
Presentation to Russian VIII Private Equity Congress

Distressed and Special Situations
Funds: Specific Terms and Recent
Trends

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Debevoise
& Plimpton

Overview of Global Opportunistic Investors

- Key **financial** buyers in the distressed and opportunistic asset space:
 - ❑ Family offices / large private investors (3G; Bass; Michael Dell; BGI)
 - ❑ Conglomerates (Berkshire Hathaway)
 - ❑ Private “drawdown” funds
 - ❑ Hedge funds with illiquid “side pockets” flexibility
 - ❑ More recently: pension funds and sovereign wealth funds (CPPIB; Temasek and GIC; OMERS; Ontario Teachers)
- Focus on alternative funds:
 - ❑ Debt/credit opportunities funds
 - ❑ Private equity funds
 - ❑ Hedge and “hybrid” funds

Select Strategies

- Buying Stressed or Distressed Debt Instruments
 - ☐ Wholesale acquisitions of loans and other assets from banks and “workouts” of individual loans
 - ☐ Opportunistic acquisitions in public markets
 - ☐ Sovereign debt claims? (e.g., Argentina)
- Acquisitions of Assets
 - ☐ Bankruptcy asset sales
 - ☐ Disposition of Assets or Subsidiaries to provide urgent liquidity
- “Rescue financing”:
 - ☐ Companies emerging from bankruptcy (“DIP” financing)
 - ☐ Urgent financings (e.g., regulatory needs)

Global Asset Managers Specializing in Distressed Investing



ANGELO,
GORDON
& CO.



FORTRESS



OAKTREE



ARES



CAPITAL PARTNERS



LONE STAR FUNDS



CERBERUS
CAPITAL MANAGEMENT, L.P.

Global Asset Managers Specializing in Distressed Investing – Raised Capital and “Dry Powder”

Firm	Total Funds Raised in Last 10 Years (\$million)	Estimated Dry Powder (\$million)
Fortress Investment Group	15,842	6,884
GSO Capital Partners	19,403	4,970
Centerbridge Capital Partners	17,640	4,724
Sankaty Advisors	13,184	3,595
Oaktree Capital Management	55,686	3,590
CarVal Investors	13,968	2,499
Avenue Capital Group	19,041	2,133
Castlelake	4,269	1,999
The Catalyst Capital Group	3,269	1,967
Cerberus Capital Management	9,329	1,923

Source: Preqin Private Debt Online; as of February 2016

Distressed Debt Funds – Facts



\$21.4bn

Aggregate capital raised by North America- and Europe-focused distressed debt funds closed in 2015.



Number of distressed debt funds that held an interim or final close in 2015.



15 Months

Average time taken to reach a final close for distressed debt funds closed in 2015.



\$52.9bn

Total dry powder for North America- and Europe-focused distressed debt funds as at January 2016.



\$1.5bn

Average target size of a distressed debt fund currently on the road, notably higher than other private debt strategies.



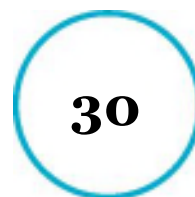
77%

North America-focused distressed debt funds in market are targeting the majority of total capital sought by the strategy.



\$43.5bn

Aggregate capital targeted by distressed debt funds currently in market globally.



Number of distressed debt funds on the road as of January 2016.

Recent Distressed Debt Funds – North America and Global

10 Largest North America-Focused Distressed Debt Funds Closed, 2013-2015

Fund	Sponsor	Final Close Date	Fund Size (\$million)
Centerbridge Capital Partners III	Centerbridge Capital Partners	Oct '14	\$6,000
GSO Capital Solutions Fund II	GSO Capital Partners	Jul '13	\$5,000
CVI Credit Value Fund III	CarVal Investors	Jun '15	\$3,046
Wayzata Investment Partners III	Wayzata Investment Partners	May '13	\$2,716
Cerberus Institutional Partners V	Cerberus Capital Management	Mar '13	\$2,611
GSO Energy Select Opportunities Fund	GSO Capital Partners	Sep '15	\$2,500
Sankaty Credit Opportunities V	Sankaty Advisors	Jan '13	\$2,500
CVI Credit Value Fund II	CarVal Investors	Jul '13	\$2,323
Varde Fund XI	Värde Partners	Jun '14	\$2,000
Castlelake IV	Castlelake	Jul '15	\$1,900

Source: Preqin Private Debt Online; as of January 2016

Recent Distressed Debt Funds – Europe

10 Largest Europe-Focused Distressed Debt Funds Closed, 2013-2015

Fund	Firm	Final Close Date	Fund Size (\$mn)
Fortress Credit Opportunities Fund IV	Fortress Investment Group	Mar '15	\$5,000 USD
KKR Special Situations Fund	KKR	Dec '13	\$2,000 USD
Strategic Value Special Situations Fund III	Strategic Value Partners	Nov '14	\$1,310 USD
EQT Credit Fund II	EQT	Oct '13	€845 EUR
East Prospect Fund	EPF Capital	Nov '13	\$1,000 USD
H.I.G. Bayside Loan Opportunity Fund III	Bayside Capital	May '13	\$1,000 USD
Alchemy Special Opportunities Fund III	Alchemy Partners	Mar '14	£600 GBP
Fortress Italian NPL Opportunities Fund	Fortress Investment Group	Dec '14	€800 EUR
York European Distressed Credit Fund II	York Capital Management	Apr '15	\$534 USD
Enterprise Investment Fund	Framtakssjodur Islands	Sep '13	1,900 ISK

Source: Preqin Private Debt Online, as of January 2016

Distressed Debt Funds in the Market – Emerging Markets

10 Largest Emerging Markets-Focused Distressed Debt Funds in the Market (Q3 2016)

Fund	Firm	Region	Target Size (\$mn)
ADM Capital Somei Lending Platform	ADM Capital	Asia	\$200 USD
Avenue Asia Special Situations V	Avenue Capital Group	Asia	To come
Edelweiss Distressed Assets Fund	Edelweiss Alternative Asset Advisors	Asia	\$750USD
IFC-Apollo Distressed Debt Fund	Apollo Global Management	Asia	\$1,000 USD
Morgan Rio Private Fund II	Morgan Rio Capital Management	Americas	\$125 USD
PAG China Special Situations Fund	PAG Asia Capital	Asia	\$350USD
Pirmal India Resurgent Fund	Pirmal Capital	Asia	\$1,000 USD

Source: Preqin as of September 2016

Investment Restrictions and Deal Structures

- ***Investment Restrictions:***

- ☐ More ability to invest in non-control positions and public instruments
- ☐ Debt and equity
- ☐ Less restrictions on “hostile” deals
- ☐ Generally need flexibility **in what** to invest – derivatives, other flexible structures (e.g., a total return swap if an equity investment is not feasible for regulatory or other reasons)
- ☐ Flexibility **how to invest** (alternative investment structures, parallel funds etc)

Fund Life

- ***Investment Period and Term:***
 - ❑ Often shorter investment period (3-5 years compared to traditional 5-6 years for a buyout fund) and term (7-9 years vs 10 years) in light of more opportunistic nature
 - ❑ E.g., sometimes funds raised to capitalize quickly on a certain attractive opportunity (2008-2009: distressed real estate loans and financial institutions; 2015: energy)
- ***Follow-On Investments:***
 - ❑ Flexibility to invest in different layers of capital structure?
 - ❑ Valuations?
- ***“Follow-Up” Investments:–***
 - ❑ Flexible structures to fund investments in process absent a binding agreement or term sheet

Availability of Capital; Reinvestment

- **Reinvestment:** More flexibility than in a buyout fund –
 - ☐ Reinvest all invested capital returned during the investment period?
 - ☐ Reinvest any current income?
 - ☐ Reinvest profits?
- **Capital Calls:** Need more ability to invest opportunistically and have available capital quickly –
 - ☐ Shorter periods for capital calls from investors
 - ☐ Ability to call capital for reserves (without identifying a specific investment)
 - ☐ Credit facility secured by unpaid capital commitments to bridge capital calls; secured by assets?

Economic Terms

- **Generally:** Driven by the risk and return profile of the asset class
 - ❑ Distressed debt funds often target the same returns (18-25% gross IRR) as buyout funds
 - ❑ Distressed debt investing is often a part of strategy of funds also engaged in more straightforward buyouts, deploying capital opportunistically depending on the economic cycle (e.g., Centerbridge, Apollo and Cerberus are the well-know players with this approach)
 - ❑ As a result, the main economic terms do not differ significantly from those of the buyout funds
- **Management Fees:** Do not differ significantly from the buyout funds
 - ❑ 1.25-2% on commitments during the investment period
 - ❑ 1-1.75% on invested capital thereafter

Economic Terms (cont'd)

- ***Carried Interest:*** Often a mix of features from buyout and debt funds
 - ❑ More often than buyout funds use all capital back (“European”) distributions waterfall – “getting to carry earlier” to retain investment professionals less acute concern if the investment period and term are shorter
 - ❑ Preferred return (8%) and carried interest (20%) rates generally similar to buyout funds
 - ❑ More focus of investors on clawback protections in light of the risky strategy and illiquid nature of assets if the waterfall is not “all capital back”
- ***All Partners Giveback***

Legal Issues and Exposures to Focus On

- ***Higher Litigation Risk:*** Need an appetite to litigate against equity holders / other providers of capital to a company in bankruptcy or distress
 - ❑ Providing “rescue financing” and fraudulent transaction laws across the globe
 - ❑ Political implications / headline risk
- ***Implications and Recommendation for Fund Terms***
 - ❑ Indemnity protections for a sponsor and its management
 - ❑ Need less limitations on ability to recall distributions made to fund investors (time / amount / purpose of the recall)

Questions?



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