

Interpreting the current credit markets

Source: Lincoln International LLC, Chicago
Compiled by Sahely Mukerji

The financial crisis has had a deep impact on economic activity over the last 18 months. What started as a problem related to the securitization of sub-prime mortgages has expanded to affect practically all aspects of the economy. Bank financing has been scarce, not only for leveraged buyouts or other mergers and acquisitions, but also to fund the everyday operations of companies large and small.

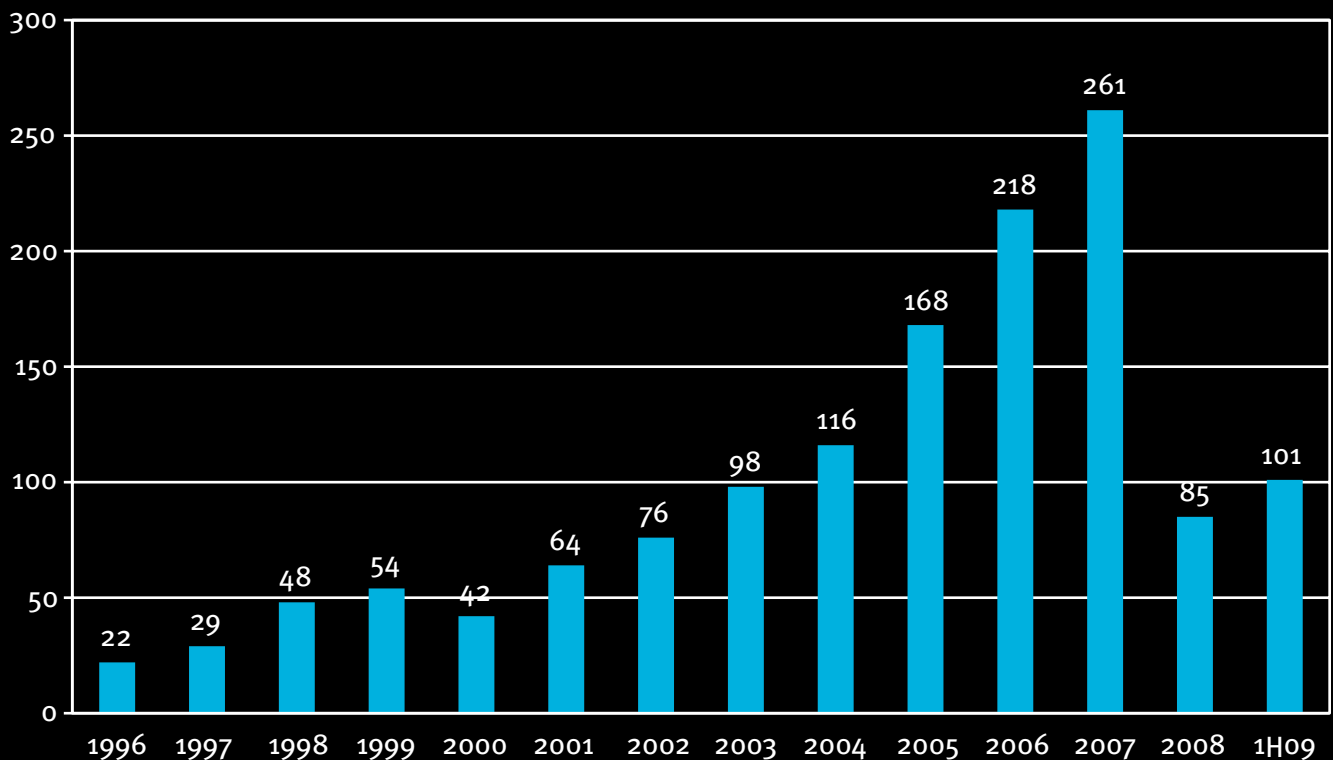
There are multiple factors underlying the current scarcity of capital. Bad investments and lending decisions caused many lending institutions to fail, decreasing the number of lenders in the market, and institutions that have survived the crisis had their capital reserves depleted, making them more cautious about future commitments. Uncertainty about the future performance of the economy also is preventing the credit markets from functioning smoothly. Forecasting a business's financial results in this economic climate has been difficult, making underwriting decisions more complicated. As shown in the charts below, the crisis has impacted the markets in three areas: a decrease in the number of lenders in the market; a decrease in the total amount of available capital (or debt); and

higher interest rates for those companies able to obtain financing.

Due to the decrease in the number of lenders and amount of available capital, many companies are having a difficult time finding sufficient debt. This is especially the case for small and mid-sized businesses. Some small businesses with declining performance are having a difficult time finding any debt capital. Under these circumstances, businesses typically focus more on managing working capital and obtaining financing through vendors and suppliers, while trying to obtain prompt payment from customers. Until the credit markets recover, this will remain a common focus across all industries.

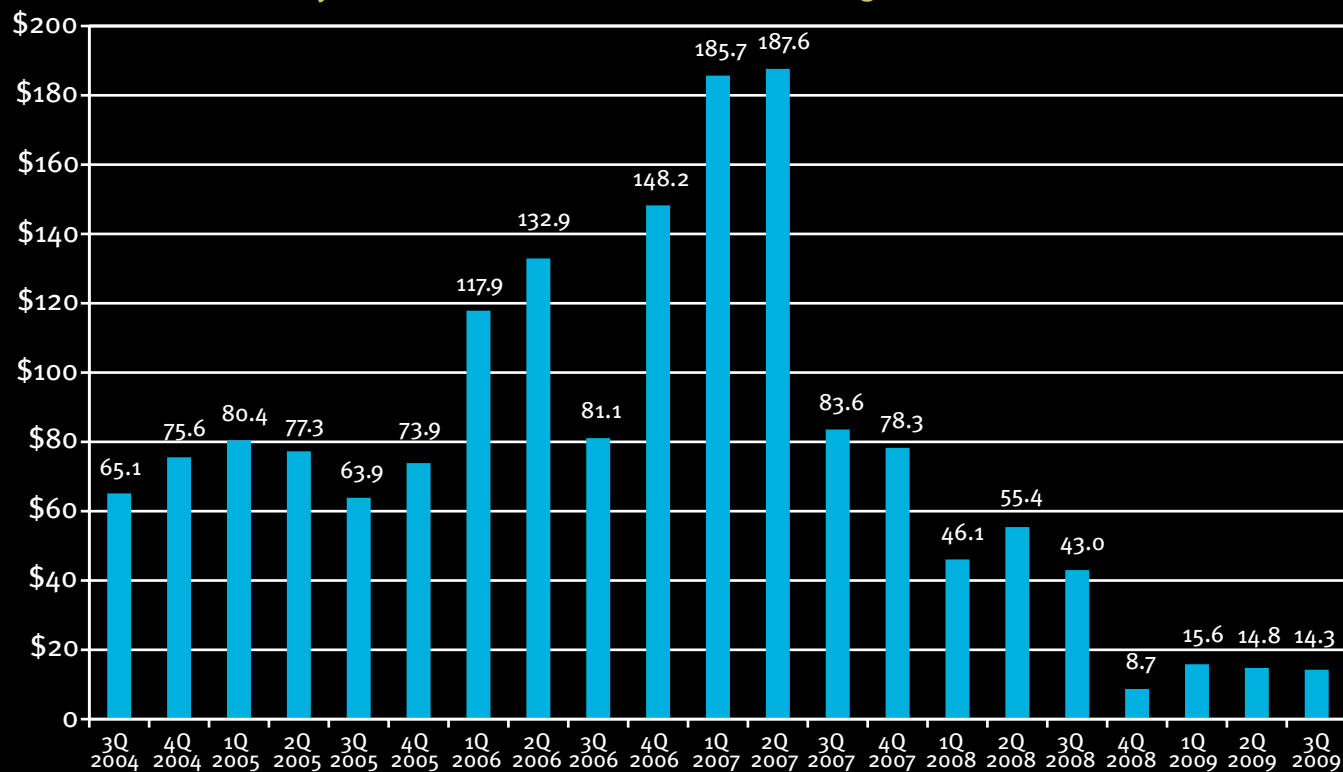
While still in its early stages, Lincoln International is beginning to see a slight recovery in the credit markets. In the last month, Lincoln has started to see some appetite for lending from investors that were previously staying in the sidelines, and some companies have generated strong interest from a variety of sources. However, capital is still not widely available, and the number of lenders active in the market remains low by historical standards. For companies seeking debt to maintain and grow operations, it is advisable to start the process early and anticipate that obtaining commitments will take longer than it used to during the bull market.

Active institutional investors who have made 10+ commitments per year

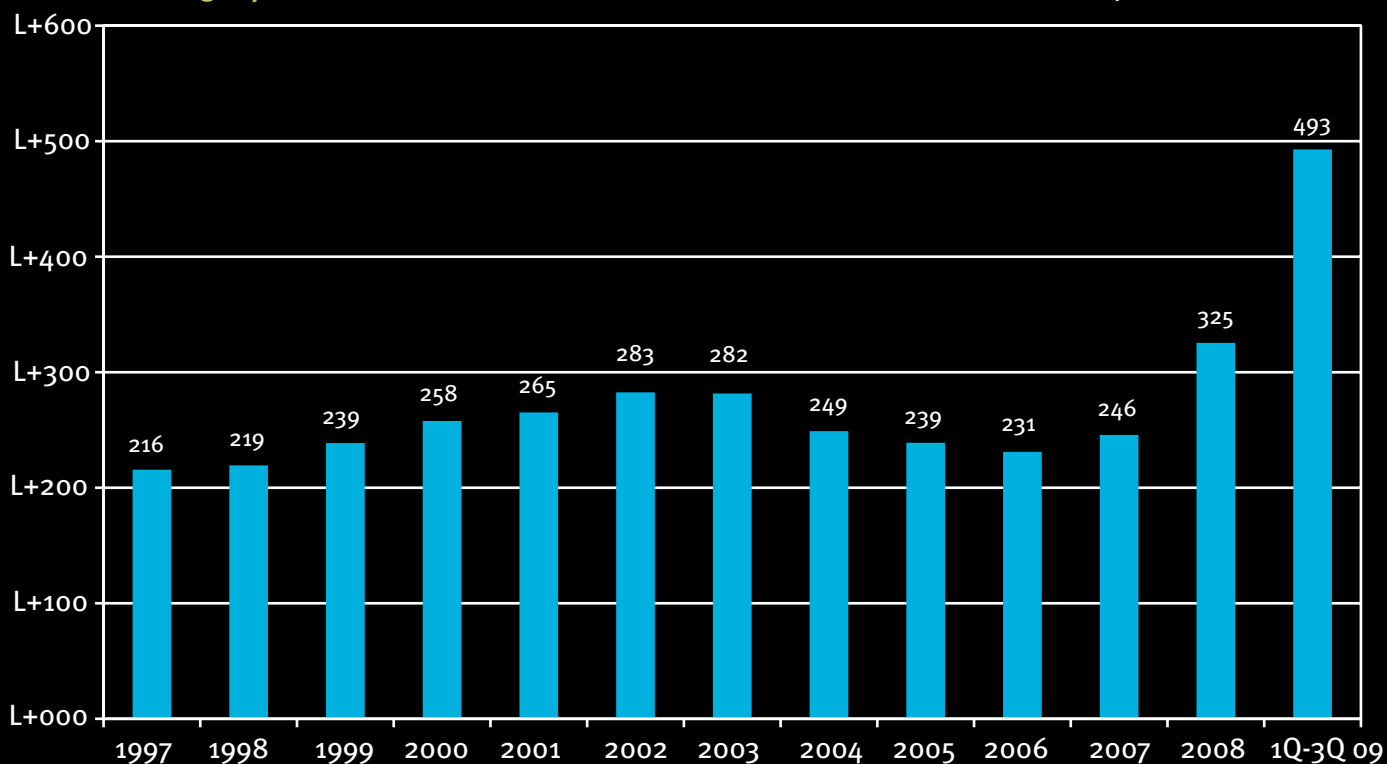


Source: Standard & Poor's Leveraged Commentary and Data

Quarterly U.S. dollar-denominated new-issue leveraged loan volume (\$ in billions)†



Average spreads of senior cash flow loans for middle market transactions (basis points above LIBOR)†



† Source: Standard & Poor's Leveraged Commentary and Data