The Q3 2015

Preqin Quarterly Update

Private Debt

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

Content includes...

Fundraising

Private debt fundraising picks up in Q3.

Funds in Market

Private debt funds in market are seeking an aggregate $117bn.

Investors in Private Debt

Direct lending funds are likely to be the most sought-after strategy in the next 12 months.

Fund Performance and Dry Powder

Europe-focused dry powder has increased by 66% since December 2014.

Plus, Special Guest Contributors:
Tikehau IM

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alternative assets. intelligent data.

Foreword - Ryan Flanders, Preqin

Twenty-seven private debt funds reached a final close in Q3 2015, managing to secure a total of $19.3bn in commitments globally. The private debt industry has continued to prosper in North America, once again supported by strong direct lending fundraising figures. Europe also had a successful quarter in terms of fundraising, with the aggregate capital secured by funds focused on the region surpassing the amount of capital raised by North America-focused funds.

It seems institutional investors are showing a healthy appetite for senior secured and unitranche structures within direct lending, as mandates continue to widen and include private lending vehicles. A total of $9.0bn was secured across 11 direct lending vehicles globally in Q3, more than twice the total amount raised within mezzanine, which closed the quarter with $4.0bn across five vehicles.

The final quarter of 2015 could see an interest rate adjustment that would affect the near-term future of private debt, according to the most recent commentary by US regulators. Though most private lending vehicles use a floating rate, an increase in interest rates would be the first step in the revitalization of traditional fixed income assets. That said, it is certainly clear at this point in the game that private debt has carved out a substantial hold in institutional portfolios as a yield-producing asset class that should continue to see nominal growth, expansion and acceptance.

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.

Contents

Direct Lending : How to Capitalize on New Opportunities

Cécile Mayer-Lévi & Jean-Baptiste Feat,
Co-Heads of Private Debt, Tikehau IM

How much opportunity is there for alternative lenders within Europe given the difference in regulation from country to country?

Alternative financing solutions are progressively expanding throughout Europe to become one of the mainstream options offered to corporates and private equity firms to access long-term debt financing.

The local specificities per country, in particular in terms of legal framework for lenders' protection, have paved the way for local private debt markets. Depending on the size of financing, alternative lenders could be split into two main categories: (1) global firms with coverage out of London and (2) local deal making presence in several key European countries.

Due to structural shifts in regulation and retrenchment from banks, alternative financing is growing at a fast pace. The UK remains the largest market in Europe, followed by France. Alternative financing encompasses two main categories of financing: direct lending for SME corporates and acquisition financing for LBO.

The search for long-term financing at attractive conditions has opened a new market for bonds issued by small- to mid-sized companies. Regulation has softened to allow institutional investors to directly support SMEs in the absence of rating or listing.

What we've recently observed is that regulation in some countries, such as Italy, has really made progress both from a regulatory and fiscal standpoint, hence opening the private debt market. This situation is particularly true for bonds with the emergence of Mini Bonds. Despite the current QE that partially slowed down the move, we clearly note that government-based initiatives generated a structural shift in regulation in favour of alternative lenders.

France is the second most important direct lending market in Europe after the UK. France is also a good example of regulatory progress given the recent change in regulation to allow insurance groups to invest in direct lending. Furthermore, the French sovereign wealth fund, Caisse des Depots et Consignation (CDC), with the funding of several insurance groups, backed two initiatives, NOVO and NOVI, to finance French SMEs that are not under private equity ownership. Tikehau was selected for both NOVO and NOVI mandates. This is a good example of partnerships between the State, insurance companies and alternative lending asset managers/direct lending firms. These mandates are a unique opportunity for Tikehau to address new financing needs outside of the private equity sphere while developing strong corporate driven financing capabilities.

Finally, we have adopted a specific strategy of being a European player with strong local presence. Our team of 18 professionals split between our offices in London, Paris, Milan and Brussels are experienced in covering the specificities of local execution including the regulation aspect of each country. We believe it is a competitive advantage as a European player to have this in-depth knowledge and of course, we do have in-house the experience of dealing with restructuring should it be necessary.

As direct lending has seen exponential growth in the last few years within Europe, are limited partners/allocators becoming more familiar with the practice?

In our experience, insurance groups (representing over 70% of our AUM) are more and more attracted by direct lending/private debt mainly due to the limited fixed income alternatives in the current QE environment, the fit of the cash flow profile with their Strategic Asset Allocation (SAA), the limited volatility due to the private nature of the instrument (no mark-to-market), and the Solvency II "efficiency" – the capital charge is around 20% according to our calculations and apparently lower for large insurance groups with their own internal model.

In addition, public pension plans have become more familiar with direct lending as it suits their overall asset allocation. Direct lending investments are long term, so they match pension funds' liabilities and offer very attractive regular returns with a yearly coupon (paid quarterly in the case of Tikehau) and is particularly attractive given the current low rate environment.

Many of the deals in the direct lending industry occur within the private equity space. Are you able to source deals outside the sponsor environment?

In 2013, Tikehau IM was awarded the NOVO 2 mandate of €355mn and the NOVI 1 mandate of €290mn in 2015. Both mandate initiatives were led by the French state through the CDC. This initiative has been supported by 24 institutional investors (of which three are pension funds). The common objective is to provide "multi-funding" mainly via bullet debt financing and equity capital over six to eight years for French small- to mid-cap sized corporates (sales: €30-1,500mn).

Support for initiatives like NOVO and NOVI has boosted the development of the corporate direct lending market. We believe that there is a real need for alternative financing sources in this market but it takes time as entrepreneurs gradually reach the financial sponsor level of financial education. Indeed, we have already structured more than 20 corporate transactions with innovative and tailor-made structures that match perfectly the needs of these entrepreneurs.

Apart from European banking and investment community sourcing, Tikehau IM benefits from a strong and diversified sourcing network across Europe. This capability relies on the company's shareholders, partners and operating partners, as well as advisors to the Tikehau group. These individuals are all prominent figures in European business circles and bring to the table their strong relationships across industries and the financial sector. We also benefit from being independent of any bank or private equity firm and this opens us to a greater amount of conflict-free deal flow.

How responsive have corporates been to taking on a non-bank lender?

Small- to medium-sized corporates do not have the same access to financing as large corporates. Thus, having an alternative financing source is clearly attractive and safe from a diversification point of view. One of the main and recurrent reasons for corporates to involve a direct lending player is to diversify its sources of financing and no longer depend on banks which have been volatile in their lending policies and limited to providing financing with maturity under five years. Furthermore, firms with a one-stop shop offering can tailor financing solutions for corporates – this is the case of Tikehau as we can provide senior, unitranche, mezzanine and PIK/junior debt.

From the point of view of the corporate, it is important to have a financing tailored to suit the needs of the business. For example, unitranche can be appropriate for a capital intensive or acquisition driven company and thus direct all free cash flow to the real development of the company. In addition, corporate borrowers can benefit from maturity extensions with non-bank lenders such as Tikehau.

Finally, our current European deal flow of €1.3bn of opportunities under review shows the strength of the direct lending market and interest of corporates.

As a large and well-positioned player in the credit space, have you been able to leverage any other parts of your business to build your mid-market lending business?

Our firm was created by two entrepreneurs, Antoine Flamarion and Mathieu Chabran, from the finance industry who, together with Tikehau managers, remain majority shareholders. They brought on board as investors key institutional firms such as Amundi Asset Management and Arkea, in addition to partners such as Christian de Labriffe (ex-senior partner of Rothschild and Lazard) and more recently, Jean-Pierre Mustier, previously Deputy General Manager of UniCredit. Our co-heads of direct lending, Cécile Mayer-Levi (28 years' experience in the private debt sector and ex-head of Ardian private debt) and Jean-Baptiste Feat, have a wealth of information and networks in the debt market. The private debt team includes local deal teams in Brussels, Milan and London led by senior professionals with local networks.

There are strong cross-fertilization synergies with our High Yield (HY) research team: we had been approached by a corporate looking for a private deal, a couple of months after they had failed to tap the HY market. The fact that our HY team had done extensive research on the name enabled us to rapidly reach a good level of credit analysis.

Another example, frequent in the current environment, is for us to take part with our loan funds in the leveraged loan syndication (TLB tranche) of private debt opportunities that we like, which could be explored in a first step as a direct lending opportunity and could be transformed in a shared leveraged transaction. This is a way for us to leverage the extensive amount of credit analysis performed.

Finally, our European CLO (€354mn raised in July 2015), under the leadership of veteran investor Debra Andersen, gives us deeper visibility into deal flow and in general on the European debt market.

There has been an increase in bank lending recently. Have you found this to be the case and has it affected your approach and deal flow?

First of all, we view banks as partners and not competitors. We provide a financing alternative to banks who continue to maintain a corporate relationship with our issuers/companies.

The ongoing competition in the market from other direct lending firms is healthy and proves the sustainability and growth of the market.

We continue to remain selective and focused on sourcing investments with the appropriate risk/return criteria, good business model and strong management teams. Furthermore, we have chosen to remain focused on managing medium-sized funds, which means we are not obliged to "buy the market". Proof of this strategy is the fifth deal we signed in Belgium as sole arranger and unitranche financing of Pennel and Flipo for our latest fund "Tikehau Direct Lending III". This deal was proprietary and also a primary LBO. It fulfills all the criteria we look for in an investment: strong management team leading a growing and innovative business, with strong potential for additional international development, and from a transaction point of view, reasonable leverage with sound covenant coverage.

Tikehau IM

Established in 2006 as part of the Tikehau Group (AUM: €6.5bn), Tikehau IM is a specialized asset management company with a focus on:

- Financing for European corporates:
    - > Direct lending and senior loans expertise with €2.5bn in commitments;
    - > High yield expertise with high-conviction management and concentrated portfolios (AUM: €1.6bn);
    - > European CLO raised in July 2015 (€354m) by the Group
- Real estate expertise
- Innovative balanced & equity investment solutions, capitalizing on permanent Equity/Opportunistic Investment expertise developed within Tikehau Capital

privatedebt@tikehauim.com

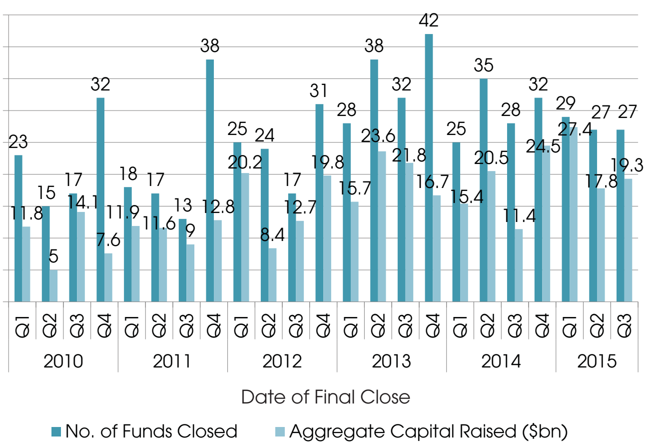
Fundraising in Q3 2015

Q3 2015 saw 27 private debt funds reach a final close, securing an aggregate $19.3bn in commitments (Fig. 1). Although the same number of funds closed in Q2 2015, aggregate capital raised increased compared to the $17.8bn that was raised last quarter.

Direct lending accounted for the highest amount of capital raised in Q3 2015, as well as representing the highest number of funds closed (Fig. 2). Interestingly, special situations vehicles overtook distressed debt in terms of number of fund closures this quarter compared with last quarter.

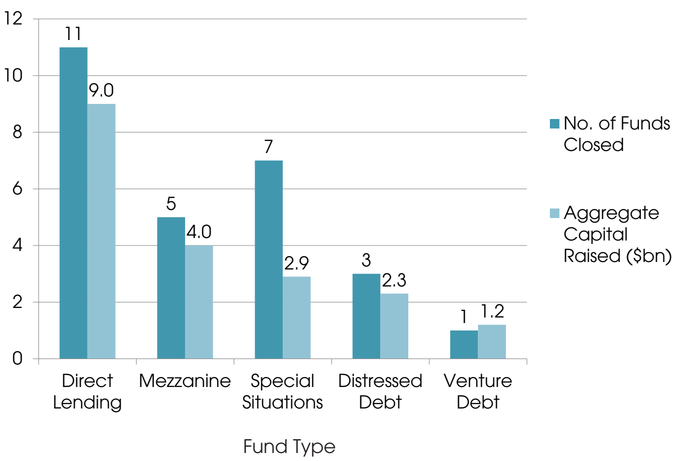
North America again accounted for the highest number of funds closed during the quarter, with 14 funds securing an aggregate $7.9bn (Fig. 3). However, for the first time this year, Europe-focused funds secured more capital than North America-focused vehicles, with $10.3bn raised in capital commitments. This is the result of the two largest funds to close in Q3 having a focus on Europe. Intermediate Capital Group's Senior Partners II, a direct lending fund, and ICG Europe Fund II, a mezzanine fund, both raised over $3bn each (Fig. 4).

Fig. 1. Global Quarterly Private Debt Fundraising, Q1 2010 - Q3 2015



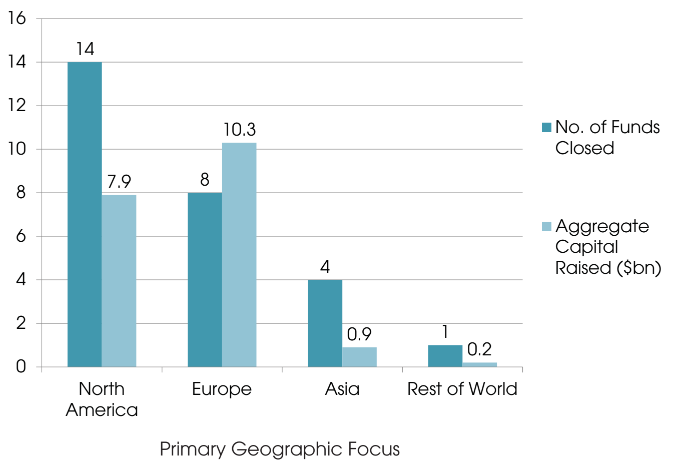
Source: Preqin Private Debt Online

Fig. 2: Breakdown of Private Debt Fundraising in Q3 2015 by Fund Type



Source: Preqin Private Debt Online

Fig. 3: Breakdown of Private Debt Fundraising in Q3 2015 by Primary Geographic Focus



Source: Preqin Private Debt Online

Fig. 4: 10 Largest Private Debt Funds Closed in Q3 2015

Fund	Firm	Fund Type	Fund Size ($mn)	Geographic Focus
Senior Debt Partners II	Intermediate Capital Group	Direct Lending	3,400	Europe
ICG Europe Fund VI	Intermediate Capital Group	Mezzanine	3,300	Europe
AXA Private Debt III	Ardian	Direct Lending	2,200	Europe
Castlelake IV	Castlelake	Distressed Debt	1,900	US
Clearlake Capital Partners IV	Clearlake Capital Group	Special Situations	1,400	US
Athyrium Opportunities Fund II	Athyrium Capital Management	Venture Debt	1,200	US
Chambers Energy Capital III	Chambers Energy Capital	Direct Lending	900	US
Permira Credit Solutions Fund II	Permira Debt Managers	Direct Lending	900	Europe
Golub Capital Partners IX International	Golub Capital	Direct Lending	600	US
ADV Opportunities Fund I	ADV Partners	Special Situations	500	Asia

Source: Preqin Private Debt Online

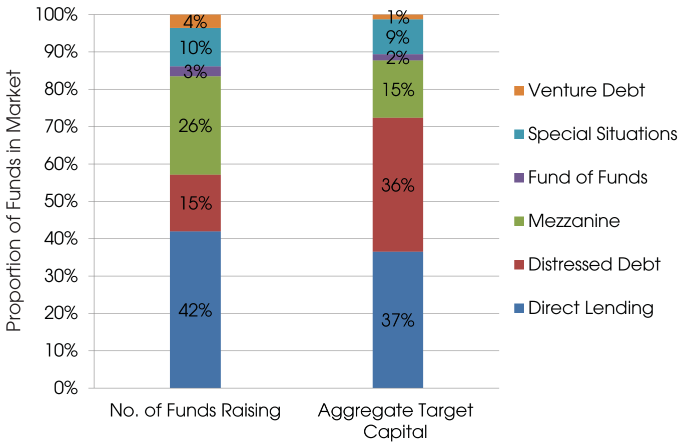
Funds in Market

At the start of Q4 2015, there were 224 private debt funds in market targeting an aggregate $117bn in capital commitments. Direct lending funds represent the largest proportion of these vehicles, both in terms of the number of funds and the amount of capital being sought, as shown in Fig. 1. Mezzanine and distressed debt funds account for 26% and 15% of funds in market by number respectively. While there are fewer distressed debt funds in market than mezzanine funds, the average target size of distressed debt funds is significantly higher, with these funds accounting for 36% of total capital being targeted.

North America-focused private debt funds in market continue to be the most numerous and seek the most capital (Fig. 2), while the amount of capital targeted by Europe-focused funds is less than at the start of Q3.

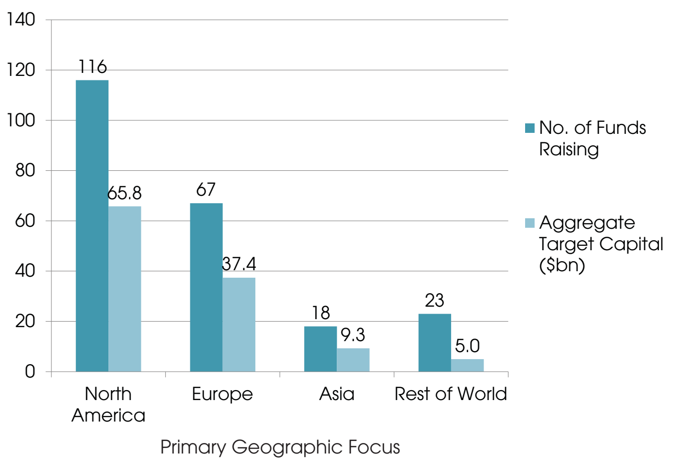
Forty-four percent of private debt funds currently in market have been seeking capital for a year or less, whereas at the other end of the scale, 30% have been in market for over two years (Fig. 3).

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



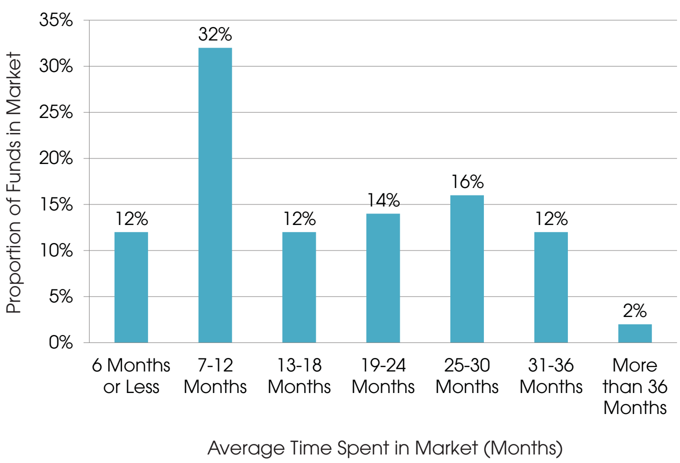
Source: Preqin Private Debt Online

Fig. 2: Breakdown of Private Debt Funds in Market by Primary Geographic Focus



Source: Preqin Private Debt Online

Fig. 3: Breakdown of Private Debt Funds in Market by Time Spent in Market



Source: Preqin Private Debt Online

Fig. 4: 10 Largest Private Debt Funds Currently in Market

Fund	Firm	Fund Type	Target Size (mn)	Geographic Focus
Oaktree Opportunities Fund Xb	Oaktree Capital Management	Distressed Debt	7,000 USD	US
KKR Special Situations Fund II	KKR	Distressed Debt	3,500 USD	Europe
Cerberus Institutional Partners VI	Cerberus Capital Management	Distressed Debt	3,000 USD	US
Crescent Mezzanine Partners VII	Crescent Capital Group	Mezzanine	3,000 USD	US
Oaktree Opportunities Fund X	Oaktree Capital Management	Distressed Debt	3,000 USD	US
Sankaty Credit Opportunities VI	Sankaty Advisors	Distressed Debt	3,000 USD	US
MHR Institutional Partners IV	MHR Fund Management	Distressed Debt	2,750 USD	US
GSO Energy Select Opportunities Fund	GSO Capital Partners	Distressed Debt	2,500 USD	US
Ares Capital Europe III	Ares Management	Direct Lending	2,000 EUR	Europe
LCM Credit Opportunities Fund III	LCM Partners	Distressed Debt	1,500 EUR	Europe

Source: Preqin Private Debt Online

TIKEHAU CAPITAL

PRIVATE DEBT SPECIALIST:
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idi
Unitranche
September 2015

Senior loan
July 2015

almerys
innover pour la vie
Management
Mezzanine
April 2015

ba&sh
Management
Unitranche
March 2015

Stretched Senior
March / June 2015

Management
Stretched Senior
December 2014

Unitranche
January / December 2014

Unitranche
October 2014

Unitranche
June / October 2014

Unitranche
September 2014 /
June 2015

Unitranche
September 2014

Mezzanine
September 2014

Mezzanine
February 2014

Preferred Equity
December 2013

Unitranche
December 2013

Stretched Senior
August 2013
Exited - August 2014

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Institutional Investors in Private Debt

Preqin's **Private Debt Online** currently tracks 1,693 active investors in the asset class. Fig. 1 shows that the 10 largest investors in private debt have an aggregate current allocation to the asset class of over $70bn, four of which are US-based public pension funds.

Fig. 2 shows that 68% of investors will consider making commitments to direct lending funds over the next 12 months, a slight increase from the proportion seen in Q2 (65%). Mezzanine and distressed debt remain the second and third most sought-after private debt fund types in Q3, with 62% and 55% of investors looking to commit to these fund types respectively in the year ahead. Private debt funds of funds will be targeted by just 9% of investors in the next 12 months, while a similarly small proportion (4%) will target venture debt.

As shown by Fig. 3, Europe has overtaken North America to become the most sought-after region for investment in private debt; 73% of investors are considering investing in funds focusing on this region over the next 12 months. North America remains, however, a common choice. Emerging markets have also experienced a surge in interest, with a quarter of investors exhibiting an interest in the region, up 10 percentage points from Q3 2014.

Data Source:

Preqin's **Private Debt Online** contains comprehensive information on over 1,600 institutional investors in private debt.

Detailed profiles include current and target allocation to private debt, strategic and geographic preferences, future investment plans and more.

For more information, please visit:

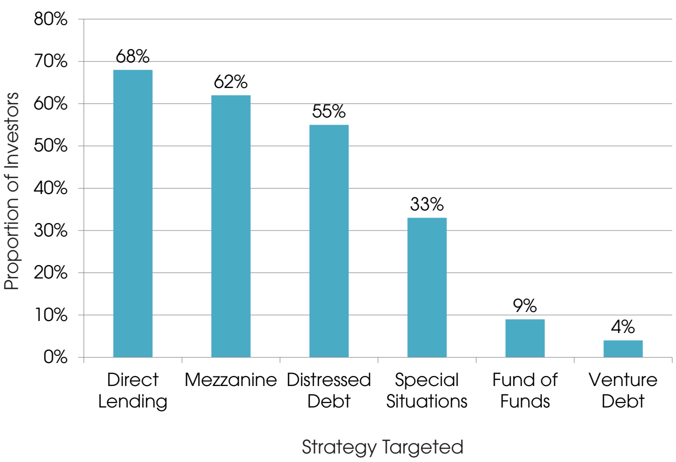
www.preqin.com/privatedebt

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

Investor	Current Allocation to Private Debt ($bn)	Investor Type	Location
TIAA-CREF	25.9	Private Sector Pension Fund	US
Netherlands Development Finance Company (FMO)	6.0	Government Agency	Netherlands
Partners Group	6.0	Private Equity Fund of Funds Manager	Switzerland
African Development Bank	5.3	Bank	Ivory Coast
New York State Teachers' Retirement System	5.2	Public Pension Fund	US
California Public Employees' Retirement System (CalPERS)	5.0	Public Pension Fund	US
KB Insurance	4.8	Insurance Company	South Korea
Florida State Board of Administration	4.4	Public Pension Fund	US
New Jersey State Investment Council	4.1	Public Pension Fund	US
IFM Investors	4.1	Asset Manager	Australia

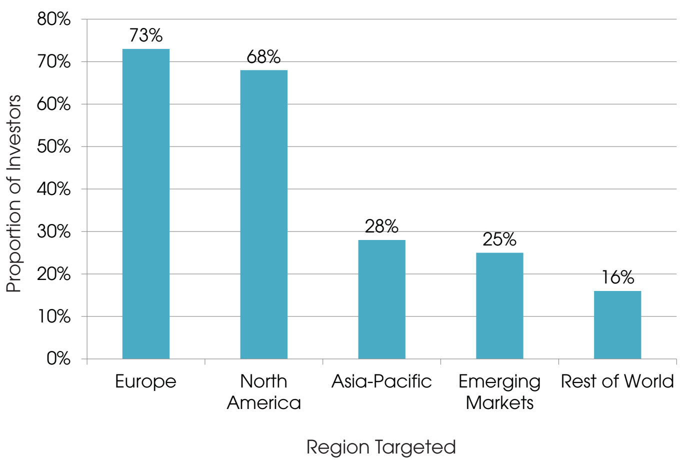
Source: Preqin Private Debt Online

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



Source: Preqin Private Debt Online

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



Source: Preqin Private Debt Online


Source new investors for funds
Identify new investment opportunities
Conduct competitor and market analysis
Track firms with capital available to invest
Develop new business

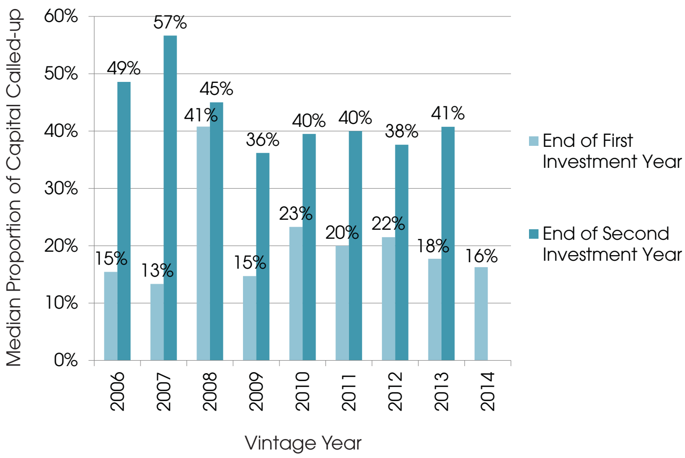
Fund Performance and Dry Powder

Fig. 1 displays the median proportions of committed capital called up by the end of the first and second investment years, among all private debt funds for vintage years 2006-2014. It shows that post-2008, the median proportion of capital called up during the first two years of investment is lower than before the financial crisis. This could be explained by recent fundraising success pushing up dry powder levels at a faster rate than available deals in a competitive marketplace. Dry powder now stands at a record $191bn, up 37% since December 2014, which may place pressure on fund managers to put this capital to work.

As shown in Fig. 2, direct lending funds account for the largest proportion of dry powder at $65bn, up 52% since December 2014. Distressed debt funds have also witnessed a notable increase in the amount of dry powder available to them, with the figure currently standing at $56bn, while mezzanine funds hold $46bn.

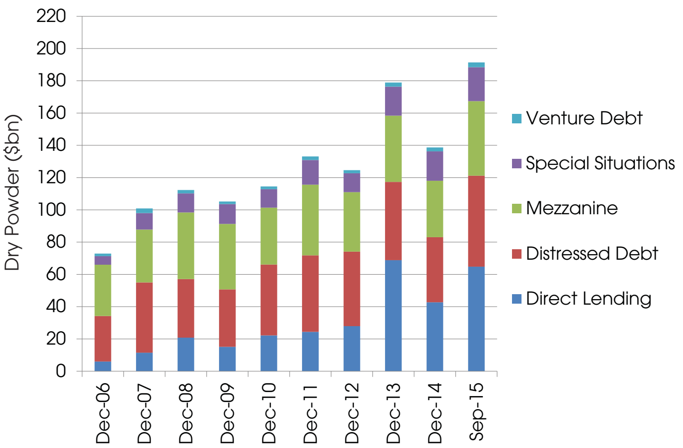
Europe-focused private debt funds have seen dry powder increase by 66% since December 2014 to reach $61bn (Fig. 3). Dry powder available to North America-focused funds currently stands at $118bn, an increase of 25% compared to December 2014.

Fig. 1: Private Debt Funds: Median Proportion of Capital Called-up by the End of the First and Second Investment Years, Vintage 2006-2014 Funds



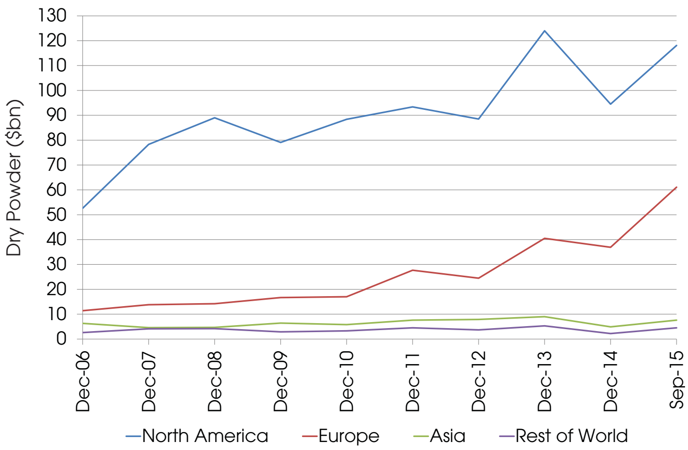
Source: Preqin Private Debt Online

Fig. 2: Private Debt Dry Powder by Fund Type, December 2006 - September 2015

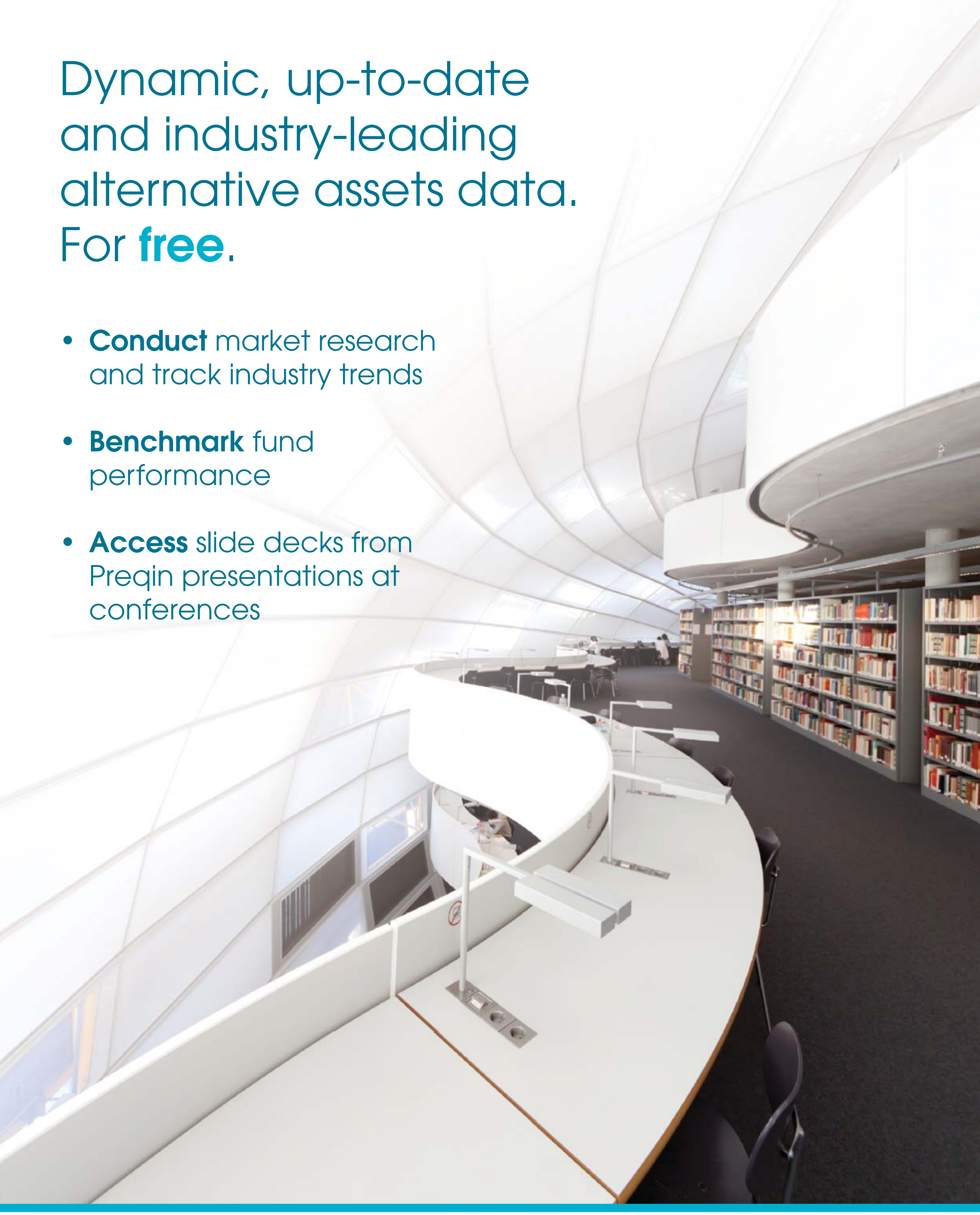


Source: Preqin Private Debt Online

Fig. 3: Private Debt Dry Powder by Primary Geographic Focus, December 2006 - September 2015



Source: Preqin Private Debt Online



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Preqin Private Debt Online

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.

Source new investors for funds

Find the most relevant investors, with access to detailed profiles for over 1,600 institutional investors actively investing in private debt, including information on their current fund searches and mandates, direct contact information and sample investments.

Identify potential investment opportunities

View in-depth profiles for over 1,800 unlisted private debt funds, including information on investment strategy, geographic focus, fundraising progress, service providers used and sample investors.

Find active fund managers in private debt

Search for firms actively targeting private debt investments. View information on key contacts, firm fundraising and performance history, and applied strategies of the firm.

Analyze the latest private debt fundraising activity

See which firms are currently on the road raising a private debt fund and which will be coming to market soon. Analyze fundraising over time by fund type, manager location and regional focus, and conduct competitor analysis.

Benchmark performance

Identify which fund managers have the best track records, with performance benchmarks for private debt funds and performance details for over 650 individual named funds.

View detailed profiles of service providers

Search for administrators, placement agents and law firms active in the private debt industry by type and location of funds, and the managers they work with.

Find out how Preqin's range of private debt products and services can help you:

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New York:

One Grand Central Place
60 E 42nd Street
Suite 630, New York
NY 10165
Tel: +1 212 350 0100
Fax: +1 440 445 9595

London:

3rd Floor
Vintners' Place
68 Upper Thames Street
London
EC4V 3BJ
Tel: +44 (0)20 3207 0200
Fax: +44 (0)87 0330 5892

Singapore:

One Finlayson Green, #11-02
Singapore 049246
Tel: +65 6305 2200
Fax: +65 6491 5365

San Francisco:

One Embarcadero Center
Suite 2850
San Francisco
CA 94111
Tel: +1 415 316 0580
Fax: +1 440 445 9595

Hong Kong:

Level 9, Central Building
1-3 Pedder Street
Central, Hong Kong
Tel: +852 3958 2819
Fax: +852 3975 2800

Email: info@preqin.com
Web: www.preqin.com