Convertible Market Update: 2021 Themes & 2022 Outlook

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MEMBER FINRA / SIPC

Capital Markets Advisory

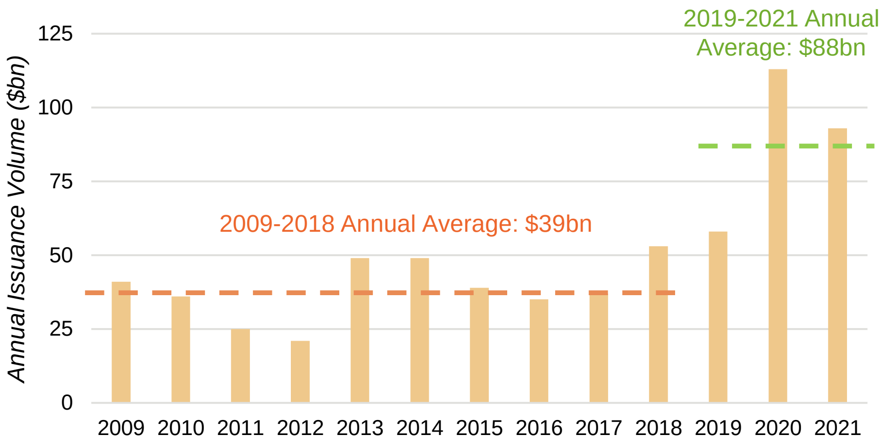
For questions or comments, please reach out to us at CEDA@icrcapital.com

Five Themes in the 2021 Convertible Market

2021 was a pivotal year in the U.S. convertible market – issuance volume was the 2nd highest since the Credit Crisis

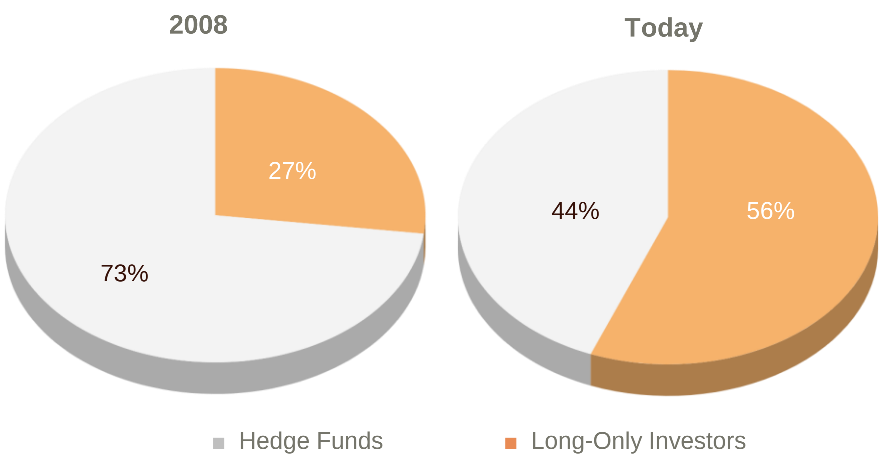
1 The resurgence of the convertible market continued in 2021 with another high-volume year

- 2021 issuance was $93bn – the second highest volume since the Credit Crisis
- 3-year trailing issuance average is now $88bn, more than double the prior 10 years' annual average of $39bn
  - 3-year average is an important metric as many convertibles have a 5-year maturity, and issuers tend to refinance their convertibles ~2 years before maturity
  - 3 years of sustained high volume can create a virtuous cycle of ongoing issuance through refinancings



2 New types of investors entered the market

- Before the Credit Crisis, only 27% of the market securities were owned by long-only investors, with the remaining 73% belonging to hedge funds [(1)]
- With increased participation from crossover investors, particularly credit funds, long-only participation is now at 56% [(1)]
- This does not necessarily mean that 56% of a new deal will be allocated to long-only investors – banks may still under-allocate deals to long-only investors
  - We recommend clients to be keenly focused on deal allocation to protect their stock price



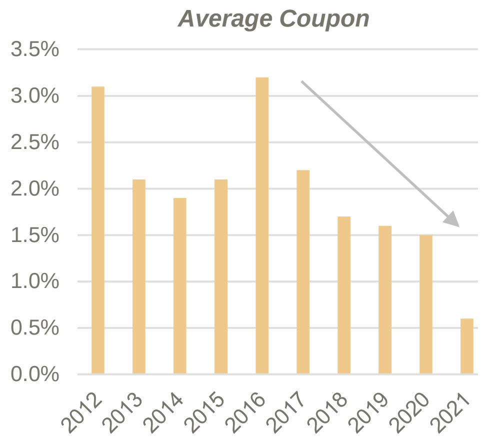
Source: ICR Capital, Bloomberg, Wall Street research.
1. Street estimate of long-only and hedge fund market participation.

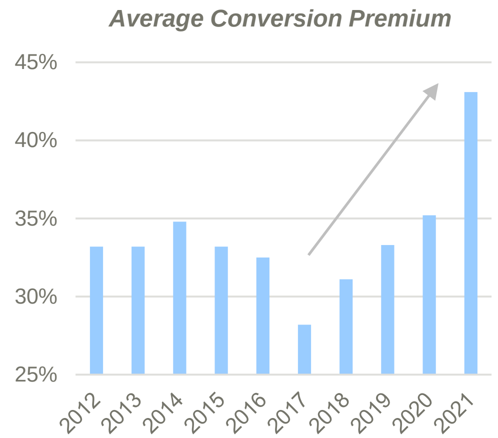
Five Themes in the 2021 Convertible Market (Cont'd)

The strength of the market allowed issuers to achieve very attractive terms

3 Terms were the best in history

- Driven by a unique confluence of high equity volatility, low credit spreads / interest rates, and market strength, issuers achieved the best convertible terms in history
  - Average coupon of 0.6%, average conversion premium of 43% [(1)]
  - After 22 zero-coupon convertibles in 2020, the market saw an additional 45 zero-coupon convertibles in 2021





4 Call spreads continued to be popular, but we saw divergence in pricing between deals with advisors and deals without

- 58% of issuers used a call spread vs. 55% in 2020
  - Upper strikes ranged from up 50% to up 150%
- For every 10% protection, issuers saved 28bps on average when using an experienced, independent advisor
  - 1.58% / $8mm of average savings on a $500mm deal
- Of note, a number of established banks have recently been declining to participate in call spreads; on the other hand, several new entrants have joined the fray and are providing aggressive bids

% of Deals with Call Spreads	58%
Average Upper Strike	95%
Capped Call vs. Bond Hedge plus Warrants	84% / 16%
Price of Every 10% Protection (with Experienced / Independent Advisor)	1.51%
Price of Every 10% Protection (without Experienced / Independent Advisor)	1.79%

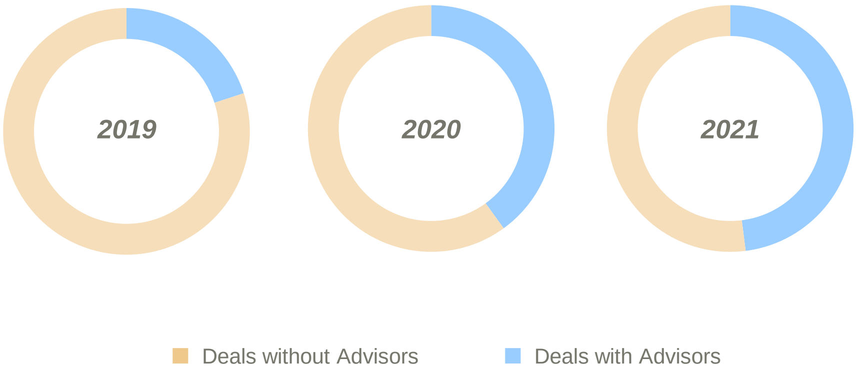
Source: ICR Capital, Bloomberg, Wall Street research.
(1) Based on convertible bond deals.

Five Themes in the 2021 Convertible Market (Cont'd)

Using advisors on a deal became common, and nearly half of U.S. convertible bond issuers used advisors

5 **Advisory market share is now approaching 50%**

- 48% of the U.S. convertible bond issuers used an advisor in 2021
  - Up from 20% in 2019 and 40% in 2020
  - It is now market standard for the advisory fee to come from the banks' fee pie
- In recent months, a number of banks have also put on the advisory hat in order to win bookrunner roles
  - We did not include these "advisors" / deals in our advisory market share calculations as they do not provide truly independent advice



Source: ICR Capital, Bloomberg.

Five Predictions for the 2022 Convertible Market

2022 will be another busy year – activity will be driven by recent tech and other high growth companies' IPOs and former SPACs

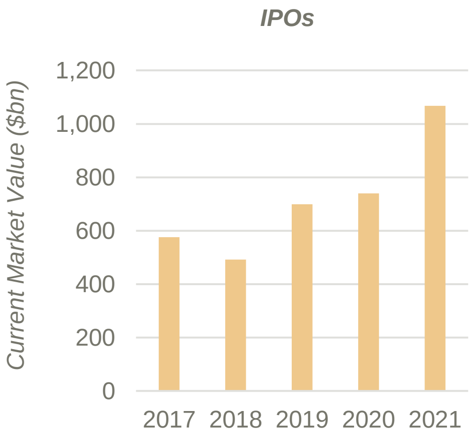
1 Issuance levels will remain elevated, although we may see more structured / privately negotiated deals

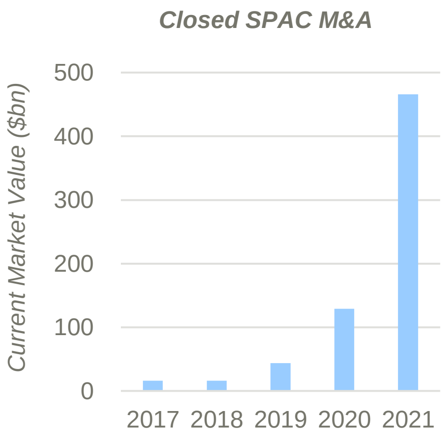
- According to a recent survey we conducted, most convertible market participants are expecting $55-70bn of issuance in 2022
  - Based on the fact that 2021 issuance was Q1 heavy and average quarterly issuance was $16.7bn in the subsequent 3 quarters
- We take a contrarian view – our analysis suggests a $70-90bn issuance year based on recent IPOs, SPACs, and upcoming maturities

Methodology	Expected 2022 Volume
Prior 3 Quarters' Average	$67bn
Street Estimates	$55 – 70bn
ICR Estimate	$70 – 90bn

2 Issuance will be driven by new IPOs and SPACs

- 2021 was the largest year for IPOs as well as SPAC M&A
  - As with prior years, a sizable portion of new deals will come from recent Tech IPOs
  - Issuance by former SPACs, many of whom are from high growth, CapEx-intensive sectors, will far exceed the $12bn issuance in 2021
- In addition, positive accounting changes (ASU 2020-06) may bring more rated issuers to the market
  - Last time accounting rules were similar to today's, 73% of the market was rated vs. currently only 18%





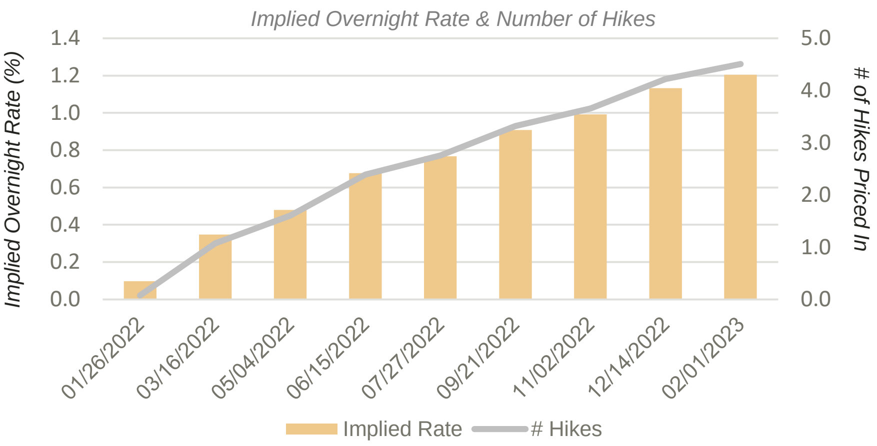
Source: ICR Capital, Bloomberg.

Five Predictions for the 2022 Convertible Market (Cont'd)

Terms will continue to be attractive, but it will be hard to beat 2021 terms

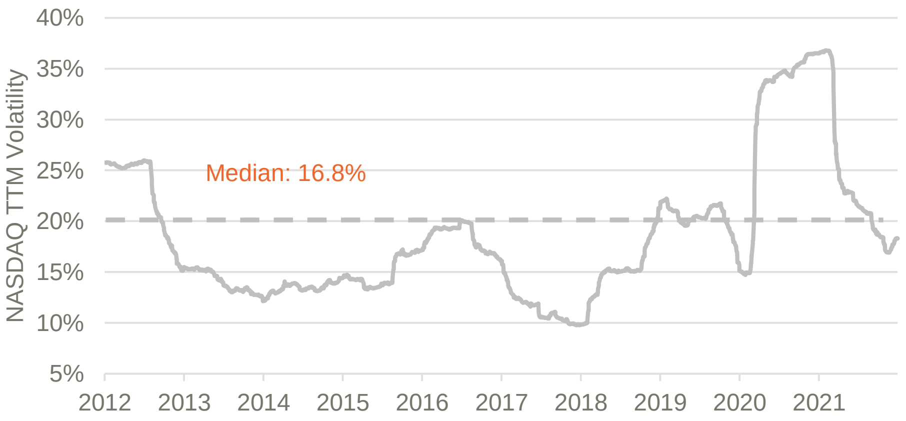
3 With interest rates expected to climb in 2022, terms will be worse vs. 2021 terms

- Rising interest rates will widen convertible terms but terms will be attractive vs. other alternatives
  - Every 100bps of increase in debt rates would impact convertible coupons by only ~50bps, making convertible coupons incrementally 50bps more attractive vs. debt
- Higher interest rates impact high growth equity valuations which may give some issuers a pause before accessing the equity / equity-linked markets
  - Some equity issuers may pivot to the convertible market if valuations are compressed



4 Lower volatility expectations will also have a modest impact on pricing

- As COVID-related market volatility subsides, investors will use a lower "input volatility" to value the option component in a convertible bond
  - Availability of zero-coupon / high premium securities will be limited to best-in-class issuers
  - Bouts of choppiness could open up unique issuance windows where market strength returns but trailing volatility is still elevated, resulting in more attractive terms



Source: ICR Capital, Bloomberg.

Five Predictions for the 2022 Convertible Market (Cont'd)

More so than in other years, we recommend clients to be ready to take advantage of market windows and "access the market when they can"

5 **2022 will be a market of windows**

- Unlike 2021 when "draw downs" were muted, 2022 is likely to be a market of windows
  - Technology is the biggest sector in the convertible market, and any sell-offs in high growth sectors will impact convertible investor appetite and market strength
  - After market choppiness, issuers are likely to rush to issue converts when stability returns – we may see "first mover advantage" followed by deal indigestion
- More so than in other years, we recommend clients to be ready to take advantage of market windows and "access the market when they can"