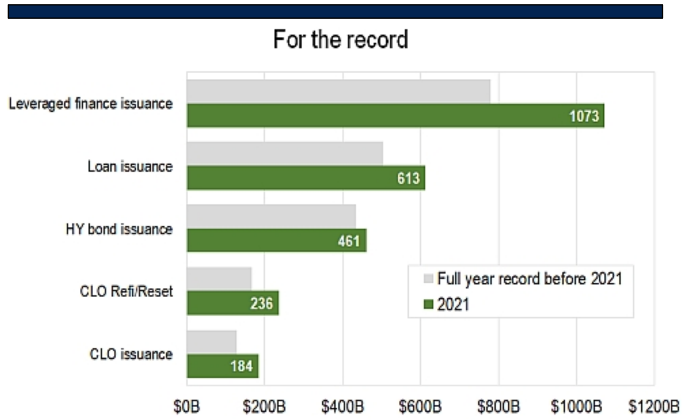
ARC

2021 Leveraged Finance Market Overview

January 13, 2022

2021, A STUNNING YEAR



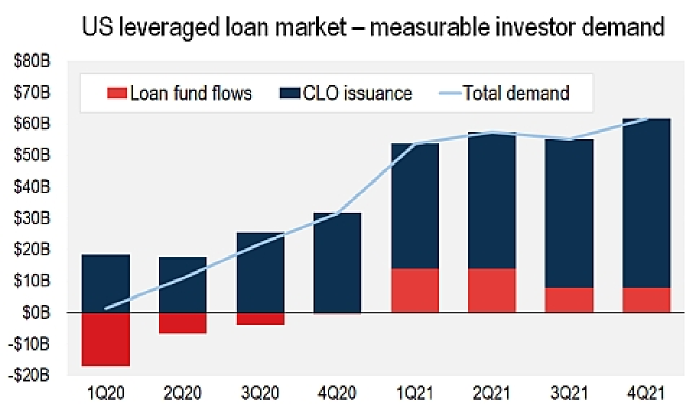
Data through Dec. 8, 2021.
Source: Leveraged Commentary & Data (LCD)

FLOURISHING SUPPLY AND DEMAND

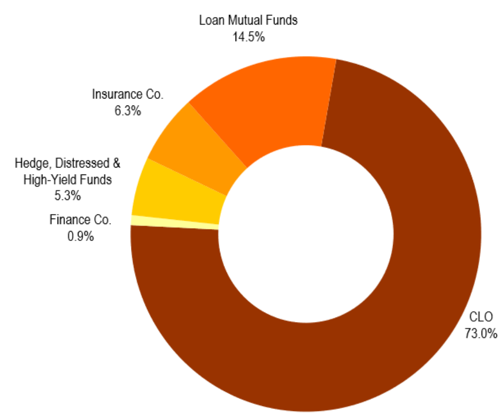
The leveraged finance market flourished in 2021 as CLOs experienced a record-breaking year and loan issuance kept pace to fuel asset allocations. In total, the market absorbed almost $1.1 trillion of new volume, of which 57% was loan issuance. As always, considerable portion of new loan volume refinanced or repaid existing loans. Consistent with prior years, the main buyers of loans were CLOs and loan mutual funds.

ROBUST DEMAND

In 2021, CLO issuance reached $182 billion, 44% higher than its prior issuance high in 2018 of $129 billion. Loan mutual funds and ETF inflows totaled to $32.4 billion; together, creating a healthy environment for new loan issuance. CLOs continue to be the largest investor class in leveraged loans, taking about 73% of the new issue market, the highest ever according to LCD.



Data through Dec. 8, 2021.
Fund flows data includes monthly reporters.
Sources: Leveraged Commentary & Data (LCD); Lipper



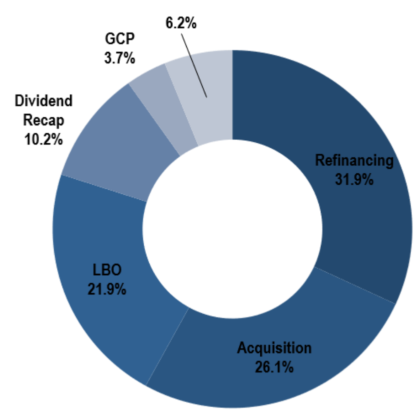
SUPPLY KEEPS UP

Record highs were reached in M&A, B-rated, sponsored issuance, and dividend recapitalizations. M&A was a main driver of this supply totaling to $571 billion in issuance as a record number of borrowers raised M&A financing in 2021 and the size of transactions increased.

Annual institutional new-issue loan volume

	2021	Historical comparison	Full year record pre-2021
'B' rated	$444B	New full-year record	$334B in 2017
Refinancing	$179B	Four-year high	$213B in 2013
Dividend recap	$82B	New full-year record	$61B in 2013
Sponsored M&A	$240B	New full-year record	$202B in 2018
Sponsored	$393B	New full-year record	$295B in 2018
LBO	$146B	Second highest on record	$160B in 2007
M&A	$331B	New full-year record	$275B in 2018
Total	$615B	New full-year record	$503B in 2017

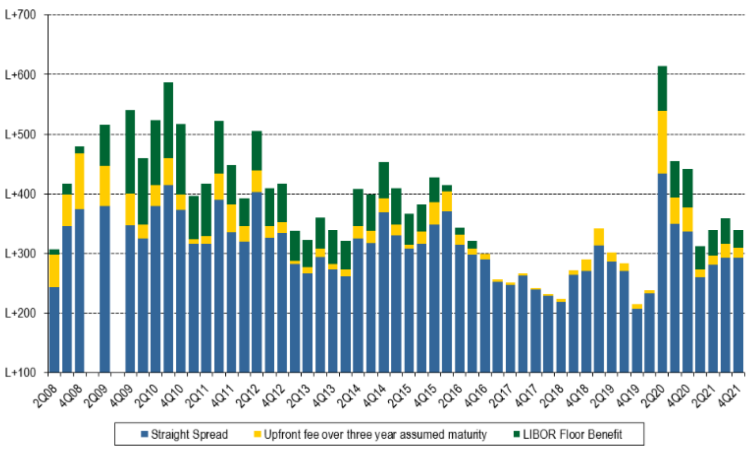
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)



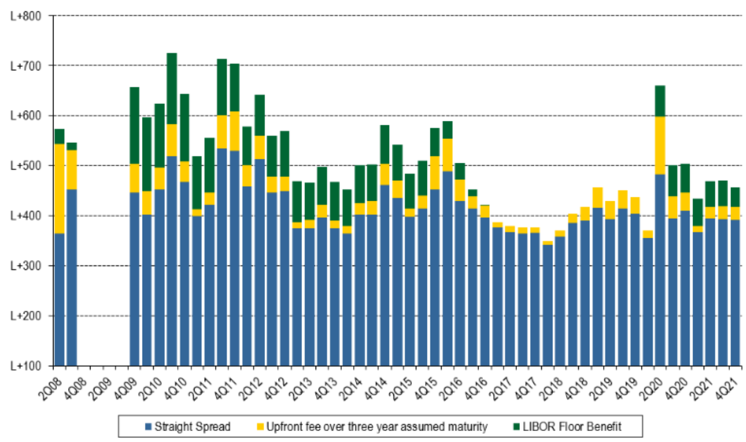
PRICING TRENDS

Average spreads for B/B+ rated issuers hovered just below 400 bps throughout the year, closing at 396 bps in December and just below 300 bps for BB/BB- rated issuers. Yield-to-maturity remained under 5% for the majority of the year, besides April. Middle market loans saw yields-to-maturity decline slightly by year end to 6%. In contrast, yield-to-maturity for large corporate and large corporate B-rated first lien loans averaged 4.4% and 4.5%, respectively.

Pricing: Quarterly Average All-in Spread of BB/BB- Institutional Loans



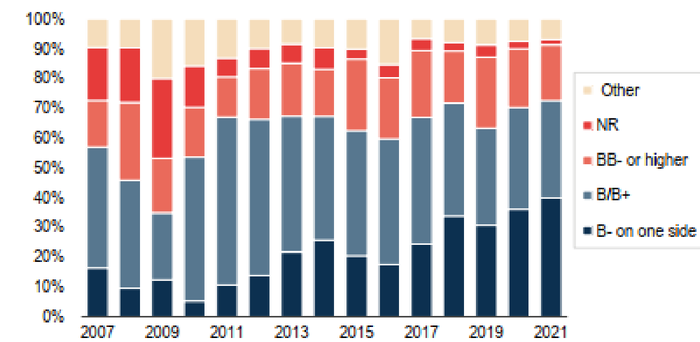
Pricing: Quarterly Average All-in Spread of B+/B Institutional Loans



BALANCING THE SCALES

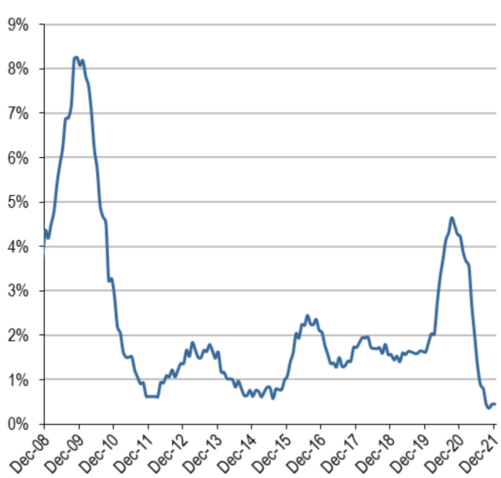
2021 was an incredibly active year in the leveraged loan market with supply and demand surging and new issuance highs reached. This new issuance activity paved the way for CLO managers to print deals at high volumes, according to LCD; signifying steady flow between supply and demand.

Chart 4: US leveraged loan issuance by borrower rating



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Default Rate
(LTM Number of Issuers in Default/Current Issuer Count)

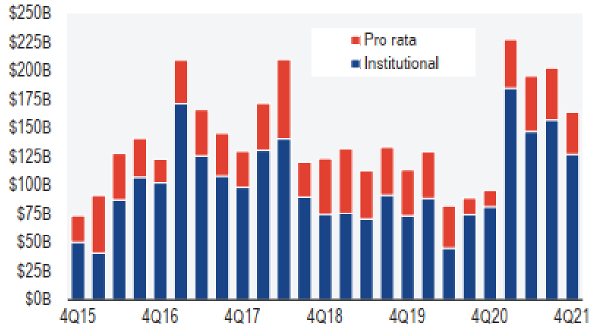


HISTORICALLY LOW DEFAULT RATE

The issuer default rate reached an all-time low of 0.29% in 2021 as companies recovered, adjusted and resumed normal business operations. This activity is also typical after a restructuring wave as weaker balance sheets are flushed out of the market. As the default rate crept up slightly in late December, it is expected to hover in the 0.80-0.90% range in 2022. This default rate is still low by any measure.

Q4 2021

Chart 13: US leveraged loan volume



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

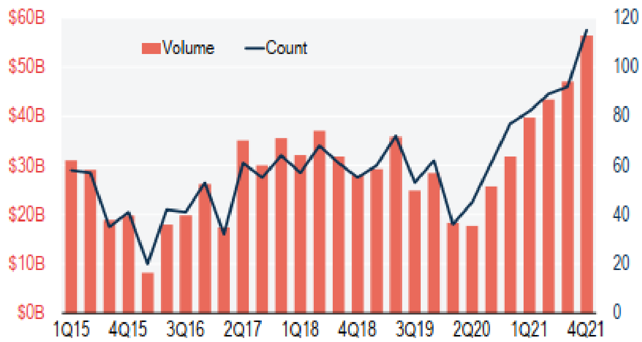
PACE SLOWS

Zeroing in on the fourth quarter, issuance slowed its pace but remained higher than any quarterly in 2019 or 2020. This deceleration was driven by lower LBO supply, and a drop in dividend recapitalization volume.

CLOS FINISH STRONG

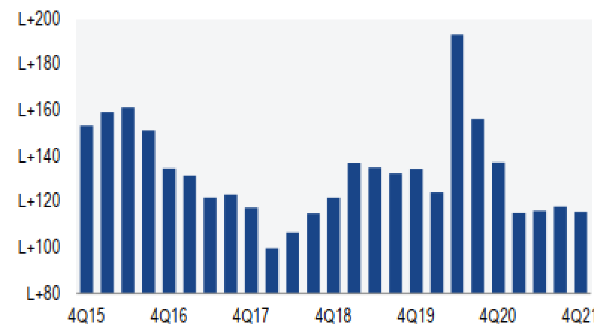
CLO issuance finished strong, driven in part by a desire to lock in LIBOR funding before SOFR becomes the standard. In general, SOFR gained momentum as banks will no longer be able to price new Libor-based loans after year end, and pre-existing loans move towards SOFR conversion by the June 30, 2023 transition date. Resets (pricing reductions) and refinancings set new issuance records at $52.9 billion; momentum is expected to keep pace as 2020-vintage deals issued during the initial COIVD-19 pandemic will be revisited by managers. With AAA spreads at near historical lows, current loan pricing supports ongoing investment.

Chart 15: US CLO issuance: Quarterly



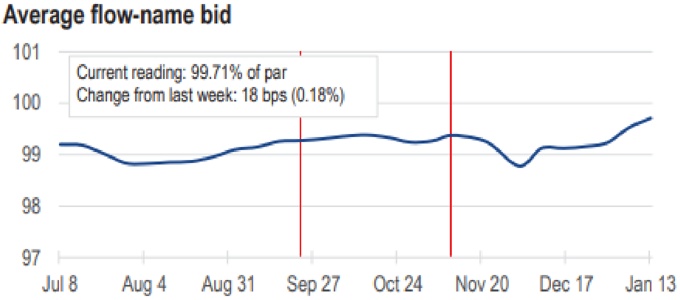
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 21: BSL CLO AAA spread



Data through Dec. 31, 2021
Source: Leveraged Commentary & Data (LCD)

Average flow-name bid



Note: Vertical lines indicate dates when flow-name constituents were updated.

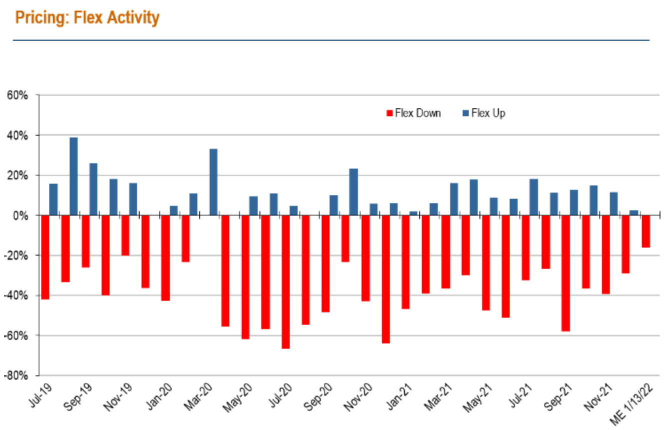
Source: Leveraged Commentary & Data (LCD)

SECONDARY MARKET

Secondary market performance tracked closely to the primary market, starting the year off strong and drifting higher near year-end. According to LCD, the average bid climbed 244 basis points in 2021, mostly in the first half of the year. Quarters three and four experienced around 24 bps increases compared to 135 bps and 83 bps for quarters one and two of 2021.

This deceleration is mostly drawn to the volatility that rose post-Thanksgiving with concerns regarding the Omnicron variant, which led to a widespread but temporary sell off in credit and equities, and overall turmoil in the capital markets. The loans most affected were in the travel and leisure industries.

2022 OUTLOOK



ROBUST MARKET

Market forecasters expect volume to remain strong in 2022, however, they do not foresee activity exceeding 2021 peaks. High ratios of market flex down to up support this conclusion, signifying a strong market. As the 2021, $615 billion institutional loan issuance volume far exceeded its previous high of $503 billion in 2017; analysts expect a range of $500-$600 billion of new issuance in 2022.

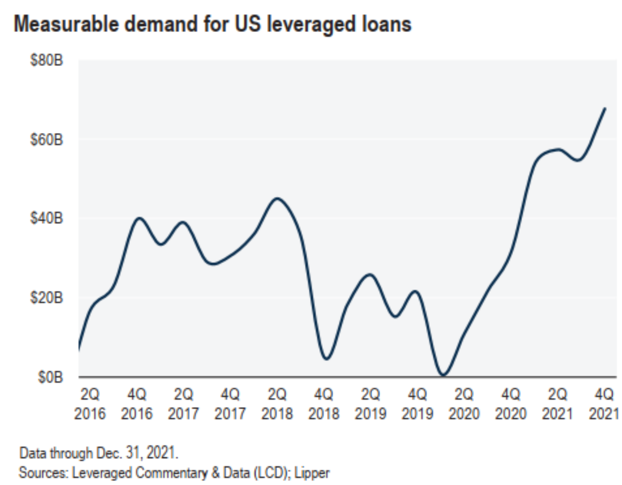
ARC expects 2022 to be a solid year in the loan market, with low default rates continuing to support CLO issuance, mutual fund inflows and new issue M&A activity.

RATE HIKES IN THE FUTURE

Moreover, issuance is expected to see an increase in refinancing and repricing activity as loans transition away from LIBOR to SOFR and due to the Federal Reserve signaling three rate hikes in 2022. Historically, rate hikes have boosted sentiment in the floating rate leverage loan asset class, helping to drive fund inflows.

DEMAND ON PAR

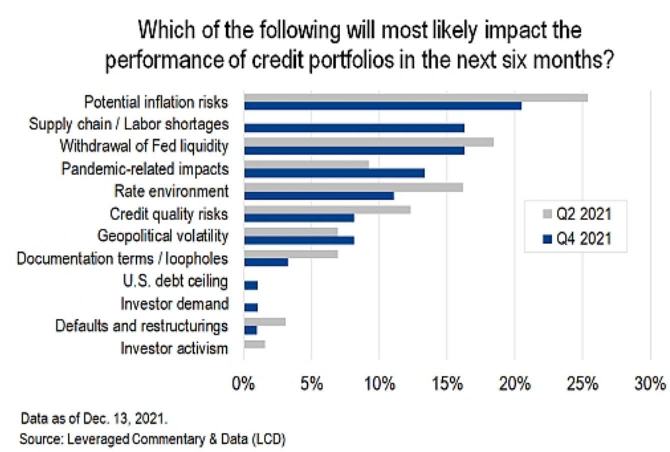
Demand is expected to remain strong as CLO issuance and inflows into loan mutual funds and ETFs are expected to remain on par with 2021 levels. A slow Q1 2022 is anticipated in CLOs as the industry adjusts to the transition from LIBOR to SOFR; it has been noted that some managers pulled their early 2022 deals forward before the Libor expiration cutoff in the new year.



POCKETS OF VOLATILITY EXPECTED

A few pockets of volatility are expected in 2022 as the real time index transition unfolds, inflation rises and the impact of future coronavirus variants remain unpredictable, at large.

According to a leveraged finance survey conducted by LCD, a majority of respondents anticipate a market correction near the end of 2022 or early to mid-2023. Inflation leads the list of concerns as it reached a 40-year high at 7% in December, largely driven by supply chain shortages.



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