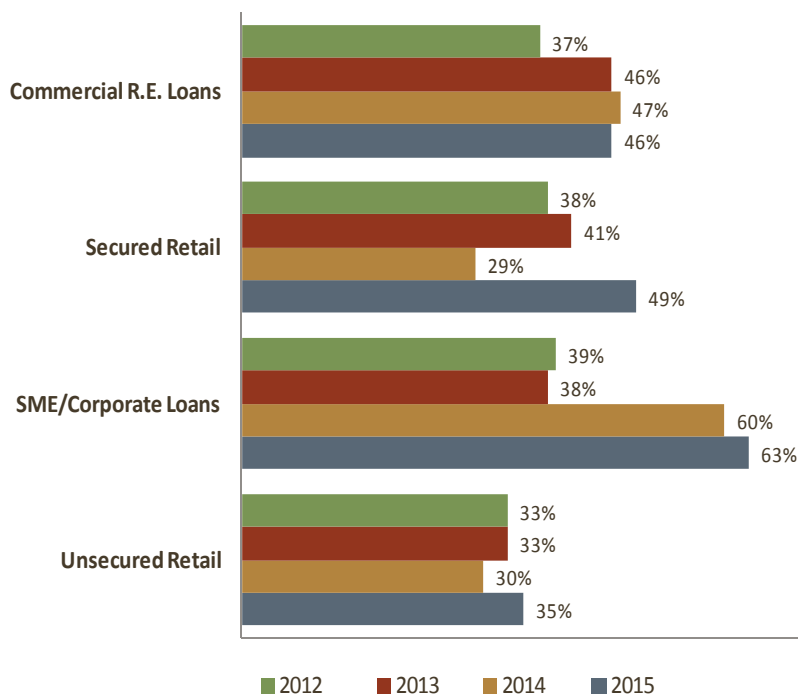


## Overview

Concerns about slowing growth in China, a sharp drop in oil prices and heightened expectations around an imminent interest rate hike by the Fed drove markets sharply lower during the third quarter. High yield markets in particular traded off with the Merrill Lynch High Yield index down 4.9% and Merrill Lynch High Yield CCC index down 8.4% for the quarter.

Buffeted from the liquidity needs of the public markets, private credit did not experience the attendant volatility. As highlighted below, pricing in European non-performing loans has not significantly changed over the past year (Exhibit 1).

Exhibit 1 – Average Price to Face Value: European NPLs



Source: 2015 PWC Survey of European market participants

## By the Numbers\*

**£2.3 billion** Lone Star completed the acquisition of Project Churchill, the largest European NPL transaction YTD

**€531 billion** Total amount of non-core commercial real estate assets held by European banks

**\$91 billion** Amount of capital raised for private debt strategies in the first 9 months of 2015

**\$32 billion** Size of GE Capital's commercial lending and leasing assets being sold to Wells Fargo

**20%** Premium offered by TPG Specialty Lending to TICC shareholders that was rejected by the TICC Board of Directors

**52%** Percentage increase in the amount of dry powder direct lending funds have since December 2014

\* Please find sources in the endnotes<sup>1</sup>

## STRATEGY UPDATES

### Direct Lending

Leverage levels in middle market loans spiked in the third quarter, eclipsing 2007 levels and hitting new record highs. The overall market, as measured by S&P, jumped to 5.6X, while leverage levels for LBOs were even higher at 5.9X.<sup>2</sup> The uptick is largely attributable to a supply/demand imbalance with transaction volumes significantly down coupled with continued demand from the sponsor community and other non-bank financing sources as fundraising for direct lending strategies continuing unabated.

Overall middle market new issuance volume as tracked by S&P fell 26% on a year-over-year basis, primarily driven by a decline in the upper-end of the middle market non-sponsored space.<sup>3</sup> Refinancings, in particular, were hard hit, falling 59% on a year-over-year basis with no refinancing deals in the pipeline as of the end of Q3.<sup>4</sup> A further breakdown by loan issuance volume using Thompson Reuters data is highlighted below (Exhibit 2).

**Exhibit 2 – U.S. Middle Market Total Loan Issuance**  
(\$ billion)

	Q3 2015	Q3 2014	YOY % change
Overall	\$27.4	\$47.1	-42%
Large Middle Market	\$21.5	\$35.2	-39%
Traditional Middle Market	\$5.9	\$11.8	-50%
Sponsored	\$10.3	\$13.9	-26%
Non-Sponsored	\$17.1	\$33.2	-48%

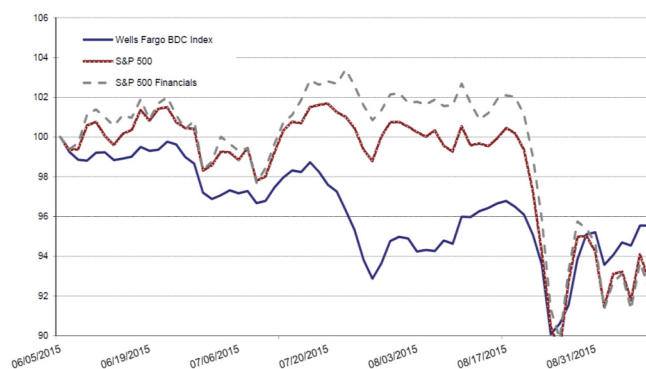
Source: Thompson Reuters PLC

Private equity sponsors continue to drive demand for debt financing as purchase price multiples hit record levels during the quarter, averaging 12.2X. Within the middle market space, multiples rose to 10.5X, up from 9.6X over the same period in 2014.<sup>5</sup>

Yields trended upward during the third quarter with first lien yields averaging 6.3%, according to S&P.<sup>6</sup> Silver Creek’s managers did not experience meaningful moves as spreads on first lien paper continued to average L+800 bps and approximately 200 bps wider on second lien paper. LIBOR floor levels of roughly 1% remained largely unchanged.

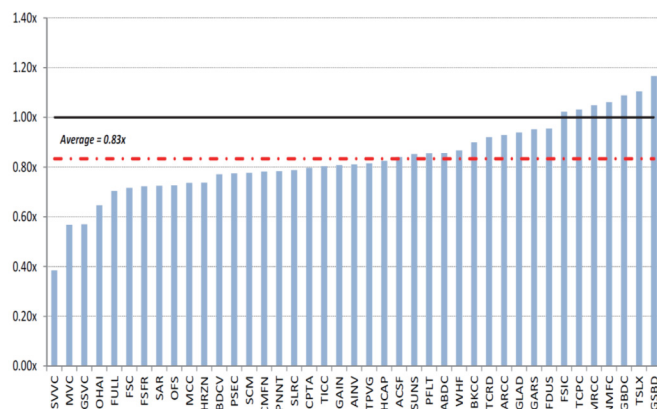
The Business Development Company (“BDC”) industry traded down significantly during the quarter, gapping down more than the S&P before trading higher (Exhibit 3). The industry traded below book, averaging 0.83x Price to NAV as of September 9<sup>th</sup> (Exhibit 4).

**Exhibit 3 – BDC, S&P 500, S&P 500 Financial Performance**



Source: Factset and Wells Fargo Securities

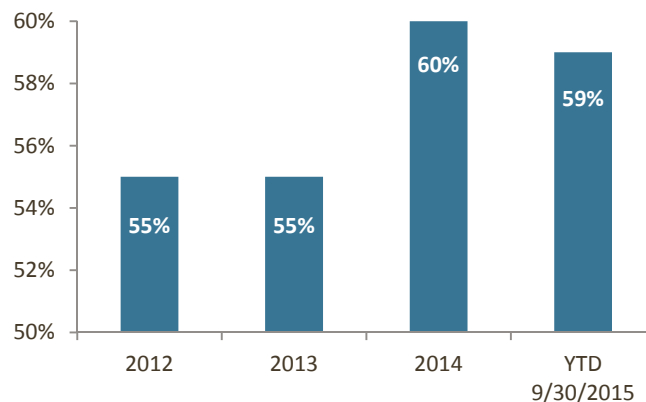
**Exhibit 4 – BDC Price to NAV (as of 9/9/15)**



Source: Factset and Wells Fargo Securities

Industry participants took action during the quarter, calling attention to shareholder unfriendly activity. TSLX led the charge, drawing attention to non-accretive equity raises, the industry’s poor stock buyback record and insufficient dividend coverage (Exhibit 5).

**Exhibit 5 – BDC Dividend Coverage**  
(Percentage of BDCs with <100% Dividend Coverage)

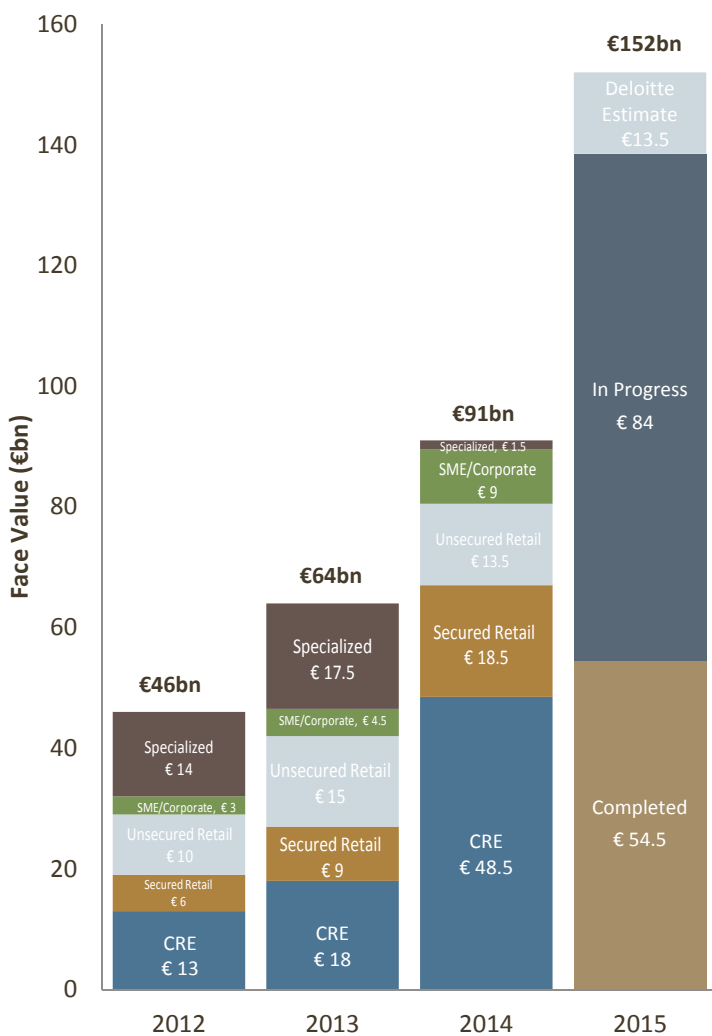


Source: TSLX

### Non-Performing Loans

The sale of non-performing loans (“NPLs”) is on pace to eclipse 2014 levels (Exhibit 6). Estimates are that €152 billion in NPLs will be sold, a 60% increase over 2014.<sup>7</sup> For reference, over the past five years (2010-2014) banks disposed of approximately €250 billion. U.K. and Irish banks accounted for approximately half of that total face amount. Going forward Italy, Spain and other southern European countries are expected to lead sales.<sup>8</sup> Current transactions in the market total €84 billion.<sup>9</sup>

Exhibit 6 – European Loan Portfolio Sales by Collateral



Source: PwC

On a collateral basis, commercial real estate (“CRE”) transactions led the market. In Q3 €21 billion of CRE transactions closed, bringing the year-to-date total to approximately €45 billion. Cushman & Wakefield is currently tracking over €92 billion in live and planned deals, slightly below the high watermark of Q2. Cerberus leads the league tables in terms of deal volume, followed by Apollo and Lone Star (see Exhibit 7).<sup>10</sup>

Exhibit 7 – CRE Investor League Table YTD

	Volume (€M)	# Transactions
1 Cerberus	7,686	8
2 Deutsche Bank / Apollo	6,265	13
3 Lone Star	5,278	4
4 CarVal / Goldman Sachs	4,735	8
5 Oaktree	2,797	6

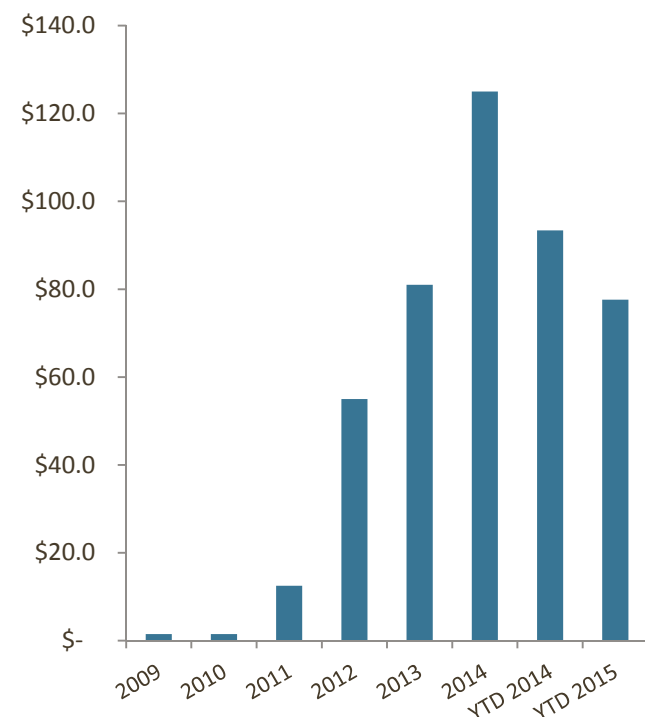
Source: Cushman & Wakefield Corporate Finance

### Opportunistic – Risk Retention

Risk retention rules – requirements that CLO managers must retain at least 5% of deals they issue – go into effect in December 2016. Market participants believe the rules will likely curb issuance and have further implications as managers with insufficient balance sheets may be forced out of the market. Strategies are also emerging with investors providing the capital needed by the CLO managers to meet the new risk retention rules.

CLO issuance is down over the year-to-date period, declining \$77.6 billion (Exhibit 8).

Exhibit 8 – Annual CLO Issuance



Source: S&P Capital IQ LCD

## Public Specialty Finance

Silver Creek actively follows a broad universe of public specialty finance companies as a liquid proxy for the private credit markets. A subset of that universe is included below (Exhibit 9).

### Exhibit 9 - Public Specialty Finance Company Representative Universe

As of September 30, 2015

	Ticker		Market Capitalization (Millions)	Forward Dividend	Price to Book	PE Ratio		Price
<b>Middle Market Lending BDCs</b>								
	American Capital	ACAS	\$ 3,310	0.0%	0.59x	13.52	\$	12.16
	Apollo Investment Corporation	AINV	\$ 1,297	14.6%	0.70x	6.04	\$	5.48
	Ares Capital Corporation	ARCC	\$ 4,554	10.8%	0.86x	9.32	\$	14.48
	BlackRock Kelso	BKCC	\$ 662	9.5%	0.83x	11.45	\$	8.86
	Fifth Street	FSC	\$ 946	14.1%	0.68x	7.38	\$	6.17
	Golub Capital BDC	GBDC	\$ 819	8.0%	1.02x	13.17	\$	15.98
	Main Street Capital Corporation	MAIN	\$ 1,333	9.8%	1.21x	11.58	\$	26.66
	Prospect Capital	PSEC	\$ 2,533	15.6%	0.70x	7.13	\$	7.13
	Solar Capital	SLRC	\$ 672	10.4%	0.70x	10.45	\$	15.82
	Triangle Capital Corporation	TCAP	\$ 548	17.1%	1.01x	7.98	\$	16.48

	Ticker		Market Capitalization (Millions)	Forward Dividend	Price to Book	PE Ratio		Price
<b>Mortgage REIT's/Mortgage Servicing Rights</b>								
	Annaly Capital	NLY	\$ 9,355	12.2%	0.83x	N/A	\$	9.87
	American Capital Agency Corp	AGNC	\$ 6,523	13.6%	0.81x	62.10	\$	18.70
	Chimera Investment Corporation	CIM	\$ 2,749	14.1%	0.79x	9.58	\$	13.37
	Colony Financial	CLNY	\$ 2,185	7.6%	0.96x	29.74	\$	19.56
	Invesco Mortgage Capital	IVR	\$ 1,507	14.3%	0.69x	37.39	\$	12.24
	MFA Financial	MFA	\$ 2,522	11.8%	0.88x	8.40	\$	6.81
	Nationstar Mortgage	NSM	\$ 1,522	0.0%	0.90x	239.04	\$	13.87
	Ocwen Financial	OCN	\$ 841	0.0%	0.78x	N/A	\$	6.71
	Starwood Property Trust	STWD	\$ 4,896	9.4%	1.17x	10.74	\$	20.52
	Two Harbors	TWO	\$ 3,242	11.8%	0.86x	6.14	\$	8.82

	Ticker	Specialty Focus	Market Capitalization (Millions)	Forward Dividend	Price to Book		Price
<b>Specialty</b>							
	AerCap Holdings	AER	Aircraft	\$ 7,549	0.0%	0.94x	\$ 38.24
	American Homes 4 Rent	AMH	REO-to-Rental	\$ 3,401	1.2%	1.16x	\$ 16.08
	Navient	NAVI	Student Loans	\$ 4,204	5.6%	1.05x	\$ 11.24
	NorthStar Realty Finance	NRF	CRE Lending	\$ 4,506	15.3%	0.99x	\$ 12.35

Source: Bloomberg

## About Silver Creek

Silver Creek Capital Management is an alternative investment boutique with a focus on private credit and hedge fund strategies. Silver Creek specializes in developing tailored alternative credit solutions for investors, utilizing highly structured exposures to niche credit opportunities as well as core private debt alternatives. With a history beginning in 1994, we have been investing in private credit since before the Global Financial Crisis and manage approximately \$7.0 billion (including unfunded commitments) on behalf of our clients.<sup>11</sup>

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<sup>1</sup> CoStar Finance, October 2015; Cushman & Wakefield, European Real Estate Loan Sales Market, Q3 2015; Preqin Q3 2015 Private Debt Quarterly Update; Private Debt Investor, November 2015; Wells Fargo Research Note, September 16, 2015; Preqin Quarterly Update: Private Debt, Q3 2015.

<sup>2</sup> S&P Capital IQ LCD Middle Market Review, Q3 2015

<sup>3</sup> Ibid

<sup>4</sup> Ibid

<sup>5</sup> Ibid

<sup>6</sup> Ibid

<sup>7</sup> CoStar Finance, European NPL sales to accelerate: up to €84bn in deals to close before year end, August 19, 2015

<sup>8</sup> CoStar Finance, European banks dispose of unwanted loan portfolios at record rate, August 18, 2015

<sup>9</sup> CoStar Finance, European NPL sales to accelerate: up to €84bn in deals to close before year end, August 19, 2015

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