2018
PREQIN GLOBAL
PRIVATE DEBT
REPORT

SAMPLE PAGES

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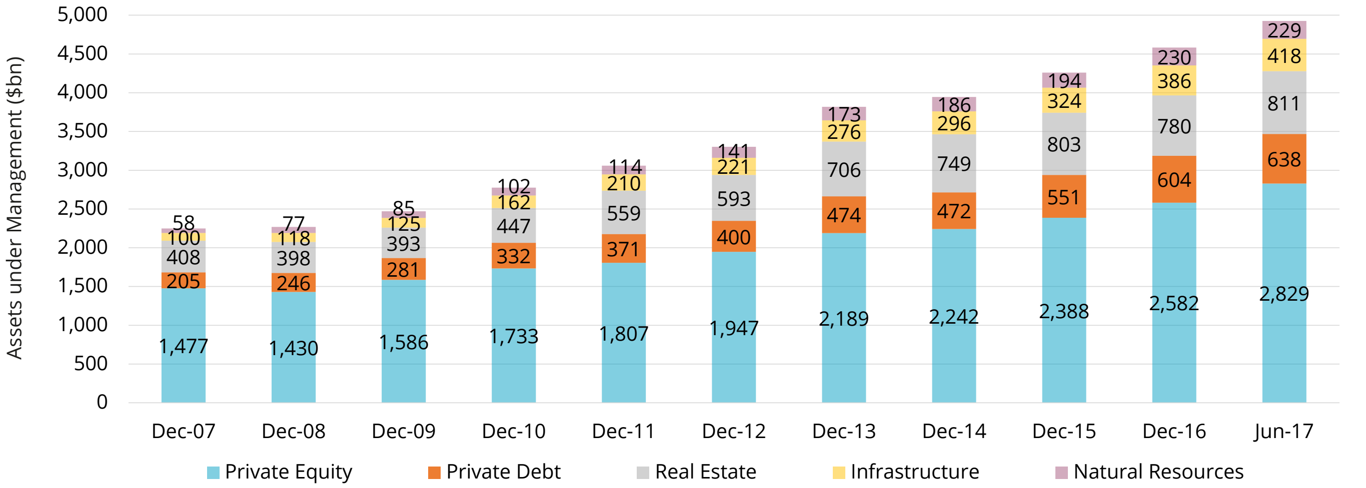
CONTENTS

PRIVATE DEBT IN CONTEXT

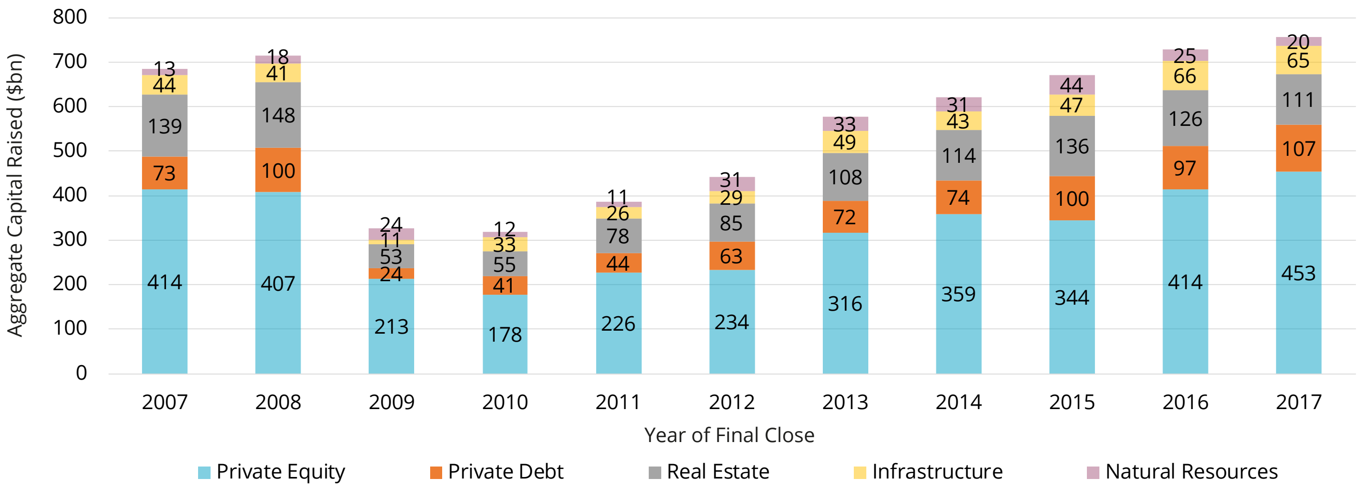
Preqin refers to 'private capital' as the broader spectrum of private closed-end funds, including private equity, private debt, private real estate, infrastructure and natural resources. Here, we put the private debt asset class into context within the wider private capital industry.

Fig. 2.1: Private Capital Assets under Management by Asset Class, 2007 - 2017



Source: Preqin Online Products

Fig. 2.2: Annual Aggregate Private Capital Raised by Asset Class, 2007 - 2017



Source: Preqin Online Products

Fig. 2.3: Top Three Challenges Facing Private Capital Fund Managers in 2018 by Asset Class

Private Equity	Private Debt	Real Estate	Infrastructure	Natural Resources
Valuations	**Valuations**	Valuations	Valuations	Commodity Prices
Performance	**Deal Flow**	Deal Flow	Regulation	Ongoing Volatility/ Uncertainty in Global Markets
Exit Environment	**Performance**	Interest Rates	Deal Flow	Public Perception of Industry

Source: Preqin Fund Manager Surveys, November 2017

PRIVATE DEBT: 2017 IN NUMBERS

SIZE OF THE INDUSTRY

$638bn
Private debt assets under management as at June 2017.

$236bn
Dry powder held by private debt funds as at December 2017.

FUNDRAISING SUCCESS

$107bn
Aggregate capital raised by the 136 private debt funds closed in 2017.

107%
Average proportion of target size achieved by private debt funds closed in 2017.

CAPITAL CONCENTRATION

$869mn
Average size of private debt funds closed in 2017.

32%
of aggregate capital was secured by the 10 largest funds closed in 2017.

KEY ISSUES

40%
of investors consider valuations as a key issue facing private debt in 2018.

45%
of fund managers believe it is now more difficult to find attractive opportunities than 12 months ago.

PERFORMANCE

80%
of investors believe that their private debt portfolios will perform about the same or better in the next 12 months than in the last 12 months.

$71bn
Total capital distributions by private debt funds in H1 2017.

INVESTOR SENTIMENT

51%
of investors have a positive perception of private debt.

42%
plan to commit more capital to private debt funds in the next 12 months than in the past 12 months.

PRIVATE DEBT BREAKS $100bn IN 2017

- Ryan Flanders, **Preqin**

Private debt fundraising surpassed $100bn in aggregate capital raised by funds closed in 2017, doing so for the first time after close calls in 2008, 2015 and 2016. Direct lending funds alone closed the year with more than $50bn in committed capital across 61 funds, double the total for 2016 ($24bn). The average fund size also more than doubled for direct lending funds closed in 2017 to $1bn compared to $478mn in 2016.

North America-focused funds once again enjoyed the highest fundraising totals, reaching $67bn. The region accounted for 63% of aggregate capital raised by funds closed during the year, and continues to host the most active private debt market. After being surpassed by Europe-focused direct lending funds in 2016, North America-focused direct lending regained the top spot, raising $32bn versus $22bn for direct lending funds focused on Europe. The overall European private debt market continues to thrive, with 40 funds having seen closures securing an aggregate $33bn in 2017, building on a strong 2016 when $26bn was raised.

Driven by strong and consistent fundraising cycles, private debt industry AUM reached a new high of $638bn as at June 2017. Dry powder as at December 2017 is also at an all-time high, with $236bn of capital available for investment. Once again we see the bulk of this capital concentrated in North America and Europe, representing 94% of dry powder held by managers, but with $16bn in Asia- and Rest of World-focused funds, it is clear that key markets outside the two main hubs of private debt are expanding. As at January 2018, 11% of private debt investors tracked by Preqin are based in Asia, up from only 6% at the start of 2016, signalling a substantial increase in activity from investors based in the region, coinciding with the more robust fundraising figures coming out in 2017.

Europe-based investors account for 24% of those active in private debt, while North America is home to 57% of institutional investors. The proliferation of interest in private debt fund exposure has clearly extended beyond just Europe and North America, with increasing numbers of investors based in countries such as India, China, Japan, Brazil and many more, which account for 19% of the 3,154 private debt investors globally.

As at January 2018, there are 335 private debt funds in market seeking $149bn across all private credit strategies, including one $10bn vehicle from Goldman Sachs. At the other end of the spectrum, regional and strategic specialization at the smaller end of the fundraising scale has led to targeted fundraises from managers with local expertise in a given region or target industry.

While the level of competition for institutional capital remains as high as it has ever been, private credit managers are enjoying unprecedented levels of positive sentiment and increasing allocations toward their offerings from a continuously expanding investor base. Investors are setting dedicated private debt targets for what has now become a key, income-producing portfolio slice for large pension funds and family offices alike, as well as other investor types in between. If managers can match the attractive performance targets originally set out, there is no reason why investors will not continue to support new vehicles, from both experienced and new managers coming in to compete for capital.

With comprehensive coverage of institutions active in private debt, vehicles on the road, firms active in the space, deals and performance data, Preqin's platform is the ultimate tool to help both investors, fund managers and service providers identify ideal partnerships into 2018.

IN FOCUS: FUNDRAISING BY PRIMARY STRATEGY

Fig. 4.21: Private Debt Fundraising in 2017 by Type

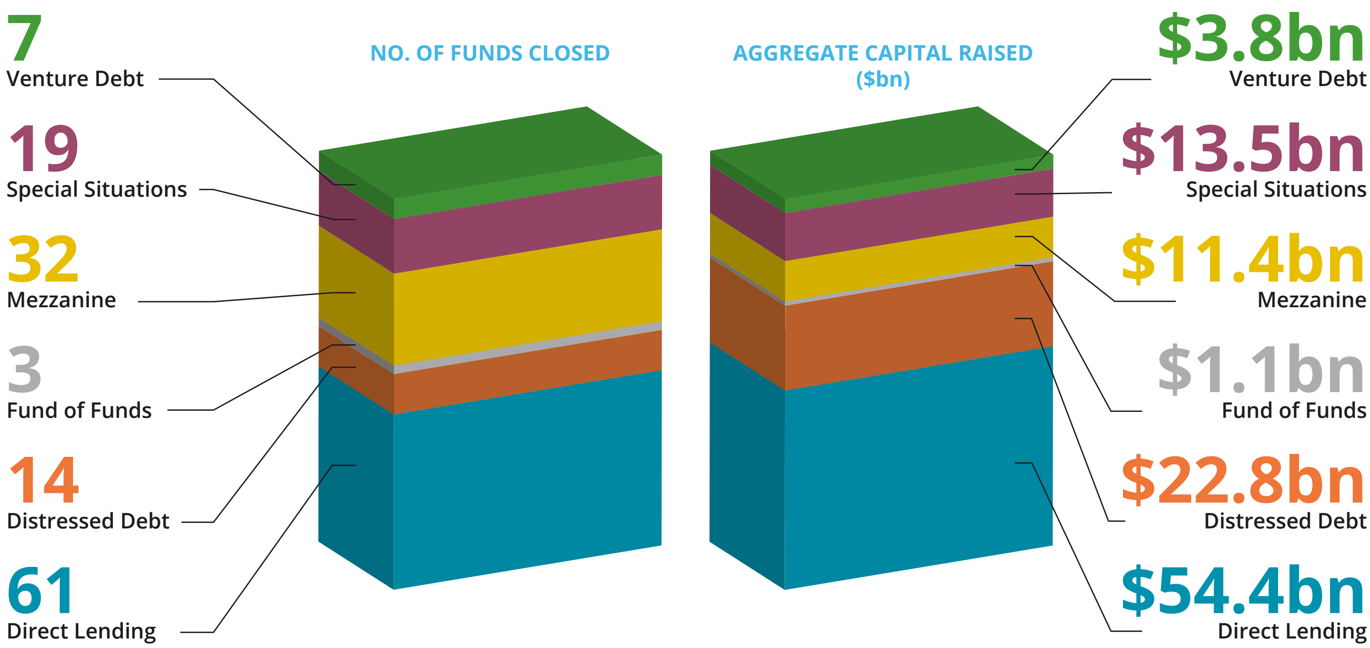
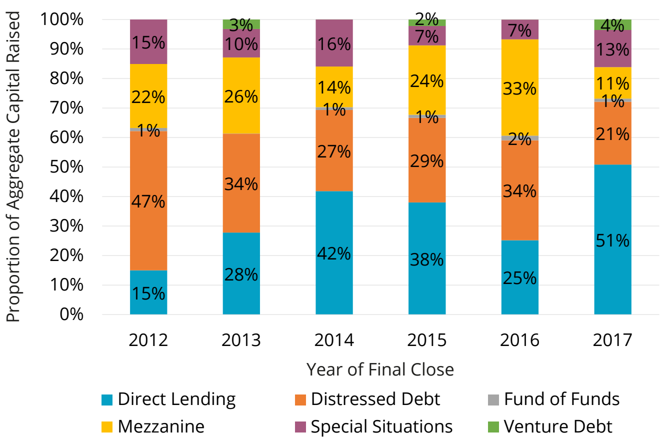
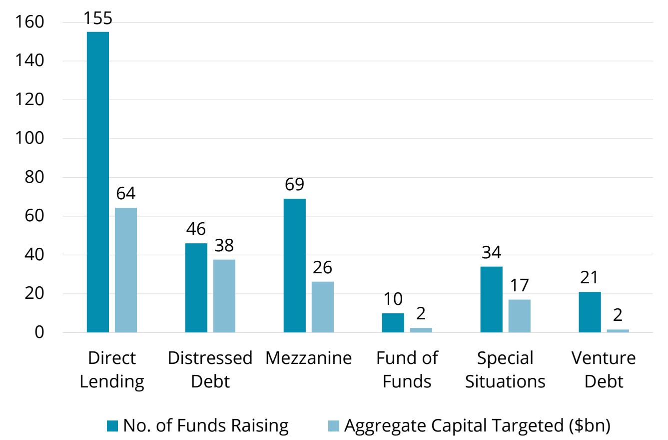


Fig. 4.22: Proportion of Aggregate Capital Raised by Private Debt Funds by Type, 2012 - 2017



Source: Preqin Private Debt Online

Fig. 4.23: Private Debt Funds in Market by Type (As at January 2018)

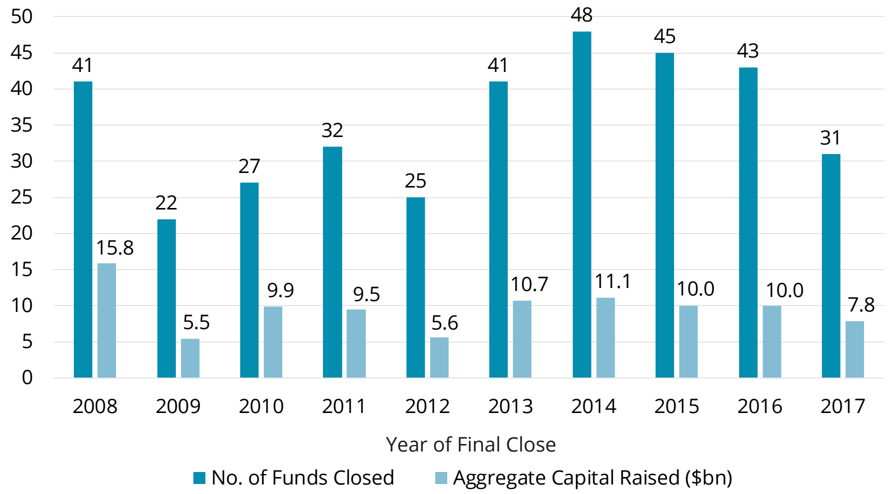


Source: Preqin Private Debt Online

FIRST-TIME FUND MANAGERS

Despite record private debt fundraising in 2017, first-time managers secured the lowest amount of capital since 2012, with 31 first-time funds reaching a final close, securing an aggregate $7.8bn (Fig. 5.11). First-time private debt fund managers have closed over 40 funds in each of the previous four years, raising an average of $10.5bn per year. With a growing selection of private debt funds in market for investors to choose from, an increasing number of managers are launching successor funds and are able to advantageously demonstrate a favourable track record. In addition, increased competition for deals may prompt investors to favour experienced debt managers.

Fig. 5.11: Annual First-Time Private Debt Fundraising, 2008 - 2017



Source: Preqin Private Debt Online

Of the first-time funds closed in 2017, 13 direct lenders secured $3.9bn in total commitments, followed by five special situations funds which raised an aggregate $1.2bn. There were eight mezzanine funds closed, two funds of funds and two distressed debt funds from first-time managers.

FUNDRAISING SUCCESS

Nearly two-thirds (63%) of first-time funds closed in 2017 secured at least 100% of their initial target, a slight improvement compared with those closed in 2016 (60%, Fig. 5.12). For experienced managers, 72% of funds closed in 2017 and 78% of funds closed in 2016 met or exceeded targets.

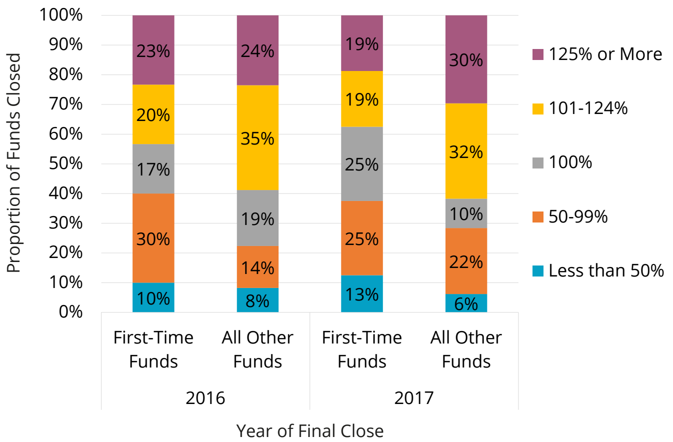
PERFORMANCE

While there are certainly substantial and varied risks that come with committing capital to new managers, there also exists the potential for outsized returns. First-time fund managers often have the ability to access niche or innovative opportunities in many sectors or regions that have not yet been reached by their more experienced peers.

First-time fund managers have outperformed experienced managers in terms of median net IRR for fund vintages 2008-2014 (Fig. 5.13); vintage 2011 and 2012 first-time funds have outperformed by the widest margin, returning 15.7% and 16.6% respectively, compared with 9.8% and 10.5% for funds led by experienced managers of the same vintages.

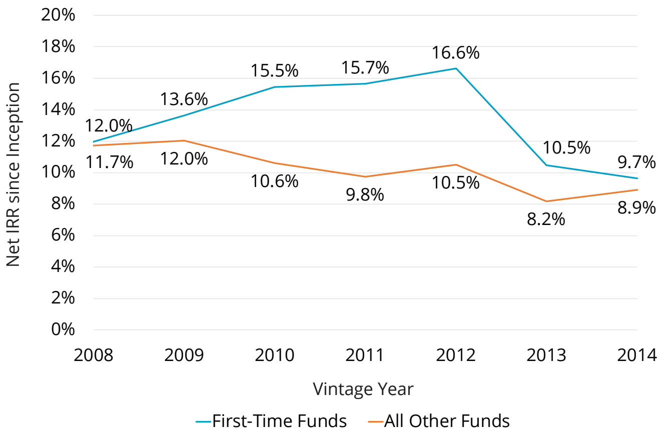
The vintage 2008 Monarch Capital Partners distressed debt fund ($330mn) achieved a net multiple of 2.4x, ranking highest among top performing first-time private debt funds of vintages 2004-2014 (Fig.

Fig. 5.12: Private Debt Funds Closed by Proportion of Target Size Achieved: First-Time vs. All Other Funds, 2016 vs. 2017



Source: Preqin Private Debt Online

Fig. 5.13: Private Debt Median Net IRRs by Vintage Year: First-Time vs. All Other Funds



Source: Preqin Private Debt Online

SEEKING RELATIVE VALUE IN GLOBAL PRIVATE DEBT

- Terry Harris, **Barings**

As institutional investors continue to turn toward private debt for potentially attractive risk-adjusted returns in a low-yielding environment, they may benefit from taking a global approach to the asset class.

Private debt continues to gain favour as yield-hungry investors look for solutions to help meet their portfolio return targets. Institutional investors in particular are often drawn to private loans for the potential to earn incremental yield relative to broadly syndicated markets. As private debt has become a more common element of institutional portfolios, investors may benefit from allocating to managers that cast a wider net when looking at investment opportunities.

The direct lending market offers investors a range of attractive potential benefits, including:

- Potential return premium versus broadly syndicated markets
- Conservative structures and loan documents with strong investor protection
- Investment diversification
- Access to a broad universe of investment opportunities
- Limited correlation to public markets

There are some key potential advantages to taking a global approach to private debt. For one, investing globally significantly increases the opportunity set of potential private loan investments, which can allow managers to invest more selectively. This is an important point because the relative value of private debt investments in each region shifts from time to time depending on market dynamics, such as the demand for debt capital by private equity funds and the supply of debt capital from both banks and unregulated institutional lenders.

SEEKING RELATIVE VALUE ACROSS GEOGRAPHIES

North America

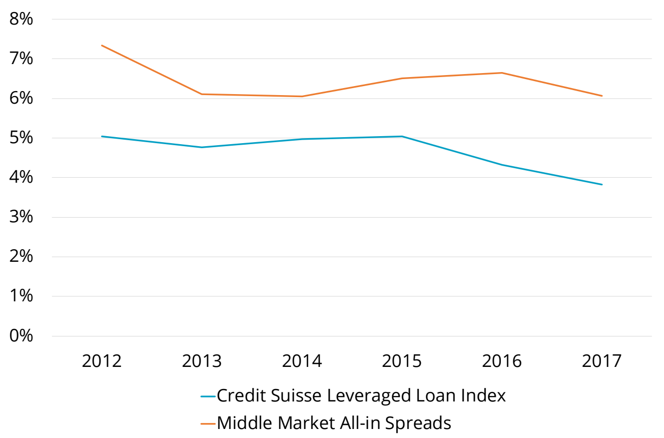
North America is the largest and most developed private debt market from both an investor and borrower standpoint. In fact, the volume of private debt issued in the US and Canada is roughly 4-5x the volume of private debt issued in Europe. The breadth and depth of the North American market lends itself to building a diversified portfolio of private loans to middle-market companies that operate across a wide range of sectors. In North America, companies that issue private loans tend to be mid-sized, with EBITDA between $10mn and $50mn – companies not quite large enough to access the broadly syndicated loan and bond markets. These companies are typically unrated but have a credit profile generally equivalent to S&P B.

In North America, private debt spreads were relatively tight during the first half of 2014, while the pricing of risk was much more attractive in Europe. Spreads in the US then widened in the latter part of 2014 through 2016, but began to tighten modestly in 2017 as US base rates increased. However, given the more pronounced tightening of spreads for broadly syndicated loans, the "originate-to-hold" spread premium for private debt remains attractive, in our view. Generally, private loans to US issuers that are structured with more conservative leverage and loan-to-value than broadly syndicated loans currently yield a premium of roughly 125 to 150 basis points, although it can be substantially higher[1].

Europe

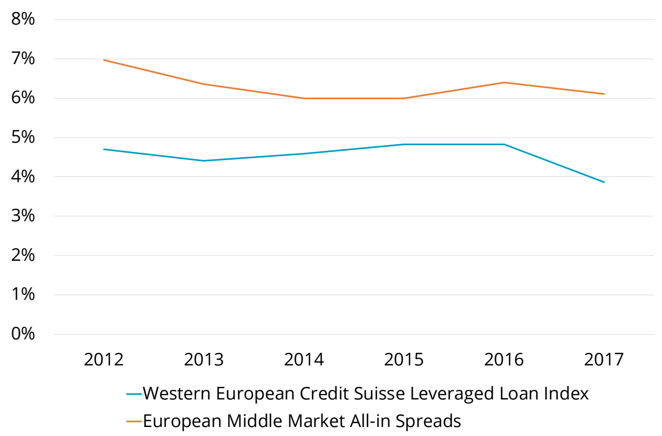
In Europe, banks still provide the lion's share of financing for middle-market companies. That said, there is an increasing opportunity for non-bank providers of private debt capital that may be able to operate with more flexibility than banks, which have been under

Fig. 1: US All-in Spreads (DM-3): Middle Market vs. Broadly Syndicated Loans



Source: S&P Margin Data (U.S.). As of October 31, 2017.

Fig. 2: European All-in Spreads (DM-3): Middle Market vs. Broadly Syndicated Loans



Source: S&P Margin Data (Europe). As of October 31, 2017.

increasing regulatory pressure. While new private debt managers have emerged to capitalize on this opportunity, more established private debt managers with longstanding deal referral relationships retain an advantage, and the low level of non-bank penetration relative to the US suggests private finance has room to continue taking market share from banks. The credit profile of private debt issuers in Europe is similar to that of issuers in North America.

While substantial capital has been raised to invest in direct lending, pricing in Europe has tightened only marginally, suggesting that there is sufficient room for the capital and that the capital is in the process of being deployed. Private loans to European issuers continue to benefit from high upfront fees, stable spreads and, in some cases, base rate floors that exceed prevailing Euribor. As a result, the current premium for private debt as compared to broadly syndicated debt is particularly attractive in Europe, in our opinion. In Europe, private loans structured more conservatively than broadly syndicated loans tend to generate illiquidity premiums of 175 to 200 basis points or more[2].

Australia, New Zealand and Developed Asia

There are also opportunities in Australia, New Zealand and developed Asia. These markets are still mainly bank dominated, but there is an emerging opportunity for non-bank lenders and there are very few established players in the region. The companies in these markets may be mid-sized but in many cases are larger, sometimes with EBITDA from $50mn to $100mn. While these are not necessarily very large companies by global standards, due to the smaller size of the market, private loan issuers in Australia and New Zealand in particular often have dominant market positions, enhancing their credit profile. These companies are typically unrated but have a credit profile roughly equivalent to S&P BB.

In the Australia, New Zealand and developed Asia markets, spreads are currently tighter compared to the US and Europe, but issuers are typically larger and have more conservative credit structures. In Australia, competition has intensified over the past year as banks have sought to grow their loan books. However, due to the lack of depth of capital markets in the region, select opportunities exist to achieve a potentially attractive illiquidity premium while investing in issuers, which if located in the US or Europe, would be large enough to issue broadly syndicated loans.

MEZZANINE DEBT

In addition to the global opportunity in senior debt, investors can find potentially attractive opportunities in private mezzanine debt, a subordinated part of the capital structure that can offer attractive absolute and relative returns. Notably, due to the “originate-to-hold” nature of private mezzanine debt, these investments tend to have lower volatility relative to liquid traded assets. Whether secured by a second lien or unsecured, private mezzanine debt is structured more conservatively than high-yield bonds, and loan agreements typically provide stronger creditor protections. Additionally, given the lack of liquidity in the asset class, investors may be compensated with significant illiquidity premiums relative to the high-yield bond market[3].

Given the currently high purchase prices paid by private equity managers to acquire portfolio companies, the returns for some current vintage private equity funds may not significantly exceed returns from investing in private mezzanine debt, which tends to exhibit much lower volatility.

A COMPELLING OPPORTUNITY

A global strategy can be an efficient way for private debt investors to access opportunities as they are sourced across different regions and markets. Because countries differ in terms of where they are in their respective economic, interest rate and business cycles, the relative attractiveness of their private lending markets can change over time. Diversifying across North America, Europe, Australia and developed Asia, therefore, may better position investors to seek relative value as private debt yields tighten or widen from time to time in each region.

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*As of September 30, 2017

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[1]*Based on Barings market observations. As of December 2017.*
[2]*Based on Barings market observations. As of December 2017.*
[3]*Based on Barings market observations. As of December 2017.*

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INVESTOR APPETITE FOR PRIVATE DEBT IN 2018

More than half (51%) of investors surveyed in December 2017 have a positive perception of the asset class, compared with just 12% that hold a negative view (Fig. 7.6).

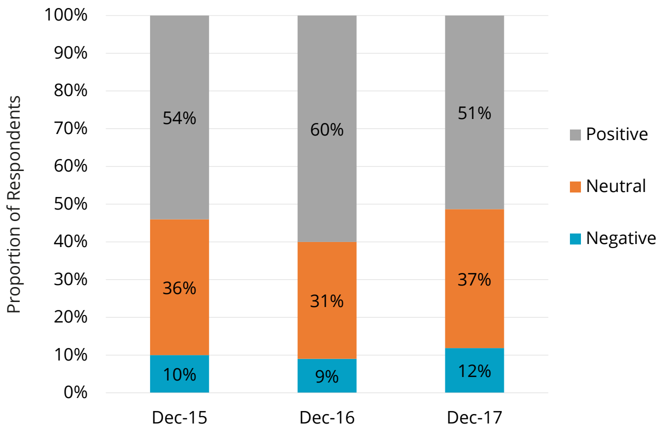
Forty-eight percent of investors plan to commit the same amount of capital to the asset class in 2018 as they did in 2017, while 42% will commit more capital (Fig. 7.7).

Although the outlook for the asset class in both the near and long term is generally positive, investors remain wary of key issues within the market in 2018. The proportion of investors that see valuations of private debt assets as a key issue has remained steady between 2017 and 2018 at 40% (Fig. 7.8). However, investors appear less concerned by other areas such as deal flow (29%), performance (17%) and regulation (16%) in comparison to one year ago.

INVESTOR ALLOCATIONS TO PRIVATE DEBT

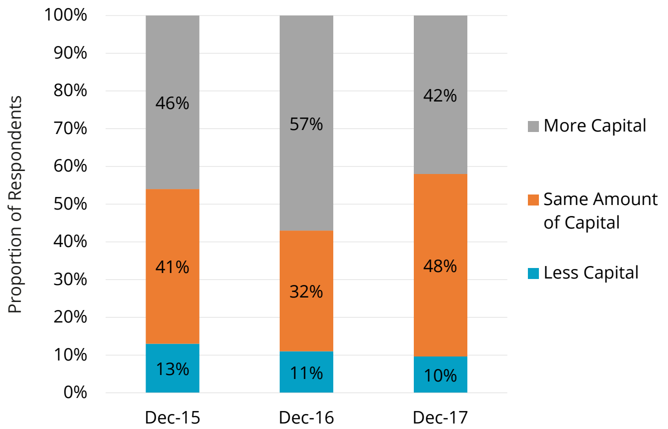
As a growing number of investors put capital into the private debt asset class over the next 12 months, average allocations are also expected to increase over the longer term: 54% of respondents plan to increase their allocations to private debt and just 2% plan to decrease their allocations, compared to 8% of those interviewed at the end of 2016 (Fig. 7.9). In addition, 48% of investors expect to increase the number of debt fund managers in their portfolios over the next two years as they increase their investments in the asset class (Fig. 7.10). Together, these suggest that institutional investor appetite for the asset class is high. Expansion of the capital pool is certainly a great sign for fund marketers, which may now see greater access to investor types

Fig. 7.6: Investors' General Perception of the Private Debt Asset Class, 2015 - 2017



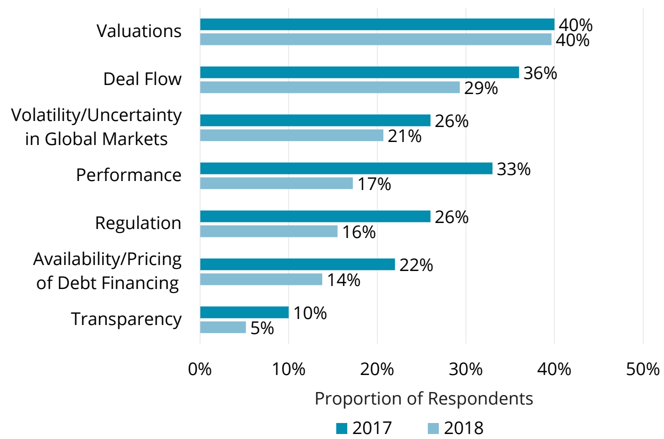
Source: Preqin Investor Interviews, December 2015 - 2017

Fig. 7.7: Investors' Expected Capital Commitments to Private Debt Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2017



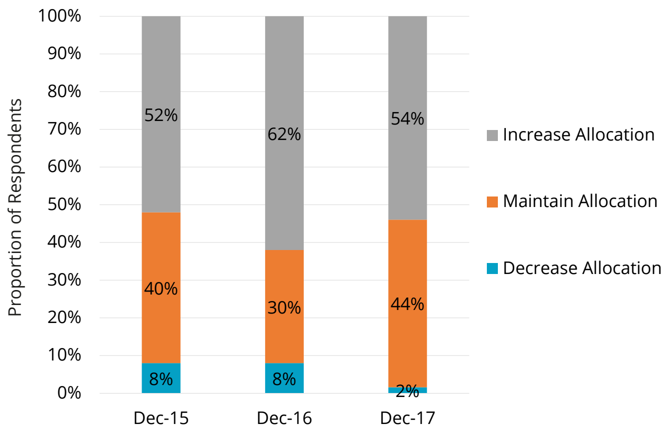
Source: Preqin Investor Interviews, December 2015 - 2017

Fig. 7.8: Investor Views on the Key Issues Facing Private Debt in 2017 vs. 2018



Source: Preqin Investor Interviews, December 2016 - 2017

Fig. 7.9: Investors' Intentions for Their Private Debt Allocations over the Long Term, 2015 - 2017



Source: Preqin Investor Interviews, December 2015 - 2017

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