

Deloitte.

Private Debt Conference

17 November 2015



Conference Agenda

1

Introduction

Alexandre Prost-Gargoz, Partner, Deloitte

2

Evolution of the private debt industry in Luxembourg

Alexandre Prost-Gargoz, Partner, Deloitte

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Fireside chat - Perspective from a GP

Chris Connelly, Head of Operations, Partner ICG interviewed by Nick Tabone, Partner, Deloitte

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Luxembourg securitization companies: Loan portfolio restructuring & (re)financing

Dr. Sebastian Bos, Senior Manager, Deloitte

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Hot topics:

a) Private Debt: Tax considerations *Christophe Diricks, Partner, Deloitte*

b) Due Diligence process and risk management *Nicolas Schoukens, Director, Deloitte*

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Evolution of the private debt industry in Luxembourg

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Market Trends

Key trends in Private debt industry

The main trends to expect: superabundant capital vs assets, shadow capital, challenging returns and competition between GPs

HIGH LEVEL OF CAPITAL, LOW YIELD, HIGH PRICED ASSETS

Dry powder levels hit a record high of \$179bn as at the end of Q2. Direct lending funds have seen an increase of 45% from December 2014 in the levels of capital available for new investments, while Europe-focused debt funds have seen an increase of 51%

“ALTERNATIVE LENDER” vs TRADITIONAL BANKING

LPs are looking at different collaboration models fitting their needs with more flexibility than traditional banking.

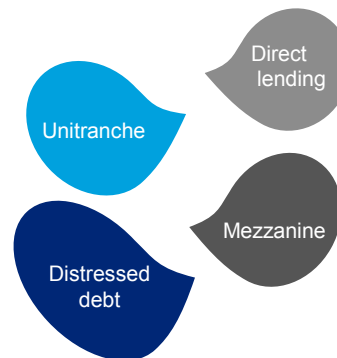
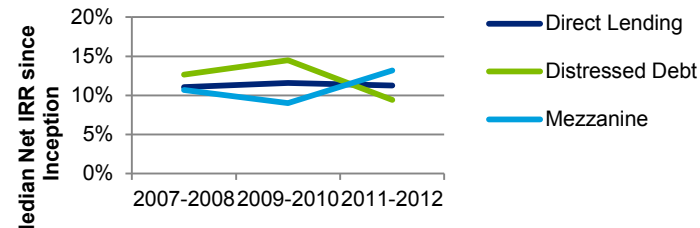
This continuing change gives ability to:

- (i) enhance more returns at a lower cost
- (ii) provide flexibility on the equity structuring
- (iii) tailor financing in niche markets

FIERCE COMPETITION BETWEEN GP'S

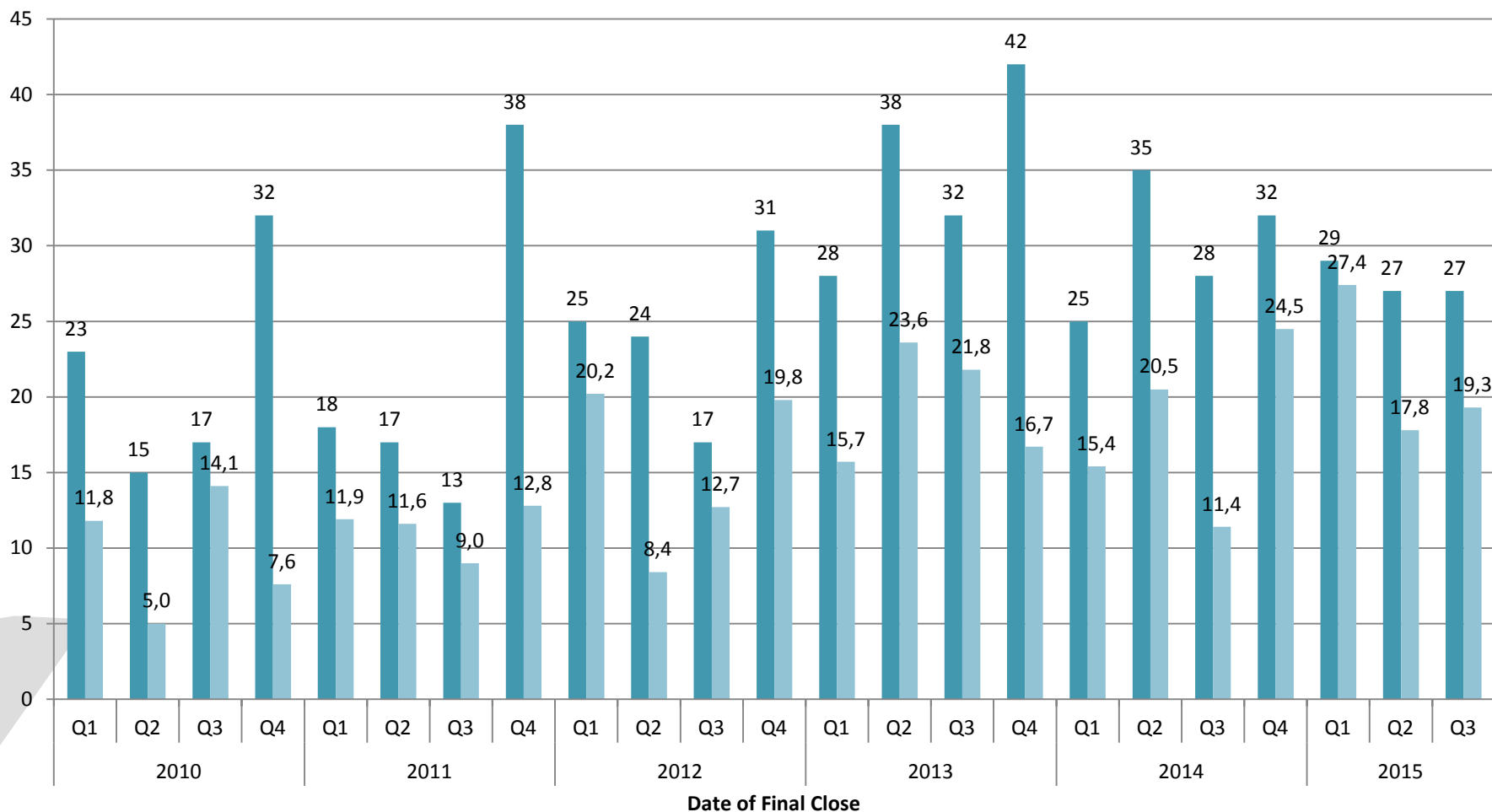
Trends in private debt fundraising seem to suggest investors are increasingly willing to invest with established fund managers that have the capability to deploy private financing capital on a large scale

Median Net IRRs by Vintage Year: Direct Lending, Distressed Debt and Mezzanine



Our outlook - Macro to micro

Global Quarterly Private Debt Fundraising, Q1 2010 - Q3 2015

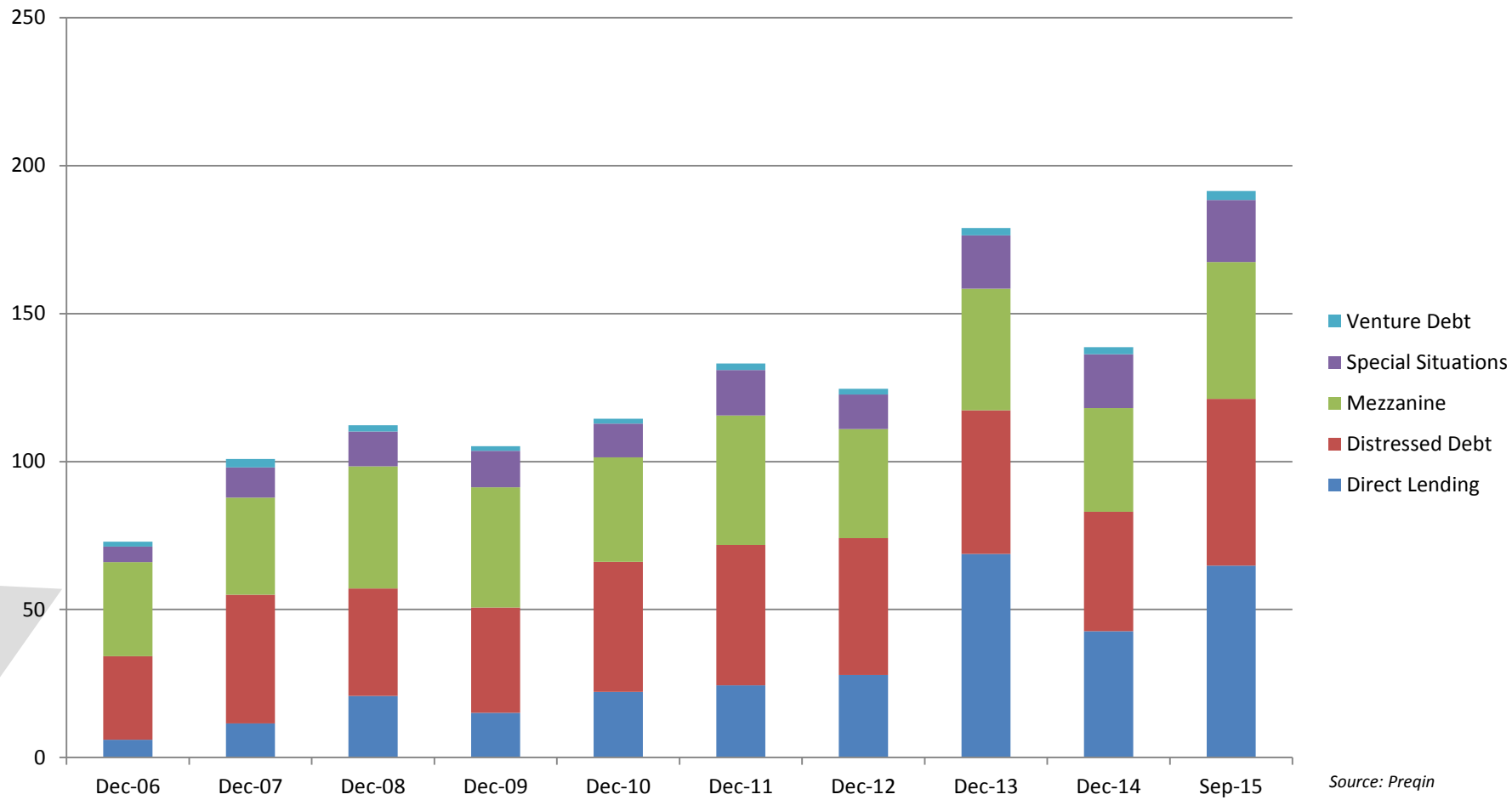


■ No. of Funds Closed ■ Aggregate Capital Raised (\$bn)

Source: Preqin

Our outlook - Macro to micro

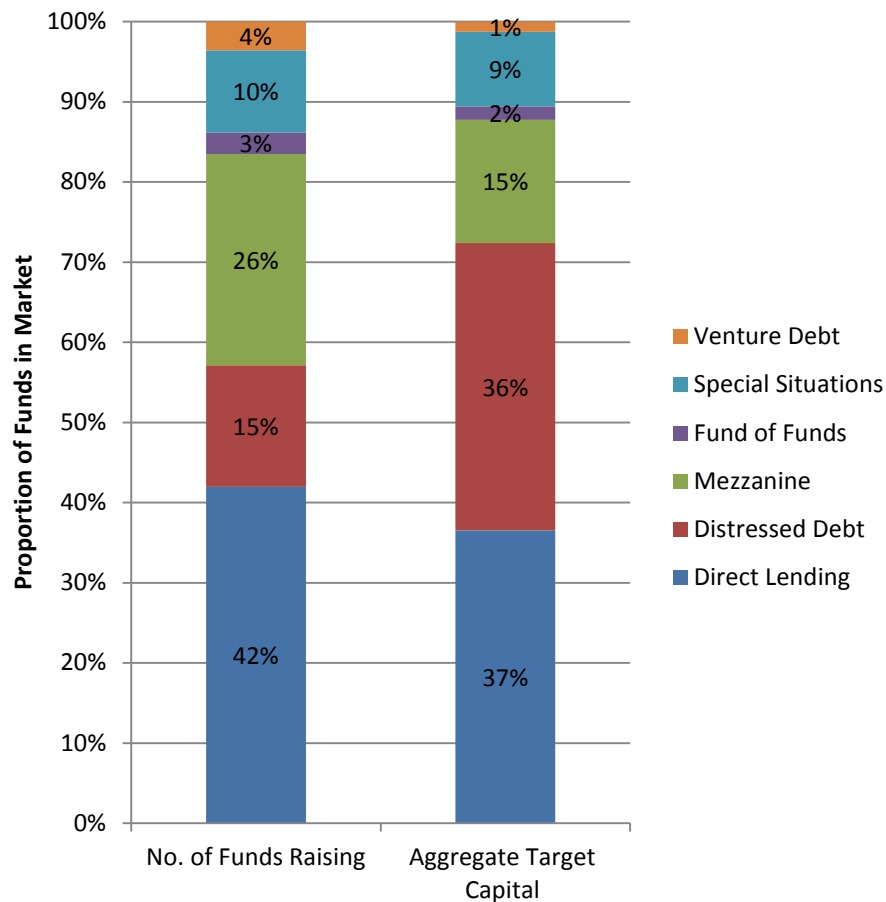
Private Debt Dry Powder by Fund Type, December 2006 - September 2015



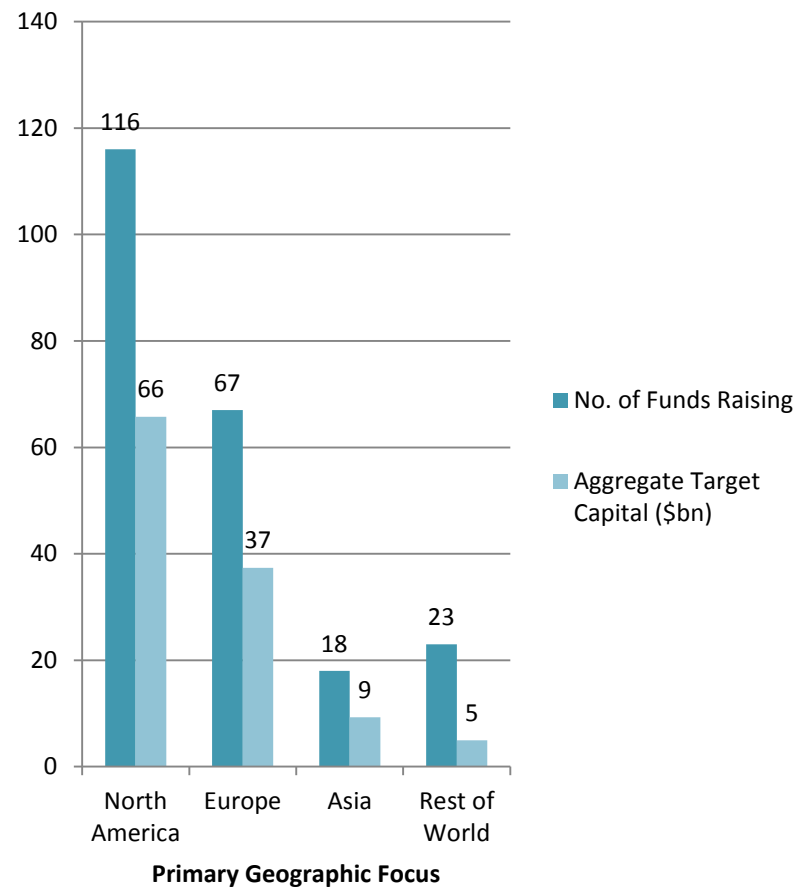
Source: Preqin

Our outlook - Macro to micro

Breakdown of Private Debt Funds in Market by Fund Type



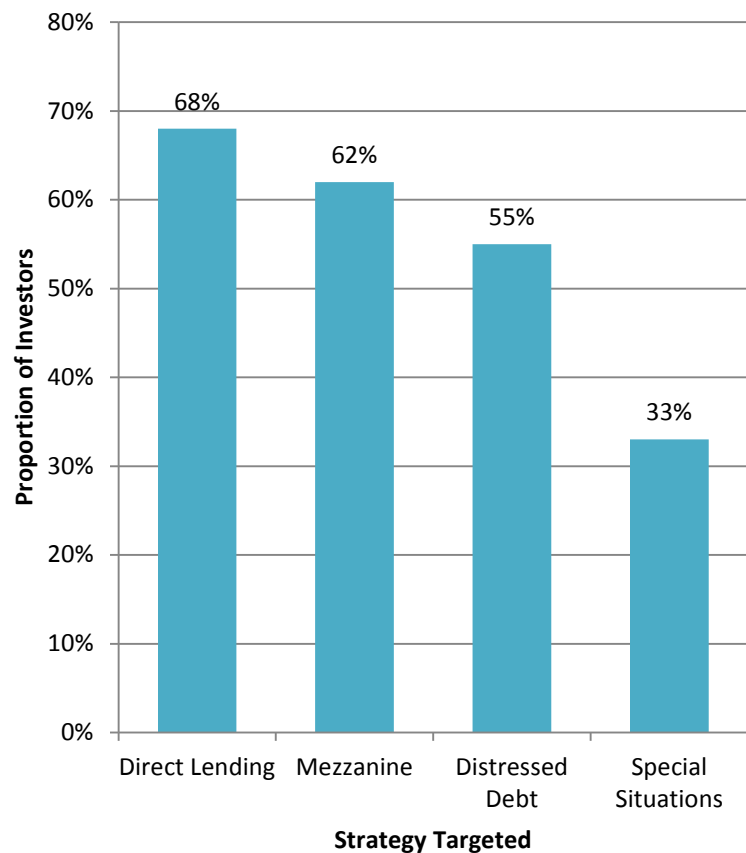
Breakdown of Private Debt Funds in Market by Primary Geographic Focus



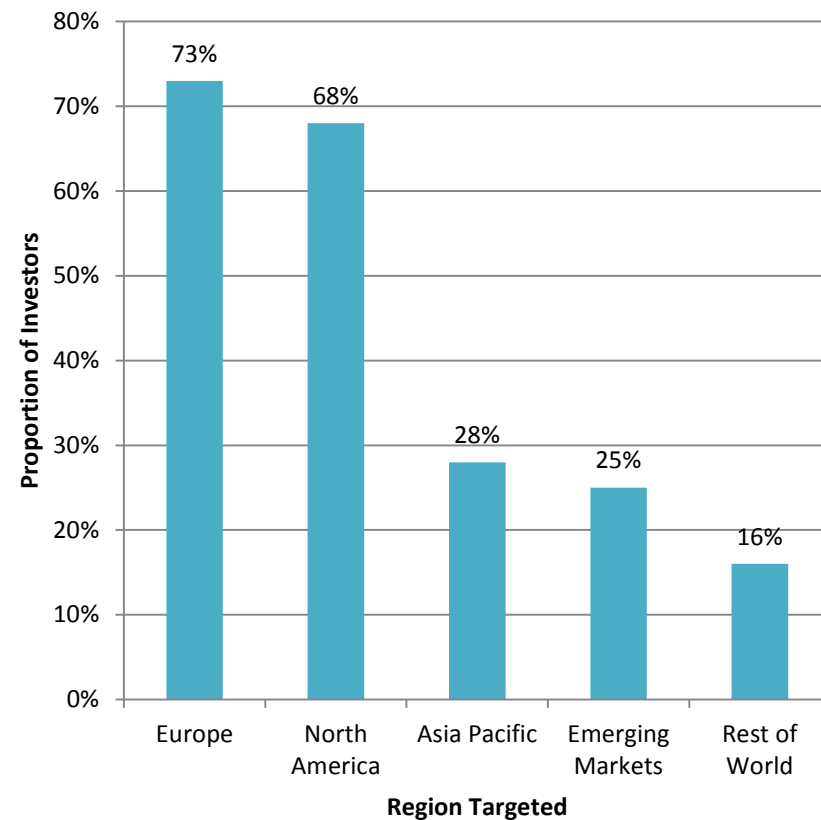
Source: Preqin

Our outlook - Macro to micro

Strategies Targeted in the Next 12 Months by Private Debt Investors



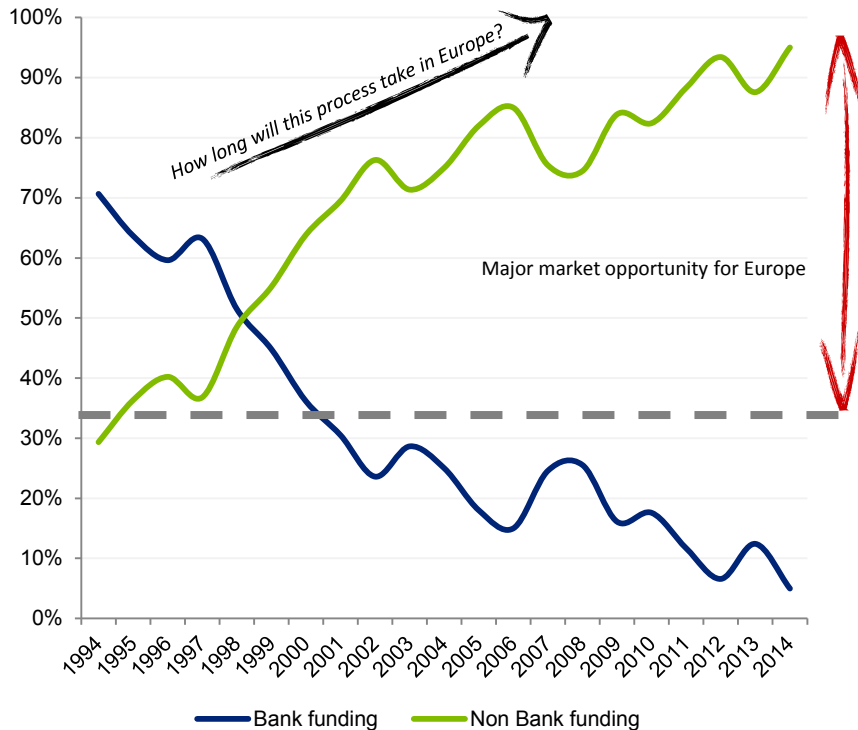
Private Debt Fund Types Investors View as Currently Presenting the Best Investment Opportunities



European Alternative Lender market

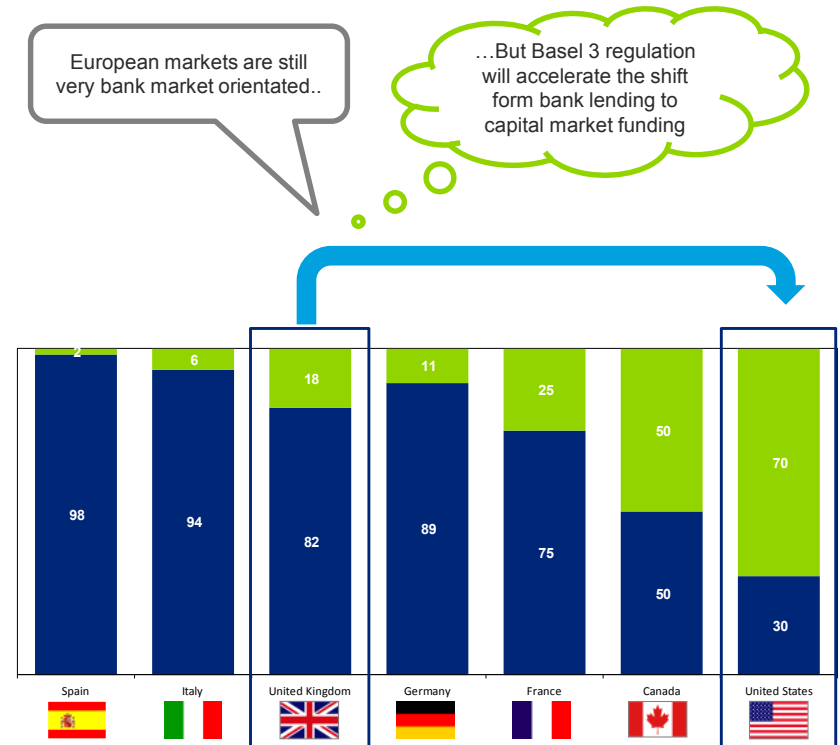
Heading towards the US model...

Transition of US leverage loan investor concentration



Source: S&P capital IQ leveraged commentary and data

Corporate Financing – Loans vs Bonds



Source: McKinsey Global Institute 2012

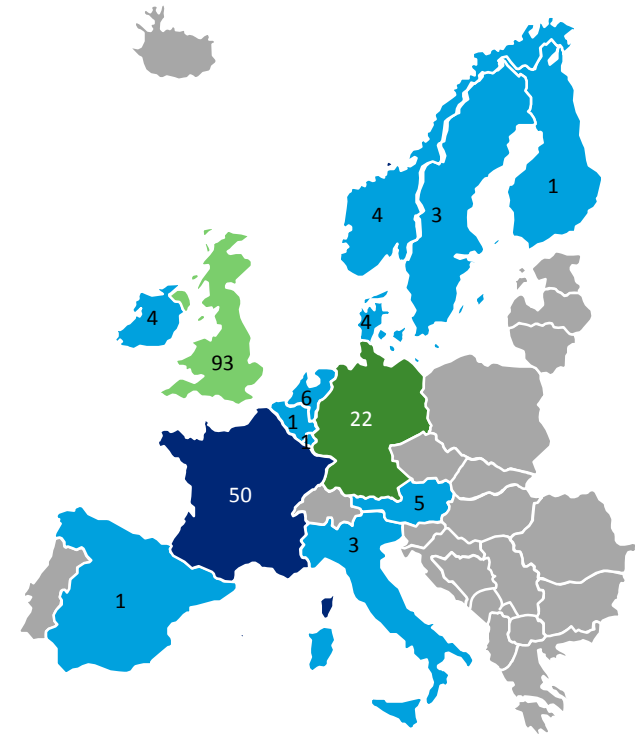
Notes: 1: Book value. 2: Includes Commercial Paper and other debt securities. 3: Includes loans from banks, non-bank financial institutions and other sectors (inc RE). Eurozone data is 2010

A shift away from bank lending likely to occur in the near future in Europe

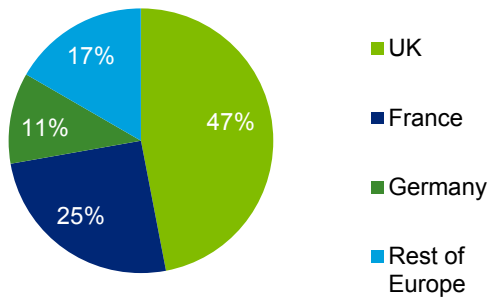
Alternative lenders increasingly targeting deals in Europe

- UK, France and Germany cover **83%** of the deal flow.
- **47%** of the transactions were in the UK, **25%** in France and **11%** in Germany.
- Out of the **33** lenders surveyed only **3** lenders have not completed a deal and a further **3** lenders have not completed deals outside of the UK.
- Unitranche product (45% of deals) **is more popular in UK**, while on the continent the senior product (37%) is dominant.
- In the UK **43%** of transactions were related to LBO financing, compared to **38%** in Europe.
- **11%** of deals in Europe relate to bolt on M&A compared to **4%** in the UK.

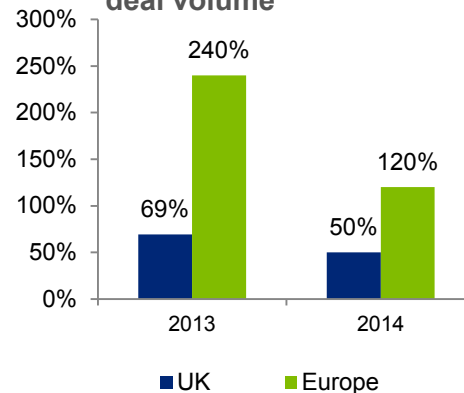
Deal volume main geographies



Deal volume main geographies



Year on year % increase in deal volume



Our outlook - Macro to micro



Largest Private Debt Funds Closed in Q3 2015

Fund	Firm	Fund Type	Fund Size (\$mn)	Geographic Focus
Senior Debt Partners II	Intermediate Capital Group	Direct Lending	3,400	Europe
ICG Europe Fund VI	Intermediate Capital Group	Mezzanine	3,300	Europe
AXA Private Debt III	Ardian	Direct Lending	2,200	Europe
Castlelake IV	Castlelake	Distressed Debt	1,900	US
Clearlake Capital Partners IV	Clearlake Capital Group	Special Situations	1,400	US
Athyrium Opportunities Fund II	Athyrium Capital Management	Venture Debt	1,200	US
Chambers Energy Capital III	Chambers Energy Capital	Direct Lending	900	US
Permira Credit Solutions Fund II	Permira Debt Managers	Direct Lending	900	Europe
Golub Capital Partners IX International	Golub Capital	Direct Lending	600	US
ADV Opportunities Fund I	ADV Partners	Special Situations	500	Asia

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Fireside chat - Perspective from a GP

Chris Connelly, Head of
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Luxembourg securitization companies: Loan portfolio restructuring & (re)financing

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Luxembourg
securitization
companies: Loan
portfolio
restructuring &
(re)financing

Dr. Sebastian Bos,
Deloitte - Restructuring

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Luxembourg securitization companies

Hot topics

- **Revival of European securitisation**
 - White paper by EcB and BoE (May 2014)
- **Simple, Transparent, Comparable/Standardized (STC/STS) securitisation**
 - EU STS securitisation framework proposal (September 2015)
 - Basel Committee STC securitisation consultation paper (November 2015)
- **Capital Requirements Directive/Regulation (CRD IV/CRR), Liquidity Coverage Ratio (LCR)**
- **Renaissance of European Commercial Mortgage-Backed Securities (CMBS)**
 - Real Estate: From single-loan to multi-loan securitisation

Luxembourg securitization companies

Benefits to originators, investors and asset managers

- **Balance sheet restructuring**
 - Continue long-standing business relationships with clients
 - Leverage on knowledge of asset managers/loan servicers
 - Cheaper financing/refinancing
- **Multi-compartment structure**
 - Pooling of loans
 - Cost savings
 - Bulk purchases (e.g. in shipping industry)
- **Potential role in revised business model for Luxembourg banks & branches**
 - Existing commercial client base
 - Local knowledge and untapped opportunities
 - “Skin in the game” and beyond

Luxembourg securitization companies

Tapping opportunities in the market

- **Shipping**

- Operating vessels: Bulker, Container, Tankers
- Storage: Tankers



- **Real Estate**

- Legacy portfolios
- Multiple-loan CMBS
- U.S.: Single-family rental (SFR)



- **Infrastructure**

- Renewables (e.g., wind, solar)



- **German Mittelstand**

- Pooling by industry
- Brewery loans



Luxembourg securitization companies

Challenges

- **Wants of originator/sponsor vs needs of investors**
 - Choice of vehicle
 - Note structure (e.g., simple, tranching, profit participating, indexing)
 - Rating and listing
- **Loan/asset documentation**
 - Incomplete/missing documentation
 - Staffing
- **Small/medium-sized originators/asset managers**
 - Missing track record
 - Lack of resources
 - Loan servicing platform

Luxembourg securitization companies

Your contacts

Deloitte.



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Hot Topics

Private Debt: Tax considerations

Christophe Diricks

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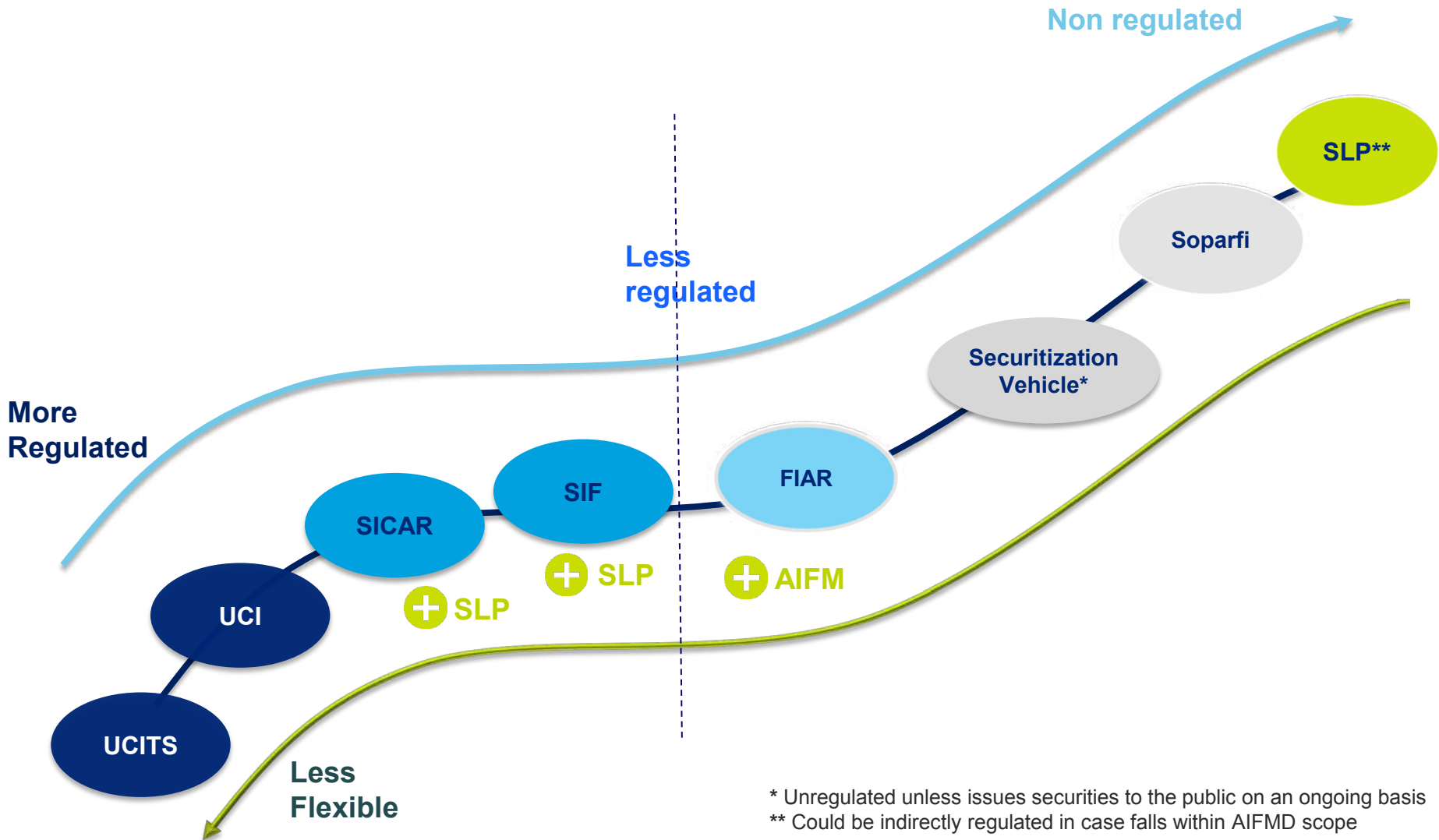
There are operational aspects to consider when establishing a debt structure...

- Avoiding the need of a banking license
- Flexibility in respect of the choice of a regulated or unregulated structure
- Flexible in terms of investment policy i.e. primary market (loan origination) or secondary market (distressed or discounted debt)
- Flexible accounting rules (Lux GAAP or IFRS)
- Low maintenance costs
- Flexible in terms of flows of income (fixed vs. variable)
- Accommodating US investors : CTB election

...and tax issues

- Neutrality for treaty protected investors:
 - The structure should have access to double tax treaties (DTTs) in order to mitigate the withholding tax at source (WHT) on interest payments
 - The structure should mitigate taxation on interest income, capital gains and potentially FX gains
 - The structure should avoid WHT on distributions to investors
- Substance is key especially in light of upcoming BEPS (action 6)
- The entity should demonstrate beneficial ownership of the income to access some DTTs (e.g. UK, Spain, Czech R., South Africa, ...) and get WHT relief
- VAT efficient

Numerous tools are available in Luxembourg...



...for multiple investment policies including loan origination

Regulatory Framework

Loan origination

- The origination of loans, which encompasses both the creation of new loans and the modification of existing loans, is the traditional activity of the banking sector

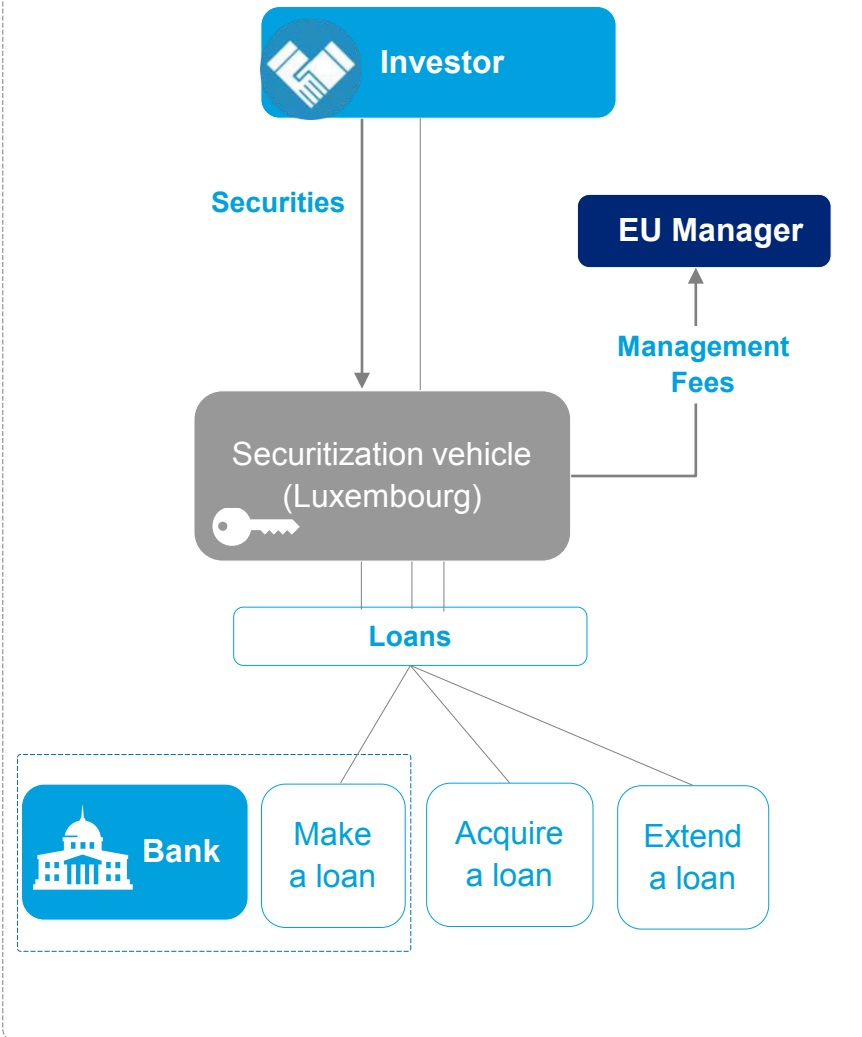
When originating loans, investors should thus pay attention to avoid being considered as carrying out an activity subject to banking license

Luxembourg banking regulation

- The Luxembourg banking law (as interpreted by the CSSF) applies to banking institutions and PFS but **DO NOT APPLY** to :
 - Intra-group transactions
 - Acquisitions of existing loans
 - Securitization undertaking, UCI, SIF, SICAR and any other entity which is subject to specific legislation even if it operates through wholly owned or controlled SPVs
 - One-off: SOPARFIs granting a single loan or performing a one-off operation
 - Private lending: SOPARFIs granting loans to a limited circle of people that can be identified

However, the selection of the vehicle will depend on the investment policy

Setting the scene: Vehicle selection



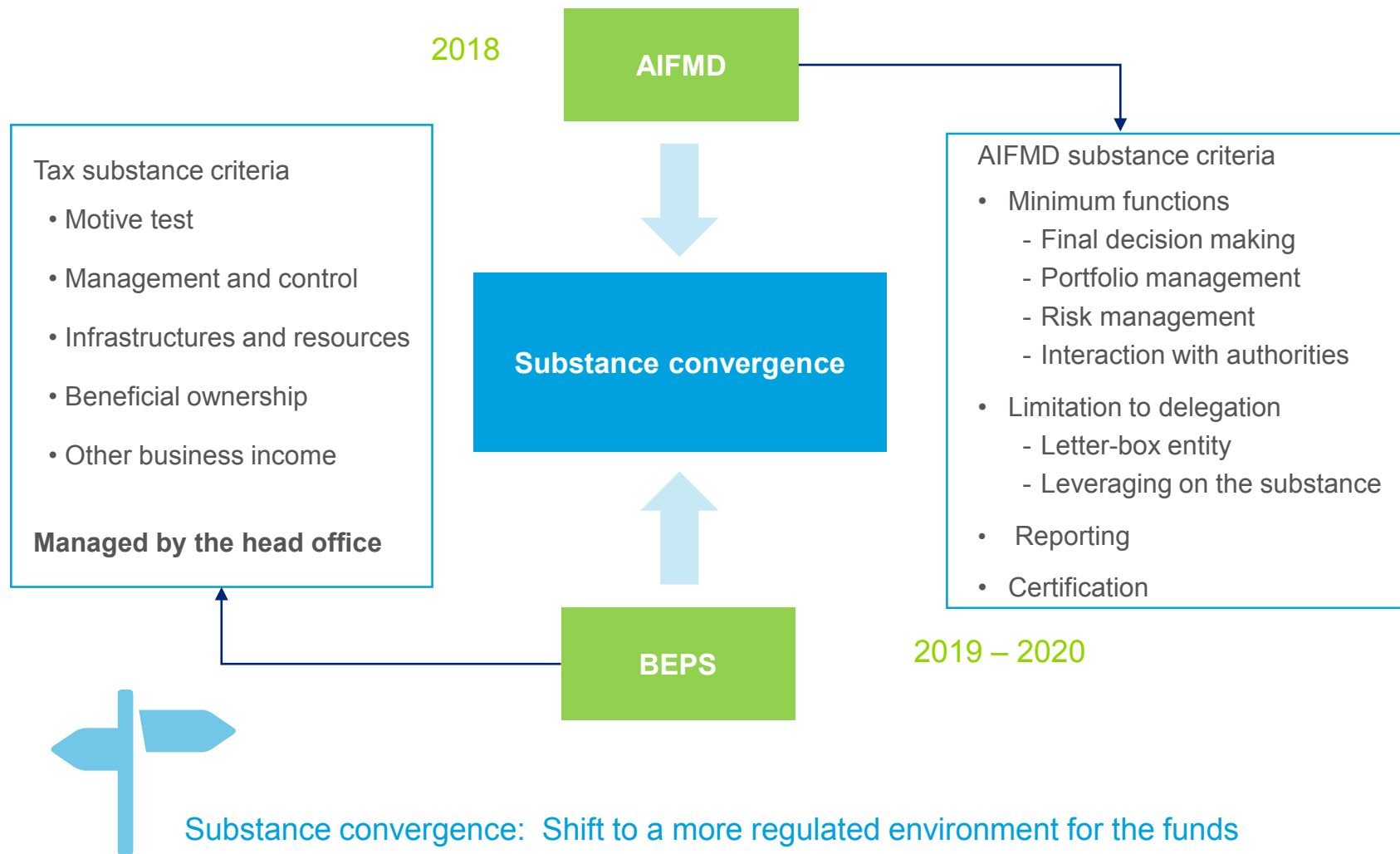
Securitization vehicle: only for passive strategy

- SV acquires/grants loans to the extent these loans are implemented thanks to a third party (e.g. bank) and the PPM specifies how borrowers are selected
- SV cannot generate any additional risk and cannot act as an entrepreneur or trader
- Re-investment of the proceeds in principle not permitted unless transferred to dedicated compartment

Benefits

- Tax neutral (CIT/MBT/NWT)
- Access to DTTs
- No WHT on dividend/interest payments
- No need for a banking license
- SV can be either unregulated or regulated
- Out of AIFMD's scope and VAT exemption on management fees (under certain conditions)
- Segregation

Thanks to AIFMD, which would shift debt funds to a more regulated environment, we should be able to address BEPS!



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Hot Topics

Due diligence process

Nicolas Schoukens

17 November 2015



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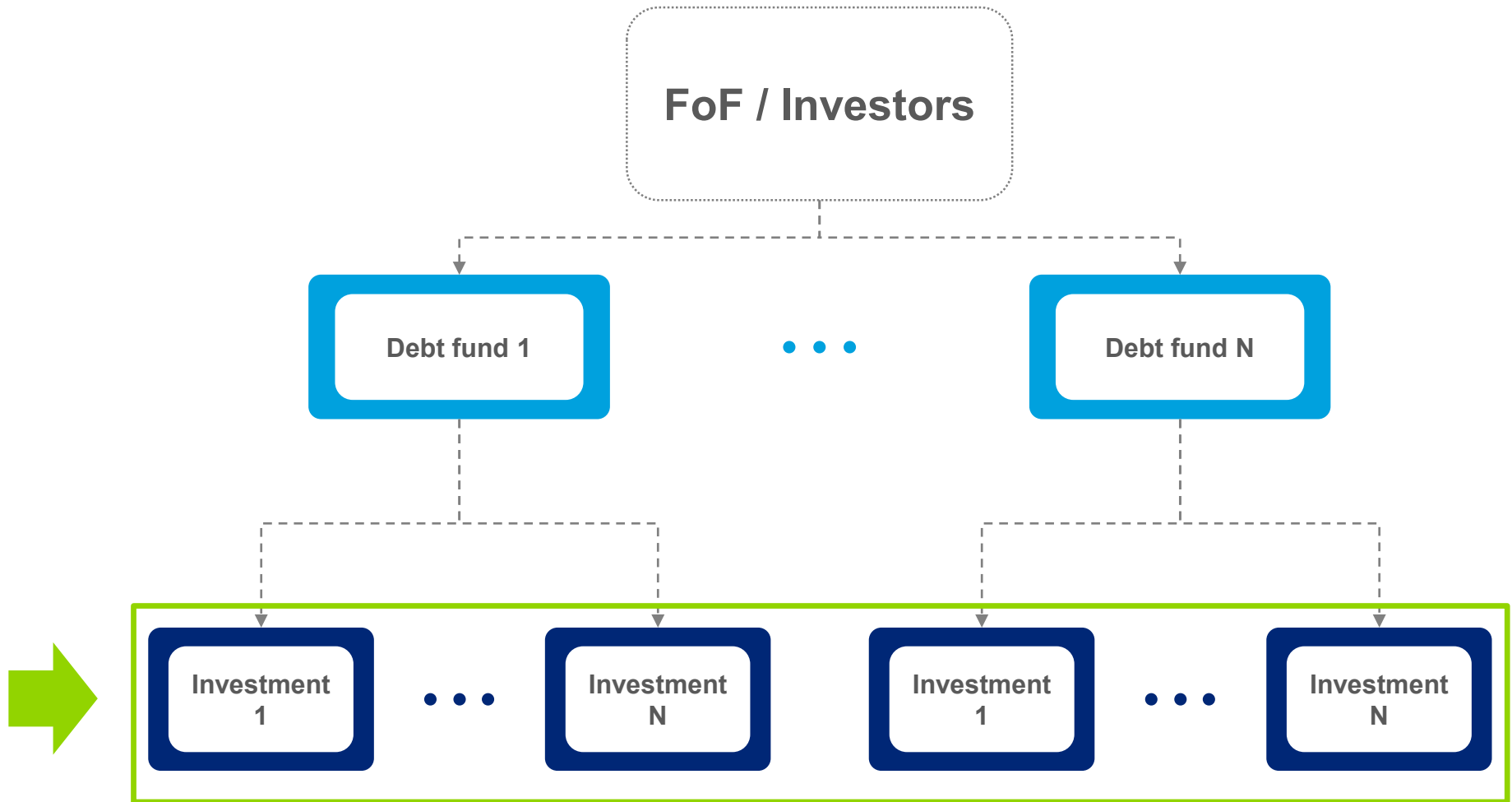
2 Understanding private debt fund vehicles

3 Private debt fund investing

4 Conclusions

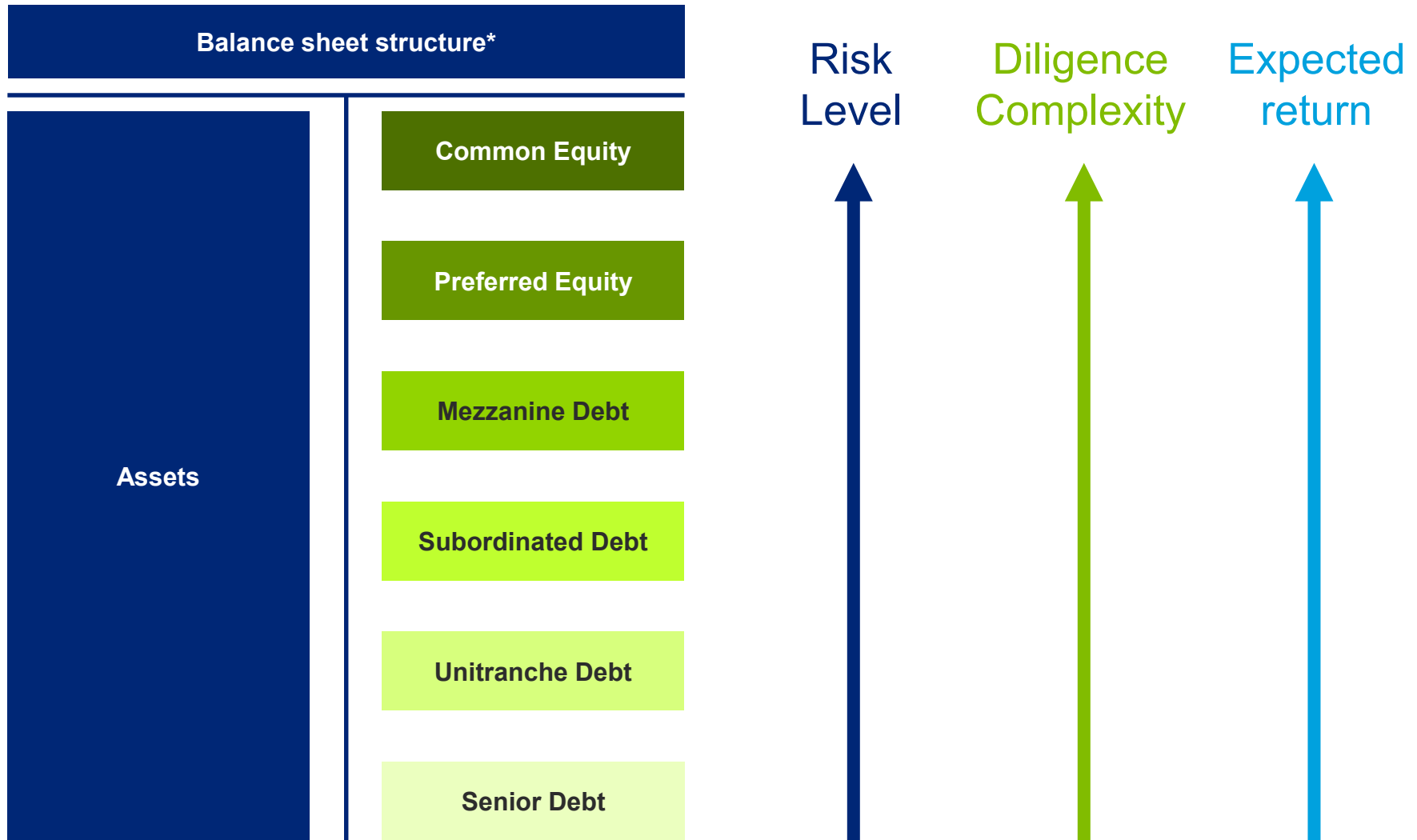
1. Understanding Private Debt Investments

The structure



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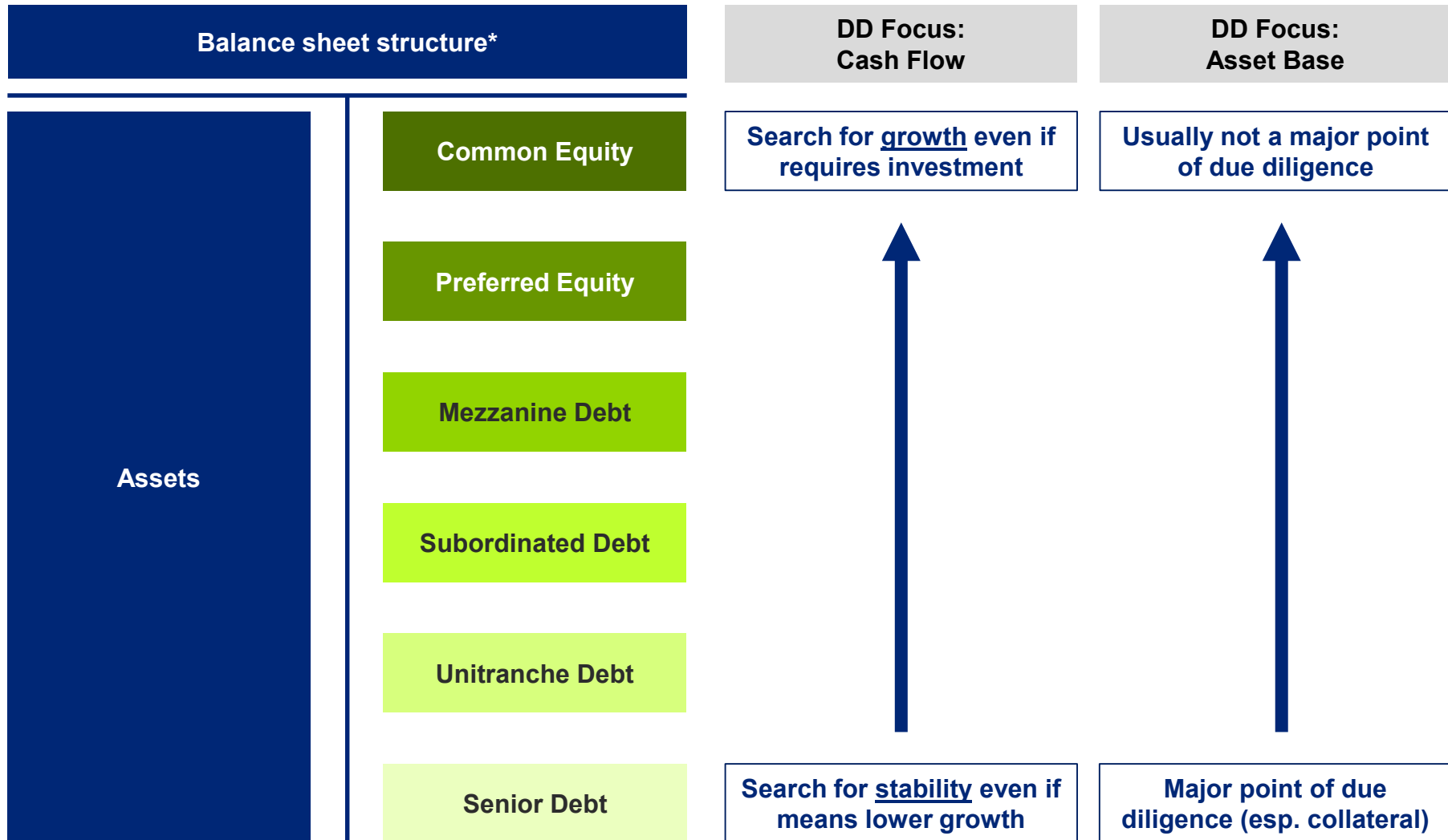
Review of the capital structure



* The list of funding sources is not exhaustive

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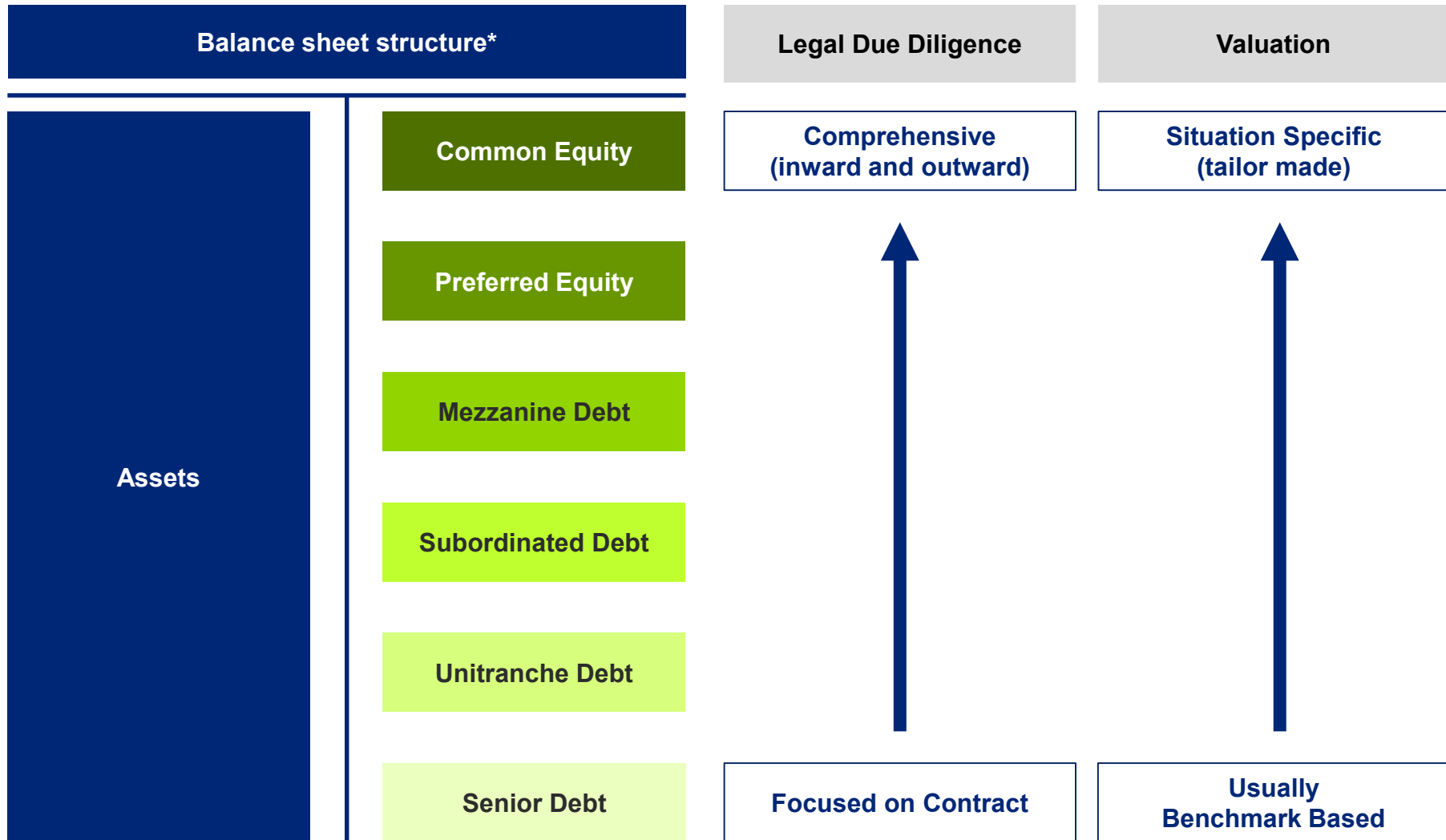
Relevance of specific due diligence dimensions



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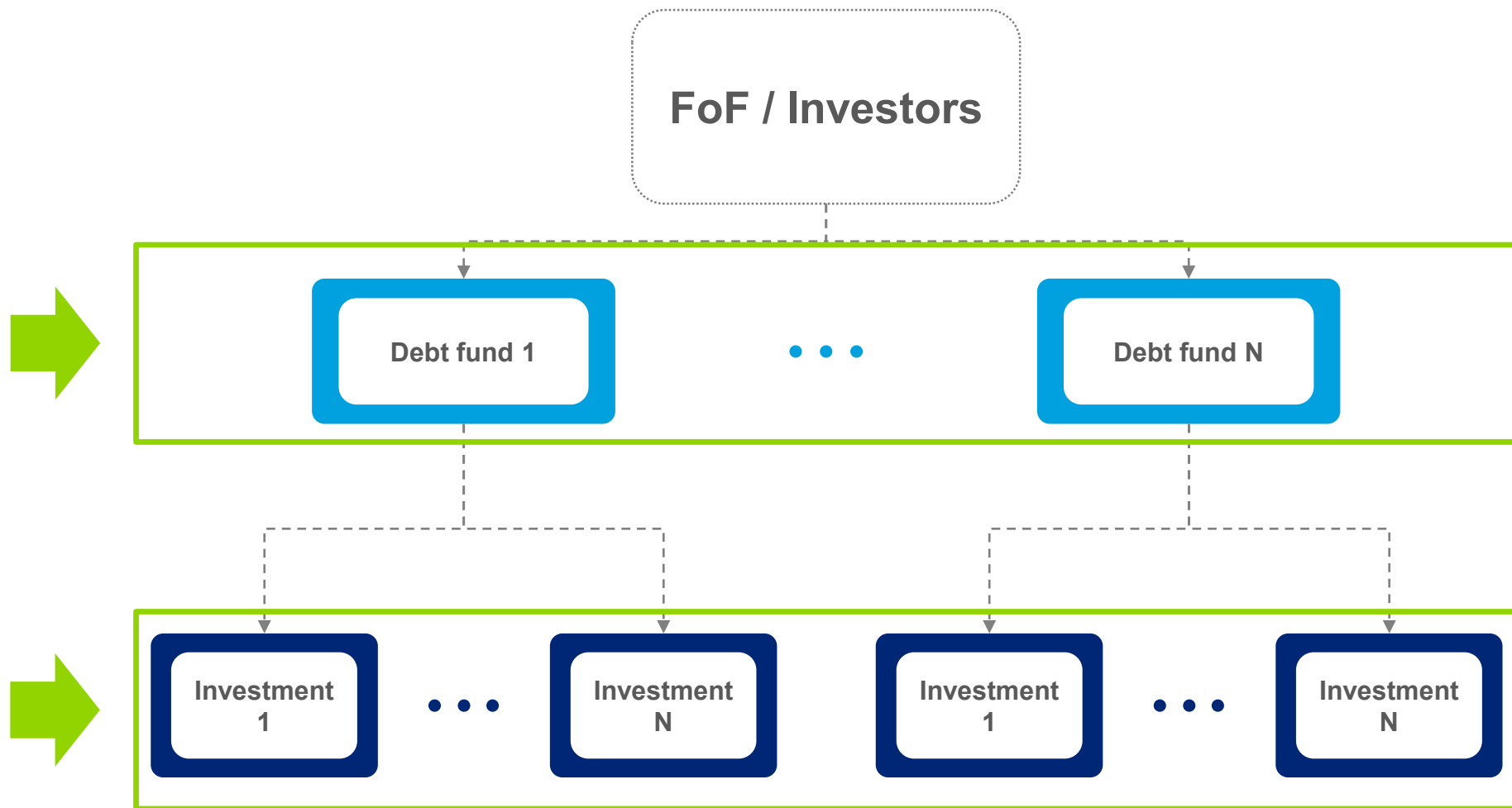
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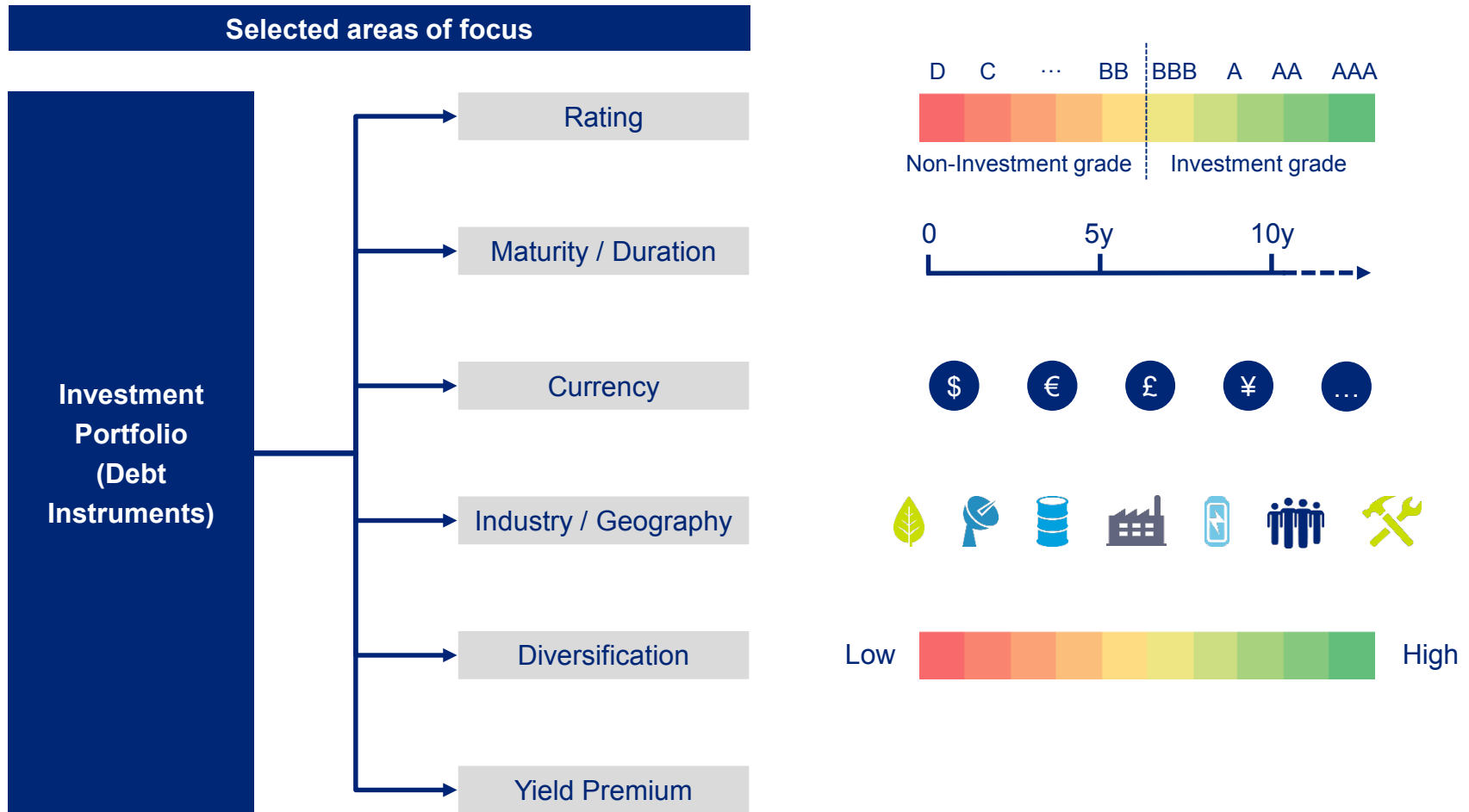
2. Understanding Private Debt Fund Vehicle

The structure



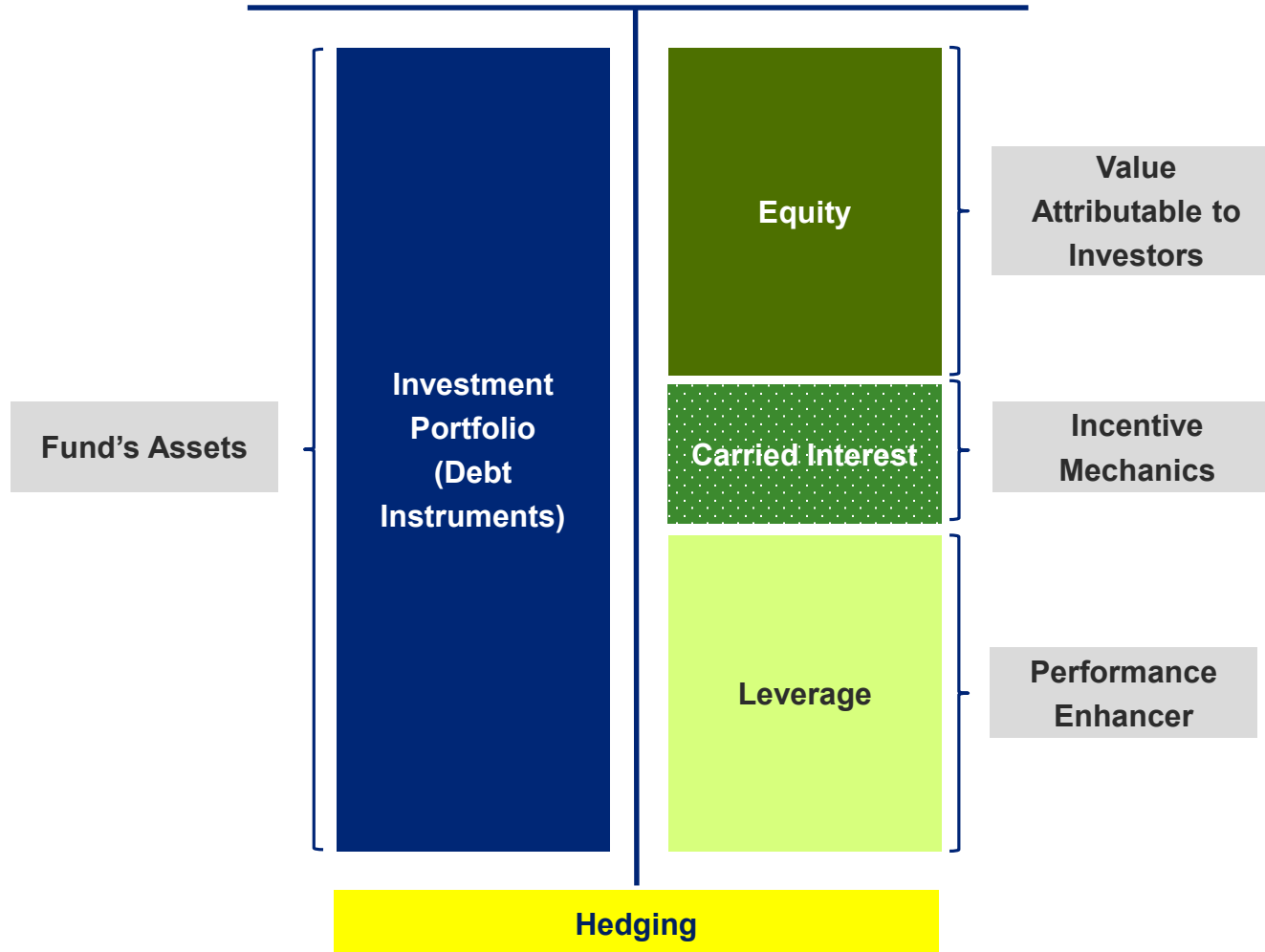
2. Understanding Private Debt Fund Vehicle

What fund managers look at portfolio level



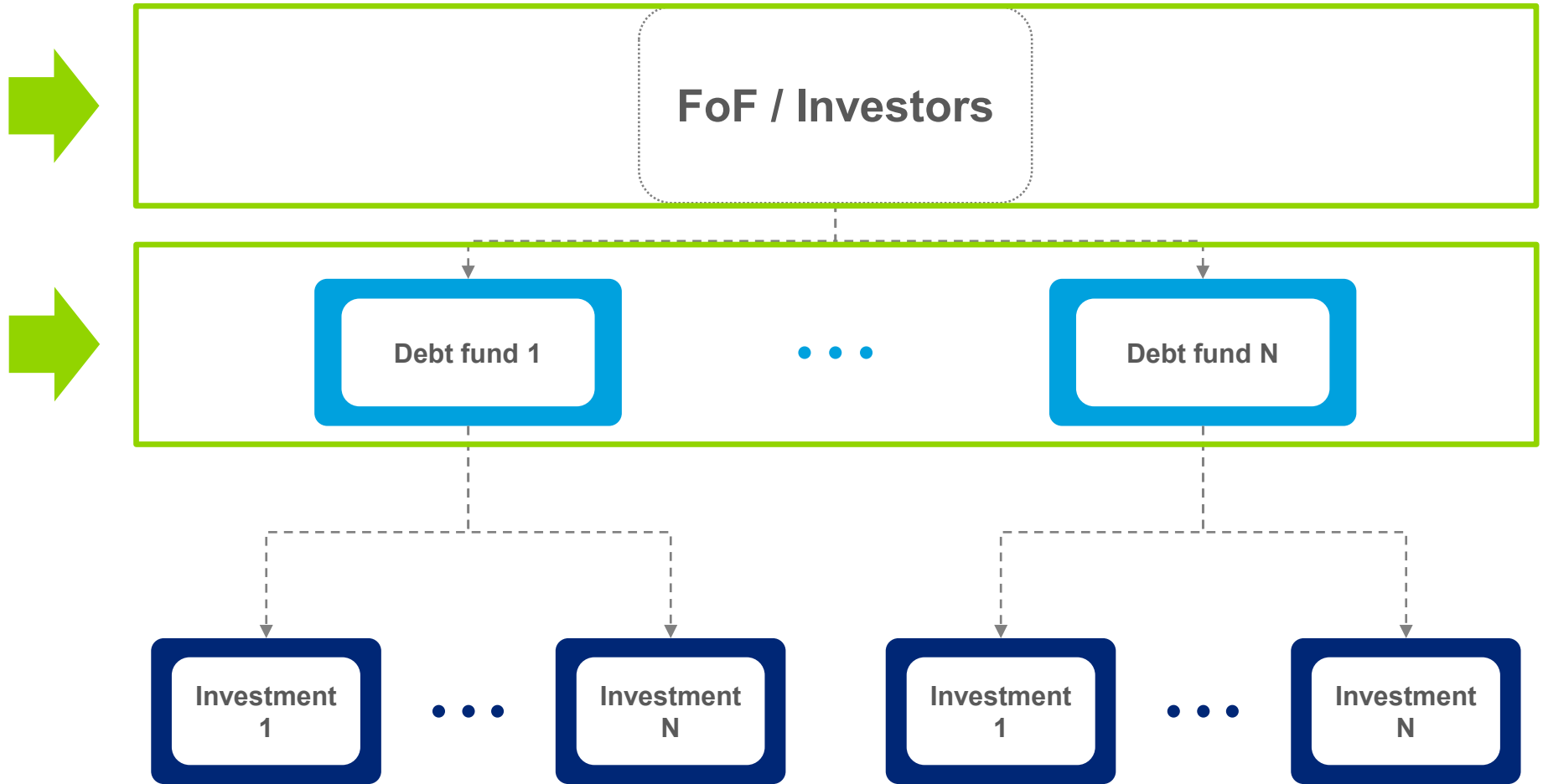
2. Understanding Private Debt Fund Vehicle

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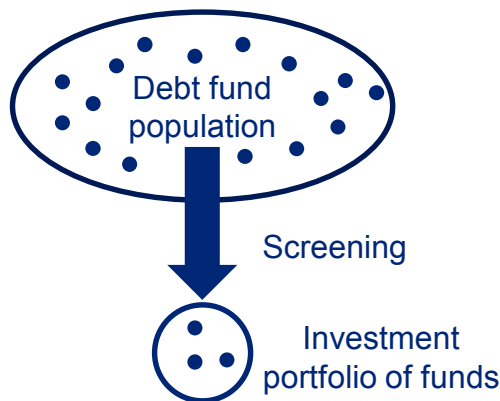
3. Selecting Private Debt Funds

The structure



3. Selecting Private Debt Funds

Timeline of investments in a debt fund



DUE DILIGENCE (Selection process)

- Investment strategy
- Existing track record
- Operational soundness
- Risk management quality
- Etc.

KPI (Monitoring and oversight)

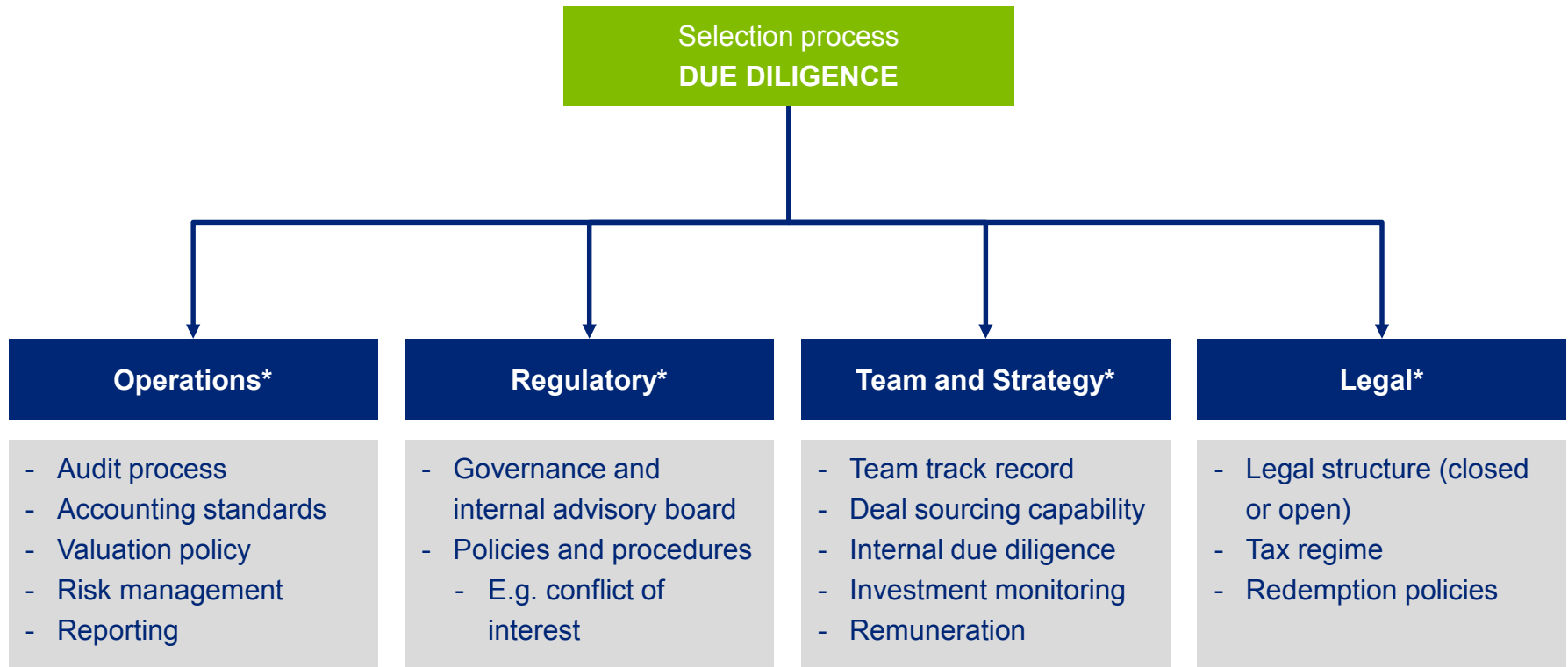
- Financial specifics:
- Net Asset Value
 - Risk/Return Profile
- Portfolio specifics:
- Duration, industry, geography, rating, etc
 - Lookthrough???

Exit (Performance Measurement)

- Cash-on-Cash
- IRR
- Liquidity
- Etc.

3. Selecting Private Debt Funds

The due diligence process



* not exhaustive

4. Conclusions

- At investment level: investment decision influenced by asset characteristics
 - Cash flows
 - Guarantees
 - Etc.
- At fund level: investment decision process relies on drivers specific to asset class
 - Importance of position in capital structure
- At FoF/investor level: fund selection process and due diligence principles not specific to asset class
 - Investment strategy
 - Existing track record
 - Operational soundness
 - Risk management quality
 - Etc.

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