October 2020

Current State of the Private Capital Markets

Founders Advisors

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The current environment creates a unique opportunity for Founders to assist clients in developing and executing on capital strategies

COVID-19 Driven Financial Disruption

- The government is supplying significant support for the economy as a stop gap measure
- Overall, capital markets liquidity remains strong but there will be a shift in the sources of capital for middle-market, private businesses
    - Lenders will continue to be selective in evaluating new deals
    - Leveraged BDCs that relied on banks for leverage and the public equity markets for core capital will begin to shrink their balance sheets

Late 2020 Impacts of Capital Dislocation

- Government stimulus will begin to wane
- Third quarter financial performance will reflect the full impact of the shut down and many companies will be in violation of loan covenants
- Lenders and investors will have had time to assess the ongoing viability of portfolio companies
- We have been in a historic credit bubble over the last few years. Health, economic, and political uncertainty will result in companies deleveraging for the foreseeable future

What We Are Watching

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Banks

- So far solid support for customers
- Well capitalized, unlike 2009
- We expect credit tightening as COVID-19 impact continues and energy credits stress portfolios
- Third quarter covenant compliance will show the extent of credit distress

Debt Funds

- A major source for M&A financing since 2019 with approximately $812 billion of assets under management
- Lender behavior in their first downturn
- Lack of access to additional capital and stressed portfolios
  - Public BDCs trading below book value
  - Leveraged BDCs exposed to bank loan availability

Government Loan Programs

- Unprecedented action by the Fed
  - Lender of last resort becomes lender of first resort
- Main Street Loan Program
  - Program has had slow adoption
  - Attractive cost of capital
  - Impact of restrictions on borrowers' willingness to access the program

Credit Parameters

- Measuring comparable financial performance
- Leverage is tightening
- Enterprise valuations have remained somewhat steady
- Sector specific dynamics- companies with head winds v. tailwinds

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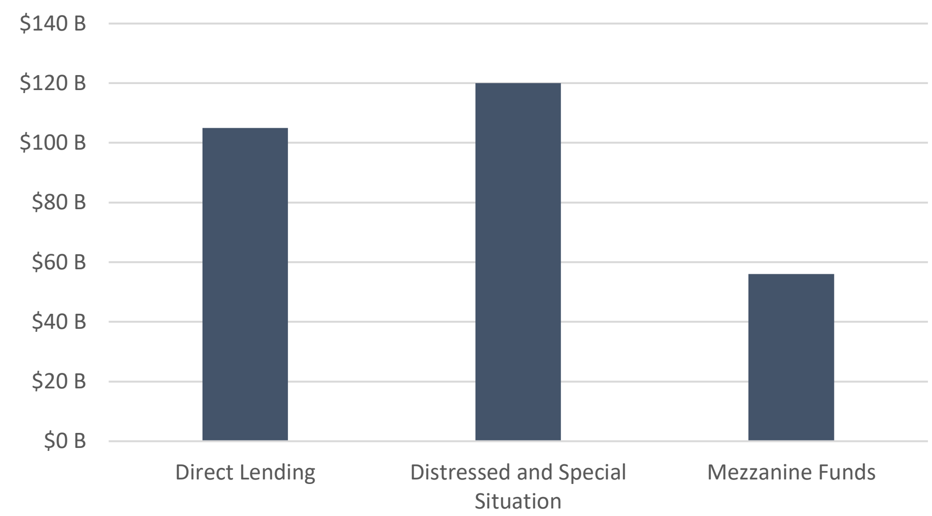
The capital markets will remain in a high state of flux for the foreseeable future. There is plenty of capital in the market, though it may not be where it has been (e.g. BDCs and credit funds) or in the form it has been in (cheap and easy)

- New participants, such as private equity firms and family offices, have repositioned themselves to provide flexible debt and preferred equity solutions
  - Founders is actively tracking these new sources of capital
- Founders is constantly monitoring capital markets conditions and players with investment appetites
- In this environment, execution risk is high but can be mitigated
  - Pre-market transactions with experienced, senior investors
  - Identify likely lenders/investors and focus on those groups
  - Lenders/investors expect a structure of the transaction to be presented in the information materials. This requires a fair amount of upfront structuring and modeling
  - Include an ”ask” in the process but be prepared to be flexible
  - Disciplined offering process, customized marketing materials

Remaining Dry Powder by Fund Type ($ in billions)



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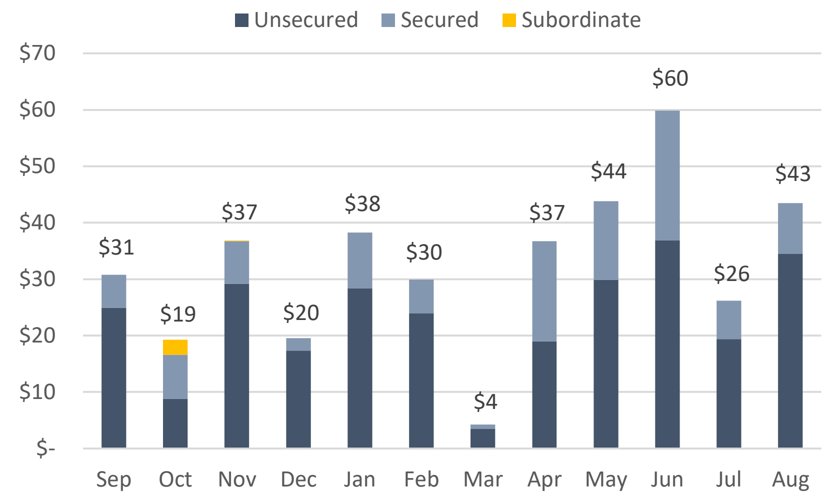
High Yield Overview

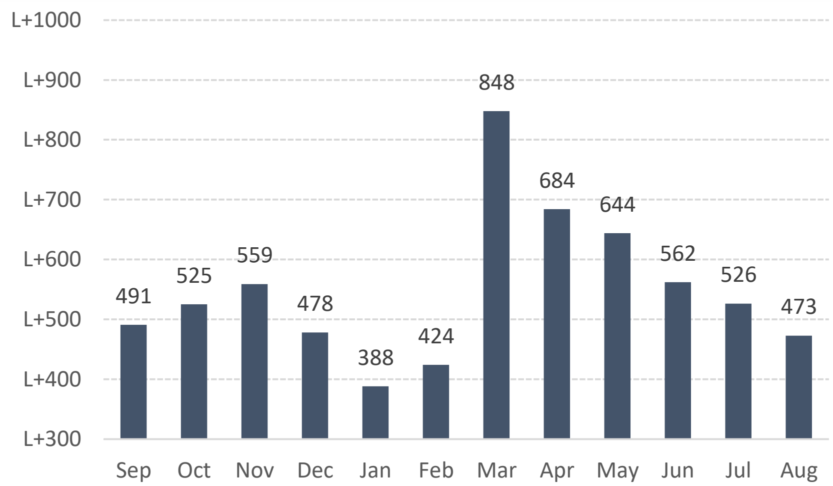
- The high yield market is a leading indicator of conditions in the private debt market
- Spreads have tightened with investors' optimism rising (short u-shaped recovery) and new capital coming into the market
- The Fed has instituted back stop programs to ensure market liquidity and initiated bond purchasing programs
- Issuance has stabilized as borrowers looked to improve and position liquidity and capitalize on tightening of spreads

Source: https://www.spglobal.com/marketintelligence/en/campaigns/high-yield-bond

High Yield – New Issuances ($ in billions)



High Yield - Average Spread (bps)



Deals That Are Getting Done

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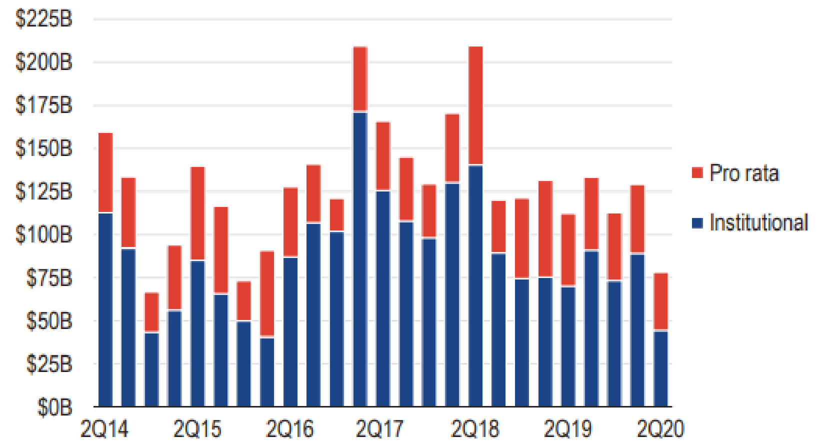
Commentary

- Most of the financing deals that have be executed in the crisis are related to M&A transactions and were generally committed prior to the crisis
- New credits are being extended to industries that have COVID-19 tailwinds or are at least insulated from the impact of COVID-19 shutdowns
- Low cashflow leverage or strong loan to asset values
- Deleveraging recapitalizations
- Leveraged loan issuances have been slower to recover than the high yield market, evidencing the more onerous requirements on issuers to complete a transaction

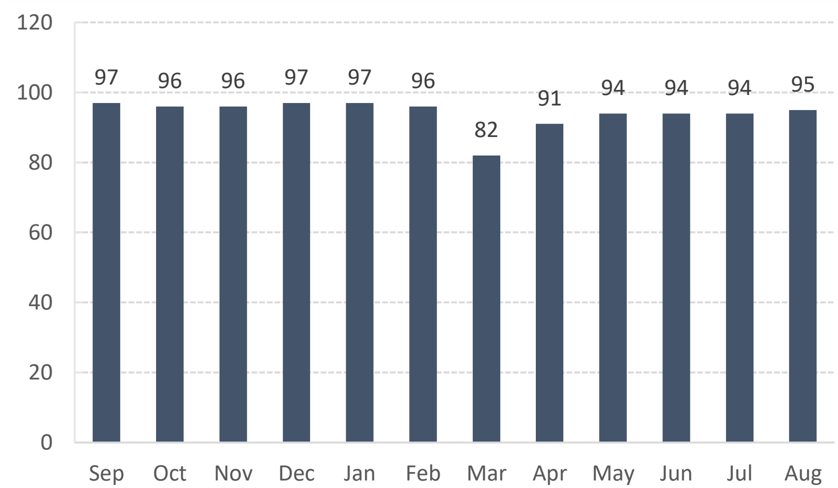
Source: https://www.spglobal.com/marketintelligence/en/campaigns/leveraged-loan

Leveraged Loan Volume



Source: LCD, an offering of S&P Global Market Intelligence

Leveraged Loans – Average Bid (bps)



Leverage Trends

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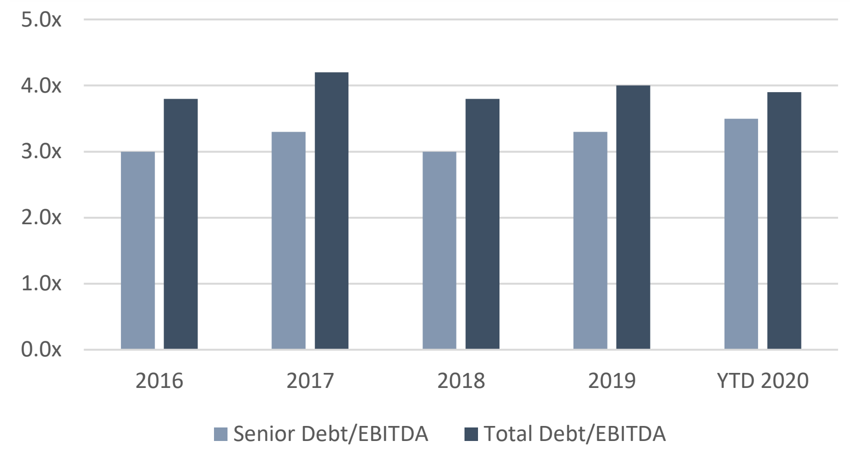
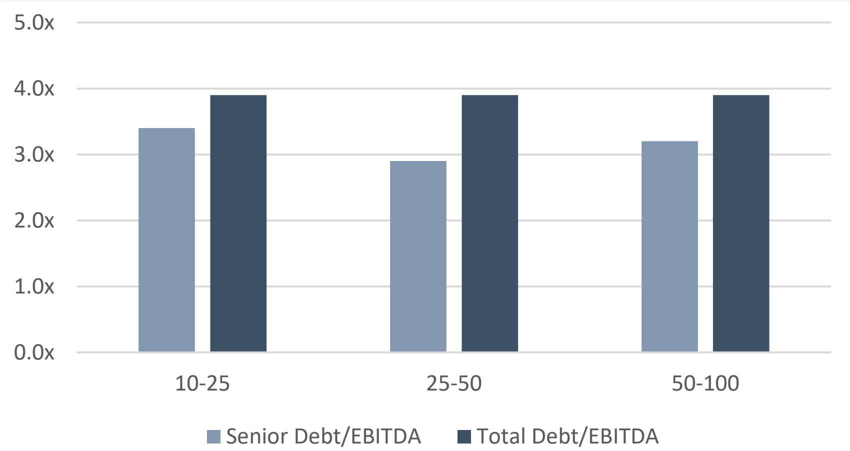
Overview

- Leverage multiples began to decline in late-2019 as lenders began to become more defensive over economic concerns heading into 2020.
- May year-to-date leverage multiples began to reflect the effect of the COVID-19 shut down and its economic impact.
- Overall, the trend of larger deals afforded more leverage continued through early 2020.
- Anecdotally, Founders believes that leverage multiples may decline by another half of a turn going into the fourth quarter.

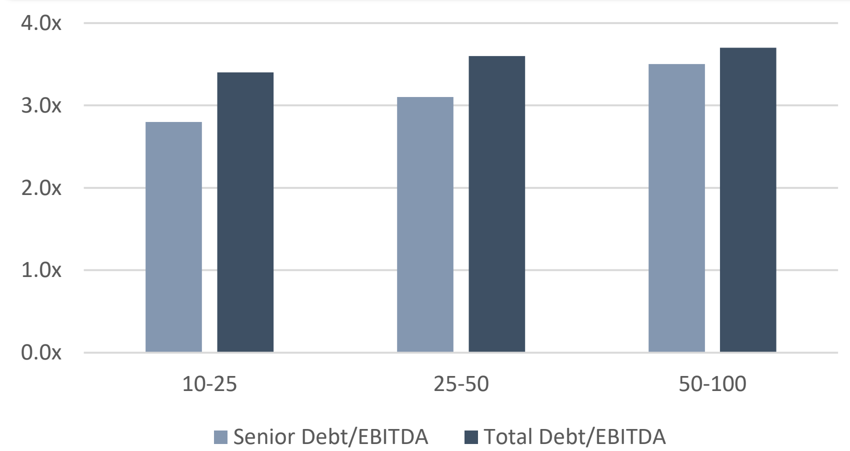
Historical Debt to EBITDA All Transactions



2019 Debt to EBITDA by Enterprise Value



2020 YTD May Debt to EBITDA by Enterprise Value



Subordinated Debt Market Dynamics

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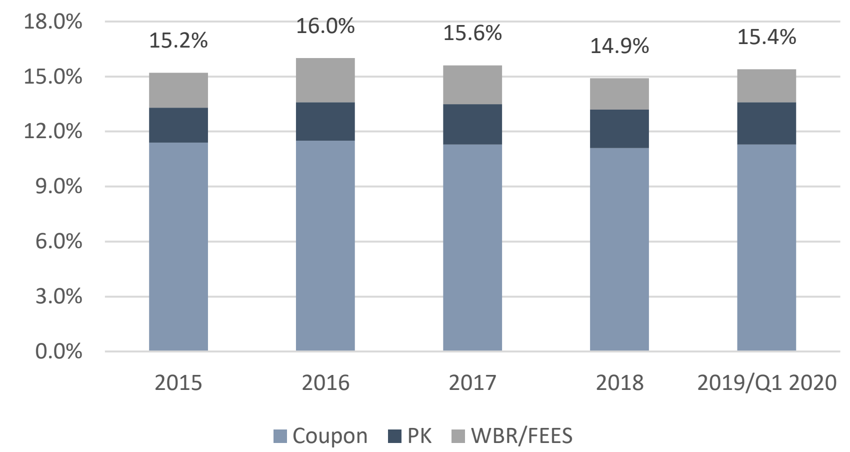
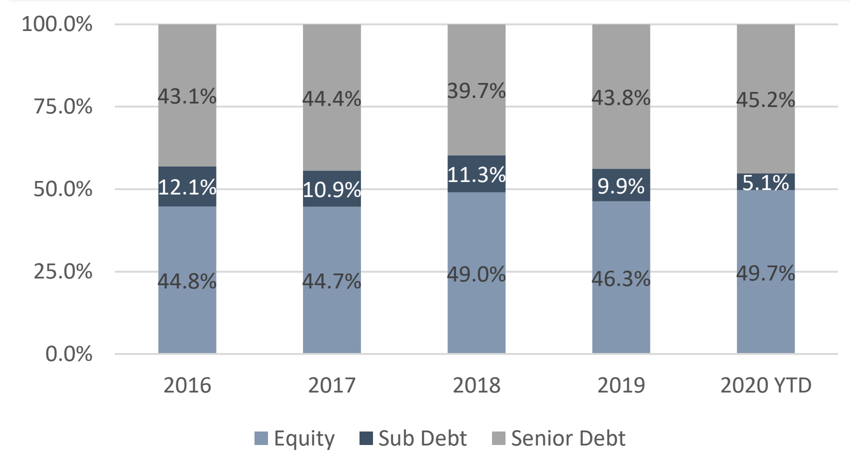
Commentary

- Yield driven investors have allocated a significant amount of capital to subordinated debt funds. Currently the funds have $50 billion in dry powder.
- The large overhang of dry powder, fewer opportunities as senior lenders became more aggressive in taking risk and PE firms investing a greater portion of equity into acquisitions and a strong economic environment resulted in a tightening of returns for subordinated debt investors.
- Founders expects that the cost of subordinated debt will remain steady as the supply of capital in the market is offset by demand as senior lenders pull back on leverage.

Subordinated Debt Pricing by Year



Equity and Debt Contribution by Year



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