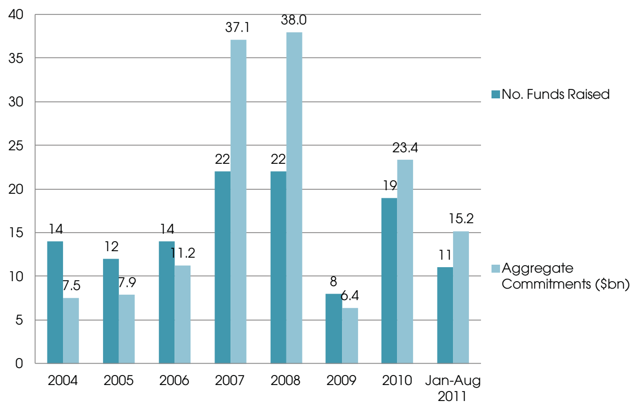
Turnaround Funds

Turnaround funds aim to revitalize companies with poor performance, in distress, or experiencing trading difficulties.

In the period from 2004 to August 2011, 43 turnaround vehicles reached a final close having raised a collective $16.6bn in commitments from investors. 2008 was the most successful year for fundraising, with eight funds raising $6.9bn, the largest being TPG Financial Partners. The fund initially raised $6bn, but cut back in size to $4.5bn in January 2009.

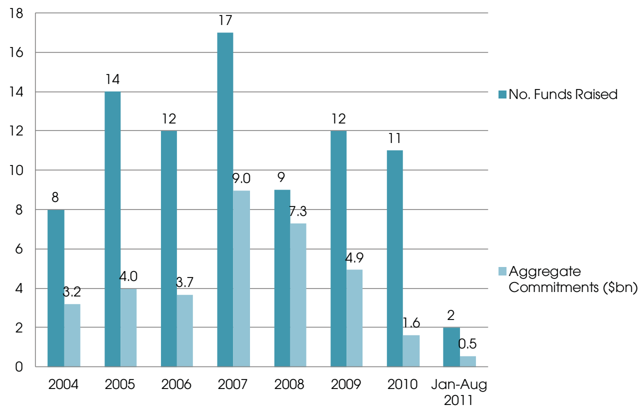
Five turnaround funds closed in the period January to August 2011; the largest of these is Tennex Capital Partners Fund,

Fig. 13: Annual Distressed Debt Fundraising, 2004 - August 2011



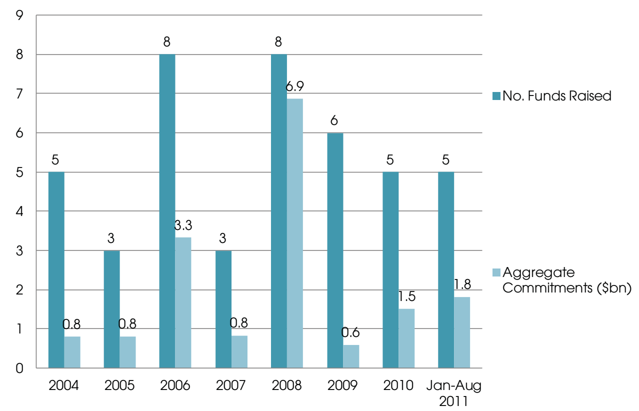
Source: Preqin

Fig. 14: Annual Special Situations Fundraising, 2004 - August 2011



Source: Preqin

Fig. 15: Annual Turnaround Fundraising, 2004 - August 2011



Source: Preqin

which closed on $452mn, $52mn above its target. It invests in underperforming middle market companies that are experiencing financial or operational difficulty.

Fig. 16: Five Largest Distressed Debt Funds to Close between 2004 and August 2011

Fund Name	Firm Name	Close Date	Final Size (mn)
OCM Opportunities Fund VIIB	Oaktree Capital Management	May-08	7,900 USD
Cerberus Institutional Partners (Series Four)	Cerberus Capital Management	May-07	7,500 USD
Avenue Special Situations V	Avenue Capital Group	Jun-08	6,000 USD
CarVal Global Value Fund	CarVal Investors	Feb-07	5,750 USD
MatlinPatterson Global Opportunities III	MatlinPatterson Global Advisors	Jul-07	5,000 USD

Source: Preqin

Fig. 17: Five Largest Special Situations Funds to Close between 2004 and August 2011

Fund Name	Firm Name	Close Date	Final Size (mn)
OCM European Principal Opportunities Fund II	Oaktree Capital Management	Jul-08	1,759 EUR
Mount Kellett Fund I	Mount Kellett Capital Management	Jun-09	2,500 USD
Crestview Capital Partners II	Crestview Partners	Nov-08	2,400 USD
Special Value Opportunities Fund	Tennenbaum Capital Partners	Sep-04	2,000 USD
KPS Special Situations Fund III	KPS Capital Partners	May-07	2,000 USD

Source: Preqin

Fig. 18: Five Largest Turnaround Funds to Close between 2004 and August 2011

Fund Name	Firm Name	Close Date	Final Size (mn)
TPG Financial Partners	TPG	Feb-08	6,000 USD*
Sun Capital Partners V	Sun Capital Partners	Apr-07	5,000 USD
Corsair Capital III	Corsair Capital	May-06	1,073 USD
Brookfield Special Situations Fund II	Brookfield Special Situations Group	Jun-08	1,000 USD
Sator Private Equity Fund A	Sator	Mar-10	500 EUR

** The fund initially raised $6bn, but cut back in size to $4.5bn in January 2009*

Source: Preqin

Current Distressed Private Equity Fundraising Market

As of August 2011 there were 62 distressed private equity funds in market targeting aggregate capital commitments of $42.6bn. These figures represent a 7% increase in the number of distressed funds on the road and a 12% increase in the aggregate capital sought compared to August 2010. The largest fund currently seeking commitments is OCM European Principal Opportunities Fund III, which is focused on investment in troubled companies headquartered in Europe and is seeking €3bn from investors.

Fig. 19 shows the number of funds in market and the aggregate capital sought in August each year between 2006 and 2011. The number of funds in market has increased year on year from 2007, when 32 funds were on the road, to 2011, with 62 funds in market seeking capital from investors. 2009 was the peak year in terms of aggregate capital sought by distressed funds in market, with the 48 funds that were on the road at the time seeking a collective $46.9bn in commitments.

As shown in Fig. 20, in terms of the primary regional focus of distressed private equity funds currently on the road, 30 primarily North American-focused funds are seeking $27.2bn in capital commitments, representing 48% of the total number of funds raising and 64% of aggregate capital sought. The largest North America-focused fund currently in market is WLR Recovery Fund V. The fund is seeking a total of $4bn in investor capital for investment in the restructuring of US-based, financially distressed companies.

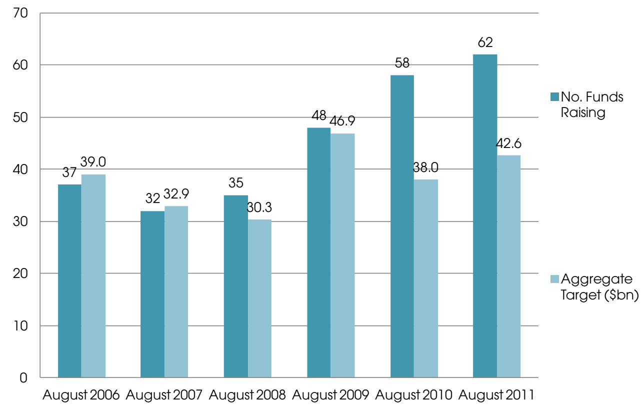
Primarily Europe-focused and primarily Asia and Rest of World-focused funds each account for 16 funds currently on the road, with the Europe-focused funds seeking a total of $11.1bn and the Asia and Rest of World-focused funds targeting an aggregate $4.3bn. The largest fund focused on Asia and Rest of World currently in market is Clearwater Capital Partners Fund IV. The fund is targeting $900mn and will look to create a diversified, cash-generative and non-correlating portfolio of special situations investments and distressed or otherwise undervalued assets and securities.

Tough fundraising conditions prevailed for private equity firms in 2010 and throughout the majority of 2011, which resulted in many GPs utilizing the services of placement agents to add value to their fundraising process. 63% of distressed private equity funds currently raising have enlisted the services of a placement agent.

Fundraising Outlook

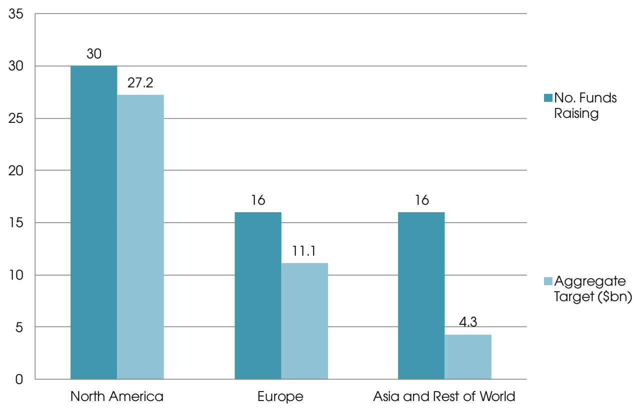
Distressed private equity fundraising has remained resilient throughout the fundraising downturn and its prospects look promising for the remainder 2011 and into 2012, with uncertain economic conditions ensuring that there is a strong pipeline of distressed private targets. When looking at funds currently raising, it is important to observe the capital already available for investment from those 45% of funds that have already held at least one interim close; these funds have closed $6.2bn in commitments so far. With 67% of distressed funds that have closed in January to August 2011 closing on or above target, 2011 looks set to be a strong year for distressed private equity fundraising.

Fig. 19: Distressed Private Equity Funds in Market over Time, 2006 - 2011



Source: Preqin

Fig. 20: Composition of Distressed Private Equity Funds on the Road by Fund Primary Geographic Focus



Source: Preqin

Fig. 21: Top Five Distressed Private Equity Funds Currently Raising by Target Size

Fund Name	Firm Name	Fund Type	Primary Geographic Focus	Target Capital Amount (bn)	Manager Location
OCM European Principal Opportunities Fund III	Oaktree Capital Management	Special Situation	Europe	3.0 EUR	US
WLR Recovery Fund V	WL Ross & Co	Distressed Debt	US	4.0 USD	US
Cerberus Institutional Partners (Series Five)	Cerberus Capital Management	Distressed Debt	US	3.8 USD	US
Third Avenue Fund I	Third Avenue Management	Distressed Debt	US	3.0 USD	US
Avenue Europe Special Situations Fund II	Avenue Capital Group	Distressed Debt	Europe	1.5 EUR	US

Source: Preqin

Distressed Private Equity Fund Managers

Distressed Private Equity Firms by Location

The distressed private equity fund manager universe has always been heavily weighted towards North America, emulating the geographic distribution of the wider private equity firm universe. As of September 2011, of the 469 firms active within the distressed private equity space, North America was home to 57%, with 253 (54%) firms based in the US. Including the 57 UK-based firms, Europe accounts for 28% of the distressed private equity manager universe. Fund managers based in Asia and Rest of World account for 15% (Fig. 22).

Strategy Preferences

The majority of firms in the current distressed private equity universe utilize more than one of the investment types featured in Fig. 23. The turnaround strategy is the most popular, with 261 (56%) firms targeting such investments. The proportions of firms including special situations and distressed debt stand at 50% and 46% respectively.

Securities Preferences

Distressed private equity firms place great emphasis on types of securities they purchase in a distressed company. As Preqin data reveals (Fig. 24), 37% of fund managers seek to purchase equity securities in a prospective portfolio company. Just under a third of distressed private equity firms look to invest in subordinated debt, mezzanine or senior loans and around a fifth of fund managers include principal equity and senior secured loans in their investment preferences.

Fund Manager Experience

Of the 469 firms investing in the distressed private equity sector, 179 manage distressed private equity funds. As shown in Fig. 25, over half of the firms managing funds have raised just one vehicle. However, 41% of these firms also have experience in raising other types of funds, including buyout and mezzanine, that may also offer distressed debt or restructuring investment exposure. Firms that have raised two or three distressed private equity funds account for 36% of all distressed private equity fund managers.

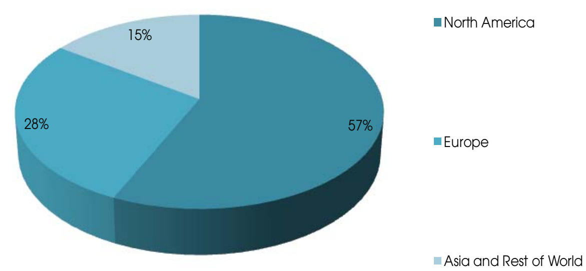
The largest player in the distressed private equity fund market, both in terms of number of funds and amount of capital raised, is Oaktree Capital Management. The firm specializes exclusively in alternative and inefficient investment markets and emphasizes an opportunistic, value-oriented and risk-controlled approach to investment niches in a range of sectors.

Distressed Private Equity Dry Powder

As shown in Fig. 26, the volume of estimated dry powder available to distressed private equity firms increased each year between 2004 and 2007, rising from $18.5bn in December 2004 to $57.7bn in December 2007.

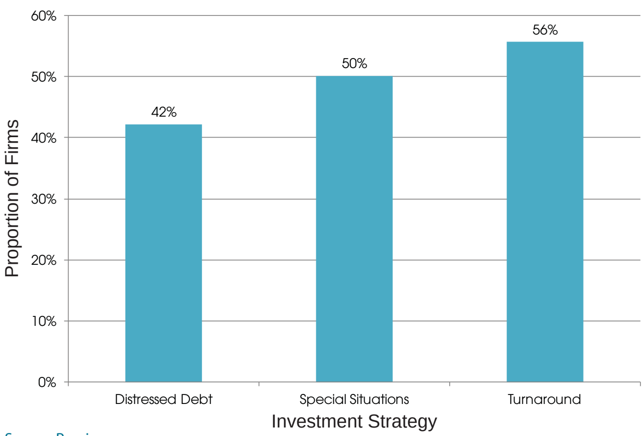
The global economic downturn in 2008 presented distressed private equity funds with an increased number of investment opportunities. As shown in Fig. 26, the amount of dry powder decreased by nearly $7bn from the previous year, despite the strong fundraising that year. The amount of dry powder available to distressed private equity managers rose again in 2009 and reached its peak in 2010 at nearly $65bn.

Fig. 22: Breakdown of Distressed Private Equity Firms by Region



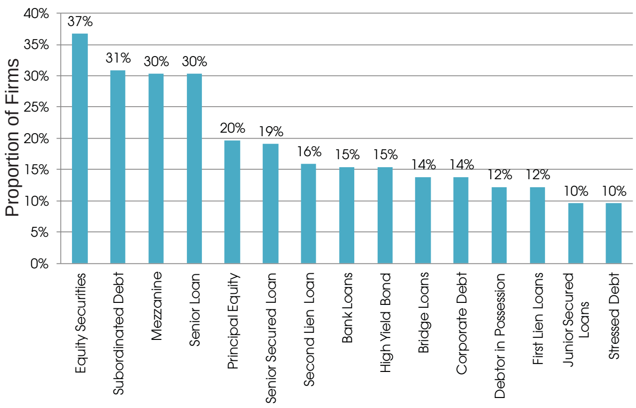
Source: Preqin

Fig. 23: Investment Focus of Distressed Private Equity Firms



Source: Preqin

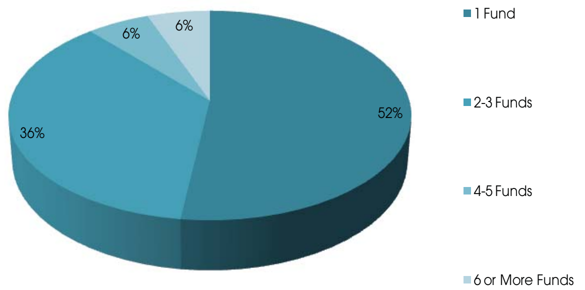
Fig. 24: Proportion of Distressed Private Equity Firms Investing in Each Type of Security



Source: Preqin

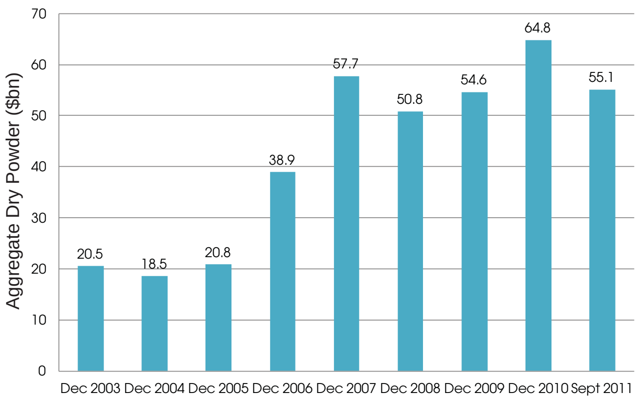
Preqin estimates that as of September 2011 the amount of dry powder available to distressed private equity funds stands at $55.1bn; 63% of that capital is held by distressed debt funds, 25% is at the disposal of special situations fund managers, and the remainder is available to turnaround funds.

Fig. 25: Breakdown of Distressed Private Equity Firms by Number of Funds Raised



Source: Preqin

Fig. 26: Dry Powder Available to Distressed Private Equity Funds over Time, 2003 - 2011



Source: Preqin

Fig. 27: Top 10 Distressed Private Equity Firms by Aggregate Capital Raised

Firm Name	Number of Funds Raised	Aggregate Capital Raised ($bn)
Oaktree Capital Management	29	45.0
Avenue Capital Group	11	16.5
Cerberus Capital Management	5	10.9
Centerbridge Capital Partners	3	9.6
MatlinPatterson Global Advisors	3	8.9
Sankaty Advisors	5	8.2
WL Ross & Co	9	7.3
Angelo, Gordon & Co	7	7.3
Sun Capital Partners	5	7.2
CarVal Investors	2	6.6

Source: Preqin

Distressed Private Equity Funds of Funds

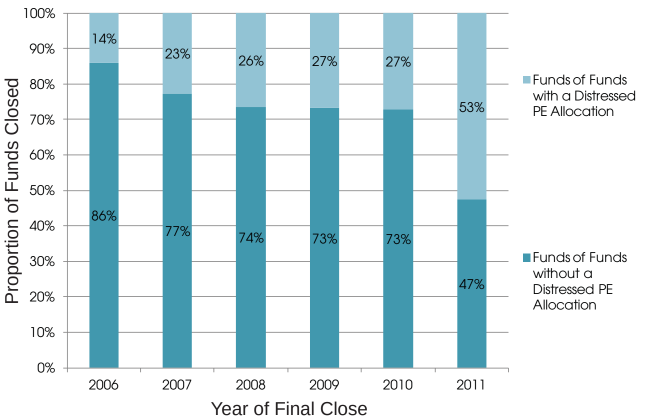
Distressed private equity has attracted increasing interest from institutional investors over the past few years. In order to meet investors' demands to gain exposure to distressed private equity, increasing numbers of fund of funds managers are now allocating capital to this area of the market.

Fig. 28 illustrates the proportion of funds of funds raised since 2006 which have the capacity to invest in distressed private equity funds. While the overall number of funds of funds raised has declined each year since 2007, the proportion that have an allocation to distressed private equity funds has gradually increased. This is likely to be a reflection of the heightened interest shown by institutional investors in distressed private equity in the wake of the financial crisis. One fund of funds manager which has been particularly active in the distressed private equity market during this period is Goldman Sachs Private Equity Group. The firm manages a series of funds of funds dedicated to investing in distressed private equity, its latest being GS Distressed Opportunities Fund IV, which closed in 2008 having collected $1.95bn in investor commitments.

In order to satisfy investor appetite for distressed private equity going forward, fund of funds managers are continuing to allocate capital to such funds. As of September 2011, there were 31 funds of funds on the road with an allocation to distressed private equity, accounting for 21% of all fund of funds vehicles seeking capital. Funds of funds with a distressed private equity allocation are seeking to raise an aggregate $10.7bn from investors. The majority (58%) are primarily seeking distressed private equity opportunities in North America, 23% are mainly focused on investing in Asia and Rest of World, and 19% are primarily focused on Europe.

There are several fairly large funds of funds currently seeking capital that will invest in distressed private equity, and Fig. 29 shows the 10 largest of these. Siguler Guff Distressed Opportunities Fund IV has the largest fundraising target. The fourth vehicle in Siguler Guff's distressed fund of funds series is seeking distressed private equity opportunities on a global scale.

Fig. 28: Proportion of Funds of Funds Raised with Allocations to Distressed Private Equity Funds, 2006 - September 2011



Source: Preqin

Fig. 29: Top 10 Largest Funds of Funds in Market That Will Invest in Distressed Private Equity Funds

Fund Name	Firm Name	Target Size (mn)	Manager Country
Siguler Guff Distressed Opportunities Fund IV	Siguler Guff	1,500 USD	US
Morgan Stanley Private Markets Fund V	Morgan Stanley Alternative Investment Partners	1,250 USD	US
Euro Choice V	Akina	720 EUR	Switzerland
Portfolio Advisors Private Equity Fund VII	Portfolio Advisors	900 USD	US
MB Special Opportunities Fund	MB Global Partners	750 USD	US
Northgate V	Northgate Capital	750 USD	US
Evolution Capital Partners II	Evolution Capital Partners (ECP)	500 USD	US
HarbourVest Partners IX - Credit	HarbourVest Partners	500 USD	US
PineBridge Private Equity Portfolio VI	PineBridge Investments	500 USD	US
Access Capital Fund V - Growth Buyout Europe	Access Capital Partners	350 EUR	France

Source: Preqin

Distressed Private Equity Performance

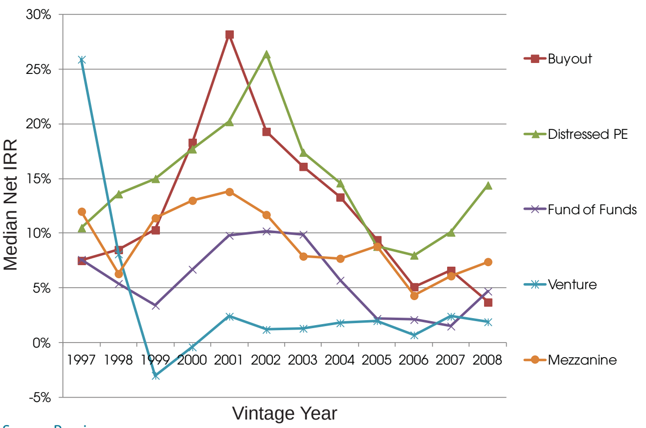
In order to gauge the performance of the distressed private equity sector, Preqin has analyzed the returns of distressed debt, special situations and turnaround funds. Preqin currently holds net-to-LP, fund-level data for over 200 distressed private equity funds. Using this data, we have been able to provide insight into the performance of the distressed private equity sector and give a comparison of its returns against other strategies.

Fig. 30 shows the median net IRRs by vintage year for each private equity strategy. The median returns of all fund types have remained positive across all vintage years with the exception of venture, which is showing median returns in the red for vintage years 1999 and 2000. The median IRRs for distressed private equity range from 8.0% to 26.4%, with the highest median net IRR being achieved by vintage 2002 funds. For vintages 2001-2005, median returns achieved by distressed private equity funds display a similar trend to returns generated by buyout funds. It is notable that for vintage years 2006-2008, distressed private equity funds have seen higher median net IRRs than all other fund types, with the onset of the financial crisis in 2008 providing many opportunities for fund managers in this sector.

Fig. 31 gives an indication of the risk versus the return across different private equity strategies for funds with vintages 1999-2008. It should be noted that this analysis has been conducted independently for each strategy and not in the context of a wider portfolio. The size of each sphere on the graph represents the total commitments made to each fund type. The risk and return of each strategy is measured by the standard deviation and median net IRR respectively. By plotting each sphere with its respective risk and return values, the spheres closer to the bottom right of the graph indicate the most favourable strategies. The graph shows that distressed private equity has the highest potential return of the strategies shown, with a median net IRR of 14.4%. With this return comes a higher level of risk relative to other fund types, as indicated by a standard deviation of 17.5%. This suggests that distressed private equity represents a higher-risk strategy than fund of funds, mezzanine and venture, but one that can offer potentially higher returns. It should be noted, however, that even though there are significant trade-offs between risk and return for each strategy, there is an even greater variation between the best and worst performing managers within each fund type and therefore the assessment should be made with this context in mind.

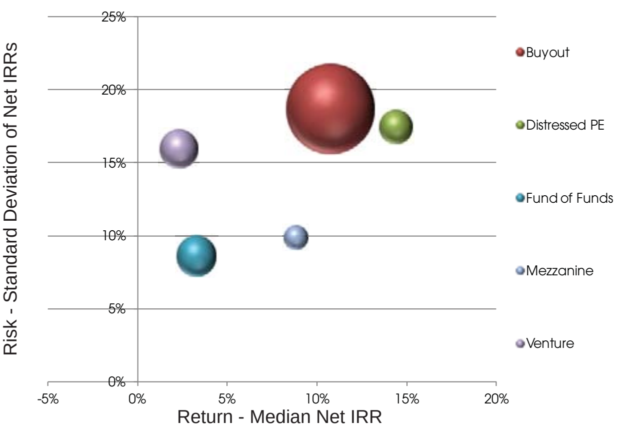
The net IRR dispersion of distressed private equity funds by vintage year is shown in Fig. 32. The highest net return is being generated by a vintage 2002 fund with a net IRR of 79.1%. The lowest return is being generated by a vintage 2006 fund with a net IRR of -64.5%; however, this figure is very much an outlier as the majority of funds across all vintage years are showing positive returns. It should be noted that funds with more recent vintages are still early in their fund lives and performance will change as fund managers look to add value to their investments.

Fig. 30: Median Net IRRs by Vintage Year



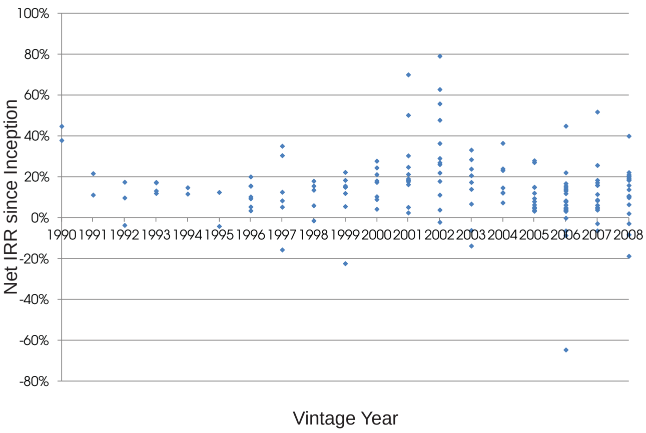
Source: Preqin

Fig. 31: Risk and Return by Fund Strategy (Vintages 1999 to 2008)



Source: Preqin

Fig. 32: Distressed Private Equity - Net IRR Dispersion by Vintage Year



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