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Welcome to the webinar:

„Effects of COVID-19 Crisis on Private Debt: Dislocations in the Broadly Syndicated Loan Market"

Introduction: Annette Olschinka-Rettig, Managing Director, BAI e.V.

Presentation: Bill Sacher, Partner & Head of Private Credit, Adams Street

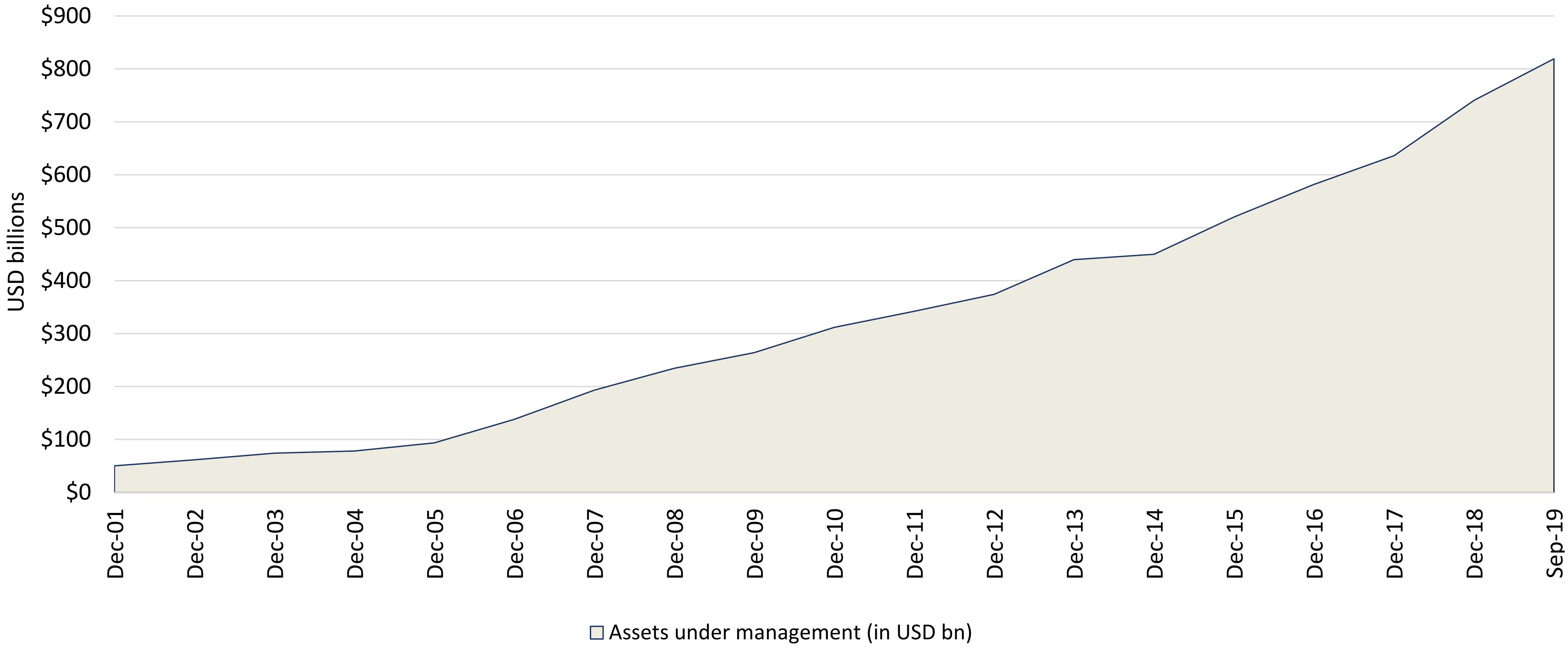
June 18, 2020

Upcoming webinars

Thursday, **June 19, 2020**	**Let's Go Digital!** (LIS)
Friday, **June 25, 2020**	**Private Equity: Why one third of carve-outs fail and how to get them right** (TMF)

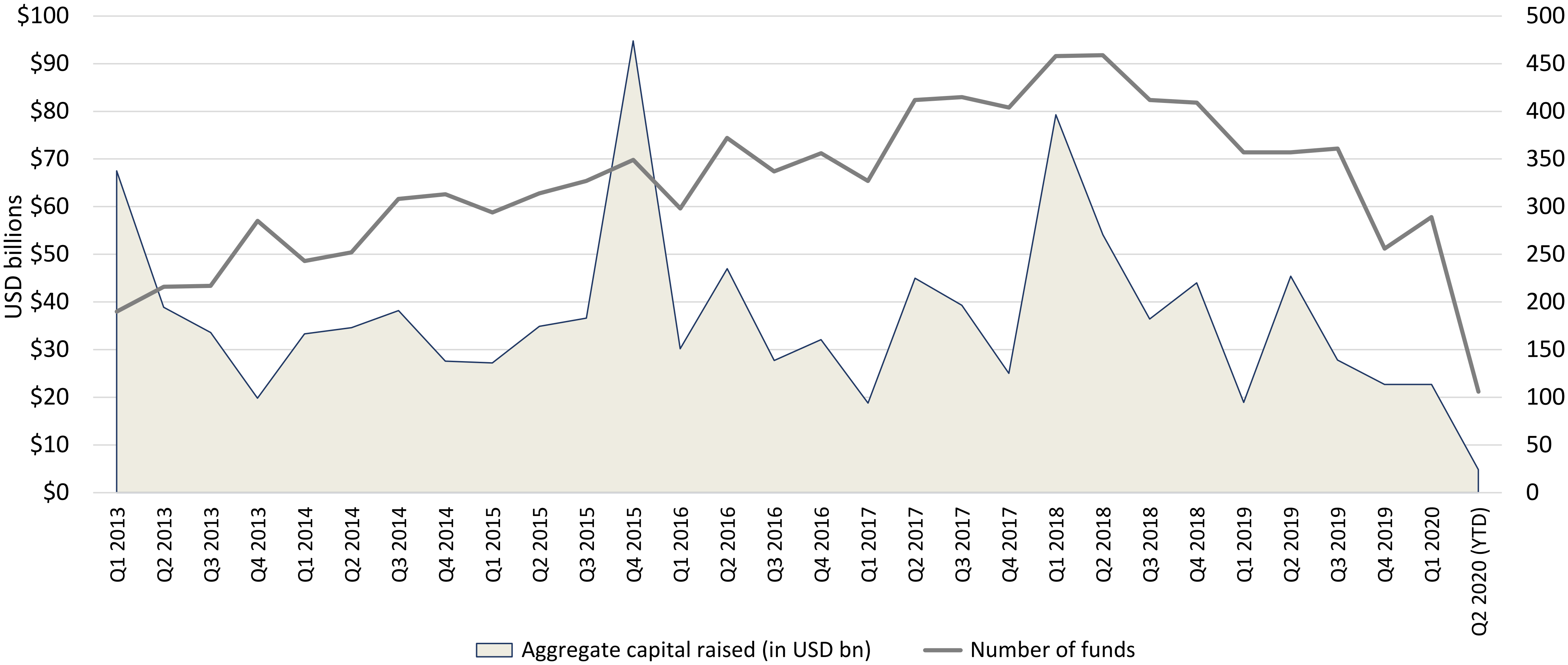
Further webinars will follow. Please see BAI homepage.

Global assets under management: Private Debt



Quelle: Preqin Pro.

Global historical fundraising: Private Debt



Quelle: Preqin Pro.

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Bill Sacher

Partner & Head of Private Credit, New York

Bill is Chair of the Adams Street Partners Private Credit Investment Committee and a member of the Executive Committee. He leads the investment and portfolio construction efforts of the Private Credit Team.

Prior to joining Adams Street, Bill was head of the US Private Debt Group (at the time the Mezzanine Debt Group) at Oaktree Capital Management. In this role he developed the strategy, managed the team, and approved the investments. In conjunction with Oaktree's in-house marketing team, Bill led the fundraising effort for each of the three funds for which he was responsible.

Prior to Oaktree, Bill worked at J.P. Morgan, where he was the Co-Head of both the Leveraged Finance Origination Team and the High Yield Capital Markets Group. Bill previously worked at NationsBank as head of the high yield business where he was responsible for the High Yield Origination Team, the High Yield Capital Markets Group, Private Placements, and NationsBridge (the banks bridge loan unit). Bill commenced his career at Bear Stearns.

Education:
New York University, BS, *cum laude*
New York University, MBA

Years of investment/operational experience: 35 years

BAI Webinar

Adams Street Partners

Effects of COVID-19 Crisis on Private Debt: Dislocations in the Broadly Syndicated Loan Market

18 June 2020

Presented by: Bill Sacher, Partner & Head of Private Credit

Adams Street

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As of June 2020

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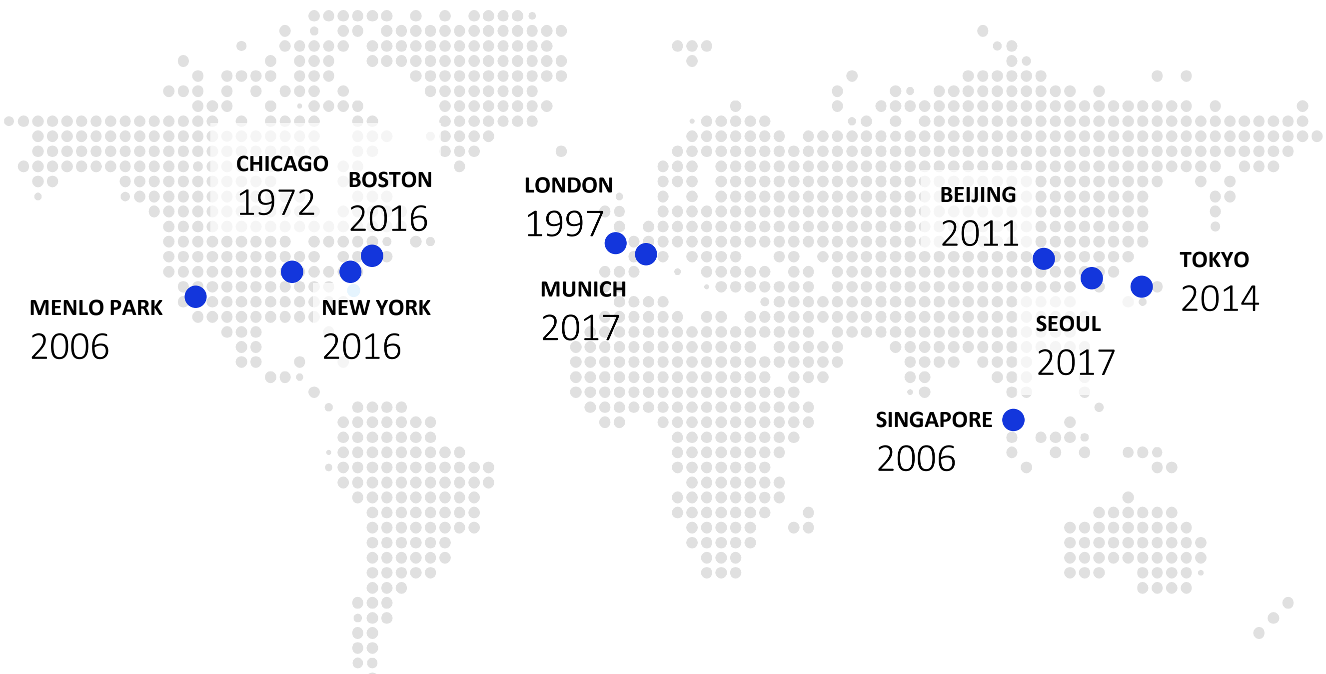
About Adams Street

Founded in 1972, Adams Street Partners is a global private markets investment manager with $41 billion of assets under management across five dedicated strategies: **primary investments**, **secondary investments**, **co-investments**, **growth equity** and **private credit**.

100%	200+	10	30	420+
Employee-owned	Employees	Global offices	Nations invested	Investors



Introduction

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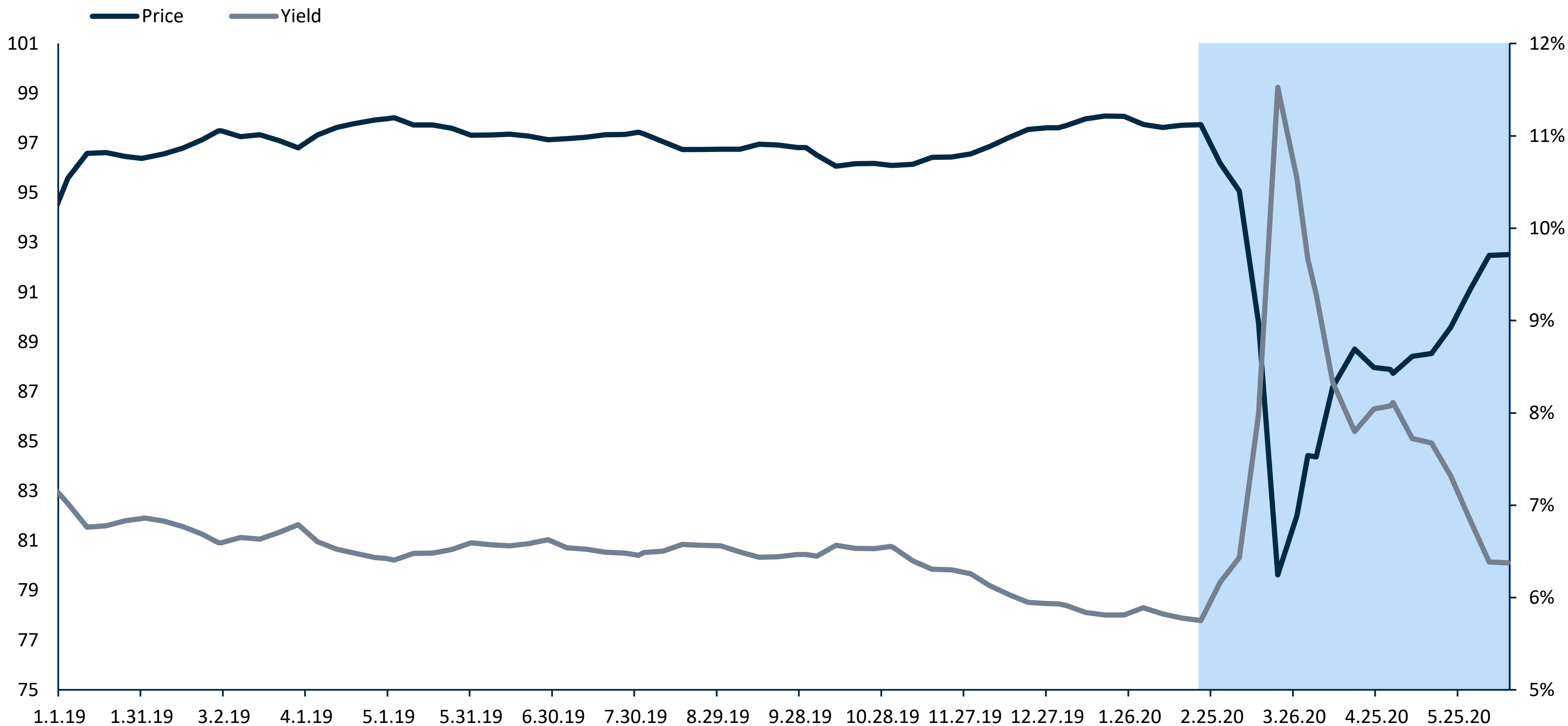
- The coronavirus and ensuing economic shutdown has created significant uncertainty for both the financial markets and the economy
- In the span of 3 months since the shutdown, the S&P 500 dropped 25% from 3,257 to 2,447 and then rose again 32% by end of May to 3,232
- For the U.S. economy the near-term effect has been significant – the Atlanta Fed estimates GDP in Q2 to be down 48.5%
- There are 21 million people out of work and the U.S. unemployment rate is up from 3.5% in February to13.3% in May
  - For context, unemployment peaked at 10.6% during the Great Recession
- In disrupted markets like this, it may be possible to purchase senior loans at discounts sufficient to generate equity-like returns (18%-30%) but with senior secured debt downside risk

Impact of COVID-19 On Credit Markets

The COVID-19 pandemic has drastically altered the public credit markets

The Overall Loan Market Has Experienced Significant Price Declines Causing Yields to Widen

YTD Overall Loan Market Excluding Oil and Gas



Source: LCD Leveraged Loan Index Discounted Spreads ex Oil and Gas, as of June 15, 2020.

Broadly Syndicated Loan Market
2008 vs. Today

Last Recession vs. Today

	2008	Today
# of Issuers	825	1172
Leveraged Loan Outstanding ($ in bn)	$596	$1,200
% of Loans Held by CLOs	52%	70%
% Covenant-Lite	16.8%	90.3%
Leverage Levels	4.9x	5.9x
% of Loans Rated B / B- and below	28.9%	55.4%

Source: LCD News, S&P / LSTA Index Factsheet as of 06/11/20

What the Future May Hold?

Prior Market Downturns

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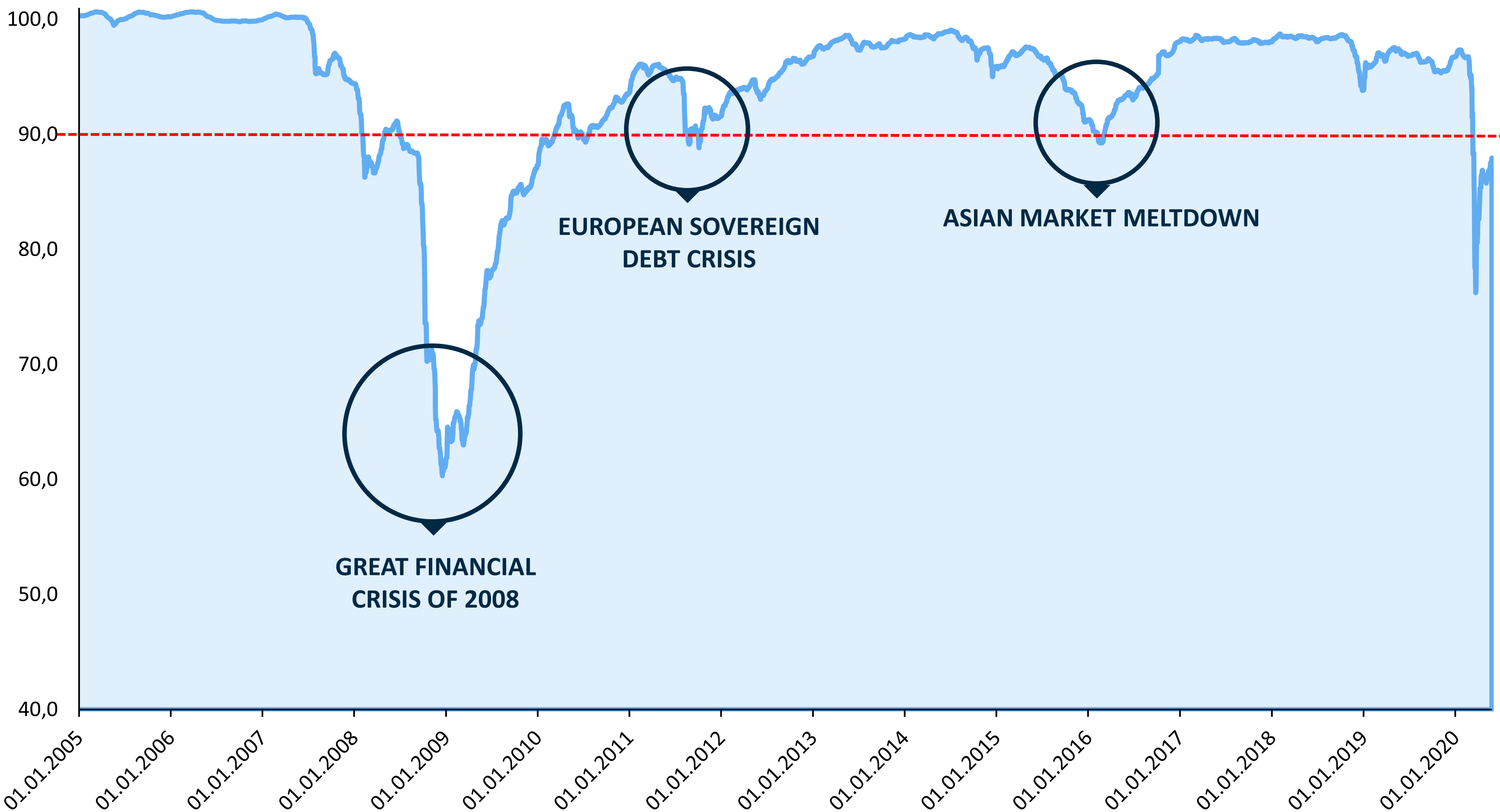
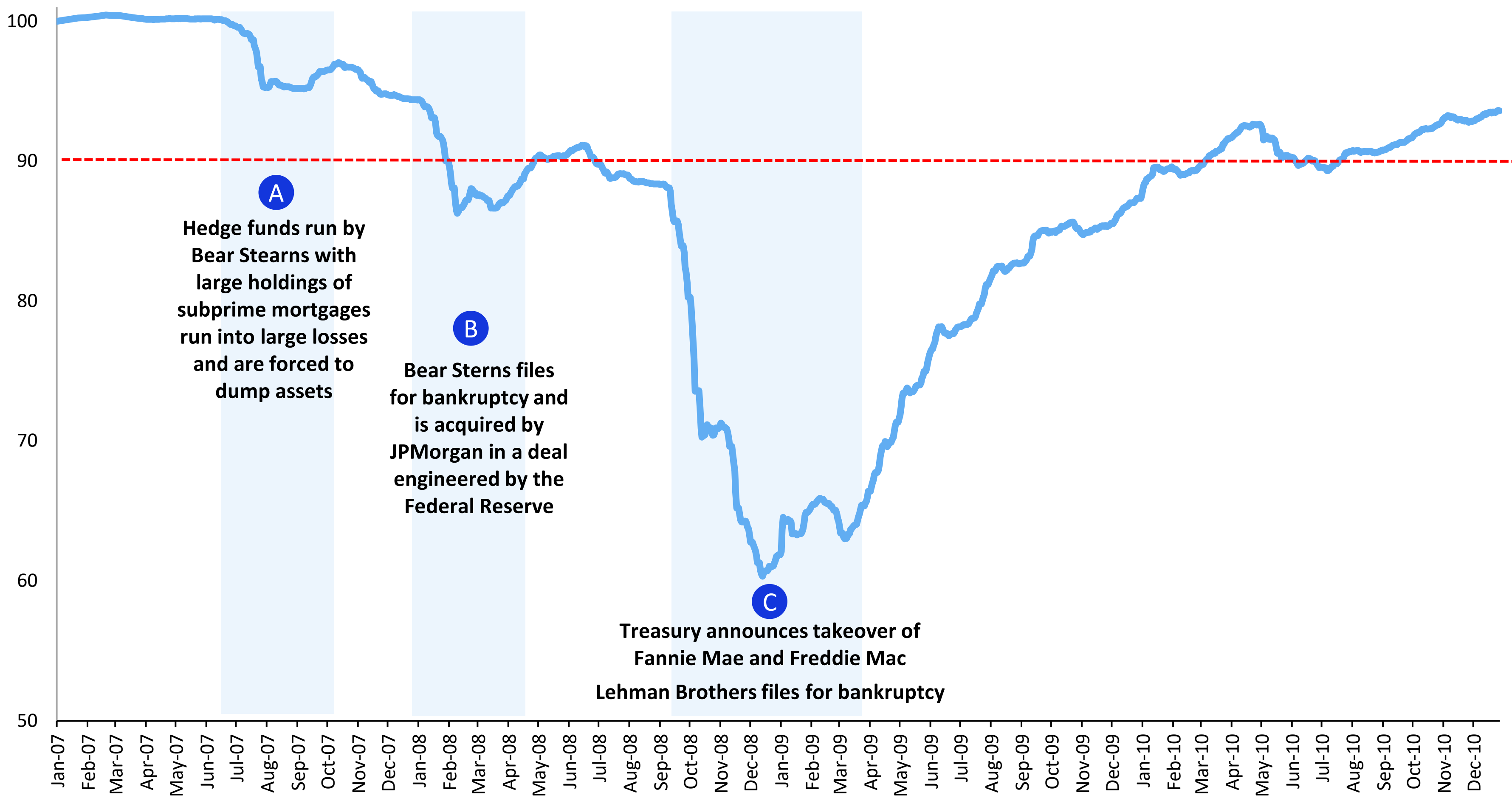
Prior to the COVID-19 disruption, leveraged loans prices have fallen below 90 on three separate occasions since 2005



Source: LCD News, S&P / LSTA Index Factsheet as of 06/11/20

Leveraged Loan Pricing During the Last Recession

What distinguished the 2008 market downturn?
It was followed by an economic downturn



Source: LCD News, S&P / LSTA Index Factsheet as of 06/11/20

Was this a short-lived blip in the broadly syndicated loan market or the beginning of a deeper, more protracted downturn to come

Much will depend on what happens in the real economy and CLOs will likely play a key role

What is a CLO?

- CLOs are highly levered investment vehicles designed to hold leveraged loans
- They currently hold approximately 70% of all outstanding leveraged loans
- They are funded with multiple layers of rated and non-rated debt
- The equity in these vehicles is typically levered 9:1
- The waterfall of cash flows generated by the underlying loans to the various tranches of debt is strictly governed by covenants, including over-collateralization tests (“O/C Test”)
  - The greater the over-collateralization, the higher the rating
- A key O / C Test limits the amount of CCC rated loans that can be held
  - Typically CCC rated loans are limited to 7.5%
- If the CCC limit is breached cash flows cease flowing to the equity, and eventually the junior tranches of debt, to pay down debt at the highest rated tranches first
- CLOs in this position may be highly motivated to sell loans held in the portfolio to get back into compliance so cash flows to the equity can resume

Historic Loan Downgrades Spurred by COVID-19 Shutdown

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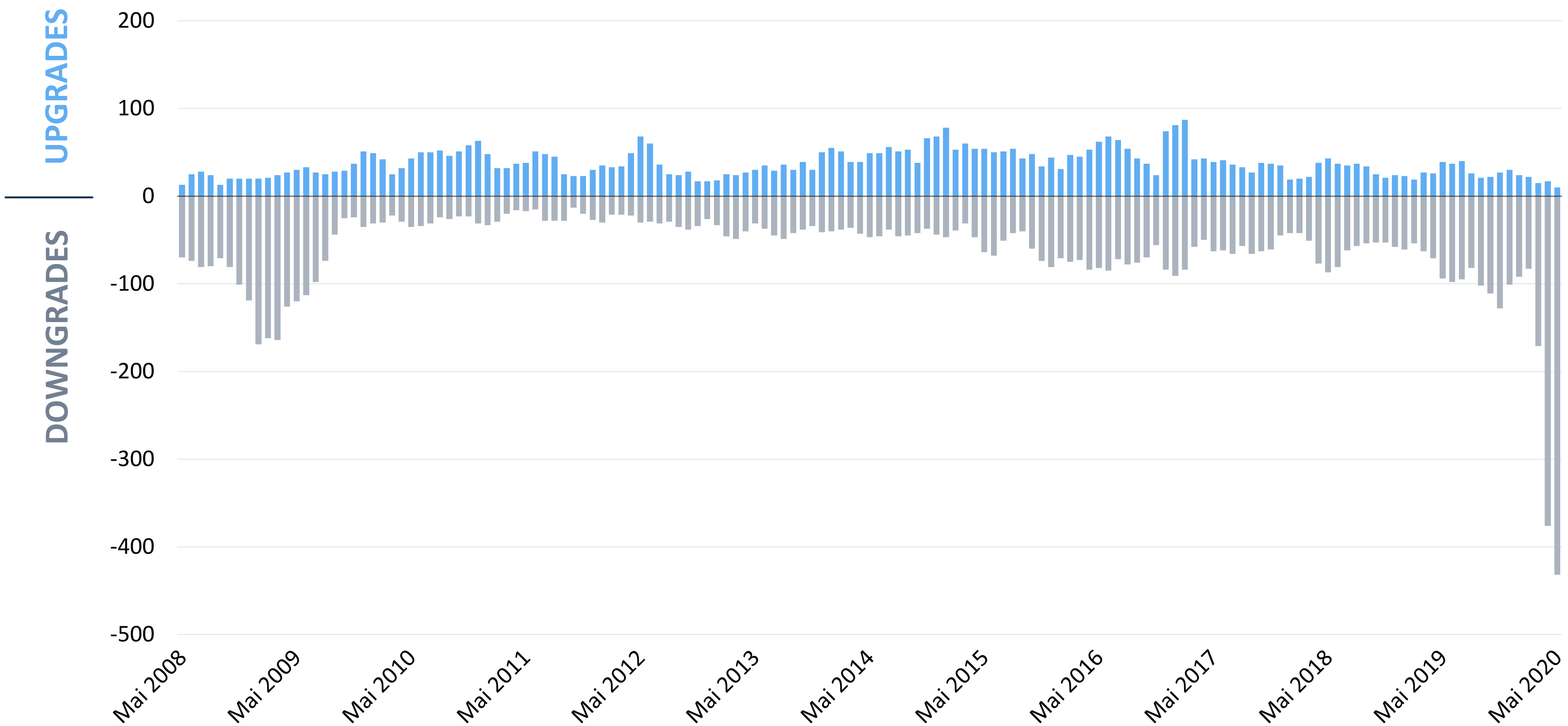
- Since the shutdown, there have been a record number of downgrades
- This has caused the percentage of outstanding CCC+ or lower rated loans to jump from 6.4% at the beginning of the year to 9.2% at the end of April
- According to S&P, close to half of B / B - rated loans rated were on negative credit watch, as of the end of April
- If a recession ensues, and more downgrades occur, CLOs will be highly motivated to sell loans en masse



Data through May 31, 2020
Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index

Many CLOs Have Already Breached Their CCC Limits

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- According to JPMorgan, 72% of CLOs they follow are failing their S&P CCC test and 38% are failing their Moody's Caa1 test
- Barclays reported that the US BSL CLOs it follows has seen more than 14% of collateral (over 200 obligors) downgraded or placed on CreditWatch negative since early March
- BofA estimates that nearly 30% of US CLOs are carrying CCC assets in excess of deal limits
- For the first time since the 2008 GFC, a CLO (APEX-JFIN) failed both the junior and senior overcollateralization tests on BB, BBB, A, and AA tranches
- Wells Fargo reported that US CLOs doubled exposure to CCC rated loans between March 31 and April 22 from 4.05% to 8.10%
  - During this time, 150 CLOs exceeded their CCC portfolio limits of 7.5% (~55% of Wells Fargo's 206 sample set)
- S&P expects the U.S. trailing-12-month speculative-grade corporate default rate to hit 12.5% by March 2021
  - In the last recession, the default rate peaked at 10.8%

1. "CLOs begin to trigger senior overcollateralization tests" S&P Global Market Intelligence, 04/15/2020.
2. "US CLOs double CCC exposure in less than a month" S&P Global Market Intelligence, 04/23/2020.

Conclusion

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- Whether this is a short-lived blip, or the early stages of the next cycle remains to be seen
- Much will depend on actual economic fundamentals, the depth of the downturn, and how long it takes to recover
- CLOs, holders of the majority of outstanding leveraged loans, are already stretched and could be forced into mass selling
- If this were to occur, the opportunities may come, but the buying window can come and go quickly
  - Investors need to be committed and in position in advance of the downturn
- While most senior loans are first in line and rank at the top of the capital structure, they are not immune to losses
  - Selecting the right loans is critical

Questions?

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Vielen Dank!

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