



AMERICAN
BANKRUPTCY
INSTITUTE

2019 Annual Spring Meeting

What Does the Future Hold?

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Discussion Materials

March 2019

Overview

| | |
|-------------------------|---|
| 1 2018 | <ul style="list-style-type: none"> Markets sustained similar trends from 2017 into Q1-Q3 '18 before significant market volatility in Q4'18 related to concerns of a near-term recession Spreads expanded to multi-year highs in Q4'18 led by volatility and credit market outflows Leveraged finance volumes driven by record M&A / LBO related issuances in 2018 Yield curve inverted in December 2018 for the first time since 2007 |
| 2 Rates and Spreads | <ul style="list-style-type: none"> FOMC raised interest rates four times in 2018 to 2.25%-2.50% range; projected to raise rates twice in 2019 and once in 2020 to a 3.125% target rate U.S. interest rates have increased across the board with 3 month US LIBOR at 2.81% while Euribor remains negative creating the largest differential since 2007 |
| 3 Default Rates | <ul style="list-style-type: none"> The current leveraged loan default rate is ~1.63% (vs. 2.05% at this time last year) Distressed investors expect default rates to trend up to 3.0% by 2020 |
| 4 Restructuring Outlook | <ul style="list-style-type: none"> The U.S. distress ratio⁽¹⁾ has increased to 8.7% which is the highest level in two years Although issuers were able to push out the maturity wall during 2018, more than \$650 billion of speculative grade debt matures over the next 3-4 years Largest percentage of credits rated B- or below since the financial crisis should lead to increased distressed activity in 2019 |

(1) Number of distressed securities divided by the total number of speculative-grade securities as calculated by S&P.

I 2018 Leveraged Finance Markets: A Year Defined in One Quarter

| A Changing Macro Landscape | Part I: More Of The Same In 1Q – 3Q | Part II: A Changing Landscape In 4Q |
|--|--|--|
| All Eyes on the Fed as uncertainty Around Forward Policy Grows | <ul style="list-style-type: none"> After a year of historically low volatility, equities ended '17 up ~19% and hit new highs in 2Q and 3Q of '18 Trade tensions and other geopolitical headlines create pockets of volatility that were short-lived as risk markets rebound quickly To start '18, the market expected LIBOR to continue to march higher with two Fed hikes in 2018, while GS Economic Research called for four <ul style="list-style-type: none"> The Fed hiked four times in '18 (Mar, Jun, Sep, Dec) The yield curve began at its flattest point since 2007 and continued to flatten over the course of '18 3m LIBOR rose 70bps to 2.40% at the end of 3Q | <ul style="list-style-type: none"> Health of the U.S. economy drove risk sentiment as concerns over the prospect of slower growth and a near-term recession took center stage <ul style="list-style-type: none"> GS Economic Research forecasts growth slowing to ~2% in '19 vs. ~3% in '18 Equity markets led the move lower – S&P / DJIA drop (14.5%) / (12%) in 4Q, erasing YTD gains and closing 2018 down (6.2%) / (5.6%) After Dec's hike, the Fed lowered '19 guidance to two hikes from three and took a generally dovish tone GS Economic Research now sees ~1.2 hikes in 2019, while the market is pricing in zero hikes in '19 and cuts in '20 The yield curve inverted in early Dec for the first time in 10+ years 10yr UST hit its highest level since 2011 in early Nov, 3.24%, before tightening 55bps to close the year 2.68% |
| U.S. Loan Volumes Outpace HY Despite Declines in both Markets | <ul style="list-style-type: none"> Total inst. loan volume YTD ended 3Q down (11%) <ul style="list-style-type: none"> Bright spot in M&A / LBO issuance, which ended 3Q YTD +13%, as sponsors and issuers continue to favor the loan market over HY 3Q YTD HY volume of \$146bn, (27%) YoY <ul style="list-style-type: none"> Significant decline in M&A and refi led the way at (25%) and (29%), respectively | <ul style="list-style-type: none"> After 4Q loan volume of \$76bn, (15%) QoQ, lowest since 1Q16, total inst. volume of \$436bn ended (13%) vs. '17's record high of \$503bn <ul style="list-style-type: none"> Record high M&A / LBO volume of \$275bn, 67% of the year's total Total HY volume of \$162bn, (39%) YoY, lowest year since 2009 <ul style="list-style-type: none"> Primary issuance came to a halt in Dec – first month with zero HY deals in 30 years |
| Loan & HY Technicals Diverge Before Outflows Accelerate at YE | <ul style="list-style-type: none"> A diverging technical backdrop between loans and HY persisted throughout the year, as CLO dynamics powered the loan market and HY funds saw persistent outflows <ul style="list-style-type: none"> Through 3Q, loans enjoyed a \$13bn net inflow from mutual funds and \$101bn of CLO creation, while \$19bn exited HY funds | <ul style="list-style-type: none"> After a reset in 4Q, both loans and HY saw net outflows on the year, clouding the technical picture heading into '19 Loan outflows of \$3bn overall, of which \$13.5bn occurred after Nov. 22, while HY outflows set a new record at \$35bn, over double the \$15bn record outflow set in '17 |
| Spreads... From Post-Crisis Tights to Multi-Year Wides | <ul style="list-style-type: none"> Spreads generally absorbed rising rates and grind tighter, although some of the loan / HY bifurcation permeated secondaries <ul style="list-style-type: none"> LL100 and HY Index spreads ended 3Q at L+298 (new post-crisis low) and 333bps (1bp above tights seen in Jan), respectively CCC outperformance in HY remained a consistent theme, with CCCs returning +6.2% through 3Q vs. +3.4% for Bs and +0.7% for BBs | <ul style="list-style-type: none"> After outperforming all other asset classes throughout the year, loans recorded a marginal positive return on the year of 0.5% HY ended down (2.1%) overall, while CCC returns fell 10% from the '18 peak to close down (3.8%) Leveraged finance secondaries ended the year trading at levels not seen since mid-2016 |

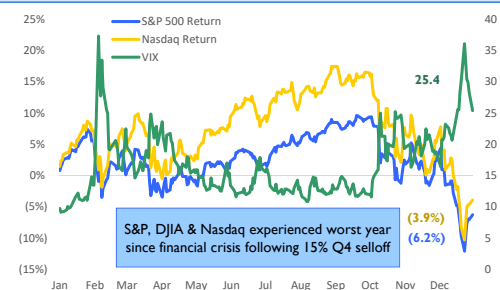
Source: S&P LCD News & Research, AMG Data Services, Dealogic, Bloomberg, Thomson Reuters, GS Economic Research, Lipper FMI.

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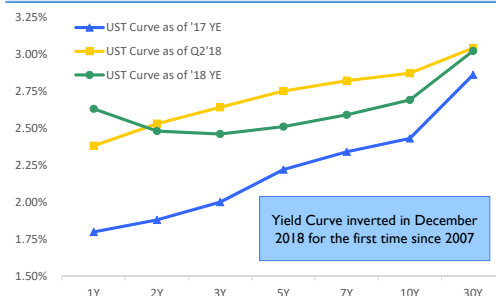
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I 2018 Market in Perspective

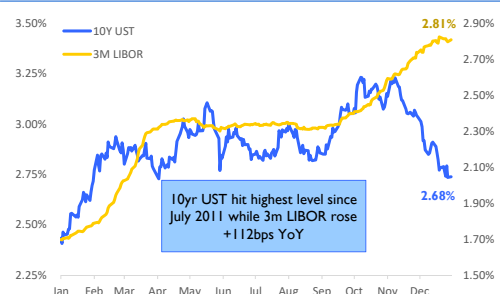
Equity Markets Experienced Losses Amid Volatility...



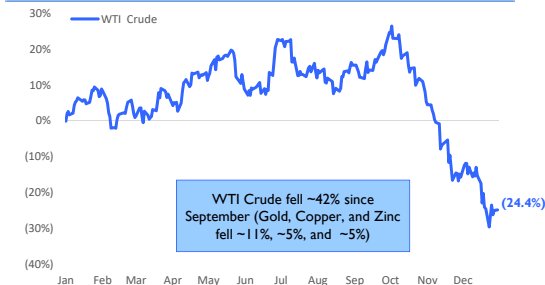
...As Forward Rates Continue To Be in Focus



Flight to Quality Sent 10yr Off Multi-Year Highs...



...As Commodities Fell Heading Into Year-End



Source: S&P LCD News & Research, Bloomberg, LevFin Insights.

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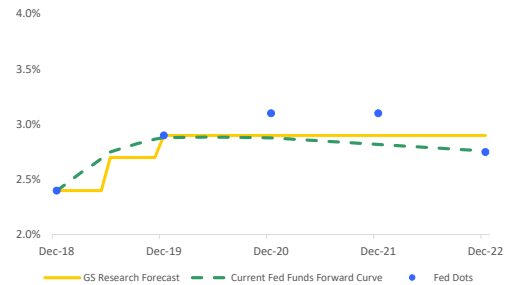
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2 Interest Rate Market Update

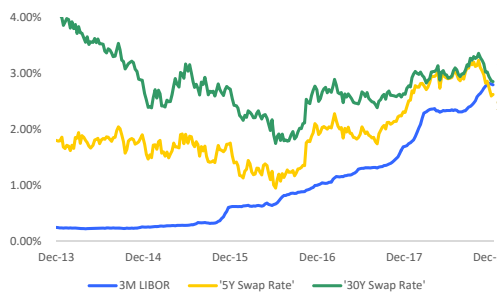
Overview

- As expected, the Fed raised the benchmark funds rate to a range of 2.25%-2.50% in its December meeting
- Central bank officials now forecast two hikes this year, down from three previously projected
 - The median "dots" continue to forecast a hike in 2020, bringing the terminal rate to 3.125%
- However, the Fed continues to include in its statement that further "gradual" rate hikes would be appropriate
- GDP is now expected at 3.0% for the full year of 2018, down one-tenth of a percentage point from September, and 2.3% for 2019, a 0.2 percent point reduction
- Fed Chairman Jerome Powell also rattled markets by saying the Fed was satisfied with its program to shrink its balance sheet and has no plans to change course

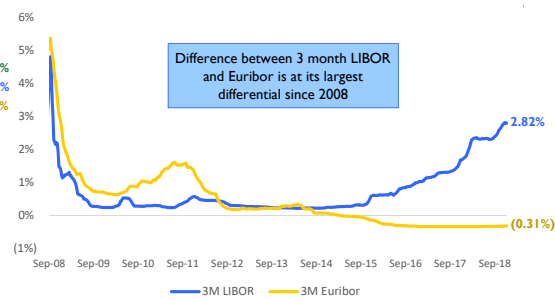
GS Forecasts and Fed Dots Remain Above Forwards⁽¹⁾



Rates Have Increased Materially Across the Curve



LIBOR / Euribor Comparison



Source: Federal Reserve, GS Economic Research and BAML Research.

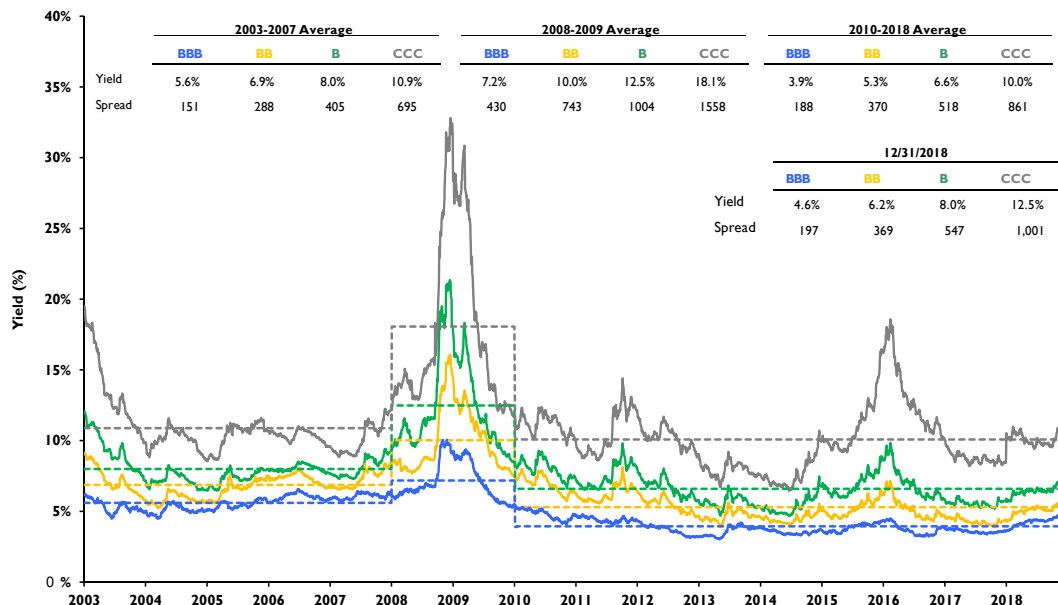
(1) Fed Dots numbers represent the median of FOMC projections for Fed Funds target rate as of December 2018. December 2022 Fed Dot represents the Fed's Longer Run projection.

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2 Credit Spreads

Credit spreads widen throughout 2018 as the fed raised interest rates and then accelerated in the Q4 as market volatility increased



Source: Barclays.

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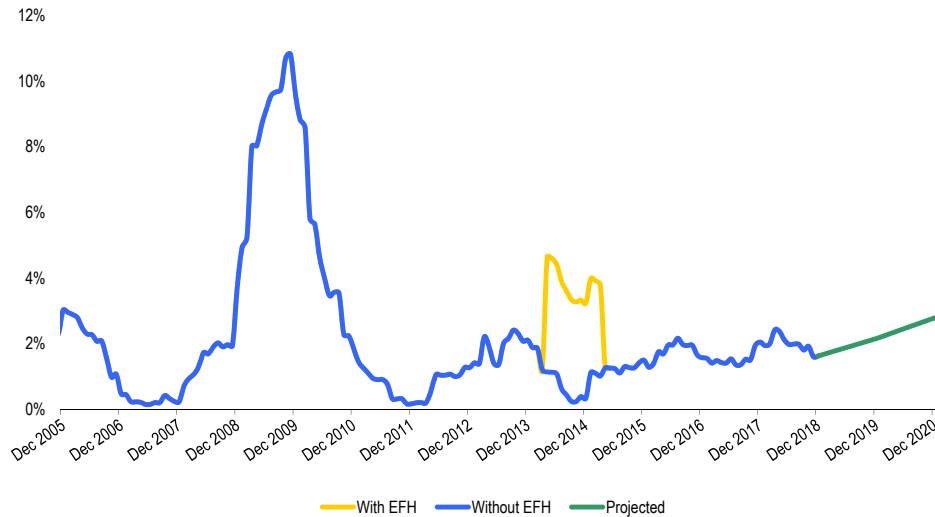
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3 Default Rates

Distressed investors expect default rates to return to near 3.0% in 2019

- Current leveraged loan default rate is ~1.63%

U.S. Trailing-12-Month Leveraged Loan Default Rate



Source: S&P Global Fixed Income Research; S&P CreditPro®.

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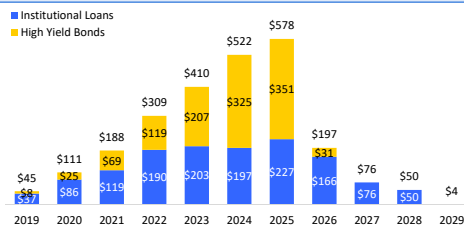
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4 Outlook

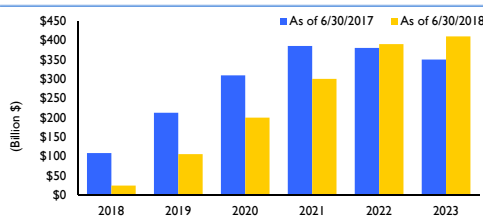
Historical default rates show that a significant percentage of speculative-grade entities default within a 3 year time horizon

- The combination of (i) low cost debt issued to speculative-grade entities in recent years and (ii) the continued rise in interest rates suggest the potential for a steady rise in default rates in coming years

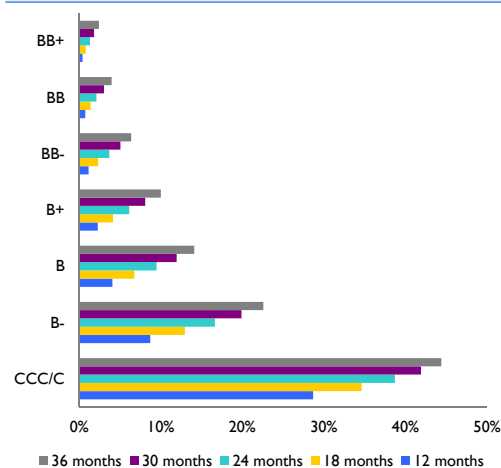
U.S. Non-Investment Grade Maturing By Year⁽¹⁾



U.S. Non-Investment Grade Maturity By Year⁽³⁾



U.S. Average Default Rates by Time Horizon⁽²⁾



Source: S&P Global Fixed Income Research.

Note: USD in billions.

(1) Per RBC Capital Markets.

(2) Data compiled between 1981 – 2016.

(3) 2018 maturities are estimated as of June 30, 2017 reflect debt scheduled to mature in the second half of the year. Excludes financial companies.

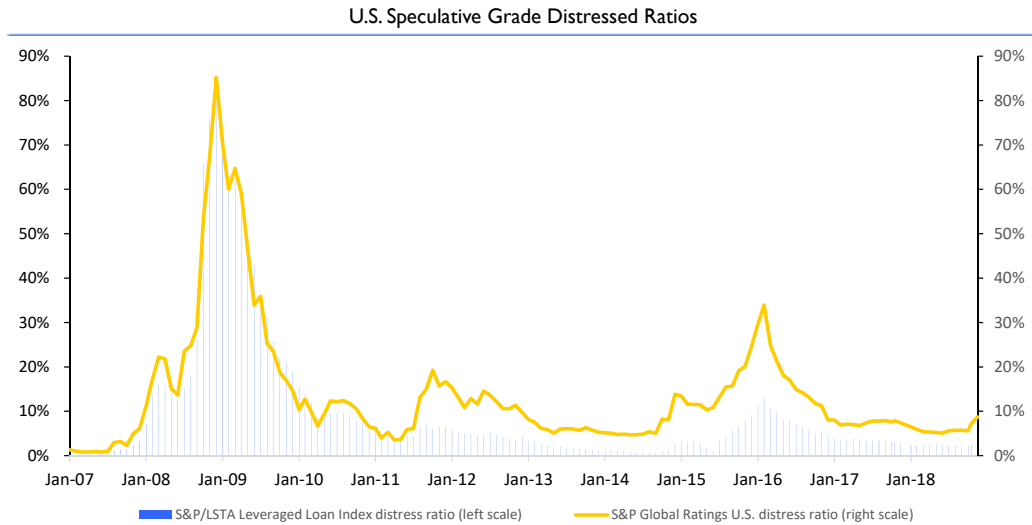
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4 U.S. Distress Ratio

The U.S. distress ratio – a barometer for potential defaults – increased to 8.7% at the end of December, down from a high of ~34% in late 2015/early 2016 and 85% during the 2008 crisis

- 25% of U.S. speculative grade corporate issuers are rated B- or lower, up from 16% in 2014 and 15% at the midpoint of 2007
 - This portion of the speculative grade universe is at the highest levels since the 2008 financial crisis



Source: LCD Research and S&P Global Fixed Income Research.

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