The Q2 2016

Preqin Quarterly Update

Private Debt

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

Content includes...

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Private debt fundraising rebounds in Q2.

Funds in Market

Distressed debt funds are seeking the most capital.

Institutional Investors

Europe looks set to be the most sought-after region in the year ahead.

Dry Powder

Private debt dry powder reaches a record $199bn.

Plus, Special Guest Contributors:
Campbell Lutyens

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Foreword - Ryan Flanders, Preqin

Twenty-six private debt funds reached a final close in Q2 2016, securing a total of $15.7bn in commitments globally. The vast majority of capital raised ($15.6bn) continues to be focused on opportunities within Europe and North America, and with 46% and 43% of investors respectively targeting the regions in the next 12 months, these already established private debt markets are likely set for further growth. There are 247 private debt funds currently in market, targeting an aggregate $141bn in capital commitments, suggesting that attracting investor capital in the year ahead will be competitive.

Direct lending funds, the most sought-after strategy for investors in the upcoming year, maintained successful fundraising figures in Q2, with 11 vehicles securing an aggregate $9.0bn in commitments, by far the most of any strategy in the asset class in the quarter. The three largest funds closed were direct lending vehicles from Ares Management, Babson Capital Management and Czech Asset Management, which held a final close for SJC Onshore Direct Lending Fund III on more than $1.7bn in May 2016.

With record dry powder levels for both North America- and Asia-focused funds contributing to the industry-wide record of $199bn as of June 2016, it will be vital for capitalized fund managers to continue accessing quality lending opportunities across global private markets to provide consistent returns to their investors.

Preqin's **Private Debt Online** is an indispensable tool for all firms looking to market funds, develop new business or find new partners in the coming months. Behind every data point in this report is a wealth of individual firm- and fund-level data available on Preqin's leading online services. We hope you find this report useful, and welcome any feedback you may have. For more information, please visit www.preqin.com or contact info@preqin.com.

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Data Source:

Private Debt Online is the leading source of data and intelligence on the growing private debt industry. This comprehensive resource tracks all aspects of the asset class, including fund managers, fund performance, fundraising, institutional investors and more.

Constantly updated by our team of dedicated researchers, **Private Debt Online** represents the most complete source of industry intelligence available today, with global coverage and all fund managers and investors profiled.

For more information, please visit: www.preqin.com/privatedebt

Appreciating the Illiquidity Trend in Leveraged Credit Markets

- Jeffrey Griffiths, Principal,
Campbell Lutyens & Co. Ltd.

Recent volatility in leveraged credit markets highlights the importance of carefully considering fund structures and the liquidity of underlying assets when making investment decisions. The Global Financial Crisis (GFC) demonstrated the robustness of closed-end vehicles such as collateralized loan obligations as resilient structures for managing leveraged loans and other sub-investment-grade credit products. Further episodes of credit market volatility during the 2012 Greek sovereign debt crisis and the recent contraction in commodity prices have shown that liquidity in leveraged loans and high-yield bonds may be more of a myth than a reality. The forced liquidation of Third Avenue Management's Focused Credit Fund in December 2015 served as a stark reminder to investors in leveraged credit that a fund's structure and market price volatility can be more of a catalyst for losses than any underlying deterioration in portfolio credit quality.

Institutional investors that seek exposure to sub-investment-grade credit have a spectrum of more and less liquid products from which to choose. The recent shift of leveraged credit markets from publicly traded, broadly syndicated instruments to more private, illiquid ones has been primarily caused by new banking regulations and capital requirements which penalize banks for holding sub-investment grade corporate credit. Despite the best efforts of central banks to encourage banks to lend to the "real economy," this liquidity has often struggled to meet the capital requirements of middle-market corporates.

This development of bank retrenchment, already well underway in the US before the GFC, and now firmly implanted in Europe, has led to a decrease in market-making for leveraged credit instruments and a growth in the stock of debt purchased by investment vehicles such as "direct lending" funds. Despite record amounts of liquidity provided by the ECB's quantitative easing and expanded asset purchase programmes, it is a serious sign that liquidity in European leveraged credit markets has deteriorated. This demonstrates that the pressure of regulatory and capital demands on banks has outweighed the benefits of lower interest rates and increased liquidity from monetary authorities.

After reaching multi-year highs during the financial crisis, bid-ask spreads in European high-yield bonds, as measured by the MarketAxess BASI index, decreased to a low point of 80 basis points in 2014, but have since risen steadily in the past year to around 120 basis points[1]. As highlighted in a recent FINRA report[2], after their first 90 days in the secondary market, par trading volume in newly issued US corporate bonds fell by 38% in 2015. This reduction in trading volume is 250% faster than occurred in 2007 (14.5% decline)[3]. Only 4% of high-yield bonds were traded electronically on the secondary market in 2014[4]. A lower percentage of trading is occurring as block trades (any trade of $5mn or greater); it is becoming more difficult to execute block-sized trades in the current market.

The emergence of mutual funds and ETFs as holders of leveraged credit may be exacerbating the problem of liquidity in the market. On August 24 2015, the equity markets had one of their most volatile days since the "Flash Crash" of 6 May 2010. Even the most liquid ETF funds were severely affected. For example, the SPDR Barclays High Yield Bond ETF experienced a volatility jump equal to 30 times its "normal" trading levels[5]. In a recent academic study[6], it was shown that open-ended corporate bond fund outflows are sensitive to bad performance more than their inflows are sensitive to good performance. They also tend to have greater sensitivity of outflows to bad performance when they have more illiquid assets and when the overall market illiquidity is high. This relationship may generate a "first mover" advantage among investors in open-ended funds, amplifying their response to bad performance and volatility in the fund's net asset value.

Given this context of increased illiquidity, it is important for investors to choose the optimal structure within which to hold sub-investment grade corporate credit. The growth of private debt funds, structured as closed-end limited partnerships with defined investment and harvest periods, is a natural and appropriate development for a market in which investors can rely less on market liquidity and mark-to-market valuations. These structures can allow investors to gain access to an increasingly illiquid asset class, typically via an experienced manager, without having to suffer the short-term, volatile mark-to-market moves that can strain the market for mutual funds, ETFs and BDCs. They can also allow for opportunistic buying of assets during market drawdowns when other structures may need to forcibly sell assets to meet redemptions.

Institutional investors with a long-term investment horizon are best positioned to benefit from this increased illiquidity. The premium earned for investing in privately arranged, direct lending leveraged credit strategies versus the more broadly syndicated alternatives may be well worth the cost of locking capital into illiquid fund structures.

Campbell Lutyens

Campbell Lutyens is an independent advisory firm founded in 1988 focused on private fund placement and secondary advisory. The firm has offices in London, New York and Hong Kong with a team of over 90 professionals with global and broad-ranging expertise in the private equity, infrastructure and private debt sectors.

www.campbell-lutyens.com

[1] *MarketAxess European BASI, http://www.marketaxess.com/research/basi/basi_europe.php, 8 July 2016*
[2] *Mizrach, Bruce. "Analysis of Corporate Bond Liquidity," FINRA Office of the Chief Economist, Research Note, December 2015.*
[3] *Mizrach, Bruce. "Analysis of Corporate Bond Liquidity," FINRA Office of the Chief Economist, Research Note, December 2015.*
[4] *Mizrach, Bruce. "Analysis of Corporate Bond Liquidity," FINRA Office of the Chief Economist, Research Note, December 2015.*
[5] *Mizrach, Bruce. "Analysis of Corporate Bond Liquidity," FINRA Office of the Chief Economist, Research Note, December 2015.*
[6] *Goldstein, Hao, Ng. Investor Flows and Fragility in Corporate Bond Funds, May 2016.*

Fundraising in Q2 2016

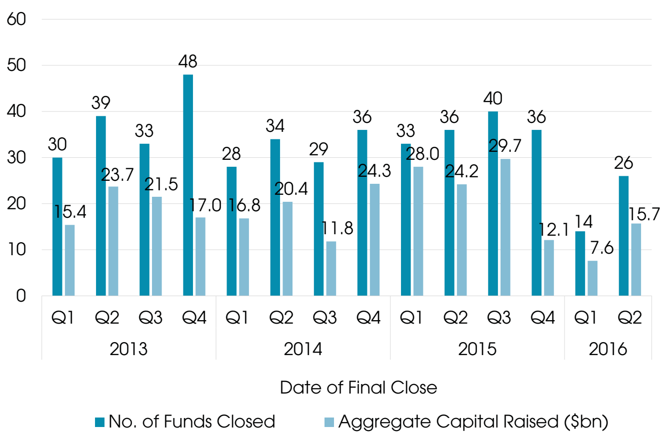
Q2 2016 saw 26 private debt funds reach a final close, securing an aggregate $15.7bn in capital commitments (Fig. 1). This is $8.1bn more than the previous quarter, but represents a significant $8.5bn decrease from the same quarter in 2015.

Fifteen North America-focused and 10 Europe-focused funds closed in Q2 2016, securing $7.2bn and $8.4bn respectively (Fig. 2). The first Asia-focused fund to reach a final close in 2016 was Topaz Private Debt I, securing $92mn in capital commitments.

Direct lending funds closed in Q2 2016 attracted the most investor capital ($9.0bn) and also accounted for the most vehicles closed globally (11, Fig. 3). There were five mezzanine and three distressed debt closures, totalling $2.5bn and $1.8bn respectively.

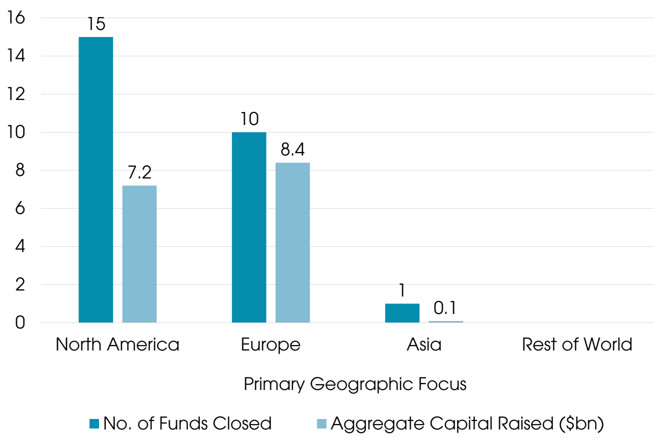
The largest fund closed in Q2 was Ares Capital Europe III, a Europe-focused direct lending vehicle from Ares Management, which reached a final close on $2.8bn in June (Fig. 4). Three of the five largest funds closed in Q2 are direct lending funds, while the remainder are both mezzanine funds.

Fig. 1: Global Quarterly Private Debt Fundraising, Q1 2013 - Q2 2016



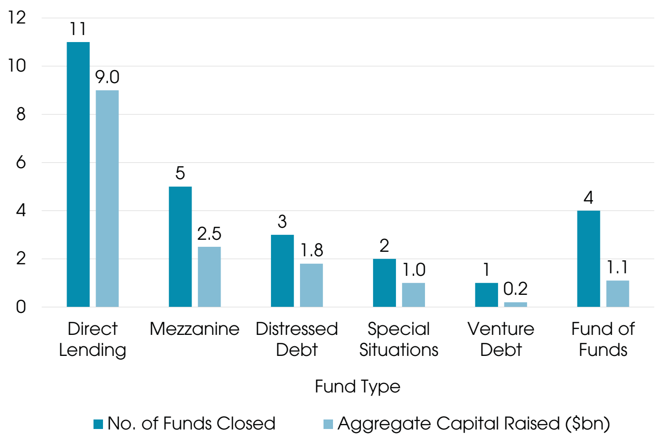
Source: Preqin Private Debt Online

Fig. 2: Private Debt Fundraising in Q2 2016 by Primary Geographic Focus



Source: Preqin Private Debt Online

Fig. 3: Private Debt Fundraising in Q2 2016 by Fund Type



Source: Preqin Private Debt Online

Fig. 4: Five Largest Private Debt Funds Closed in Q2 2016

Fund	Firm	Type	Fund Size ($mn)	Primary Geographic Focus
Ares Capital Europe III	Ares Management	Direct Lending	2,796	Europe
Global Private Loan Fund	Babson Capital Management	Direct Lending	2,000	North America
SJC Onshore Direct Lending Fund III	Czech Asset Management	Direct Lending	1,738	North America
Park Square Capital Partners III	Park Square Capital Partners	Mezzanine	1,367	Europe
BBH Capital Partners V	BBH Capital Partners	Mezzanine	802	North America

Source: Preqin Private Debt Online

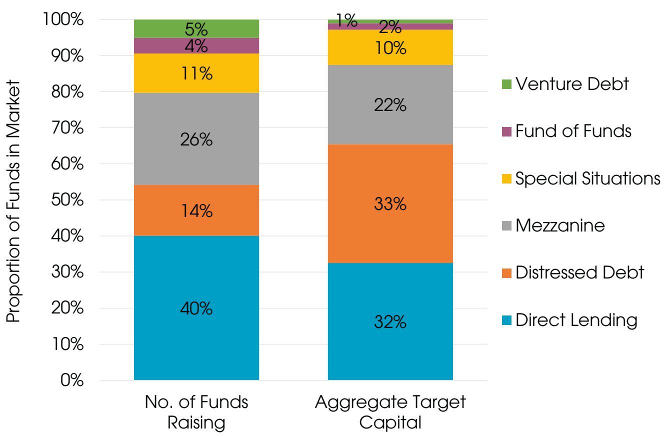
Funds in Market

As of the start of Q3 2016, there were 247 private debt funds in market targeting an aggregate $141bn in capital commitments. Direct lending funds represent the largest proportion (40%) of funds in market by number, while distressed debt funds are seeking the largest proportion of aggregate capital (33%, Fig. 1). Mezzanine and distressed debt funds account for 26% and 14% of funds in market by number respectively.

While the number of private debt funds in market has increased across all regions compared with a year ago, the aggregate capital targeted has decreased for both Europe- and Asia-focused funds, while North America- and Rest of World-focused funds have seen an increase in total capital targeted (Fig. 2).

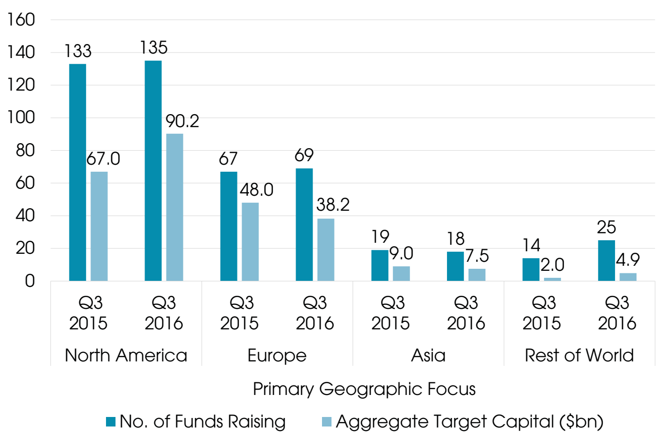
The majority (78%) of private debt funds in market have been seeking capital for two years or less (Fig. 3). In total, 40% of funds have been fundraising for a year or less, including 15% that launched less than six months ago. The largest proportion (38%) have been on the road for 13-24 months, while 16% of funds have been raising for two to three years, and 6% for over three years.

Fig. 1: Private Debt Funds in Market by Fund Type



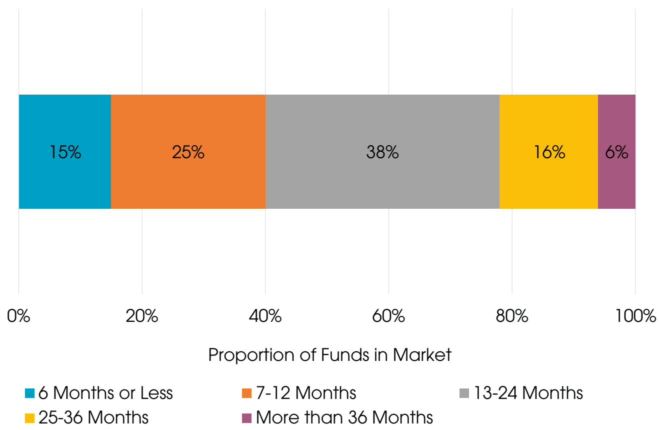
Source: Preqin Private Debt Online

Fig. 2: Private Debt Funds in Market by Primary Geographic Focus, Q3 2015 vs. Q3 2016



Source: Preqin Private Debt Online

Fig. 3: Time Spent on the Road by Private Debt Funds Currently in Market



Source: Preqin Private Debt Online

Fig. 4: Largest Private Debt Funds Currently in Market

Fund	Firm	Type	Target Size ($mn)	Primary Geographic Focus	Fund Status
Oaktree Opportunities Fund Xb	Oaktree Capital Management	Distressed Debt	7,000	North America	Third Close
GSO Capital Opportunities Fund III	GSO Capital Partners	Mezzanine	6,000	North America	First Close
Highbridge Mezzanine Fund III	Highbridge Principal Strategies	Mezzanine	5,000	North America	First Close
Apollo European Principal Finance Fund III	Apollo Global Management	Distressed Debt	3,500	Europe	Raising
Centerbridge Special Credit Partners III-Flex	Centerbridge Capital Partners	Distressed Debt	3,500	North America	Raising
Cerberus Institutional Partners VI	Cerberus Capital Management	Distressed Debt	3,500	North America	First Close

Source: Preqin Private Debt Online

Institutional Investors in Private Debt

Preqin's **Private Debt Online** currently tracks more than 2,000 active investors in the asset class. The 10 largest investors have a combined $69bn currently allocated to the asset class (Fig. 1). Of these investors, four are based in the US, led by TIAA, the largest global allocator to private debt with $25.9bn designated for private lending strategies.

Over the next year, 43% of investors that expect to be active in private debt will target direct lending, the largest proportion among all private debt strategies (Fig. 2). Thirty-nine percent of investors will target mezzanine funds, followed by distressed debt (35%), and special situations (19%). Much smaller proportions of investors plan to target private debt fund of funds and venture debt vehicles in the next 12 months, accounting for 5% each.

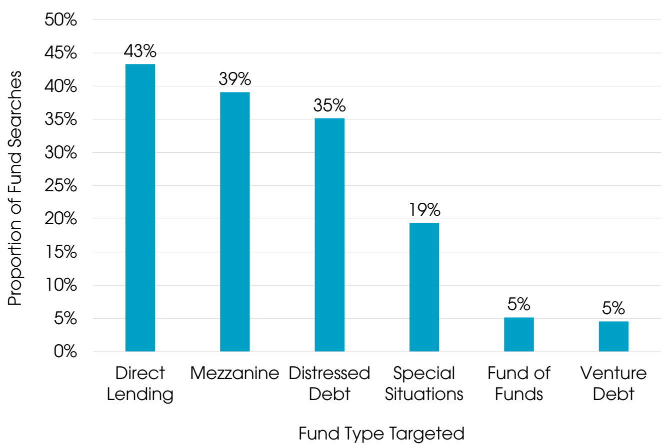
North America and Europe are likely to be the regions most targeted by active private debt investors in the year ahead, with 43% and 46% of investors seeking opportunities in these regions in the next 12 months (Fig. 3). Although North America and Europe have typically accounted for the majority of private debt activity, investors are starting to look to other regions for investment opportunities, namely Asia (16%).

Fig. 1: 10 Largest Investors in Private Debt Globally by Current Allocation

Investor	Current Allocation to Private Debt ($bn)	Investor Type	Location
TIAA	25.9	Private Sector Pension Fund	US
Partners Group	6.0	Private Equity Fund of Funds Manager	Switzerland
KB Insurance	5.4	Insurance Company	South Korea
African Development Bank	5.3	Bank	Ivory Coast
New York State Teachers' Retirement System	5.2	Public Pension Fund	US
Netherlands Development Finance Company (FMO)	5.2	Government Agency	Netherlands
California Public Employees' Retirement System (CalPERS)	5.0	Public Pension Fund	US
IFM Investors	4.2	Asset Manager	Australia
Future Fund	3.7	Sovereign Wealth Fund	Australia
Oregon State Treasury	3.5	Public Pension Fund	US

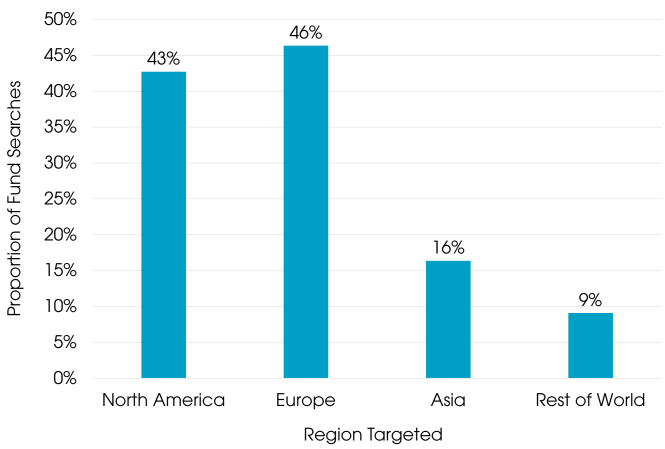
Source: Preqin Private Debt Online

Fig. 2: Fund Types Targeted by Private Debt Investors in the Next 12 Months



Source: Preqin Private Debt Online

Fig. 3: Regions Targeted by Private Debt Investors in the Next 12 Months



Source: Preqin Private Debt Online

Dry Powder

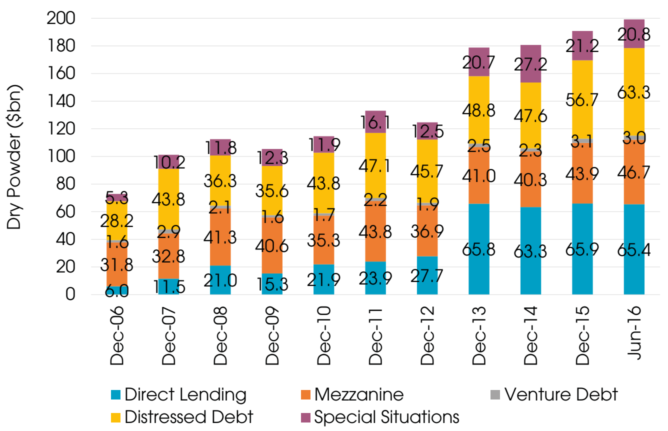
As of June 2016, private debt fund managers have a record $199bn in available capital, a significant increase when compared to the $72.9bn in 2006 (Fig. 1). Direct lending funds hold the highest amount of dry powder at $65.4bn, closely followed by distressed debt at $63.3bn, which is up from $56.7bn at the end of 2015. Mezzanine funds have a record $46.7bn as of June 2016, up from the previous record of $43.9bn as of December 2015.

North America-focused fund managers continue to have the most capital available as of June 2016, as dry powder reserves for funds focused on the region increased to $129bn (Fig. 2). Conversely, Europe-focused managers saw a decrease of almost $4bn to $57bn, indicating strong deal activity in the region, as fundraising has certainly been robust in Q2. Dry powder levels within Asia and other global regions increased, with Asia-focused reserves reaching a new high of $9.6bn as of June 2016.

Fig. 3 displays total private debt dry powder versus that of buyout funds since 2006. This comparison seeks to put the private debt market in perspective, as the recent years of substantial growth have raised concerns about sustainability moving forward. Aggregate dry powder for all private debt strategies stands at just below $200bn as of June 16 2016, 38% of the global buyout fund dry powder at $512bn. This proportion has seen a general increase over the past decade, up from 19% in December 2006.

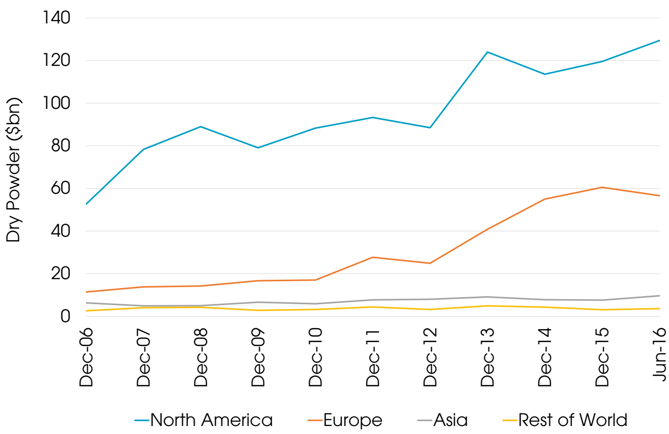
Oaktree Capital Management currently has the largest amount of dry powder at $16.1bn, followed by Goldman Sachs Merchant Banking Division with $11.5bn. Nine of the top 10 fund managers by dry powder are based in the US.

Fig. 1: Private Debt Dry Powder by Fund Type, December 2006 - June 2016



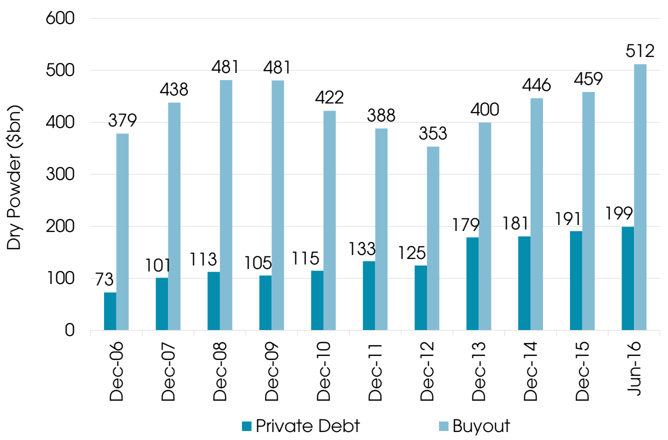
Source: Preqin Private Debt Online

Fig. 2: Private Debt Dry Powder by Fund Primary Geographic Focus, December 2006 - June 2016



Source: Preqin Private Debt Online

Fig. 3: Dry Powder: Private Debt vs. Buyout, December 2006 - June 2016



Source: Preqin Private Debt Online

Fig. 4: 10 Largest Private Debt Fund Managers by Estimated Dry Powder

Firm	Headquarters	Estimated Dry Powder ($bn)
Oaktree Capital Management	US	16.1
Goldman Sachs Merchant Banking Division	US	11.5
Intermediate Capital Group	UK	9.2
GSO Capital Partners	US	7.9
Ares Management	US	6.7
Fortress Investment Group	US	6.4
Highbridge Principal Strategies	US	5.7
Centerbridge Capital Partners	US	4.2
Bain Capital Credit	US	3.8
Cerberus Capital Management	US	3.2

Source: Preqin Private Debt Online

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With global coverage and detailed information on all aspects of the private debt asset class, Preqin's industry-leading **Private Debt Online** service keeps you up-to-date on all the latest developments in the private debt universe.

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