US Private Credit Perspectives

H1 2019 Review - Issue 1

Creditflux
An Acuris company

Debtwire
An Acuris company

This report contains updated data as of 14 October

Debtwire
An Acuris company

Funds Data

Track over 350 funds in real-time with Debtwire's Funds Database

Debtwire's new Funds Data platform changes the way professionals gain access to the information they need. Backed by our team of professionals and complemented by our trusted editorial coverage, the database tracks funds from pre-marketing, all the way through close.

Stay ahead of the competition

- Comprehensive global coverage of over 350 active funds
- Real time updates on individual active investors and fund strategies

Tailor your journey

- Customize search options for quick output and easy analysis
- Search by fund name, manager, status, region focus and vintage

Maximize Information

- Access valuable funds information compiled from across our fixed income offerings
- Uncover the biggest trends and key news items to have impacted the market through our quarterly reports

Americas
+1 212 686 5340
n.brooks@debtwire.com

EMEA
+44 (0)20 3741 1002
a.codd@debtwire.com

APAC
+852 2158 9790
sales.asia@debtwire.com

Contents

Private credit glides on but beware of headwinds

Welcome to the first edition of the Creditflux and Debtwire *US Private Credit Perspectives (USPCP)*, which investigates deal and fundraising activity in the first half of 2019

Seth Brumby
Head of Americas
Creditflux

As the credit cycle spins around, private credit funds are forging ahead on fundraising and deal making. During H1 2019, private credit managers in the US raised 12 funds worth US$17.4 billion, which is on pace to exceed the US$30.9 billion record raised in all of 2018, according to Debtwire Funds.

Commitments from institutional investors also show no signs of slowing. Many want to diversify their exposure between liquid and illiquid assets in an uncertain market. The enthusiasm amounted to 232 loans with a total issuance of US$12.2 billion in H1 2019 – down only slightly from US$14 billion in H1 2018, according to Debtwire Par.

Issuance includes a US$1.25 billion unitranche loan for ION Group's US$1.7 billion acquisition of Acuris in June 2019. (Acuris is the parent company for Debtwire and Creditflux, among others.) That's the second largest unitranche loan since last April's US$1.6 billion unitranche financing for Ministry Brands, according to Debtwire Par.

Mindful that many managers and fund structures have never weathered a recession, some pension funds slowed the velocity of their allocations as the summer drew near and the macroeconomic outlook became more uncertain, according to Creditflux.

Symptoms of souring sentiment appeared in the share price of publicly traded Business Development Corporates (BDCs). While BDCs alone don't raise money and issue new deals, they can act as a proxy for sentiment on the loan market. Assets outstanding in the BDC market have grown since Q1 2018, but they collectively traded at roughly 90% of net asset value since the start of the year, reports Debtwire Middle Market.

With uncertainty comes volatility. And where there is volatility, there are opportunities for distress and restructuring. Indeed, NEPC, one of the largest advisors to institutional LPs in North America, expressed caution on private credit in a recent public call, but noted that distress situations might provide some opportunities.

For the past couple of years, the retail and energy sectors have presented the most distress opportunities. Those trends continued while a new crop of distress – this time around opioids – began to metastasize, according to Debtwire Middle Market.

Whether via private credit funds or direct lending obligations like unitranche loans, it's worth taking a holistic approach to understanding the restructuring trends in private credit. This is not to predict another global financial crisis. Rather, it's an all-encompassing view of what could happen during the lifecycle of a private debt instrument.

To that end, *USPCP* examines restructuring trends for companies with less than US$500 million in liabilities. Findings provided by Debtwire's Restructuring Database show a consistent case load for distress investors and restructuring pros alike.

What is not consistent is how restructurings will affect one of the more flavorful offerings in the direct lending world: unitranche loans. Luckily, the legal analysts at Xtract Research have long memories and can recall that one time when RadioShack's unitranche lenders almost blew up one of the largest restructurings in the retail sector.

Direct lending keeps rolling on

Despite a slight year-on-year dip, the US private credit market continues to perform strongly

Nancy Tai
Manager of Americas fixed income data, Debtwire Par

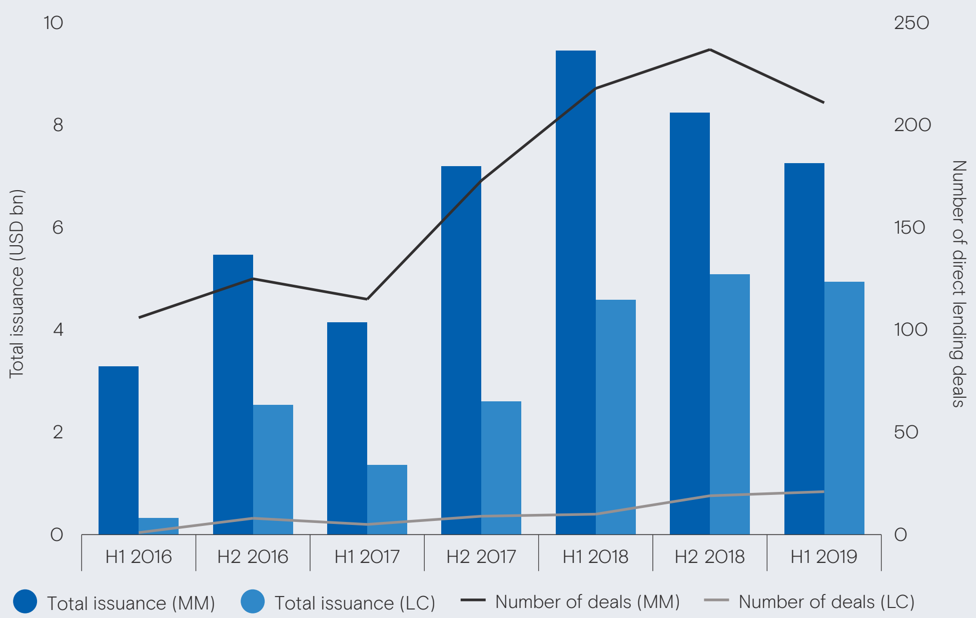
Direct lenders raised 232 loan deals with a total direct lending issuance of US$12.2 billion, slightly down from the US$14 billion and US$13.3 billion issuance seen in H1 2018 and H2 2018 respectively. M&A and buyout financings continued to be the main drivers in this market, together contributing more than 50% of total issuance and total number of deals in the first six months of 2019.

With the strong fundraising environment and the limited number of direct lending transactions in the loan market, private credit managers are also shopping for larger transactions where they can deploy their capital. Of the 232 deals closed in the first half of the year, there were 21 large cap direct lending deals totaling US$5 billion, compared to 10 deals in H1 2018 and 19 deals in H2 2018.

Major deals included Appriss Holdings, a Kentucky-based data and analytics software company, which raised a Golub Capital-led US$430 million unitranche facility for the equity investment from Clearlake Capital Group. Meanwhile Antares, another active direct lender, originated a total US$405 million unitranche deal for Carlyle and TA Associates to acquire Weiman Products, an Illinois-based manufacturer and distributor of specialty cleaning products, from Cortec Group.

In terms of private equity involvement, sponsor-backed financings remain the key component in the US private credit space. In the first half of 2019, 173 out of 232 loan facilities were backed by financial sponsors, which were primarily for event-driven activities.

US Direct Lending Loan Issuance - Large Cap & Middle Market



Assumptions: MM defined as drawn loan <USD 150m
LC defined as drawn loan >USD 150m

Note: subject to further updates as more data is collected
Source: Debtwire Par

Non-sponsor-backed financings, though more difficult to originate than sponsor-backed ones, generate more yield which allows direct lenders to diversify their portfolios and develop business relationships with different issuers. In H1 2019, the market saw 59 non-sponsor-backed deals totaling US$3.7 billion, and most of these deals were for new money financings.

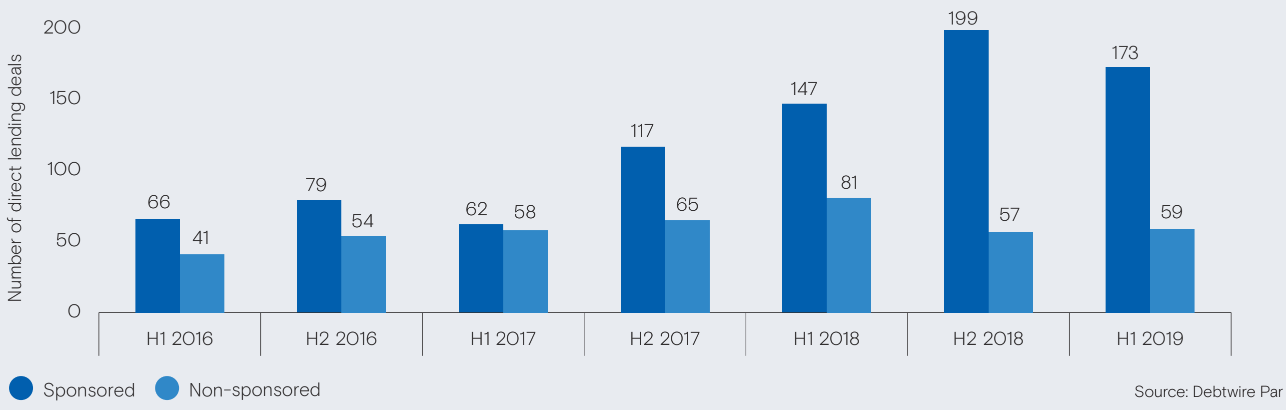
Sector wise, the Technology, Media and Telecommunication (TMT) industry took the largest market share by number of deals in the first half of 2019, raising 51 transactions. Of these transactions, computer software companies were the most active issuers, seeking funds for innovative development and the support of M&A activities. Following the TMT sector, Business Service providers and Medical companies took the second and third largest market shares with 47 and 32 deals respectively.

H1 2019 US Direct Lending Loans

Rank	Direct Lender	Number of deals	Market Share %
1	Madison Capital	52	14.21%
2	Antares	45	12.30%
3	MidCap	22	6.01%
4	Owl Rock	20	5.46%
5	Twin Brook	16	4.37%
6	CIT Group	15	4.10%
7	Monroe	14	3.83%
8	Golub	13	3.55%
9	Ares	12	3.28%
10=	AllianceBernstein	11	3.01%
10=	Bain Capital	11	3.01%

Source: Debtwire Par

Number of the US Direct Lending Loan Deals - Sponsored vs Non-sponsored



Source: Debtwire Par

Sector Distribution by Number of Direct Lending Loan Deals - H1 2019

Source: Debtwire Par

Size matters for business development companies

Business development companies (BDC) are part of the private credit mix but they are evolving into a cycle of consolidation

Bill Weisbrod
Senior reporter
Debtwire

As credit investors scour the globe for returns in a low-yield environment, US mid-market leveraged loans are increasingly popular. And business development companies provide public exposure to what is otherwise very private credit.

BDCs are closed-end funds that distribute income to shareholders via dividends. As required by law, 70% of BDCs' holdings must be in investments in so-called 'qualifying assets,' which are typically privately held, mid-sized, US-based companies.

For comparison with other US-based debt investment vehicles, as of 31 March, the BIZD BDC ETF produced a 9.7% dividend yield compared with 8.2% for the AMLP MLP ETF, 5.4% for the HYG High Yield ETF and 4% from the VNQ REIT ETF.

Big guns hurt BDCs

Recently, smaller BDCs have struggled to compete with those affiliated with larger credit management platforms that originate bigger deals and hold bigger amounts. That has sparked consolidation and hurt performance for smaller BDCs.

Large private credit fund managers, many of which manage BDCs, are using size to their competitive advantage. This is, in part, because they can act as a back-up option for companies that don't want to deal with a fraught syndication process amid market turbulence. For example, in August, Debtwire's Middle Market reported that private credit fund and BDC manager Golub Capital provided animal hospital operator Blue River Pet Care with a US$270 million term loan to back a buyout by Partners Group. The issuer had originally planned to tap the syndicated loan market.

And, in August, Ares Capital, the largest BDC by market capitalization, said that its average portfolio company LTM EBITDA in Q2 2019 was US$70.9 million. That was up from US$66 million in Q1 2019 and US$49.5 million in Q2 2018.

"Our ability to be a meaningful and stable source of capital with large client-hold capabilities enhances our position as markets evolve," Ares Capital Corporation CEO Kipp deVeer said in the BDC's Q2 earnings conference call in July.

Advantages of the business development company structure include pass-through tax treatment for income, fees for managers as high as 2% on assets and 20% on investment income, as well as the option to list stock publicly and thus raise money from retail investors.

Ups and downs for BDCs

There are currently 99 total BDCs in existence, 78 of which were formed in the last decade, according to law firm Eversheds Sutherland. Fifty-two of these are publicly traded, with the rest either non-traded or private. As of Q1 2019, publicly traded BDCs had US$75.3 billion in assets under management, up from US$62.7 billion in Q1 2018, according to research from investment bank Keefe, Bruyette & Woods.

But BDCs have problems. As of August, publicly listed BDC shares were collectively trading at an average of 90.6% of stated net asset value according to Keefe, Bruyette & Woods. That reflects market sentiment that public BDCs' assets are worth just under 91% of their stated value.

And size is not the only predictor of how investors will value BDCs. FS KKR Capital and Prospect Capital are the third and fourth largest BDCs respectively by market cap and both were trading below 75% of net asset value as of 23 August.

However, size does help, as smaller BDCs are either looking for exits or struggling to keep up. For example, Alcentra Capital Corporation, which has a US$114 million market cap, sold out to a BDC managed by Crescent Capital in August. Other small-scale BDCs could be next.

What US limited partners want

While US institutional investors have diversified their investment portfolios across continents in recent years, there is still a preference for investing in domestic funds. Meanwhile, ESG is becoming a fundamental factor

Sofia Karadima
LP researcher
and writer
Acuris

Private credit has become a popular asset class globally among investors, as recent regulations and bank retrenchment has restricted the ability of traditional bank lenders to provide capital.

In terms of recent commitments that US-based LPs have made, North American-focused funds have been the destination of choice, although pan-European manager searches are also evident. As the interest in direct lending has increased, so too has the emphasis that LPs are placing on integrating and embracing environmental, social, and governance (ESG) policies into due diligence and investment processes.

Home and away

The US is historically the largest direct lending market, giving investors a greater amount of choices in terms of strategies. In addition, US private credit funds tend to apply more leverage, resulting in potentially higher returns for investors.

Although Europe has lagged behind North America, US investors have shown appetite for exposure to the European private credit market, with numerous mandates for private credit managers recently awarded or launched.

Los Angeles City Employees' Retirement System (Lacers) awarded four contracts for a US$670 million private credit mandate search earlier this year. Benefit Street Partners and Monroe Capital were selected for the US portion, while Alcentra and Crescent Capital secured the non-US portion.

Other US-based pension funds that have recently invested in European funds include Alaska Permanent Fund Corporation and Pennsylvania State Employees Retirement System (SERS). They have recently backed Permira Credit Solutions IV, where the fund's strategy focuses on primary and senior secured investments in mid-market European companies.

North American investors are also showing an interest in backing euro-denominated funds to diversify their allocation. "For North American investors committing to European direct lending, it is always a trade-off," says Partners Group's managing director Alexander Ott. "Two years ago, everyone was sticking with the US dollar, but that has changed. Investors want the diversification."

The US has a very competitive landscape, especially in the middle and lower middle-market. However, the situation in Europe is different. Drew Schardt, Global Head of Private Credit Hamilton Lane, says that Europe has a smaller number of managers in the competitive landscape compared to the US, where the middle and lower middle market is very competitive. However, he adds that Europe is a relationship-driven market and the nuances vary from country to country.

Looking to the old world

Despite the US being the larger market in terms of direct lending, Ott says that the opportunity in 2019 lies in Europe. "In direct lending, volatility creates opportunity and increases relative value. Brexit, the Italian banking crisis, the Greek debate offer a certain degree of volatility, and that's why I think that there is a tilt towards Europe.

"Furthermore, if you look at the US market, we have seen steps towards deregulation, which makes the marketplace more competitive. And a more competitive environment always makes the market less attractive for investors."

Allocations on the up

Several investors are set to further allocate into direct lending over the months to come and take advantage of the opportunities that this asset class

H1 2019 DLP allocations

Fund backed	Region focus	Institutional investor
BlackRock Direct Lending Fund IX	Americas	San Mateo County Employees' Retirement Association
HarbourVest Credit Opportunities Fund II	Americas	Boston Retirement System
LBC Credit Partners V	Americas	Minnesota State Board of Investment
AG Direct Lending Fund III	Americas	Santa Barbara County Employees' Retirement System
Benefit Street Partners Senior Secured Opportunities Fund II	Americas	Vermont Pension Investment Committee
MGG SF Evergreen Unlevered Fund	Americas	San Francisco City & County Employees' Retirement System
Raven Asset-Based Opportunities Fund IV	Americas	Detroit General Retirement System
THL Credit Direct Lending Fund IV	Americas	Santa Barbara County Employees' Retirement System
WHF STRS Ohio Senior Loan Fund	Americas	State Teachers Retirement System of Ohio

Fund backed	Region focus	Institutional investor
GSO European Senior Debt Fund II	Europe	Ohio Police & Fire Pension Fund
Kreos Capital Fund VI	Europe	Alaska Permanent Fund Corporation University of Michigan Endowment
Permira Credit Solutions IV	Europe	Alaska Permanent Fund Corp Pennsylvania State Employees' Retirement System
OrbiMed Royalty Opportunities Fund III	Americas, Asia, Europe, Oceania	Texas County & District Retirement System

offers. Alameda County Employees Retirement Association has recently launched a private credit portfolio, with plans to invest up to US$490 million and meet a target allocation of 4% by 2023. The Californian pension fund is interested in investing in a blend of leveraged and unleveraged private credit funds, which may include investments in performing senior corporate loans, secured by first and second liens against assets of the company, among other assets.

San Antonio Fire & Police Pension Fund has also launched a private debt search with a focus on hard-asset lending, and it is planning to commit US$60 million before the end of the year.

Another LP with plans to make commitments as part of its fiscal year 2019-2020 pacing plan is the San Jose Federated City Employees Retirement System and Health Care Trust. The pension fund is set to invest US$20 million in private debt.

Different views on the E, S and G

When it comes to ESG, the appetite and rhythm for integration and impact investing varies depending on the location and nature of the limited partners (LPs) and general partners (GPs) to whom they are committing. To date, public pension funds have been earlier adopters of ESG considerations, particularly in Europe, Australia and Canada.

LPs based in Scandinavia and the Netherlands, are considered the pioneers of ESG investments, with sources claiming that responsible investing is currently higher on the agenda of European investors, compared to their North American peers.

However, others highlight that the agendas differ in terms of priorities, with North American LPs more concerned about diversity, and focusing more on the 'G' component of ESG, compared to the European investors engaging more on environmental and social issues.

Fundraising is on a tear in H1 2019

Fundraising for private credit funds showed no signs of a slowdown over the first half of this year with a flurry of fund launches

Michelle D'Souza
Reporter,
Creditflux

In 2018, a record level of capital was raised for US direct lending strategies, according to Creditflux data, with 20 funds garnering a total of US$30.9 billion. And the trend doesn't seem to be on the way out in 2019. A total of 12 funds focused on direct lending closed between January and June, with managers raking in at least US$17.48 billion.

Big guns, big funds

Goldman Sachs' merchant banking division is one of the largest capital raisers in the private debt asset class, with over US$80 billion raised in the past 20 years. And the New York-based manager added to the pot in May, closing the largest US private credit fund of the year so far. Broad Street Senior Credit Partners II held a final close with US$4.4 billion (including leverage) ready to deploy. Senior Credit Partners II continues the same strategy as its predecessor vehicles, focusing on originating loans for mid-sized to large companies in North America and Western Europe with enterprise value above US$300 million. Its predecessor fund Broad Street Senior Credit Partners closed in July 2015 with US$3.16 billion total capital.

Ares Capital Management also got off to a strong start in 2019, with a final close for Ares Senior Direct Lending Fund in January at US$3 billion. With leverage, the fund is anticipated to have US$5 billion to deploy.

Ares noted that it had upped the target size for the strategy in its third quarter 2018 results, from US$3.5 billion to US$4.7 billion, following its global fundraising successes that quarter. On the back of a US$1.4 billion first close in July, Ares brought in US$1.6 billion of capital commitments during the third quarter, plus an additional US$600 million after quarter end — bringing total capital to US$2.2 billion by November.

Meanwhile, the asset manager's European arm launched its largest European private credit fund in July last year, hitting its €6.5 billion hard cap — which could reach €10 million capital to deploy with leverage.

Twin Brook, Angelo Gordon's direct lending subsidiary, closed AG Direct Lending Fund III at US$2.75 billion. The fund, which had an original US$2 billion target size, is expected to have US$5 billion of buying power with leverage. Fundraising remained in line with its predecessor AG Direct Lending Fund II, which closed in July 2017 at US$2.3 billion.

The firm's strategy differentiates slightly from the Goldman and Ares funds, with the New York-based manager focusing purely on the lower middle market. The vehicle will provide senior investments to sponsor-backed companies with US$3 million and US$50 million EBITDA and average hold sizes between US$25 million and US$150 million. It will also invest in second lien, mezzanine, and equity co-investments.

Investors assemble

Institutional investors — including pension funds, insurers, endowments, sovereign wealth funds (SWFs) and family offices — continue to feverishly inject capital into the asset class. Despite compression in overall yields and increased

> Institutional investors — including pension funds, insurers, endowments, SWFs and family offices — continue to feverishly inject capital into the asset class.

competition, private debt offers investors lower volatility and higher expected returns than the public credit markets.

Public Sector Pension Investment Board, for example, remained bullish on private credit after generating a 9.2% one-year internal rate of return on its private debt portfolio, exceeding its 5.6% benchmark, according to its annual 2019 report.

However, consultant NEPC flagged caution to the asset class during its private markets quarterly earnings call, noting that there has been a larger pullback from the asset class. The firm has switched to a slightly more negative view on US direct lending with "conditions creeping up in underwriting standards and rates," according to Phil Nelson, director of allocation at NEPC.

NEPC noted that it struggled to see where the risk-return value is to a total return portfolio. Despite that, there is some value in having dry powder. But investors should be thoughtful about how that is allocated.

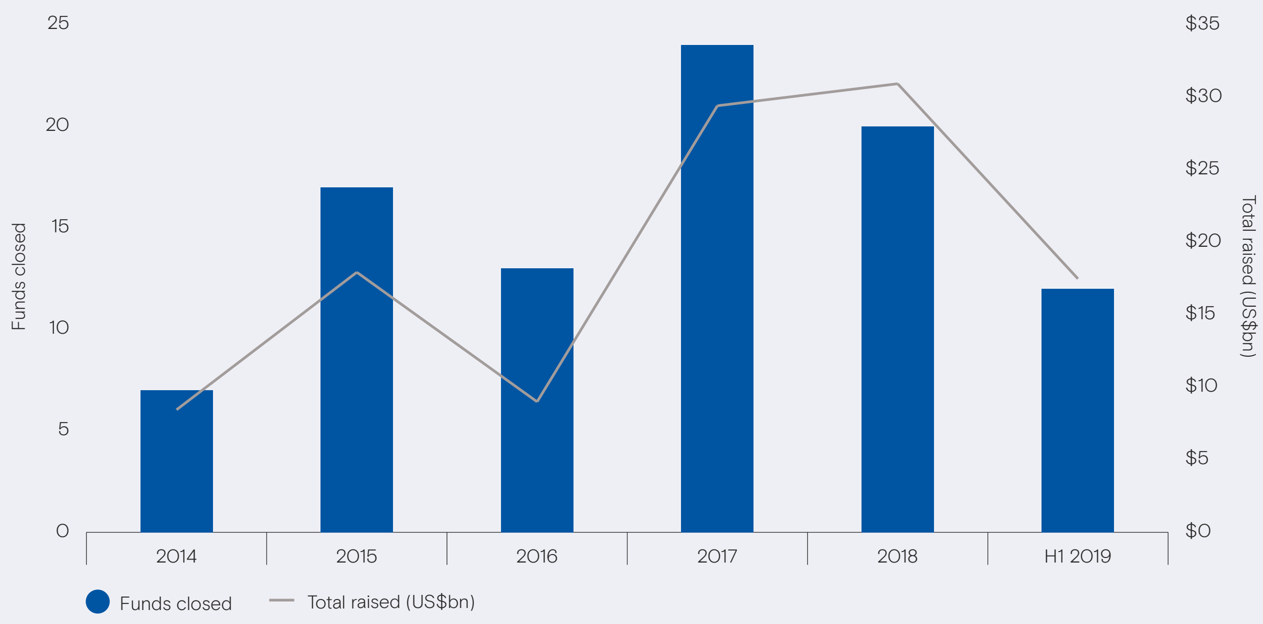
Largest North American direct lending funds closed in H1 2019

Fund name	Amount raised (US$bn)
Broad Street Senior Credit Partners II	4.4
Ares Senior Direct Lending Fund	3
AG Direct Lending Fund III	2.75
NB Private Debt Fund III	1.7
Audax Direct Lending Solutions Fund	1.65
Penfund Capital Fund VI	1.15

Select funds in the market

Fund name	Target size
TCW Direct Lending Fund VII	2.5
Cerberus Levered Loan Opportunities Fund IV	2.5
Summit Partners Credit Fund III	1.5
BlackRock Middle Market Senior Fund	1.5
Churchill Middle Market Senior Loan Fund II	1

North American direct lending fundraising 2014 - 1H19



"Direct lending is the most attractive risk adjusted return that you see in the market today"

Chris Flynn, CEO of THL Credit, tells *USPCP* about changing deal structures, the opportunities in direct lending and the risks

Chris Flynn
CEO of THL Credit

How have direct lending/private credit deal structures changed over the past 12 months?
Sponsor equity contributions remain quite significant, ranging from as low as 30% to as high as 70%, with an average of approximately 50%. Strong equity contributions give us comfort in building our portfolios, especially compared to the 2008 downturn when equity contributions were typically in the 25% to 35% range.

From a structural standpoint, there is continued pressure from some sponsors who are looking for more flexibility as it relates to financial covenants. We believe the core middle market — defined as US$10-40 million in EBITDA — has remained more disciplined. The core middle market has maintained very strong negative covenants which, quite frankly, are very important and frequently ignored in broader discussions regarding structure.

What kind of financing do your more mature funds employ?
Historically our private funds have been unlevered. Today, TCRD, our publicly traded business development company, is levered at a target range of 0.6-0.8x and is structured as an asset-based loan with varying advance rates extended based on the type of security.

Today, the market for leverage on financial assets is very competitive as many banks have moved away from providing direct loans to sponsor-backed leverage buyouts but now do so indirectly through these financing arrangements.

What is the best argument for increasing allocations to direct lending?
Direct lending is the most attractive risk adjusted return that you see in the market today. As yields have come down, it's given people some pause. At THL Credit, our investments are floating rate and senior secured, and if we do our job well, we should have minimal volatility to NAV and pay out about a 2% to 2.5% quarterly distribution. That translates to an 8% to 10% return on average, unlevered at about a 50% loan-to-value based on average equity contributions from sponsors.

There are not many other opportunities that offer an investor that kind of return with quarterly distributions and do so with a 100% floating rate book. Plus, we've got good downside protection because there's an equity player sitting behind us.

Most of the biggest LPs, such as US insurers, public pensions, university endowments, are making permanent allocations to the direct lending market.

What are the largest risks to the market?
First, there is a lot of capital chasing financing opportunities for levered funds. As it becomes easier to add leverage to your portfolio of loans, some investors shift their focus away from return on assets (ROA) to return on equity (ROE). When investors start looking at ROE, a figure artificially bolstered by leverage, they tend to misprice the ROA because the leverage is so cheap. That's another risk overlooked by the market.

We also think some investors in the direct lending space have begun to run a bit more concentrated in their funds because of a scarcity of deal flow. For example, in high conviction loans where investors would usually only hold a 2.5% position, we are seeing them buy in at 5%. And if it's a tier one sponsor, maybe they're moving to 6% or 7%. In my view, concentration and fixed income should never work hand in hand.

"The largest risk is a major economic recession. This isn't a recession-proof strategy"

Kristofer Kwait, co-CIO of Commonfund Asset Management Company, tells *USPCP* about the resilience of private debt, fee structure and covenant reductions and the key risks to the market

Kristofer Kwait
co-CIO of Commonfund Asset Management Company

How has private credit performed over the past year and do you expect that to continue?
Last year was a good year for high yield, which returned about 7.5% or so, but leveraged loans were up as well. The economy was fine, credit conditions weren't tested and interest rates stayed low and even moved lower. But importantly, we didn't have interest rates go up a lot, which on the surface can sound okay because these are floating rate loans and as a lender you get paid more when rates rise, but that can also put pressure on the companies and potentially cause defaults. And we did see in general, most private direct lenders outperformed high yield.

What is the anticipated trend on private credit/direct lending allocations over the year?
I don't see a high probability of a recession next year. And, unless we have a severe long-lived recession, private investments are relatively resilient even in an economic slowdown. However, as we go longer in the cycle, you'll start to see more dispersion in returns from the A players versus the B and C players. Our clients — foundations and endowments — do seem to be increasing their allocations to illiquid [investments]. But we're seeing more of a trend towards private equity because over time, PE will produce a higher long-term expected return than direct lending. When clients can take on more liquidity risk, we re-allocate a large portion of their liquid credit to private credit.

What kind of incentives and fees are general partners employing to entice more investors?
We don't start our process with, "let's find managers with the lowest fees" because it's all about the quality of what we're buying. But as to fees, we have seen them come down a little bit. Some managers are now charging a low flat fee on invested capital with no performance fee. And I think it's because there are a lot of loans and there's a little bit more asset-gathering competition. These tend to be larger funds and larger deals. And because of that, there's often fewer covenants in place to protect the downside — which we don't find attractive.

What is the best argument for upping allocations to direct lending over the next year?
We believe equities can keep going over the next year. But equities aren't cheap and, if you can issue high single-digit unlevered loans for short periods, I think you could capture equity-like returns with considerably less risk. These are cash-flowing deals. And I think you're getting diversification, some degree of downside protection, and some degree of resiliency in an economic slowdown.

What are the largest risks to the market?
The largest risk is a major economic recession. This isn't a recession-proof strategy. You're taking risks, but I do think that a typical recession that isn't very severe could potentially improve the opportunity set in this space because you could start lending at higher rates with new capital. The second risk is the supply of capital. There is a lot of money coming into the space. Seeing that, the larger managers can sit out a quarter. Or they could allow their yields to come down a bit if things get more competitive. But if you're a late-cycle start-up, you might have to put that money to work and that would concern me a little bit. I think there is a lot of capital coming in and that's something to watch.

Restructuring on the rise in H1 2019

It's time to stop forecasting for a broad downturn. Distress cycles are now sector specific, not systemic. So, the question becomes, which sector is next?

Seth Brumby
Head of Americas
Creditflux

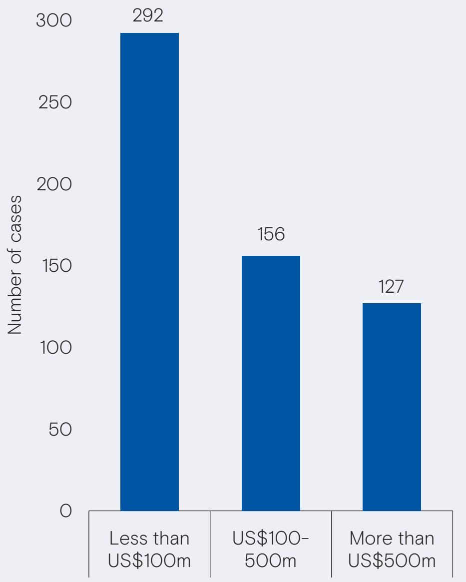
There were 57 bankruptcies in 1H19 for companies with less than US$500 million in assets and liabilities. That's a 35% increase year on year, but still less than the 62 bankruptcy filings of similar size during the height of the secular distress in the energy space in 2016, according to Debtwire's Restructuring Database.

From January 2016 through 30 June 2019, there were 625 Chapter 7 or Chapter 11 bankruptcy petitions. Of those, 498 had less than US$500 million in assets and liabilities. When looking at petitions by type, 51 were Chapter 7 petitions while 241 were Chapter 11 filings. Many of those Chapter 7 bankruptcies were conversions from Chapter 11 following an auction of debtor assets. Freefall liquidations are rare.

Nevertheless, it's worth comparing the prevalence of Chapter 7 petitions for middle and small to medium-size enterprises (SME) with companies that had assets and liabilities larger than US$500 million. Over the same time period for the larger category, there was just one Chapter 7 (Scottish RE).

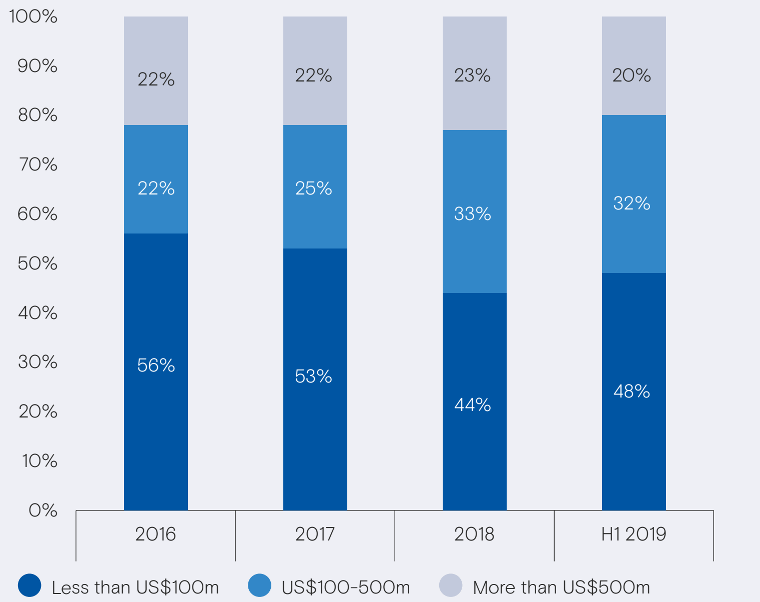
With the prevalence of Chapter 7 bankruptcy filings, the picture might look bleak for lenders

Number of cases by liability size

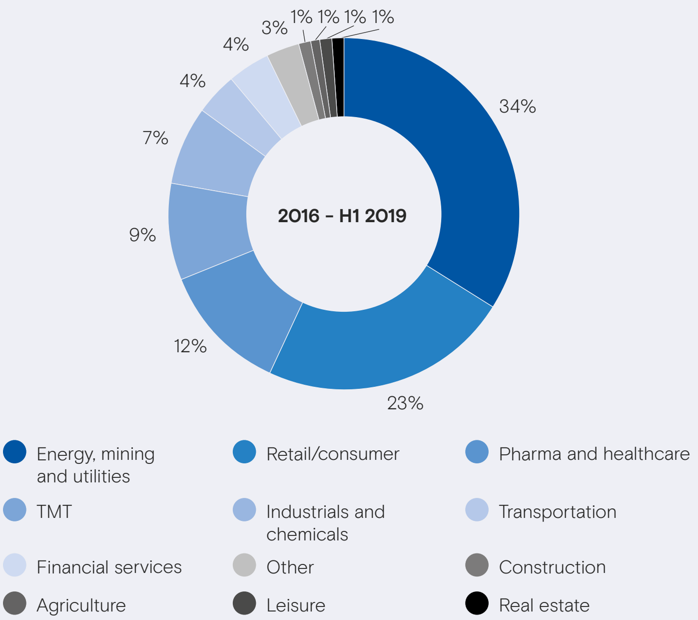


Does not include 50 cases wherein liabilities were not disclosed.

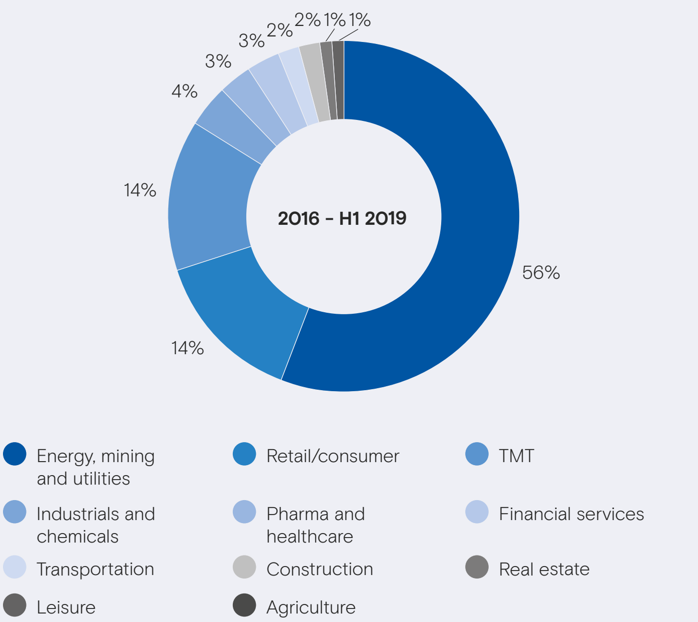
Proportion of cases by liability size bar chart



Proportion of cases by sector, 2016-H1 2019



Proportion of total liability by sector, 2016-H1 2019



unfortunate enough to follow a middle market or SME into bankruptcy. Considering that many investors are girding for another restructuring cycle, it's important to point out that distress is, in more recent memory, sector specific and not necessarily systematic.

As noted on page 16, retail represents the principal number of filings for H1 2019. But when we extend the trend back to January 2016, oil and gas leads the way with 80 bankruptcy petitions whereas retail accounted for 62. Healthcare came in third at 42.

However, when we look a little deeper, these figures shouldn't be surprising or troubling. Restructuring cycles cannot always be a 'great financial crisis', like the one a decade ago.

So instead of waiting for a broad downturn that affects every part of the economy, it's worth changing that paradigm to something more specific. Instead of asking when the next distress cycle will come, investors should admit that distress is already here, and it's sector specific.

For energy, it has come and is largely gone. In retail, it is still playing out. If restructuring trends are any indicator, healthcare is the next in line.

625

The number of bankruptcies that have taken place in the US between 2016 and H1 2019

50%

Half of all bankruptcies between 2016 and H1 2019 were in the EMU sector

Retail sector hit by a wave of restructurings

While the market remained strong in H1 2019, it wasn't all good news as retail and the opioid epidemic injected uncertainty into private credit

Hema Oza
Editor
Debtwire Middle Market

Distress in retail was a prevalent topic in the first half of 2019. A number of mid-market issuers threw in the towel amid ongoing operational challenges in the industry. Collateralized loan obligations (CLOs) invest in many middle market loans. Some of that debt has fallen into distress, although the total exposure of CLOs to distressed middle market loans is minimal.

Among the filers, retailers Things Remembered, Charlotte Russe and Charming Charlie were all repeat visitors to the restructuring party, with each facing renewed stress after completing prior workouts. Things Remembered confirmed a liquidation plan to distribute proceeds from asset sales and will sell to Enesco, a fellow giftware retailer which will keep 50 of the debtor's 400 stores open. The other two will wind down operations and close all stores, although Charlotte Russe still could receive an offer to revive the brand.

Also on the liquidation front, National Stores decided to convert the case to Chapter 7 following arguments from lenders that determined the discount retailer was administratively insolvent. The retailer initially filed for Chapter 11 with a plan to close certain stores and find a buyer for the rest.

Furniture and home décor retailer Z-Gallerie was pushed into bankruptcy with a restructuring plan allowing the debtors to either pursue a sale or reorganize by giving their equity to secured lenders and close underperforming locations.

More retail restructurings
A fellow victim of sluggish consumer sentiment, Modell's Sporting Goods emerged as a distressed retailer facing the all-too-familiar competitive struggles plaguing the bricks and mortar side of the industry.

Away from retail, middle market gun distributor United Sporting Companies filed for bankruptcy to implement a wind-down plan. The debtor intends to liquidate its assets after failing to secure a buyer, refinance its debt or secure additional credit from existing lenders prior to the filing.

The opioid epidemic reared its ugly head with INSYS Therapeutics filing for bankruptcy after the company pleaded guilty to five counts of mail fraud. The specialty pharma's practices came to light beginning in August 2013 with lawsuits from individuals, with several states and the Department of Justice (DoJ) joining later.

The DoJ agreed to accept a US$243 million general unsecured claim in the Chapter 11 case, with a recovery capped at US$195 million, to settle the criminal charges. INSYS will settle civil claims with a payment of a US$2 million fine and a US$28 million forfeiture. The company still faces approximately 1,000 lawsuits from municipalities, individuals and insurers, among others.

Distress in retail was a prevalent topic in the first half of 2019. A number of mid-market issuers threw in the towel amid ongoing operational challenges in the industry.

Unitranche restructuring uncertainty under Chapter 11

USPCP explores the potential impediments that unitranche filings may face when undergoing a Chapter 11 restructuring

Richard Goldman
Director of Legal Operations,
Xtract Research

Given the recent growth of the US unitranche financing market, it is only a matter of time before some of those financings undergo court-supervised restructurings under Chapter 11 of the US Bankruptcy Code. And while there is nothing apparent about a typical unitranche financing credit agreement that would prevent a bankruptcy court from efficiently administering the debtor-borrower's bankruptcy, the attendant Agreement Among Lenders (AAL) might provide otherwise.

Similar to an intercreditor agreement that accompanies the more traditional, two-tier structure found in the syndicated TLB market, an AAL re-engineers the terms of a unitranche loan into separate tranches of 'first out' and 'last out' debt. It also sets forth the respective lenders' priorities, rights and remedies, which include fundamental bankruptcy issues such as creditor classification under a Chapter 11 plan and waivers of voting rights.

Considering the substantive rights that AALs address, it is easy to imagine that disputes will arise during Chapter 11 cases regarding the interpretation and enforcement of AAL provisions that, depending on the nature of the dispute, could delay confirmation or the ability to effectuate confirmation of the debtor's plan of reorganization. To avoid this, parties — especially the debtor-borrower — would likely ask the bankruptcy court to adjudicate the dispute.

But does a bankruptcy court maintain jurisdiction to adjudicate AAL lender disputes? The answer, unfortunately, is unclear.

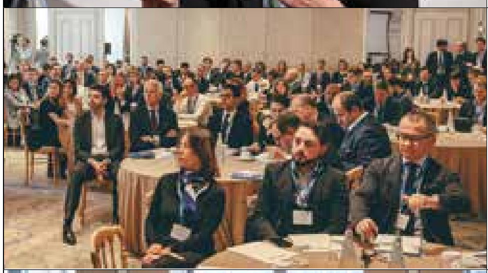
Section 510(a) of the Bankruptcy Code provides that "a subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law." It is well-settled that section 510(a) applies to intercreditor agreements, thereby providing bankruptcy courts with the authority to adjudicate issues that arise under those documents. Though some might be quick to extrapolate that precedent to AALs, there is a fundamental distinction between AALs and intercreditor agreements that could cut against that application.

Unlike intercreditor agreements, the debtor-borrower is not a party to an AAL. As a result, when a dispute arises concerning the interpretation or enforcement of AAL terms, it is a purely an inter-lender dispute. As such, a bankruptcy court may be constitutionally foreclosed from, or simply disinclined to, resolving the matter.

Making matters worse, there is very little settled case law on bankruptcy courts' jurisdiction to resolve AAL disputes. The most notable Chapter 11 case concerning an AAL inter-lender dispute arose in RadioShack's 2015 bankruptcy. There, certain lenders asked the court to interpret an AAL provision that concerned last out lenders' right to credit bid their debt and satisfy first out debt obligations. Though, upon the consent of relevant parties, the court agreed to hear the issue and provided guidance to the parties on how it viewed their respective rights, the matter ultimately settled. As a result, the RadioShack court never issued a written decision on whether it maintained jurisdiction to the AAL dispute.

While there is a strong argument that AALs constitute subordination agreements and fall within the application of section 510(a), without settled case law on this point, unitranche borrowers and lenders entering Chapter 11 should beware that any disputes arising under the AAL could be referred to another court, potentially resulting in substantial delay to the restructuring.

Creditflux/Debtwire 2020 H1 dates for your diary

	**Credit Dimensions,** *11 March, New York*	The only event for the rapidly expanding synthetic structured credit market returns for the fifth time, gathering all the key players in the tranches and bespokes market for a half day of buy-side led content and networking.
	**European Direct Lending Forum,** *1 April, London*	The marriage of two long running events will this year combine the best Creditflux content with that of Debtwire into a single conference covering the full life cycle of the European direct lending market.
	**Symposium & Manager Awards,** *29 April, London*	This global CLO conference gathers 500 senior executives in London for a full day covering both the US and European CLO market, followed by the hotly-contested Creditflux Manager Awards dinner.
	**Debtwire Italian Restructuring Forum,** *19 May, Milan*	This restructuring forum gathers 200 professionals from Italian distressed investing, workout and private credit communities to provide legal updates on the Italian bankruptcy laws, UTPs and sector opportunities.
	**US Private Debt Forum,** *12 June, New York*	Whether they call it direct lending, private credit or the middle-market, investors are continuing to pour money into this space. This forum will cover the whole life-cycle of the middle-market, from fundraising to origination to securitization.
	**Women in CLOs,** *28 April, London* **Women in CLOs,** *17 July, California* **Women in CLOs,** *10 November, New York*	Series of 3 networking events in key markets specifically aimed at women working in the CLO industry. Attendance by sponsor invitation only.

For more information on speaking, sponsoring or attending contact ***sponsorship@acuris.com***

www.events.acuris.com

Creditflux
An Acuris company

Debtwire
An Acuris company

About Creditflux and Debtwire

Creditflux
An Acuris company

Creditflux, an Acuris company, has been the leading supplier of global news and analysis on structured credit funds since its launch in 2001. We publish a monthly newsletter, online daily news and a comprehensive fund database of CLOs and other credit funds. Creditflux provides unrivalled news and analysis for investors, dealers and service providers who need to know what is going on in these fluctuating markets and is often first with the key information these firms need to know about these asset classes.

Visit **creditflux.com** for further information.

Debtwire
An Acuris company

Debtwire, an Acuris company, is the leading provider of expert news, data and analysis on global leveraged credit. Our end-to-end coverage goes behind the scenes from primary issuance to the first sign of stress through restructuring and beyond. With global breadth and local depth, Debtwire's award-winning editorial, research and legal analyst teams produce original content that helps subscribers make more informed decisions. Subscribers trust Debtwire - the pioneer in the market - for comprehensive coverage across geographies, companies and asset classes.

Visit **debtwire.com** for further information.

Contacts

For sponsorship enquiries

Americas

Alissa Rozen
+1 212 500 1394

EMEA

Chris Coe
+44 (0) 20 3741 1075

Karina Ross
+44 (0) 20 3741 1058

For subscription enquiries

Americas

Jason Papper
+1 212 686 5066

EMEA

Will Brayshaw
+44 (0) 20 3741 1090

Felipe Poveda
+44 (0) 20 3741 1258

EMEA
10 Queen Street Place
London
EC4R 1BE
United Kingdom

+44 203 741 1000

Americas
1501 Broadway
8th Floor
New York, NY 10036
USA

+1 212 500 7537

Asia
16/F Grand Millennium Plaza
181 Queen's Road Central
Hong Kong

+ 852 2158 9790