SILVERCREEK
CAPITAL MANAGEMENT

PRIVATE CREDIT
# MARKET UPDATE

MID-YEAR 2016

## Overview

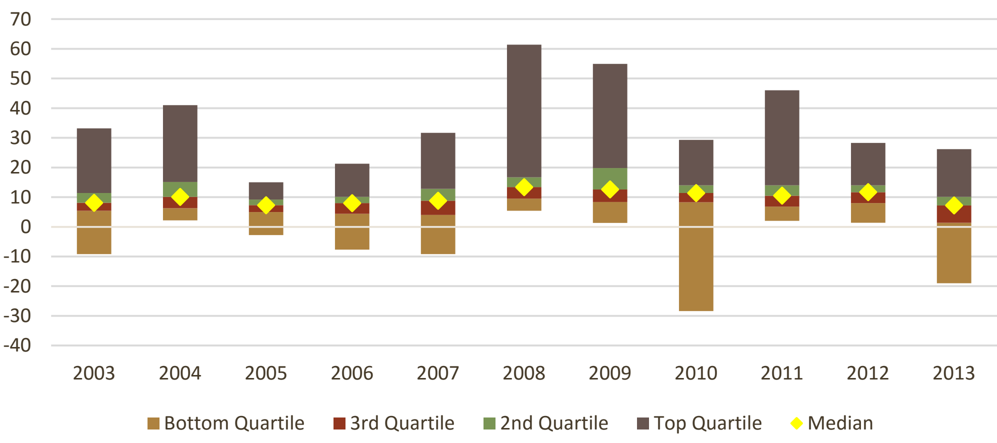
Oil prices, Brexit and the U.S. presidential election. In this mid-year private credit market update, we avoid all of these attention grabbing topics and instead provide data and analysis on less followed (although we would argue equally interesting) issues like capital flows in the lower end of the middle market. Below are a few key highlights.

- While off pace from 2015, private debt fundraising remains robust with over $46 billion raised as of June 30th. Investors continue to favor North America and Europe with only 6% of capital raised to focus on Latin America, Asia and Middle East/Africa on a combined basis. Investor interest in mezzanine appears to have been renewed as the strategy now accounts for 35% of targeted capital.[1] Direct lending continues to draw significant investor interest with 46% of investors planning to commit more to direct lending in 2016.[2]

- As fundraising has been robust, capital deployment has been mixed with dry powder levels rising to record levels. Dry powder in distressed climbed over 33% from 2014 levels to $63.3 billion as manager's ramp up for the next opportunity. Over 26% of the private credit industry's total dry powder is held by five managers. [3]

- As investors continue to focus on core private debt strategies and a select group of managers, the merits of diversification appears to have not yet been fully embraced. The below graph illustrates the benefits of diversification in private debt, showing the significant diversion of returns by vintage year (Exhibit 1).

**Exhibit 1 – Distributions of Returns by Vintage Years: All Private Debt (Net IRR %)**




Source: Thompson Reuters/Wells Fargo

## By the Numbers

**100** Number global corporate defaults year to date, a milestone reached in July and the highest number of defaults since 2009[4]

**$5.9 billion** Lone Star Real Estate Fund V, the largest private debt fund raised year to date[5]

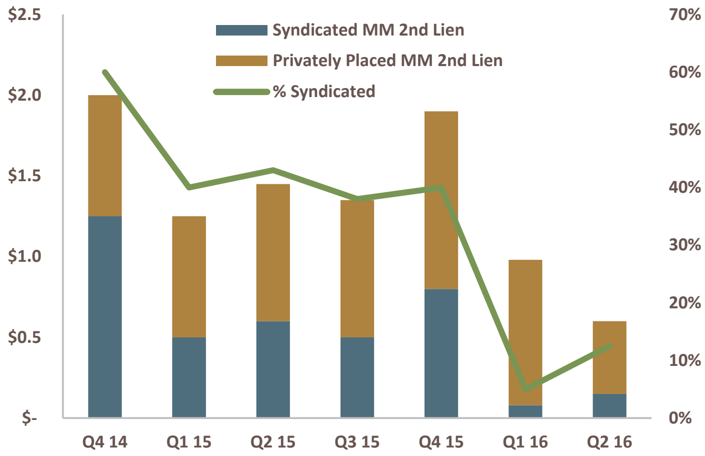
**65.8%** Percentage of issuers of broadly syndicated loans which are "covenant-lite" structures[6]

**$199 billion** Record amount of dry powder in the private credit industry, as of June 2016[7]

**60%** Probability assigned by Deutsche Bank of a recession occurring over the next 12 months. The broader consensus among economists is 21%.[8]

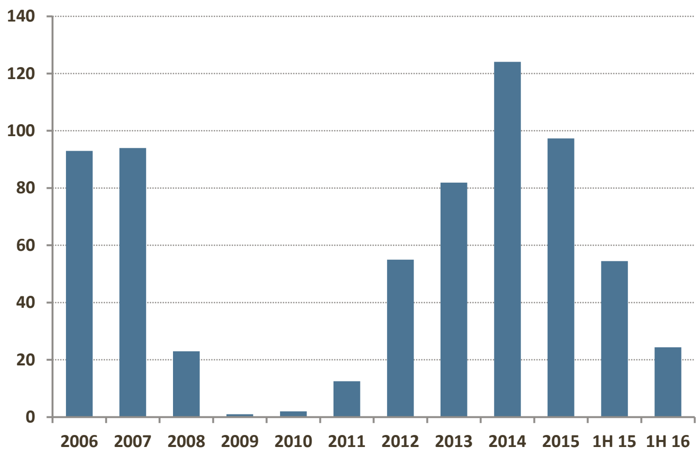
**63** Number of deals by European non-bank lenders completed in Q1 2016[9]

Exhibit 2 – Second Lien Volume (as of 6/30/16; $bn)




Source: Thompson Reuters/Wells Fargo

Exhibit 3 – U.S. CLO Issuance ($bn)




Source: LCD

# Strategy Updates

## Direct Lending

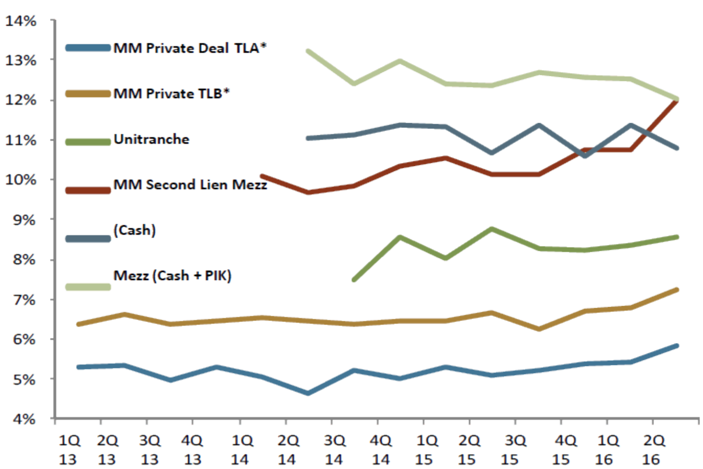
Pricing power has favored mid-market non-bank lenders recently as new issuance in the broadly syndicated market has dropped significantly. The syndicated mid market second lien new issuance market was effectively closed over the year-to-date period as illustrated below (Exhibit 2). The CLO new issuance market also remained weak as risk retention rules continue to stymie the market (Exhibit 3).

These dynamics helped drive mid market direct lending yields higher on average over the first half of the year. Yields on second lien loans, in particular, increased significantly and are now are at comparable levels to mezzanine (Exhibit 4). First lien and unitranche yields have also widened out, although not by as much as second liens. Pricing on first lien loans averages L+550-650bps, while unitranche pricing averages L+750-850bps. Original Issuer Discount (OID) remains unchanged at 2%, on average.

Leverage levels have trended modestly down since the end of last year, averaging 3.0X to 4.0X for first lien loans and 4.0X to 5.5X for unitranche. The premium for non-sponsored backed deals remained largely unchanged at approximately 100 to 150 basis points. Non-sponsor backed deals continue to grow in Europe, albeit slowly. (Exhibit 5).

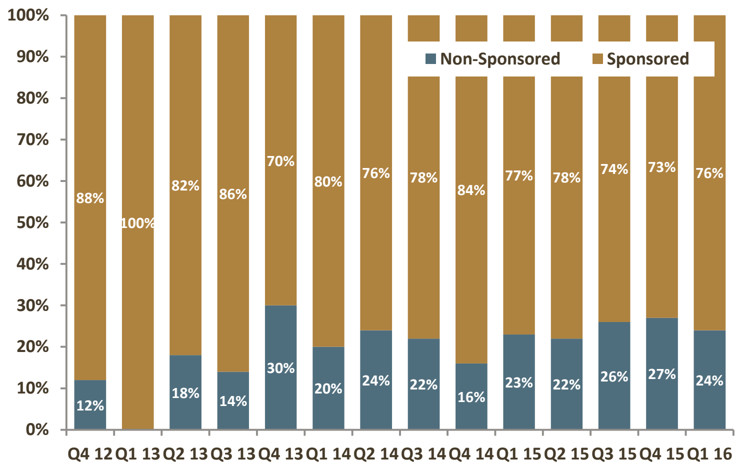
Investor appetite for mid market direct lending remains high, and expectations are that 2016 will likely rival 2015 in terms of fundraising, particularly in Europe (Exhibit 6). Globally, 11 direct lending funds closed during the second quarter, totaling $9.0 billion in aggregate commitments. As of the beginning of Q3, approximately 100 direct lending managers are currently in the markets.

Exhibit 4 – Middle Market Yields Across Capital Structure




*TLA – Term Loan A (senior), TLB – Term Loan B (subordinated), PIK – Payment in Kind
Source: Thompson Reuters/Wells Fargo

Exhibit 5 – European sponsor vs non-sponsored transactions



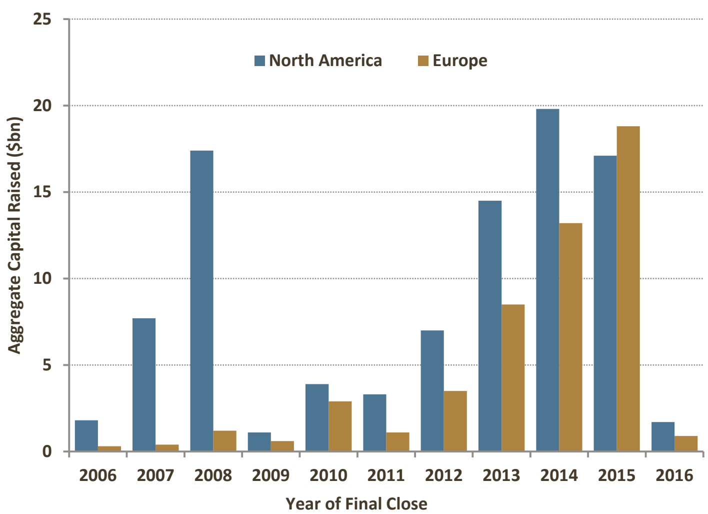

Source: Deloitte Alternative Lender Deal Tracker, Q1 2016

The Business Development Companies ("BDC") market continues to draw attention. Earlier this year nearly all BDCs were trading below book value with Wells Fargo reporting in mid-January 2016 that pricing implied that 60% of BDC loans would default. The market has largely traded back and dispersion has now returned (Exhibit 7).

## Non-Performing Loans (NPLs)

PwC reports that the aggregate size of the non-core loan assets held by banks -- €2.3 trillion including €1.1 trillion in NPLs -- has not meaningfully changed over the past 5 years, a surprising fact given the recent significant asset sales.[15]

**Exhibit 6 – Direct Lending Funds Raised: U.S. and Europe as of April 2016 ($bn)**




Source: Preqin

**Exhibit 7 – Select BDC Pricing (as of August 2, 2016)**

| | | PRICE | PRICE / NAV | DIVIDEND YIELD |
|---|---|---|---|---|
| Hercules Capital Dividend Yield | HTGC | 13.33 | 1.36 | 9.29 |
| Triangle Capital Corporation | TCAP | 19.75 | 1.30 | 10.97 |
| Golub Capital BDC | GBDC | 18.78 | 1.20 | 6.74 |
| TPG Specialty Lending | TSLX | 17.49 | 1.15 | 8.92 |
| TCP Capital Corporation | TCPC | 15.81 | 1.07 | 9.09 |
| FS Investment Corporation | FSIC | 9.39 | 1.03 | 9.52 |
| New Mountain Finance Corporation | NMFC | 13.27 | 1.02 | 10.24 |
| Solar Senior Capital | SUNS | 16.78 | 1.02 | 8.43 |
| Solar Capital | SLRC | 19.95 | 0.97 | 7.97 |
| Ares Capital Corporation | ARCC | 15.15 | 0.93 | 9.94 |
| THL Credit | TCRD | 11.70 | 0.93 | 11.57 |
| TICC Capital Corp. | TICC | 5.59 | 0.88 | 20.60 |
| BlackRock Capital Investment Corp | BKCC | 8.25 | 0.82 | 10.12 |
| Prospect Capital Corp. | PSEC | 8.30 | 0.80 | 12.11 |
| Apollo Investment Corporation | AINV | 5.64 | 0.78 | 14.01 |
| PennantPark Investment Corp. | PNNT | 7.30 | 0.75 | 15.24 |
| Medley Capital Corp | MCC | 7.16 | 0.66 | 16.55 |
| Fifth Street Finance Corp. | FSC | 5.56 | 0.62 | 12.83 |

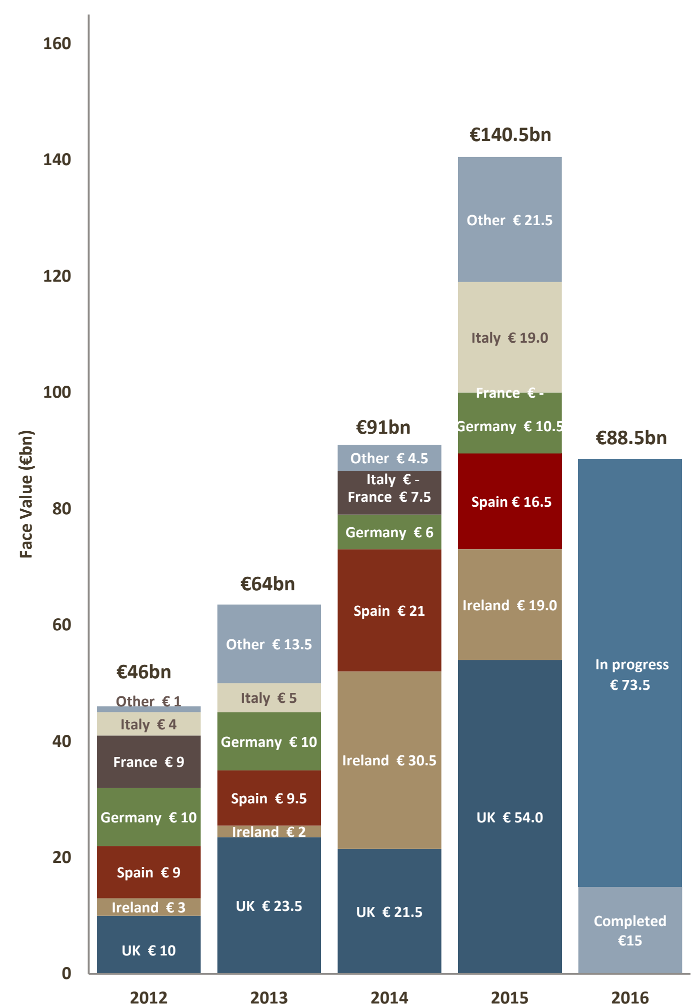
Source: Bloomberg/Wells Fargo

The composition of those assets has, however, materially changed. Ireland, U.K, and Spain have reduced their NPL exposure by a significant amount, collectively accounting for approximately 67% of asset sales over the past three years. With UK NPL volumes off 30%, the pace of asset sales in Italy, which holds the largest amount of NPLs at €200 billion, is expected to increase in 2016. As of the end of Q1, Italy had €39.5 billion of asset sales in progress, representing over half of the In Progress YTD sales (Exhibit 8). Greece is another market where asset sales are expected to continue, with PwC reporting annual growth rate of 16-19% on asset base of €107 billion.[16]

European non-core loan transactions stood at €88.5 billion at the end of Q1 2016. At approximately 63% of total transactions in 2015 PwC expects that transaction volume will reach the record levels set in 2015.[17]

CRE transactions had a slow start to the year. Approximately €3.7 billion in transactions closed in Q1, down 91% on Q4 2015. Transaction sizes averaged €207 million with no "mega" deals competed.[18]

**Exhibit 8 – European Non-Core Loan Transactions by Geography**




Source: PwC

## About Silver Creek

Silver Creek Capital Management is an alternative investment manager with a focus on private credit, hedge fund strategies and timber. Silver Creek specializes in developing customized 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 $6.7 billion (including unfunded commitments) on behalf of our clients.[19]

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2 2016 Preqin Global Private Debt Report
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4 S&P Global LCD Distressed Weekly, July 22, 2016
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6 LCD Distressed Weekly, July 8, 2016
7 Preqin Quarterly Update: Private Debt, Q2 2016
8 Wall Street Journal, "Yield Curve Shows 60% Chance of Recession, Deutsche Bank Says," July 5, 2016; LCD Distressed Weekly, July 22, 2016
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15 PwC, Market Update, Q1 2016
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18 Cushman & Wakefield, European Real Estate Loan Sales Market, Q1 2016

19 Silver Creek Capital Management LLC ("Silver Creek Capital") was organized in 1999 as the successor entity to offer other fund of fund products in addition to the original fund established by the founders of Silver Creek Capital in 1994.

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