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2017 PREQIN GLOBAL PRIVATE DEBT REPORT

SAMPLE PAGES

ISBN: 978-1-912116-72-0
$175 / £125 / €150
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CONTENTS

PRIVATE DEBT: 2016 IN NUMBERS

SIZE OF THE INDUSTRY

$595bn
Private debt assets under management as at June 2016.

$224bn
Dry powder held by private debt funds as at June 2016.

FUNDRAISING SUCCESS

$93bn
Aggregate capital raised by the 131 private debt funds closed in 2016.

107%
Average proportion of target size achieved by private debt funds closed in 2016.

CAPITAL CONCENTRATION

$710mn
Average size of private debt funds closed in 2016.

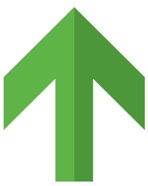
47%
of aggregate capital raised in 2016 was secured by the 10 largest funds closed.

KEY ISSUES

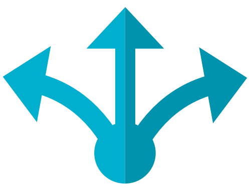
40%
of investors consider valuations as one of the key issues facing the private debt asset class in 2017.

31%
of fund managers believe it is more difficult to find attractive investment opportunities than 12 months ago.

PERFORMANCE EXPECTATIONS



93%
of investors believe that their private debt portfolios have met or exceeded performance expectations over the past 12 months.



$58bn
Total capital distributions in H1 2016.

INVESTOR SENTIMENT

68%
of investors have a positive perception of private debt.

62%
of investors plan to increase their allocation to private debt over the longer term.

ASSETS UNDER MANAGEMENT AND DRY POWDER

Assets under management (AUM) in the private debt industry, defined as the uncalled capital commitments (dry powder) plus the unrealized value of portfolio assets, have quadrupled since 2006, reaching $595bn as at the end of June 2016 (Fig. 3.1). This marks the tenth consecutive year of growth for the asset class, which notably did not see a contraction in 2008/2009, as many other asset classes did. Between December 2015 and June 2016, AUM grew 7.1%, likely due to a combination of factors, namely strong fundraising, increased deal activity and investment performance bolstering the unrealized value portion of assets.

AUM BY VINTAGE YEAR

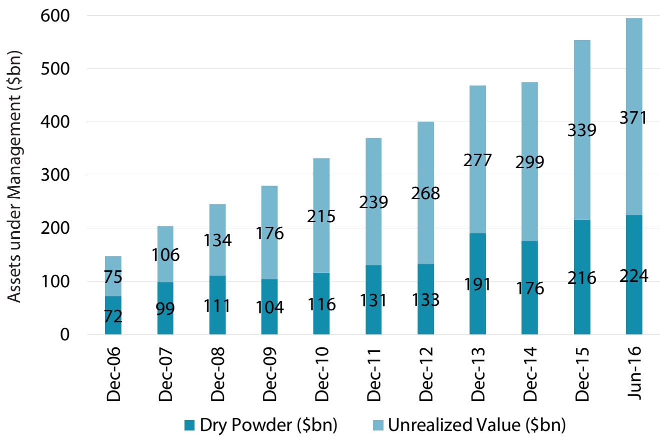
As seen in Fig. 3.2, viewing industry AUM by vintage year of the underlying funds relays a somewhat different picture. More than half of total dry powder is held in funds of vintages 2015-2016, with that figure growing to 74% when including vintage year 2014.

Alternatively, 61% of unrealized value is held in funds from vintage years 2006-2012. This represents an estimated $222bn still at large for funds potentially as much as a decade old.

AUM BY FUND TYPE

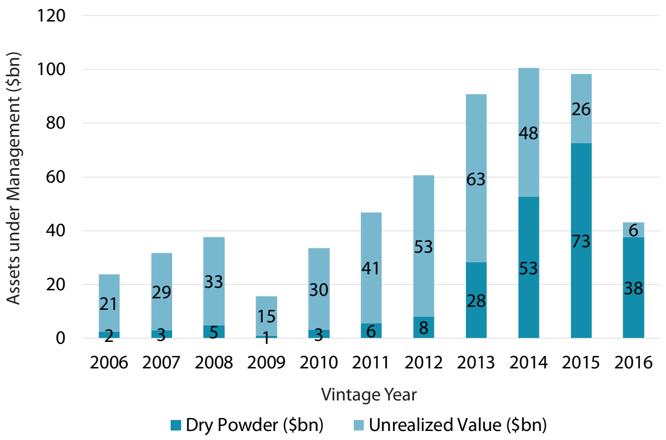
The average lifespan of private debt funds differs by strategy employed. Fig. 3.3 shows the proportion of total unrealized value held across the five main private debt fund types by vintage year. Direct lending funds have a far smaller proportion (12%) of capital tied up in vintage 2006-2010 funds than the other strategies, which each hold between 35% and 45%. Direct lending funds have 88% of unrealized value held in 2011-2016 vintage funds, owing to the nature of the strategy, which typically sees capital distributions earlier relative to traditional alternative strategies.

Fig. 3.1: Private Debt Assets under Management, 2006 - 2016



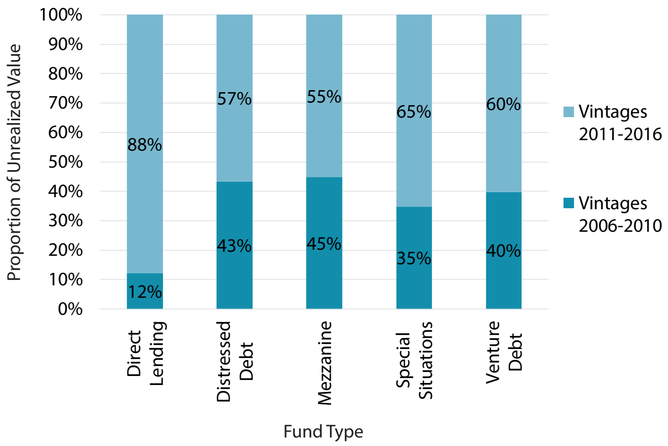
Source: Preqin Private Debt Online

Fig. 3.2: Private Debt Assets under Management by Vintage Year (As at June 2016)



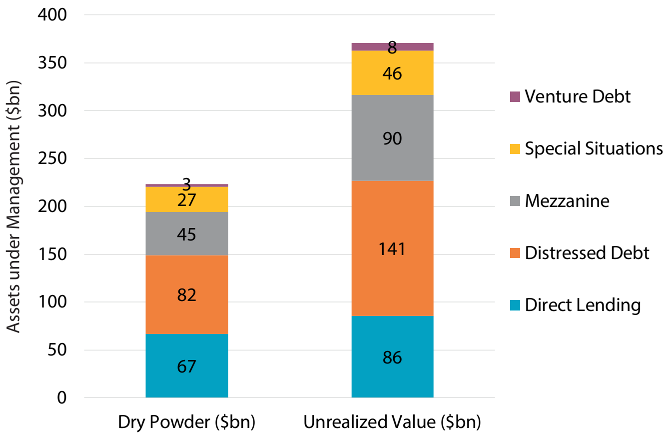
Source: Preqin Private Debt Online

Fig. 3.3: Unrealized Value by Fund Type and Vintage Year Grouping (As at June 2016)



Source: Preqin Private Debt Online

Fig. 3.4: Private Debt Assets under Management by Fund Type (As at June 2016)



Source: Preqin Private Debt Online

2016 FUNDRAISING MARKET

An aggregate $93bn was raised across 131 private debt funds closed in 2016, marking the second consecutive year, and third overall, in which fundraising totals have surpassed $90bn (Fig. 4.1). This figure is likely to increase as more data becomes available, and the fundraising total for 2016 is expected to meet or exceed the level seen in 2015 ($97bn).

> ***The 10 largest funds closed in 2016 accounted for 47% of overall fundraising, compared with 25% in 2014***

CAPITAL CONCENTRATION

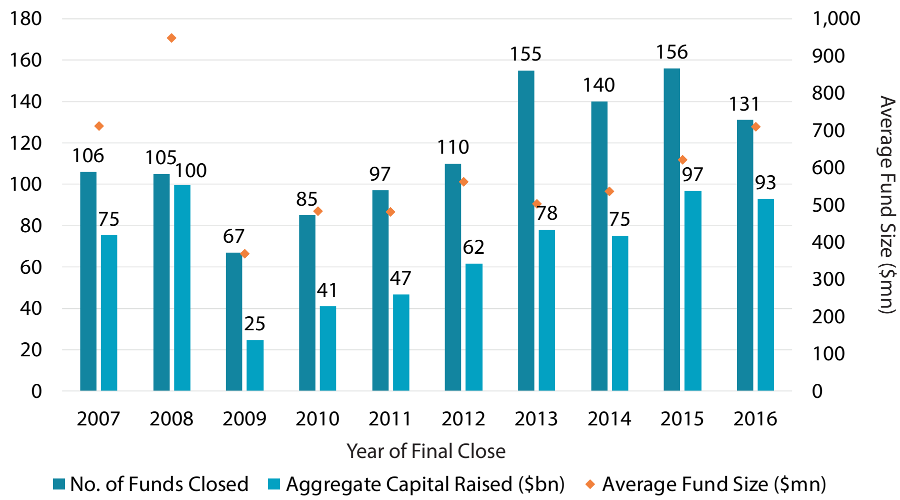
The trend towards a greater concentration of capital among fewer funds continued in 2016: 16% fewer funds closed than in 2015, resulting in the average fund size increasing to $710mn. Investors have committed larger amounts of capital annually, but placed this with roughly the same number of or fewer fund managers. The 10 largest funds closed in 2016 accounted for 47% of overall fundraising, compared with 25% in 2014.

FUNDRAISING SUCCESS AND TIME ON THE ROAD

Many of the funds that did reach a final close in 2016 were successful relative to their original fundraising targets: 74% of funds closed in 2016 were able to meet or exceed their target size. On average, funds closed in 2016 took longer to reach a final close than in years past: the average time spent in market was 21 months, the highest figure over the period 2007-2016, surpassing the average of 19 months spent on the road by funds closed in 2012 (Fig. 4.2).

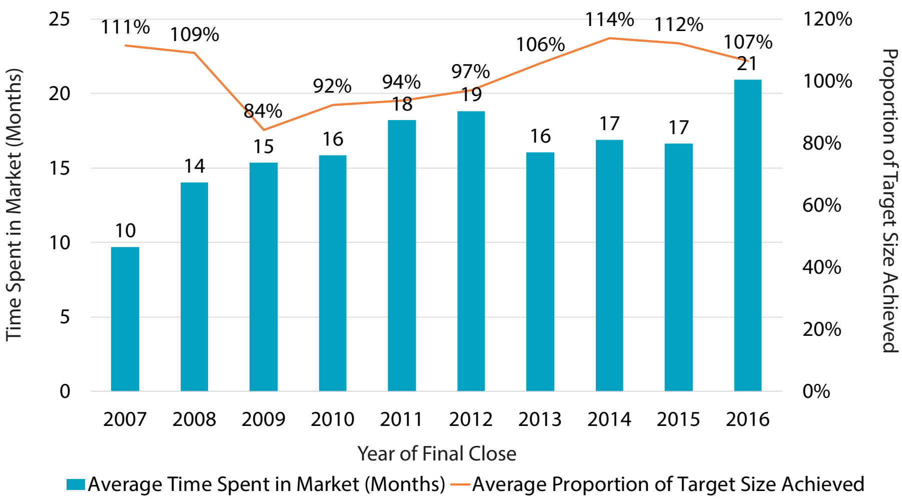
Among private debt strategies, mezzanine funds reached a final close the quickest in 2016, averaging 19 months in market. Mezzanine funds, on average, also had the most fundraising success, closing at 120% of target. Direct lending funds spent an average of 20 months in market to reach 106% of their initial target, while distressed debt funds took 21 months to close, raising just 89% of their initial target.

Fig. 4.1: Annual Private Debt Fundraising, 2007 - 2016



Source: Preqin Private Debt Online

Fig. 4.2: Private Debt Fundraising Momentum, 2007 - 2016

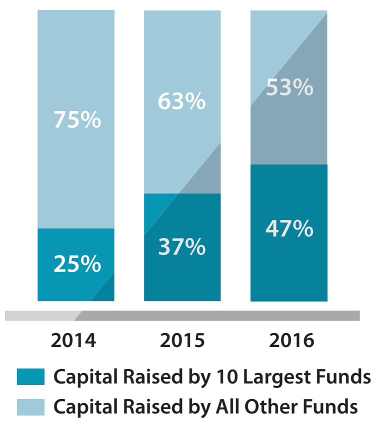


Source: Preqin Private Debt Online

FUND TYPES

Distressed debt commitments to funds closed in 2016 grew by 14% from the previous year to reach $32bn across 18 funds (Fig. 4.4). This is the strategy's largest annual fundraising total since 2008 ($45bn) and represents the greatest proportion (34%) of capital committed to private debt funds in 2016 (Fig. 4.5).

AGGREGATE CAPITAL RAISED BY LARGEST FUNDS CLOSED, 2014 - 2016



DISTRESSED DEBT FUNDRAISING

Distressed debt funds closed in 2016 raised an aggregate $32bn, the most of any private debt strategy, and the highest annual total for the strategy since 2008 (Fig. 4.21). This 14% year-on-year increase in capital commitments was achieved by just 18 funds, five fewer than in 2015. As a result, the average distressed debt fund size increased by 46% over the same time period from $1.2bn to $1.8bn, twice the average size of mezzanine funds.

Annual North America-focused distressed debt fundraising increased by $6.6bn from 2015 to 2016, while Europe-focused fundraising remained steady at $7.0bn; commitments to funds targeting opportunities in Asia & Rest of World decreased significantly from $3.0bn to $300mn (Fig. 4.22).

North America-focused funds accounted for 77% of the capital secured by distressed debt funds closed in 2016, securing $24bn across 13 vehicles, while the $7.0bn secured by Europe-focused vehicles was raised by four funds, one fewer than the previous year.

OUTLOOK

Overall, there are 39 distressed debt funds in market (as at the end of February 2017) targeting an aggregate $30bn, compared to 31 funds targeting $44bn at the same time in 2016. The average target size of distressed funds raising capital, at $758mn, is just over half of what it was 12 months ago ($1.4bn). However, the three largest private debt funds currently in market are all distressed debt focused, targeting $3.5bn each, and together account for 36% of aggregate capital targeted by the strategy. Additionally, fund managers may face challenges in securing capital in 2017 as investors view distressed debt less favourably than both direct lending and mezzanine.

AVERAGE SIZE OF PRIVATE DEBT FUNDS CLOSED IN 2016 ($mn)

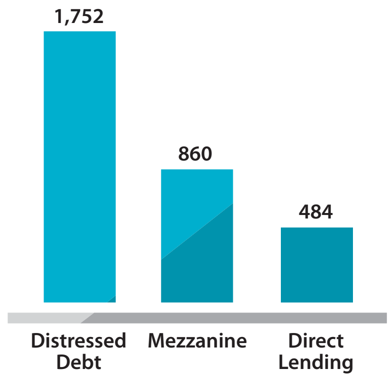
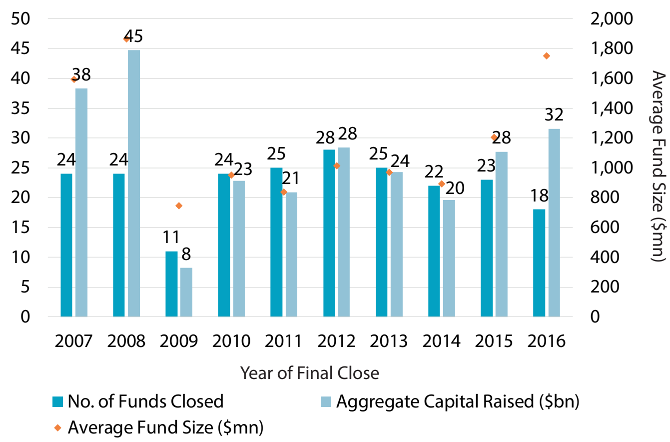
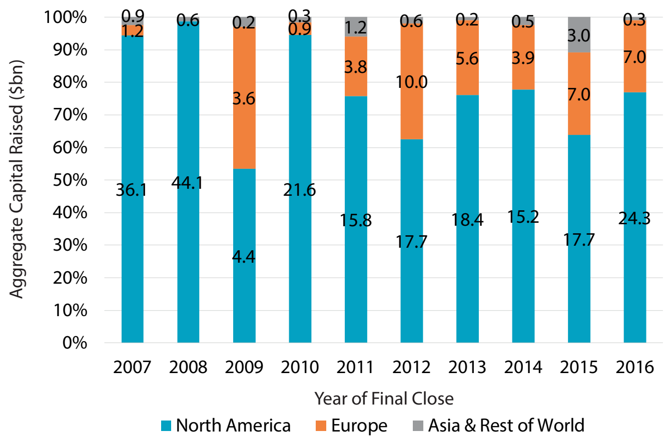


Fig. 4.21: Annual Distressed Debt Fundraising, 2007 - 2016



Source: Preqin Private Debt Online

Fig. 4.22: Annual Distressed Debt Fundraising by Primary Geographic Focus, 2007 - 2016



Source: Preqin Private Debt Online

The three largest private debt funds in market are all targeting distressed debt opportunities:

Apollo European Principal Finance Fund III

Firm: Apollo Global Management

Primary Geographic Focus: Europe

Target Size: $3.5bn

Centerbridge Special Credit Partners III-Flex

Firm: Centerbridge Capital Partners

Primary Geographic Focus: US

Target Size: $3.5bn

Cerberus Institutional Partners VI

Firm: Cerberus Capital Management

Primary Geographic Focus: US

Target Size: $3.5bn

EVOLUTION OF THE INVESTOR UNIVERSE

The private credit space has continued to evolve in the past decade as institutional investors are increasingly taking advantage of the fund opportunities that have arisen globally since 2007. Preqin's **Private Debt Online** contains detailed information on more than 2,400 institutional investors that are either actively investing in private debt opportunities or looking to make their maiden commitment. This marks an increase of more than 500 individual investors over 2016, showing heightened interest in the asset class.

LOCATION OF ACTIVE INVESTORS

While 83% of private debt investors are located in either North America or Europe, this represents a decrease of five percentage points from the previous year, indicating that investors in Asia & Rest of World are increasing their exposure to the asset class (Fig. 7.1).

Three of the 10 largest global investors (by current allocation to private debt) are among the 17% of investors based in Asia & Rest of World: South Korea's KB Insurance allocates nearly a quarter (24%) of its $23bn in AUM to the asset class, and Ivory Coast-based African Development Bank allocates 15% of $35bn.

MAKE-UP OF ACTIVE INVESTORS

Institutional investors continue to outnumber private wealth investors in private debt: 85% of investors are institutions, while 15% manage private wealth. Public and private sector pension funds represent the largest proportions of investors in the asset class, 14% and 16% respectively, followed by foundations (13%).

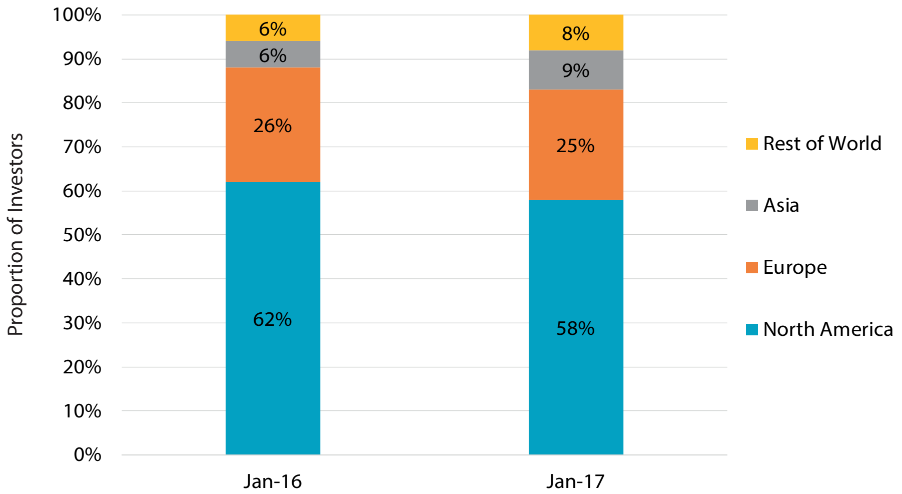
While foundations account for the third largest proportion of active private debt investors by type, they contribute the third smallest amount of aggregate capital. Comparatively, pension funds tend to account for larger proportions of invested capital as a result of typically larger AUM; public and private sector pension funds contribute the largest proportions of aggregate capital at 32% and 24% respectively (Fig. 7.3).

AVERAGE ALLOCATIONS

The average current and target allocations of a private debt investor currently stand at 4.7% and 9.2% respectively. However, there is significant variation among investor types, typically associated with the amount of AUM and years of experience in the asset class. Total capital commitments to private debt will likely continue to grow, as average target allocations exceed average current allocations for all investor types.

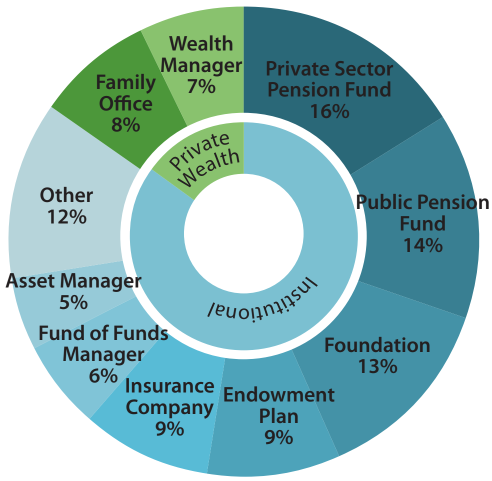
Family offices continue to have both the highest current allocation (10.7%) and the highest target allocation (20.7%) as a proportion of AUM (Fig. 7.4). This can be attributed to fewer restrictions, increased flexibility and their appetite for higher returns compared to other asset classes. Specifically, two New York-based single-family offices are looking to make new

Fig. 7.1: Institutional Private Debt Investors by Location, 2016 vs. 2017



Source: Preqin Private Debt Online

Fig. 7.2: Institutional Private Debt Investors by Type



Source: Preqin Private Debt Online

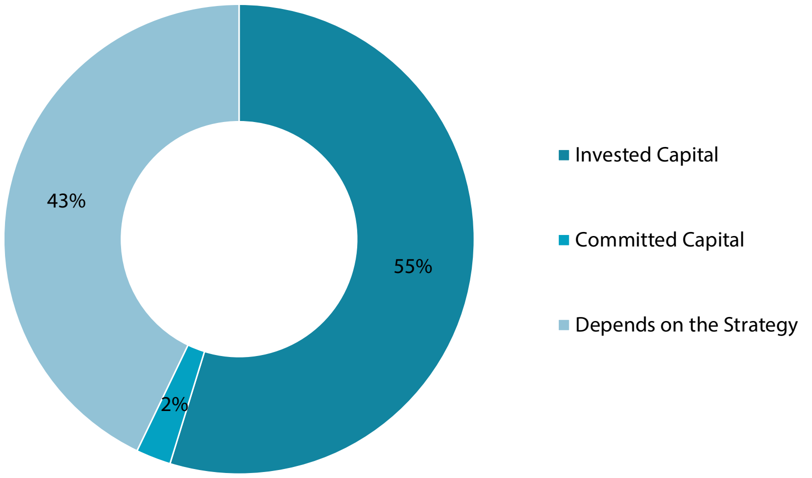
INVESTOR ATTITUDES TOWARDS FUND TERMS AND CONDITIONS

MANAGEMENT FEES

Preqin interviewed a selection of institutional investors in December 2016 regarding their attitudes towards fund terms and conditions. When asked about the structure of management fees paid to their private debt managers, the majority (55%) of investors expect to pay fees only on the capital that has been put to work by a manager, but almost half (43%) would expect the fee structure to vary based on the strategy of the fund (Fig. 9.3).

Investors' opinions on the fees charged by their direct lending investments fall along similar lines, with 64% of investors expecting to pay management fees on invested capital for direct lending funds, compared to just 3% that expect to be charged based on committed capital (Fig. 9.4). Direct lending funds generally carry no equity component, which is one of many reasons they may be less costly for a manager to maintain. In this case, investors can expect to pay less in management fees, despite seeing returns that, on a risk-adjusted basis, can be quite attractive to them.

Fig. 9.3: Private Debt Investors' Expectations of How Management Fees Should Be Charged

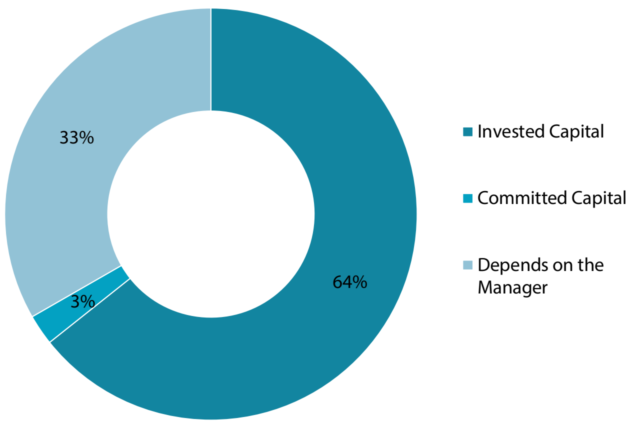


Source: Preqin Investor Interviews, December 2016

ALIGNMENT OF INTERESTS

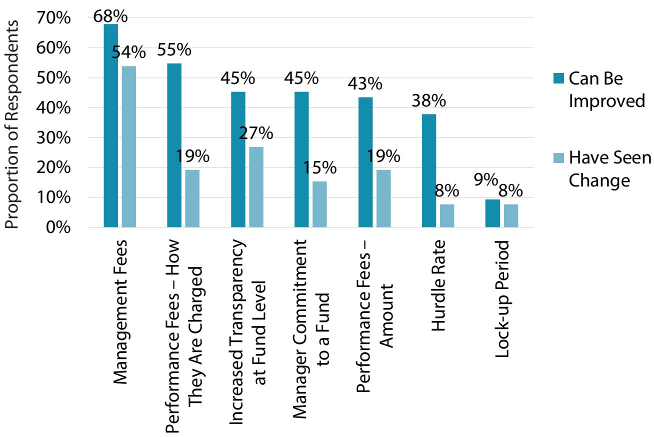
Overall, 63% of private debt investors believe that their interests are aligned with those of their fund managers, while 37% believe that interests are not aligned. Management fees were cited by the largest proportions of investors as an area of fund terms that can be improved (68%), and where changes have been seen in the past 12 months (54%, Fig. 9.5). Fee structure can be the basis for a fruitful manager-investor relationship, and in some cases, investors appreciate the potential trade-off between higher fees and improved portfolio performance, and are therefore satisfied with compensating managers for incremental portfolio gains. Other key areas with potential for improved alignment as cited by investors include how performance fees are charged (55%), the manager commitment to a fund (45%), greater transparency at fund level (45%) and the amount of performance fees (43%).

Fig. 9.4: Direct Lending Investors' Expectations of How Management Fees Should Be Charged



Source: Preqin Investor Interviews, December 2016

Fig. 9.5: Areas in Which Investors Have Seen a Change in Prevailing Terms and Conditions in the Last 12 Months and Where They Can Be Improved



Source: Preqin Investor Interviews, December 2016

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