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Oaktree Jockeys to Boost New Direct Lending Funds

By Tom Stabile November 1, 2017

Oaktree Capital Management is striving to carve out a bigger position this year in the fast-growing direct lending market as a horde of rivals has been **barreling into the segment**. Oaktree has launched two new funds, rebranded its mezzanine debt unit, and acquired two business development companies (BDCs) in the push but has not yet outlined results from these efforts.

The manager has made senior secured direct lending deals through various strategies in the past, but never had a dedicated fund like the ones it launched in January, the Oaktree Middle-Market Direct Lending Fund and an unlevered counterpart. It has been touting its past expertise honed in other strategies as its recipe for success for the new funds, as CEO **Jay Wintrob** outlined on Oaktree's third quarter earnings call last week.

"Private lending to the middle market is right in the wheelhouse of what Oaktree has done for over a decade," he said. "Historically, it's been done in a handful of our existing investment strategies."

The new funds are led by co-portfolio managers **Bill Casperson** and **Raj Makam**, who head up the former middle market mezzanine debt finance unit that Oaktree recast as its U.S. Private Debt group earlier this year in a bid to broaden the team's profile. That group runs $1.4 billion, largely in legacy mezzanine debt funds.

While Oaktree's branding as a senior secured direct loans specialist is newer, it has to be considered a contender by virtue of its size, its private credit market reach, and its existing middle-market team, says **Ryan Flanders**, head of private debt products at **Preqin**.

"We have to consider Oaktree a big player here in middle market lending," he says. "A lot of that was mezzanine, but they have pivoted. You can definitely say they have emphasized this area more, and are looking to increase [their presence]."

Oaktree's moves to grow in the market come as direct lending has attracted big capital this year, with $37 billion raised to date, just short of the segment's record 2015 haul of $38 billion, Flanders says.

"It's very likely we'll surpass it this year," he adds.

Oaktree furthered its efforts to bulk up in direct lending with its acquisition of the two BDCs from **Fifth Street Asset Management**, a deal announced in July and closed last month, which Wintrob said last week expands the manager's investment team and its status as a lender in the segment.

"[W]e're quite enthusiastic about the prospects of solidifying this platform and its second order effects on the rest of Oaktree in terms of attracting deal flow, being able to look at types of deals and larger deals that could potentially be shared across Oaktree funds, and just generally being viewed as a bigger presence in the market," he said.

Oaktree's middle market direct lending funds launched in January are being marketed as first in a new series, and are targeting $750 million, according to an industry source requesting anonymity. That's a relatively modest target compared to other direct lending players currently seeking capital, such as a $3.5 billion fund from **HPS Investment Partners**, a $3 billion strategy from **BNY Mellon**'s **Alcentra Group**, a $2.5 billion product from **Ares Management**, and a $2 billion fund from **KKR**, according to Preqin data.

Oaktree also has launched into a market crowding up with first-time middle market direct lending funds from a range of players, such as **Adams Street Partners**, **TIAA**'s **Churchill Asset Management**, **Stone Mountain Capital**, and **Capital Dynamics** – and with more big entrants such as **Brookfield Asset Management** planning new funds. And managers are snapping up direct lending sales professionals, with 13 hires in the third quarter, 10 in the U.S., according to **Context Jensen Partners**.

Oaktree marketed its new direct lending strategy earlier this year to the **San Joaquin County Employees' Retirement Association** with a presentation to the pension's board in April in which it heavily touted its past middle market experience, largely on the mezzanine side of its business as well as a few other funds. Oaktree has invested about $900 million in senior secured direct lending deals over the past decade spread across various strategies, the presentation noted, and those deals had achieved 7.3% average returns.

The presentation tagged Oaktree's former mezzanine team led by Casperson and Makam as the group leading the new funds, along with **Peter Chang** and **Matias Stitch** as managing directors, among others on the portfolio management squad.

The pension board asked its staff to go ahead with due diligence on Oaktree's strategy, but has yet to announce a hire. It had outlined a potential **$50 million mandate**, according to *MandateWire*.

Wintrob had said on an earnings call in July that Oaktree is expecting first closes for the new senior secured loan strategies by the end of the year.

Oaktree has a good chance to succeed with its direct lending venture, thanks in part to its broader private credit market profile in areas such as distressed debt and liquid strategies, as well as its resources as a $100 billion manager, says **David Haarmeyer**, an independent private funds researcher and consultant in the Boston area.

"It's easier to build up in adjacent strategies when you have that scale," he says. "They have more infrastructure – back office and everything else – compared to a smaller firm starting up with a strategy."

Oaktree also may benefit from an ongoing trend of large institutional investors consolidating their private equity manager rosters – creating opportunity and incentives to deliver products in new corners of the market, Haarmeyer says.

"It goes back to relationship building," he says. "If investors want fewer partners, being a one-stop shop plays to your hand."