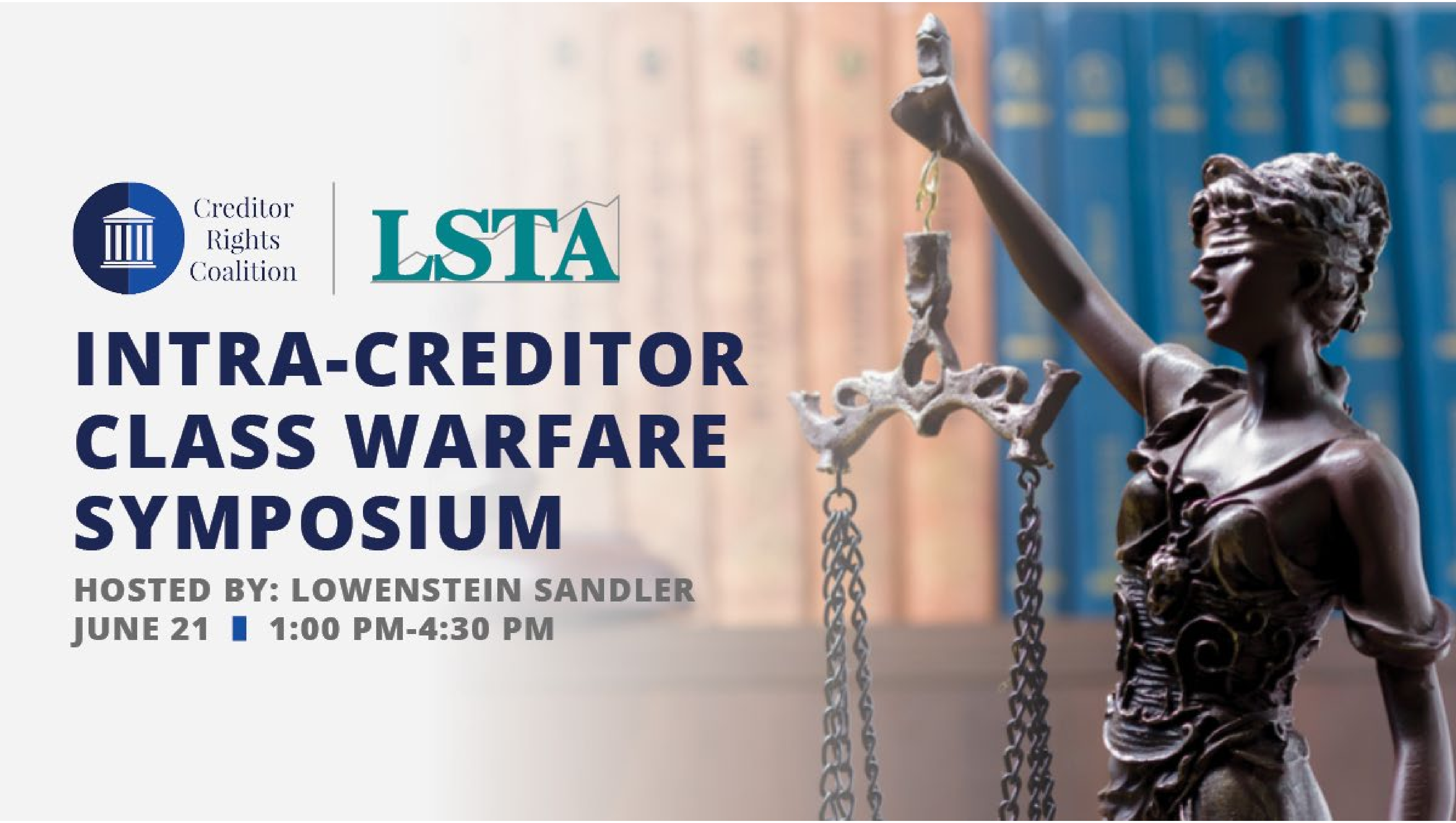
Panel 2: How we got here?



Evolution of Complexity in the Leveraged Finance Market

Time Frame	Market Structure	Overview
The Modern Day LBO is Born (1980 +/-)	Banks	• High interest rates and low equity prices led to "value" buyouts • Private equity market takes root (KKR founded in 1976, Forstmann Little in 1978) • This is the beginning of the modern LBO / leveraged finance market • Investor universe is club deals arranged amongst banks • One document for the RCF + TL; deals are heavily covenanted • Market size is ~$50bn
Drexel Changes the Landscape (Mid 1980's)	Banks <u>Prime Rate Funds</u> <u>High Yield Bonds</u>	• Syndicated loan market begins to develop – still bank-based with no real institutional loan involvement beyond Prime Rate Funds • Drexel fundamentally changes the business; HYB market begins to take off • Loans still heavily covenanted and "buy and hold" – limited secondary market • Clearly defined swim lanes (loans vs. bonds)
Rise of the CLOs (1990's)	Banks Prime Rate Funds <u>CLOs</u> High Yield Bonds	• CLO technology originally developed in the 1980s for the mortgage market now applied to senor secured bank debt • Beginnings of the syndicated institutional loan market; underwrite to distribute model takes hold • Development of relative value; how should loans price vis-à-vis bonds • Secondary loan market develops providing liquidity to investors • LSTA created in 1995 • PE value prop has shifted from buying cheap assets to making operating improvements and financial engineering • Introduction of new debt instruments – HoldCo PIKs – to fund dividends • Still clearly defined swim lanes; bond analysts and loan analysts separate; relatively few, if any cross over managers

Evolution of Complexity in the Leveraged Finance Market (cont.)

Time Frame	Market Structure	Overview
Life Gets Interesting (2000 – 2007)	Banks Prime Rate Funds <u>CLOs: TLBs go cov-lite</u> High Yield Bonds	• Repeal of Glass-Steagall in 1999 leads to consolidation of commercial and investment banks • Market liquidity increases – S&T functions mature • CLOs now dominate the senior secured loan market • Introduction of even more creative financing tools – PIK Toggle • Introduction of 2nd lien loans (secured bonds in disguise) • Cov-lite term loans are introduced in the US (with Europe following ~10 years later) • Loan docs become ever more permissive; balance of power generally on the issuer side • Norm is that bond investors see docs before settling on price whereas loan investors settle on price before seeing docs • Market volume explodes to ~$500bn pre-GFC; swim lanes begin to widen
Post Credit Crunch (2009 – 2015)	Banks Prime Rate Funds CLOs: 1st Lien / <u>2nd Lien</u> High Yield Bonds	• 2013 leveraged lending guidance issued by the OCC/Fed/FDIC leads to (i) expanded definitions of EBITDA and (ii) growth of unregulated lenders / private debt / BDCs • PE funds get into the credit business • Swim lanes begin to disappear with the merger of asset managers; one stop shop for loans and bonds with buyside analysts covering both products
Welcome to the Show (2015 – Present)	Banks Prime Rate Funds CLOs <u>Private Credit</u> High Yield	• Consolidation of the buyside – the big get bigger • Asset managers play up and down the capital stack and are now in the RCF business • Private credit market dominates the middle market and replaces syndicated loans & bonds in periods of market disruption • Markets react to macro events / volatility more quickly than in the past with the balance of power shifting between buyer and issuer depending on market conditions • Increasing complexity of the market leads to fully developed capital markets desks at IBs, PE firms, and credit investors • Swim lanes almost completely disappear

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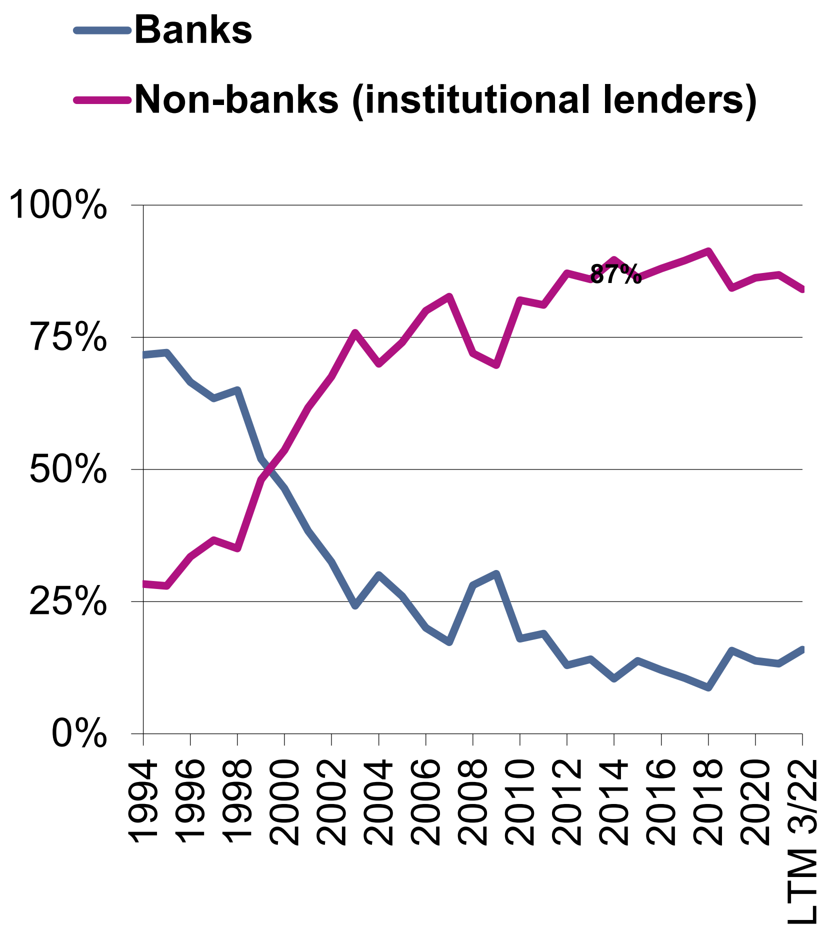
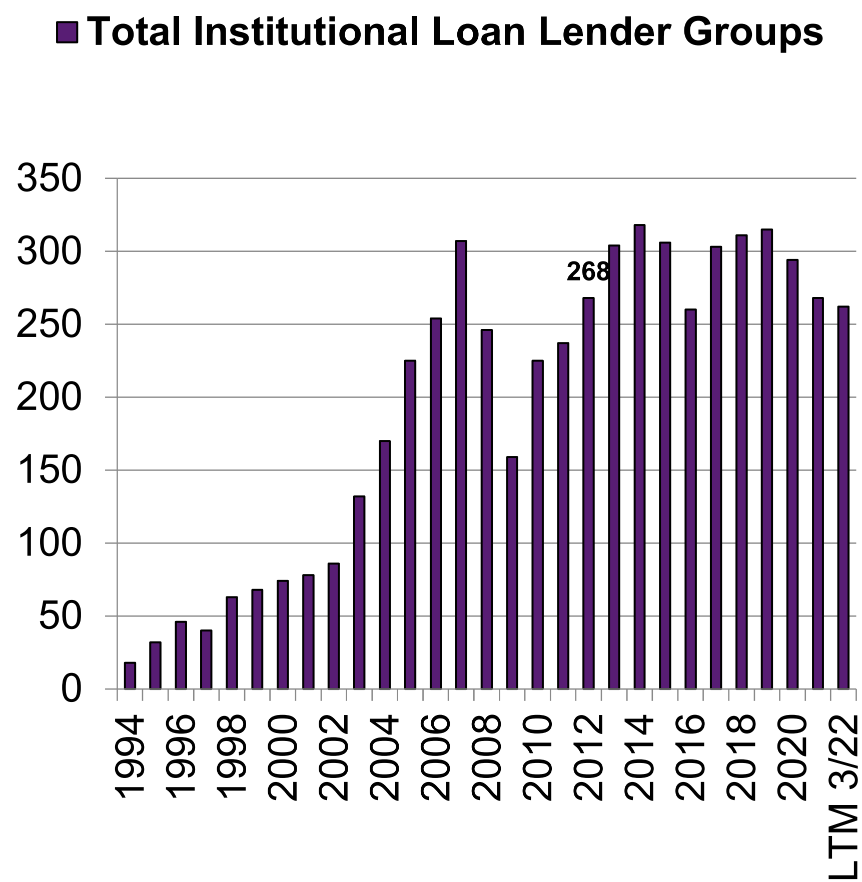
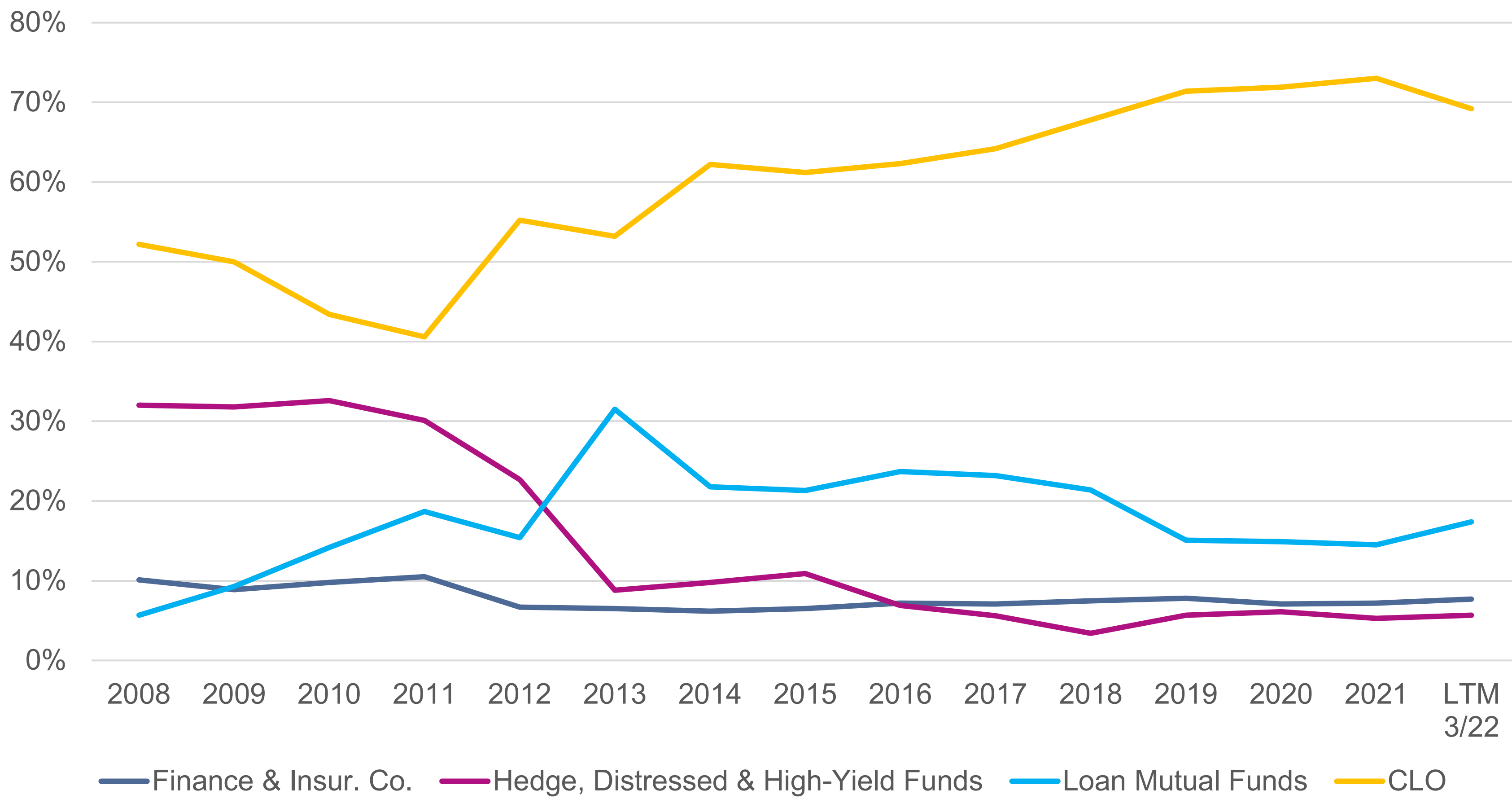
Over the Past 12 Years, The Primary Source of Leveraged Lending has Been Non-Banks





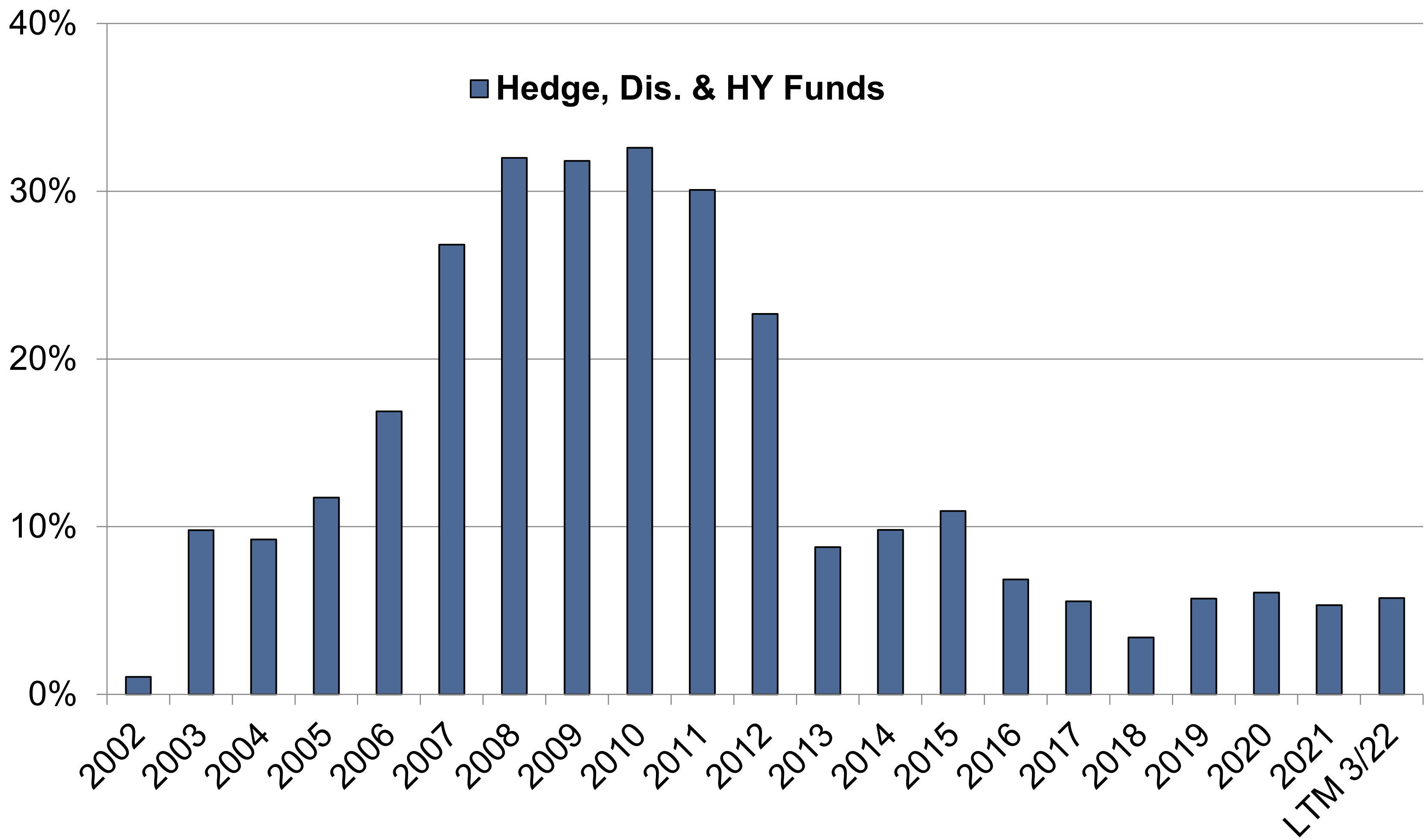
Source: S&P Capital IQ LCD

Break-down of Non-Bank Leveraged Primary Lending



Source: S&P Capital IQ LCD

Hedge, Dis. & HY Funds have become a relatively small portion of the market



Source: S&P Capital IQ LCD

Where are we Today?

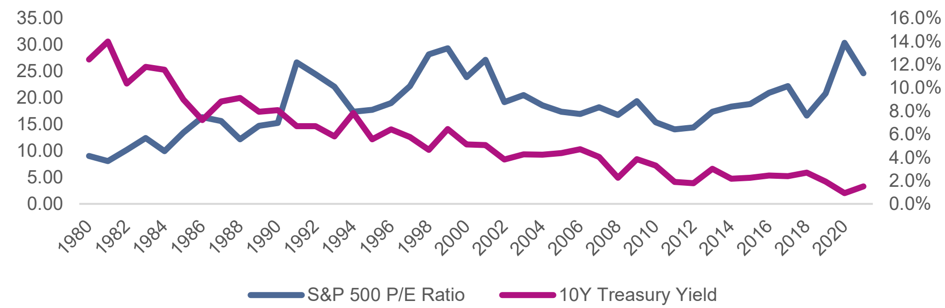
Commentary

- Current market structure allows for efficient raising of massive amount of debt capital
- Risk adjusted returns available for every form of risk appetite
- Demand for private equity and private debt seemingly insatiable
- Consolidation of credit managers is still in early innings
- Complexity is here to stay; there is market demand for complexity
- We are now seeing the evolution of two markets:
  - The “auction” market - dominated by CLOs and HYB, which are buyers of both market risk and idiosyncratic risk - focused on ratings / liquidity
  - The private debt “club” market - comprised of buyers of primarily idiosyncratic risk and less concerned about ratings / liquidity. Private credit deals usually have superior docs to the “auction” market i.e. covenants
- There will always be tension between (i) debt and equity and (ii) various classes of debt
- **With respect to loans, being both senior and secured is foundational. For the system to work, this must be true**

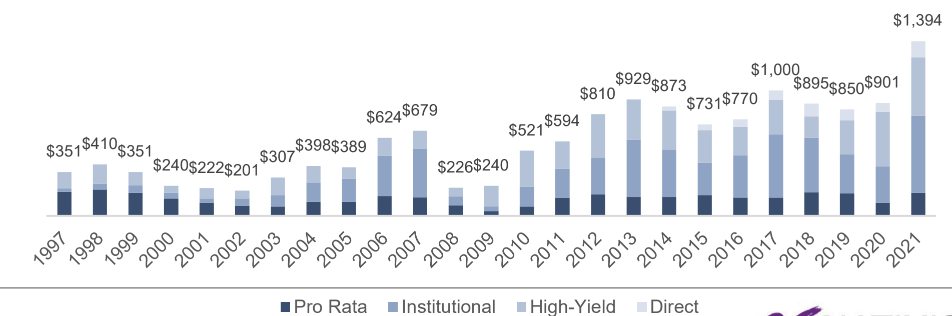
Massive Market

- The leveraged finance market has grown tremendously from ~$50bn in the 1980s to ~$500bn in mid-2000s and to ~$1 trillion of issuance in 2021
- CLO’s, private credit, and high yield bonds are each trillion-dollar markets

10Y Treasury Yield vs. S&P 500 P/E Ratio



Annual Leveraged Finance Issuance ($mm)



Note: Per Bloomberg, LCD, Loan Connector

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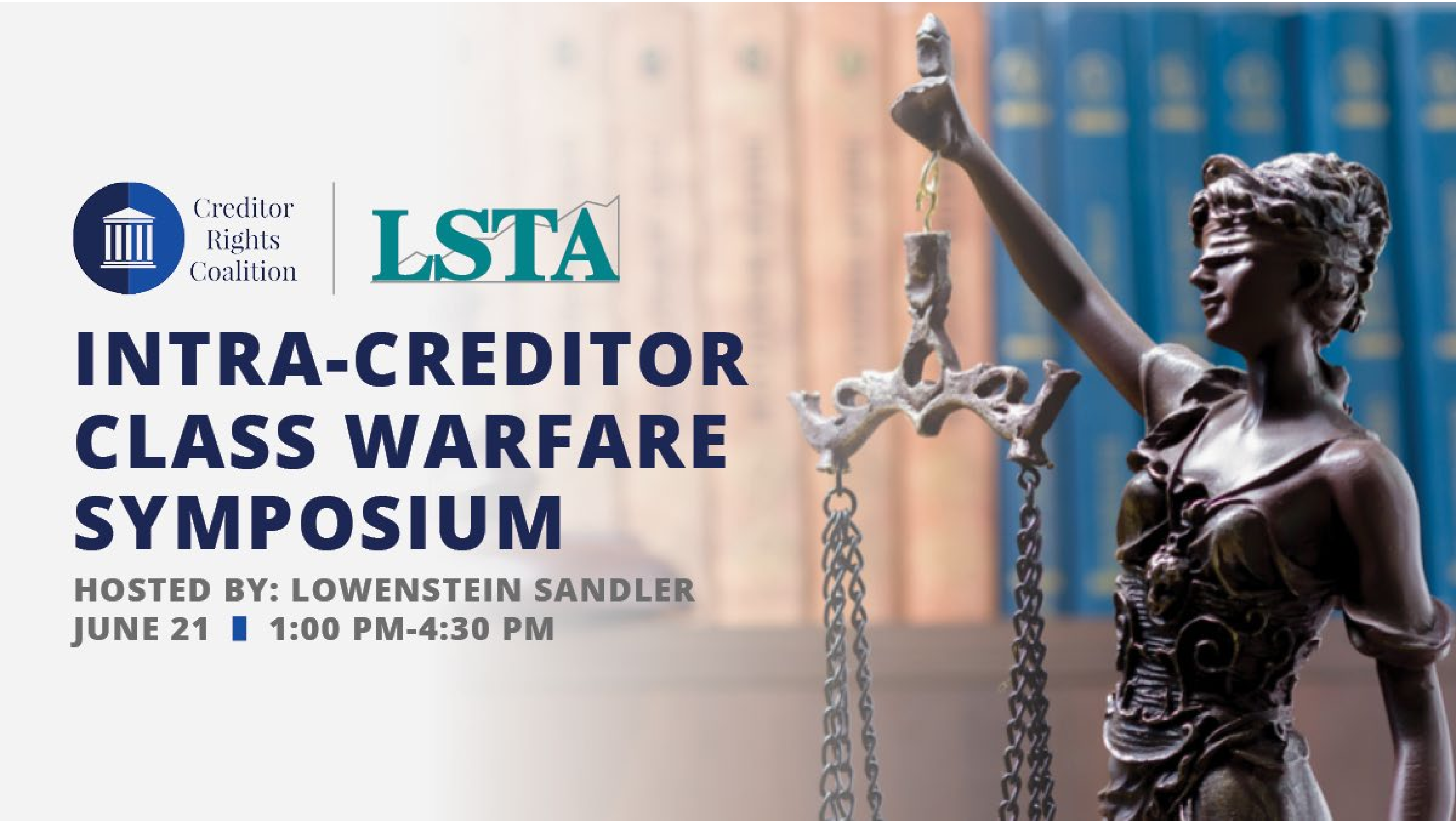
Creditor
Rights
Coalition
LSTA
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SYMPOSIUM
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JUNE 21 1:00 PM-4:30 PM