



PREQIN SPECIAL REPORT: **PRIVATE DEBT FUND MANAGER** **OUTLOOK**

H1 2018



FOREWORD

The private debt industry witnessed considerable growth throughout 2017, with a record \$107bn secured by funds that reached a final close during the year. This Special Report looks at the results of Preqin's November 2017 survey of 94 private debt fund managers, covering topics such as key issues affecting the industry, competition, investor appetite and future fundraising plans.

With optimism among the investor community remaining high moving into 2018, fund managers are attempting to capitalize on this, with 346 private debt vehicles currently in market (as at February 2018) targeting an aggregate \$456bn globally. However, ongoing challenges remain for private credit managers, as an evolving credit environment and more competition than ever before is now the reality of private lending; 70% of fund managers are facing greater competition compared to 12 months ago.

Managers are optimistic about their prospects at present: 77% of respondents plan to deploy more capital in 2018 than they did in 2017. Additionally, 92% of managers expect industry assets under management to increase in 2018, again signalling fundraising confidence in the asset class.

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Key Challenges

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Competition

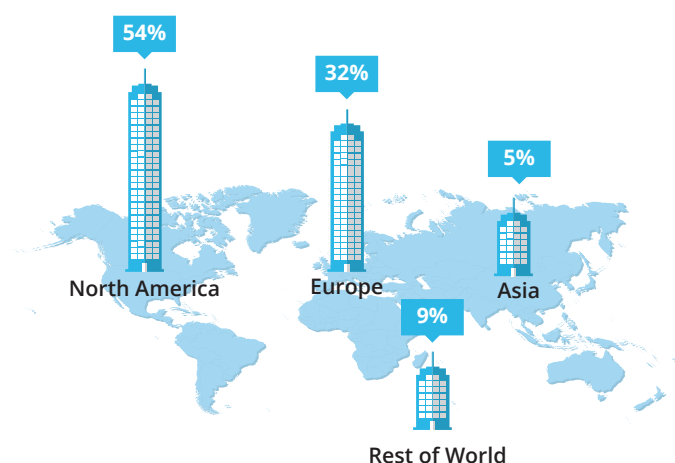
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Fund Manager Views on Investor Appetite

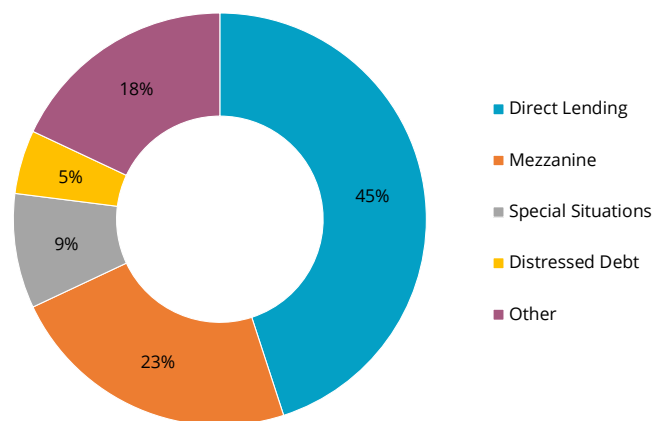
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Outlook and Future Plans

Survey Respondents by Headquarters Location:



Survey Respondents by Primary Investment Strategy:



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KEY CHALLENGES

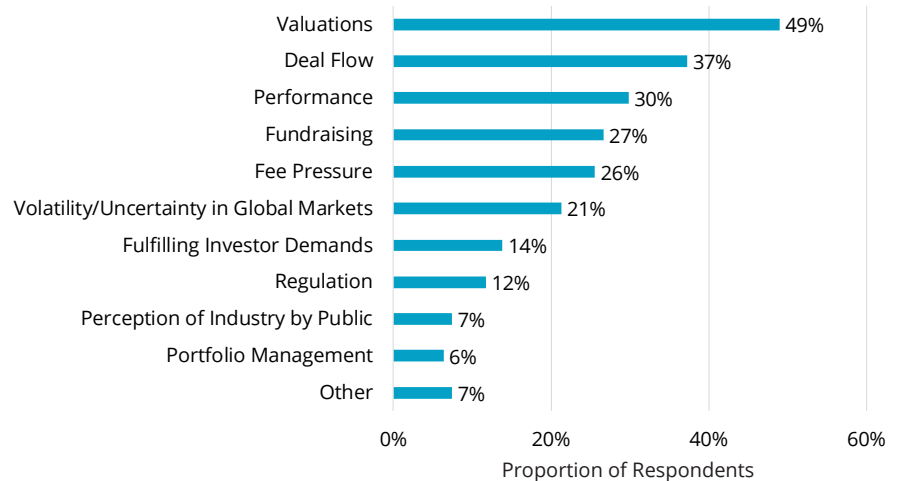
In November 2017, Preqin surveyed 94 private debt fund managers to ascertain the key issues affecting their business and the wider industry at present, as well as their outlook for 2018.

“Deal pricing remains at the top of the list of challenges across the alternatives industry for 2018”

The maturing private debt landscape has offered a host of challenges for fund managers in recent years, with valuations at the forefront, as cited by 49% of fund managers surveyed (Fig. 1). Deal pricing remains at the top of the list of challenges across the alternatives industry for 2018, with lofty valuations becoming increasingly commonplace. As deal terms have steadily become more borrower friendly each year, any change to the credit environment could greatly affect the health of current private debt assets.

Deal flow was cited as a key issue by 37% of respondents, with access to high-quality opportunities becoming more difficult to attain in a highly competitive private credit

Fig. 1: Key Challenges Facing Private Debt Fund Managers in 2018



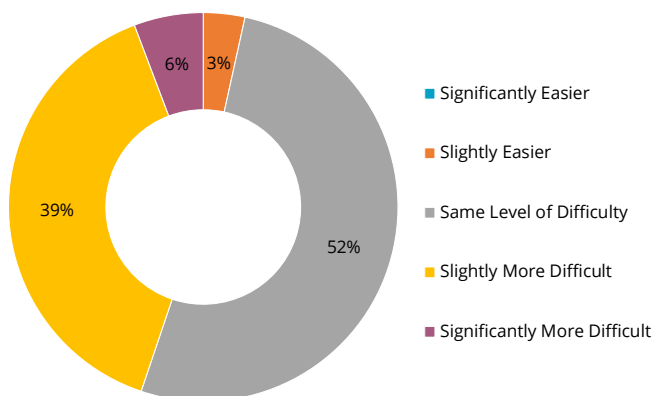
Source: Preqin Fund Manager Survey, November 2017

environment. Further to this, performance was cited by 30% of fund managers as a key challenge in 2018, followed closely by fundraising (27%) and fee pressure (26%). With average fund sizes growing and new managers entering the market as the industry matures, investors can negotiate more modest fees for certain strategies where transparency has also come to lead the conversation.

Just over half (52%) of managers reported the same level of difficulty in finding investment opportunities as 12 months

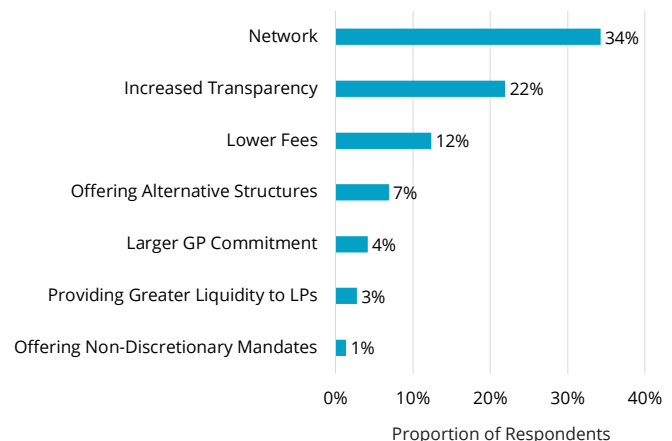
earlier, while 45% feel the process is more difficult (Fig. 2). Given the growing levels of participants in the marketplace, managers with great networks and processes in place should have the upper hand in accessing deals, even more so as successful track records continue to grow; 34% of managers surveyed see their network as their most important differentiation factor among peers (Fig. 3).

Fig. 2: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

Fig. 3: Fund Manager Views on the Most Important Differentiation Factors



Source: Preqin Fund Manager Survey, November 2017

COMPETITION

The private debt market has become increasingly competitive over the past couple of years, as more fund managers have entered the asset class and valuations have continued to rise. A significant 70% of fund managers believe there is now greater competition for transactions than 12 months ago, while no fund managers cited less competition (Fig. 4). Among direct lenders specifically, 71% are experiencing more competition (Fig. 5).

Only 14% of direct lenders surveyed have seen lending terms become more lender friendly in 2017, while 63% have seen

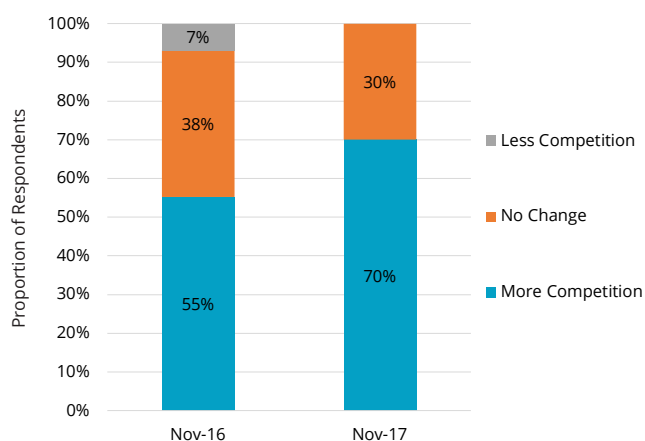
terms become more borrower friendly (Fig. 6). Increased levels of borrower-friendly terms would be a result of more potential lenders across certain markets competing to offer attractive terms to a borrower, and on the bottom line this levelling of the marketplace is a positive for most parties involved, limiting covenants and decreasing the likelihood of defaults.

In efforts to find and access investable opportunities, half of survey respondents are reviewing more opportunities now than 12 months ago, potentially expanding their scope in the process (Fig. 7). Only 13% are

reviewing fewer opportunities than a year ago and 37% are reviewing close to the same amount of investment opportunities.

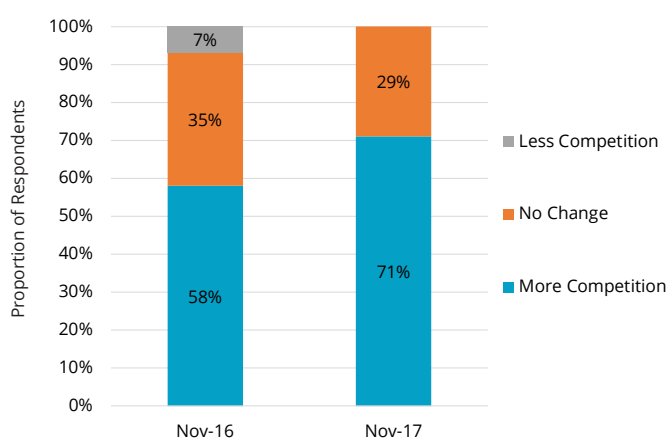
As fund managers appear to be conducting more thorough and diligent searches for accessible lending opportunities, investors have an increasing array of access points for specialized and niche markets. Managers that are heavily differentiated are likely to hold a fundraising and deal-making advantage, as specific expertise in a given region or vertical could be deciding factors in investor allocation decisions.

Fig. 4: Private Debt Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago, 2016 vs. 2017



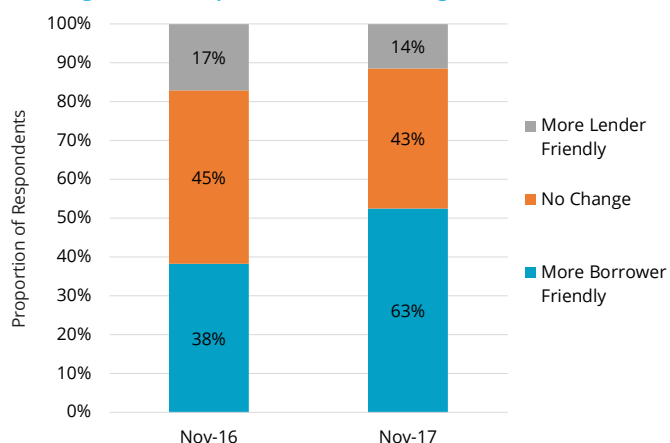
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 5: Direct Lending Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago, 2016 vs. 2017



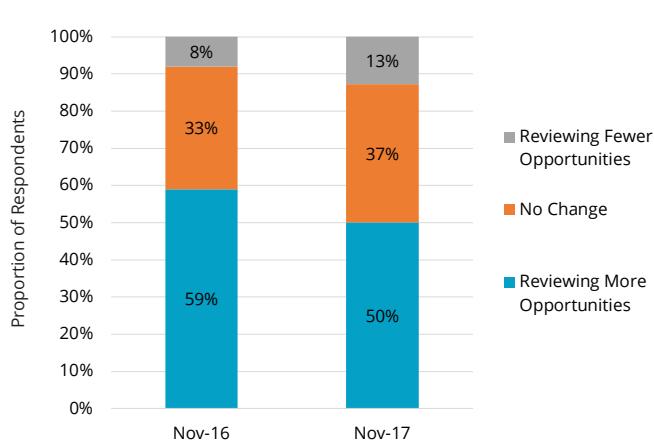
Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 6: Direct Lending Fund Manager Views on Changes in Lending Terms Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 7: Fund Manager Views on the Number of Opportunities Reviewed per Investment Compared to 12 Months Ago, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017



FUND MANAGER VIEWS ON INVESTOR APPETITE

Looking back on 2017, 76% of private debt fund managers surveyed have seen an increase in investor appetite for private debt exposure in the past 12 months, while only 5% reported a decrease, reflecting the confidence of an expanding investor base (Fig. 8). Variations in the timing of fundraising cycles, manager track record, fund strategy, location and other factors certainly contribute to managers' differing experiences while seeking capital; however, the predominant trend in recent years has been institutional investors setting aside larger allocations for private

debt funds across strategies and capital seniorities.

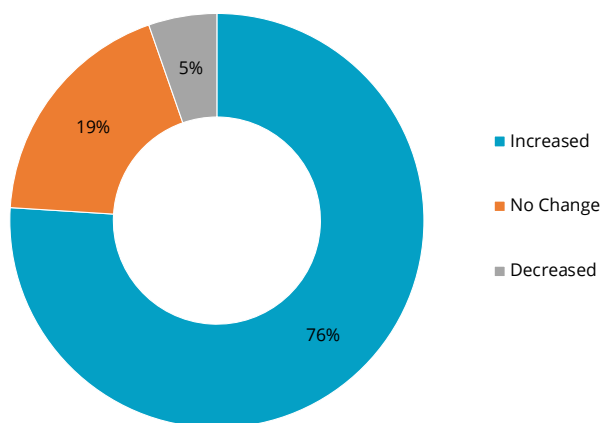
The largest increase in appetite for private debt over the past year was seen from family offices, with 64% of fund managers reporting an increase in interest (Fig. 9). Sixty percent of fund managers also saw increased appetite from both public and private sector pension funds. Only 17% of managers saw an increase in appetite from banks, while 19% saw a decrease.

Sixty-five percent of managers experienced an increase in demand for private debt

among investors based in Europe (Fig. 10). Fifty-nine percent of respondents noted an increase in investor appetite from investors based in North America, while 44% recorded the same for Asia.

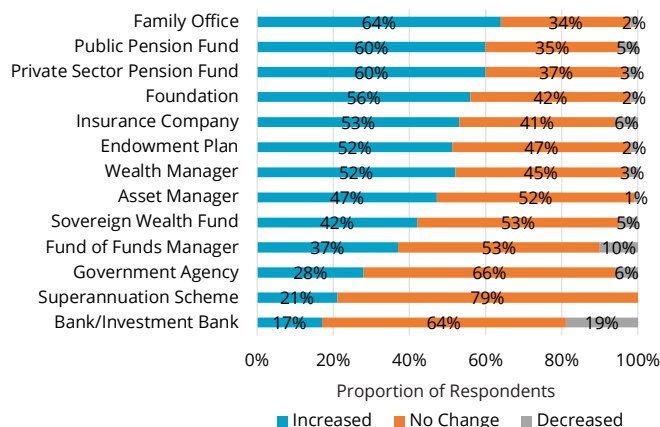
The vast majority (83%) of managers surveyed reported an increase in competition for investor capital over 2017 (Fig. 11). The influx of emerging fund managers, larger funds, and fee and performance pressure could all have contributed to the heightened competition for investor capital during 2017.

Fig. 8: Fund Manager Views on How Institutional Investor Appetite for Private Debt Has Changed over the Past 12 Months



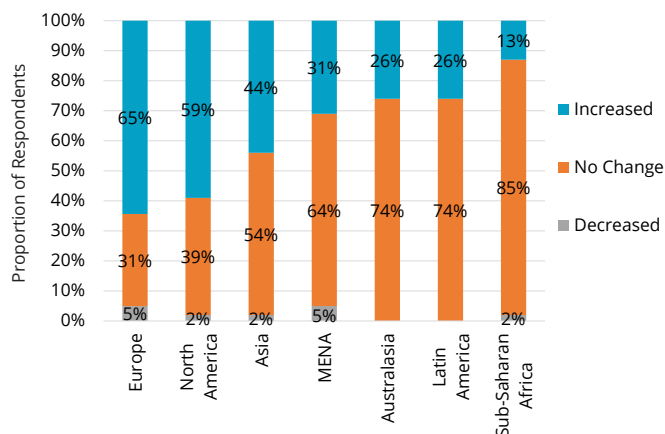
Source: Preqin Fund Manager Survey, November 2017

Fig. 9: Fund Manager Views on How Institutional Investor Appetite for Private Debt Has Changed over the Past 12 Months by Investor Type



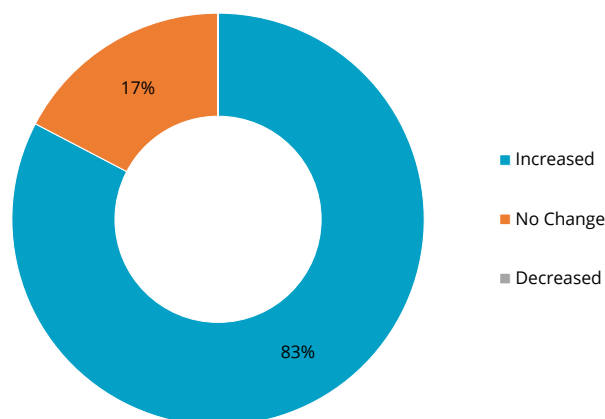
Source: Preqin Fund Manager Survey, November 2017

Fig. 10: Fund Manager Views on How Institutional Investor Appetite for Private Debt Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, November 2017

Fig. 11: Fund Manager Views on the Level of Competition for Investor Capital Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2017

OUTLOOK AND FUTURE PLANS

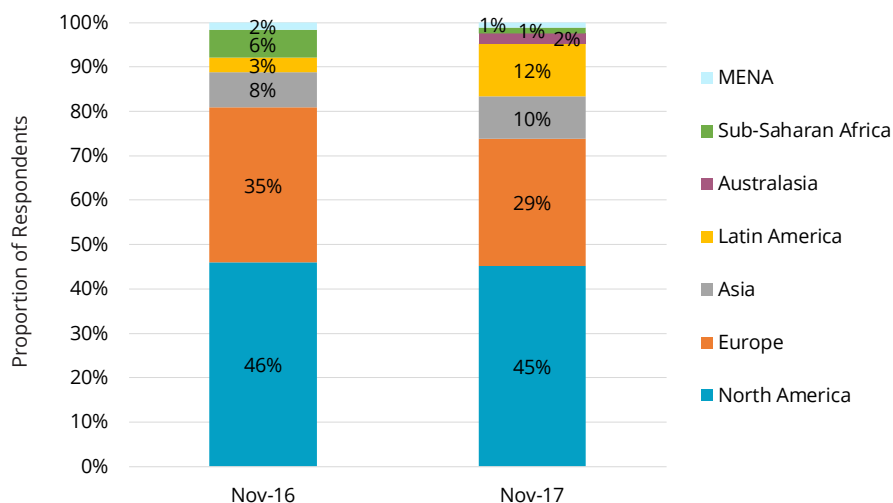
North America remains the region that the largest proportion (45%) of fund managers believe will present the best opportunities in the next two years, followed by Europe (29%), Latin America (12%) and Asia (10%, Fig. 12). Latin America has seen considerable expansion in private debt opportunities, as one year ago just 3% of managers believed that the region was the strongest destination for private debt investment.

“North America remains the region that the largest proportion (45%) of fund managers believe will present the best opportunities in the next two years

The largest proportion (38%) of fund managers surveyed consider environmental, social, and corporate governance (ESG) factors as part of the deal-making process for all transactions, while 25% consider ESG factors for some (Fig. 13).

The most prominent factors considered across each of the three areas of ESG

Fig. 12: Fund Manager Views on the Region Presenting the Best Private Debt Investment Opportunities over the Next 12-24 Months, 2016 vs. 2017

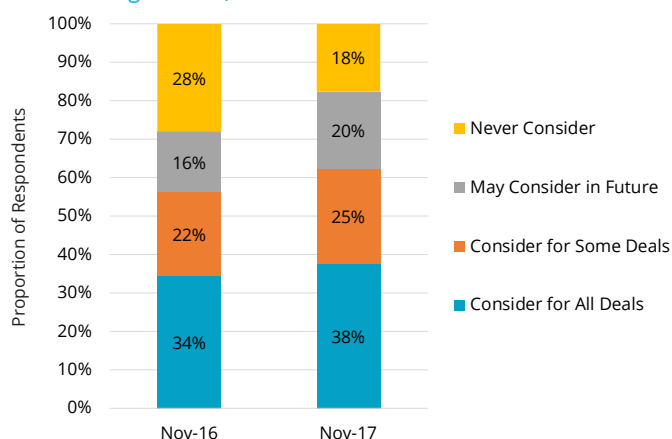


Source: Preqin Fund Manager Survey, November 2016 - 2017

were hazardous waste disposal (46%), human rights (49%) and balanced management structure (61%). ESG factors are likely to become more important to a growing number of fund managers in the near future, as investors are increasingly looking to commit to funds that consider ESG policies. Given the competition for capital within private debt, it could be an advantage for fund managers to apply ESG factors moving forward in order to stand out from the crowd.

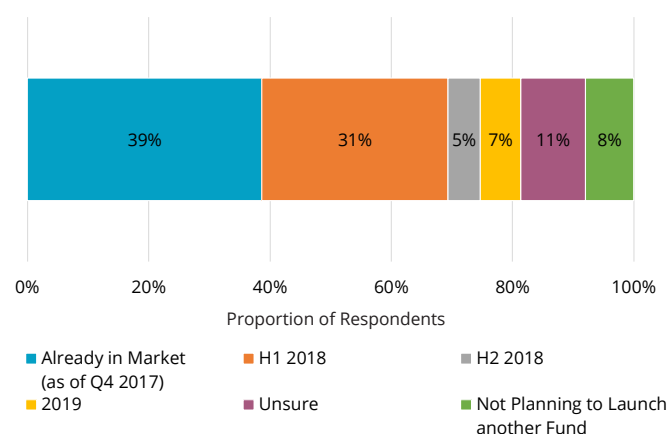
As seen in Fig. 14, 39% of respondents were in market with a fund at end of 2017, while 31% were planning to launch a vehicle in H1 2018. With private debt fundraising at record levels in 2017 and investor appetite strong, there is motivation and confidence among managers to raise capital with intentions to enter a healthy, but possibly transforming, credit marketplace. Twelve percent of respondents are planning to launch a fund in H2 2018 or in 2019.

Fig. 13: Fund Managers that Consider ESG Factors as Part of the Deal-Making Process, 2016 vs. 2017



Source: Preqin Fund Manager Survey, November 2016 - 2017

Fig. 14: Timeframe with Which Fund Managers Intend to Launch Their Next Private Debt Fund



Source: Preqin Fund Manager Survey, November 2017



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