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CLO Market Revives and Consolidates

The structured credit products industry has seen a modest revival since 2010. Since the financial crisis, investors have been searching to identify promising opportunities and investment firms have begun packaging new products, albeit at levels far below those prior to the crisis. It is not surprising then, in a world beset by negligible interest rates and volatile equity markets, that investors are willing to review the potentially higher return products they ran from four years ago.

Many pension funds seeking the elusive 8% average annual return are upping the "alpha" portion of their fixed income allocations, for example. That's been a plus for a robust junk bond market and for once-hot structured products like collateralized loan obligations (CLOs), which consist of pools of below-grade commercial loans.

During the height of the market in 2006-2007, a total of some $170 billion in CLOs was issued in the U.S., the dominant market. By 2009, the number had fallen to a barely discernible $1.2 billion. The new issues market registered a mild return in 2010 to $4.1 billion and rose to more than $12 billion in 2011. In the first quarter of this year, sales approached $6 billion, including a $450 million CLO that **Citibank** sold for **Silvermine Capital Management**, according to the *Wall Street Journal*. The leveraged loan market that feeds the creation of CLOs has also enjoyed a revival, rising 50% last year to $566 billion, although volume trailed off in the fourth quarter, according to Fitch Ratings.

In response to this growing if tempered demand for CLOs and other collateralized debt obligations (CDOs) — and growing sentiment that CLOs offer solid value and limited risk — asset managers have been scooping up the products. Private equity firms have been the most notable actors in this two-year consolidation process, driven by a "get big or get out" philosophy. For one thing, their core business of corralling institutional capital for buyouts, including the related due diligence, makes CLO management a logical fit, in particular since many of the loans comprising CLOs are used to fund acquisitions and leveraged buyouts. For sellers, those attributes — including access to capital — are equally compelling. Dodd-Frank Act rules that could require issuers to hold a 5% stake in these financial instruments are another concern for independent CLO issuers.

Aside from the business logic of the acquisitions, for some private equity firms the deals dovetail with an effort to extend their revenue streams. In particular, firms such as **Blackstone Group** and **Carlyle Group** that are either publicly traded or preparing to go public have an eye on investors, who prefer a diverse product portfolio. Armed with the proceeds of its $4 billion partial initial public offering (IPO) in 2007, Blackstone made the largest credit-related transaction to date right in the middle of the financial crisis in 2008. The deal for **GSO Capital Partners**, with a price tag that could reach $945 million based on five-year performance, added $10 billion in AUM and provided Blackstone with one of the largest credit platforms among alternatives firms ($21 billion in AUM). The addition catapulted Blackstone into the No. 4 spot among CLO providers from No. 15, according to Creditflux. In a display of bullishness about the opportunistic potential of credit-related acquisitions, Blackstone chairman and CEO

continued on next page

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Stephen Schwarzman said of the GSO deal that the "current dislocation in the credit markets" provided an "ideal time to create a more diversified, powerful platform."

Blackstone's strategy to capitalize on that dislocation has advanced with three more deals under the GSO umbrella. In 2010, the target was the collateral management agreements for CLOs and CDOs managed by Callidus Capital Management, amounting to $3.2 billion in AUM. In its 2010 annual report, Blackstone said the deal "enhanced its position to benefit from the recovery" of the CLO market. The company also developed three CLOs totaling $1.3 billion, describing them as targeting "high-quality loan assets with an expectation for stable returns." In 2010, Blackstone's credit businesses accounted for 7% of net-fee-related earnings.

Last year, the company extended its CLO portfolio with two acquisitions from Irish firms, the largest involving Dublin-based **Harbourmaster Capital**, an 11-year-old European leveraged loan firm that manages and advises $11 billion in AUM. The various deals make GSO one of the largest European leveraged loan investors, with some $16 billion in AUM. In total, GSO has more than $45 billion in credit-related AUM.

Carlyle, which filed to go public last September, has been another active buyer, with several acquisitions since 2010. The key target that year was Stanfield Capital Partners, which had collateral management contracts for $4.2 billion in CLO funds as well as investment management agreements and nearly $1 billion in three separately managed accounts. For its part, Stanfield bowed to a consolidating marketplace in which it said investors were seeking "firms that possess the broad array of resources found at large global asset managers." Carlyle followed that by winning the auction for $1.2 billion in CLOs from a U.S. unit of **Mizuho Alternative Investments**.

In 2011, Carlyle added another $500 million in a CLO management contract from **Wells Fargo's Foothill Group** while creating its first newly issued CLO since 2008 — a $507 million product that invests in corporate leveraged loans and high-yield bonds. In total, Carlyle has nearly $13 billion in CLOs. Carlyle's structured credit business is the largest asset class (55%) in its Global Market Strategies segment, which accounted for around 14% of the company's AUM and revenues as of June 2011.

Blackstone and Carlyle have been joined by a third private equity brand name, **Apollo Global Management**. In 2011, Apollo — which began trading on the New York Stock Exchange last March following a $565 million IPO — picked up more than $3 billion in CLO assets through the acquisition of North Carolina's **Gulf Stream Asset Management**. The addition of Gulf Stream gives Apollo more than $14 billion in AUM in its senior loan business. Like Stanfield, Gulf Stream referenced the consolidation trend in explaining the sale and said "our investors will benefit from Apollo's leading global integrated investment platform and its credit and capital market expertise."

In December 2011, Apollo acquired a larger alternative credit manager, **Stone Tower Capital**. Based in New York, Stone Tower manages $17 billion in assets in a variety of corporate credit funds through 12 CLOs, separately managed accounts, credit opportunity funds and structured credit funds. Apollo chairman and CEO Leon Black said the transaction "leverages Apollo's existing capabilities and further enhances our significant scale and diversity as a leading global credit manager." The transaction will also make Capital Markets the largest segment in Apollo's business, with $39 billion in AUM (total AUM: $82 billion). Apollo's credit-oriented Capital Markets unit enjoyed 56% average annual growth in AUM between 2004 and 2010. In the second quarter of 2011, Apollo also raised $461 million for its third CLO since 2010.

Los Angeles-based private equity firm **Ares Management** enhanced its European credit portfolio by acquiring London's **Indicus Advisors**, with $2 billion in European CLOs and other credit assets. Ares reportedly made two other credit-related acquisitions last year, including another European CLO. Ares expressed a positive outlook on the prospects for European corporate credit, which has experienced a slower recovery than in the U.S., and said it intended to "participate significantly in this growth by offering highly attractive risk/reward opportunities to our investors." **Citigroup** entered the market through its **Citi Capital Advisors** alternatives platform, acquiring the management responsibilities for CLOs with $2 billion in AUM from **DiMaio Ahmad Capital**, a New York-based specialist in credit products. The bank said Citi Capital Advisors will continue to expand its portfolio of credit products. Other companies that made CLO deals last year include New York's **Resource Capital Corp**. and London's **Rothschild**. ▲