



HOULIHAN LOKEY

ALTERNATIVE ASSET UPDATE

SPOTLIGHT: FUND FINANCING

MARKET PULSE | May 26, 2020

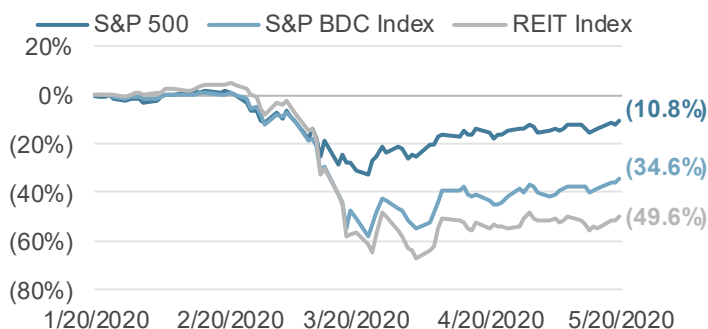


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Observations

- Phase 1: Products using short-term funding or MTM leverage, such as mortgage REITs, come under heavy liquidity pressure.
- Phase 2: Demand for liquidity solutions for GPs/LPs begin to rise; term financing solutions and NAV-based lending are experiencing strong demand.
- Phase 3: Substantial bid/ask ranges on portfolio investments inhibit secondary transactions and other deal flow.

Public Market Statistics



PRIVATE FUND FINANCING SPOTLIGHT

With turmoil in the market, GPs are facing liquidity strains; however, fund-level financing and NAV loan providers are actively seeking to put capital to work in the COVID-19 environment.

MARKET UPDATE

- Capital providers are “open for business,” with modest changes.
 - Low impact to pricing (widened up to ~100bps for debt and up to ~300bps for preferred equity), but pricing has not moved for some time.
 - LTVs are considerably lower given challenges relying on NAV.
- In fact, there has been an increase in capital providers seeking to deploy fund-level capital in this environment; we estimate the immediate capital availability at more than \$10 billion.
- This could allow sponsors to solve equity needs at portfolio companies with cheaper, non-dilutive debt or preferred equity at the fund level.
- Fund-level financing could be utilized by GPs for opportunistic, defensive, or fund management purposes, but debt tends to be used for defensive purposes and preferred equity for offensive purposes.

STRUCTURAL FEATURES

- Debt is slightly less expensive, but preferred equity tends to have limited to no covenants, no fixed term, and higher LTVs; however, each transaction is highly structured to meet the needs of the GP/investor.
- Capital is senior to common equity and collateralized by fund assets.
- The delayed draw feature is available to provide GPs with optionality, given the uncertainties in today’s market.
- Loans could be provided directly to the portfolio company with fund-level guarantees.

Recently Closed Transaction by Houlihan Lokey



provided \$75 million of fund-level financing to support follow-on growth at various portfolio companies and buyout certain LP interests to an

Alternative Asset Manager with approx. \$1.0 billion in AUM

Financial Advisor

POTENTIAL USES

Opportunistic

- Cure gap in acquisition financing, as traditional markets lack liquidity
- Buy out existing debt or equity co-investors seeking liquidity in underlying portfolio companies

Defensive

- Support underlying portfolio companies via working capital or other purposes
- Cure covenant breaches

Fund Management

- Bridge closing of a new fundraise (e.g., GP using capital to fund GP commitment)
- Provide liquidity for LPs

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OVERALL MARKET ISSUES, DEVELOPMENTS, AND OBSERVATIONS

REITs	<ul style="list-style-type: none"> While the majority of mortgage REITs have rebounded from recent lows, they remain valued below 1.0x book value. Key differentiators have been the credit quality of assets and the stability of funding. Multiple capital-raise transactions have been announced (with more likely in process) to reduce repurchase obligations and mark-to-market exposure.
BDCs	<ul style="list-style-type: none"> Stock price valuations continue to recover from the late-March lows. <ul style="list-style-type: none"> Hitting a trough of ~0.5x NAV per share, publicly traded BDCs have recovered materially; larger BDCs are trading near 0.75x–0.80x. Overall, the industry is still significantly off 1.0x NAV and below the December 2018 sell-off. Dividend yields remain elevated, indicating an expectation of dividend cuts as BDCs address unprecedented liquidity needs. <ul style="list-style-type: none"> Yields are averaging ~13% across the sector, with larger BDCs trading more favorably. Liquidity remains of utmost importance across the industry, with BDCs that rely heavily on revolving credit facilities rapidly seeking alternative term liquidity sources.
Capital Calls and Unfunded Commitments	<ul style="list-style-type: none"> Select LPs facing liquidity issues or the denominator effect are looking to offload unfunded commitments; while muted, we expect this issue to intensify over the coming months. Certain investors are willing to take over unfunded commitments by utilizing the existing commitments as collateral as well as a negotiated distribution waterfall between the existing LP and new investor.
Secondaries/ GP-Led Transactions	<ul style="list-style-type: none"> GP-led transactions (e.g., continuation funds) continue to remain on hold. Some secondary firms have been successful in working with their GP relationships to acquire debt or co-investor equity at underlying portfolio companies. While it is very challenging to price equity in this environment, highly structured transactions are available for investors seeking liquidity by pricing a subset of the exposure at par with the remaining exposure subordinated, subject to a certain return on new investment. It will likely take another quarter or two for secondary investors to place meaningful reliance on reported NAVs.
GP Stakes	<ul style="list-style-type: none"> COVID-19 induced market volatility has increased buyer/seller information asymmetries, underscoring the continued importance of working with an advisor that has an intimate understanding of both sellers' and buyers' needs. Significant and rising interest from structured equity buyers and direct lenders will provide GP stake transaction leverage. Transaction-related tax considerations are of increasing importance to selling GPs/partners.
Valuations (Private Equity/ Private Debt)	<ul style="list-style-type: none"> Private equity portfolio marks are expected to be down 10%–15% on average in Q1, with Q2 marks expected to be down further. Even companies across industries performing well in the crisis may decline in value, given higher required rates of return and reduced valuation multiples. Pricing in prior financial crises did not hit lows for 6–12 quarters post-event. Public indices for private markets are down more than 25% YTD. (See Page 4)

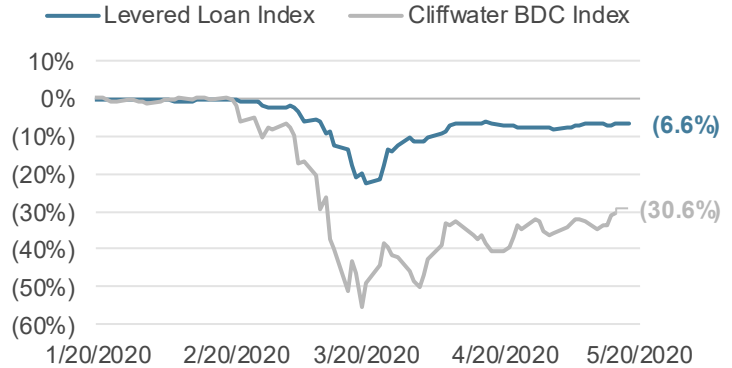
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Observations

Public Market Statistics

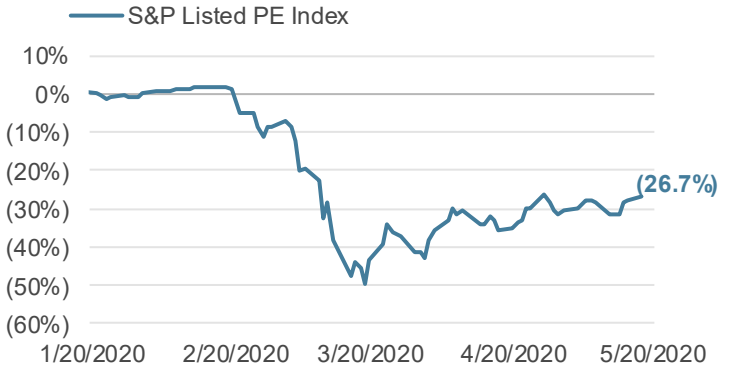
CREDIT AND LENDING

- Bankruptcy filings beginning:
 - Retail/consumer: J.Crew, Pier 1, J.C. Penney
 - Out-of-home: Gold's Gym
 - Energy: Diamond Offshore Drilling
- Yields rising considerably:
 - Leveraged loan index: 8.0%
 - Listed credit products: 14.2% (See Page 5)



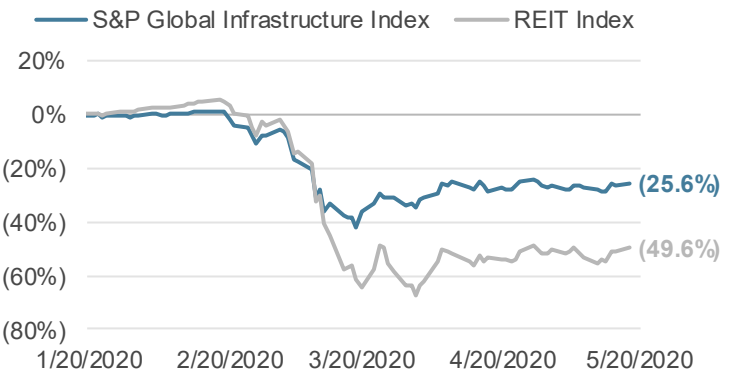
PRIVATE EQUITY

- Industry dry powder is estimated at \$1 trillion.
- Funds raised in the prior two years are expected to have above-average IRR returns vs. long-term industry averages by 5%–10%.
- Significant rebound is expected in listed PE share prices.
 - Median yield of listed products: 4.4% (See Page 5)
- NAV lending is expanding, while secondary transactions cannot be priced appropriately.



REITs AND INFRASTRUCTURE

- Listed infrastructure yielding 6.9% (See Page 5)
 - Close to leveraged loan yields of ~8.0%
 - Stability of cash flows will be tested; however, long-term structures yield stability.
 - The impact of inflation on pricing is still unknown.
- REITs are still under pressure due to leverage and default expectations.



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(\$ in millions)

Firm Name	Ticker	Market Cap	NAV	Price to NAV	Dividend Yield
<i>Credit Lending</i>					
Aberdeen Income Credit Strategies	NYSE: ACP	\$135	NA	NA	18.6%
Eagle Point CLO Equity Fund	NYSE: ECCB	167	\$303	0.55x	8.8%
GP Investments	BDL: GPINA	358	365	0.98	NA
Hercules Capital	NYSE: HTGC	1,207	1,097	1.10	12.9%
Horizon Technology Finance	NASDAQ: HRZN	171	193	0.88	12.1%
Oxford Lane Capital Corp	NASDAQGS: OXLC	223	269	0.83	54.4%
Oxford Square Capital Corp	NASDAQGS: OXSQ	121	165	0.73	33.5%
VPC Specialty Lending	LSE: VSL	177	300	0.59	14.2%
High		\$1,207	\$1,097	1.10x	54.4%
Mean		320	385	0.81	22.1%
Median		174	300	0.83	14.2%
Low		121	165	0.55	8.8%

<i>Infrastructure</i>					
Atlas Corporation	NYSE: ATCO	\$1,859	\$3,585	0.52x	6.9%
Brookfield Infrastructure Partners	NYSE: BIP	12,875	4,008	3.21	4.8%
First Trust Energy Infrastructure	NYSE: FIF	189	NA	NA	12.1%
Foresight Group	LSE: FTSV	24	40	0.61	7.5%
GCP Infrastructure Investments	LSE: GCP	980	980	1.00	6.8%
High		\$12,875	\$4,008	3.21x	12.1%
Mean		3,186	2,153	1.34	7.6%
Median		980	2,282	0.81	6.9%
Low		24	40	0.52	4.8%

<i>Private Equity Fund of Funds</i>					
Apax Global Alpha Limited	LSE: APAX	\$635	\$1,099	0.58x	7.4%
BMO Private Equity Trust	LSE: BPET	299	304	0.98	3.9%
Castle Private Equity	SWX: CPEN	114	157	0.73	27.5%
HarbourVest Global Private Equity	LSE: HVPE	1,054	2,060	0.51	NA
ICG Enterprise Trust PLC	LSE: ICGT	468	794	0.59	3.4%
JPEL Private Equity Limited	LSE: JPEL	158	271	0.58	NA
NB Private Equity Partners Limited	ENXTAM: NBPE	622	900	0.69	4.4%
Pantheon International Plc	LSE: PIN	955	1,514	0.63	NA
Private Equity Holding	SWX: PEHN	126	231	0.54	4.1%
SL Private Equity	LSE: SLPE	454	710	0.64	4.5%
High		\$1,054	\$2,060	0.98x	27.5%
Mean		489	804	0.65	7.9%
Median		461	752	0.61	4.4%
Low		114	157	0.51	3.4%

High		\$12,875	\$4,008	3.21x	54.4%
Mean		1,016	921	0.83	13.0%
Median		299	365	0.64	7.5%
Low		24	40	0.51	3.4%

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(\$ in millions)

Firm Name	Ticker	Market Cap	Book Value	Price-to-Book Value	Dividend Yield
Residential Mortgage REITs					
AGNC Investment (Agency)	NASDAQ: AGNC	\$7,411	\$8,309	0.89x	11.1%
ARMOUR Residential (Agency)	NYSE: ARR	527	786	0.67	26.4%
New Residential Investment (Non-Agency)	NYSE: NRZ	2,777	4,451	0.62	3.3%
New York Mortgage Trust (Non-Agency)	NASDAQ: NYMT	730	2,205	0.33	0.0%
Redwood Trust (Non-Agency)	NASDAQ: RWT	519	725	0.72	30.1%
Residential Mortgage REIT Average		\$2,393	\$3,295	0.65x	14.2%
Hybrid Mortgage REITs (Agency and Non-Agency)					
Annaly Capital Management	NYSE: NLY	\$9,198	\$10,721	0.86x	16.1%
Chimera Investment	NYSE: CIM	1,576	3,243	0.49	25.3%
MFA Financial	NYSE: MFA	720	3,384	0.21	0.0%
PennyMac Mortgage Investment Trust	NYSE: PMT	1,080	1,524	0.71	10.7%
Two Harbors Investment	NYSE: TWO	1,313	1,927	0.68	4.4%
Hybrid Mortgage REIT Average		\$2,778	\$4,160	0.59x	11.3%
Commercial Mortgage REITs					
Apollo Commercial Real Estate	NYSE: ARI	\$1,244	\$2,401	0.52x	20.6%
Arbor Realty Trust	NYSE: ABR	839	987	0.85	16.4%
Blackstone Mortgage Trust	NYSE: BXMT	3,125	3,651	0.86	11.0%
Granite Point Mortgage Trust Inc	NYSE: GPMT	284	961	0.30	0.0%
KKR Real Estate Finance Trust	NYSE: KREF	841	1,030	0.82	11.7%
Starwood Property Trust	NYSE: STWD	3,706	4,448	0.83	15.3%
TPG RE Finance Trust Inc	NYSE: TRTX	513	1,231	0.42	25.7%
Commercial Mortgage REIT Average		\$1,508	\$2,101	0.66x	14.4%
High		\$9,198	\$10,721	0.89x	30.1%
Mean		2,141	3,058	0.63	13.4%
Median		1,080	2,205	0.68	11.7%
Low		284	725	0.21	0.0%
BDCs					
Ares Capital Corporation	NASDAQ: ARCC	\$5,874	\$6,583	0.89x	11.5%
Apollo Investment Corporation	NASDAQ: AINV	608	1,216	0.50	20.5%
BlackRock TCP Capital Corp.	NASDAQ: TCPC	536	680	0.79	15.9%
FS KKR Capital Corp.	NYSE: FSK	1,658	3,028	0.55	23.0%
Goldman Sachs BDC, Inc.	NYSE: GSBD	645	595	1.08	11.5%
Golub Capital BDC, Inc.	NASDAQ: GBDC	1,908	1,956	0.98	11.5%
Hercules Capital, Inc.	NYSE: HTGC	1,207	1,097	1.10	12.9%
New Mountain Finance Corporation	NYSE: NMFC	840	1,078	0.78	16.0%
Oaktree Specialty Lending Corporation	NASDAQ: OCSL	609	752	0.81	9.0%
Owl Rock Capital Corporation	NYSE: ORCC	4,859	5,507	0.88	11.9%
PennantPark Floating Rate Capital Ltd.	NASDAQ: PFLT	311	470	0.66	14.7%
PennantPark Investment Corporation	NASDAQ: PNNT	204	517	0.40	25.4%
Prospect Capital Corporation	NASDAQ: PSEC	1,784	2,933	0.61	16.0%
TCG BDC, Inc.	NASDAQ: CGBD	464	799	0.58	21.6%
TPG Specialty Lending, Inc.	NYSE: TSLX	1,184	1,037	1.14	10.4%
High		\$5,874	\$6,583	1.14x	25.4%
Mean		1,513	1,883	0.78	15.5%
Median		840	1,078	0.79	14.7%
Low		204	470	0.40	9.0%

Note: Reflects select companies; market data as of May 20, 2020.
Source: S&P Capital IQ, SNL Financial.

How Houlihan Lokey Can Help

Houlihan Lokey's product knowledge, industry expertise, and global reach deliver superior results. Our broad platform of services makes us uniquely qualified to advise on all strategic opportunities related to both GP/manager and fund/LP interests.

Manager- and Fund-Related Services and Solutions

Manager-Related (GP)

Mergers and Acquisitions

GP Equity Stakes

Manager Resolutions

Investment Management Agreements

GP Advisory

Other GP Financing

Fund Advisory Services and Solutions

Continuation Vehicles/Fund Recapitalizations

Fund-Level Financing (Debt/Preferred Equity)

Asset Sales/LP Sales/Fund Tender and Staple

Forbearance Negotiations

Permanent Capital

Fund Placements

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Asset Management— U.K.



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