
Presentation to Russian VIII Private Equity Congress

Distressed and Special Situations
Funds: Specific Terms and Recent
Trends

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& 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



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.



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



\$1.5bn
Average target size of a distressed debt fund currently on the road, notably higher than other private debt strategies.



\$43.5bn
Aggregate capital targeted by distressed debt funds currently in market globally.



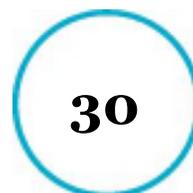
Number of distressed debt funds that held an interim or final close in 2015.



\$52.9bn
Total dry powder for North America- and Europe-focused distressed debt funds as at January 2016.



77%
North America-focused distressed debt funds in market are targeting the majority of total capital sought by the strategy.



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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