

EUROPEAN DISTRESSED DEBT MARKET OUTLOOK 2017

JANUARY 2017



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2016 proved to be another challenging year for the restructuring community, mostly as a result of a continued slim pipeline of workouts and distressed opportunities. Hedge fund returns remained well off the pace of their previous years, although bets on commodities, especially oil & gas, paid out handsomely, enabling many funds who had jumped in too early the prior year to make good their previous losses.

The oil & gas sector, especially suppliers and services providers, was the main driver of workouts in Europe last year. While many names have rallied as oil prices came off their lows and stabilised, many companies remain at risk until exploration investment picks up meaningfully.

According to this year's survey, restructuring activity should pick up. With Trump and Brexit both confounding pollsters against all odds, investors are a lot warier over further geopolitical shocks as several looming key European elections pose potential pitfalls this year. After many false dawns, we may start to see interest rates come off their multi-year lows, which would also push some tottering credits into workouts.

Respondents are fairly pessimistic over Brexit, with a majority expecting a recession this year and many funds planning to scale back investments in the UK. However, private equity (PE) respondents are more bullish and aim to take advantage of any downturn.

Sterling has slumped as the UK increasingly looks likely to pursue a hard exit and quit the single market, which should boost exports but will hit some sectors hard. Retailers risk getting caught between weaker consumer spending coupled with surging purchasing costs.

Brexit is also set to alter the legal restructuring landscape, threatening to end COMI shifts to the UK by European issuers seeking to implement workouts via scheme of arrangement, as European courts will likely no longer recognise UK judgements. With a number of European jurisdictions reforming their insolvency frameworks, a challenger to London could emerge.

Banks, especially Italian lenders, provided plenty of opportunities for distressed investors in 2016, and will likely continue to do so as the ECB gets tough on swelling NPL mountains and forces the sector to get these millstones off its neck. That, together with a flatlining economy and modest insolvency regime reforms, suggests Italy could be one of the hotspots in restructuring this year.



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Very few people could have predicted the events of 2016, even more so the market reaction to them.

QE and investors' eagerness to put money to work have sustained borrower-friendly market conditions, the strength of credit markets continuing unabated by the significant changes to the political landscape occurring in the UK, Europe as well as further afield. High yield and leveraged loan markets have continued to converge, the latter continuing to adopt an increasing number of conventions from the former in order to compete for new deals. Consequently today, half of the leveraged loans outstanding in Europe are now cov-lite.

The widely held view in the market is that 2016 was a quiet year in terms of restructuring, particularly compared with the US. The default rate in Europe has been extremely low: 2% compared with 5% in the US; in both geographies activity was concentrated in the oil & gas as sector. The survey suggests there has been a high volume of amendment activity in sponsors' portfolio companies, but it seems that many situations have been fixed under the radar.

A European systemic banking crisis has been averted (so far), with billions of NPLs coming to market during the year providing significant opportunity for distressed investors; NPL activity was mainly focused on real estate and consumer credit books, with Italian banks in particular holding back from disposals of corporate loans. In many situations where corporate debt has been disposed, transactions have been facilitated by creative structures that bridged the bid-ask spread, minimising the pain for lenders.

We enter 2017 with a great deal of uncertainty and many events that will shape Europe's future

already on the agenda for the year: the UK's invocation of Article 50, elections across France, Germany and possibly Italy and radical change in the White House, to name but a few.

Perhaps as a consequence of this uncertainty, this survey suggests an increase in restructuring activity for 2017. This may be in part because 2016 was a low point in volumes, but also appears to reflect a genuine anticipation of a wider economic downturn. The data suggests a continuation of global themes seen in 2016 with activity expected in oil & gas (in particular oil field services), shipping and financial services sectors; however, every country will also see its own themes emerge, for example retail and construction in the UK. Distressed funds certainly seem to be investing in 2017, having stated an intention not to decrease headcount through the year.

Most likely, the few remaining covenants will continue to be reset at sponsor and non-sponsor companies, with liquidity/maturity events remaining the only trigger event. For this reason, a new wave of restructuring is unlikely to start until credit markets cool down. At that point we expect that alternative credit providers will step into the breach, continuing to facilitate refinancing, but more selectively, pushing weaker credits to restructure.

In parallel with these trends, as the UK grapples with Brexit and the question of forum shopping, other restructuring regimes across Europe will continue to jostle for position. In this, as with many other emerging themes, 2017 could be the year that sets European market conditions for distressed investing for years to come.



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2016 was a bad year for economic pundits and a good year for bold spirits with an eye for 'black swan investments'. If you had placed a successful £40 bet on a Brexit outcome in May 2016 and gathered your winnings and immediately wagered that Trump would win the US presidency, you would have yielded a £455 prize (a spectacular 1037.5% return)! Accordingly, it is with some trepidation that we hazard any possible views for the 2017 restructuring market.

From a European perspective, the conduct of the Brexit negotiations will be key. Those who predicted economic meltdown in the immediate aftermath have been proved wrong – the referendum vote was not Europe's 'Lehman' moment. Whatever the outcome, untangling a 43-year-old relationship is going to be interesting.

The list of European companies which have used UK schemes of arrangement and insolvency procedures in recent years has been extensive. It is hard to see how post-Brexit the UK can continue in its role of European restructuring destination of choice for large ticket restructurings. Insolvency reform continues in Europe whatever the direction of travel for the UK and the key change this year is that the Recast Regulation on Insolvency Proceedings comes into force on 26 June 2017. The Recast Regulation introduces, amongst other things, co-ordination proceedings for group companies, more detailed rules on the Centre of Main Interest, and an extension of the scope of the regulation to certain pre-insolvency procedures. The European Commission continues to consult widely on insolvency harmonisation across the EU, a key proposal being a preventative restructuring framework which will allow distressed companies to restructure their business prior to a full-blown insolvency.

We continue to expect further bank stress in Europe. The Italian banking system retains something in the region of €360bn non-performing loans and the sales transactions which have occurred to date are fairly small scale compared to the size of the problem. One stress factor for European banks is that many European financial institutions hold much of their low-risk investments in domestic sovereign bonds. Such banks are uniquely vulnerable in the event of a sustained sovereign bond bear market. After years of tentative steps we think that 2017 will be a year of restructurings, equity raisings, forced consolidations, and NPL sales/securitisations for the Italian banking system. Interestingly the market survey points to Belgium and a number

of other countries as the centre of possible bank resolution activity.

Much of Orrick's restructuring work has focused on European high yield restructuring in 2016 and we expect a continuation of this trend even if the default rate stays relatively benign. Looking back at our market survey introduction for the 2016 edition, at least in Europe, the concern regarding a slew of oil company insolvencies has been "the dog that hasn't barked". There have been oil related/service company restructuring in Europe of course but the market has not mimicked the US market where scale of insolvencies of oil companies has dwarfed the failures in Europe. For distressed investors, the highly liquid US high yield market was evidently more attractive for oil-related bond investments compared to Europe in 2016. As ever, the dynamics play out somewhat slower in Europe particularly as more of the debt of oil corporates is in the form of less liquid bank debt rather than bond debt. We expect that 2017 will be the year when oil and oil services companies based in Europe are going to have to tackle their capital structures in a fundamental way and that banks make some tough decisions on some of their exposure to the sector. We are also seeing tentative signs of a welcome pick up of oil field development investment.

US interest rates have hit an inflection point and it is tempting to predict that one of the longest bull runs in global economic history has come to an end. Bond managers are going to need to position themselves for steepening interest rates and a normalisation of monetary policy. A raising dollar will not make conditions easy for emerging market companies with significant US dollar indebtedness.

Fundamentals aside, 2017 is going to be a year where politics could end up being the biggest risk factor for investors. An outbreak of US protectionism has got to be close to top of the list of concerns but with a number of European elections, and the aforementioned Brexit negotiations moving forward, the year will not be dull.



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On 23 June 2016, the UK voted to leave the EU and the word Brexit entered the global lexicon. It has rarely been out of the headlines since the day of the referendum.

As part of our survey, we canvassed distressed and PE investors about Brexit and the impact it would have on investment and business in general. The results are decidedly mixed.

The starkest finding is that the majority of investors feel that Brexit will plunge the UK into recession either this year or next. On a more positive note, 58% of distressed and 54% of PE investors have no intention of relocating outside the UK, while only a handful are considering reducing their headcount.

While this is an interesting snapshot of investor sentiment, the actual impact of Brexit may not be felt for years, if not decades.

Q Will the UK enter into a recession?

Both distressed and PE investor expectations surrounding the UK's growth prospects have clearly dampened in the wake of Brexit, but the views are mixed on whether this will plunge the UK into recession.

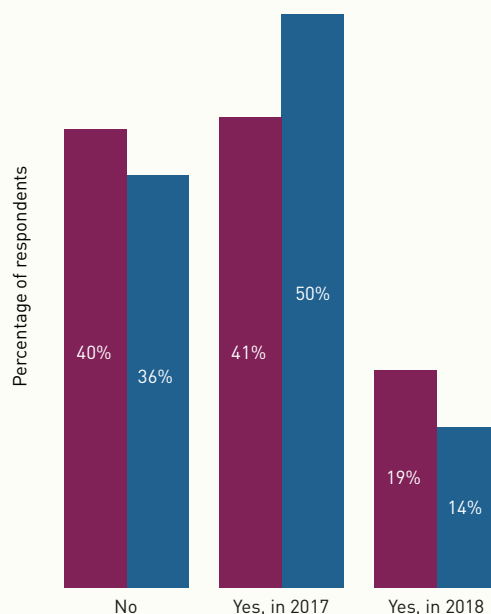
According to 60% of distressed investor respondents, the UK will enter into a recession, with some 41% expecting this to occur this year, and 19% expecting it next year. Private equity investors were slightly more pessimistic, with 50% saying the recession would likely occur this year and 14% expecting a recession in 2018.

However, a sizeable minority – around 40% of distressed investors and 36% of PE investors – believe that the UK will experience growth over the next few years or have faith in the UK Government's attempts to mitigate the fallout from the country's departure from the EU.

"The UK Government is taking measures to control the outcome of Brexit by introducing new provisions and benefits to businesses and the financial sector," a Swedish hedge fund CEO notes. "The market will be negatively impacted by Brexit, but will not go into recession. The growth pace of the economy will be considerably slow, however."

"While economists expect the UK economy to grow in 2017 and 2018, certain sectors will be negatively impacted by the post-Brexit vote fall in Sterling and rising inflation."

—David Wyles, President, Greenhill



Key:

- Distressed investors
- Private equity

"In the light of recent economic data, predictions for a UK recession seem overblown in 2017. We remain concerned regarding rising consumer debt levels and there are certain sectors however (such as retail and health care) under great pressure from a combination of higher inflation, increases in minimum wages and revaluation of business rates."

—Stephen Phillips, Orrick Partner, Restructuring, London

Q Are you more or less inclined to invest in the UK than 12 months ago?

Respondents are divided over whether the UK is more or less appealing to invest in today than 12 months ago, but overall their interest seems to have cooled.

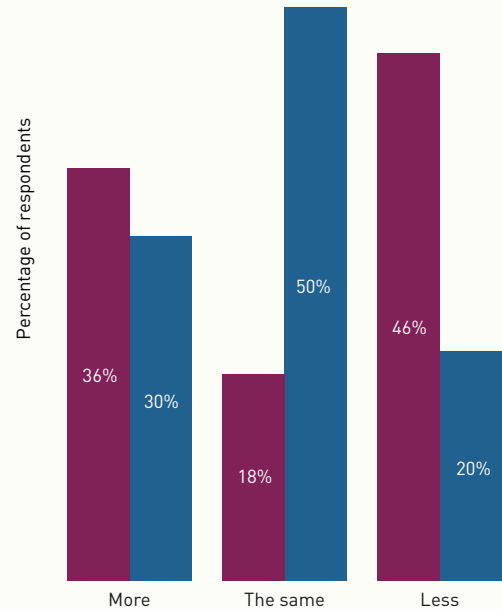
At 46%, a near majority of distressed investors are less inclined to invest in the country over the next year. However, only 20% of PE investors are less inclined to consider the UK, with half of PE respondents' sentiments towards UK investment remaining indifferent.

"The impact of Brexit on the attractiveness of the UK as an investment destination is likely to play out over decades. Until the negotiation starts in earnest, it is going to be hard to even begin to make a determination of the impact. We saw a pause in M&A activity and capital raisings in advance of and following the referendum result last year. Towards the end of the year, however, people were coming to terms with the new reality with lower sterling making businesses in the UK look more attractive to overseas buyers."

—Hilary Winter, Orrick Partner, Corporate, London

"Investors surveyed clearly believe that Brexit will have a significant impact on the UK – most immediately linking it with a high chance of recession in 2017. This has not reduced their investment appetite for the UK nor caused them to reduce headcount."

—Anthony Parsons, Head of European Corporate Advisory, Greenhill



Key:

■ Distressed investors
■ Private equity

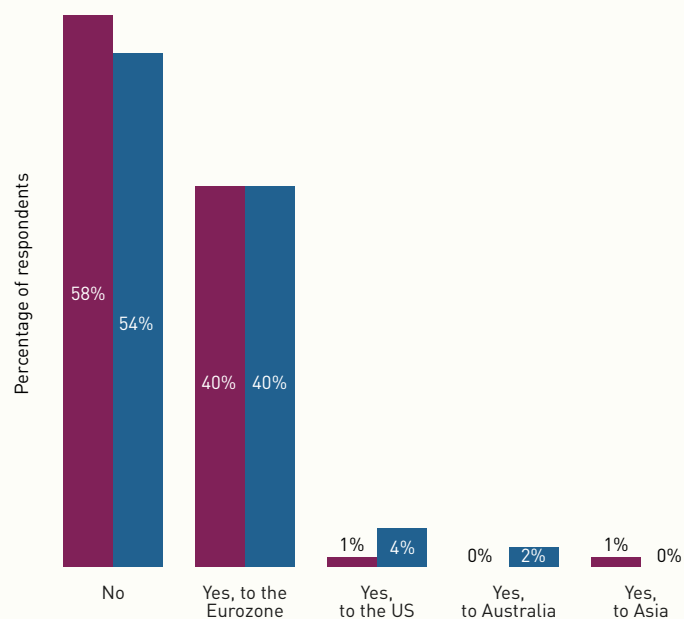
Q Are you planning to relocate any activities as a result of Brexit?

Respondents are equally mixed over whether they will relocate any activities due to Brexit. The majority of distressed investors (58%) and PE investors (54%) are not planning to do so. Respondents highlight reasons such as reduced operating costs in the UK and the benefits of a highly developed market.

However, a large minority in both camps (40%) say that they plan to relocate to the Eurozone.

"As a French corporate finance lawyer based in London, I have a unique perspective on this. I am staying put and expect London to be an attractive place to do business in the future. It is natural that each of the European financial centres will be looking to assess if any opportunities are going to arise as a result of Brexit."

—David Syed, Orrick Partner, Corporate Finance, London



Key:

■ Distressed investors
■ Private equity

Q Are you planning to increase/decrease or maintain headcount as a result of Brexit?

Headcounts look unlikely to change much as a result of Brexit. A majority of distressed investor respondents (56%) and PE respondents (50%) are planning to maintain headcount.

In the distressed investor group, 22% each are planning to increase and decrease their staff numbers in the wake of the referendum result. Meanwhile, 42% of PE respondents are planning on increasing headcount, possibly foreseeing increased activity in the wake of Brexit, or increasingly complex transactions.

Several respondents note that Brexit has not materially affected their businesses. A French managing partner at a hedge fund comments: "Brexit has not impacted our business much, mainly as we had already analysed its possible impacts and accordingly set our strategies to avoid the negative consequences. Our headcount will not change because we have the potential and work flow to keep all our resources on board."

"We are looking to increase headcount because there are more possibilities for investment, and opportunities will continue to rise in the coming months, so we will require more people to work with us," a UK-based proprietary trader says.

But several respondents voice fear over the continued health of their operations in the UK.

"Both the break with the European Union and the uncertainty associated with it could be bad for the business and damaging to the UK economy. Accordingly, we plan to decrease headcount in the UK," a Switzerland-based proprietary trader says.

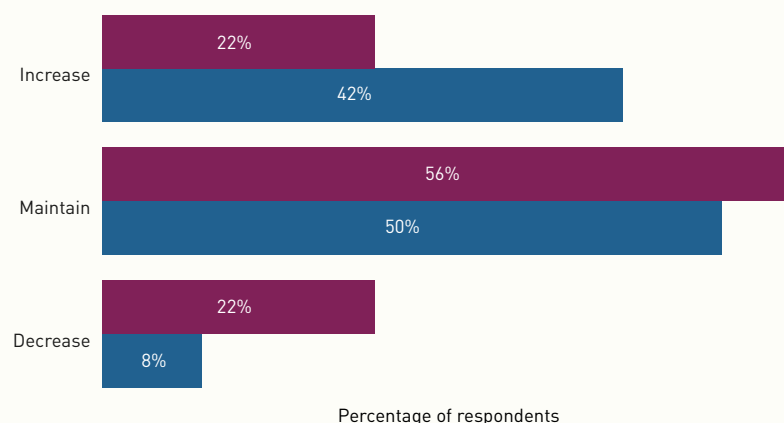
"Interesting how the increase and decrease figures for headcount is exactly equal – opinion is split. We haven't seen clients move away yet, but 2017 is the year when financial institutions are likely to finalise, and begin to implement their plans."

—Stephen Phillips, Orrick Partner, Restructuring, London

Key:

■ Distressed investors

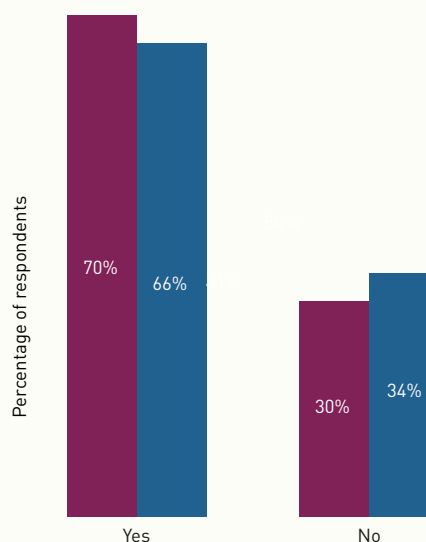
■ Private equity



Q Do you think the remaining EU member courts will stop recognising the UK insolvency processes?

Both groups anticipate a similar impact on the recognition of UK insolvency processes in EU member courts. Seventy percent of distressed investor respondents and 66% of PE respondents anticipate a 'hard' Brexit in terms of legal arrangements and expect that the EU member courts will stop recognising the UK insolvency process.

Close to one-third of distressed investor respondents (30%) and slightly more PE respondents (34%) expect that EU member courts will continue to recognise UK processes. Those in the 'no' group may anticipate that while the legal systems will change, EU member courts will de facto continue to recognise the UK's insolvency process.



Key:

- Distressed investors
- Private equity

"European insolvency systems have been improving in recent years. In addition, we see many advisers and judges look enviously at the UK's position. Brexit may provide an opportunity for local practitioners to drive a localism agenda."

—Saam Golshani, Orrick Partner,
M&A and Restructuring, Paris

"The use of schemes of arrangement to assist many European companies has been good for the UK and beneficial for European companies. Whilst in time I would be disappointed if there is not an equivalent recognition regime put in place on Brexit to mimic existing insolvency/judgement arrangements, I am not sure how high a priority this will be. There may be vested interests in Europe which may not wish this to happen."

—Stephen Phillips, Orrick Partner,
Restructuring, London

"Legal restructuring tools have come a long way in the past 20 years, keeping pace with the increasing complexity of balance sheets – the UK is leading the global marketplace, but must keep innovating, especially post Brexit."

—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA,
Greenhill

In the fourth quarter of 2016, Debtwire canvassed the opinions of 80 hedge fund managers and proprietary trading desk traders based across Europe.

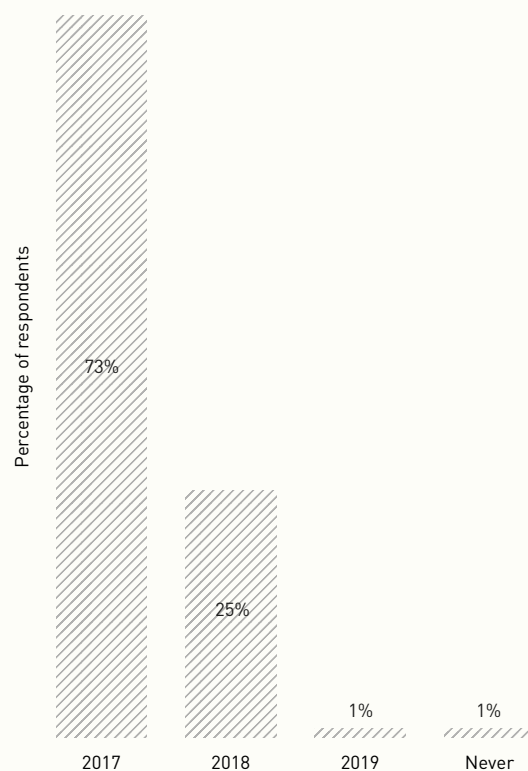
Interviewees were asked about the distressed debt market in 2016, and their expectations for 2017 and beyond. The interviews were conducted by phone and respondents were assured anonymity. The results are presented in aggregate.

Q When do you expect the volume of European restructurings to hit its next peak?

At 73%, nearly three-quarters of respondents expect that the volume of European restructurings will hit its next peak this year, and a quarter (25%) expect it next year. Respondents point to broader economic turmoil as the main driver of activity. That is roughly in line with last year's survey, in which over half of the respondents tipped 2017 as the peak (48% voted for 1H17 and 8% for 2H17).

"We have already witnessed a high rate of restructurings in 2016 and I believe the number of businesses looking to go through restructuring will continue to rise. Most of them will be victims of [certain] region's poorer economic performance, and are also impacted by significant competition and other market uncertainties," a managing director of a Germany-based proprietary trading firm comments.

"Companies have been altering their strategies so that they can deal with the current problems in the market, but they will not be able to sustain themselves without restructuring," a London-based proprietary trader predicts.



"Credit markets and QE have supported troubled corporates over recent years with easy access to credit at attractive pricing, leaving only the most challenged assets requiring financial restructuring. This trend will eventually revert and lead to a significant increase in volumes of corporate restructurings."

—Carlo Bosco, Financial Advisory and Restructuring, Greenhill

"In the 2015 report, 1% of the market ticked the 2017 box and I think over the years of the survey, there has been a tendency to predict a restructuring spike just around the corner. This year, with rising interest rates and an end to QE programmes in prospect, we may see a return to historic default rates and an appreciable increase in activity."

—Stephen Phillips, Orrick Partner, Restructuring, London

Q Which form of debt renegotiation do you expect to be most, and least, prevalent in 2017?

The largest share of respondents (37%) predict that break-up or asset disposals will be the most popular workout strategy this year, which is in line with last year's survey, in which 41% picked this option.

Amend & extends were the second most widely expected process at 24% versus 35% last year. However, debt buybacks jumped to third place from last place in 2016, with 18% of respondents expecting them as the most likely form of debt renegotiation this year compared to just 3% in last year's survey.

Many respondents still considered debt buybacks the least likely workout solution at 29%, however this was down from 35% last year. Debt equitisation/exchanges were the second least likely tool at 24% followed by forward start facilities at 16%.

"Many businesses are extending their covenants, asking for more time to help them recuperate from the current slow-growing market," a Germany-based senior partner at a hedge fund notes.

"Activity levels in our M&A teams were robust in Europe last year and this is consistent with the focus on asset disposals expressed in the survey."

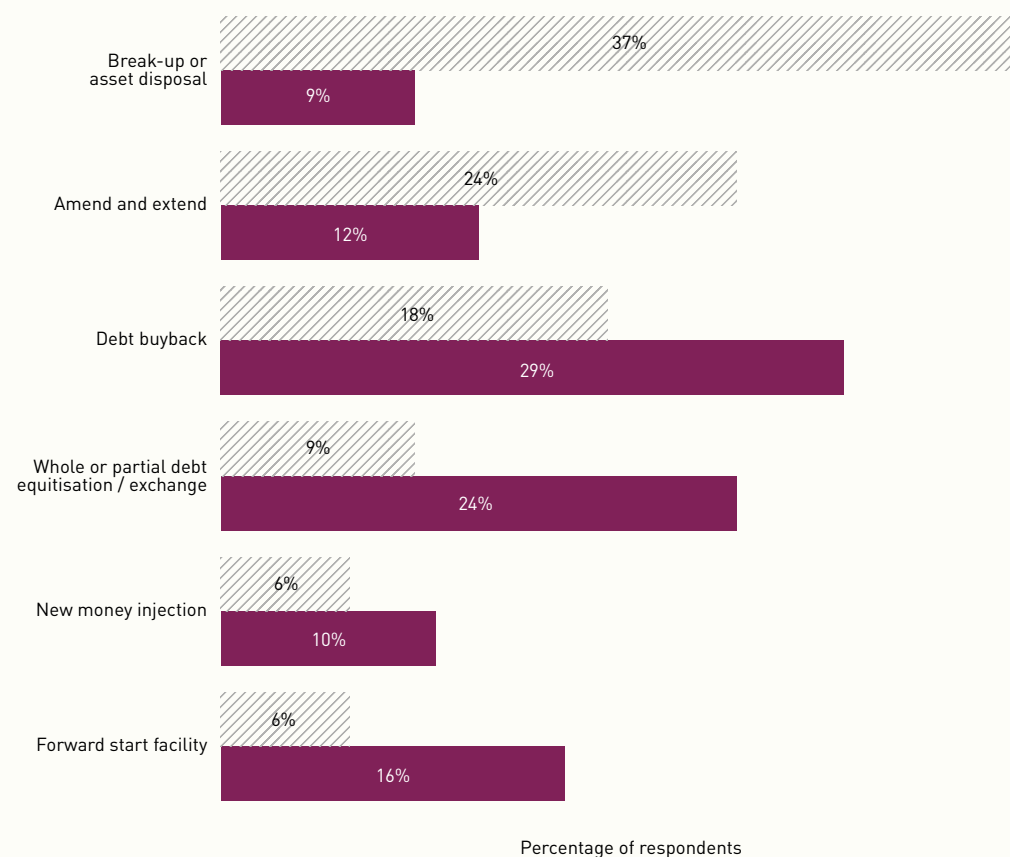
—Alessandro De Nicola, Orrick Partner, M&A, Milan

"The key question on a restructuring should be: 'What is the best for the company?' M&A will eventually play an important role, but is typically only successful after the restructuring has happened as a second step exit route."

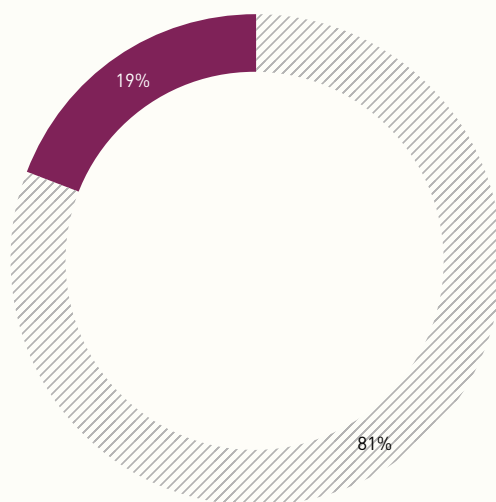
—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill

Key:

▨ Most ■ Least



Q What proportion of sub-investment grade companies do you believe are likely to face debt restructurings in 2017?



Key:

■ 5-10% ▨ Over 10%

A large majority (81%) of respondents believe that over 10% of sub-investment grade companies will likely face restructurings this year, which is marginally down but in line with last year, when 86% expected over 10% of junk-rated issuers to hit problems.

"Sub-investment grade companies have been hit by problems like a volatile market and lower demand in 2016. This has affected their returns and the amounts they have been able to generate," a UK-based proprietary trader notes.

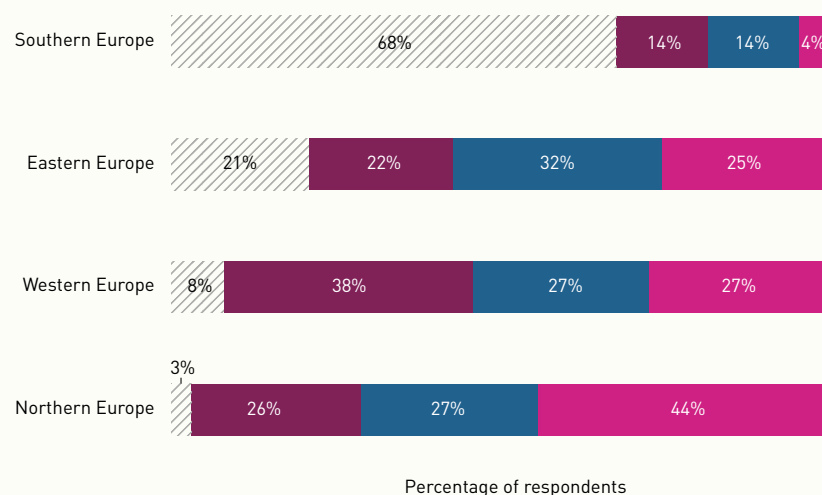
"We often see marginal smaller companies facing difficulties obtaining financing which then tips them into restructuring mode. Too small to be of interest to the large funds or high yield institutional market and sometimes too large, or complex, or problematic for some of the corporate lending units of banks, the findings don't surprise me."

—Dominic O'Brien, Orrick Partner, Finance, London

"The S&P European Leveraged Loan Index default rate has not been above 10% since early 2010."

—Charles Pontvianne, Financing Advisory and Restructuring, Greenhill

Q Where do you expect most European debt restructurings to originate?
Rank the following regions from 1 to 4, where 1=most debt restructurings



Key:

1 2 3 4

Southern Europe remains the geography most likely to drive European restructurings in 2017, according to 68% of respondents, followed by Eastern Europe (21%), Western Europe (8%) and Northern Europe (3%). That mirrors last year's views, although reflects a more positive view on Southern Europe. In last year's survey, some 91% of respondents expected the region to account for the most workouts.

"Many distressed investors have focused on Italy in the last two years, after years spent in Spain. So far, there has been only limited activity, but we see significant opportunities for investors interested in providing new money and acquiring distressed assets."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

"We remain very active in Italy, advising on restructuring matters, sales and securitisations of NPLs and bank resolution matters. The survey results, which point to strong activity in Southern Europe, are consistent with our expected activity levels."

—Patrizio Messina, Orrick Partner, Structured Finance, Rome

Q Please rank the following countries from 1 to 6, where 1= most debt restructuring

As expected, given the results to the previous question, respondents expect Italy (46%) and Spain (32%) to be the most likely candidates with the most debt restructurings in 2017. That is in line with last year's results, although the results were reversed with Spain above Italy.

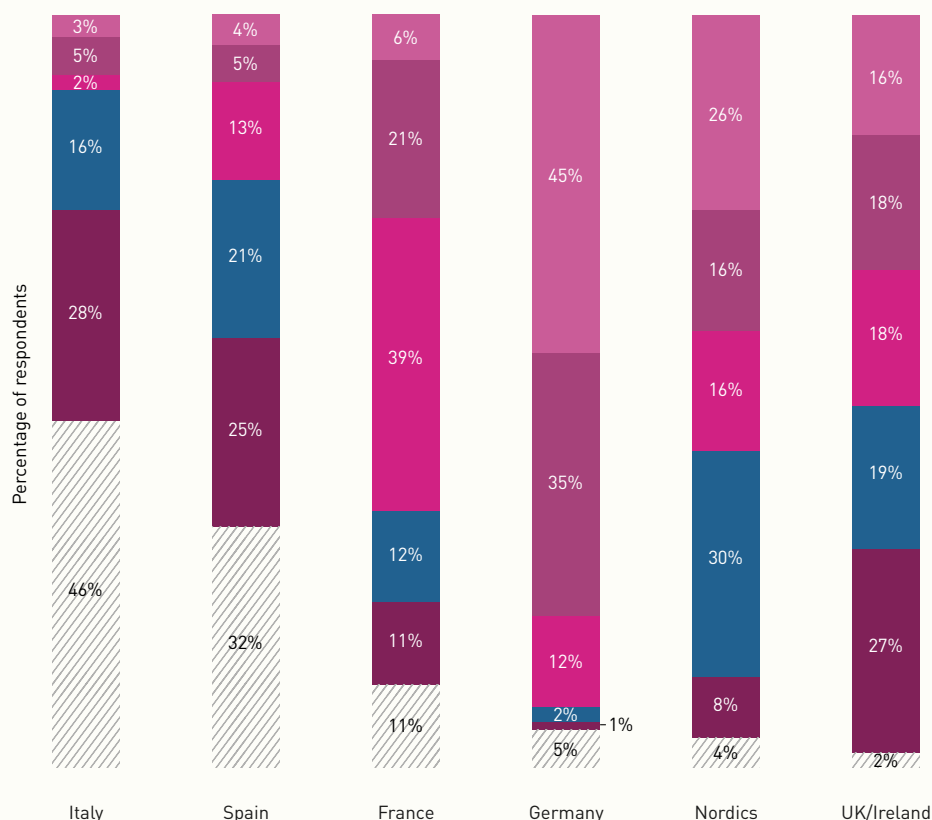
"The Italian market has been in shambles, and the political and debt problems have crippled the market. Italian companies need capital most desperately to restructure so that they can perform again. Spain has also not been growing at a steady pace. The lack of growth has created a large market for distressed debt," a London-based CEO of a proprietary trading firm comments.

It is interesting to note that many respondents feel the UK and Ireland will have a fairly large level of restructuring – although only 2% of respondents believe that the region will see the most activity – a smaller share than Germany (5%) or the Nordics (4%).

"We are frequently asked by our Italian corporate clients whether we know of institutional clients willing to lend into a stressed capital structure to take out local bank debt. We expect to see more funds buy local debt and drive processes."

—Marco Nicolini, Orrick Partner, M&A, Rome

Key:



Q Where do you expect to find the best distressed opportunities going forward? (Select one option)

As in last year's edition of the survey, over half of respondents (55%) believe that Europe will continue to provide the best distressed opportunities in the future, pointing to increased political and macroeconomic issues increasing the number of businesses attractive to distressed investors.

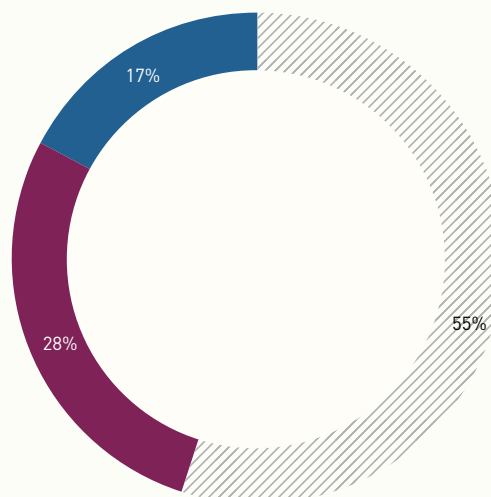
"Europe has been impacted tremendously due to the recent market shift, which was caused by the uncertainties surrounding Brexit," a Sweden-based hedge fund CIO says. "The instability in the political environment and trade relations have impacted businesses across various sectors negatively. This has led to an increase in the number of distressed situations."

Mirroring last year's survey, around a quarter of this year's respondents (28%) believe that the best distressed opportunities will be found in Asia.

"Following stock market problems in China, companies in countries like China, Thailand and Japan have not been able to grow. Returns have fallen and these companies need capital to boost growth in their markets. This has helped create a strong market for hedge funds and other investors to invest in distressed debt in these countries," a respondent says.

"The North American restructuring market has been robust for the last 24 months due to dislocation in the oil & gas and metals & mining sectors. With the level of restructuring activity in these sectors declining, we still anticipate heightened North American restructuring activity on the backs of secular trends in bricks and mortar retail, higher interest rates, and regulatory uncertainty in healthcare. We have recently worked with our European colleagues on a number of cross-Atlantic restructurings that allow us to optimise the choice of legal regime and potential sources of capital."

—Eric Mendelsohn, Head of Financing Advisory and Restructuring, North America, Greenhill



Key:

- Europe
- Asia
- North America

"I am surprised to see North America ranks so low. Last year, the US distressed debt market was active particularly in energy-related debts. This year, we expect to see the US have a higher default rate than Europe, and with a deeper, more liquid market, we think funds are going to have plenty of things to do."

—Raniero D'Aversa, Orrick Partner, Restructuring, New York

Q Which macroeconomic factors will drive a European restructuring wave next year? Rank from 1-8, where 1= most important factor

Similar to last year, when the fears were somewhat premature, the largest share of respondents (22%) expect rising interest rates as the most important macroeconomic factor driving European restructurings in 2017.

"Interest rate are likely to rise soon, and this will impact businesses' ability to secure funds for development, restricting their growth and thus putting them into a restructuring phase, like we saw during the last recession," a German hedge fund managing director comments.

Looking outside the very top results, it is also clear that investors believe that Brexit and EU political instability are going to be key drivers for the next wave of European restructuring.

"There is a concern that a Trump presidency may drive a protectionist agenda which sets off a chain of 'tit for tat' barriers. This doesn't seem to show in the survey results, and recent stock market moves have reacted very positively to the US election result. It remains to be seen as to whether the market is cherry picking the positive policy announcements and ignoring the possible downside."

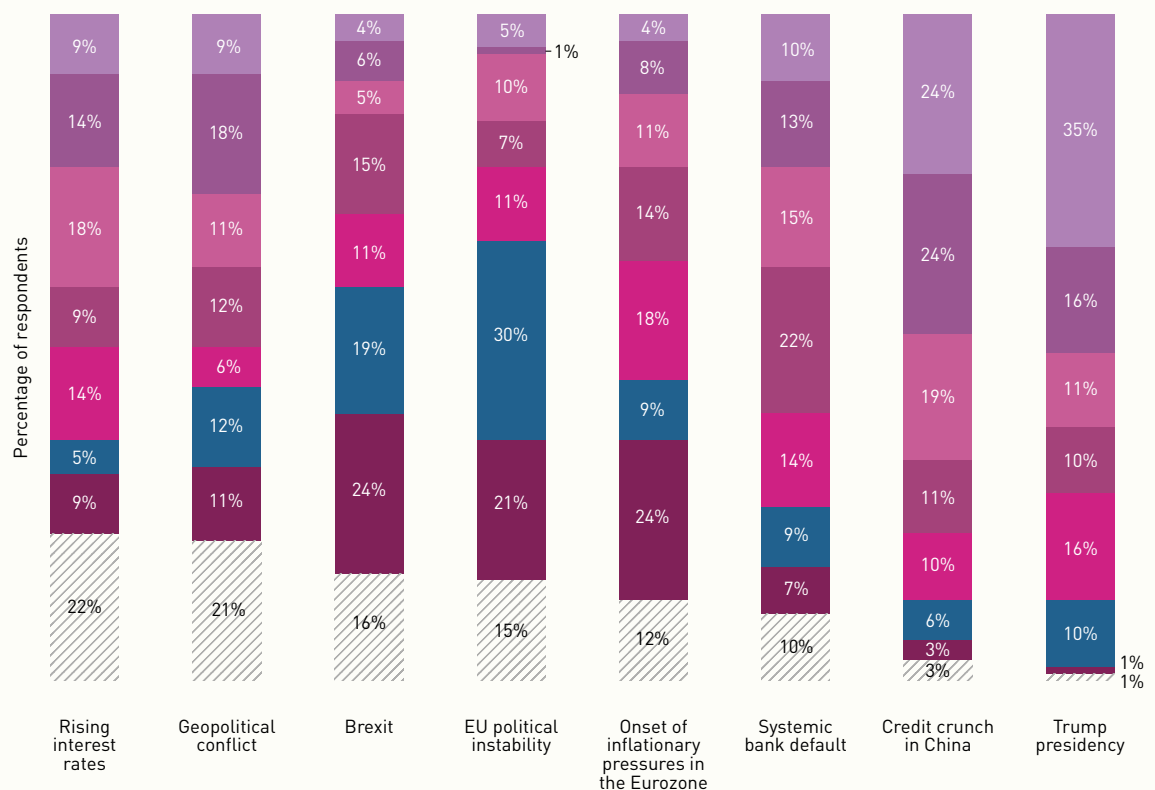
—Stephen Phillips, Orrick Partner, Restructuring, London

"Brexit and EU political instability are two key short-term factors – unsurprisingly, they are in the top three factors for approximately 60% of the respondents to the survey. All other factors could be critical, but will probably impact the environment after 2017."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

Key:

1 2 3 4 5 6 7 8



Q Please indicate the following in terms of the opportunities they represent for distressed investors in 2017.

The largest share of respondents say that energy (89%) will offer distressed investors the most opportunities. This is a noticeable increase from last year's edition of the report, when 72% of respondents foresaw significant activity in the sector. This is followed by financial services (85%) and infrastructure (83%). Following the recovery in prices, oil & gas slipped to fourth place (74%) from first last year (94%).

The telco/cable and technology sectors are expected to generate significant opportunities this year according to 54% of respondents, a sizeable increase from 34% and 40% respectively, in last year's report.

"While we see some global sector trends, like energy, financial services and shipping, other sectors will vary by country. Brexit could have a significant impact on UK retail, property and construction and business services, which are some of the least favourite in the survey."

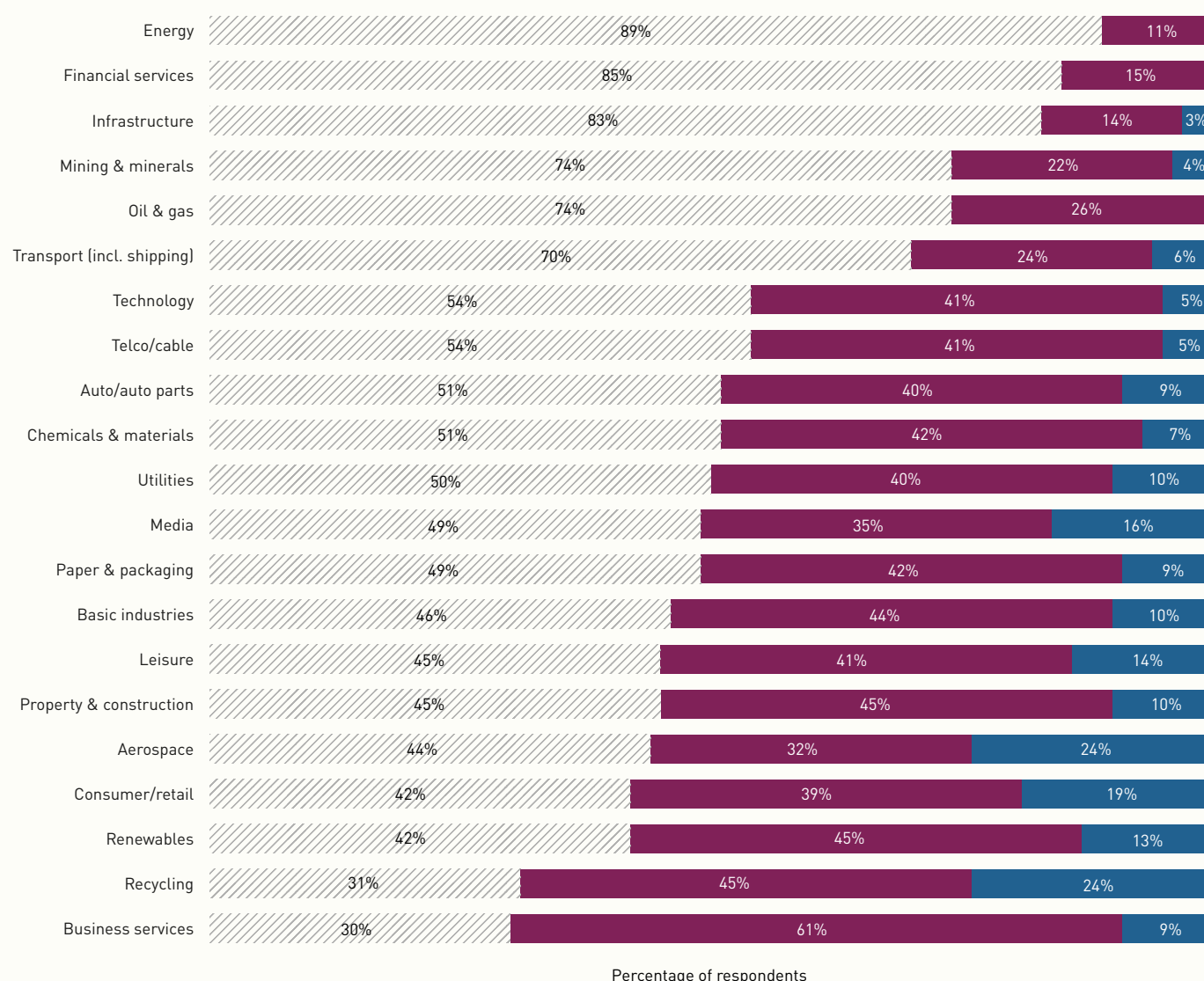
—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill

"Independent oil production companies will remain under pressure, but the sector can be proud of how quickly it has moved to get its costs under control. As well as measures to get their balance sheets in order this year, we also expect corporates to increase their investment in new fields, albeit from the low base of the past few years implemented by investment from private investment houses and funds."

—Peter Roberts, Orrick Partner, Energy & Infrastructure, London

Key:

/// Significant opportunities ■ Some opportunities ■ Few opportunities



Q Which oil & gas sectors offer the best opportunities?

Oil services (50%) and rigs (50%) are tipped to offer the best opportunities again this year by respondents, although rigs have become more popular, which likely reflects the recovery in oil prices.

"The cost of operations has increased significantly and the demand for oil service businesses has reduced, which is causing more businesses to enter distressed situations," a Sweden-based hedge fund executive comments.

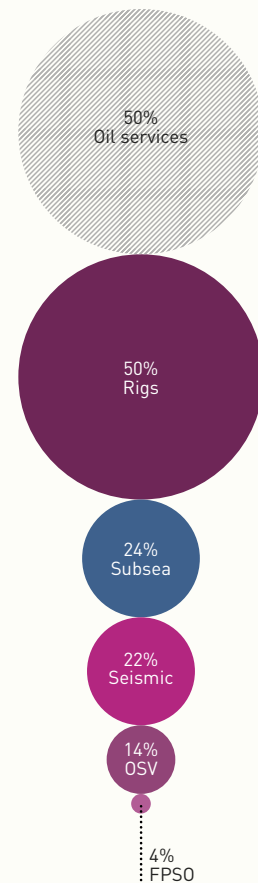
Interest in seismic operators also rose, likely reflecting Norwegian seismic operator PGS' recent exchange offer and the current workout process of French peer CGG.

"We are busy on shipping and rig-related capital structures. The shipping sector has remained in the doldrums since 2008 and there remains a lot of work to do to see the situation stabilise."

—Bill Haft, Orrick Partner, Banking & Finance, New York

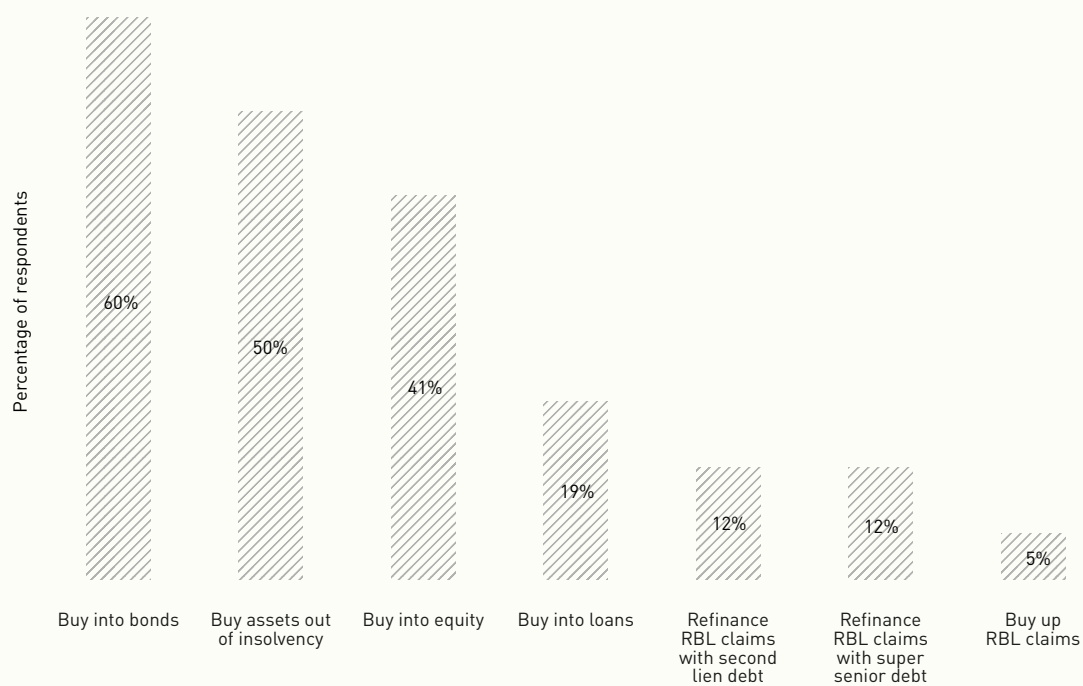
"O&G service companies with shorter-term contracts have been the ones that suffered the most last year, together with E&P companies. The gradual rise in oil prices in the second-half of the year has positively impacted valuations, but it has not fully resolved the structural issues in the industry. In Europe, we expect the pressure on O&G service companies exposed to the North Sea to continue and gradually move to players with longer term contracts that eventually will need to face the new environment. The view on these trends and the consolidation that we expect to take place in the coming years will be key drivers for distressed investors. In addition to short-term contracts, higher asset intensity and lack of resolve to aggressively reduce costs are further problems for services providers. The ability to work closely with customers, and with alliance partners, to tailor solutions will decide the winners/losers and who survives then thrives on the back end. The down cycle seems to be lower for longer too. This won't turn in the short term, so value engineering really matters."

—Steve Cruise, Head of Industrial Corporate Advisory, Greenhill



Percentage of respondents

Q What is the best way to invest in distressed oil & gas situations?



The largest share of respondents considered buying into bonds (60%) as the best way to invest in distressed oil & gas situations, a shift from last year when 26% considered buying equity as the best way followed. The second largest share (50%) selected buying assets out of insolvency, a sharp jump from last year when just 16% of respondents picked this route.

"Oil & gas assets are generally highly priced but as the valuations of assets in insolvency are low, there is a high possibility of turning around the business. We believe that this will reap benefits in the long run," a London-based proprietary trader says.

"Reserve Based Loans (RBLs) are low on the list here. Banks have been cautious about off-loading risks and damaging relationships and so we are not sure there has been much trading of RBLs. To the extent funds have wanted to get involved, bonds have been the best place to obtain exposure, but, compared to the US, there is limited supply in Europe outside the Nordic market."

—Colin Graham, Orrick Partner, Energy & Infrastructure, London

Q In which markets are you considering distressed oil & gas opportunities?

The US market (62%) and the North Sea (58%) are the most popular destinations for distressed oil & gas opportunities, according to respondents.

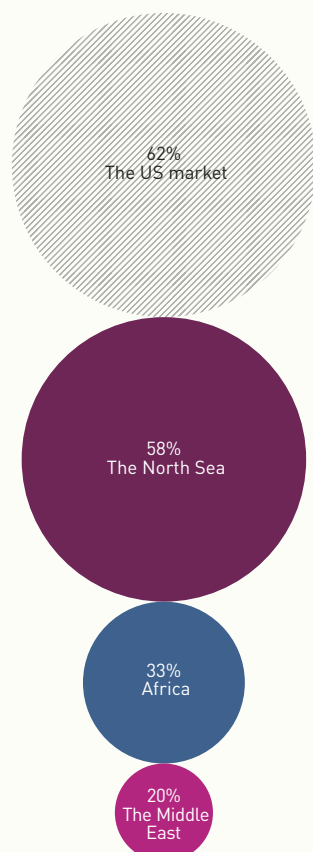
"The US market is currently competitive: with demand in the domestic market remaining high, getting buyers is relatively simple. The costs are higher but funds and capital are easy to get access to," a Germany-based proprietary trader comments.

"Many clients concentrated their activity in the US for obvious reasons of supply and opportunity which is far greater in the US compared to the handful of high yield bonds in the North Sea market."

—Douglas Mintz, Orrick Partner, Restructuring, Washington

"The North American energy sector has seen a real improvement in operating performance and debt markets have tightened. Many issuers are now able to access acquisition and refinancing debt capital near 2013/14 levels."

—Jim Rogers, Energy Corporate Advisory, Greenhill



Q Where do you think oil prices will go in 2017?

A sizeable minority (40%) of respondents believe that oil prices will stay range-bound in 2017 but over half think they will rise in the coming year, with 46% expecting prices to climb to the USD 60s and a further 14% expecting them to reach the USD 70s.

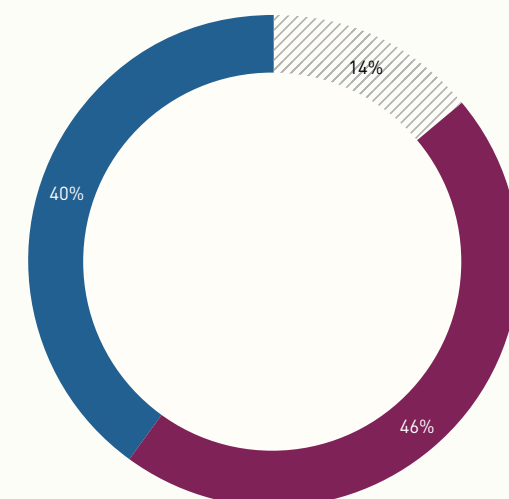
"Interest rate surges are likely to put pressure on the commodity market, causing oil prices to rise. However, the rise will be very gradual, starting in 2017 and will pick up further over the coming years," a Milan-based proprietary trader predicts.

"Even if demand/supply is expected to improve in the primary oil market, most expectations are that capex will remain significantly below the levels seen in 2013 and 2014, hence the negative outlook for OFS providers."

—Doris Salzburger, Natural Resources Corporate Advisory, Greenhill

"The battle to obtain control of the equity of oil and oil field services companies, with the object of taking advantage of a rising oil price, will be a theme for 2017 and beyond."

—Stephen Phillips, Orrick Partner, Restructuring, London



Key:

- ▨ Climb to USD 70s
- Climb to USD 60s
- Stay range-bound in the USD 50s

Q Out of the following, please rank the three instruments that you think will offer the most attractive investment opportunities in 2017. Please rank 1-3, where 1= most attractive

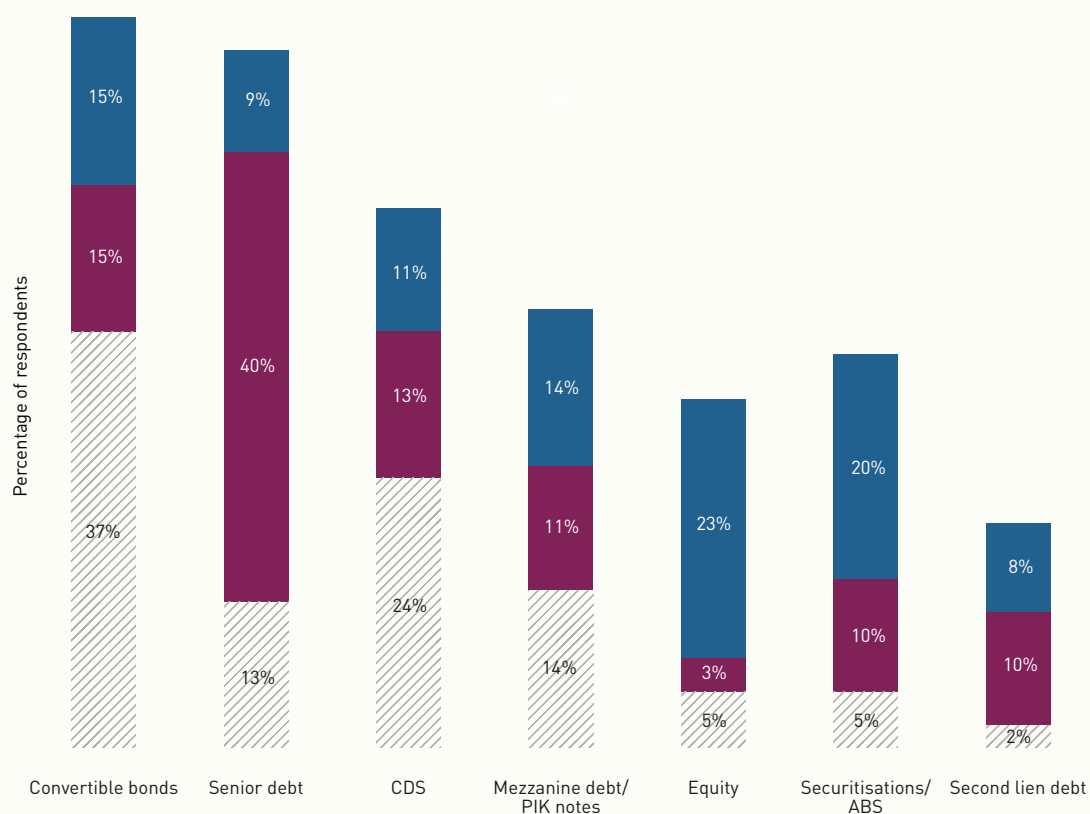
At 37%, the largest share of respondents believe convertible bonds will offer the most attractive investment opportunities in 2017. This mirrors last year's survey, when the most respondents (31%) picked convertibles.

"Convertible bonds are more fundamentally attractive and a more preferable investment type, compared to the current equity performance. Convertibles help secure assured returns and offer higher rewards in long-term investments," a Germany-based proprietary trader says.

CDS jumped to third place in terms of attractive investments in 2017 with 48% overall, up from eighth place (5% overall) last year.

Key:

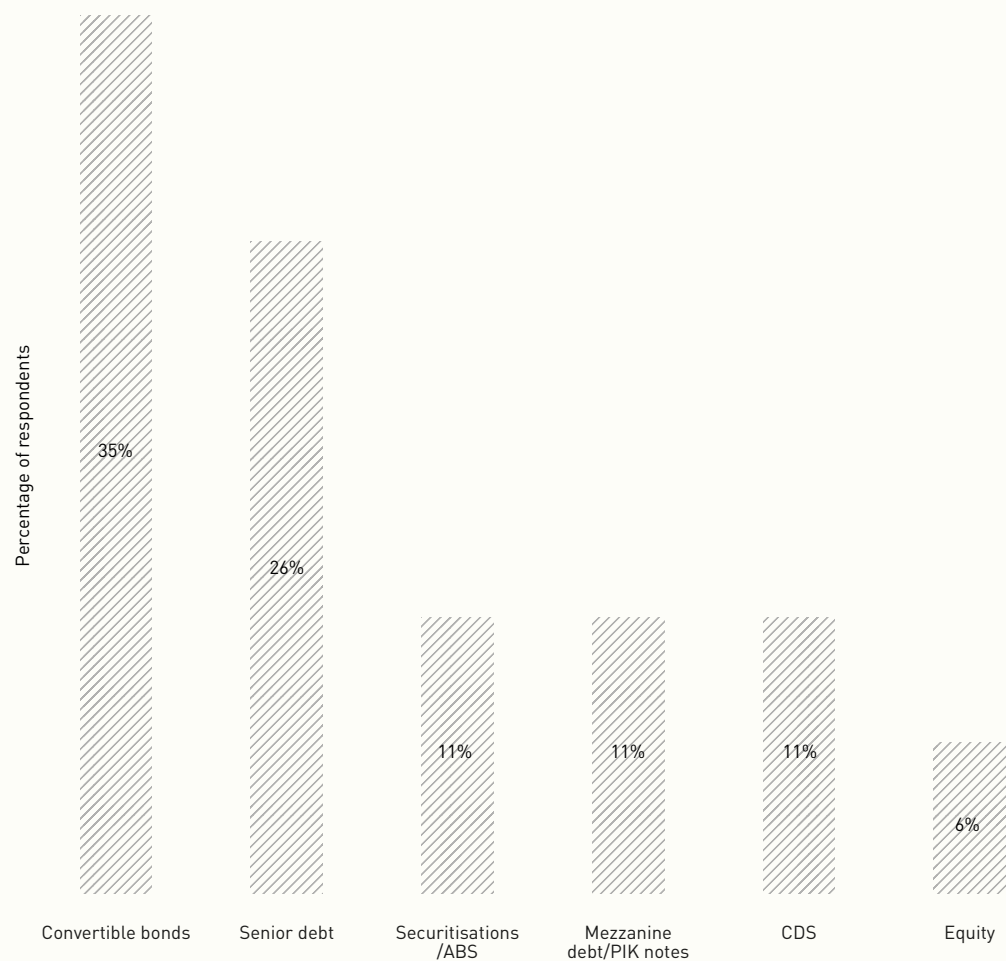
1 2 3



Q Which instrument is most likely to be attractive as a means to secure control of a credit in 2017?

Convertible bonds (35%) and senior debt (26%) once again topped the list as most attractive instruments to secure control of a credit in 2017, although last year they were both tied in first place with 27%.

“The risks involved with senior debt are much lower. As the market conditions and business performances are deteriorating, there is a high possibility of losing out on investments made. Therefore, investing in senior debt propositions will help secure the credit,” a Germany-based proprietary trader says.

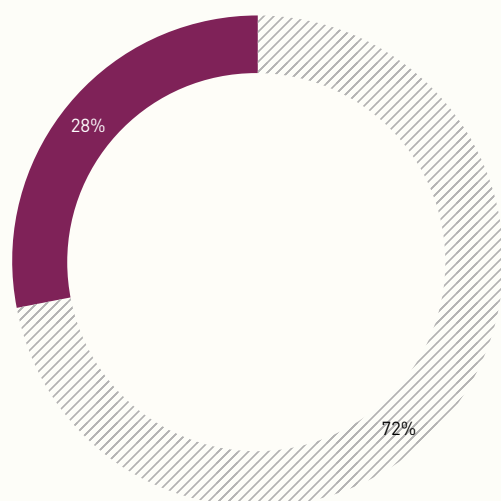


Q Do you expect an increase in high yield related restructurings in the next 18 months?

At 72%, the lion's share of respondents expect an increase in high yield-related restructurings over the next year and a half, which is in line with last year's survey findings, where 78% of respondents foresaw an increase.

"We have been busy with a number of high yield restructurings this year and, even if the default rate stays flat, the size of the market has grown impressively since 2008 and so we expect an increase in new restructurings in 2017 and beyond."

—Stephen Phillips, Orrick Partner, Restructuring, London



Key:

/// Yes ■ No

Q Have covenants become so weak that you effectively need a liquidity event to trigger a restructuring?

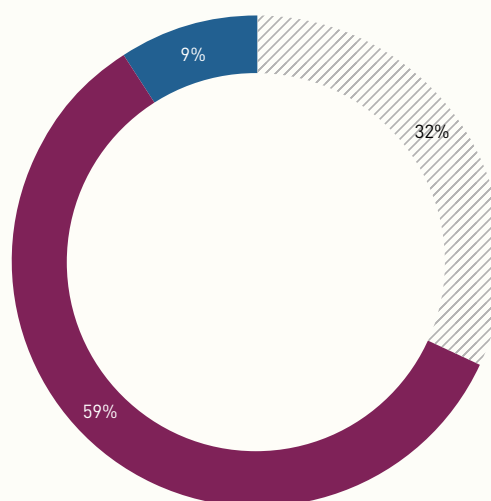
Nearly a third (32%) of respondents think covenants have become so weak that they effectively need a liquidity event to trigger a restructuring. While this is slightly down on last year (43%), the number that disagree also reduced, falling to 9% from 12%.

"The few remaining covenants will most likely continue to be reset at sponsor and non-sponsor companies, with liquidity/maturity events remaining the only trigger event."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

"Many borrowers and PE houses in Europe obviously like the flexibility which 'cov-lite' structures provide, but most owners/debtors will take active steps before they can't pay to avoid a total free fall insolvency. In the emerging markets the dynamics are often different and we do see restructurings start far too late."

—Peter O'Driscoll, Orrick Partner, Emerging Markets, London



Key:

/// Agree ■ Neutral ■ Disagree

Q Rate the following bankruptcy jurisdictions on a scale from 1 to 5 (1= avoid at any cost, 2= avoid if possible, 3= average but not ideal, 4 = acceptable, 5= 1st rate)

In terms of the most popular jurisdictions for bankruptcy, respondents again considered Germany, the Netherlands and the UK as the most attractive, and the southern jurisdictions as the least attractive. The UK was voted the most efficient jurisdiction, with a 4.25 out of 5 rating.

Spain has improved versus last year in terms of range of available options (3.61 versus 3.34 last year) and outcomes (3.51 versus 3.14 last year).

"The UK today has the most attractive restructuring regime and this will likely not change in the near future, with the English Scheme now rivalling the US Chapter 11 as a viable, cost-effective tool to restructure balance sheets, irrespective of whether or not the borrower it is UK-based. Having worked on German restructurings, the finding that it is the most attractive regime is surprising."

—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill





"Given the scale of the use of schemes of arrangement in recent years, the fact that Germany beat the UK on every measure bar one is surprising as we are not seeing 'COMI shifting' of European corporations of companies to do restructurings in Germany. Italy beating France is also counterintuitive to us, France isn't perfect, but sauvegarde has proved a workable implementation tool since it was introduced over 10 years ago."

—Emmanuel Ringeval, Orrick Partner, Banking & Finance and Restructuring, Paris

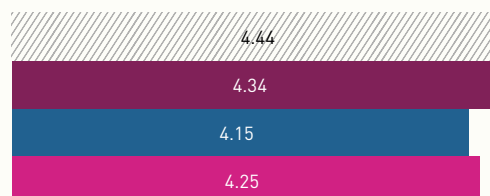
"Other countries like Italy have been going through some meaningful reforms, but still have untested regimes. It is critical to know the local legal framework and understand how this can interact with other more developed systems like the US and the UK to provide the most effective solutions in a restructuring."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

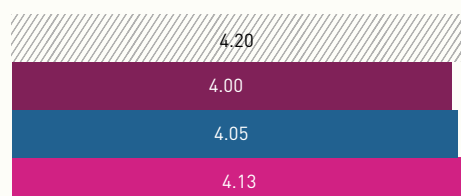
Key:

 Range of available options
 Efficacy
 Outcome
 Speed

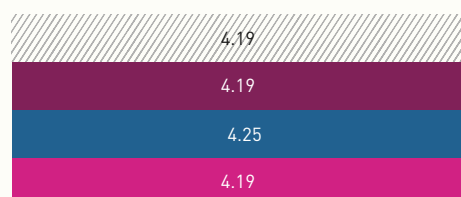
Germany



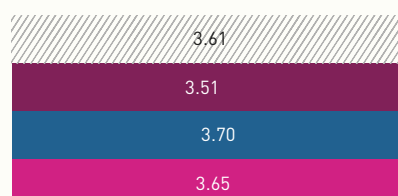
Netherlands



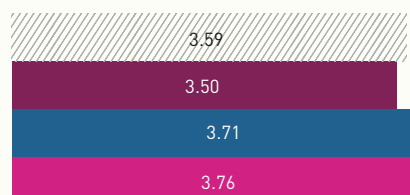
United Kingdom



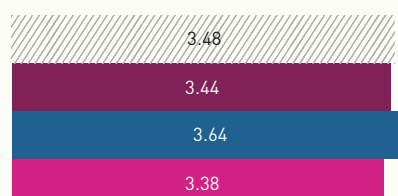
Spain



Italy



France



Q What will be the key driver behind primary market activity in 2017? (Select one)

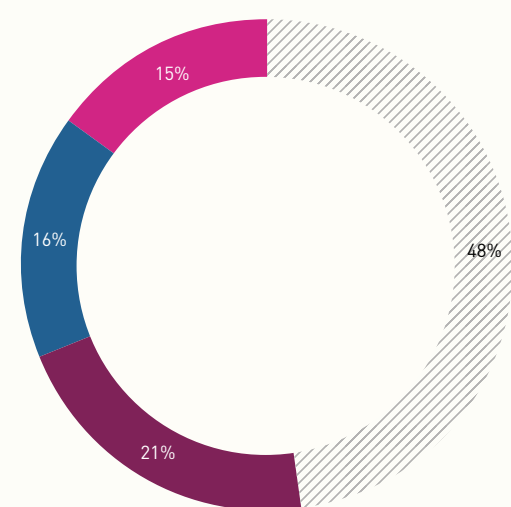
Mirroring last year's findings, nearly half of respondents (48%) believe that M&A will be the key driver of primary market activity in the coming year. Respondents point to several reasons for a renewed interest in acquisitions, including fewer failed deals in recent months, consolidation in key sectors and better valuations.

"The drive to tackle competition has given rise to more M&A deals. Businesses are looking to acquire smaller businesses in their categories in order to secure the benefits of size and scale," a Germany-based hedge fund manager notes.

A further 21% of respondents say that refinancings will spur primary market activity in 2017, while 16% expect dividend payouts/recaps to drive activity and 15% tipped LBOs, which is roughly unchanged from last year.

"The buoyant equity markets seem to have been able to withstand a number of political shocks, and whilst you cannot discount further political shocks in 2017 given upcoming European elections, we remain cautiously optimistic for M&A activity."

—Jean-Pierre Martel, Orrick Partner, M&A and Private Equity, Paris



Key:

- /// M&A
- Refinancings
- Dividend payouts/recaps
- LBOs

Q In percentage terms, how much will liquidity increase/decrease in the primary market in 2017?

Almost half the respondents expect liquidity in the primary market to increase this year. Sixty-seven percent of those interviewed believe that liquidity will increase more than 10% but some 18% expect liquidity to decrease.

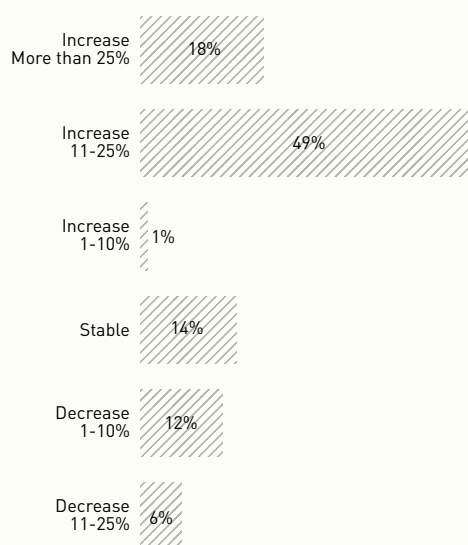
"Liquidity in the market will remain the same it was last year," a UK-based proprietary trader said. "There are still companies in the market that are performing well and there are buyers willing to make strategic acquisitions where they are certain of growth and returns."

"There is a lot of appetite from hedge funds to participate in primary deals in distressed situations to invest in large enough tickets at the right price."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

"As counsel to many debtors across Europe, we think there are a healthy range of options open to the right client. The interest from US institutional accounts since 2008 has been growing and the European high yield market is well established. This picture looks set to continue in 2017 barring some external shock."

—Nell Scott, Orrick Partner, Corporate, London



Percentage of respondents

Q Who will be the main players behind primary market activity in 2017?

According to the largest share of respondents (55%), hedge funds will be the main players behind primary market activity this year. This represents a change from last year, when mutual funds, insurance companies and pension funds ranked ahead of hedge funds.

"Hedge funds will continue to provide liquidity as they have sufficient free capital to invest," a France-based proprietary trader says.

Mutual funds, insurance companies and pension funds remain a key player in primary markets according to respondents, ranking second (46%).

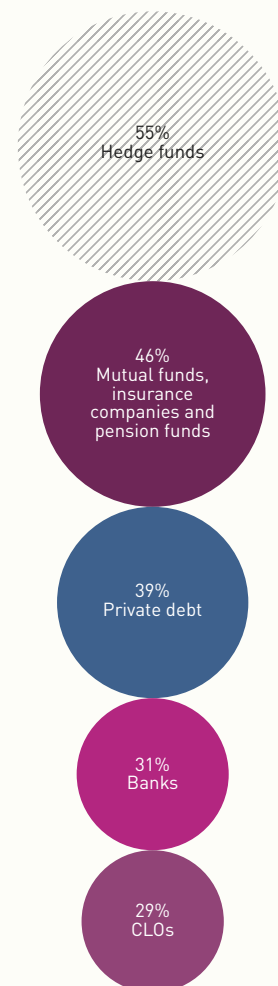
"Pension funds and mutual funds have been able to get a lot of capital and will look for opportunities to invest. Mutual funds have been backing a lot of investments in distressed debt. They need to make large amounts of returns in short periods and investing in debt has helped them get this," a London-based proprietary trader comments.

"Hedge funds and credit funds are not a three-headed monster. They are much more flexible than any other finance provider and are able to take bigger risks to rescue businesses which would otherwise fail. Even in less critical situations, they can provide creative solutions at increasingly acceptable pricing."

—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill

"CLO involvement in the market has reduced in proportion since its pre-2008 highpoint. Institutional credit funds have plugged that gap in the primary market and such funds are very active in the private direct lending market too."

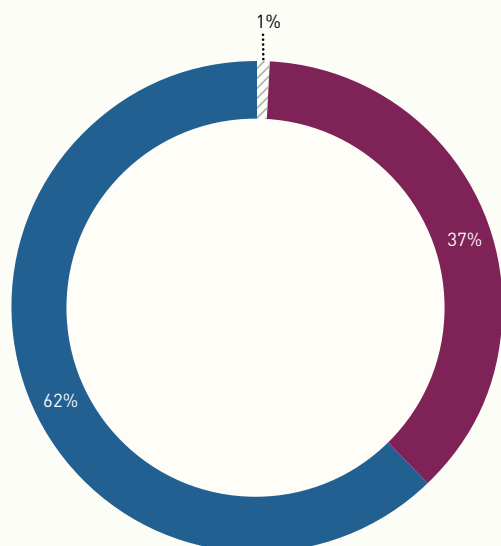
—Dominic O'Brien, Orrick Partner, Finance, London






Q In percentage terms, to what degree do you think banks' ability to lend new money or extending existing debt facilities has diminished as a result of Basel III rules?

Respondents continue to note that banks' ability to lend has diminished as a result of Basel III rules. Some 62% believe that it has decreased between 0% and 25%, but a chunky 37% think it has decreased between 26% and 50%.

"Increased capital requirements and liquidity ratios are impacting banks' positions to lend and earn returns, which is impacting businesses looking for capital to grow," a London-based hedge fund partner notes.



Key:

-  More than 50%
-  Between 26%-50%
-  Between 0%-25%

Q Are you actively raising long-term capital for direct lending?

Respondents appear to have increased appetite for raising long-term capital. Some two-thirds of this year's respondents are doing so, up from 53% of 2016's interviewees.

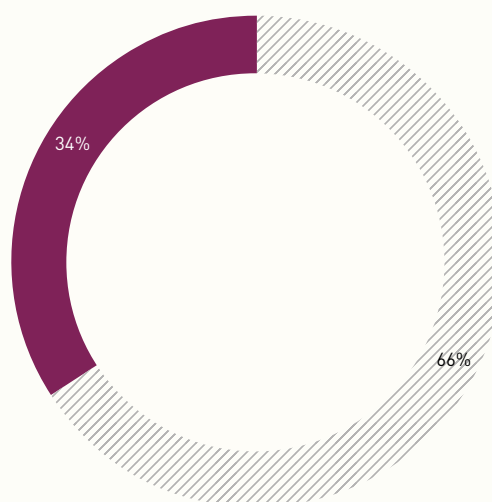
"We have identified potential investment opportunities that will help us secure higher returns in the long run," a London-based hedge fund partner says. "These businesses are mainly evolving with the use of technology, which is likely to be a high-growth segment in the next few years."

"Growth of technology-related lending and investment generally is a trend we are seeing in our technology and venture capital practice. The technology-related ecosystem is maturing in Europe and deal sizes are increasing."

—Shawn Atkinson, Orrick Partner, Corporate, London

"Private debt fundraising has seen a continued growth in the amount of investor capital entering the asset class, with yearly amounts raised close to tripling since 2010. There is currently a substantial amount of dry powder available for deployment into the asset class."

—Briac Houtteville, Capital Advisory, Greenhill



Key:

-  Yes
-  No

Q If yes, what kind of ticket sizes are you planning to offer?

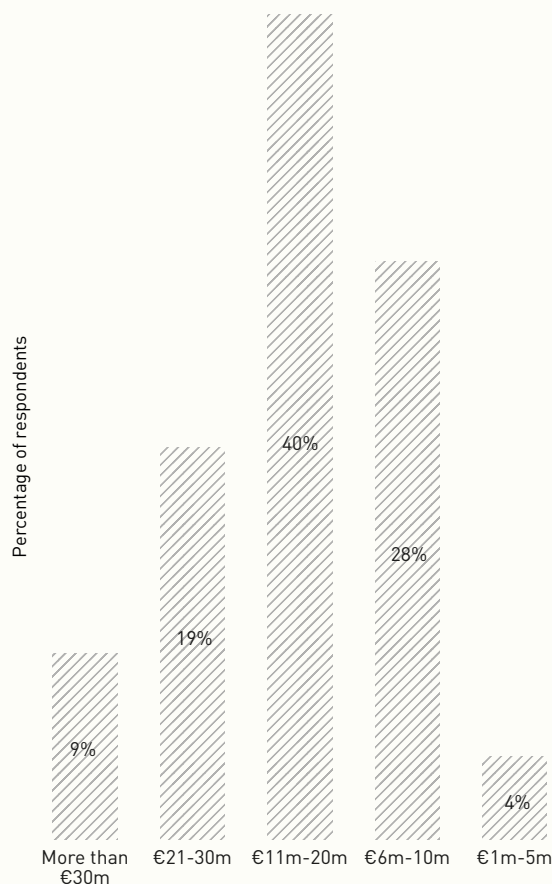
Of the firms raising capital for direct lending in the next year, the largest share (40%) are planning to offer ticket sizes of between €11m and €20m, with 32% of respondents targeting tickets of €10m or less, and 28% intending to offer tickets greater than €20m.

"Small tickets are challenging for the larger funds, leaving an opportunity for smaller/local funds to participate in less competitive situations, especially in Southern Europe."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

"We often think that it isn't easy for our smaller clients who are looking to raise £1-10m to get loans. Most funds tell us the work is just as involved as a £40-50m loan, but with lesser returns."

—Dominic O'Brien, Orrick Partner, Finance, London

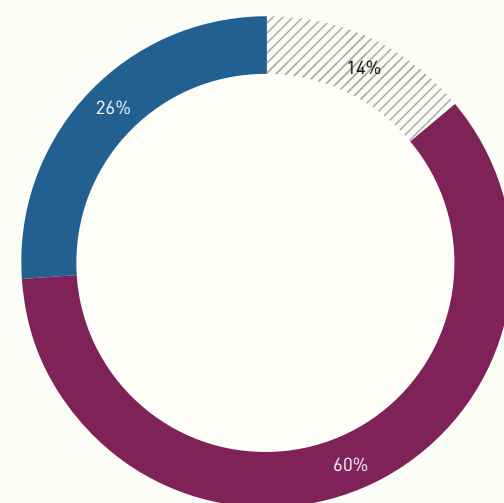


Q How long do you have capital locked up for?

A majority of respondents (60%) say that they have capital locked up for one to three years, which is down from last year when 70% of those interviewed stated that they had capital tied up for this period. Roughly a quarter of respondents (26%) say that their capital timelines are even shorter, from six months to one year, which is up from 20% last year.

"We have considered a fairly small timeline as we look to continuously move our investments across short-term returns in order to accumulate higher return multiples," the head of trading at a Paris-based proprietary trading firm comments. "We have been successful in achieving our desired targets within these timelines, which also helps in making new investment allocations to better opportunities in the market."

A hedge fund executive based in the UK says shorter lock-ups are due to the more volatile market. "We have locked up capital for a very short period as we are considering the significant risks in the market that are likely to impact our investments negatively. Therefore we are not taking the risk of investing for longer periods as it can result in little to no returns for our investors."



Key:

- 5 years plus
- 1-3 years
- 6 months to 1 year

Q Where have you deployed your capital in 2016? And where do you expect to allocate your capital in 2017?

During 2016 respondents primarily deployed capital in distressed debt (25%), followed by high yield bonds (21%) and listed equity (18%).

For 2017, they plan to invest in distressed debt (26%), high yield bonds (22%) and direct lending (15%) this year.

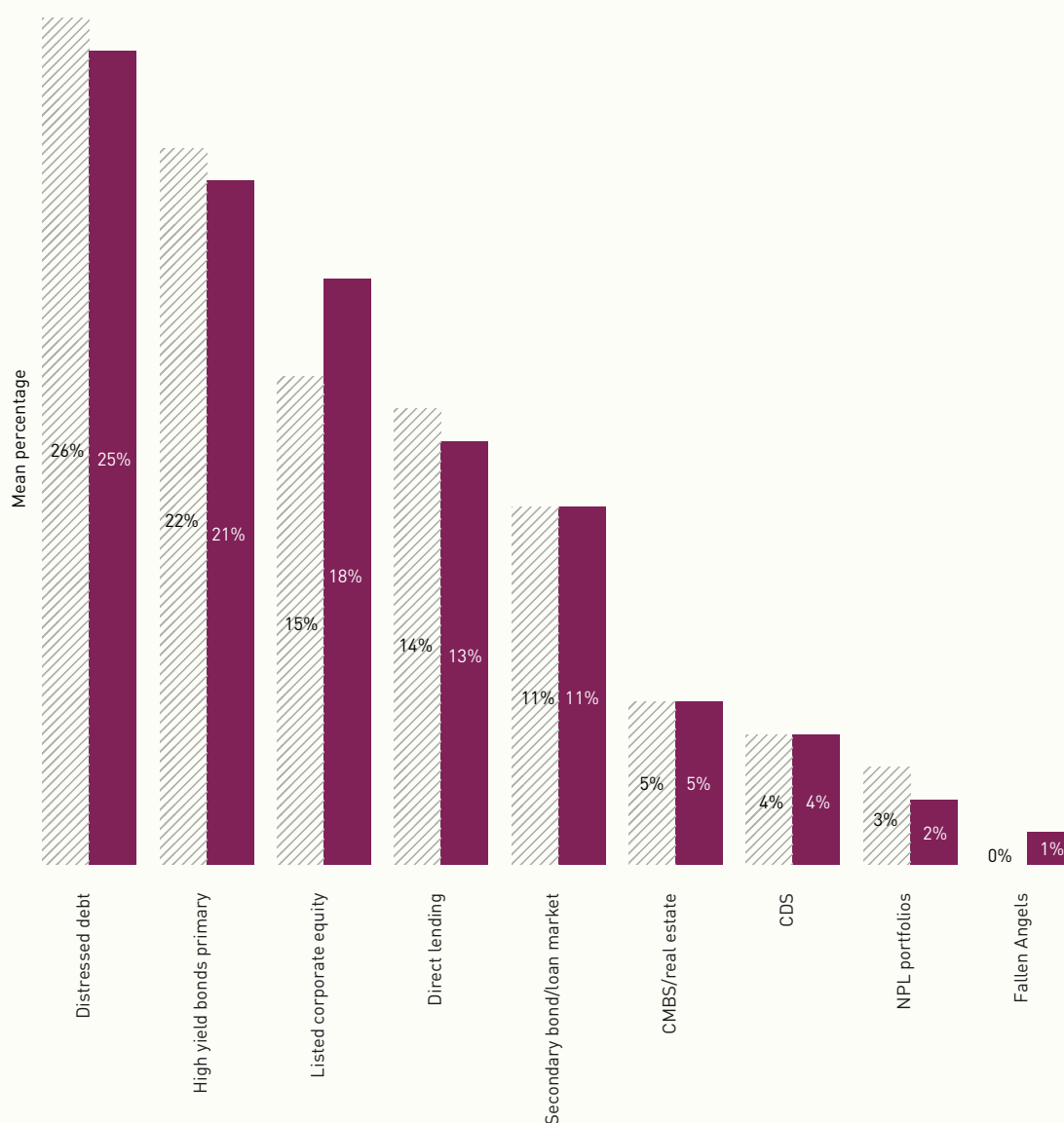
By comparison, respondents had invested in high yield bonds (35%), listed equity (31%) and distressed debt (28%) during 2015 and planned to deploy their capital in high yield bonds (35%), distressed debt (31%) and listed equity (30%) in 2016.

As far as capital deployment is concerned, the majority will maintain the same habits in 2016 and 2017. The average percentage allocation to distressed debt remains consistent across the two years – 25% and 26% respectively. The same is true of allocation to the high yield bond market (21% and 22% respectively). The figures are similar to last year; however, distressed debt has moved from third to pole position.

Key:

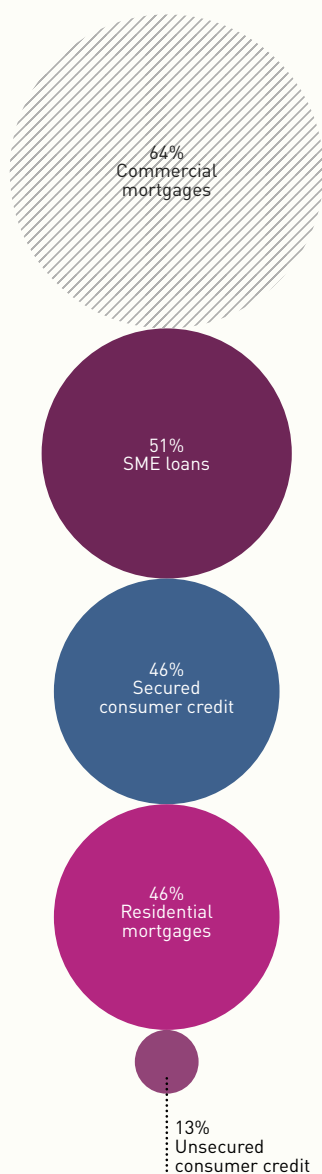
2017

2016



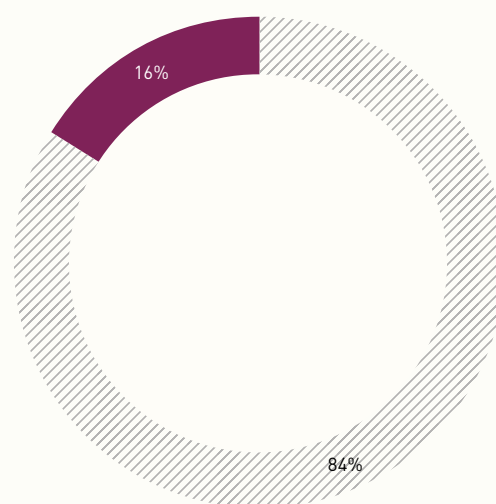
Q If you invest in NPLs, what kind of NPLs do you invest in?

Of those who do, the largest share (64%) invest in commercial mortgages, followed by SME loans (51%), secured consumer credit (46%), residential mortgages (46%), and unsecured consumer credit (13%).



Q Have you increased your asset allocation to distressed investing in the last 12 months?

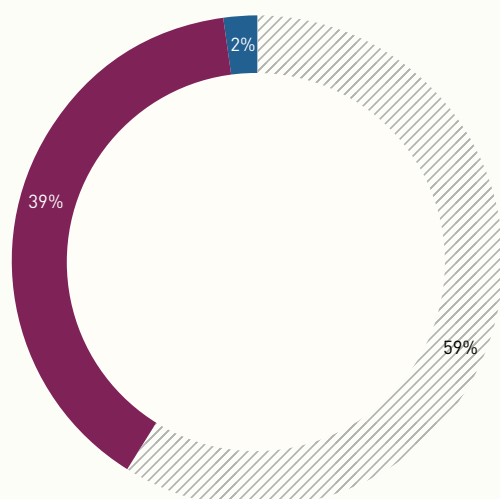
A large majority of respondents (84%) have increased their asset allocations to distressed investing in the last 12 months, with just 16% decreasing their allocations – which is in line with last year's survey. "The number of distressed opportunities to invest in has increased," a Germany-based proprietary trader says.



Key:

- ▨ Yes
- No

Q What do you expect to happen to your distressed allocation in 2017?

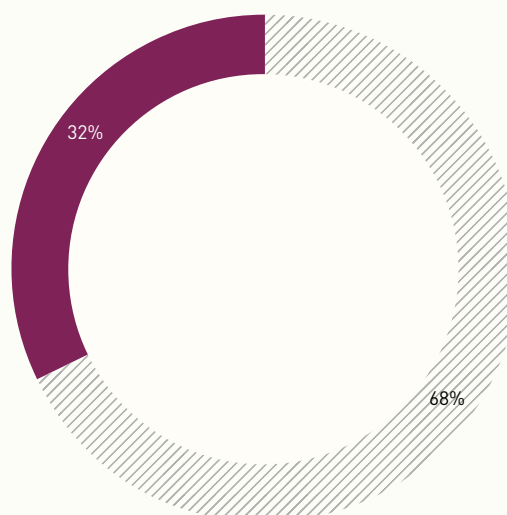


Key:

- /// Increase
- Stay the same
- Decrease

Some 59% of respondents expect to increase their allocation to distressed investments in 2017, 39% to maintain it and just 2% to decrease it. That broadly mirrors last year's results when 61% planned to up their allocations, 35% maintain it and 4% decrease it.

Q Are you actively raising funds to invest in distressed debt?



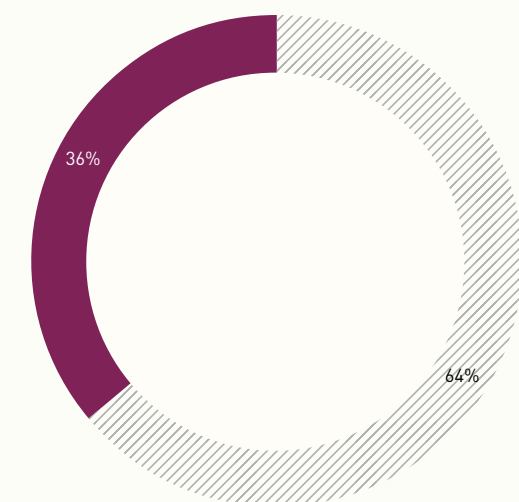
Key:

- /// Yes
- No

Over two-thirds of respondents (68%) are actively raising funds for distressed debt, a marked increase from this report's 2016 edition, when 57% of respondents were doing so.

"Our distressed allocation ratio is already high, and to fulfil that we will source funding options," the CEO of a Switzerland-based proprietary trading firm says.

Q Do you anticipate tougher fundraising conditions in 2017?



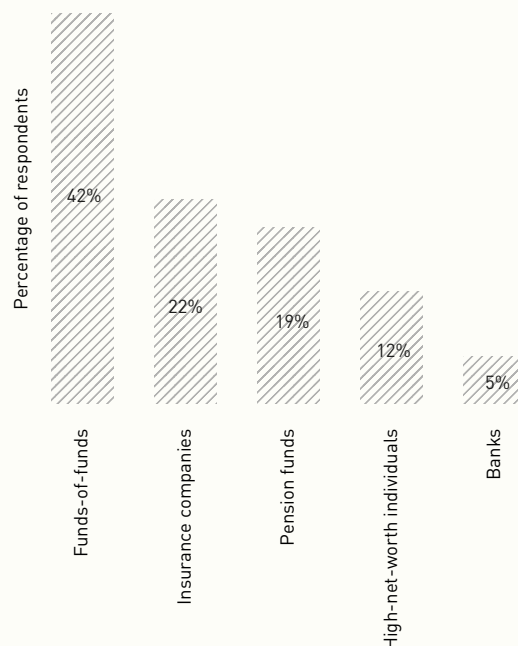
Key:

 Yes
 No

Sixty-four percent of respondents anticipate a tougher fundraising climate. This percentage has edged up from last year's edition of the report, when 54% foresaw more challenging fundraising conditions.

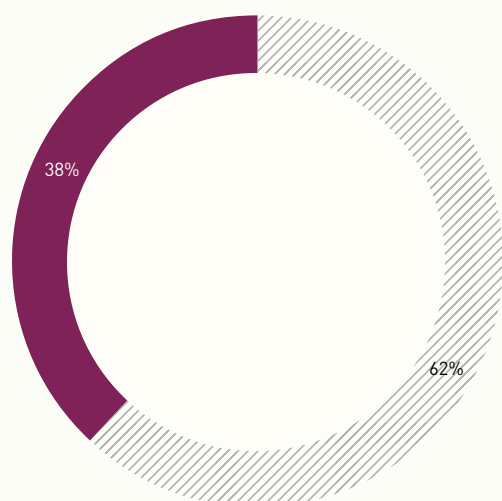
"Competition is still very high, this will increase risks and make it difficult for us to invest in distressed debt," a Germany-based hedge fund executive says. "Raising funds will also be tough because investors are less open to investing in debt or investing in general."

Q Which source do you expect to represent the largest investment in distressed funds in 2017?



Respondents increasingly expect funds-of-funds to make the largest investments in distressed funds in 2017, with 42% versus 33% last year. Interest from insurance companies appears to be on the decline with 22% of respondents saying that they would be the busiest investors in 2017, versus 32% in 2016. Pension funds are expected to play a bigger role this year (19%), pushing high-net-worth individuals (12%) into fourth place from third last year.

Q Do you expect it to be more or less difficult to source distressed opportunities in Europe in 2017?



Key:

 More
 Less

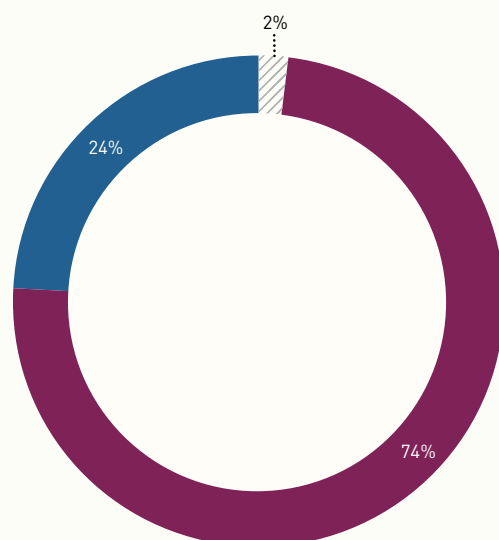
Respondents expect distressed opportunities in Europe to be more difficult to source in 2017, with 62% expecting opportunities to be scarcer versus 50% last year.

Businesses domestically and internationally are looking at expanding their presence through distressed acquisitions as valuations are significantly low, notes a CEO of a Swiss prop trading firm.

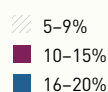
"Interesting that whilst the survey results show a greater willingness to allocate capital to distressed investments (and a greater willingness to raise capital for this purpose) but that respondents believe sourcing debt is going to be harder. Is this a recipe for mispricing of distressed opportunities as more capital chases fewer opportunities?"

—Saam Golshani, Orrick Partner,
M&A and Restructuring, Paris

Q What percentage return have you achieved in 2016?

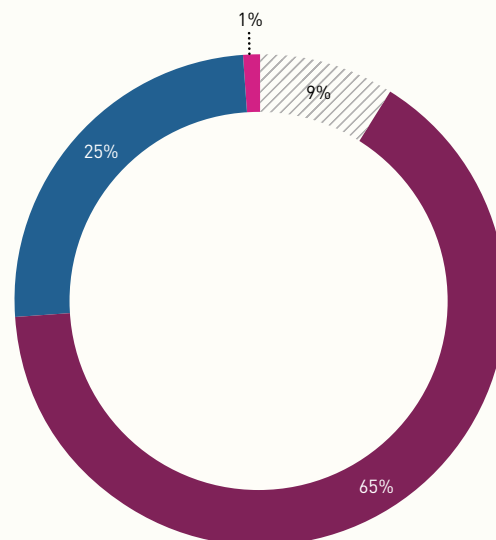


Key:



Three-quarters of respondents achieved returns of between 10-15% in 2016, and 24% delivered 16-20% returns. This was a modest reduction in performance from 2015, when roughly 69% of respondents achieved 10-15% returns, and around 31% delivered 16-20% returns.

Q And what was your Sharpe ratio?



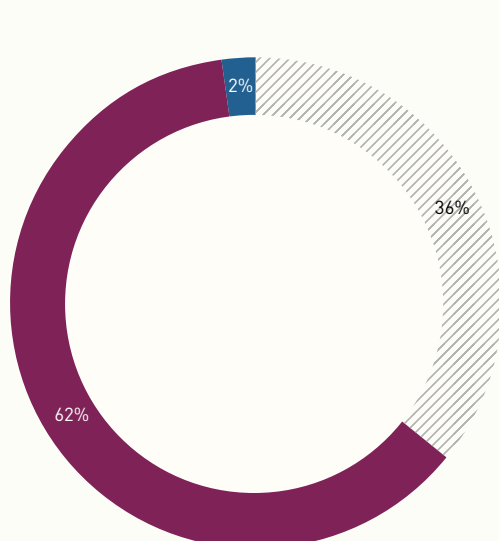
Key:



The majority of respondents (65%) had a Sharpe ratio between 10% and 15% during 2016, with a quarter of respondents between 16% and 20% and 9% scoring ratios of between 5% and 9%.

Several respondents note that, due to market volatility, their Sharpe ratios fell short of expectations.

Q What percentage return do you expect when investing in distressed debt in 2017?



Key:

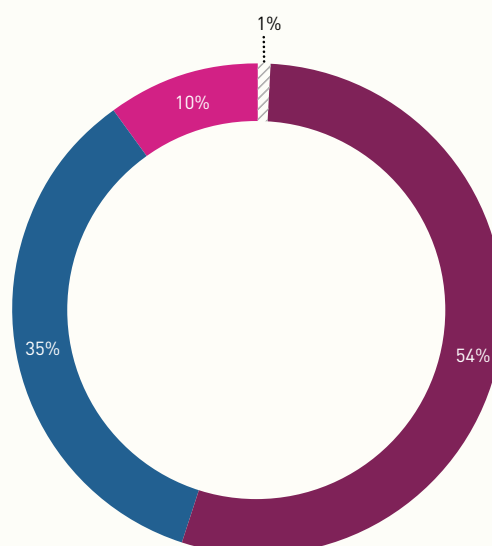
// 10-15%
 ■ 16-20%
 ■ 21-30%

Respondents scaled back their expectations for distressed debt returns for this year. While 73% of 2016's respondents anticipated returns of between 16% and 20%, only 62% of this year's participants say the same, while the percentage of respondents anticipating returns between 21% and 30% has grown from 27% in 2016 to 36% in 2017.

"It always strikes me that in a very low interest rate/low default rate world, the return expectations are so high for distressed debt funds and it is no surprise that expectations have, rightly in my opinion, being scaled back. It tends to be a market where there are super normal returns for brief periods of time and, for the rest of the time, investors need to stay disciplined."

—Stephen Phillips, Orrick Partner, Restructuring, London

Q What Sharpe ratio are you targeting?



Key:

// 5-9% ■ 16-20%
 ■ 10-15% ■ 21-30%

The largest share of respondents (54%) are targeting Sharpe ratios of between 10% and 15% to balance risks with rewards.

A further 45% are aiming at more ambitious Sharpe ratios of between 16% and 30%.

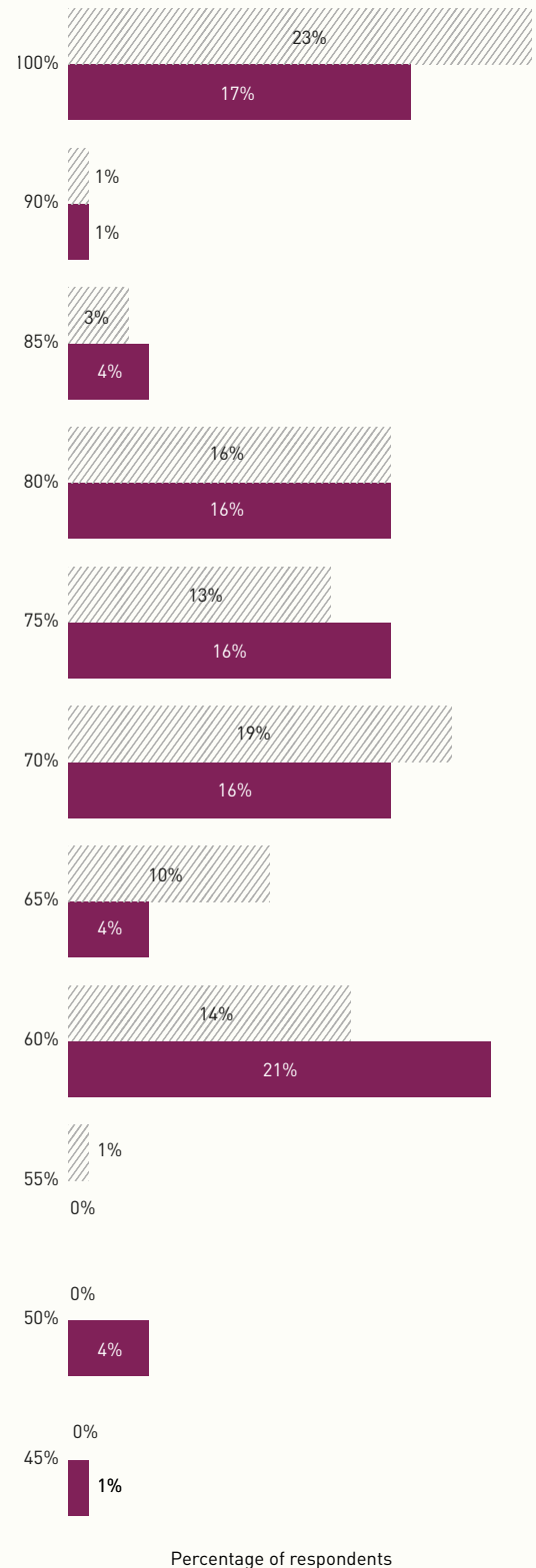
"Our targets are to ensure that the returns we make are high. We have developed our investment strategies in a way that we are not exposed to any real risks and are able to make necessary changes to our investments," a London-based hedge fund manager says.

Q What percentage of AUM are currently invested and what percentage do you expect to have invested in 12 months?

Respondents are clearly planning on investing more of their assets over the next year. For example, 17% currently are 100% invested, but 23% expect to be a 100% invested in the next 12 months. Some 5% of interviewees currently have 50% or less of their assets invested, but no respondents plan on having less than half of their assets invested in the next year.

"We perceive that investors that are able to sit on cash are waiting for the market to correct before investing."

—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill



Key:

▨ In 12 months ■ Currently invested

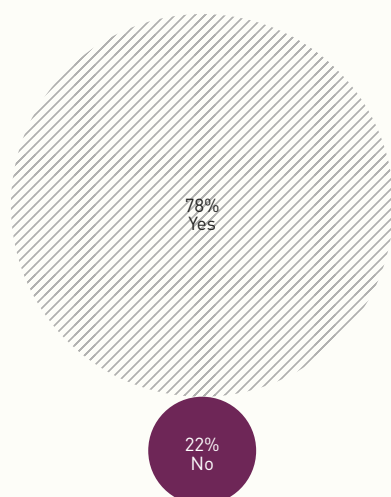
Q Do you seek equity control of companies via a 'loan-to-own' strategy?

Over three-quarters of respondents (78%) seek equity control of companies via loan-to-own strategies. This is a marked increase from last year, when only 57% said that they planned to do the same.

"We need to make sure we have a controlling stake in the company. This will help us find a buyer and exit the company without any legal or managerial problems later on," an Italian CEO of a hedge fund says.

"More and more investors see a loan-to-own strategy as the best alternative to create real value. This is particularly true in Continental Europe, where banks have been unable to drive corporate turnarounds."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill



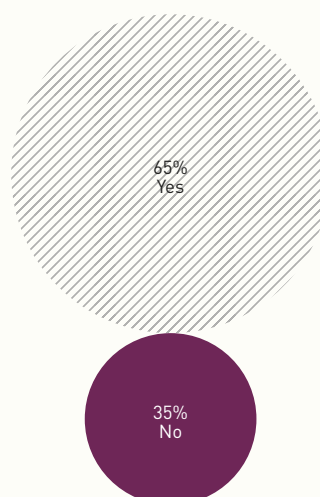
Q Do you think acquiring a blocking stake will be the key to loan-to-own strategies in 2017?

According to 65% of respondents, acquiring a blocking stake is key to loan-to-own strategies in 2017, an increase from last year when 59% considered blocking stakes essential.

"Blocking stakes are a strategy that an increasingly large number of hedge funds and PE companies have been using," a Germany-based prop trader notes. "Blocking stakes stop management from getting more than one investor into a company, thereby reducing the complexities of a deal at the time of an exit."

"In any review of a capital structure of a corporate debtor we do for a client, we emphasise the various key voting thresholds for certain corporate actions by stakeholders, either under the documents or as required under a process. Distressed investors must be aware of the thresholds to avoid surprises."

—Stephen Phillips, Orrick Partner, Restructuring, London

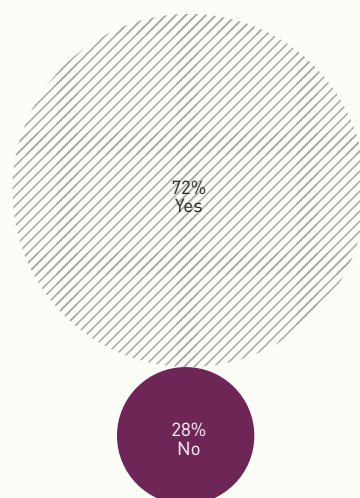


Q Do you expect an increase in the number of investors intent on acquiring control through equitisation in 2017?

At 72%, a clear majority of respondents expect to see an increase in the number of investors who want to acquire control through equitisation. As with last year's survey, respondents say that this strategy gives investors greater management control, which they believe will help achieve greater returns and make an exit smoother.

Still, this is a notable drop-off from last year's survey, where 90% of respondents predicted the same.

"There will not be an increase in the number of investors making companies public," one respondent says. "The risks of carrying out an IPO are very high under current market conditions. Hedge funds will avoid taking on these risks and will instead look for strategic buyers instead."



Q What are the key metrics you are tracking to determine potential investment opportunities? (Please rank top 3, 1= most important)

While the most respondents (62%) use financial ratios to some degree to track and determine potential investments, the largest share of respondents (30%) say that economic trends and performances by geography and industry are the most important metrics, followed by price movements (19%). This mirrors last year's report, when the most respondents said that they used financial ratios, but the greatest share of respondents said that economic trends and price movements were the most important.

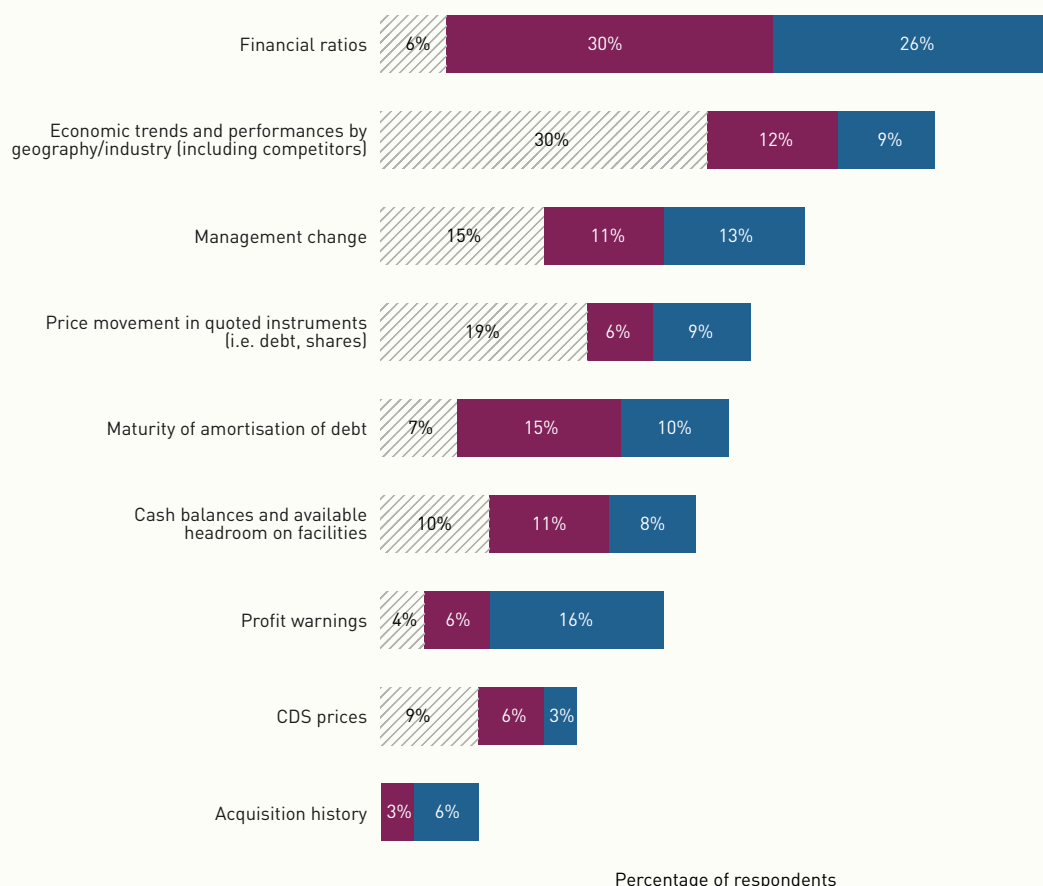
"The best indicators of how a company will perform are the economic trends – we depend on these to understand the market and how businesses in a sector are performing," an Italy-based hedge fund executive says. "We also look at the financial ratios to understand the debt that a company has and how efficiently it will perform and reduce debt."

"Our market screening of course starts with a sector thesis and quantitative analysis, but in reality quickly moves to qualitative, case-by-cases analysis. Without the latter, the numerical data has little analytical value. The process still depends on traditional news sources and word of mouth rather than social or other forms of new media."

—Anthony Rawlinson, Financing Advisory and Restructuring, Greenhill

"When we speak to clients as to how they find opportunities, we often see them getting interested in a sector, doing a deep dive and then tracking the key companies. There is a mixture of an opportunistic approach and a methodological one. Being prepared when the right investment comes along is key."

—Saam Golshani, Orrick Partner, M&A and Restructuring, Paris



Key:

1 2 3

Q What are your key sources of origination for distressed debt opportunities?

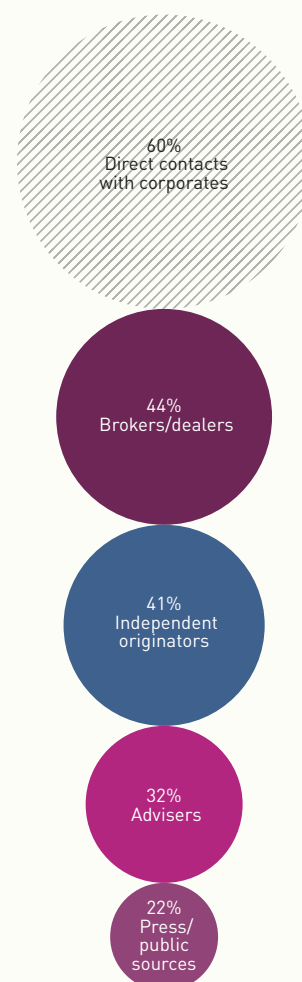
The lion's share (60%) of respondents use direct contacts with corporates to source distressed debt opportunities, followed by brokers or dealers (44%), independent originators (41%), advisers (32%) and the press or public sources (22%).

"I always stress to my colleagues that we should be looking for opportunities for our clients. We always want to bring interested parties together; it should be part of any good adviser's DNA whatever discipline they practice in."

—Raniero D'Aversa, Orrick Partner, Restructuring, New York

"We focus on corporates and their shareholders but receive many leads from hedge funds that value our ability to unlock situations for the benefit of the corporate which has a positive impact on all stakeholders."

—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill



Q What are the main issues preventing your investment in distressed debt opportunities? (Please rank top 3, 1= most important)

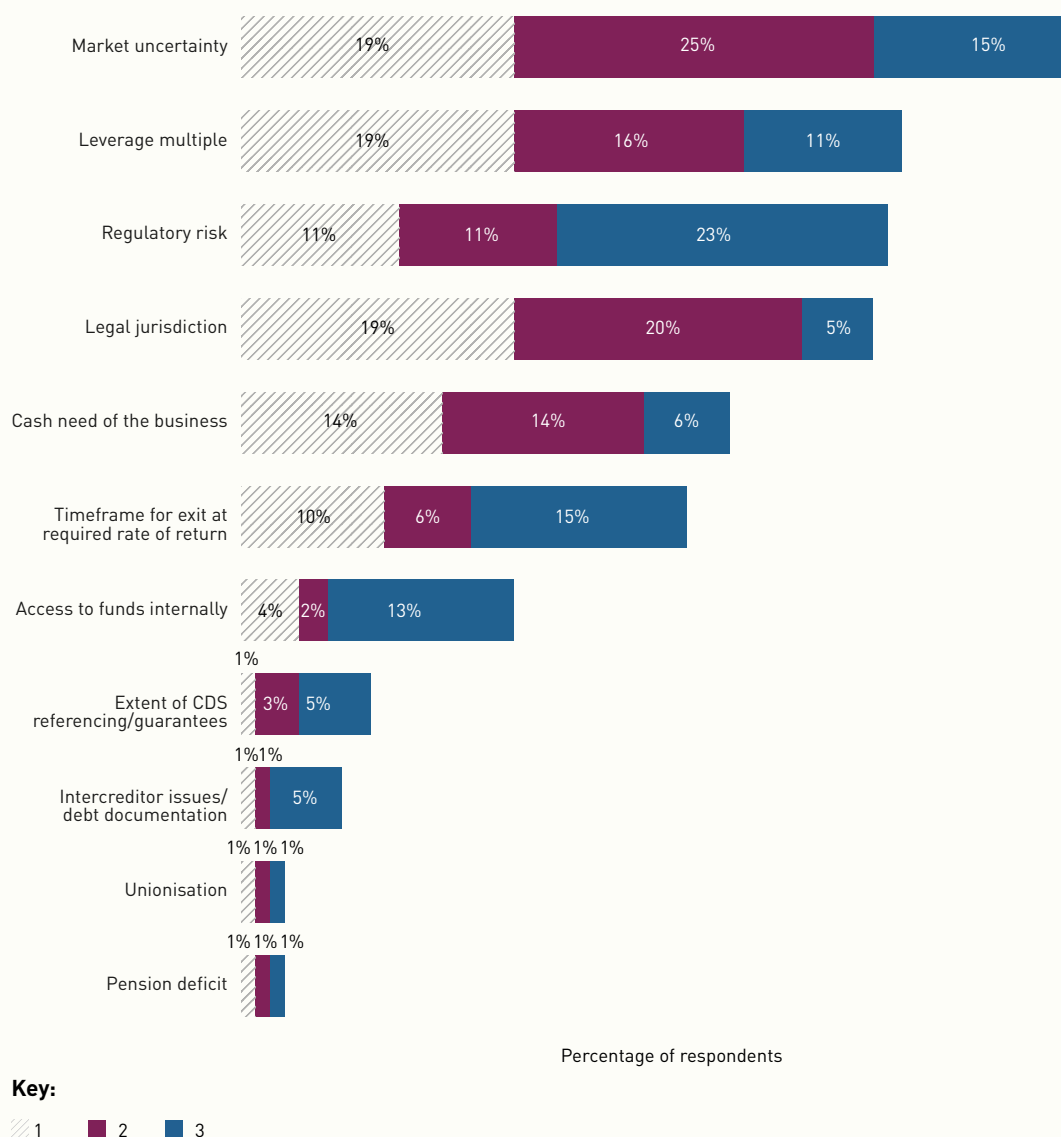
Market uncertainty remains the main deterrent to investing in distressed debt, with 59% of respondents citing it as a reason and 19% as the most important reason, which was roughly in line with last year's findings. But prospective investors have become a lot more sensitive to leverage multiples, with 19% selecting it as the main reason and 46% as one of the main reasons to hold back, compared to 14% as the main reason and 30% as one of the reasons in last year's survey.

"Getting returns is a concern. We invest only to exit when we get the amounts we expected, but we also invest over a short period of time," comments a Switzerland-based prop trader.

A Greece-based prop trader says, "There are many legal problems that have interfered with our investment strategies and have prevented us from making the investments we wanted. We have had to reduce the amounts we invest in distressed businesses."

"There is still a strong preference for Northern European countries and more liquid investments, but the limited number of opportunities is driving investors to more complex situations, more illiquid instruments and more challenging jurisdictions."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill



Q What level of yield do you consider 'distress'?

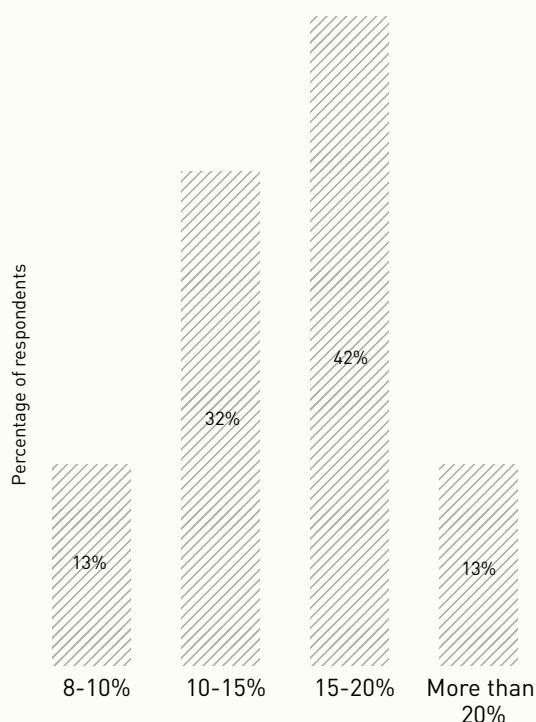
Some 32% of respondents consider that yields between 10-15% constitute distress, while 42% believe it is above 15-20%. Some 13% think returns of more than 20% represent distress, down from 31% last year.

"As the cycle changes, the perception of what yield constitutes distress often changes dramatically."

—Saam Golshani, Orrick Partner, M&A and Restructuring, Paris

"Many situations we consider challenged are currently yielding single-digit returns, thereby suggesting that the market is overvaluing assets."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill



Q In January 2016 the BRRD came into effect, providing European regulators with a bank resolution tool. Will this fix the 'too big to fail' problem?

At 81%, respondents resoundingly agree that the BRRD will help to fix the 'too big to fail' problem. Respondents' comments largely focused on the BRRD helping banks to reduce debt and stay afloat, versus having an impact on their size or ability to fail.

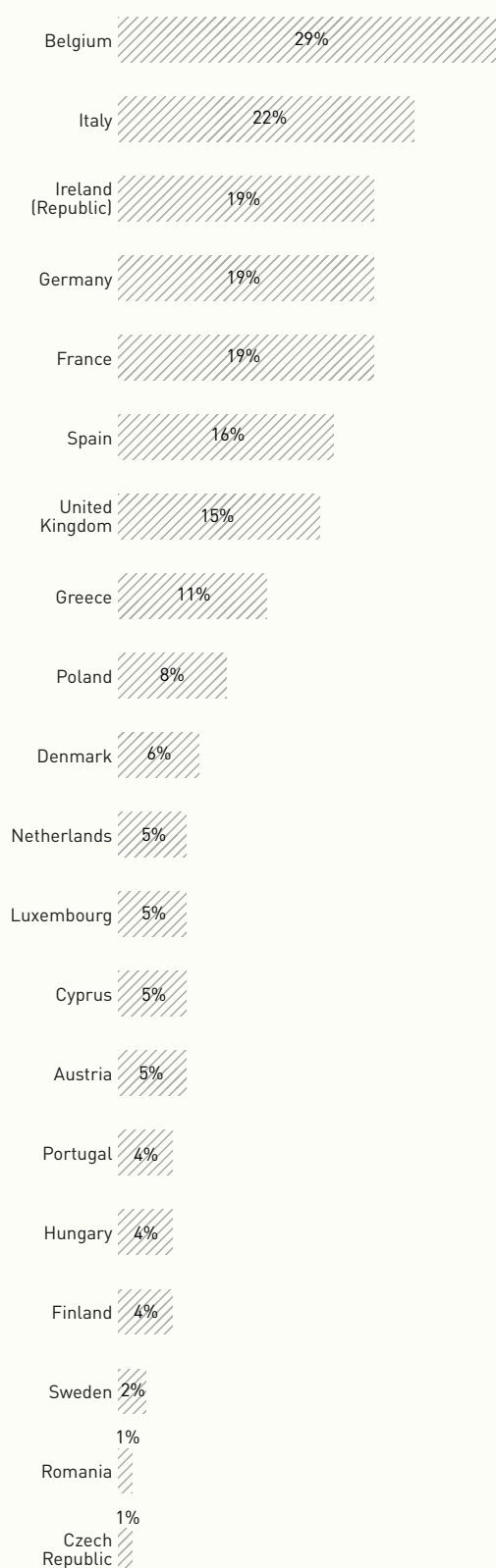
"The presence of many retail bondholders who also have bank accounts held with the issuer has complicated the authorities' use of the BRRD in Italy. The BRRD should not be seen as a silver bullet, but it provides a helpful, if controversial, starting point."

—Madeleine Horrocks, Orrick Partner, Structured Finance, Milan



Q Which countries do you expect to make use of the tool the most? (Select the top two from the list of EU countries)

The largest share of respondents (29%) point to Belgium as the country that will use the BRRD the most, likely because Belgium has already made early use of several of its provisions. Italy was next at 22% followed by Ireland, Germany and France all tied in third place at 19%.

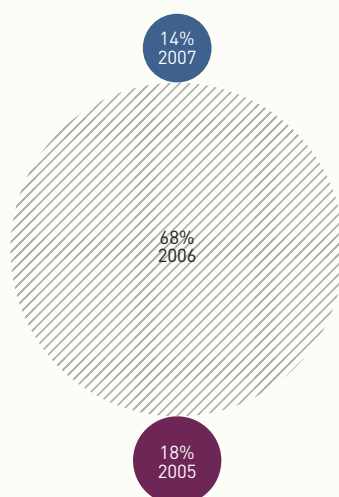


Q Looking at where we are in the current credit cycle, would you judge the current conditions to be most similar to 2005, 2006 or 2007?

The largest share of respondents (68%) see current credit conditions as most analogous to those in 2006. This is in line with last year's survey when 63% thought conditions matched 2006.

"The current credit system is very similar to the way it was in 2006, because investors were very worried then and were investing small amounts in different sectors," a London-based prop trader says.

Just 18% of respondents say current conditions mirror 2005, and 14% that they mirror 2007.



In Q4 2016, Debtwire interviewed 50 PE executives to gain insight into their views on restructuring, the current state of the market, and their expectations for the coming year.

The interviews were conducted by telephone and respondents were guaranteed anonymity. The results are presented in aggregate.

Q What percentage of your portfolio underwent some form of financial restructuring in 2016?

Respondents in this year's survey report much larger shares of their portfolios undergoing some type of restructuring in the past year. While no respondents in last year's edition reported restructurings in more than 60% of their portfolio, 4% of respondents do so this year. Further, while nearly a quarter of last year's respondents (23%) reported low levels of restructurings – in 10% to 20% of their portfolios – only 4% of this year's respondents say the same.

A Swiss-based partner points to the harsher macroeconomic climate as the cause: "With the slowdown in the Chinese market, and the problems in the EU and Brexit, a few of our portfolio companies have been performing very badly, growth has been slow and our returns have been hit very hard. Because of this, we had to carry out restructurings because our companies needed to stem losses."

"The increase in largely behind-the-scenes restructuring events at many sponsor companies is a lead indicator of more restructuring to come in the next two years across both sponsor-backed and corporate assets."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

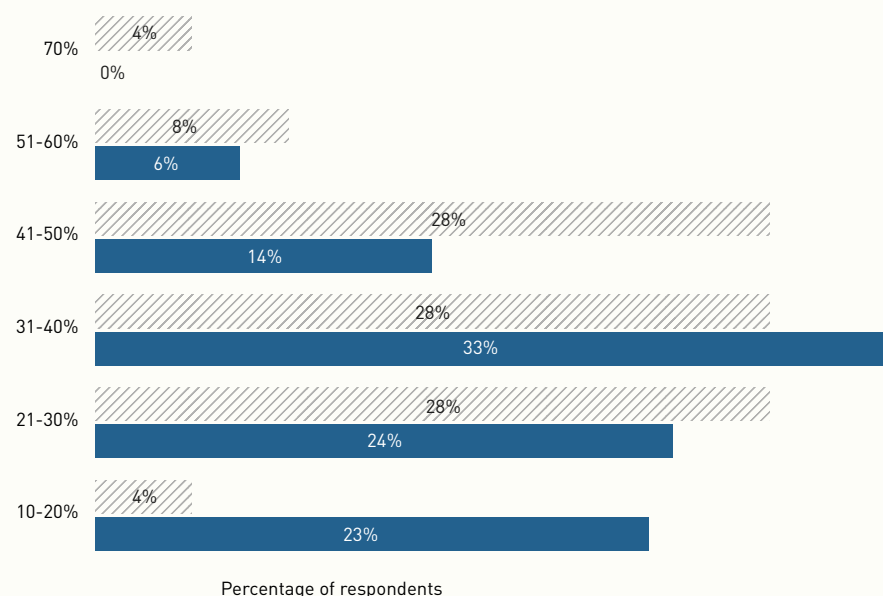
"It is testament to the dexterity of PE houses that whilst the default rate remains low there is a lot of restructuring activity going on under the surface which forestalls full-blown problems."

—Shawn Atkinson, Orrick Partner, Technology Companies Group, London

Key:

2016

2015



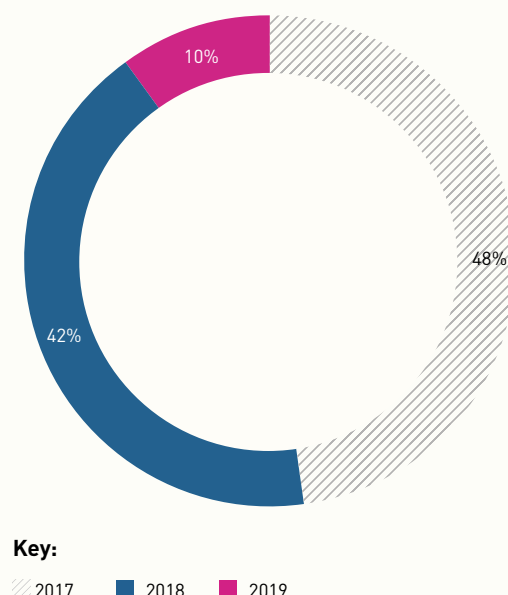
Q When do you expect the volume of European restructurings to hit its next peak?

The largest share of respondents (48%) expect that the volume of European restructurings will hit its next peak in 2017. A 'perfect storm' of macroeconomic factors will result in 2017 seeing a spike in restructurings, according to a London-based partner: "European restructuring activity will increase overall in 2017. The current economic slowdown and the sluggish growth along with the geopolitical worries, weaker high yields and the current oil & gas price fall will all contribute."

Yet, the majority of interviewees believe that the next peak is not imminent, with 42% expecting it in 2018 and 10% in 2019. Still, some of these respondents believe that worsening conditions in 2017 will lay the groundwork for the coming years. "The next peak will be reached over a period of time. We expect growth to slow next year, and an increase in interest rates. This will be bad for the market and will make accessing loans harder. To perform and get capital, companies will have to eventually restructure," says the head of investment at a Nordic PE firm.

"Whilst distressed debt investors are marginally more pessimistic for 2017 (or optimistic, depending on your view), both creditors and debtors are agreed that there will be an increase in restructuring activity and the difference in outlook is the timescale."

—Saam Golshani, Orrick Partner, M&A and Private Equity, Paris



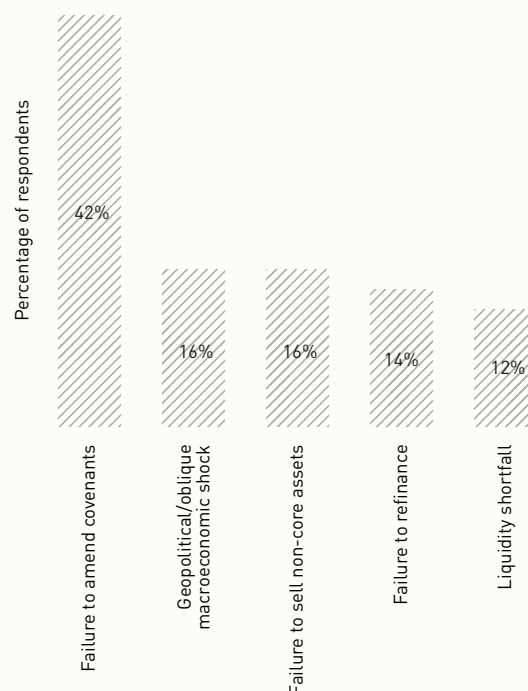
Q What do you expect to be the single largest contributing factor to trigger restructurings for PE portfolio companies?

According to 42% of respondents, the main factor triggering restructurings is the failure to amend covenants. This is a noticeable departure from last year's edition, when only 13% cited this. A Swiss partner explains how not being able to re-write covenants has become increasingly problematic: "Without being able to re-write covenants, companies have had to restructure to get capital and have even had to carry out asset sales. PE companies have not always been successful in carrying out an amendment in their contracts and this has resulted in issues for portfolio companies."

This is followed by geopolitical/oblique macroeconomic shock (16%), failure to sell non-core assets (16%), failure to refinance (14%) and liquidity shortfalls (12%).

"Liquidity is the ultimate trigger for a restructuring. Covenants provide an opportunity for creditors to get a seat at the table and potentially force the company to review options, but of themselves are unlikely to trigger a fundamental course of action. It is important for sponsors to engage early, before a breach, so as to lead the negotiation without their back against a wall."

—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill



Q What is the likelihood of the following macroeconomic factors driving a European restructuring wave next year?

All respondents believe that Brexit is likely (10%) or highly likely (90%) to trigger a European restructuring wave in 2017. This is followed by rising interest rates, with 70% believing it is highly likely to spur restructurings, EU political instability (66%), systemic bank default (64%) and inflationary pressure in the Eurozone (56%).

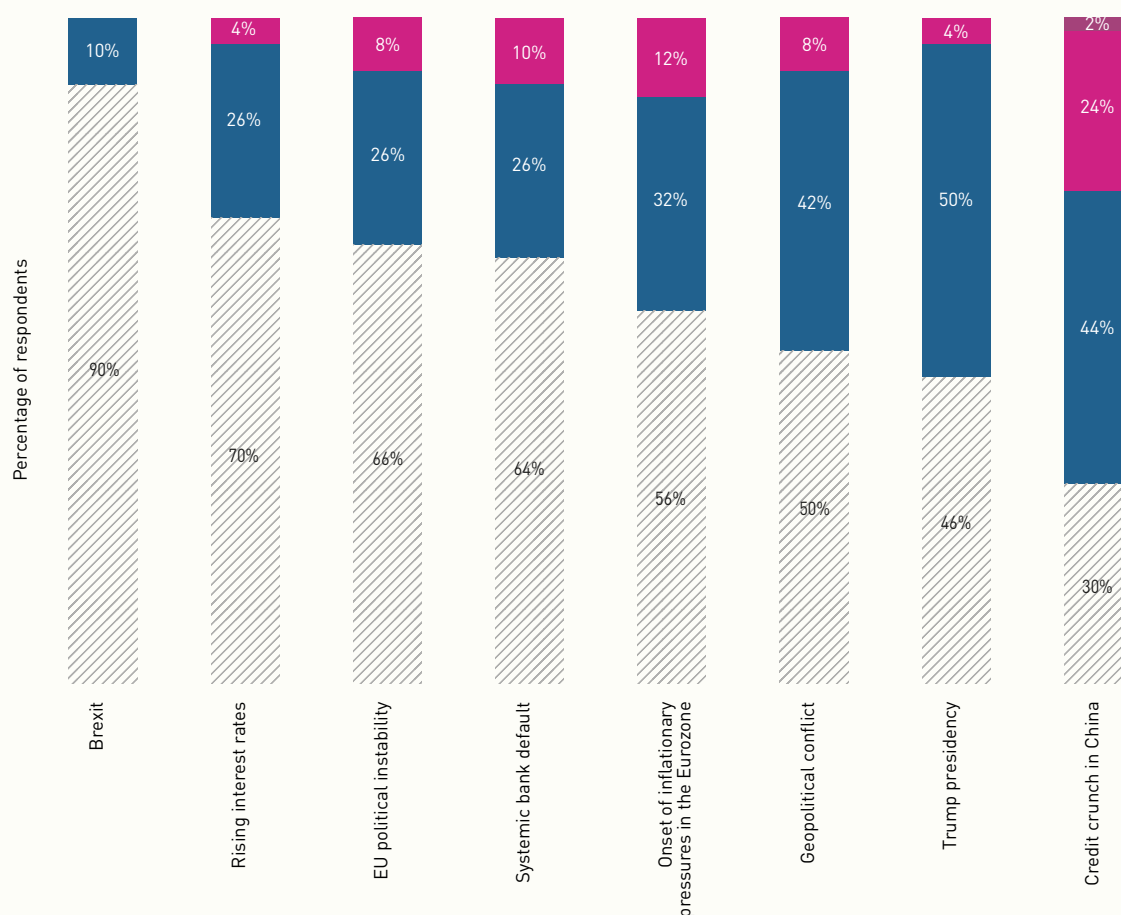
"An end to QE and rising interest rates are going to be big factors in 2017; Brexit will have to go very wrong to trigger a problem across Europe."

—Stephen Phillips, Orrick Partner, Restructuring, London

A UK-based partner describes how a confluence of these factors will likely result in increased restructuring activity. He states: "Many macroeconomic problems already exist and will only increase next year. In the coming year, there is no hope of improvement, which is why we will see more restructurings. These include high interest rates, EU political instability, the impact caused by Brexit and geopolitical conflicts. The Chinese economic slowdown would also be a reason for this as European trade and economy will also be impacted."

Key:

Highly likely Likely Probable Not likely



Q What is the greatest challenge to completing financial restructurings?

At 38%, the largest share of respondents say that business models that are unworkable in the current climate are the biggest challenges to completing restructurings. This closely mirrors last year's survey, when 34% of respondents said the same.

Following at a distance, other challenges include divergent creditor attitudes (16%), lender perception of sponsors' available funds/track records (14%), availability of funds (14%), low valuations (10%) and lack of proper restructuring tools (8%).

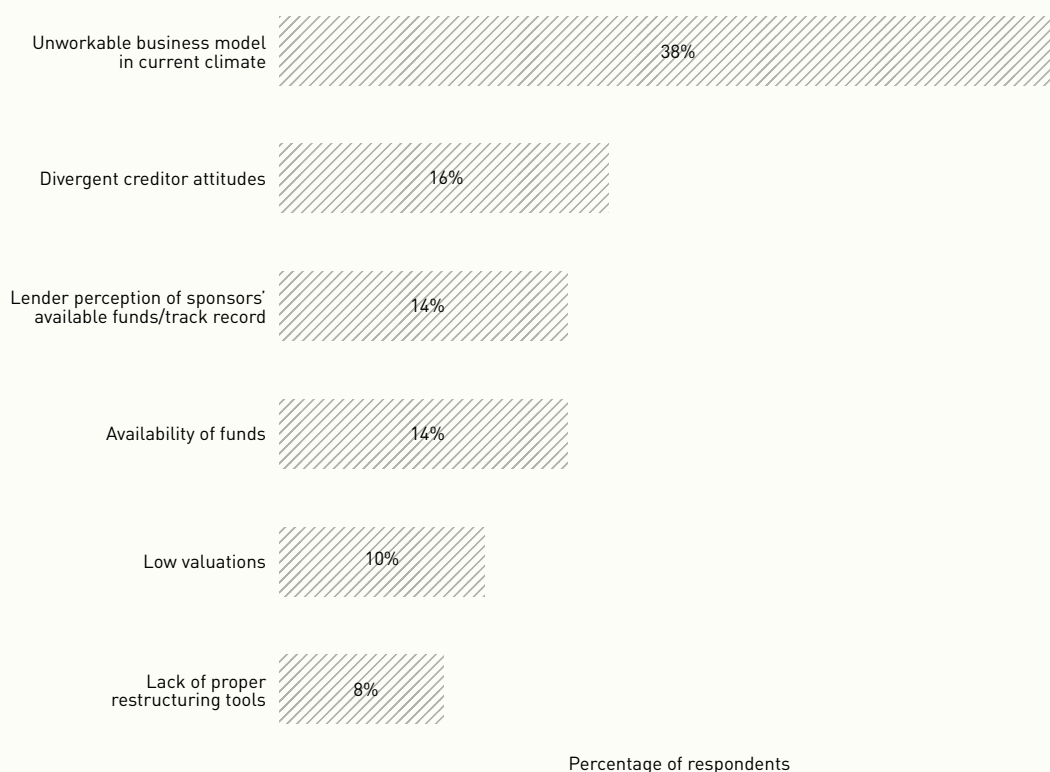
Although only 10% of respondents point to low valuations as an issue, a number go on to comment on the situation. For instance, a Sweden-based managing partner notes: "The cost of our assets has been on the lower side because of the market's performance. Getting buyers to acquire our assets has not been simple. Because of this our capital base has shrunk."

"There are a number of jurisdictions in Europe, perhaps the majority, where shareholder 'cram down' is hard. Personally, I would have thought the 'lack of proper restructuring tools' should come higher in the list."

—Stephen Phillips, Orrick Partner, Restructuring, London

"In many jurisdictions shareholders have a role to play. They can extract significant value and concessions if they play their hand well."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill



Percentage of respondents

Q Which two main lessons has the private equity industry learned from restructurings completed in 2016?

According to the largest share of respondents (26%), the most important lesson learned from completing restructurings in the past year was to build a relationship with their syndicates. This is a marked change from the previous edition of the survey, when only 10% said that this was the most important lesson.

This is followed by 'work on contingency plans', with 22% saying this is most important. This is also an increase from last year's survey, in which 7% pointed to this factor as most important. A Germany-based managing partner explains the increasing relevance of contingency plans in the current market. "Having a contingency plan for when the market starts underperforming is crucial. Companies have not had these plans in place, and when market conditions deteriorated they have had problems growing," he notes.

"Contingency planning is critical to avoiding messy, value-destructive restructuring processes. These processes are often complicated by approaching creditors too late, limiting the options available to debtors and their shareholders."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

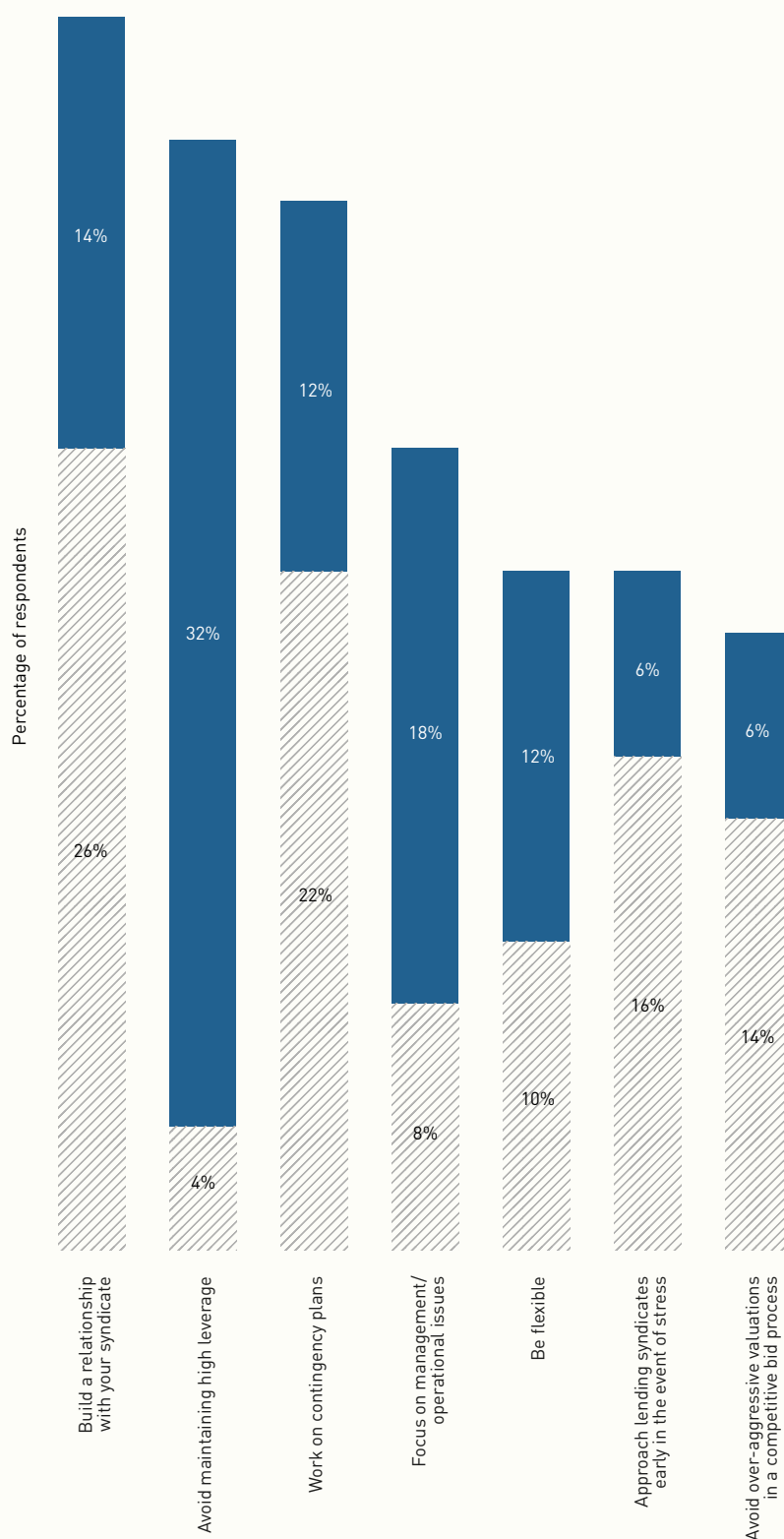
"Whilst maintaining relationships with syndicate members is key in bank facilities, it has little relevance in a bond context – debtors have to find a way of forging relationships with bondholders in high yield restructurings, which is often less chartered territory for management."

—Nell Scott, Orrick Partner, Corporate, London

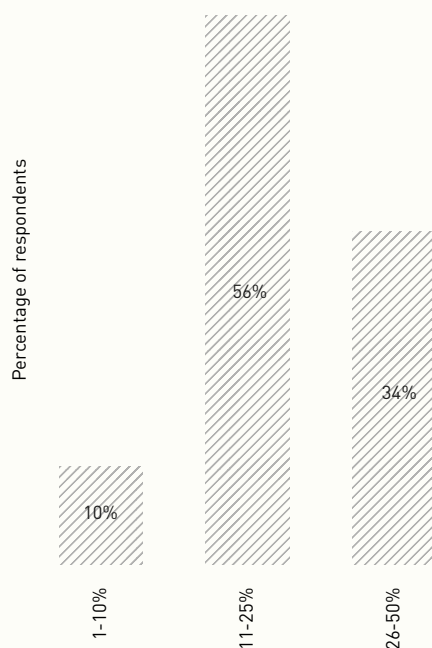
Key:

Most important

Second-most important



Q What percentage of your portfolio companies have you injected additional equity into in 2016?



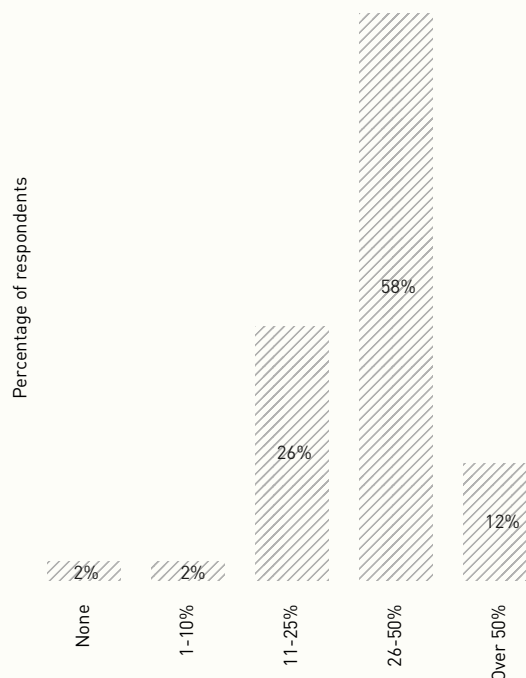
When asked what percentage of their portfolio companies have received capital injections in 2016, the majority of respondents (56%) say between 11% and 25%. Thirty-four percent of respondents injected equity into 26% to 50% of portfolio companies. This roughly mirrors the previous edition of this survey, in which 47% of respondents injected capital into 11% to 25% of portfolio companies, and 27% of respondents into 26% to 50% of their portfolios.

A Frankfurt-based partner discusses why the percentage of companies receiving capital injections continues to be quite high: "We have had to inject capital into quite a few of our companies to help them restructure and to get capital. The market has been growing at a very slow pace and there is a lack of investors and investment options."

"New money is a powerful tool in a restructuring and can give significant leverage to shareholders. The market is evolving and there are more and more options also available to sponsors that run out of dry powder but want to retain control. Debtors and their shareholders need to carefully plan the negotiation and act ahead of an event that could limit this control."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

Q What percentage of your portfolio companies will you have to consider injecting additional equity into in 2017?



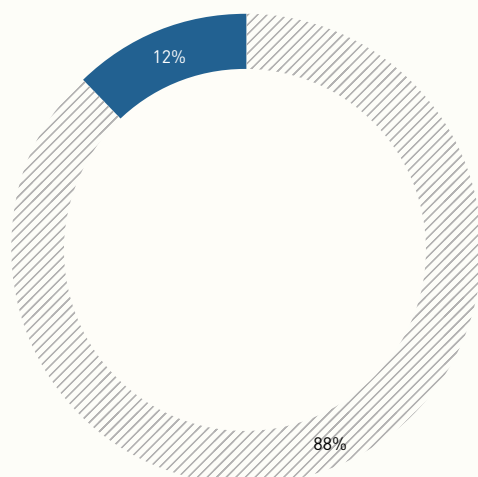
Most respondents (58%) say that they will likely consider injecting equity into 26% to 50% of their portfolio companies in 2017, in order to strengthen their capital structure. This mirrors last year's report, when 60% of respondents said the same.

Still, findings from this year's edition of our survey point to worse health among respondents' portfolio companies. In this year's survey, 12% say they will consider injecting additional equity into over 50% of their portfolio companies. No respondents last year gave this answer. Further, only 2% of those interviewed this year say that they will not inject additional equity into any portfolio companies, compared to 7% last year. A Sweden-based executive highlights worsening market conditions as the reason behind increased equity injections: "We are planning on injecting more capital into our companies. We need to do this to help them grow and get better returns, and because they were not able to get capital from the market."

"The results surprise me as to the expected scale of the additional investment, we would have expected external debt to feature more as a funding source."

—Dominic O'Brien, Orrick Partner, Finance, London

Q Are you more or less likely to consider injecting additional equity in portfolio companies this year compared to last year?



Key:

- More likely to inject additional equity
- Less likely to inject additional equity

The lion's share of respondents (88%) are more likely to inject additional equity into portfolio companies this year relative to last year.

A slim 12% say that they do not plan on doing so. Still, these respondents had strong rationales for this. A Germany-based managing partner says: "For now, we are not planning on injecting any more capital into our portfolio companies, as we have already injected a lot and are running out of money to invest in them."

Q In a restructuring scenario, what are the main considerations when you review new investment in portfolio companies? (Rank 1-8, 1= the highest priority)

Respondents mainly consider two factors when reviewing new investments in portfolio companies during a restructuring scenario: the ability to obtain priority ranking on new monies (selected by 26% of respondents as the highest priority), and dry powder remaining in the fund (selected by 24% of respondents as the highest priority).

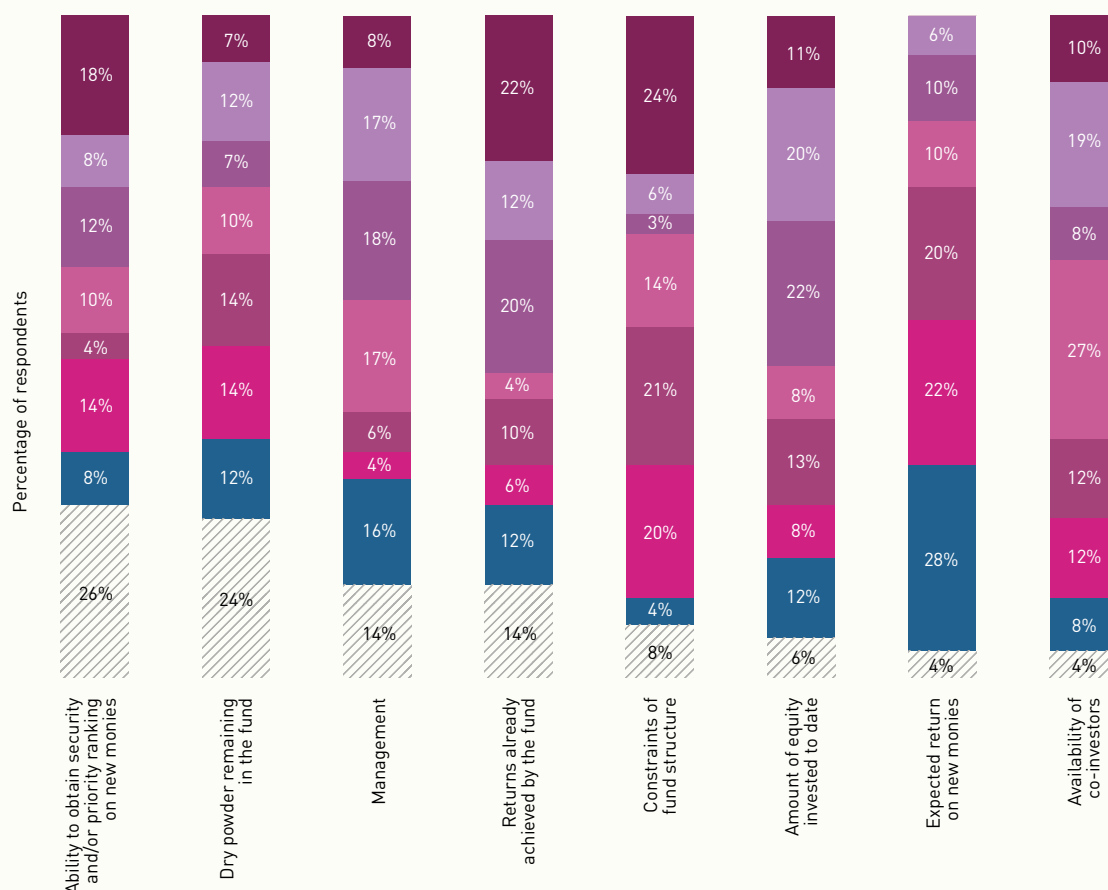
This is a moderate departure from last year's survey. While the largest share of respondents pointed to the ability to obtain priority ranking on new monies, the second largest share pointed to the amount of equity invested to date, which only 6% of the current respondents consider to be the highest priority.

"Creditor priority for new money is often a battleground. Existing lenders are loathe to see their priority eroded – the collapse of Afren plc is still raw for some lenders as it illustrated the example of the possible consequences for senior lenders of agreeing to a super senior facility coming in. At the same time the general rule is that new money is key and dictates terms in stressed scenarios."

—Stephen Phillips, Orrick Partner, Restructuring, London

Key:

1 2 3 4 5 6 7 8



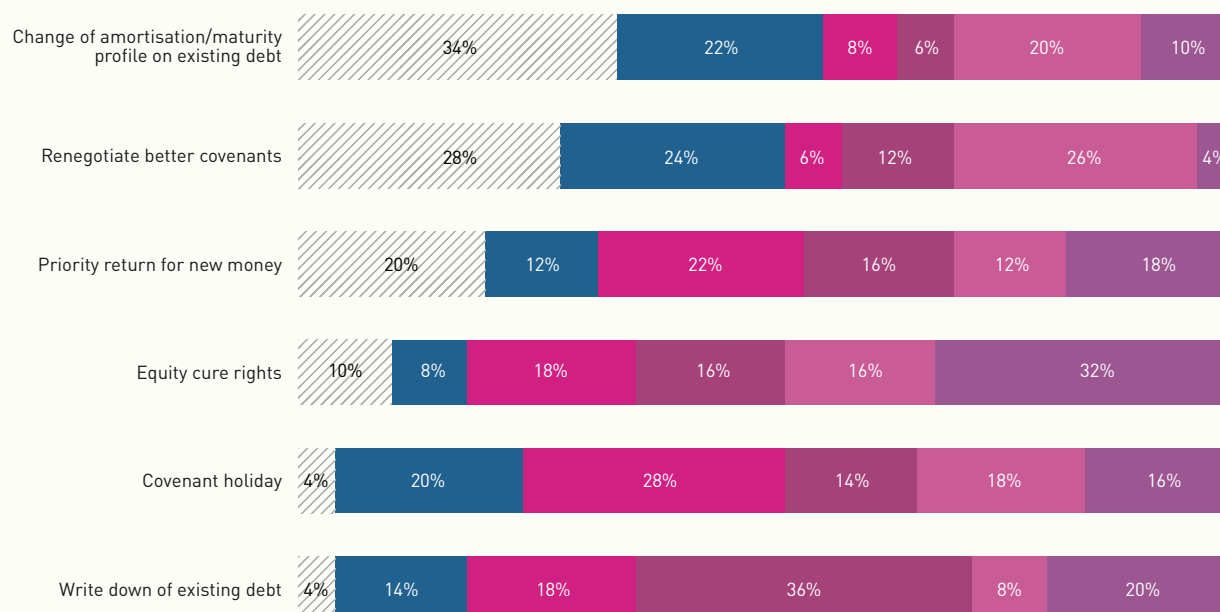
Q What leniencies do you expect from lenders in return for new money injections? (Rank 1-6, 1= highest priority)

The largest shares of respondents say that they are most likely to expect changes of amortisation/maturity profiles on existing debt (34%) and renegotiating better covenants (28%) in return for new money injections.

This roughly parallels last year's study, in which over a quarter of respondents pointed to both of these leniencies as the highest priorities.

Key:

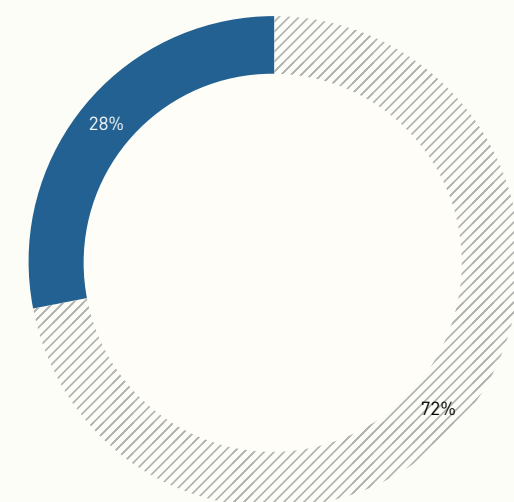
1 2 3 4 5 6



Q Do you expect lenders to be more open to write down/equitisation in 2017 vs. 2016?

Nearly three-quarters of respondents agree that lenders will be more open to write downs or equitisation in 2017 as compared to 2016. But it's worth noting that this is a decline from last year's edition, when 87% expected lenders to be more open.

Indeed, the 28% who do not expect lenders to be more amenable to write downs or equitisation were a vocal minority. A managing director at a Germany-based firm explains his view: "Lenders will not write down the amounts they have lent. They will, in fact, pursue their investments. We expect that companies will start performing better and investors will take advantage of this and will try to get back the amounts they have invested."



Key:

 Yes
 No

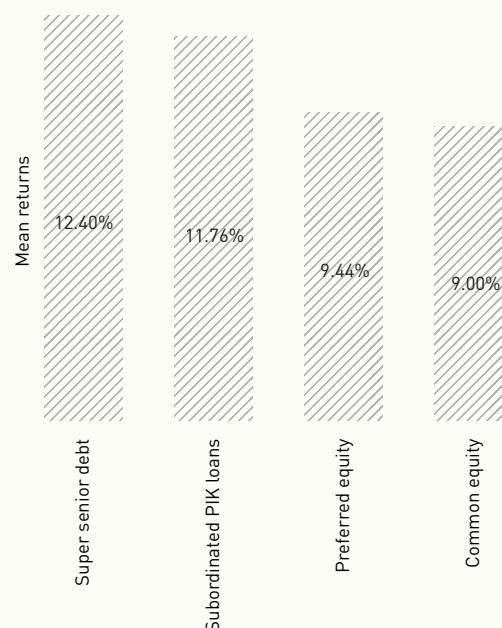
Q When allocating new money in a restructuring scenario, what annual returns (%) do you expect from investment in the following instruments?

Respondents' expectations for returns vary somewhat when allocating new money in a restructuring scenario. Respondents expect the highest annual returns from super senior debt, with 12.40%. This is followed by subordinated PIK loans, at 11.76%. This is a slight departure from last year's study, in which respondents expected the highest returns from subordinated PIK loans, at 14.60%.

Also, respondents only expect returns of 9.44% from preferred equity, a noticeable drop-off from last year's survey, when respondents expected returns of 12.63%. This is followed by common equity, with respondents anticipating returns of 9.00%, mirroring last year's result of 8.57%.

"It is interesting and somewhat counterintuitive that expectation of returns for equity rank below debt."

—Emmanuel Ringeval, Orrick Partner, Banking & Finance, Paris

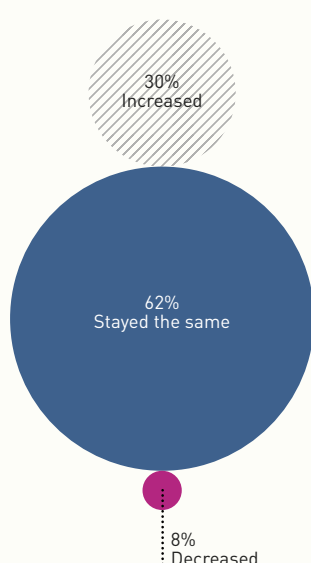


Q Has the return you require on new money injections increased, decreased or stayed the same from last year?

According to 62% of respondents, the returns they require on new money injections has stayed the same. This is a sizeable increase from last year's study, in which only 47% of respondents said that they required returns to stay the same.

Meanwhile, the share of respondents who saw increases on their required returns declined from 40% in the previous edition to 30% in the current study. This again points to a more difficult climate for PE firms. Still, some of this sub-set of respondents offer a positive take on expected returns.

A Sweden-based partner comments, "We have been able to create value and make positive changes in our portfolios. Our returns from the amounts we have injected into our portfolio companies has made us higher returns than last year. We used capital to make a few positive changes in portfolio companies and will go on injecting capital if it helps us."



Q Faced with maturities on your portfolio companies in 2016, what method have you used by percentage? (Showing mean)

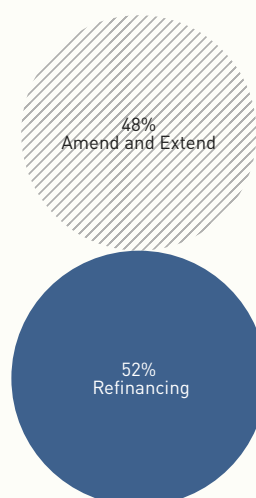
When faced with maturities on portfolio companies, respondents are almost equally likely to use amend and extends, with an average usage of 48% and refinancings, with an average usage of 52%. This closely parallels findings from last year's study.

A Switzerland-based partner explains why his firm has relied more on amend and extends: "The number of refinancing activities that our firm has carried out in 2016 is quite high, and we have needed to do so to some extent. However, with a lack of capital and investors, we have chosen to amend and extend more of our contracts for a bit longer."

On the other side of the coin, a French partner describes why his firm has turned more to refinancings, noting that: "We have had to restructure and refinance not only our companies but many of their loans and debts as well as their contracts. Brexit really impacted our portfolio and their performance and it has been difficult achieving growth after Brexit and the uncertainty that has come along with it."

"The refinancing market remains fairly healthy, Brexit and US election results notwithstanding."

—Dominic O'Brien, Orrick Partner, Finance, London



Q What do you think will happen to the amount of 'amend & extends' next year?

Over half of those polled (54%) expect the amount of amend and extends next year will increase. Respondents say that savvy companies will use them to wait out poor market conditions. "There will absolutely be an increase in the amount of amend and extends witnessed next year. This will continue to be a key feature of European deals. Businesses will not be able to get capital as there are no sources, neither through the investors nor through existing cash reserves, and will turn to amend and extends," notes a London-based partner.

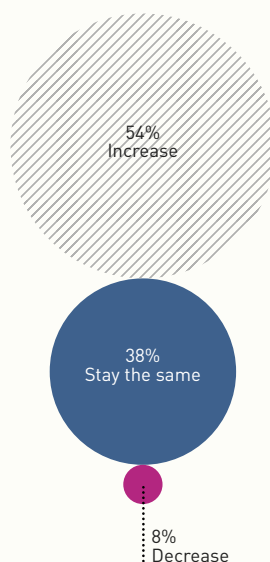
Curiously, though, nearly three-quarters of respondents in last year's survey foresaw an uptick in amends and extends, even though market conditions were more hospitable.

"It remains to be seen if creditors will continue to be as obliging to agree to A&E requests in 2017 as they have been in previous years."

—Scott Morrison, Orrick Of Counsel, Restructuring, London

"Portfolio companies average time holding by private equity firms has increased to 5.5-6 years (since 2013), up from closer to 4-4.5 years (before 2010) hence the need for adjustments to both the terms and the duration of portfolio companies' debt. The average holding period has also been longer for European companies vs. US companies."

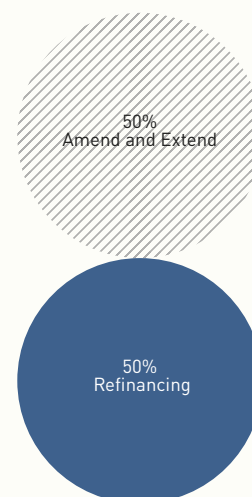
—Briac Houtteville, Capital Advisory, Greenhill



Q And what do you anticipate using in 2017 by percentage? (Showing mean)

Respondents are exactly split when considering whether they will use amend and extends or refinancing in the coming year. Again, this rough split between the two is a continuation from previous editions of the survey.

While respondents highlight the virtues of both options, a London-based partner explains why refinancings are right for his firm's portfolio companies, given the current economic climate: "We are definitely considering refinancing in the next year. The prime reason for this would be the lower interest rates that we would be able to get as compared to amend and extends, where the interest rate is really high. A lower rate translates to lower payments."



Q When refinancing your portfolio companies in 2016 what percentage have you used of the following instruments? And what do you anticipate using in 2017 by percentage? (Showing mean)

When considering the type of instruments used during refinancing portfolio companies over the past year, respondents on average used high yield the most, with a mean of 36%. Last year's respondents also used high yield in an average 36% of cases. Mezzanine (20%), PIK (15%) and unitranche (10%) remained relatively stable compared to last year's survey. Leveraged loans were used much less frequently, however. This year, they were used an average of 19%, versus 30% in the previous year's edition.

When asked to explain their answers, respondents are clear that a mix of instruments is important to balance risk and reward. A CIO at a Germany-based firm comments: "We use a majority of mezzanine debt and will increase the use of our mezzanine and PIK when investing. We feel this will be good for us and will help us get higher returns from deals. We also feel investing through these instruments allows us to reduce risks."

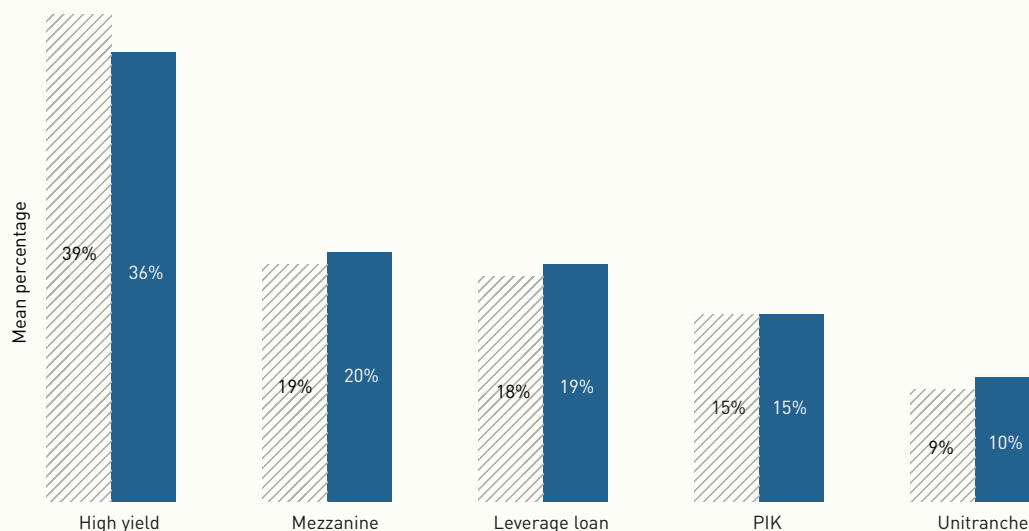
Respondents anticipate using nearly identical usages to restructuring instruments in 2017. Thirty-nine percent plan on using high yield, followed by mezzanine (19%), leveraged loans (18%), PIK (15%) and unitranche (9%).

"The European high yield market can be somewhat binary, either it is red hot or it has ground to a halt, but looking at this with a long-term perspective it continues to make solid progress as a source of finance for European investors."

—Sushila Nayak, Orrick Partner, Finance, London

Key:

▨ 2017 ■ 2016



Q Do you expect that you may need to restructure one or more of your own portfolio companies in the next 12 months?

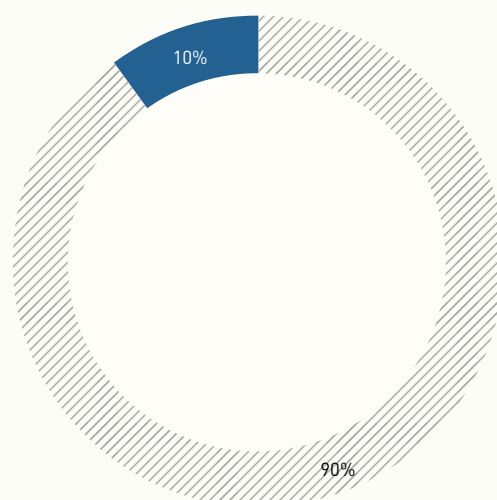
At 90%, the vast majority of respondents anticipate having to restructure one of their portfolio companies over the next year. This is similar to last year's survey, when 93% of respondents planned on doing so. Respondents seem to be taking a defensive posture when planning for restructurings.

"No private equity fund is immune from underperforming investments. What has changed is the professionalisation inside some of the larger sponsors with dedicated resources to debt funding and credit negotiations."

—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill

"Seeing this result, it looks like restructuring advisers will need to gear up for a very active 2017/8. We are not seeing a step change in the number of restructurings just yet, but we expect an increase this year, particularly in the French market."

—Saam Golshani, Orrick Partner, M&A and Private Equity, Paris

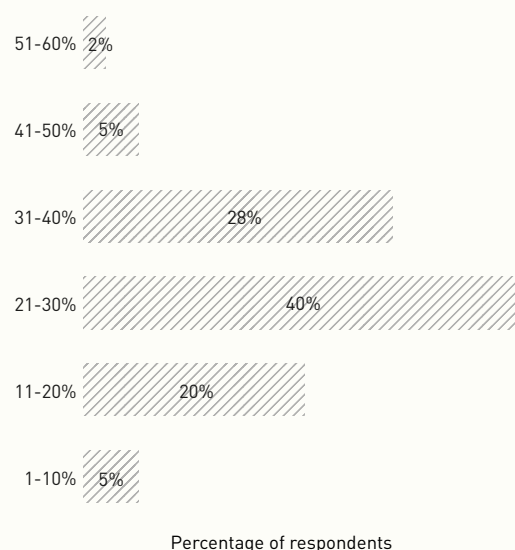


Key:

- Yes
- No

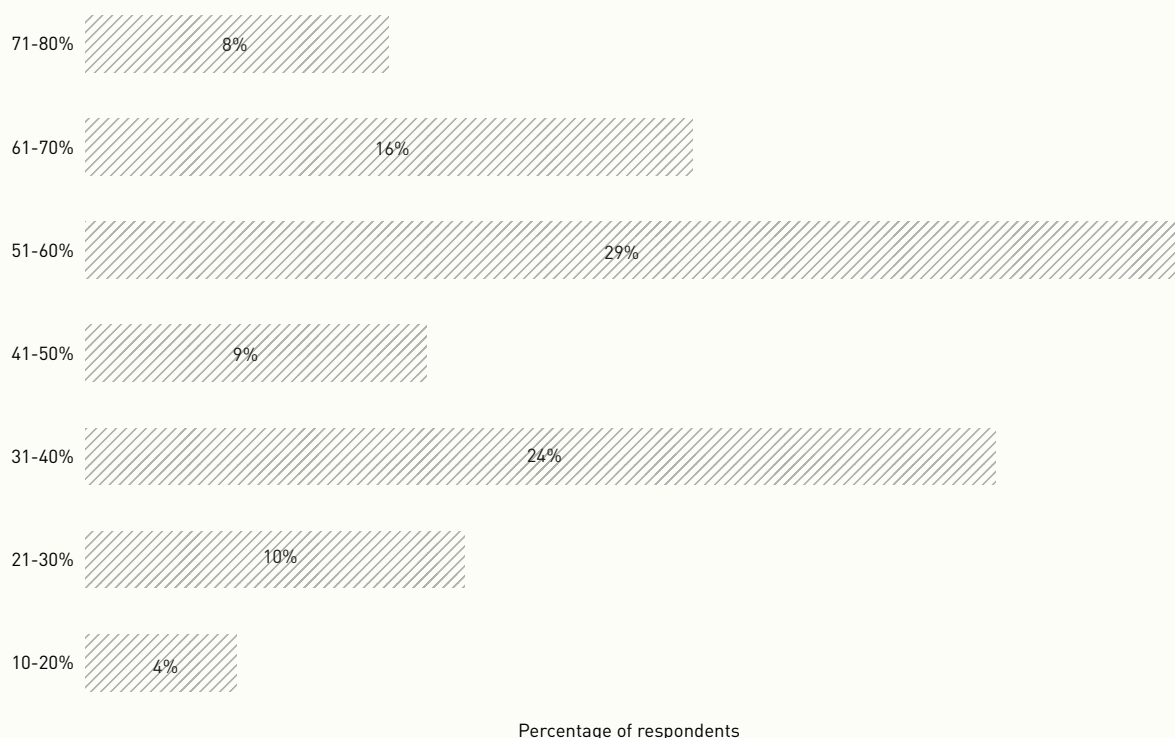
Q What percentage of your portfolio is performing below the level of the acquisition business plan?

When considering the share of their portfolios with sub-par performance, the largest share of respondents (40%) say that this lies between 21% and 30%. This is an increase from last year's survey, when only 30% of respondents' portfolios fell into this bracket. Indeed, this year's respondents report significantly higher percentages of their portfolios performing below the level of their acquisition business plans, with 28% citing between 31% and 40% of portfolio companies missing the mark, compared to 14% in the 2016 survey. Further, 7% of this year's respondents say that more than 40% of their portfolio is not meeting expectations, in contrast to no respondents in last year's edition.



Q How many of these represent potential stressed/debt restructuring candidates in the next 12 months?

Over half of respondents (53%) say that between 51% and 80% of these low-performing portfolio companies represent potential stressed/debt restructuring candidates over the next year. This is a stark rise from the 15% of respondents saying the same in the previous year's edition, a possible signpost of a more challenging climate in 2017. Meanwhile, only 14% of respondents say that less than 30% of their low-performing portfolio companies are distressed candidates, compared to 29% in the previous edition of this study.



Q For those companies in your portfolio which may be restructured, please rank the following method of restructuring in order of likelihood (Rank 1-7, 1= most likely)

When asked to rank the most common restructuring methods in the coming year, the lion's share of respondents (54%) points to operational changes. Respondents say that this is crucial to cut costs. This is followed at a distance by asset disposals (18%) and equitisation/deleveraging (18%).

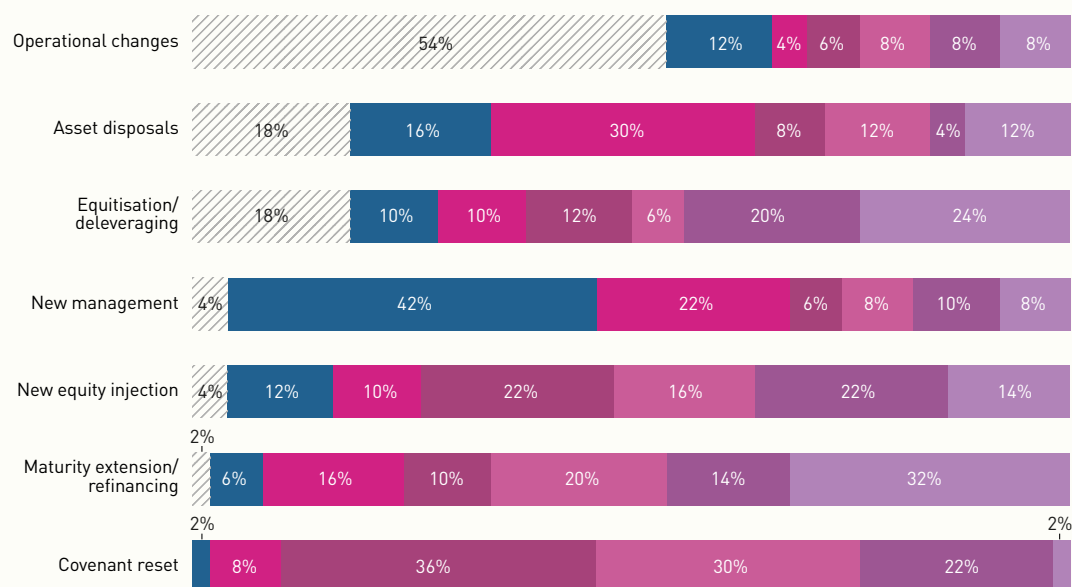
Respondents' comments highlight that a range of methods are necessary to restructure their businesses to enable them to thrive in what is set to be a challenging 2017. A Swiss partner explains: "Our portfolio has been affected by the instability in the market, so we will have to make changes to our growth strategies. A few of our companies are in the red and we need to look into them closely. We plan on changing a few of their operations and are trying to make the management better so that they are less prone to risks."

"There are clear opportunities in distress for healthier companies, but not only for them. A merger with a peer can create a stronger combined entity that can deleverage through synergies and be more attractive for equity investors. Execution is critical and requires both M&A and restructuring expertise."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill

Key:

1 2 3 4 5 6 7



Percentage of respondents

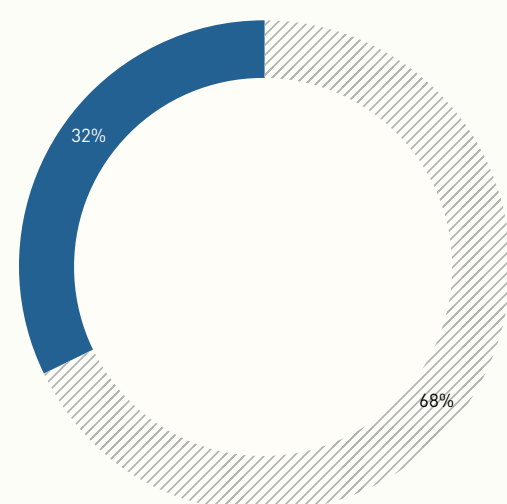
Q Have you actively looked at a potential exchange offer or covenant reset for the bonds of a portfolio company in 2016?

Over two-thirds of respondents (68%) have actively looked at a potential exchange offer or covenant reset for the bonds of portfolio companies in the past year. A Germany-based CIO describes the necessity of doing so for his firm: "Our companies were loss-making. If we stuck by the old covenants, we would have not been able to keep our side of deals and could have faced legal issues. To avoid this, we changed our covenants."

Yet, a sizeable minority (32%) have not done so. Respondents in this sub-set say that it is because their bond investments have met their expectation. "We looked at the performance of our bonds and feel we had invested in good bonds that were not very risky, we did not need to engage in a potential exchange, we will be able to get returns and are certain of growth. Our bonds will generate good returns for us," a Switzerland-based partner comments.

"Exchange offers are a very low-cost alternative to more formal insolvency or scheme type restructurings and we think exchange offers should be considered before looking at more fundamental restructuring methods."

—Nell Scott, Orrick Partner, Corporate, London



Key:

Yes
 No

Q Do you anticipate a tougher fundraising environment in 2017?

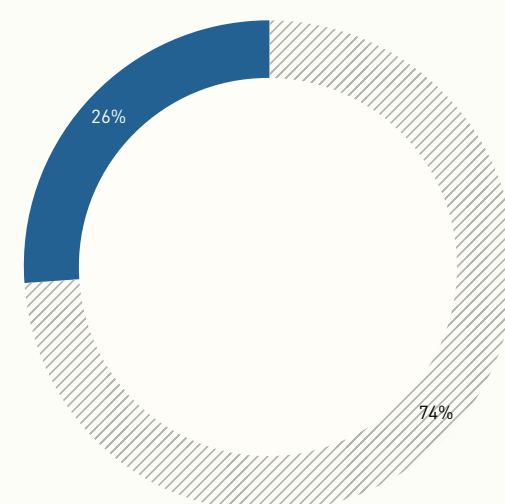
Around three-quarters of respondents agree that 2017 will be a tougher fundraising environment compared to 2016. This marks a 14 percentage-point increase from last year's study, possibly reflecting the uncertainty over the market in the coming year.

A France-based managing partner describes his more negative outlook. "There are already several challenges that are making the fundraising environment a tough place today," he says. "It will stay difficult in the coming months because the market will be volatile. With this we expect to see reluctance from investors."

An Austria-based managing director echoes these sentiments: "In many markets in the EU and in the US, growth has stagnated – even demand has been falling. Looking at this trend, we doubt investors will be willing to invest large amounts of capital in the market. Getting access to funds will become difficult especially since debt market conditions have become volatile and interest rates are likely to increase."

"This seems a fairly pessimistic outlook and, with recent economic news being more optimistic, we wonder whether this percentage would be lower if the survey was done now."

—Dominic O'Brien, Orrick Partner, Finance, London



Key:

Yes
 No

Q Do you expect an increase in the number of PE portfolio exits in 2017 ahead of new fundraising plans?

At 62%, a majority of respondents expect to see an increase in the number of exits in 2017. But this is a much more tempered view than in the previous edition of the survey, when 87% of those interviewed held this view.

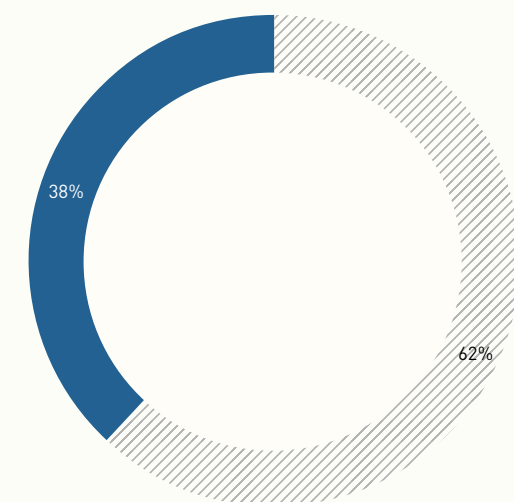
And while last year's respondents presented a sunny view of buyers' appetites for PE assets, this optimism is noticeably absent from this year's comments.

"Looking at Germany, activity levels seem a little anaemic at the moment. We see trade sales driving exits at the moment."

—Thomas Schmid, Orrick Partner
M&A and Private Equity, Munich

"There has been a stampede to exit investments in 2016 and this will continue in 2017. We expect this activity to tail off during 2017 ahead of the potential downturn that is anticipated by both sets of respondents."

—Pieter-Jan Bouten, TMT Corporate Advisory,
Greenhill



Key:

/// Yes
■ No

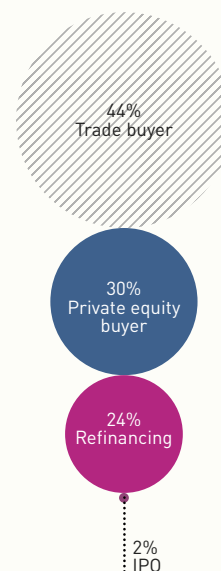
Q What type of exit do you think will be most prevalent in 2017?

When asked the type of exit, will be most common in the coming year, a majority of interviewees (44%) point to trade buyers. This is a steep drop-off from last year, in which 73% of those surveyed said trade buyers would be the most prevalent, perhaps indicating more diversity in the market.

Further, PE buyers appear to be more prevalent, with 30% of respondents this year indicating that they will be most prevalent in 2017, compared to 7% in last year's edition. One respondent notes that this is because PE firms have more liquidity relative to other buyers.

"Whilst there appears to be more interest from private equity buyers and PE transactions are increasing, the balance sheets of strategic investors remain strong and we see sales to strategic investors as continuing to be the more common exit route in 2017."

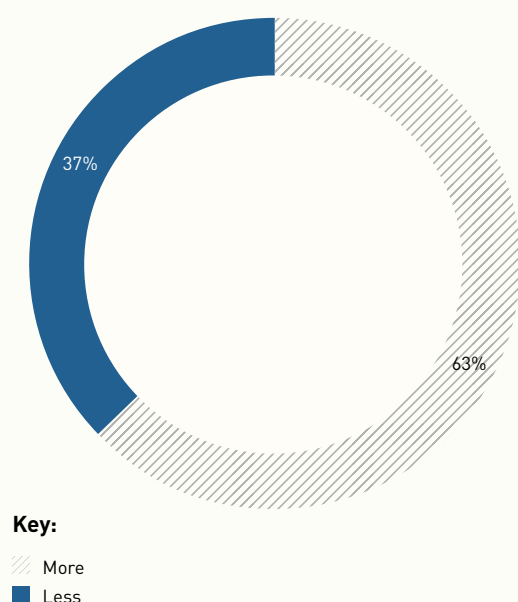
—Jinal Shah, Orrick Partner, Corporate, London



Q Do you expect the market will be more or less supportive of secondary and tertiary buyouts in 2017 relative to 2016?

Sixty-three percent of respondents agree that the market will be more supportive of secondary and tertiary buyouts in the coming year, relative to 2016. While this is a sizeable share, it represents a stark drop-off from last year's report, when 90% of respondents thought that the market would be more supportive.

A Germany-based managing director says that the market will not so much be more supportive, as much as there will be a dearth of other viable buyers: "There is a lack of buyers and growth rates are predicted to be stagnant in the coming months. We think there will be an increase in the number of tertiary and secondary buyouts as PE firms use these strategies to sell their assets."



Q In the wider European market, please rank these financial restructuring outcomes as most (6) and least likely (1) in 2017:

When considering the most likely restructuring outcomes in Europe, the largest percentage of respondents (28%) point to insolvency. This mirrors 2016's survey, in which 30% of respondents cited this as a likely outcome.

But in the survey's previous edition, the biggest share of respondents (37%) said that incremental investment refinancing was the most likely outcome, compared to only 14% today, possibly pointing to a more challenging lending climate.

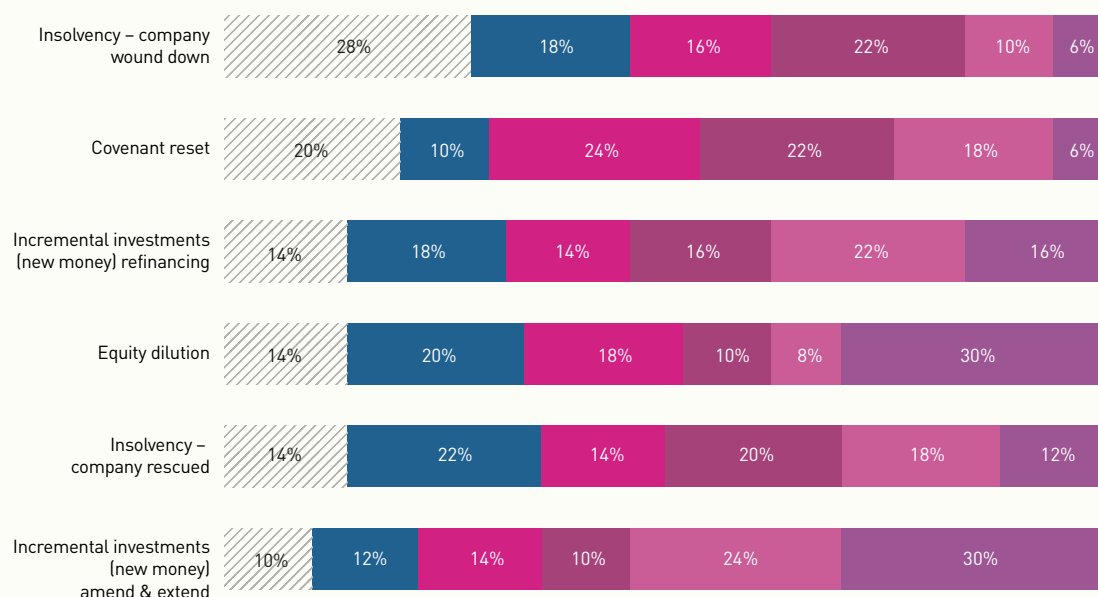
Several respondents underscore this point, and note the limited options available to companies in need of restructuring. "By resetting covenants and amending and extending contracts, companies will be better at handling their debts and will be more successful at restructuring. Looking at the financing situation in the market companies do not have many options and these are the best ones available to them," comments a Germany-based managing director.

"Not much mention of out of court UK schemes in the commentary. Scheme restructurings of European (and non-EU such as Ukraine) companies have been healthy last year."

—Stephen Phillips, Orrick Partner, Restructuring, London

Key:

6 5 4 3 2 1



Percentage of respondents

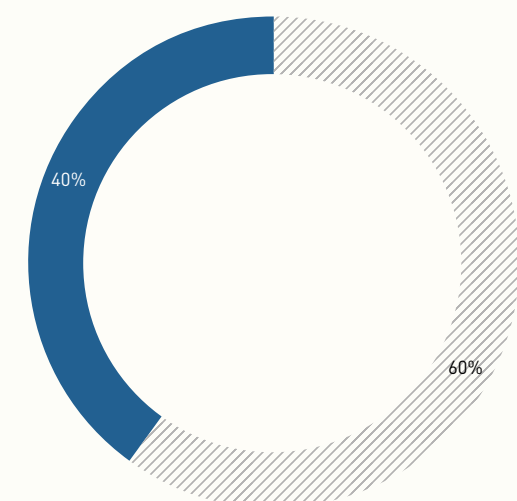
Q Do you expect to play an active role in the restructuring of non-portfolio companies in 2017?

Respondents are somewhat split over whether they will play an active role in the restructuring of non-portfolio companies this year, with 60% expecting that they will and 40% expecting that they will not. Those answering in the affirmative say that they will do so to help offset the low-growth environment. For instance, a Germany-based managing director comments: "We offer restructuring services to other companies and will use our knowledge in restructuring to help us earn more capital for our company. This will also help us meet our return targets, which have fallen because of lower growth rates."

Those who say they will not play a role in restructuring non-portfolio companies say that this is a resource-intensive process, and that their attention is better directed elsewhere. A Madrid-based managing director elaborates: "We do not have resources that we can spare to carry out restructurings for companies not in our portfolio. We are still working out our restructuring and are trying to make sure our company grows well and manages to tackle risks."

"Sponsors are looking for creative ways to generate above-average returns. Increasingly this requires them to look outside of mainstream processes to situations such as restructurings, which tend to be less competitive than conventional auctions."

—Carlo Bosco, Financing Advisory and Restructuring, Greenhill



Key:

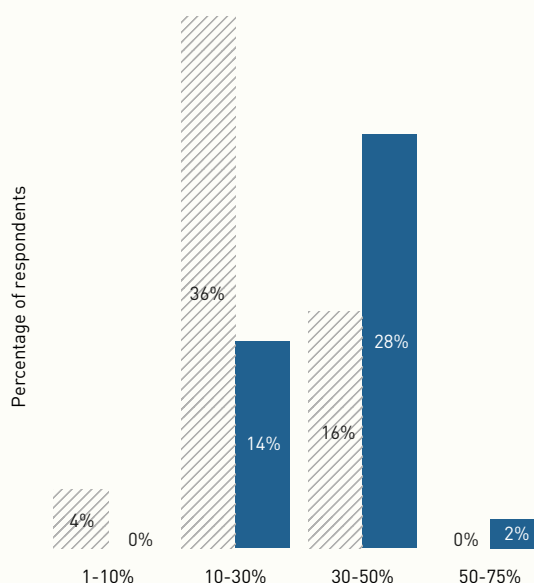
Yes
No

Q On what scale (in percentage terms) do you anticipate LBO deal volume to increase (or decrease) in 2017?

At 56%, the majority of respondents anticipate LBO deal volume to increase in 2017, indicating continued appetite for LBOs and success in undertaking them.

A managing director based in Germany comments: "We expect the volume of LBOs to increase. We still use LBOs to finance our deals and to get the capital we need to make changes to the company. We still feel it is easiest getting investments from investors and investing in LBOs."

On the other side of the coin, 44% of investors expect LBO volumes to decrease. A Netherlands-based managing director explains why he believes LBOs are declining in popularity: "Firms are now trying to reduce the amount of leverage they have accumulated, and through leverage buyouts PE firms have only increased debt. This has been problematic because paying off debts has become tougher."



Key:

Increase
Decrease

Q What are your key operational priorities in managing your current portfolio? (Please rank 1-6, 1= most important)

Respondents' key operational priorities for managing their portfolios include improving the top line (51%) and taking cost out of the business (26%). This is a dramatic shake-up from last year's edition, when the highest priority was improving internal systems/financial reporting. This year, this is the top priority for a slim 4% of respondents.

Still, respondents' comments make clear that these areas of focus cannot be taken in isolation. A UK-based partner describes his firm's multi-pronged approach to improving operations: "Taking cost out of the business would be the most important operational priority. When dealing with multiple business units cost-cutting, streamlining operations and improving management are all interconnected efforts. We are trying to monitor every unit's performance separately and are trying to undertake the necessary steps to improve them. As of now, we are focusing on improving the management efficiencies."

"Sponsors rightly focus on the operations but, at the same time, should assess the opportunity to proactively use financial restructuring techniques to extend runway and create more value."

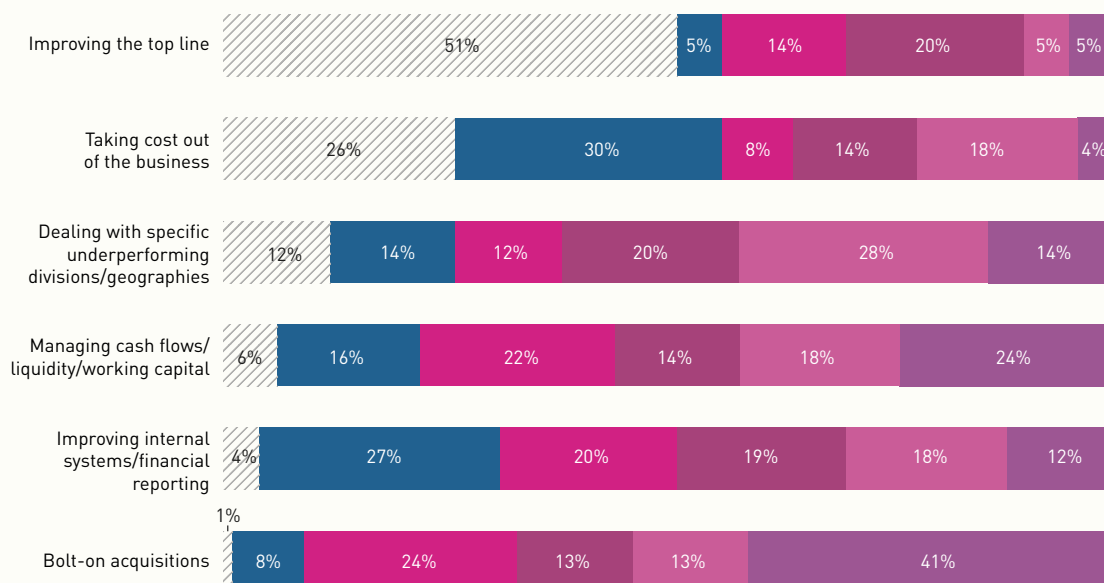
—Gareth Davies, Head of Financing Advisory and Restructuring, EMEA, Greenhill

"For UK-based companies, in particular reducing costs in an inflationary post-Brexit environment will be tough."

—Stephen Phillips, Orrick Partner, Restructuring, London

Key:

1 2 3 4 5 6



Q What percentage of activity will be devoted to developing the existing portfolio through bolt-on acquisitions rather than new investments in 2017?

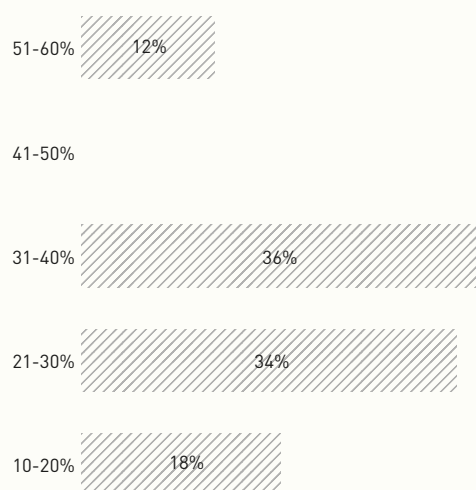
When considering the percentage of activity that will be devoted to developing existing portfolios through bolt-ons, the largest share of respondents (36%) say between 31% and 40%. This is closely followed by 34% of respondents who point to the 21% to 30% bracket. This is a departure from last year, when 57% of respondents cited figures between 20% and 30%.

A London-based managing director indicates increased enthusiasm surrounding bolt-on acquisitions: "We are looking for a few new companies we can acquire. We will help develop them and make them operate better to get us higher and stronger returns. We feel through a bolt-on acquisition we will be in a position to grow better."

Yet, other respondents indicate a strong preference for new acquisitions over bolt-ons. "We do not want to go on investing in developing our current portfolio. We have invested in companies that are able to grow on their own. We want to instead focus on developing a portfolio where we are less exposed to market risks and returns are guaranteed," comments a London-based partner.

"As equity markets and valuations remain high, we have seen an increase in platform investments where add-on acquisitions allow private equity investors to play multiple arbitrage."

—Pieter-Jan Bouten, TMT Corporate Advisory, Greenhill

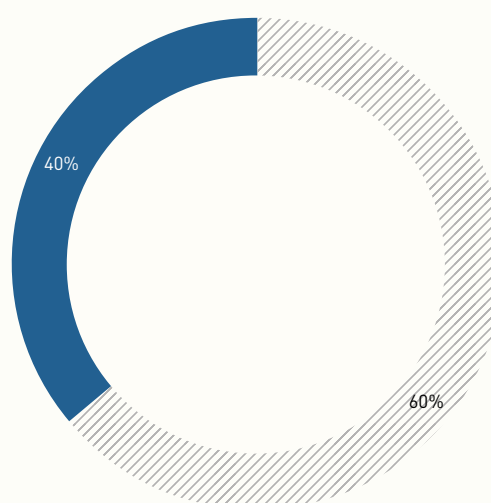


Percentage of respondents

Q Do you expect dividend recaps to increase in 2017?

Roughly two-thirds of respondents expect dividend recaps to increase over the next year. Still, this is a more conservative outlook than in previous editions of the survey: 77% and 84% expected an increase in dividend recaps in 2016 and 2015, respectively.

Echoing sentiments heard throughout this study, respondents say that dividend recaps will remain popular because PE firms have few options available to them. A London-based managing director elaborates: "Portfolio companies need to pay off debts and have PE companies exit them. With the market as bad as it is, many buyers are trying to buy their stake in their company for a cheaper amount and are paying off PE companies to acquire their share of the company for a price slightly higher than the market."



Key:

- Yes
- No

Q What percentage of deals have you financed with private debt/alternative capital?

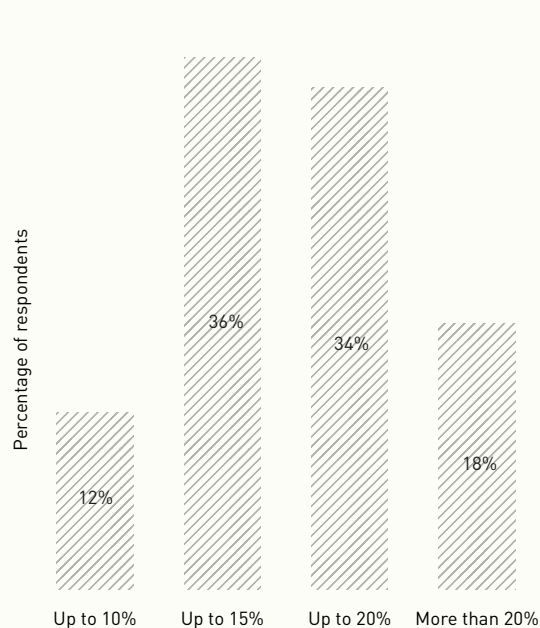
The largest share of respondents say that they have financed up to 15% and up to 20% of deals with private debt or alternative capital. Respondents strike a positive note about this type of lending, and have used it for its straightforward process and availability.

A London-based partner elaborates: "We have used many different types of private debt. We have used these debt mechanisms because we have been able to raise the capital we required and they have made it simpler executing deals."

An additional 18% of respondents say that they have financed more than 20% of deals with private debt or alternative capital, and 12% have financed only up to 10% of deals with these types of debt.

"The ease of execution and quick decision-making is one of the key selling points for alternative credit providers."

—Dominic O'Brien, Orrick Partner, Finance, London



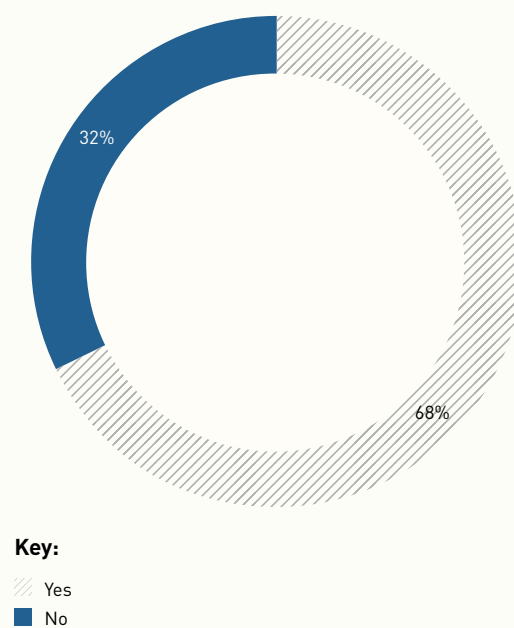
Q Do you foresee a greater role for direct lending by funds in the next two to three years?

At 68%, a clear majority of interviewees foresee a greater role for funds' direct lending over the next few years. Respondents describe constrained lending from more traditional sources, and PE direct lending filling a void in the market. For instance, a France-based managing partner states: "Distressed scenarios are on a rise in Europe. Businesses here are lacking the necessary capital and the resources to bear the heavy burden of debts. Therefore, these companies will seek direct money investments opportunities in the form of equity."

Still, a sizeable minority (32%) disagree that direct lending is on the rise. A Portugal-based partner believes that direct lending will be replaced by more traditional forms: "For now, I do not see a change in the way direct lending will impact companies. Direct lending will play a role but companies will use it only until market conditions improve and capital becomes easier to get. Once this occurs, companies will turn to the market to carry out their financing activities."

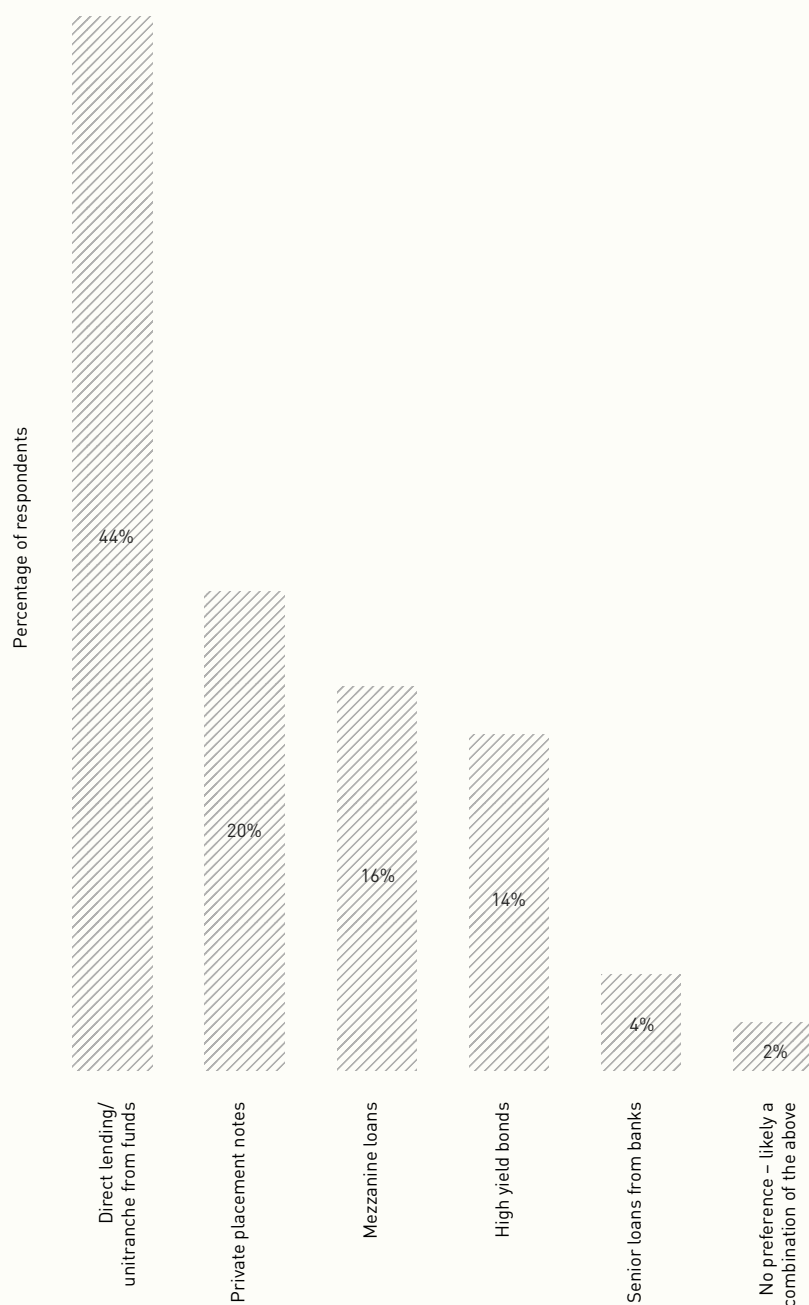
"Whilst 68% is a high figure, there has been a clear reduction from last year which suggests banks and the bond market are strong alternatives for corporations looking for investment."

—Nell Scott, Orrick Partner, Corporate, London

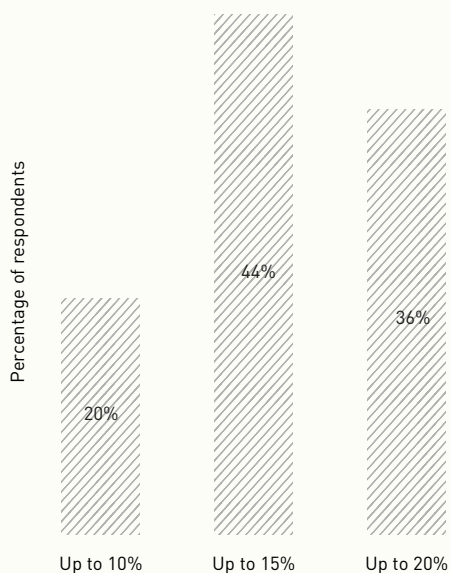


Q What do you anticipate to be the likely source of financing for the largest portion of your portfolio companies in 2017?

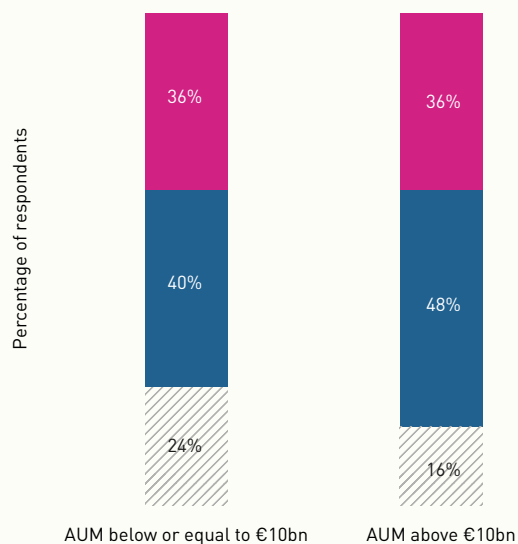
At 44%, biggest percentage of respondents anticipate that direct lending or unitranche from funds will be the most likely source of funding for their portfolio companies in the coming year. This is followed by private placement notes (20%), mezzanine loans (16%) and high yield bonds (14%).



Q How much of a single fund would you invest in a single company?



Q How much of a single fund would you invest in a single company? (by AUM)



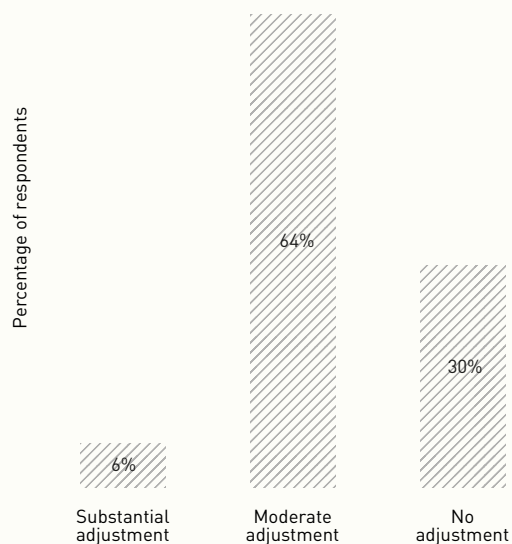
Key:

Up to 10% Up to 15% Up to 20%

When asked how much of a single fund respondents would invest in a single company, the biggest share of interviewees says up to 15%. Respondents in this category say that they are cautious to invest too much in one company. For instance, a London-based partner says: "The most we will inject in a company will only be around 15% of our fund. We need capital for other business activities and investing a larger amount will leave us with less capital to grow."

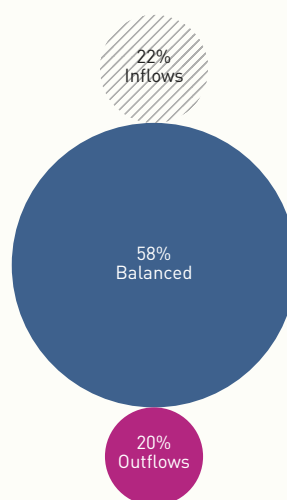
Yet, a sizeable 36% of respondents are willing to invest up to 20% of a single fund. These respondents indicate greater risk appetites than their counterparts. "We have invested a significant amount of our fund and will go on investing it if we feel we are able to create opportunities. We will also go on investing if we can make positive changes that will help us carry out a sale in the future and get back returns that we had hoped to make," notes a Germany-based partner.

Q Are your LPs adjusting their return expectations in view of the ultra-low interest environment?



At 70%, a majority of respondents' LPs are adjusting their return expectations in light of the low interest rate environment. Only 30% of respondents' LPs have not adjusted their expectations.

Q Have you experienced inflows or outflows during 2016?



The majority of respondents (58%) say that they have remained balanced in 2016. Twenty-two percent of respondents have experienced inflows, while 20% experienced outflows.

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