

Phoenix Management Services “Lending Climate in America” Survey



**3rd Quarter 2020
Summary, Trends, and Implications**

PHOENIX
"LENDING CLIMATE IN AMERICA"
3rd Quarter 2020

SUMMARY, TRENDS AND IMPLICATIONS

- 1. Of the millions of workers furloughed between March, when the COVID-19 outbreak triggered an unprecedented shutdown of the nation's economy, and June, 22% have been permanently laid-off. Prior to the widespread availability of a vaccine, do you believe we will see companies continue to operate at post-COVID headcount levels, or will companies continue to ramp back up to their pre-COVID headcount levels?**

Garnering the highest percentage of responses (64%), were lenders that believe companies will operate at post-COVID headcounts until a vaccine is widely available. Thirty-six percent of the lenders surveyed believe companies will continue migrating towards pre-COVID headcount levels.

- 2. Which of the following issues do you believe will be most important in this year's presidential election?**

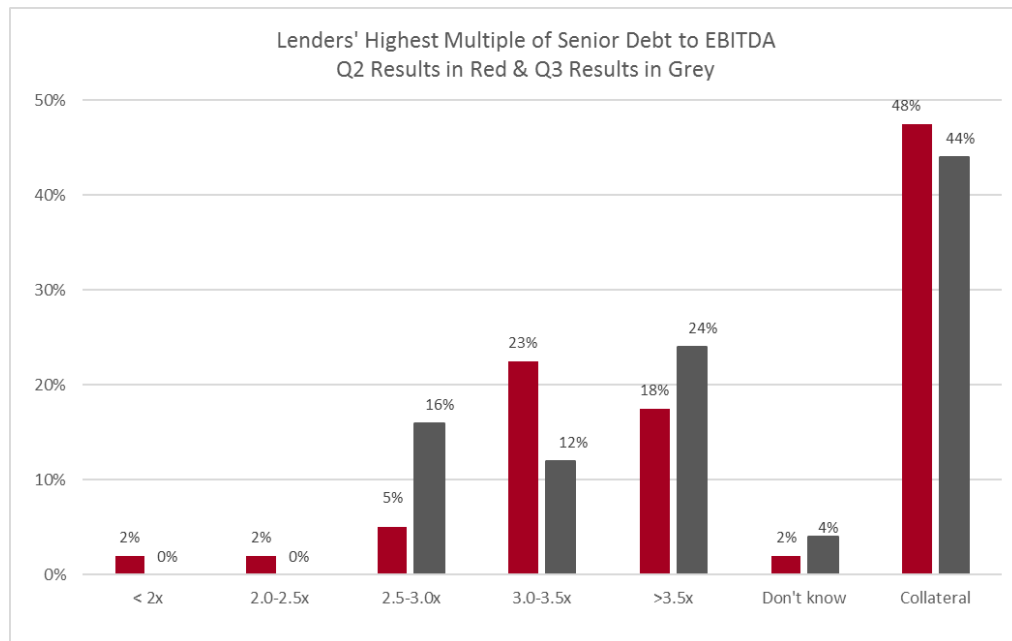
The answer that received the highest percentage response, 48%, were the lenders that believe the Coronavirus will be the most important issue in this year's presidential election. Of the lenders surveyed, 44% of respondents believe fiscal policy will be the most important issue in this year's presidential election, while 4% of lenders believe a) economic inequality, and b) supreme court appointments will be the most important issues. None of the lenders surveyed believe foreign policy will be the most important issue in this year's presidential election.

- 3. How do you expect your loan portfolio to perform in Q4 versus Q3, assuming the status quo regarding the COVID-19 pandemic (i.e. no major increases in cases or death from Q3 and no vaccine) from a risk rating perspective?**

Lenders garnering 44% of responses expect their loan portfolios to stabilize in Q4 versus Q3 from a risk rating perspective. Of the lenders surveyed, 32% expect their loan portfolios to decline, and 24% of lenders expect their loan portfolios to improve from a risk rating perspective in Q4.

- 4. Leverage multiples slightly shifted in Q3 2020.**

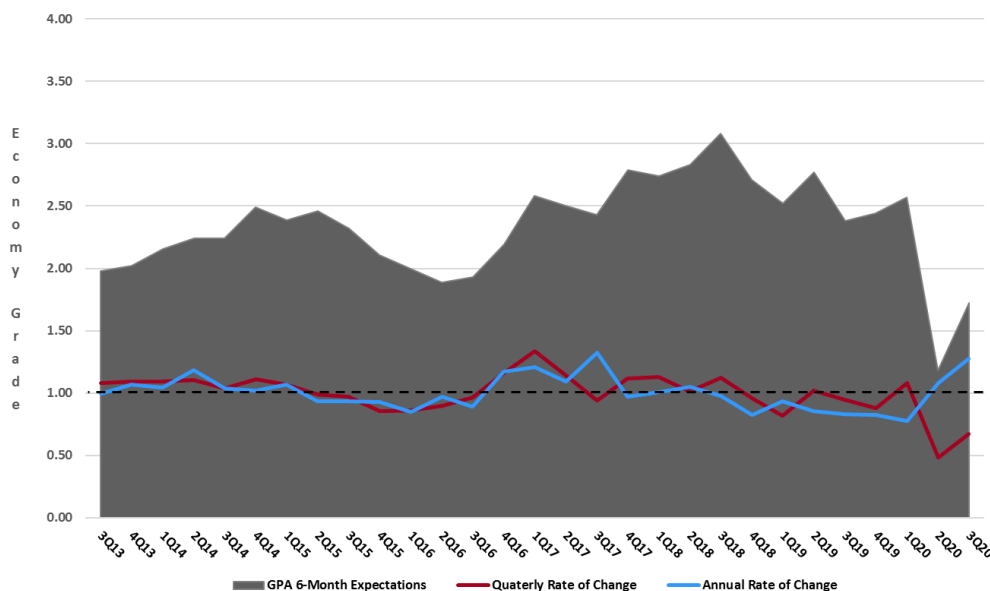
Leverage multiples slightly shifted in Q3 2020 with 24% of lenders indicating that the >3.5x range would be the highest EBITDA ratio they would consider versus 18% in Q2 2020. The percentage of respondents who would consider a debt to EBITDA ratio of 3.0-3.5x decreased to 12% from the previous quarter's results of 23%. Forty-four percent of lenders responded that they were collateral lenders and therefore do not make decisions based on cash flow/leverage multiples.



5. Near-term and long-term economic performance expectations increase in this quarter’s survey.

Lenders optimism in the U.S. economy for the near-term increased this quarter to a GPA of 1.72 from the Q2 2020 results of 1.18. Forty-eight percent of the lenders believe the economy will perform at a “C” level over the next six months, and 40% believe the economy will perform at a ‘D’ level. Of the lenders surveyed, 12% expect the U.S. economy to perform at a “B” grade.

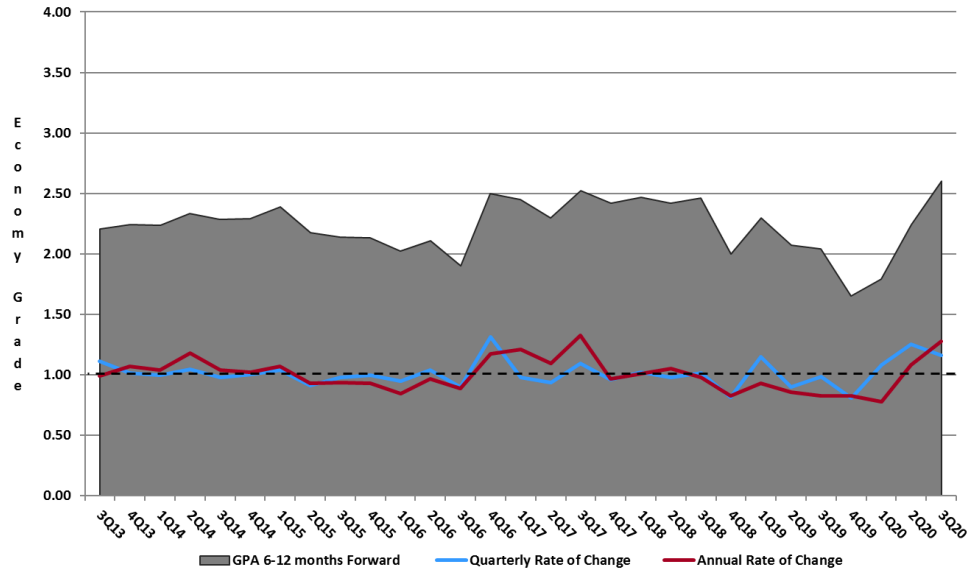
Lender Expectations for Economy (Forward Six Months)
4.0=A, 2.0=C. 0.0=F



** Rate of Change of 1.0 is at equilibrium and signifies “no change” from the corresponding prior period of comparison.*

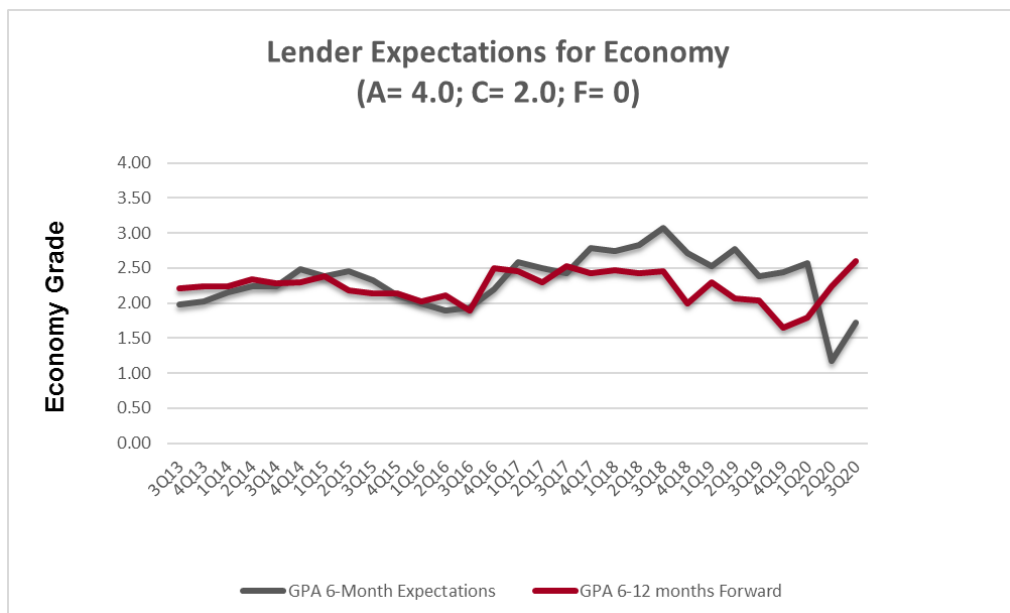
Lenders growth expectations for the U.S. economy beyond six months increased this quarter as well. The weighted average increased to a 2.60 GPA from 2.24 the previous quarter. 48% of lenders believe the economy will perform at a “C” level in the next six to twelve months which represents a decrease of 7-percentage points from the Q2 2020 results of 55%. The percent of lenders (44%) that believe the economy will perform at a “B” level increased 20-percentage points from Q2 2020. The lenders (8%) who believe the economy will perform at an “A” over the next twelve months remain unchanged.

Lender Expectations for Economy (Forward Six-Twelve Months)
4.0=A, 2.0=C, 0.0=F



* Rate of Change of 1.0 is at equilibrium and signifies “no change” from the corresponding prior period of comparison.

The Q3 2020 survey continued the recent trend of a higher long-term GPA than near-term GPA. Although lenders are still quite pessimistic about the U.S. economy due to COVID-19, they are becoming slightly more optimistic about the U.S. economy in the long-term.



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Survey Results

1. The majority of lenders believe companies will continue to operate at post-COVID headcount levels until a vaccine is widely available.

Lenders were asked: Of the millions of workers furloughed between March, when the COVID-19 outbreak triggered an unprecedented shutdown of the nation's economy, and June, 22% have been permanently laid-off. Prior to the widespread availability of a vaccine, do you believe we will see companies continue to operate at post-COVID headcount levels, or will companies continue to ramp back up to their pre-COVID headcount levels?

Remain at post-COVID headcount levels until a vaccine is widely available.	64%
Continue migrating towards pre-COVID headcount levels.	36%

2. The majority of lenders believe the Coronavirus will be the most important issue in the upcoming presidential election.

Lenders were asked: Which of the following issues do you believe will be most important in this year's presidential election?

Coronavirus	48%
Fiscal Policy	44%
Economic Inequality	4%
Supreme Court Appointments	4%
Foreign Policy	0%

3. The majority of lenders expect their loan portfolios to remain stable in Q4 2020.

Lenders were asked: How do you expect your loan portfolio to perform in Q4 versus Q3, assuming the status quo regarding the COVID-19 pandemic (i.e. no major increases in cases or death from Q3 and no vaccine) from a risk rating perspective?

Decline	32%
Stabilize	44%
Improve	24%

4. Highest Senior Debt to EBITDA Leverage Institutions Would Consider

Respondents were asked the highest multiple of Senior Debt to EBITDA their financial institution would consider with regard to a loan request.

<u>EBITDA Level</u>	<u>2Q 2020</u>	<u>3Q 2020</u>
Greater than 3.5x	18%	24%
Between 3.01x and 3.50x	23%	12%
Between 2.51x and 3.00x	5%	16%
Between 2.01x and 2.50x	2%	0%
Less than 2.0x	2%	0%
Collateral lenders	48%	44%
N/A	2%	4%

5. Anticipated Change in Senior Debt to EBITDA Multiple

Respondents were asked, over the next six months, how the Senior Debt to EBITDA multiple would change at their financial institution.

<u>Change in Senior Debt to EBITDA Level</u>	<u>2Q 2020</u>	<u>3Q 2020</u>
Increase greater than 0.5x	10%	4%
Increase less than 0.5x	5%	0%
Decrease less than 0.5x	18%	16%
Decrease greater than 0.5x	7%	0%
No change	10%	32%
Collateral lenders	45%	44%
N/A	5%	4%

6. Factors with Strongest Potential to Affect Near-Term Economy

Respondents were asked, over the next six months, which two factors had the strongest potential to affect the economy.

<u>Factors Affecting Near-Term Economy</u>	<u>2Q 2020</u>	<u>3Q 2020</u>
Other	45%	58%
Stability of Stock Market	23%	46%
U.S. Budget Deficit	7%	33%
Constrained Liquidity in Capital Markets	65%	29%
Unstable Energy Prices	33%	8%
Sluggish Housing Market	12%	8%

7. Industries Expected to Experience Greatest Volatility

Respondents were asked, over the next six months, which industries will experience the most volatility (i.e. Chapter 11 filings, mergers and acquisitions, declining profits, etc.). Respondents were asked to select the top three industries.

Industries Experiencing Most Volatility	2Q 2020	3Q 2020
Retail Trade	72%	88%
Accommodation and Food Services	80%	71%
Arts, Entertainment, and Recreation	46%	54%
Real Estate	28%	33%
Educational Services	10%	17%

8. Customers' Plans in the Next Six to Twelve Months

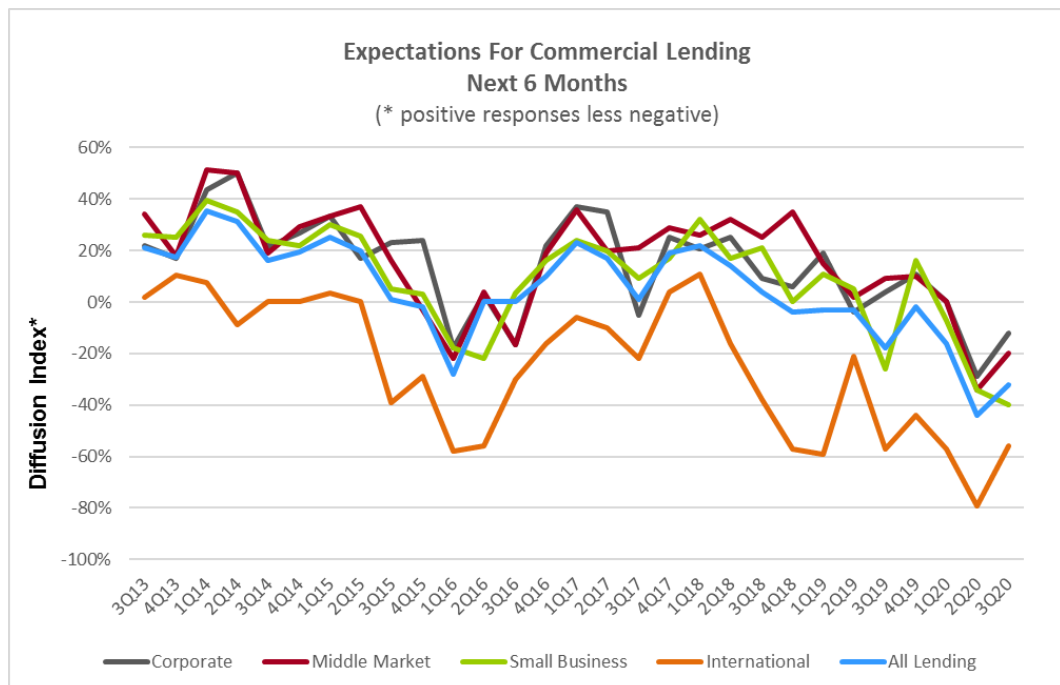
Respondents were asked which of the following actions their customers planned in the next six to twelve months. Lenders were asked to designate all potential customer actions that applied.

Customers' Plans	2Q 2020	3Q 2020
Raising Additional Capital	68%	62%
Capital Improvements	16%	48%
Introducing New Products or Services	29%	38%
Entering New Markets	13%	24%
Making an Acquisition	13%	19%
Hiring New Employees	11%	19%
"Other" Initiatives	13%	14%

9. Economic Indicators

Respondents were asked whether they expected the following economic indicators to be up, down, or remain the same over the next six months.

- In Q3 2020, lenders optimism increased in large corporate (-12%) and middle market (-20%), while small business lending decreased to -40%. The diffusion index for the average for all lending increased to -32% from -44% in Q2 2020.



	<u>2Q/2020</u>					<u>3Q/2020</u>			
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>		<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>
Corporate Lending	24%	53%	23%	-29%	Corporate Lending	8%	20%	72%	-12%
Middle Market Lending	21%	55%	24%	-34%	Middle Market Lending	20%	40%	40%	-20%
Small Business Lending	29%	63%	8%	-34%	Small Business Lending	24%	64%	12%	-40%
International Lending	3%	82%	15%	-79%	International Lending	0%	56%	44%	-56%

- The unemployment diffusion index decreased to -36% in Q3 2020 compared to 26% in Q2 2020. In addition, the loan losses diffusion index decreased to 84% compared to 100% in Q2 2020, and the bankruptcies diffusion index decreased from 100% in Q2 2020 to 84%.

	<u>2Q/2020</u>					<u>3Q/2020</u>			
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>		<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>
Loan Losses	100%	0%	0%	100%	Loan Losses	88%	4%	8%	84%
Bankruptcies	100%	0%	0%	100%	Bankruptcies	88%	4%	8%	84%
Interest Rates	13%	11%	76%	2%	Interest Rates	0%	4%	96%	-4%
Unemployment	58%	32%	10%	26%	Unemployment	12%	48%	40%	-36%
Bank Failures	50%	0%	50%	50%	Bank Failures	28%	8%	64%	20%

10. U.S. Economy Grade – Next Six Months

Respondents were asked how they expected the U.S. economy to perform during the next six months on a grading scale of A through F.

- Lenders optimism on the U.S. economy significantly increased in points this quarter from 1.18 in Q2 2020 to 1.72 in Q3 2020. In this current quarter, the majority of lenders (48%) believe the economy will perform at a “C” level during the next six months. This represents an increase of 19 points from the previous quarter. Of the lenders surveyed, 40% believe the economy will perform at a “D” level which represents a decrease of 13 points from the previous quarter. There was an increase of lenders (12%) that believe the economy will perform at a “B” level from the 3% in Q2 2020.

<u>Grade</u>	<u>2Q/2020</u>	<u>3Q/2020</u>
A	0%	0%
B	3%	12%
C	29%	48%
D	53%	40%
F	16%	0%
Weighted Average Grade	1.18	1.72

11. U.S. Economy Grade – Beyond the Next Six Months

Respondents were asked how they expected the U.S. economy to perform beyond the next six months on a grading scale of A through F.

- Lenders expectations for the U.S. economy’s performance in the longer term significantly increased from the prior quarter. The weighted average GPA increased 36 points from a 2.24 in Q2 2020 to 2.60 in Q3 2020. Of the lenders surveyed, 48% feel as though the U.S. economy will perform at a “C” level beyond the next six months, while 44% expect the economy to perform at a “B” level, an increase of 20 percentage points from Q2 2020. In addition, the lenders who believe the economy will perform at a “D” over the next twelve months decreased 11 percentage points.

<u>Grade</u>	<u>2Q/2020</u>	<u>3Q/2020</u>
A	8%	8%
B	24%	44%
C	55%	48%
D	11%	0%
F	3%	0%
Weighted Average Grade	2.24	2.60

12. Customers’ Future Growth Expectations

Lenders assessed their customers’ growth expectations for the next six months to a year.

- The percentage of respondents indicating their customers have “moderate” growth expectations for the next six months to one year increased 39 percentage points to 60%. In Q3 2020, 32% of lenders ascribe “no growth” for their borrower’s in the next six months, a 44-percentage point decrease from the previous quarter, and 8% of lenders ascribe to “strong” growth.

<u>Indication</u>	<u>2Q/2020</u>	<u>3Q/2020</u>
Very Strong	0%	0%
Strong	3%	8%
Moderate	21%	60%
No Growth	76%	32%

13. Loan Structure

Respondents were asked whether their financial institutions planned to tighten, relax, or maintain their loan structures (collateral requirements, guarantees, advance rates, loan covenants, etc.) in each of four different-sized loan categories.

Many lenders (81%) plan to maintain their current loan structure. In Q3 2020, 19% of lenders plan to tighten their loan structure, a decrease of 37-percentage points, while 0% of the lenders surveyed plan to relax maintain their current loan structure.

	<u>2Q/2020</u>			<u>3Q/2020</u>		
	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>
Loans > \$25 million	53%	38%	9%	21%	79%	0%
\$15 – 25 million	56%	38%	6%	17%	83%	0%
\$5-15 million	60%	34%	6%	17%	83%	0%
Under \$5 million	58%	36%	6%	21%	79%	0%
Overall Average	56%	37%	7%	19%	81%	0%

14. Interest Rate Spread

Lenders were asked whether their financial institutions planned to reduce, maintain or increase their interest rate spreads and fee structures on similar credit quality loans.

A majority of lenders (67%) plan to maintain their interest rate spreads and fee structures. In Q3 2020, the percentage of lenders that plan to tighten their interest rate spreads decreased to 27%, and there was a 1-percentage point increase (6%) that plan to reduce their interest rate spreads.

	<u>2Q/2020</u>			<u>3Q/2020</u>		
	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>
Loans > \$25 million	6%	36%	58%	8%	67%	25%
\$15 – 25	6%	36%	58%	13%	62%	25%
\$5-15 million	3%	40%	57%	4%	71%	25%
Under \$5 million	3%	43%	54%	0%	67%	33%
Overall Average	5%	39%	56%	6%	67%	27%

15. The Fed and Interest Rates

Respondents were asked in what direction they thought the Fed would move interest rates and by how much in the coming six months.

88% of respondents in Q3 2020 believe the Fed will leave interest rates unchanged in the next six months. Of the lenders surveyed, 12% of respondents favor a decrease of -1/4 points.

<u>Bps Change</u>	<u>2Q/2020</u>	<u>3Q/2020</u>
+ 1/2 point or more	0%	0%
+ 1/4 point	6%	0%
Unchanged	83%	88%
- 1/4 point	0%	12%
- 1/2 point or more	11%	0%
Weighted Average	-0.04 bps	0.03 bps

16. Current Competition

Respondents were asked to identify the segment of the industry from which they were experiencing the most competition.

- Regional Banks and Commercial Finance Co. continue to place at the top of the survey, garnering 68% of responses. Local Community/Commercial Bank saw an increase with 20% of respondents, and Factors saw a decrease of respondents with 4% in Q3 2020.

	<u>2Q/2020</u>	<u>3Q/2020</u>
Regional Bank	35%	36%
Commercial Finance Co.	32%	32%
Local Community/Commercial Bank	11%	20%
Money Center Banks	8%	8%
Factors	14%	4%
Other	0%	0%