9th Annual Risk Conference

Panel on Leveraged Buyouts

DePaul University
Driehaus College of Business
The Center for Financial Services

Federal Reserve Bank of Chicago

March 29, 2016

Introductions

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Federal Reserve Board
Senior Credit Risk & Policy

Stephen Isaacs

BMO Harris Bank
Managing Director
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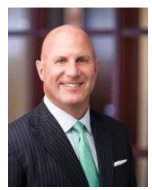
Phillip Bronsteatter

Pfingsten Partners
Principal

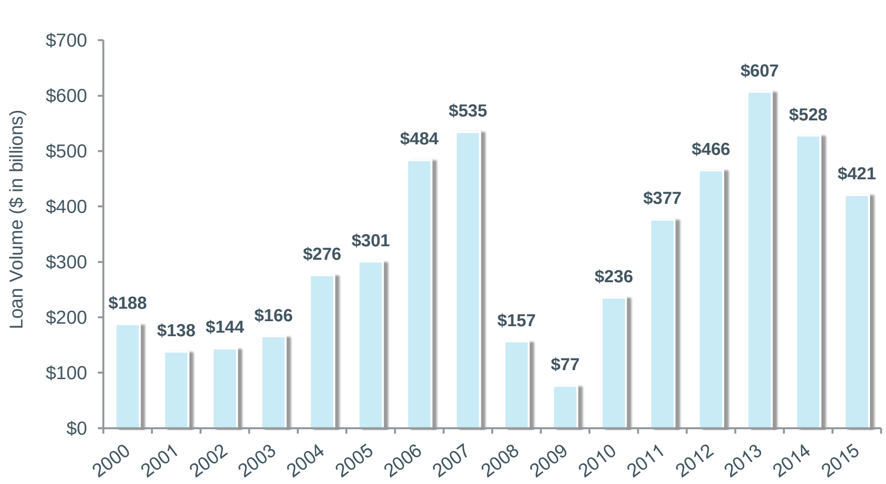


Richard Jander

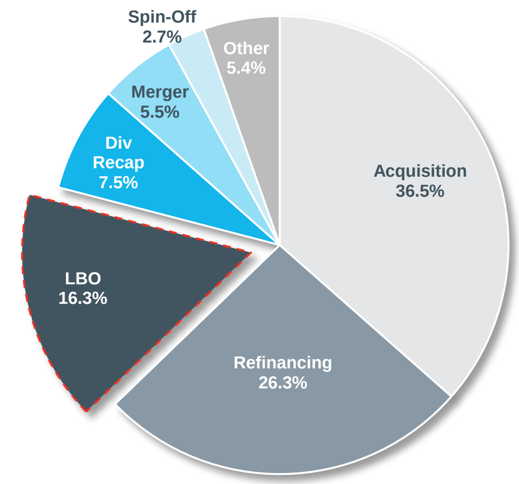
Maranon Capital
Managing Director

U.S. Leveraged Loan Market and Buyout Activity

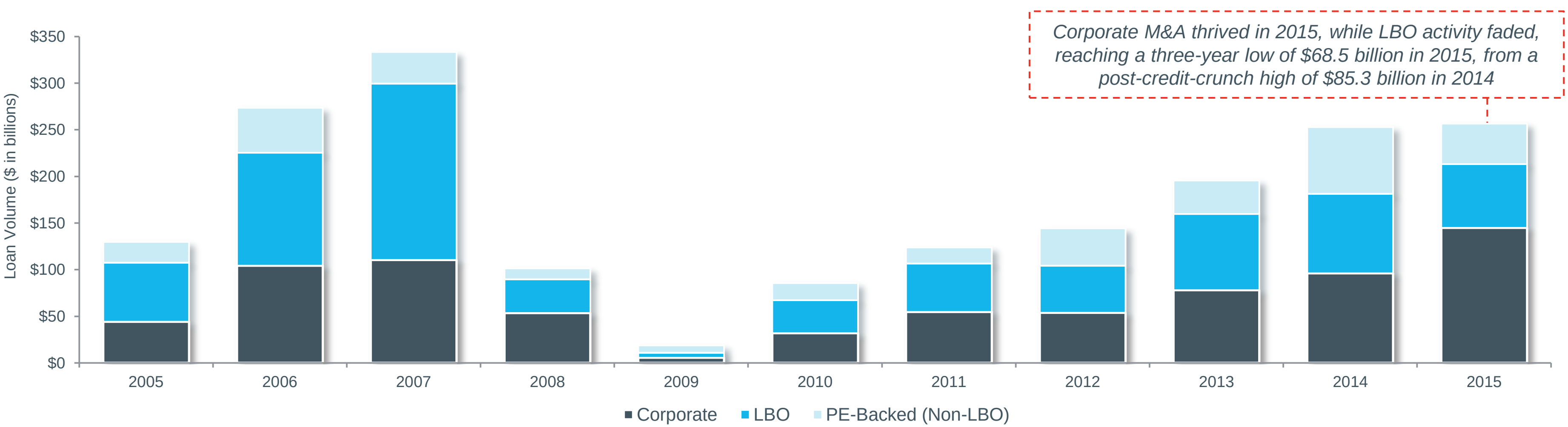
New Issue Leveraged Loan Volume



New Issue Loan Volume by Purpose in 2015



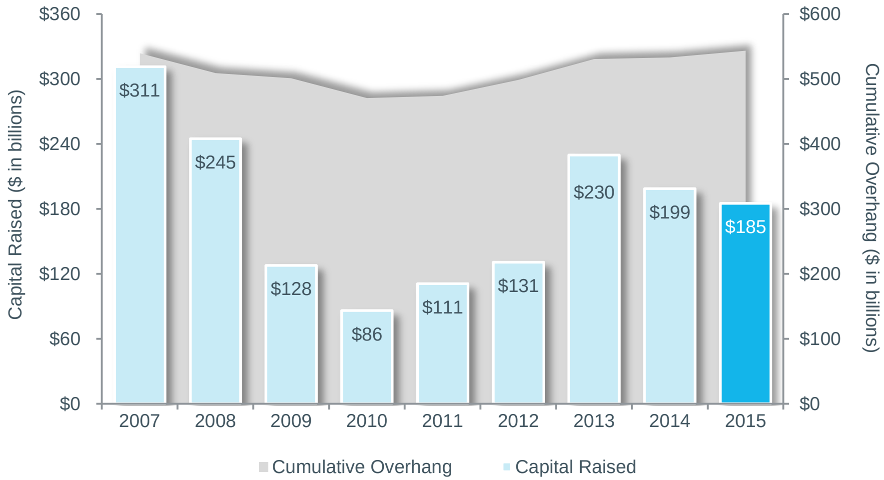
U.S. New Issue Leveraged Loan M&A Volume by Purpose



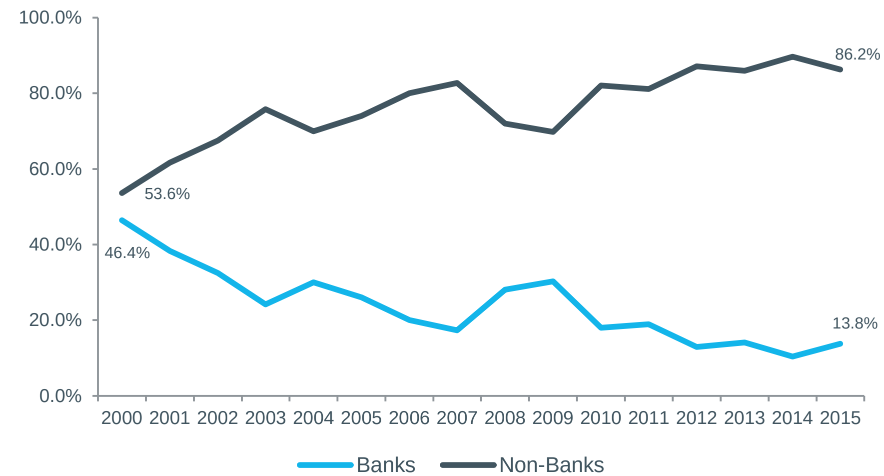
Source: S&P LCD

Key Drivers for Leveraged Buyout Activity

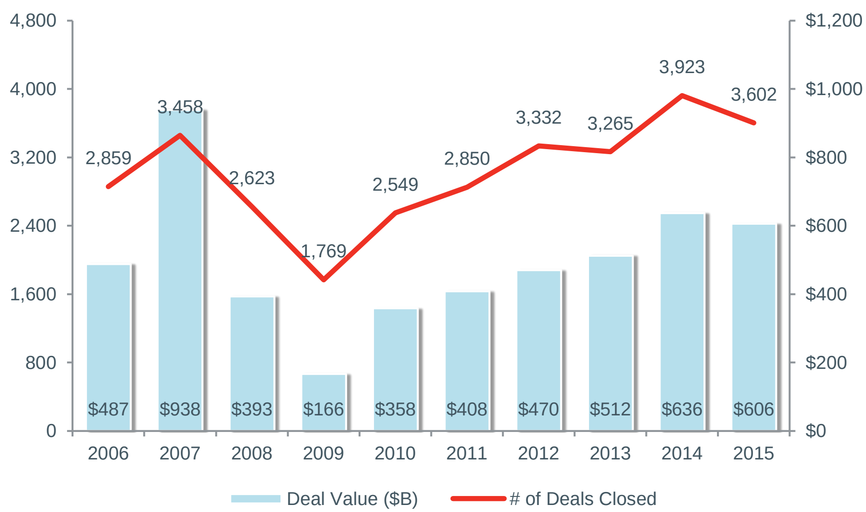
Private Equity Dry Powder



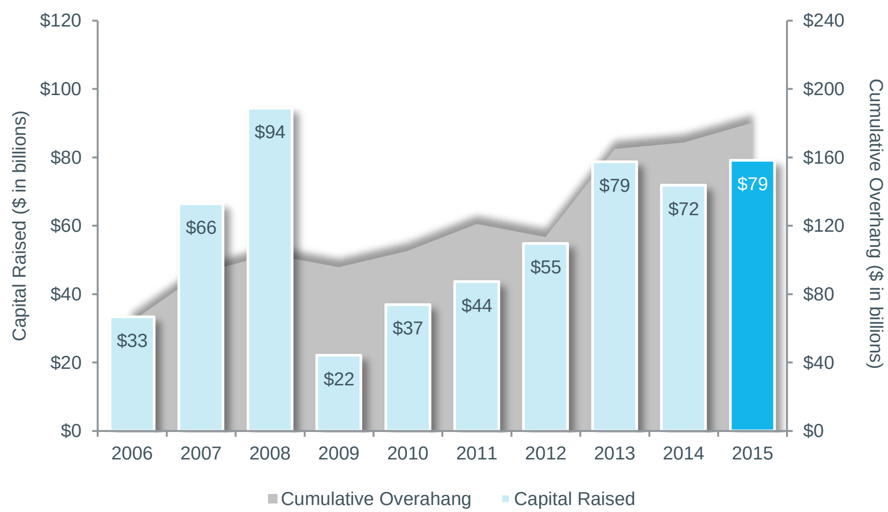
Primary Market for Leveraged Loans



U.S. Private Equity Activity by Year



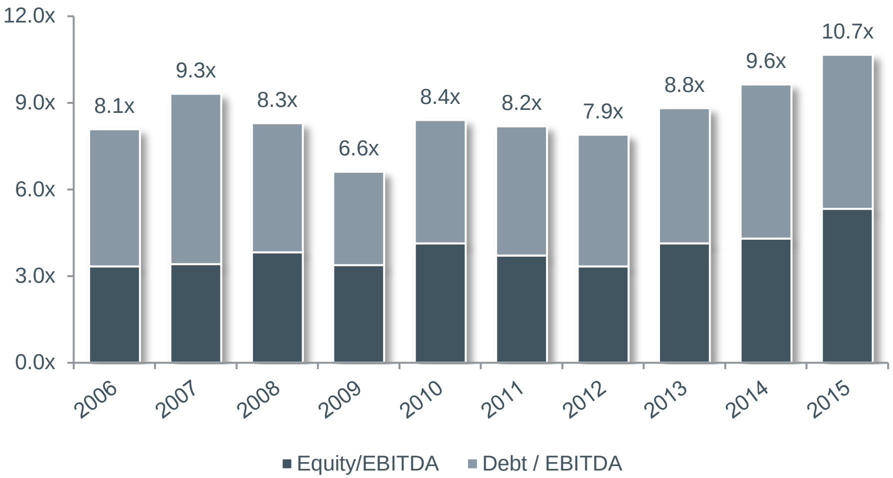
Private Debt Dry Powder



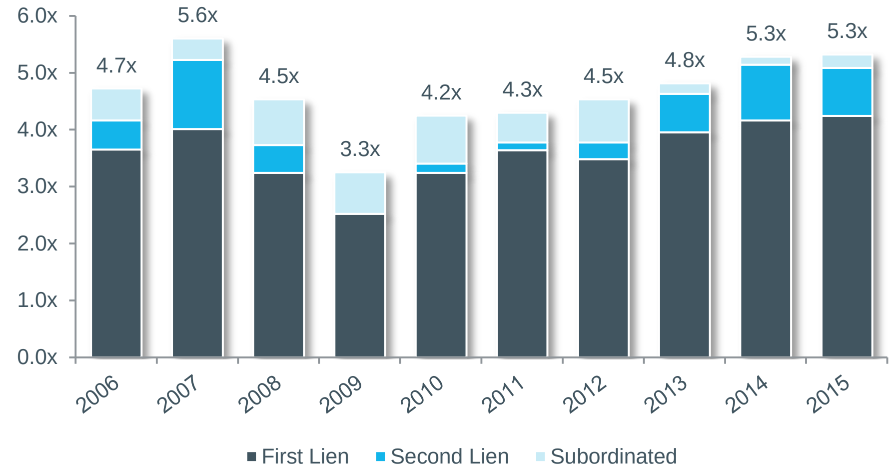
Source: S&P Capital IQ, Pitch Book, Preqin

Overview of Transaction Structures

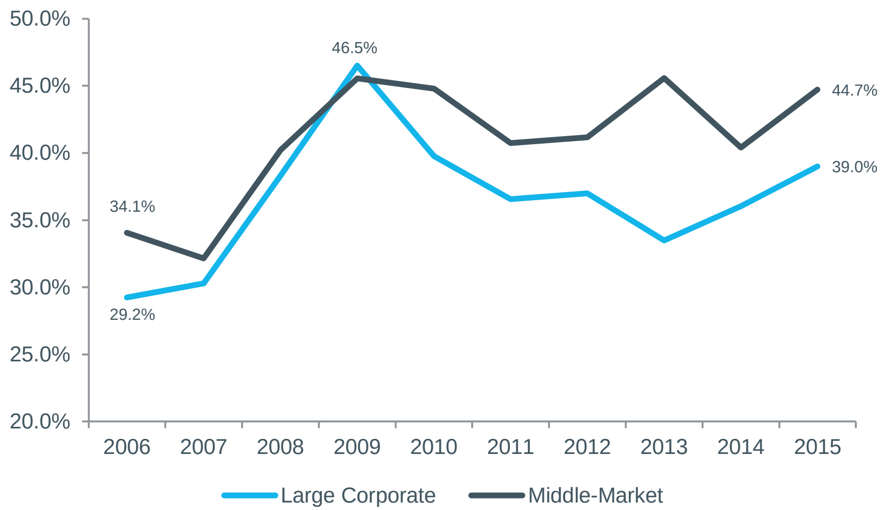
Average Middle-Market LBO Purchase Price Multiples



Debt Multiples of Sponsored Middle-Market Loans



Average LBO Capital Structure



All-In Spreads of Institutional Loans Backing LBO's

Source: S&P LCD (Middle-Market Defined as Less Than $50 Million EBITDA)

Leveraged Lending Regulatory Environment

Leveraged Lending Issues in Lead-Up to Financial Crisis

- Significant growth in issuance (2005 – 2007)
- Differences in underwriting for loans held versus loans distributed to the market
- Absence of meaningful financial covenants
- Inadequate reporting or aggregating of enterprise-wide exposure
- Insufficient documentation to support validation of financial sponsor projections and/or enterprise values

Updated Interagency Leveraged Lending Guidance Issued in 2013 and FAQs Issued in 2014

Purpose is to ensure:

- Institutions engage in transactions that reflect a sound business premise, an appropriate capital structure, reasonable cash flow and reasonable leverage (i.e., prohibition against non-pass originations)
- Borrowers have the capacity to repay and de-lever over a reasonable period of time
- Institutions define exposure and concentration limits
- Management information systems reporting is comprehensive and aggregate across all business lines

Guidance applies to all supervised financial institutions that originate, hold, distribute or participate in leveraged lending activities

2015 Shared National Credit Press Release: Statement on Leveraged Lending

- Volume of non-pass loans declined sharply post issuance of FAQs
- Weak underwriting characteristics continue to include minimal deleveraging capacity
- Loan covenant protection deteriorated as evidenced by reduced number of financial maintenance covenants, the use of net debt in leverage covenants, excessive headroom, springing features **and various accordion features including incremental facilities that allow increased debt above starting leverage and the dilution of senior secured positions**
- Incremental facilities are drawing attention because of their increased usage in conjunction with relaxation of other structural elements such as covenants and restricted payments