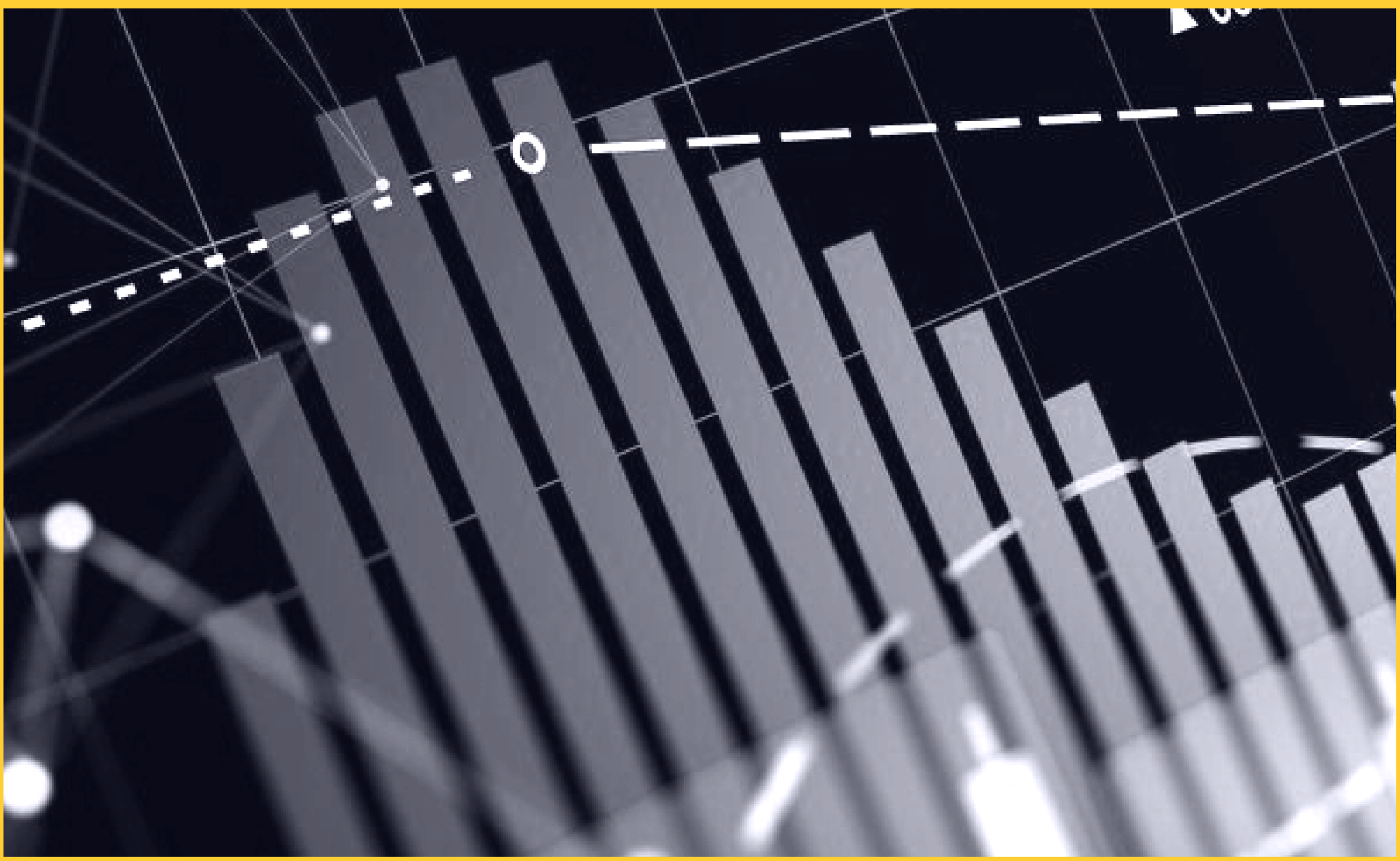
Annual Review & Mid-Market Lending Outlook 2021



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INTRODUCTION

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When I started Cerebro Capital three years ago, I never could have predicted the macroeconomic impacts and changes COVID-19 would bring to the debt markets in 2020. As I reflect back on my personal experience as a corporate banker during the 2008 crisis and now managing a fintech company through a global pandemic, market intelligence continues to be the key component in navigating the rapidly changing business environment. Providing critical market data and bringing transparency to opaque capital markets has never been more important and continues to be our primary focus.

This year, Cerebro saw an unprecedented increase in borrower demand at the same time that lenders were tightening credit standards. Cerebro's platform supported **thousands of corporate borrowers** across 100+ industries for both sponsored and non-sponsored middle market companies **seeking over $8 billion in total debt financing**. Our ability to match the borrowing needs of middle-market companies continues to expand, with over 800 lenders now included in our diverse lender network.

As we look to the future, our mission to bring efficiencies, intelligence, and predictability to the corporate debt process will continue to guide our focus. As you plan for 2021 and beyond, we are ready to help you navigate the credit markets in this ever changing world.

Matthew Bjonerud

Matthew Bjonerud
Founder & CEO
Cerebro Capital

RAPID CHANGES IN 1H20

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Pre-COVID Lending for the Middle-Market

In the first two months of 2020, lender behavior was similar to what borrowers saw in the previous five years. SBA lenders, commercial banks and non-bank lenders were willing to stretch capacity for borrowers with substantial operating and tangible assets. Cash flow lenders favored institutionally backed borrowers over privately owned borrowers. Non-bank lending institutions expanded the loan options available to middle market borrowers.

Market Shock in Q2

The coronavirus crisis created a widespread need for additional capital across mid-market companies. But with credit appetites shrinking almost overnight for both bank and non-bank lenders in Q2, companies were left floundering for options. The CARES Act passed by Congress in late April included multiple loan programs intended as short term solutions to prop up previously strong companies that were unable to maintain cash flows to keep employees paid during shutdowns.

While the Paycheck Protection Program was largely considered a success despite a turbulent roll out, the Main Street Lending Program in contrast was drastically underutilized.

Even with government backed loans, it was not surprising that loan approvals stalled as credit standards tightened considerably. Lenders lacked the ability to forecast when different states would reopen and/or force additional shutdown measures, and were quickly trying to assess the risk in their current customer portfolio.

By late summer, companies in directly impacted industries were tripping loan covenants and bleeding cash while other companies - albeit a smaller number - were thriving and looking for growth opportunities amidst the new work from home environment. Understandably, overall demand for debt capital surged.

Interestingly, the data on middle-market borrower demand from commercial banks varied when compared to non-bank lenders.

LENDER BEHAVIOR 2H20

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The Federal Reserve Q3 Senior Loan Officer Opinion survey of commercial banks indicated that credit standards tightened but demand was decreasing for C&I loans.

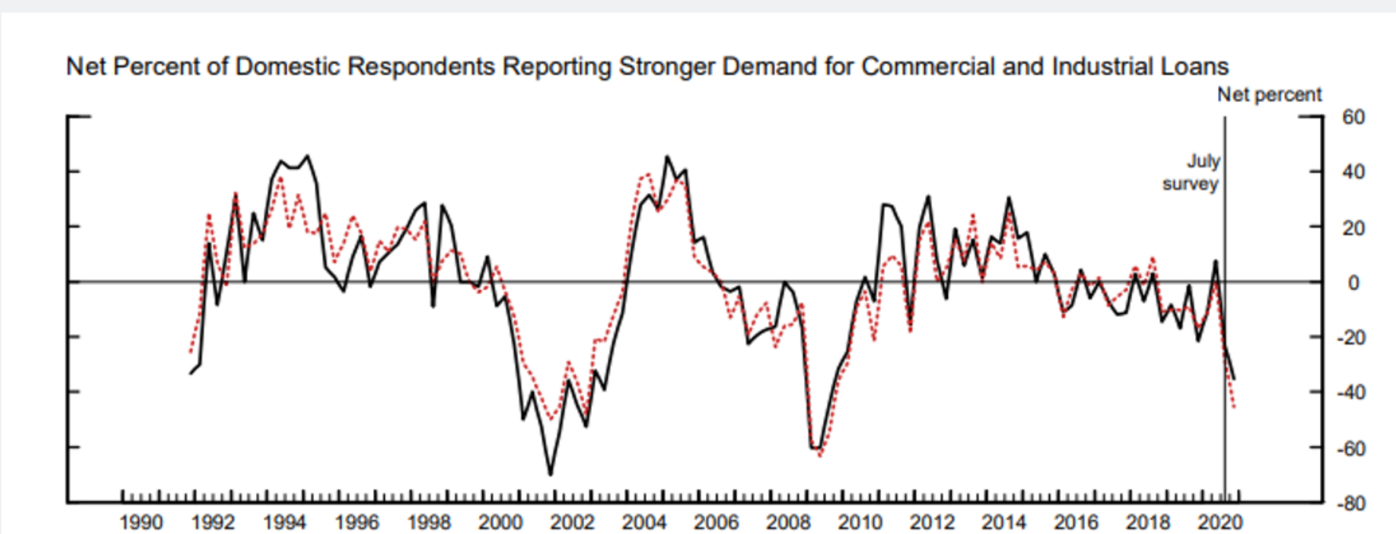
This seems counterintuitive to what was happening in the larger market and this is most likely due to the fact that companies in directly impacted industries were being turned away before they even reached the credit committee. Many companies were already in default on existing loans, so they lacked the ability to request more funding from banks.

Conversely, non-bank lenders were less constrained given they didn't have the burden of implementing and adopting new government backed loan programs.

In fact, over 60% of non-bank lenders saw loan demand increase or remain the same in Q3, according to Cerebro's study of non-bank lenders.

With overall demand at a peak, the barriers to get a loan funded were exacerbated by lenders focusing on their existing portfolio clients, tighter underwriting standards and lack of bandwidth to field new requests. The net impact across the market was an increase in the cycle time of navigating a search for a lender.

Additionally, lenders were waiting until after November elections to have more certainty around shutdown policies that would impose operating restrictions as well as financial stimulus measures.



Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices

MAIN STREET LENDING PROGRAM RECAP

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While the Federal Reserve set formulaic guidelines and bare minimum requirements to allow a large number of companies to qualify, banks were directed to underwrite loans based on their “normal” underwriting standards. **This created a huge gap between eligibility and the threshold needed to receive credit committee approval.**

Further, MSLP was structured as a cash flow based, bridge loan structure which is typically not available to many small and medium-sized businesses in a conventional bank loan. These mismatches, coupled with the recent frenzy of the PPP program, limited interest from many commercial banks to consider offering MSLP loans.

Banks willing to provide MSLP loans most often extended term sheets to strong borrowers who could pledge large collateral amounts. Ultimately, fewer borrowers could access the program than were originally intended.

As of mid-November, the utilization of the program was less than 1% of the $600B earmarked dollars.

Over $42 billion in collateral was pledged to secure < $5 billion in MSLP loans.

Federal Reserve Periodic Report Nov 13th, 2020

Will it be reinstated?

The program is set to expire Dec 31st. As of the publishing date of this report, participation had trended up every month, but the program had not been officially extended or reinstated.

The most optimistic reports indicate that widespread vaccines are at least 6 months away. Impacted industries are still expecting multiple quarters of struggle.

Given the purpose of MSLP was to help borrowers obtain bridge financing, we believe the new administration and Treasury leadership will likely provide an extension and changes to the program to reach more corporate borrowers.

2021 OUTLOOK: COMMERCIAL BANKS

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While we are optimistic about the U.S. economy in 2021 given the prospect for widespread COVID-19 vaccination in the first half of the year, we do not expect middle-market lenders to loosen their underwriting criteria immediately and expect a continuation of a reduced appetite for new credit deals throughout 2021.

There are two key reasons for this:

- Most businesses will show disruptions in their historical financial results, and lenders will offset risk by increasing underwriting standards. We expect commercial banks to increase collateral requirements and more frequently require personal guarantees.
- Projected financial results will likely be impacted by permanent shifts in supply and demand models for multiple industries

Additionally, we expect a high level of variation in how and when lenders respond to market shifts as we saw during the aftermath of the 2008 crisis. Some banks will adapt more quickly to market shifts than others.

In short, prolonged volatility in the lending markets will impact even the strongest borrowers, who will now need to spend more time finding the right lenders with the expertise and the credit appetite to offer competitive terms.

That doesn't mean that companies with deteriorated performance are totally out of luck. We expect commercial banks will continue to grow their loan portfolios for government backed loan programs like the SBA 7a & 504, USDA B&I, and MSLP (if reinstated) to help support those borrowers.

We anticipate that many commercial banks will expand their government loan program offerings and will quickly adapt to new programs, all in an effort to win market share in 2021.

Commercial bank lenders will likely have a **reduced appetite for new credit deals** throughout 2021 when compared to their pre-COVID levels. They will continue requiring **higher collateral** amounts and **personal guarantees** more often than before.

2021 OUTLOOK: NON-BANK LENDERS

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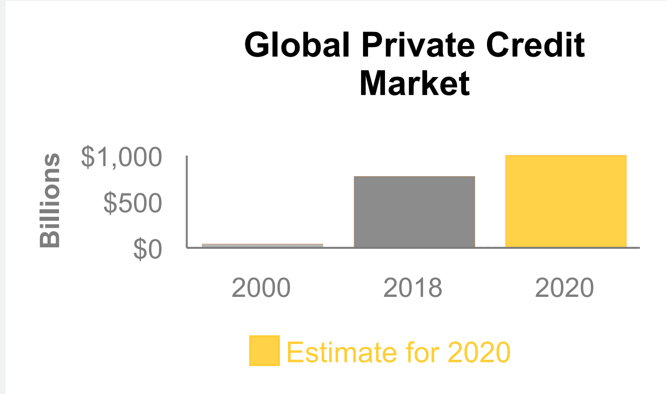
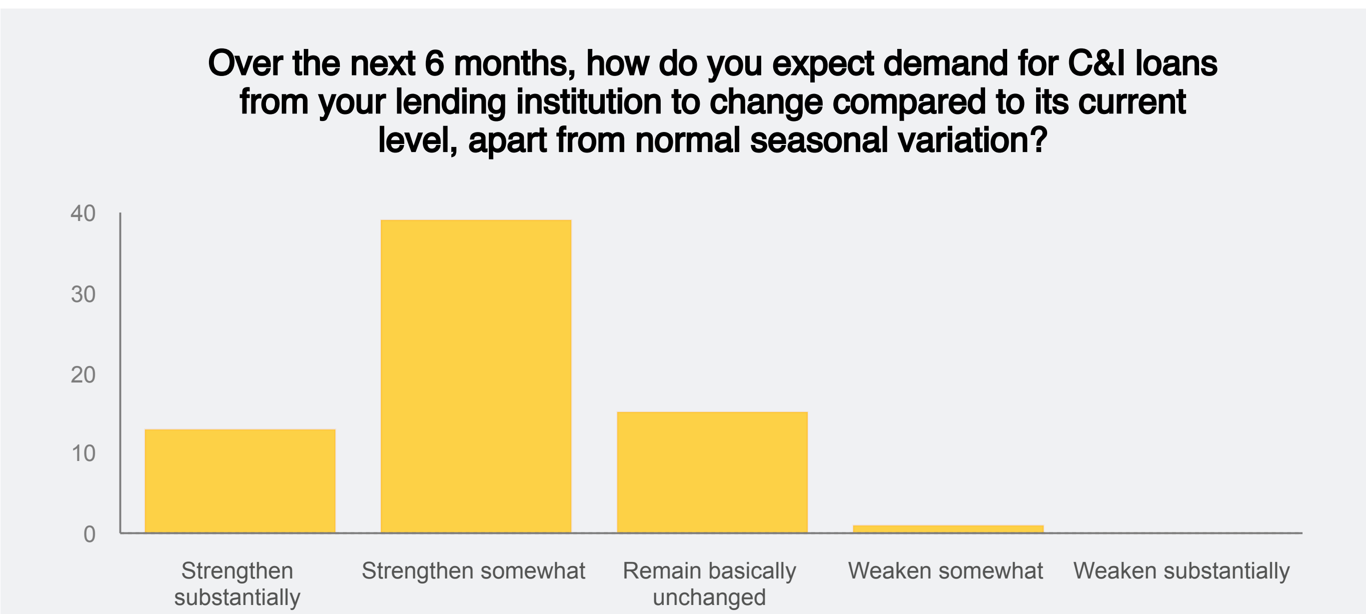
After the 2008 crisis, there was a surge in non-bank lending. We have multiple indications the same will be true in 2021 and beyond. For companies that tripped loan covenants in 2020, the non-bank market will be a welcome home - albeit a more expensive one. Non-banks will get the benefit of fielding loan requests that previously would have gone to commercial bank lenders.

In fact, **over 75% of non-Bank lenders expect demand for C&I loans to strengthen over the next six months**, according to Cerebro's Non-Bank Lending Survey that was released as a comparison to the Federal Reserve's Loan Officer Survey on Q3 lender behavior.



Source: Kelsey Butler, Bloomberg

Many non-bank lenders were well capitalized before COVID and remain so heading into 2021. The combination of dry power and a higher cost of capital, will allow non-bank lenders to benefit as companies return to growth. Corporate borrowers will benefit from higher leverage amounts and more flexible covenants offered by non-bank lending partners in the coming years.



Source: Cerebro Capital Non-Bank Lending Q3 2020 Survey

HOW CEREBRO CAN HELP

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In an environment like this, borrowers will have to search further, deeper and longer across the lender universe to ensure access, efficiency and optimization in their pursuit. Cerebro's technology is designed by former lenders with a core mission of making a debt search to be more efficient so operators and sponsors can focus on running their business and less time on financing it.

We do anticipate normalcy will return to the debt markets in some time, but it is not likely to be on the same schedule for every borrower and every lender. With this in mind, Cerebro is working diligently to expand our network of lenders, improve our understanding of their capabilities, and enhance the tools available to borrowers to communicate the characteristics of their business and monitor their search process.

If we can help your company achieve your financing goals in 2021, please get in touch.

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Debt Placement Innovated

Cerebro Capital offers the only data-driven loan marketplace for middle-market corporate borrowers and commercial lenders. Combining the power of technology, streamlined processes, and transactions team expertise, Cerebro offers the greatest certainty that your company will find the right lending partner in the market.

Benefits of the platform include:

- 800+ BANK & NON-BANK LENDERS
- PRECISE LENDER MATCHING
- MANAGED RFP PROCESS
- CONFIDENTIALITY & DATA SECURITY
- TRANSACTION & LOAN EXPERTS
- SUCCESS-BASED FEE MODEL

Powered by over 800 bank and non-bank lenders, Cerebro Capital is a data-driven platform purposefully designed to democratize access to credit markets by connecting corporate borrowers with lenders for corporate loans ranging from $2 million to $100 million. **Contact Cerebro.**