PREQIN QUARTERLY UPDATE: PRIVATE DEBT Q2 2017

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

Content includes:

Fundraising
Funds in Market
Institutional Investors
Dry Powder
Deals
Fund Performance

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FOREWORD - Ryan Flanders, Preqin

Momentum from record private debt fundraising at the end of 2016 has slowed slightly throughout the first half of 2017, which has been headlined by three fund closures north of $3bn, including Cerberus' $4bn distressed debt fund closed in Q2. Twenty-eight private debt funds closed in the second quarter of 2017, securing an aggregate total of $16bn in capital commitments globally – down from $26bn in Q1 2017. This is the first time since Q2 2014 ($19bn) in which Q2 private debt fundraising has not surpassed $20bn.

Distressed debt funds, while representing only two of the 28 private debt funds closed in Q2, accounted for 34% ($5.5bn) of total capital raised. Direct lenders enjoyed continued fundraising success, raising a combined $6.4bn, with strong investor interest prevailing in the US and Europe. Since the beginning of 2016, direct lending funds have secured $46bn raised across 82 funds, a substantial figure which has put the strategy squarely in sight for institutional investors looking to generate returns in a low interest rate environment.

With the addition of private debt deals to Preqin's platform, this Quarterly Update now includes sample deals from the first half of 2017, as well as industry and geographic breakdowns for private lending transactions. In H1 2017, 68% of private debt deals took place in North America, as the home of the most fundraisers, investors and borrowers in a single region globally continues to push forward.

Near-record levels of dry powder in the industry could be putting pressure on the fundraising market, as managers are currently saddled with $205bn in available private debt capital. With dry powder at such high levels, managers may be cautious with fund sizes moving forward, hoping to temper investor expectations with deal flow and interest rate projections in the future.

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

PRIVATE DEBT OPPORTUNITY IN INDIA

- Venkat Ramaswamy, **Edelweiss**

There has been significant interest in and conversation on private credit in the US and Europe over the last few years; however, Edelweiss has been focused on India. Can you explain the dynamic there, as opposed to the more often discussed US and European markets?

Edelweiss' focus on private debt has been driven by the structural growth story in India, which is reinforced by a stable and development-oriented government. Bank credit growth has tapered while the corporate bond market is only just starting to develop.

With India transitioning from a $2tn to a $5tn economy over the next decade, it creates a huge opportunity for capital solution providers. This has led to an increased requirement for capital from corporate sponsors/entrepreneurs and real estate developers for growth/acquisitions. Additionally, there is a huge potential opportunity, which started over the last three years, to invest in special situations in stressed operating companies.

Private debt in India today is considered as a real alternative to private equity by entrepreneurs in corporate India, as well as by RE developers. The implementation of the Insolvency and Bankruptcy Code (IBC) has further made the private debt opportunity more attractive for foreign investors.

What are the risks of investing in India as opposed to the more developed US and European markets?

Investing in India requires a thorough understanding of the borrower and their situation. It requires an institutional framework for practical and effective risk management, along with significant local knowledge and presence.

India has an effective but slow legal system. In 2002, the SARFAESI Act (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) was enacted to protect the rights of secured lenders and licences were awarded to Asset Reconstruction Companies (ARC). Edelweiss is the largest ARC in India with AUM of ~$6bn.

Subsequently, to address the needs of all creditors (secured, unsecured, operational and financial), the government earlier this year enacted the IBC, which forces the lenders to come together and decide on a resolution strategy within a defined timeframe. Failing which, there is a threat to liquidation.

Another risk is the absence of India-based operational turnaround teams.

Also, investors are exposed to currency risk. However, India's macroeconomic strength, as well as the global commodity slowdown, supports the probability of a stable Indian rupee.

What sort of deals are you looking at in India?

Primarily growth/rebuilding-focused situations, including:

- Financing for investing in operating companies, financing for equity buyout from PE investors, asset acquisition, etc.
- Providing structured credit solutions to residential RE developers – primarily for project construction post all significant zoning/government approvals.
- Credit solutions to stress/distress companies – buyout of bank loans to restructure for value creation/ priority debt for working capital requirements/primary capital for last-mile financing.

What do you see as the opportunity in credit in the shorter and longer terms in India?

We look at private debt as a structural opportunity in India, driven by the Indian growth story and the inability of traditional sources of funding, especially government-owned banks, to meet the requirements due to their internal constraints.

Sponsors of Indian companies will have increased funding requirement for their expansion/acquisitions as the current environment is seen as the beginning of an investment cycle.

The residential RE sector in India is $120bn and is growing at 5-8% per annum. The adoption of Real Estate Regulation Act (RERA) is expected to further encourage the RE demand. Increasing urbanization, a growing middle class, the rise of the services sector and the housing shortage will create significant opportunity to provide funding to developers to bridge this demand.

Industrial stressed asset loans are concentrated in specific sectors with infrastructure, metal & mining, engineering & construction contributing more than 70% of the total $104bn of industrial stress. These sectors are primarily cyclical in nature and are now at the cusp of the beginning of the growth cycle.

VENKAT RAMASWAMY

Venkat Ramaswamy is Executive Director of Edelweiss Financial Services Limited, one of India's leading financial services companies. He co-founded Edelweiss in 1996, which over the last two decades has become a diversified financial services company with various Credit & Non Credit businesses and a young Life Insurance business. Venkat has been one of the driving forces in transforming what was once India's first new age boutique investment bank to a leading diversified financial conglomerate. Amongst his responsibilities, he also Co-Heads two of Edelweiss' most strategic businesses – Distress Assets & Resolution business and Global Asset Management business, while continuing to play a mentorship role with the Edelweiss Investment Banking business.

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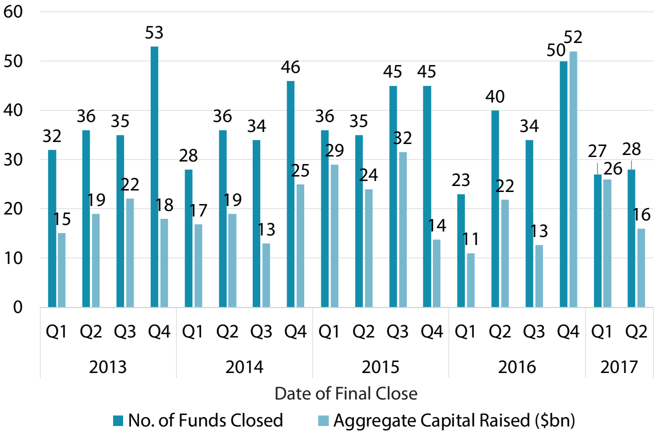
FUNDRAISING

Twenty-eight private debt funds reached a final close in Q2 2017, totalling $16bn in capital commitments (Fig. 1). Quarterly fundraising since 2013 has seen an average of 37 funds secure around $22bn in aggregate capital, with an average fund size of $595mn. Q2 2017, for which figures are likely to increase as more data becomes available, currently has an average fund size of $552mn. Nineteen North America-focused funds reached a final close in Q2 2017, securing $13bn in aggregate capital (Fig. 2). Five Europe-focused funds raised a total of $2.2bn, while four funds targeting Asia & Rest of World brought in an additional $200mn.

Direct lending and distressed debt vehicles together accounted for 75% of all capital secured by private debt funds closed in Q2 2017, raising $6.4bn and $5.5bn respectively (Fig. 3). While direct lending accounts for the largest proportions of both funds closed (45%) and capital commitments (41%) for the quarter, distressed debt closed the smallest proportion (7%) of funds yet more than a third (35%) of capital. Nine mezzanine funds reached a final close for an aggregate $2.1bn and special situations funds raised $1.5bn across four funds; no venture debt or private debt funds of funds closed in the second quarter.

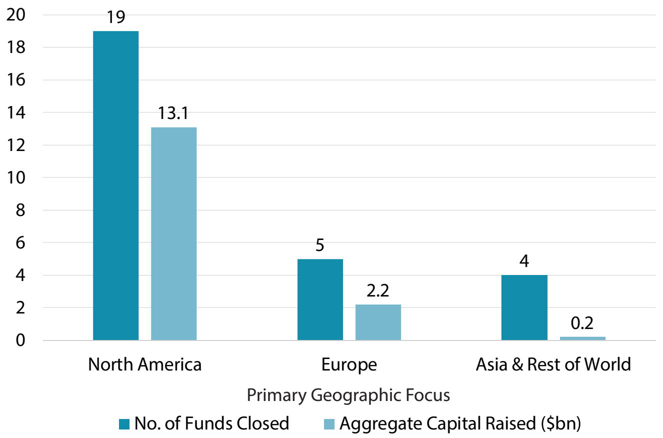
Fig. 1: Private Debt Fundraising, Q1 2013 - Q2 2017



Source: Preqin Private Debt Online

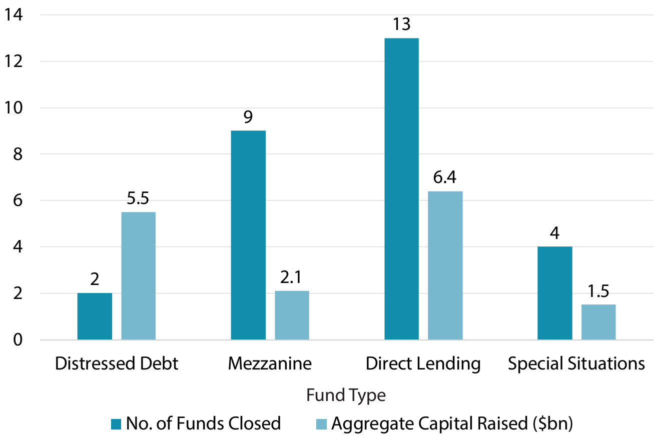
Cerberus Capital Management's Cerberus Institutional Partners VI was the largest fund ($4bn) closed in Q2, significantly ahead of Permira Debt Managers' Permira Credit Solutions Fund III, which secured €1.7bn. Cerberus' vehicle will target distressed debt in North America, while Permira's will follow a direct lending strategy in Europe (Fig. 4).

Fig. 2: Private Debt Fundraising in Q2 2017 by Primary Geographic Focus



Source: Preqin Private Debt Online

Fig. 3: Private Debt Fundraising in Q2 2017 by Fund Type



Source: Preqin Private Debt Online

Fig. 4: Five Largest Private Debt Funds Closed in Q2 2017

Fund	Firm	Fund Size (mn)	Type	Geographic Focus
Cerberus Institutional Partners VI	Cerberus Capital Management	4,000 USD	Distressed Debt	North America
Permira Credit Solutions Fund III	Permira Debt Managers	1,700 EUR	Direct Lending	Europe
PIMCO Corporate Opportunities Fund II	PIMCO	1,503 USD	Distressed Debt	North America
GoldPoint Mezzanine Partners IV	GoldPoint Partners	1,300 USD	Mezzanine	North America
Fundamental Partners III	Fundamental Advisors	993 USD	Special Situations	North America

Source: Preqin Private Debt Online

FUNDS IN MARKET

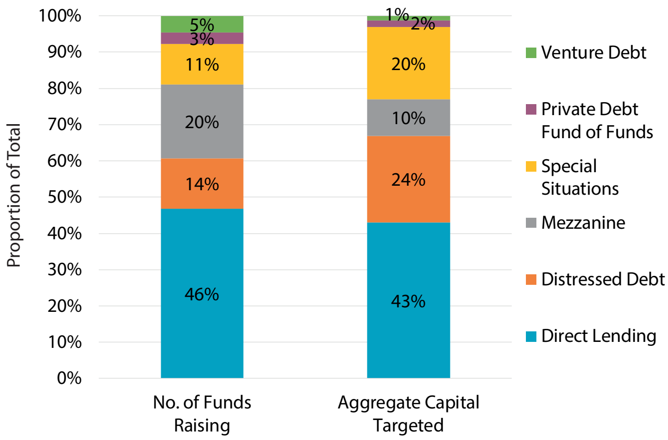
As at the start of Q3 2017, there are 310 private debt funds in market seeking an aggregate $137bn in capital. These figures have increased over the previous quarter, when 260 funds were targeting $123bn globally at the start of Q2.

Direct lending funds continue to represent the largest proportions of both funds in market and aggregate capital targeted (Fig. 5), with 144 funds seeking a total of $60bn. Forty-five distressed debt funds are in market targeting $33bn, while 63 mezzanine funds seek $14bn. Special situations funds, which account for 11% of funds in market, are seeking $28bn in aggregate capital.

Compared with this time last year, North America-, Asia- and Rest of World-focused private debt funds have seen an increase in both the number of funds in market and targeted capital (Fig. 6). Europe has an additional five funds in market compared to the previous year, but these funds are targeting slightly less capital.

The majority (51%) of private debt funds in market have been on the road for one year or less, and a further 34% have been in market for 13-24 months (Fig. 7). Fifteen percent of funds have been on the road for more than two years, including 1% that have been actively raising for more than three years.

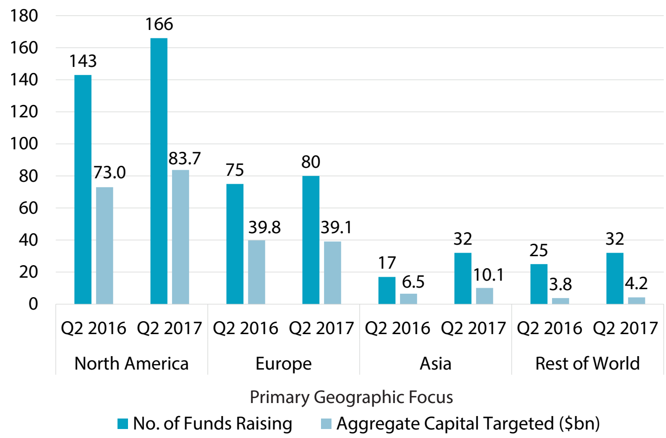
Fig. 5: Private Debt Funds in Market by Fund Type



Source: Preqin Private Debt Online

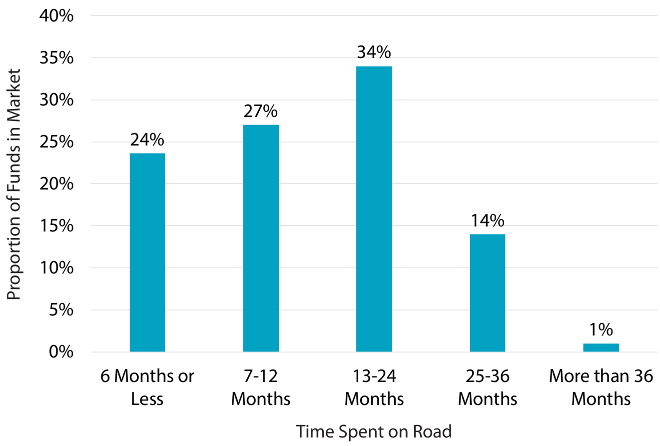
The five largest funds in market account for roughly 20% of targeted capital within the private debt asset class. 3G Special Situations Fund V, launched in November 2016 and currently the largest fund in market, is seeking $10bn for special situations investment (Fig. 8). The fund will focus on distressed companies in the US across a broad range of industries.

Fig. 6: Private Debt Funds in Market by Primary Geographic Focus, Q2 2016 vs. Q2 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 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

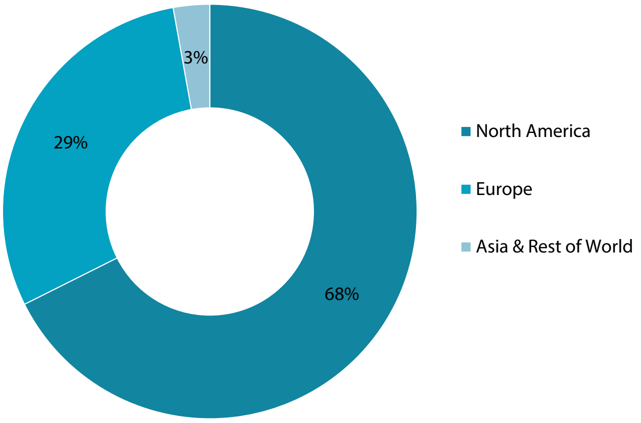
DEALS

The first half of 2017 saw robust private lending activity in North America, which was home to 68% of private debt deals tracked by Preqin (Fig. 9). Due to a confluence of factors such as the regulatory environment, political structures and the slowdown of traditional lending, the private debt market has been mainly concentrated in North America and Western Europe. Activity up until the mid-2000s was dominated by distressed debt and mezzanine financing, but with direct lending activity having picked up momentum in the past decade, lenders throughout the capital stack continue to find many sponsored and non-sponsored deal targets in North America and Europe.

More than 1,200 private debt fund managers are focused on opportunities in Europe and North America, but there is certainly private lending activity in other regions as well: Preqin's **Private Debt Online** tracks 297 private debt managers targeting Asia, in addition to 227 focused across the Middle East, Africa and South America. The most transactions in H1 2017 took place in the industrials sector, which accounted for 30% of all deals, double the proportion of the next most prominent industry (Fig. 10).

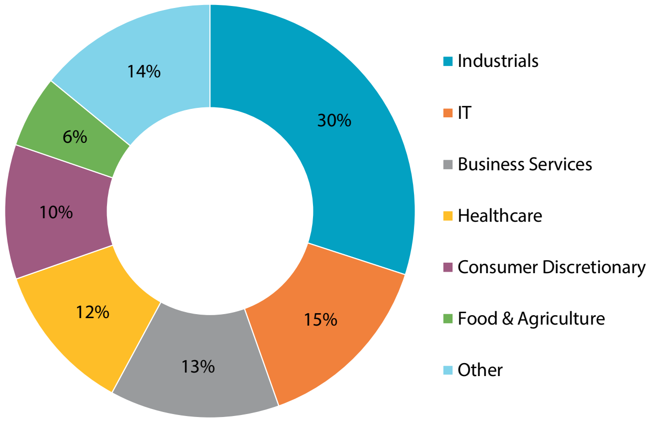
As nearly 80% of tracked private debt deals are private equity sponsored, the private debt deals market is quite correlated to that of the buyout space. The remaining 20% of deals occur as non-sponsored transactions, issuing debt directly to borrowers that are not supported by private equity managers, and therefore can present a different risk profile entirely when compared to a sponsored firm.

Fig. 9: Private Debt Deals Completed in H1 2017 by Location



Source: Preqin Private Debt Online

Fig. 10: Private Debt Deals Completed in H1 2017 by Primary Industry



Source: Preqin Private Debt Online

Fig. 11: Sample Private Debt Deals Completed in H1 2017

Portfolio Company	Investment Type	Primary Industry	Debt Financing Provider(s)	Debt Size ($mn)	Capital Structure
Cole-Parmer Instrument Company	Buyout	Healthcare	Angel Island Capital, Antares Capital, Golub Capital, Jefferies Capital Partners	630	Senior Debt
Soho House Group	Recapitalization	Consumer Discretionary	Permira Debt Managers	351	Senior Debt
Mood Media Corporation	Public-to-Private	Telecoms, Media & Communications	HPS Investment Partners	315	Senior Debt
Rex Energy	Growth	Energy & Utilities	Angelo, Gordon & Co	300	Senior Debt
Halogen Software, Inc.	Add-on	IT	Golub Capital	286	Unitranche
Riverview Power	Recapitalization	Energy & Utilities	Ares Capital	250	Senior Debt
TestEquity LLC	Buyout	IT	NXT Capital	116	Senior Debt
Echelon	Growth	Energy & Utilities	Monroe Capital	100	Senior Debt
Results Physiotherapy	Growth	Healthcare	Golub Capital	71	Unitranche
Catalina Holdings (Bermuda)	Growth	Business Services	Twelve Capital	46	Junior/Subordinated

Source: Preqin Private Debt Online

INSTITUTIONAL INVESTORS

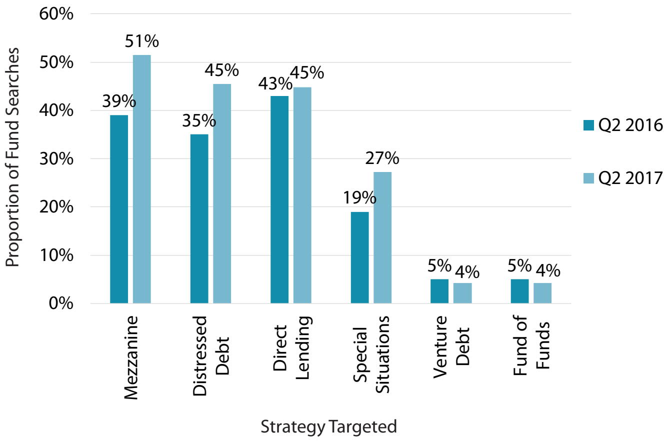
Tracking more than 2,800 active investors in private debt globally, Preqin's **Private Debt Online** collects detailed allocation plans from the widest range of investors in the alternatives industry. As at the end of Q2 2017, the 10 largest investors in private debt currently allocate a combined $75bn to the asset class.

Since Q2 2016, mezzanine has seen the largest change in investor appetite among private debt strategies, with the proportion of investors actively seeking mezzanine opportunities in the year ahead growing from 39% to 51% (Fig. 12). At present, direct lending and distressed debt are each targeted by 45% of active investors, followed by special situations at 27%.

In terms of geography, the largest proportion (45%) of investor fund searches for the next 12 months are targeting Europe-focused funds, followed closely by funds focused on North America (41%, Fig. 13). The proportion of investors searching for opportunities in emerging markets has increased from 9% in Q2 2016 to 13%. Asia-focused vehicles have also seen a slight uptick in appetite.

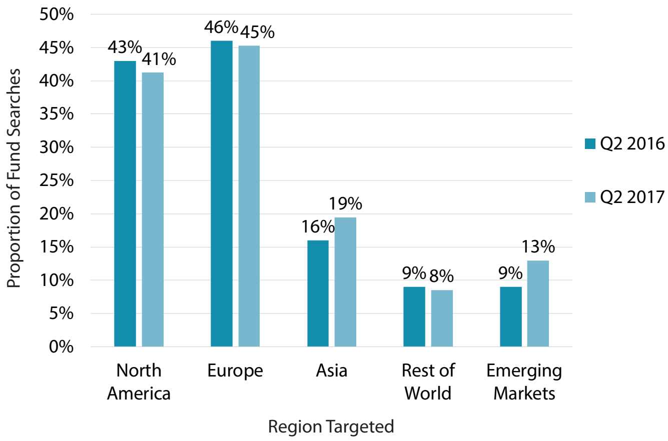
Investors' plans for their private debt portfolios remain diverse: more than half (54%) of investors plan to commit less than $50mn to private debt over the next 12 months, while 34% will allocate between $50mn and $499mn (Fig. 14). The majority (77%) of investors plan to make these capital commitments via five or fewer private debt funds over the next year (Fig. 15).

Fig. 12: Strategies Targeted by Private Debt Investors in the Next 12 Months, Q2 2016 vs. Q2 2017



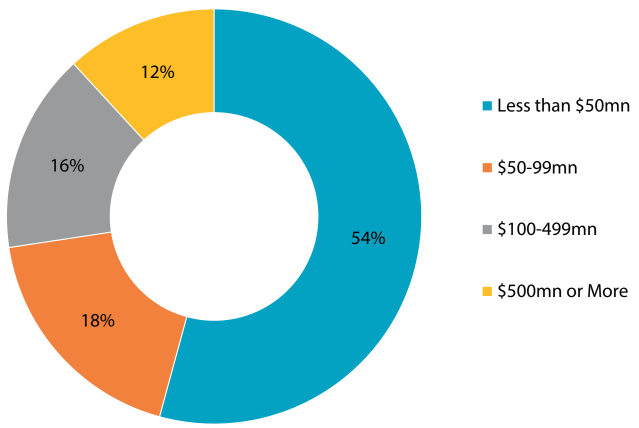
Source: Preqin Private Debt Online

Fig. 13: Regions Targeted by Private Debt Investors in the Next 12 Months, Q2 2016 vs. Q2 2017



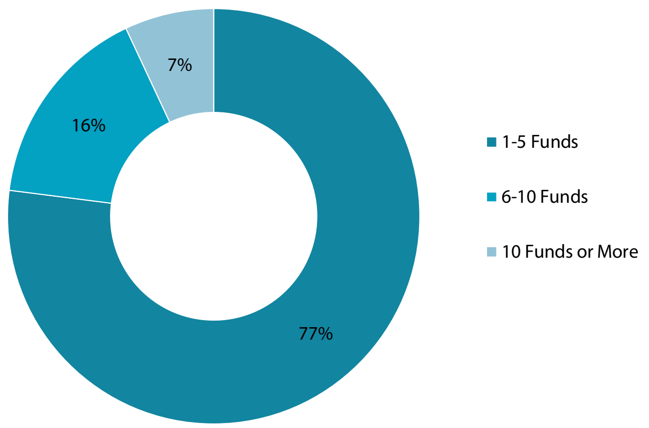
Source: Preqin Private Debt Online

Fig. 14: Amount of Capital Investors Plan to Commit to Private Debt Funds in the Next 12 Months



Source: Preqin Private Debt Online

Fig. 15: Number of Private Debt Funds Investors Plan to Commit to in the Next 12 Months



Source: Preqin Private Debt Online

DRY POWDER

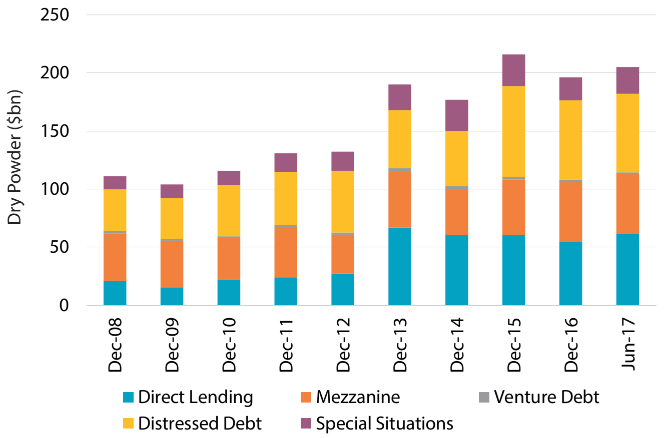
As at June 2017, private debt managers hold $205bn in dry powder, up $8.9bn from December 2016 (Fig. 16). Distressed debt funds continue to hold the most dry powder ($68bn) of any private debt strategy; direct lending and mezzanine follow with $61bn and $51bn respectively.

North America-focused funds account for two-thirds ($138bn) of available private debt capital, adding $4.6bn since December 2016 (Fig. 17). The amount of available capital held by funds focused on Europe increased by 11% to $57bn, the largest growth of any region. Dry powder levels in Asia-focused funds declined by $1bn, while Rest of World-focused dry powder remained the same at $1.6bn.

Fig. 18 displays total private debt dry powder versus that of buyout funds since 2008, providing context for the private debt market and potential capacity for capital deployment amid continued growth. Although the aggregate amount of available capital for private debt as at June 2017 has surpassed $200bn for the second time since 2008, as a proportion (36%) of total buyout dry powder, this is the lowest figure since December 2011.

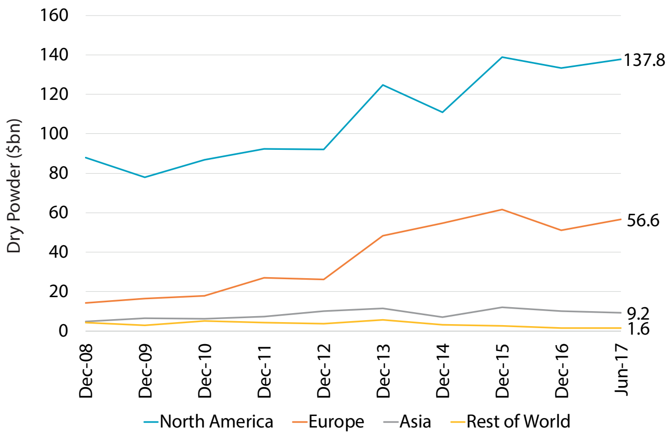
Oaktree Capital Management continues to hold the largest amount of capital available for investment ($13.6bn) among private debt managers (Fig. 19), although this has decreased by $3.4bn over Q2 2017. GSO Capital Partners ($13.2bn) and Goldman Sachs Merchant Banking Division ($8.0bn) round out the top three.

Fig. 16: Private Debt Dry Powder by Fund Type, 2008 - 2017



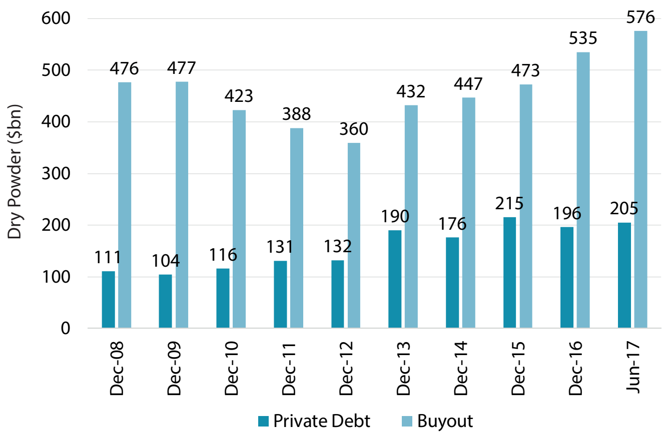
Source: Preqin Private Debt Online

Fig. 17: Private Debt Dry Powder by Primary Geographic Focus, 2008 - 2017



Source: Preqin Private Debt Online

Fig. 18: Dry Powder: Private Debt vs. Buyout, 2008 - 2017



Source: Preqin Private Debt Online

Fig. 19: 10 Largest Private Debt Fund Managers by Estimated Dry Powder

Firm	Headquarters	Estimated Dry Powder ($bn)
Oaktree Capital Management	US	13.6
GSO Capital Partners	US	13.2
Goldman Sachs Merchant Banking Division	US	8.0
HPS Investment Partners	US	6.5
Cerberus Capital Management	UK	6.5
Hayfin Capital Management	UK	5.6
Ares Management	US	5.5
Intermediate Capital Group	US	5.4
Fortress Investment Group	US	4.6
Crescent Capital Group	US	3.9

Source: Preqin Private Debt Online

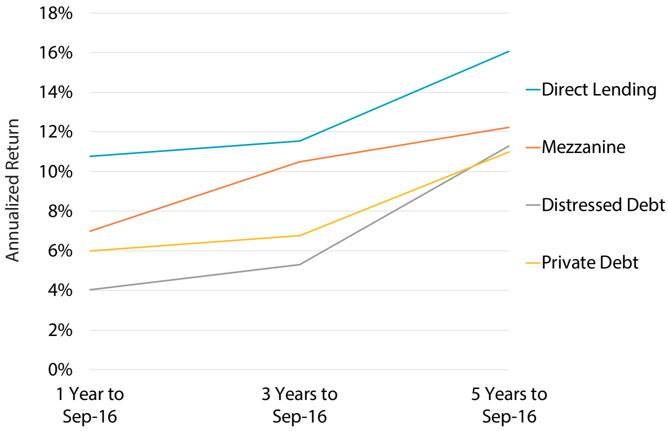
FUND PERFORMANCE

Direct lending funds have the highest horizon IRRs across the one-, three- and five-year periods shown in Fig. 20, with the five-year figure standing at over 16%. Mezzanine strategies on an annualized basis have provided robust returns above that of the private debt asset class as a whole, with a five-year horizon IRR of 12.2% to September 2016. Overall, direct lending has produced low double-digit returns in all three timeframes, as has mezzanine over the three- and five-year investment horizons.

Among post-2006 vintage private debt funds, funds of vintage 2009 have the highest median net IRR (+14.0%) and also the highest top quartile boundary at 20.5%, which is nearly 3x that of the bottom quartile boundary (+7.0%), highlighting the importance of manager and fund selection in the asset class (Fig. 21).

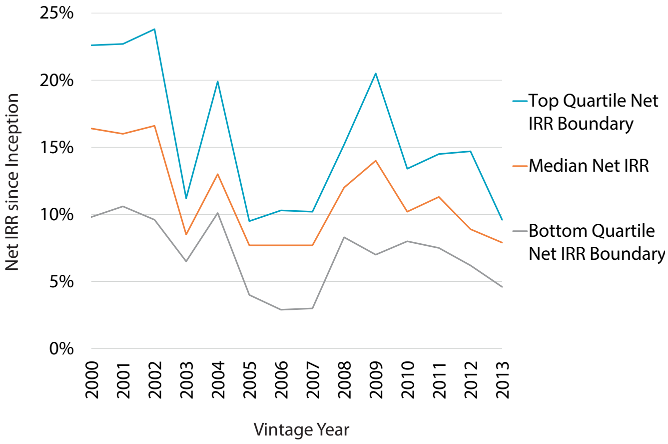
Dry powder levels within the private debt asset class have remained near all-time highs in recent quarters. Current available capital for the asset class sits at $205bn as at June 2017, $10bn less than the record high of $215bn in December 2015. Fig. 22 illustrates the relationships between called-up 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. As expected, the ratio of distributed to paid-in capital is substantially smaller among more recent vintage funds than earlier vintages, and the inverse is true for the ratio of residual value to paid-in capital. Private debt funds of 2010 vintage have distributed 84% of paid-in capital back to investors, while 2011 vintages have distributed 43%.

Fig. 20: Private Debt: Horizon IRRs by Fund Type (As at September 2016)



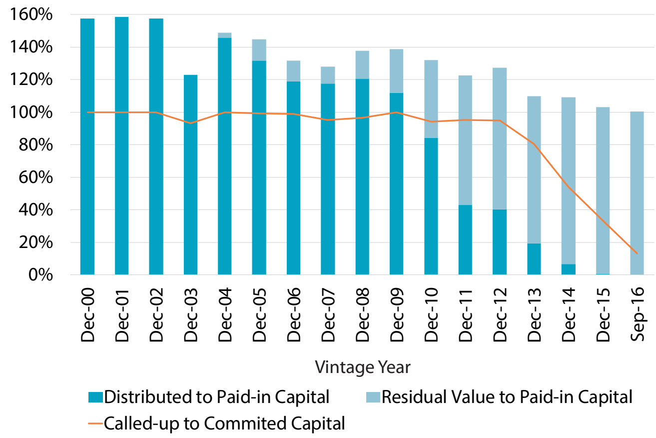
Source: Preqin Private Debt Online

Fig. 21: Private Debt Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin Private Debt Online

Fig. 22: Private Debt - Median Called-up, Distributed and Residual Value Ratios by Vintage Year



Source: Preqin Private Debt Online

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