Fitch Ratings KNOW YOUR RISK

Fund & Asset Manager Rating Group

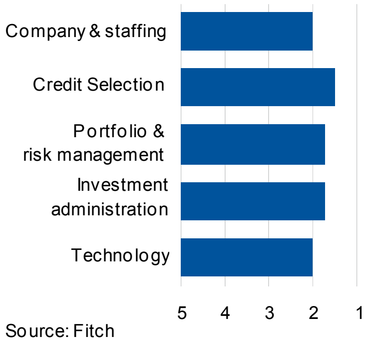
CDO Asset Managers
UK
Rating Report

Alcentra Ltd

Asset Manager Rating

MANAGER RATING M1 FitchRatings www.fitchratings.com

Rating Criteria



Source: Fitch

'M1' Description

Asset manager operations demonstrate lowest vulnerability to operational and investment management failures.

Analysts

Aymeric Poizot, CFA, CAIA
+33 1 44 29 92 76
aymeric.poizot@fitchratings.com

Manuel Arrive, CFA
+44 20 7682 7499
manuel.arrive@fitchratings.com

Related Research

- *Reviewing and Rating Credit Asset Managers* (July 2009)
- *Reviewing and Rating Asset Managers* (June 2009)
- *Changing Trends in Credit Asset Management (February 2009)*

Summary

- Fitch Ratings has assigned an 'M1' asset manager rating to the European asset management operations of Alcentra Ltd (Alcentra).
- The 'M1' rating reflects Alcentra's established European sub-investment grade management platform, including strong operational capabilities supported by extensive information technology and staff resources. The rating also takes into account the depth and stability of company staffing, as well as its thorough, established credit analysis and disciplined portfolio management process, notably for collateralised loan obligation (CLO) management. While benefiting from the support of its parent, The Bank of New York Mellon Corporation (rated 'AA-/F1+', Outlook Stable), Alcentra operates as a profitable independent subsidiary. Capitalising on its strong position in the CLO management space, Alcentra has recently taken part in the consolidation of the industry, by acquiring CLO businesses from various US financial institutions, most recently including US CLOs from Rabobank Group, increasing assets under management (AUM) by USD1.5bn.
- Fitch will monitor Alcentra's ability to minimise defaults and exposure to assets rated 'CCC' and below in managed CLOs, in the face of a continued challenging economic environment. This will be dependent upon the company's ability to perform appropriate levels of credit monitoring and relative value analysis, and to maximise return on capital, through working out of distressed debt and restructuring debt. In addition, following the restructuring of a credit hedge fund last year, the company's ability to rebuild a strong fund platform diversified across sub-investment grade instruments will be key to its long-term sustainability. This will involve, as fund and segregated mandate assets grow, strengthening distribution capabilities, portfolio construction and risk management processes for total return funds. Several funds, focused on loans or CLO tranches, are expected to be launched in the near future, while a distressed credit fund has been in existence since end-2007 and a structured credit fund already launched in September 2009.
- Alcentra is a global asset management firm focused on sub-investment grade debt fund management, mainly leveraged loans. Formed in March 2003, it was acquired in January 2006 by The Bank of New York Mellon Corporation. Senior management and other employees currently own 9% of the company. As at September 2009, Alcentra's total assets under management (AuM) was USD18bn globally (including the new US businesses), across 42 funds, including 31 CLOs. As of end-June 2009, Alcentra had EUR9bn of European leveraged loans under management, of which 91% was in CLOs. Alcentra employs 35 people in London, including four portfolio managers and 10 credit specialists.

Manager Profile

Alentra Ltd

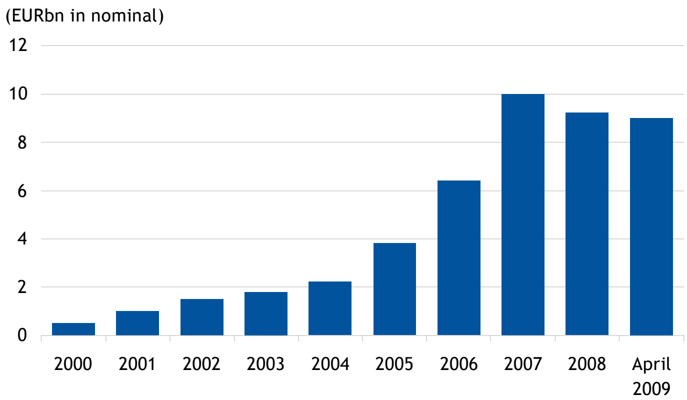
Alcentra Ltd (Alcentra) is a global asset management firm focused on sub-investment-grade debt fund management. It was formed through the acquisition of Barclays Capital Asset Management Limited (BCAM) from Barclays Bank Plc in Europe in March 2003, and the acquisition of Imperial Credit Asset Management from Imperial Credit Industries, Inc. in the US in March 2002. In January 2006, a majority stake in Alcentra was acquired by The Bank of New York Mellon Corporation. The senior management team and employees currently own 9% of the company.

Alcentra manages European sub-investment-grade debt through CLOs, mezzanine funds and credit hedge funds for a total of EUR9bn (nominal assets). The firm is in the process of launching new funds and managed accounts, all specialised in sub-investment-grade debt, and was recently appointed as manager of several CLOs in the US (taken over from Rabobank and Bank of New York Capital Markets).

Address	Alcentra Europe 10 Gresham Street London EC2V 7JD	**Ownership**	Bank of New York Mellon (91%) and executives and employees (9%)
Website	www.alcentra.com	**Parent/affiliates**	Alcentra Management (Ireland) Ltd, Alcentra NY LLC, Alcentra Investments Limited (Bermuda)
Type of organisation	Asset Manager	**Chairman ,CIO and CEO**	David Forbes-Nixon
Year founded	2003	**CFO and COO**	Robert Bennett
Domicile, place of incorporation	UK and Wales	**Key portfolio managers**	Graham Rainbow (CLO), Damien Miller (Special Situations), Graeme Delaney-Smith (Mezzanine), Hiram Hamilton (Structured Credits)
Registration(s)/jurisdiction(s)	FSA, SEC, Irish Financial Regulator	**No. of investment professionals**	15
		No. of employees	35 in Europe (54 globally)

Assets Under Management

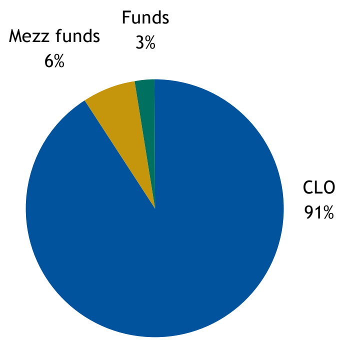
European AuM Growth



Source: Alcentra

European AuM Breakdown by Product Type

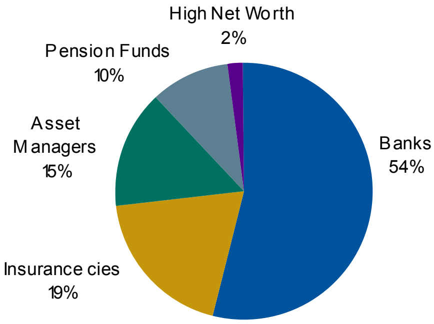
(April 2009 in nominal)



Source: Alcentra

AuM Breakdown by Investor Type

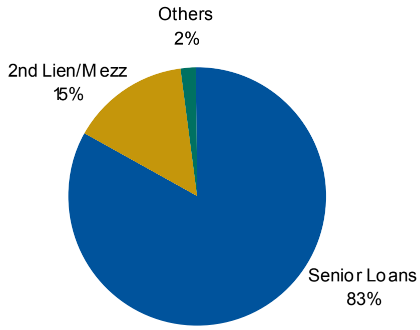
(August 2009)



Source: Alcentra

AuM Breakdown by Asset Class

(August 2009)



Source: Alcentra

Alcentra Ltd

Key Rating Drivers	Rating M1

Strengths

- One of the three largest and longest established European CLO managers
- Tenured and experienced professional team at all levels
- Strict and stable investment and credit discipline
- Very strong operational capabilities supported by extensive IT and staff resources

Challenges

- To diversify away from CLO management to become a global credit asset manager focused on sub-investment grade debt
- To maintain CLO and fund performance in more challenging markets, mitigated by the long, good performance track record demonstrated to date
- To raise capital (in unlevered loan funds and managed accounts invested in loans, distressed assets and structured credit) in more challenging conditions. This involves rebuilding a strong fund expertise after restructuring of a credit hedge fund

Company & Staffing	Score 2.00

- 91% owned by the BNY Mellon (rated 'AA-'/Outlook Stable/'F1+') and 9% by executives and employees
- Alcentra remains operationally independent from its parent company
- Well capitalised and highly profitable - modest decrease in revenues expected in 2009 - cash from operations largely reinvested in seed capital
- One of the longest established CLO managers in Europe, having launched its first CDO in 2000 and first CLO in 2001
- Critical mass, leading market presence and favourable track record through the cycle provide Alcentra with a competitive advantage in today's market, while positioning it well to be a consolidator of the industry
- 16 European CLOs, four funds and three managed accounts under management
- Broad investor base with approximately 300 clients from 30 countries
- European credit HF being liquidated with the creation of two share classes (one recovery with 80% AUM, one liquidation)
- Launch of new funds (investing in loans and structured credit assets), managed accounts and acquisition of new CLO businesses (recently in the US with six CLOs from Rabobank)
- Top tier service providers
- Very good depth and breadth of staff across the organisation – four PMs and 10 analysts in Europe – 20 operations, accounting and business development
- Control structure focusing on first level (ie. controls by operational staff) and benefiting from technology and reporting capabilities – clear separation of front office and operations – no dedicated risk or control function, per se
- IT, compliance and organisation outsourced to service providers where appropriate to focus on core functions

Credit Selection	1.50

- Superior sourcing capacity and access to information given size and track record
- Rigorous two-step credit approval process formalised in a preliminary and a final credit committee
- Analysis includes financial modelling, scenarios and formal internal ratings
- European credit track record shows lower default rates than average market as at June 2009
- Room for more formalised top-down process and inputs for credit funds' portfolio construction

Portfolio & Risk Management	1.75

- The investment style of Alcentra is conservative and credit focussed within a buy-and-hold approach with the exception of the distressed fund process, which is more trading / relative-value oriented
- Investment, fund allocation and sell decisions are the responsibility of the PMs
- Consistent allocation/divestment policy in loan portfolios – portfolio construction of distressed fund very judgmental and allowing for concentration at PM's discretion
- European portfolios are not overly diversified, with sizable top positions in line with strong opinions of credit research
- Two analysts dedicated to distressed situations and work out, on top of senior staff members' experience. One distressed specialist being replaced
- Risk process highly embedded in the selection and monitoring process, relying on technology (eg. automatic compliance checks) and firm-wide reporting
- Mark-to-market risk limited to distressed fund and addressed by conservative redemption terms
- Very disciplined asset level credit risk monitoring based on regular portfolio review, monthly financial monitoring of individual issuers and maintenance of a watchlist

Investment Administration	1.75

- Comprehensive supplemental reporting produced to supplement the trustee report - concise and relevant
- Basic newsletter displaying market commentary, performances and main breakdowns for credit funds
- Superior administration capabilities thanks to effective workflows, use of state-of-the-art technology and extensive staff
- The scalability of the operational platform facilitates organic and external growth of the business
- Close relationship with main trustee (BoNY Mellon)

Technology	2.00

- All CLOs and funds are set up and monitored via Wall Street Office (WSO), which was implemented as soon as 2001
- Recent acquisition of Geneva as a NAV engine for credit funds
- Various spreadsheets are used for research and monitoring
- Ongoing efforts to further automate, for example, with the implementation of an interface with Markit to streamline recurrent manual entries (loan rollover, pay-downs, etc.)
- Effective and tested disaster recovery procedures
- Dedicated IT consultant specialised in WSO developments in the absence of in-house IT staff

Company & Staffing

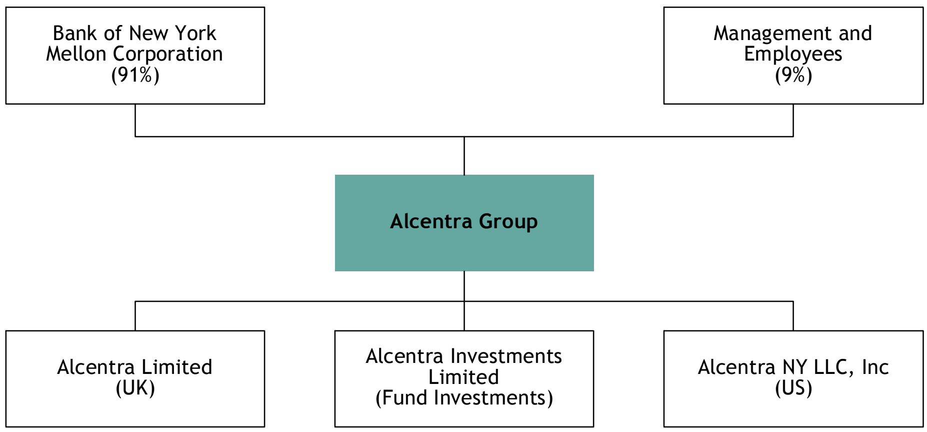
Shareholding & Financial Standing

Alcentra was established in 2001 through the acquisition - by the Alchemy Group, a private equity group, and the founding partners - of Imperial Credit Asset Management from Imperial Credit Industries Inc in the USA in March 2002, and of Barclays Capital Asset Management (BCAM) from Barclays Bank Plc in Europe in March 2003. In 2005, the Alchemy Group, Alcentra management and employees, sold a combined 80% holding in Alcentra to the Bank of New York Mellon Corporation (BNY Mellon, rated 'AA-/F1+', Outlook Stable) (with Alcentra senior managers and staff retaining the remaining 20% stake in the company); the deal was completed in January 2006. Since then, BNY Mellon increased its stake to 91%. The holding is incorporated in the US and directly or indirectly owns several entities among which:

- Alcentra Ltd, in which the European fund management operations as well as the global administration operations are lodged;
- Alcentra NY LLC, where the US fund management operations are based; and
- Alcentra Investments Limited, a Bermuda-based company, which serves as an investment vehicle in Alcentra's CLOs and funds (see below).

The following diagram details Alcentra's simplified corporate structure:

Structure Diagram



Source: Alcentra

Fitch's analysis of Alcentra's financial condition was based on an analysis of the full, audited accounts (clean opinion by KPMG) of both Alcentra Ltd and the holding company, as of 31 December 2008. Alcentra is a profitable business, with continued profit growth and a good financial condition. The operating cash flows generated by Alcentra Ltd are generally reinvested in the form of seed capital in the funds and holdings of equity tranches of CLOs. These investments are lodged in Alcentra Investments Limited. Consistent with other CLOs managers, a significant proportion of the revenues are subordinated fees, which may be shut down should the performance of the CLOs' collateral deteriorate. Alcentra expects a 20% decrease in total fees for 2009 compared to 2008, which would leave the firm still profitable. As per Fitch's estimates, the firm would be at breakeven, in the absence of subordinated fees.

As an FSA regulated entity, Alcentra Ltd is required to hold appropriate levels of regulatory capital. In practice, it has cash balances and liquidity facilities that equates to several years of expenses. The holding has some debt with its parent, BNY Mellon, in the form of a term loan and a revolving credit facility, recently renegotiated.

Experience and Asset Structure

Alcentra is recognised as one of Europe's leading CLO managers, and management of the CLO product is the core activity. Alcentra calculated that in Q209 its market share was around 5%, documenting its established overall position in the European leveraged loan market. According to data compiled by Fitch, Alcentra is among the three largest European CLO managers as of June 2009, both in notional amounts of CLO paper outstanding and number of CLOs under management. In addition to the CLOs, Alcentra manages six funds, for a total of approx. 900mEUR of assets under management:

- a European credit fund (a total return fund launched in November 2004, EUR130m unlevered as of September 2009);
- two mezzanine funds (launched in May 2005 and December 2007 for EUR254m and EUR273m, respectively, as of September 2009);
- a special situations fund (launched in November 2007 for EUR50m with a target size of EUR150-200m), all currently unlevered.
- An unlevered loan fund (launched in August 2009);
- A structured credit fund (launched in September 2009).

It is also responsible for three total return managed accounts, two of which were launched in 2007 and the third one in august 2009. The European credit fund (close to EUR2bn of AUM at its peak in 2007), which suffered from significant redemptions from typical hedge fund investors such as FoF, has been restructured with the creation of two sub-funds, one for recovery and one for liquidation.

In the US (outside the scope of the rating), Alcentra has 15 CLOs under management from its offices in New York (formerly Los Angeles, which was closed in 2009). While Alcentra ranks as one of the largest CLO managers in Europe, it is still somewhat smaller in the US. As the development of the US business is a strategic objective, the former lead CLO manager in London has been moved to become US CIO and Alcentra is taking an active role in the consolidation of the CLO industry. Recently, it has taken on US CLO business from BoNY Capital Market and Rabobank.

Alcentra focuses exclusively on sub-investment-grade assets, currently largely leveraged loans, and plans to expand its product offering in this segment by launching new vehicles such as unlevered loan funds or managed accounts or a fund invested in CLO tranches. Similarly, Alcentra intends to diversify further across other sub-investment-grade instruments, such as distressed, high yield bonds and mezzanine. While CLOs represent the bulk of the assets and revenues, the diversification of the product offering is strategically important and Fitch will monitor how Alcentra builds a strong diversified fund platform while adhering to its core sub-investment-grade expertise. This will involve, as fund and segregated mandate assets grow, strengthening and adapting distribution capabilities, portfolio construction and risk management processes.

Alcentra has aligned itself with the interests of its investors through co-investment in the equity pieces of its CLOs; this averages 1% per CLO, for a total investment amount of EUR60m globally. The new funds have also been largely seeded by Alcentra itself (for a total of approximately EUR80m).

As of June 2009, the Alcentra group managed over USD18bn globally, with Alcentra Ltd, the European arm of the Alcentra group, managing 16 European CLOs representing EUR9bn of AUM. Alcentra's first CLO, Jubilee I, was launched in 2001, and since then Alcentra has continued to steadily issue CLOs every year until last year. Growth of the CLO business has increased dramatically since December 2005, with 11 CLOs issued since that time (five in 2006, four in 2007 and two in 2008 to date). Alcentra has approximately 300 clients from around 30 countries. These investors are typical CLO investors (three quarters are banks or insurance companies) and Alcentra has started to expand its investor outreach to long-term players more accustomed to funds and mandates, such as pension funds.

Alcentra has one of the longest histories of CLO management in Europe (since 2001). Its experience in leveraged finance asset investment and management goes back further, to 1999, while the core team that went on to found Alcentra was at BCAM.

Corporate Independence & Governance

While benefiting from the support of its parent, Alcentra operates as an independent subsidiary in terms of operations, controls and investments. The board of the holding company consists of nine directors, all from Alcentra or the BoNY Mellon group, without external independent members. Alcentra Ltd is FSA regulated and other affiliates are regulated by the SEC or the Irish Financial Regulator.

All the funds and CLOs use top tier service providers, the main ones being BoNY as CLO trustee or hedge fund custodian, Goldman Sachs as prime broker and KPMG as fund auditors.

Alcentra benefits from a robust control environment with well-documented procedures. The strength of Alcentra's procedures and controls are driven by two key factors: firstly, the Alchemy Group's investment in Alcentra was structured around its exit strategy, initially planned through an IPO. As a result, Alcentra was built in preparation for being launched as a publicly listed and traded company, with all appropriate procedures and controls in place. Ultimately, Alchemy's holding was bought by BNY Mellon, rather than Alcentra becoming a listed company, but nonetheless, the public company controls remain integral to Alcentra. Secondly, as an FSA regulated entity, Alcentra is required to have a full suite of appropriate procedures and controls in place. Alcentra used an external consultant, Resources Compliance, Inc to assist it in preparing its procedures in accordance with FSA regulation. In addition to assisting with the preparation procedures, the consultant provided Alcentra with detailed feedback on its procedures and controls, along with an action plan to enable it to effect these recommendations.

Alcentra is furthermore audited by BNY Mellon's internal audit function. The head of compliance is James Algar, who also heads up the European administration team with Stuart Medlen.

Staffing

Roles and responsibilities between and within teams are clearly defined and Fitch can identify a clear segregation between investment and operations. At the most senior level, the operational responsibilities are split between a chairman/CEO, a US CIO and a CFO/COO. To date, Alcentra has not set up a fully-fledged independent risk management and control function, most controls being performed on a first-level basis by operational staff and by senior management through good reporting capabilities.

Alcentra's senior management team continues to bring consistent and stable leadership to the business. Following the decision in 2008 of the former president, Christopher Damico, to take a back-seat role in the business, David Forbes-Nixon (previously managing director and head of Europe) became group chairman and CEO, and Stephen Bruce (previously managing director and head of US) replaced Mr. Damico as president. Both are founding partners of the firm. In early 2009, Paul Hatfield, managing director and previously main CLO portfolio manager, moved to New York as US CIO. He was replaced in its function of European CLO portfolio manager by Graham Rainbow, 17 years of experience, who joined Alcentra in June 2008. Overall, the management team is highly experienced and long tenured, with an average of over 20 years' relevant experience and over eight years' company tenure.

Alcentra benefits from good breadth and depth of staff across the organisation: it employs 54 people worldwide, with 35 people employed in Europe. The European office is split into the following five teams:

- the European portfolio management/credit team of 13 (of which three are portfolio managers), responsible for portfolio management and credit research;
- the administration team of 13, responsible for global CLO and fund administration;
- the financial administration team of three;
- the business development team of four; and
- the credit structuring team of two, responsible for structuring, investment in structured assets (via the fund launched in September 2009) and equity valuations.

Alcentra has experienced a low staff turnover since inception. Over the last year, there have been few departures from the team, which has in fact grown to 40 staff in Europe from 33, with additions in fund administration, structuring and marketing. The staff retention strategy incorporates a market rate salary and bonus, and an equity distribution scheme. Under the equity distribution scheme, members of staff own a 9% holding in the Alcentra group, according to seniority/tenure, providing a strong incentive (given Alcentra's profitability) for staff to remain long term. Additionally, the founding partners have signed lock-in contracts that prevent them from extracting their personal investment from the firm for a predefined period. These contracts are complemented by five-year non-compete contracts. Other senior staff members have signed three-year lock-in contracts.

The portfolio managers are highly experienced and long tenured. CLO portfolio management is the responsibility of Graham Rainbow as the main CLO portfolio manager, with David Forbes-Nixon as co-portfolio manager. The two mezzanine funds are managed by Graeme Delaney-Smith (14 years of experience) and the special situation fund by Damien Miller (12 years of experience) Fitch perceives some key person dependency on the portfolio managers. Nonetheless, the portfolio managers are well supported by the senior credit analysts and the current number of distinct portfolios and trading volumes do not create excessive risk. Should the situation evolve, notably given the firm strategy to broaden its product offering, Fitch would expect more staff dedicated to portfolio management activities.

The portfolio managers are complemented by an equally experienced pool of 10 credit research analysts. Members of the portfolio management/credit team have an average of 11 years' leveraged finance experience. Kevin Lennon and Richard Samuel, senior analysts and members of the investment committee, have 19 years' industry experience and 7 years' company tenure. Alcentra operates a matrix approach to research, with analysts specialised by industry sector where appropriate. Each analyst covers two sectors and analysts are responsible both for analysing new issues and monitoring loans under management. On average, each analyst has a relatively low workload of around 17 loans, while Alcentra considers 25 loans per analyst to be the maximum (at or before which point further resources would be added to the team). Recruitment to the team has historically been from the leading leveraged finance investment houses.

In addition to the seven analysts who are specialised by industry sector or countries (where local jurisdiction knowledge plays a key role, such as France, Spain or Belgium), Alcentra employs two work-out specialists, one senior and one junior. The senior work-out specialist left the team recently and is to be replaced shortly by someone with a similar profile, ie with significant experience of distressed companies. The role of the work-out specialist is to monitor and work out the "watch list" (38 loans as of June 2008), including participation in steering committees for transaction restructuring.

Alcentra's European administration team is well staffed by 11 experienced professionals. It is led jointly by James Algar and Stuart Medlen. James Algar has 26 years' industry experience and 10 years' company tenure, having originally moved over to Alcentra from BCAM at Alcentra's inception, while Stuart Medlen has 11 years' experience and five years' company tenure. They provide effective leadership to the team.

Roles and responsibilities between and within teams are clearly defined. In the administration team, analysts are divided appropriately between the following functions:

- CDO administration (four staff);
- loan settlements and support(three staff); and
- total return fund administration (four staff).

Early this year, two staff in charge of US CDO transaction management moved from the LA office to London. All members of staff in the administration team have experience of operating Wall Street Office (WSO), resulting in a good overlap of staff. Historically, Alcentra has mainly recruited administrative personnel from the trustees (complemented by other individuals from the market) with the result that most people joining the team already have WSO experience.

As already noted, Alcentra has not set up a dedicated risk management team.

Alcentra is also fully supported by dedicated financial administration, marketing and structuring teams. The financial administration team supports Robert Bennett as CFO and COO, and was strengthened in 2008 with the addition of another accountant. The marketing/strategic planning team, now of four staff, was also strengthened recently and Alcentra's strategy of developing beyond CLOs may call for additional resources in the future. Lastly, Alcentra added a credit structuring team in 2008, currently consisting of two people, including a portfolio manager, Hiram Hamilton, with 10 years' structuring experience, who is in charge of managing the structured credit fund launched in September 2009.

Non-core activities, such as IT or organisation/formal compliance are outsourced to properly selected service providers.

Credit Selection

Alcentra's credit investment and portfolio management processes are both thorough, and executed with the highest standards of care. The investment style is conservative, credit focused and buy-and-hold, demonstrated through Alcentra's consistent credit strategy. The special situation fund, with EUR50m under management, is a total return fund, thereby more opportunistic and trading oriented.

Sourcing

Historically, Alcentra has sourced the majority of its assets from the primary market and has one of the best sourcing capabilities in that market in Europe. Until the primary market slowed down in summer 2007, Alcentra benefited from excellent sourcing capabilities, which are driven by a number of interrelated factors, including the following:

- Alcentra has a substantial market share, with EUR9bn (European) of AUM, accounting for approximately 5% of the total European leveraged loan market in 2008, according to company calculations. Given the large volume of AUM, Alcentra was able to fund large ticket sizes, up to EUR300m for senior secured positions and up to EUR200m for mezzanine and second-lien positions.
- Alcentra has one of the longest track records in the European leveraged loan market, thus demonstrating to the market both the credit consistency of its analysis, and its commitment to that market.

- Relating to its long investment track record, Alcentra has developed relationships with the leading private equity sponsors, syndication desks and middle market intermediaries for the mezzanine assets. These relationships are strong both at an institutional level and at a personal level, driven by the close relationships of senior members with the major players, particularly in the private equity community.

Research

The investment process involves two steps; an initial pre-screening stage focuses the comprehensive research on a limited number of credits and allows Alcentra to give early feedback to arrangers. The pre-screening criteria cover aspects such as the size of the company - Alcentra prefers to target larger companies with an enterprise value of greater than EUR200m - the capital intensity of the business, and the amount of cash the business can generate, among other factors. The mezzanine fund however focuses on EUR20m to EUR40m positions from middle market transactions. A special concern at the pre-screening stage is more volatile industries, and businesses with significant differences from their peers. In these cases, investments are made on a case-by-case basis. The result of the pre-screening is presented to the credit investment committee by the analyst, at which point the committee requires the analyst's recommendation and the support of one of the portfolio managers to move to the full analysis.

The credit investment committee involves the most senior investment professionals: David Forbes-Nixon (CIO and chairman of the investment committee), Graham Rainbow (CLO portfolio manager), Graeme Delaney-Smith (mezzanine debt portfolio manager), Damien Miller (special situations portfolio manager), Kevin Lennon (senior analyst) and Richard Samuel (senior analyst). The committee has an average industry experience of over 18 years. The committee decision will either be an approval, a disapproval or a decision to commence coverage. Should the decision be the third one, the credit will be monitored, but will require further analysis before an investment is considered. Committee decisions are documented and signed off by authorised signatories.

The full due diligence is detailed and of good quality. It follows a standard top-down and bottom-up methodology, beginning with a top-down analysis of the industry (and of the company within the industry), including the market positioning of the company and operational aspects of the company. This stage of the process includes the analysis of the credit metrics and financial forecasts of the company. Alcentra uses a standardised financial model in which the transaction case is compared against a flat EBITDA case and a proprietary Alcentra case, as appropriate. Analysts also produce an assessment of the recovery value in the event of default. The second, bottom-up step of the analysis examines the capital structure of the transaction, both at the hold-co and op-co level, and transaction security rights and obligations. This analysis is complemented by meetings with the management of the company, where possible, and by a review of all the loan documentation, using external counsel as appropriate. The output of the analysis is a 15-20 page credit report, which includes the outputs of the financial models, the recovery analysis, and an internal credit rating. The report is presented to the investment committee, at which the committee will either approve, decline or recommend further monitoring of the credit. This investment committee takes the credit decision, while the actual investment decision is the responsibility of the portfolio manager, in line with the allocation policy documented by Alcentra in 2008.

In its European loan portfolio, from 2001 to 2008, Alcentra suffered from three defaults, below the market average, and 12 defaults[1] year to date as of August 2009, in line with market. Compared to other European CLO managers, at this point

[1] It is worth noting that some of these were technical defaults, with recovery close to 100% across the capital structure.

of the cycle, Alcentra's loan book is on average skewed toward better credit, with less exposure to 'CCC' and below rated assets, though it differs significantly from one CLO to another.
For the special situation fund, the selection process combines fundamental and technical analysis, the former component being largely supported by the same credit selection process as for CLOs.

Overall, the credit research process is very fundamental, bottom-up driven, consistent with the way CLOs are managed. While it gives some weight to sector and macro considerations, Fitch would expect increasing formalisation of a top-down process, as Alcentra develops investment vehicles more actively managed and exposed to market risk.

Relative Value Analysis

CLOs or mezzanine funds are currently managed through a buy-and-hold approach, with the objective of minimising credit events while maximising capital recovery should defaults occur over the life of the fund. In that context, market pricing and relative value are secondary considerations from a pure portfolio management perspective.

In the case of the special situation fund, which is actively traded (one trade a day on average), and more generally the newly launched total return funds, market pricing plays a more important role and, without particular formalisation given the still limited liquidity in the sub-investment-grade market, relies on the experience and trading skills of the portfolio managers.

The asset selection process for the unlevered fund investing in high-grade tranches of CLOs will consist of:

- a price screening (focus on tranches priced below 50%); and
- a fundamental review and stress tests of the structures through Intex to remove assets with a default prospect over six to 12 months under stress scenarios.

Portfolio and Risk Management

Portfolio Construction

The CLOs and mezzanine funds' portfolio construction process put particular emphasis on ensuring opportunities are properly sized. This means that Alcentra has not sought over-diversification and top positions are rather big, reflecting strong confidence in their credit standing based on the fundamental analysis described above. This is particularly true for the mezzanine funds, which have approximately 15-20 positions. Last year, a formal allocation policy based on available cash and CLO characteristics was implemented to allocate fairly transactions across investment vehicles.

The special situation fund is more actively traded and concentrated and the process more informal, based on the judgment of the lead portfolio manager. It can invest in loans, bonds, equities and CDS.

Trading and Work Out

Alcentra has good access to the secondary market through established relationships with leading bank trading desks and other market participants. Clearly, markets have changed and strong primary access is not as important post-credit crunch, given the lack of new primary flow. Nonetheless, it has not dramatically increased its usage of the secondary markets, remaining a fundamentally buy-and-hold investor. Furthermore, it has more recently deployed cash to build par by purchasing loans at prices above 85% (limit applied in calculating the overcollateralisation test). The special situation fund is actively traded (on average one trade a day, although frequency varies widely) both on the long and short side.

Alcentra recruited a work-out specialist in 2006 in preparation for a downturn in the credit markets. Having left the firm recently, he will be replaced soon. A junior analyst is also dedicated to distressed assets. The role of the work-out specialist is to manage the watch list and to guide the work-out process should Alcentra decide to go through that process (currently for eight transactions). Where Alcentra believes it can achieve better recoveries by going through the work-out process it will do so, as compared to an early pre-default sale price. Further support in a work-out situation would be provided by David Forbes-Nixon and Graeme Delaney-Smith, all of whom have had prior work-out experience.

Risk Monitoring

Given that most of the assets consist of closed-end vehicles (CLOs or mezzanine limited partnerships), risk monitoring focuses essentially on credit risk. Liquidity and market risk however remains relevant for total return portfolios.

Credit risk management is a function of the portfolio managers, effected through daily portfolio reviews, monthly updates on individual credit and quarterly full portfolio reviews. Portfolio managers interact closely with the credit and administration teams. Procedures governing all aspects of CLO management and administration are documented in detailed manuals and workflows, updated frequently.

On a day-to-day basis, and at the portfolio level, controls are affected through WSO, where, for example, full pre-trade compliance checks are a function of the administration team. The administration team acts as a second level of control on all trades, before the trade ticket is sent to the trustee. Alcentra has implemented systems to generate automatic trade tickets through WSO (see *Technology*). While Alcentra has sufficient portfolio risk analytics for the nature of its business, Fitch notes that the development of total return funds will require the enhancements of tools to facilitate investment risk analysis and reporting at the portfolio levels through key credit and market risk indicators. In a similar vein, a second level of controls through an independent risk management function may have to be added should the total return business grow.

Alcentra's portfolio is under constant supervision and analysis, allowing quick reaction to market trends. In the context of weaker primary flow, the surveillance process has become more intensive and rigorous at every stage. On a daily basis, the CLO portfolios are monitored by the administration team to evaluate the impact of any purchases, sales, rating actions, prepayments etc on the portfolio. All changes that affect the portfolio are reported on an ongoing basis to the portfolio manager, but formalised in thrice-weekly morning meetings. Credit market issues, portfolio trends and news flows are discussed at these meetings. Two weekly packs, one for CLOs and one for funds, are produced and circulated throughout the firm. They provide all positions and key metrics across portfolios, offering a systematic tool to supervise books.

Liquidity can represent a relevant risk for funds and Alcentra aims at limiting asset liability mismatch through conservative redemption terms and the use of side-pockets. Funding has become a secondary issue as funds now have very limited leverage (through total return swaps for the special situation fund or a credit facility for the mezzanine fund).

On a monthly basis, financial information (comprising updated credit metrics) on each asset is received and input to well designed, individual spreadsheet-based monitoring sheets that allow for comparison of ongoing results against budget and for relative performance analysis between companies in the same industries/sectors. Individual loan models are also updated, and the analyst reviews the trend data and updated model outputs. The outputs of the monthly updates are circulated to the team as "flash notes": short summaries detailing the key components of that company's performance over the month. Where deterioration has been detected, the "flash note" is more detailed, and further action may be taken as warranted, including a full re-analysis of the due diligence package. The purpose of "flash notes" is to efficiently communicate performance information and to avoid any shocks at the quarterly portfolio reviews.

On a quarterly basis, in addition to updating credit metrics in the monitoring sheets, updated budget figures are received and reviewed against current and historical credit metrics. With this information, analysts complete a formal quarterly review of all assets and present an appropriate update of the rating to the credit committee. Alcentra uses rating scales to reflect credit, liquidity and recovery. Credit is scored from '1' – '5', with 1 being the highest, liquidity from 'A' to 'D', and recovery as a percentage. As soon as an asset is downgraded to '3', it is placed on the watch list, for which the work-out specialists are responsible. Of the approximately 150 credits Alcentra has under surveillance (as of June 2009), 40 were on the watch list.

While Alcentra's stated investment style is buy-to-hold for CLOs and mezzanine funds, a disciplined sell philosophy is adhered to. Investments are considered for sale if a spread price target is achieved, if credit deterioration is experienced, if relative value is identified, or if the sale will benefit portfolio diversification. The sell decision resides with the portfolio manager, and no committee approval is required. The portfolio manager is also responsible for sourcing best execution on the intended trade, in the absence of dedicated trading staff. Typically, Alcentra sells stressed assets, or those that are anticipated to become stressed and, more recently, Alcentra has exploited market rallies to dispose of certain assets. The sell decision remains the responsibility of the portfolio managers, based on the credit decisions of the investment committee.

As already noted, the special situation fund is more actively traded and can sell assets more frequently on the basis of pricing opportunities.

Investment Administration

Alcentra's investment administration capabilities are, in Fitch's opinion, best-in-class in Europe. It has a very strong team in place, a well developed and overseen relationship with the trustee on all its CLOs, the use of the industry standard loan administrative tool, and very good supplemental investor reporting in the case of CLOs. In 2008-9, Alcentra created a global operations platform, largely centralised in London with streamlined processes.

Reporting & Communication

Alcentra is committed to delivering timely and transparent information to all investors. In the case of CLOs and mezzanine funds, trustee reports are complemented by portfolio commentaries prepared by the portfolio managers. These typically consist of an overview of the diversity of the portfolio, a comment on any trends in the weighted-average rating factor (WARF), weighted-average recovery rate (WARR) and weighted-average spread (WAS), and a brief outlook for the portfolio. Additionally, prices are provided on all positions in the portfolio. In Fitch's opinion, these reports provide a concise and timely insight to investors. All trustee reports are distributed by the trustee, and are also available through Alcentra's website at www.alcentra.com. On the website, investors can also access offering circulars, and the latest prices on all positions, which are updated monthly. Alcentra actively engages with investor requests for further information, as demonstrated by the strengthening of its marketing team (see *Staffing*), and through its commitment to treating all investors equally (evidenced by the use of its website as the main tool for distributing any additional information).

Funds, which are still small in AuM, benefit from a simple newsletter that discloses performances, allocations and provides a typical market commentary. Should assets and the number of investors grow, Fitch sees room for additional information and analysis to be provided.

Administration

Loan settlements are a function of the administration team, where detailed check-lists for loan settlement and loan legal documentation have been prepared and are followed in detail. Loan settlement flow charts are regularly updated. The administration team is responsible for back-office controls, such as daily cash reconciliation with the trustee. The depth of experience and the clear separation of duties and responsibilities in the administration team ensure the effectiveness of these operational controls.

All of Alcentra's portfolios are set up and modelled in WSO, as the industry standard loan administrative software solution. WSO was rolled out in 2001 as the core administrative system, and has been used on every vehicle since then. The latest versions of WSO are installed and operational for all CLOs, resulting in operational efficiencies. The process for adding new deals to WSO is highly efficient, as demonstrated recently with the acquisition of several CLO businesses. As soon as Alcentra is mandated on a new deal, Markit (vendor of WSO) is simultaneously mandated to build the model for the deal in WSO. This ensures that the deal compliance model in WSO is in place and tested by the effective date.

In 2008, Alcentra acquired Geneva as a fund accounting system. While all positions for funds are booked and monitored in WSO, NAV calculation for independent checks of the fund administrator services is performed in Geneva.

Trustee relationships are well developed, and Alcentra's systems are well integrated with trustee systems. Alcentra uses BNY Mellon Global Corporate Trust (previously JP Morgan Corporate Trust Services) as the trustee on all of its European transactions. As a result, Alcentra is a leading client and has a long relationship with the trustee. Similarly to Alcentra's relationship with Markit, this results in Alcentra receiving a very good service from the trustee as a key client. Furthermore, as the trustee also runs WSO as its main administrative tool, the interaction with Alcentra is seamless. The administration team is the key point of contact with the trustee. Principal account balances are tied-out with the trustee daily, while other account balances are reconciled twice weekly. In addition to cash balances, the administration team maintains a log of unsettled trades, which are reconciled daily with the trustee. The use of WSO by both parties facilitates the largely automated reconciliation process.

More recurrent procedures on loans, such as rollovers or pay-downs, are being streamlined, thanks to the acquisition of WSO Data and WSO Fax (see below). Valuation on loans is provided by Markit.

Technology

Alcentra's technology is an adequate match to the requirements of loan portfolio management and credit research practices. Its main tools are WSO for asset administration, complemented by spreadsheet-based solutions for asset analysis, Intex for equity tranche valuation and Geneva for fund accounting.

Front Office Systems

Given the nature of the sub-investment-grade instruments it manages, Alcentra does not have, nor in fact need, a sophisticated front-to-back office trading or portfolio management system. Instead, its IT requirements are more than adequately met through its core system for portfolio monitoring and loan administration - WSO. WSO is integrated to front-office systems, notably for the portfolio manager information packs. These packs, prepared weekly, are spreadsheet-based and driven by data dumps from WSO. These produce snapshots of key metric performance and portfolio diversity; they form the basis for the supplemental portfolio manager commentary reports.

Other front-office systems include the asset monitoring spreadsheets that are updated with monthly and quarterly account and budget information on every asset and used for performance monitoring and relative value analysis. Alcentra's models for individual assets are standardised, proprietary, spreadsheet-based tools used for scenario analysis (see *Portfolio Management*). The spreadsheets used for credit research (modelling) and surveillance are adequate for Alcentra's requirements and are complemented by the portfolio analysis provided through WSO. On the liability side, Alcentra does not use a proprietary cash flow model for stress testing structures. It does, however, have Intex, currently used to value the equity of its CLOs under management and stress test other CLOs structures.

Middle- and Back-Office Systems

WSO is used across all vehicles, and was implemented in 2001. It provides a complete suite of CDO administrative modules, all of which are implemented and tested. These include risk management functions that allow for the tracking of the size of all positions across the portfolio, detailed asset and portfolio tracking functions and cash balance reconciliation functions. In addition to the standard modules (compliance, reporting, etc), FCS has provided a number of custom tools to Alcentra, in response to the company's specific requirements. These include tools such as the "scheduler", which updates all compliance tests daily and drives portfolio manager information packs, and an automatic trade ticket generator that complies with all trustee requirements and precludes the possibility of any human error. Alcentra has installed the latest version of all modules of WSO, resulting in improved run-times and increased operational efficiency. An automated interface with Markit is being implemented to directly upload loan rollovers, pay-downs and other cash flows via a daily feed into WSO, freeing up time for administrative staff for controls and added-value tasks.

Comprehensive reporting functionality, integral to trustee reconciliation, is provided through WSO at individual asset, as well as portfolio and enterprise-wide levels. Additionally, Alcentra subscribes to Markit for third-party prices on its loans under management. As of 2008, Alcentra had integrated, automatic price feeds from Markit to WSO, thus providing more responsive reporting.

In 2008, the Geneva NAV calculation tool, provided by Advent, was added for use on the funds and mirror a fully fledged NAV, including performance fee calculation and share classes.

Data Management & Integration

WSO serves as a backbone to the overall data structure and systems as well as service providers are, as much as can be, interfaced with the central application. With respect to position keeping, trade settlement and administration, Fitch views Alcentra's platform as highly integrated.

To date, Alcentra has not set up dedicated central databases and streamlined query tools for client relationship management, credit research, monitoring and reporting, which remain essentially based on spreadsheets. Fitch perceives data management and integration as a potential area of improvement to continue to lead industry best practices. The agency notes that the absence of a dedicated IT resource may make further IT development challenging.

IT Security

Alcentra does not have an in-house IT support team, preferring instead to outsource this function and concentrate on its core competency in portfolio management. Since 2003, Alcentra has used a consultant to provide all IT support, co-ordinated by the office manager. Consultants are used regularly to produce bespoke reports and to aid in projects, such as the automatic integration of LoanX prices to WSO in 2008 or WSO fax implementation this year. Appropriate disaster recovery systems are in place, including a disaster recovery centre located in Kent, daily tape back-ups of all core systems and off-site mirror servers.

Appendix 1

Staffing Summary

	Background highlights
David Forbes-Nixon Chairman and CIO 23 years' industry experience 12 years' company tenure	• Founding member of Alcentra, Chairman, CEO and CIO. • Previously Global Head and CIO of BCAM, which he set up, along with the par loan trading business. • Director of the Loan Market Association (LMA) and chair of the LMA valuation committee from its inception in 1996 until 1999. • Three years at Bankers Trust as Vice President and Head of leveraged loan distribution. • Five years at Chemical Bank in structured finance and loan syndication. • BSc (Hons.) in Chemical Engineering from Birmingham University.
Graham Rainbow Executive Director and Senior CLO Portfolio Manager 18 years' industry experience One year' company tenure	• CLO portfolio manager. • Previously, co-head of the leveraged syndicate desk at Barclays Capital, responsible for underwriting senior, second lien and mezzanine LBO debt. • 13 years at Barclays Capital in loan trading, credit and sales before joining the Leveraged Finance team in 1998. • BSc (Hons.) in Management Science from Warwick University and an MBA from Warwick Business School.
Graeme Delaney-Smith Executive Director and Head of Mezzanine Investments 16 years' industry experience Five years' company tenure	• Mezzanine fund portfolio manager. • Previously Senior Deal Executive at ICG. • Five years at Royal Bank of Scotland (RBS), latterly in the leveraged finance team. • MBA from Heriott Watt University Business School, Edinburgh. • Degree from Napier University and a chartered accountant (CA).
Robert Bennett CFO & COO 19 years' industry experience Six years' company tenure	• Responsible for group finance. • Previously Finance Director, Compliance Officer and Company Secretary for Baffin (UK) Ltd, a property fund manager. • Ten years in the financial markets divisions of Binder Hamlyn and Arthur Andersen. • BSc (Hons.) in Mathematics from Bristol University, and a CA.
Julian Colville Executive Director Investor Relations and Strategic Planning 14 years' industry experience Four years' company tenure	• Responsible for investor relations, marketing and strategic initiatives. • Previously worked at Barclays Capital in the strategic planning team and at Booz Allen Hamilton in the financial services practice. • Five years at Robert Fleming in institutional equity sales. • MBA from London Business School and MA in History from Edinburgh University.
James Algar Executive Director Transaction Management and Head of Compliance 26 years' industry experience 12 years' company tenure	• Head of Administration team and Head of Compliance. • Original member of the Alcentra team, having joined from BCAM. • Previously Associate Director in transaction management team at BCAM. • Five years at HSBC Investment Bank in specialised finance support. • Further nine years experience within financial services.
Kevin Lennon Executive Director and Head of Credit 19 years' industry experience Eight years' company tenure	• Head of credit and senior analyst covering the food and beverage, retail and leisure and entertainment sectors. • Previously senior industrial analyst at BCAM and leveraged finance analyst at Fitch Ratings. • Worked for 10 years at Natwest Bank, latterly in the head office credit committee.
Stuart Medlen Executive Director 9 years' industry experience 5 years' company tenure	• Responsible for CDO portfolio monitoring, trustee oversight and interaction with other third parties. • Previously worked as an Assistant Treasurer for JP Morgan's Institutional Trust Services for four years. • BA (Hons) Literature and History from the University of Greenwich.
Hiram Hamilton Executive Director and Head of Credit Structuring 11 years' industry experience One year's company tenure	• Responsible for credit structuring, cash flow modelling and equity valuation. • Previously Head of CDOs at Morgan Stanley in London where he structured and originated various credit arbitrage vehicles over an eight-year period. • Began his career as an analyst at Prudential Securities in the asset-backed securities group.

Source: Alcentra

Appendix 2

European CDOs Under Management (At SEP 2009)

Name	Closing	Structure	Primary asset type	Original size (EURm)
Jubilee CDO II	Jun 02	Cash flow	European High Yield (HY) loans	460
Jubilee CDO III	Dec 03	Cash flow	European HY loans	350
Jubilee CDO VI	Jul 04	Cash flow	European HY loans	410
Hamlet	Mar 05	Cash flow	European HY loans	300
Jubilee CDO V	May 05	Cash flow	European HY loans	555
Wood Street CLO I	Sept 05	Cash flow	European HY loans	461
Wood Street CLO II	Feb 06	Cash flow	European HY loans	400
Wood Street CLO III	May 06	Cash flow	European HY loans	550
Jubilee CDO VI	Jul 06	Cash flow	European HY loans	400
Jubilee CDO VII	Oct 06	Cash flow	European HY loans	500
Wood Street CLO IV	Dec 06	Cash flow	European HY loans	550
Jubilee CDO I - R	Mar 07	Cash flow	European HY loans	900
Wood Street CLO V	May 07	Cash flow	European HY loans	500
Wood Street CLO VI	Aug 07	Cash flow	European HY loans	326
Jubilee CDO VIII	Dec 07	Cash flow	European HY loans	400
ECF Financing CLO B.V.	Mar 08	Cash flow	European HY loans	389
Jubilee CDO IX	Jun 08	Cash flow	European HY loans	372
			Total	**7,823**

N.B. Jubilee CDO I was called in December 2006 at a 12.1% internal rate of return to the equity holders
Source: Alcentra

European Funds Under Management (At SEP 2009)

Name	Closing	Structure	Primary asset type	Unlevered market value (EURm)
European Credit Fund	Nov 04	Irish Fund	European High Yield (HY) loans	130
Mezzanine Fund	May 05	Jersey LP	Mezzanine	254
Global special situations	Nov 07	Irish Fund	European HY loans	86
Mezzanine Fund	Dec 07	Jersey LP	Mezzanine	273
Managed accounts, Loan Fund, Structured Credit Fund	2007-9	Accounts	European HY loans/SFS assets	150
			Total	**893**

Source: Alcentra