

Choose Your Own Adventure Private ABS Edition

ATALAYA CAPITAL MANAGEMENT LP | Q1 2024

Embrace the Road Less Traveled

Atalaya has been a longtime champion of asset-based specialty finance investments – in particular, private ABS strategies where credit facilities are secured by diversified pools of consumer and commercial credit assets. To advocate for this somewhat nuanced strategy, we have written several whitepapers on topics ranging from the historical strength of the U.S. consumer, to the attractive features of consumer and commercial credit assets, to the structural advantages of private ABS.

Still, we are often challenged by the question, “but, what if...?”

To that end, we invite you to embark on your own underwriting adventure – where you, the reader, chooses your own path of skepticism. Please join Atalaya on the “road less traveled” to understanding U.S. consumer health and the attributes of private ABS that have “made all the difference”. At the end, we believe you will have the tools to decide if you agree that consumer and commercial private ABS strategies are a compelling investment and an asset class well-equipped to perform across market cycles.

On this adventure, you can take your own unique path and skip to the sections that are relevant to your experience with consumer and commercial private ABS. Alternatively, you can simply read straight through the Chapters as detailed in the overview below:

Chapter 1 | Murky but Perky

The Macroeconomic Backdrop and Strength of the Consumer

Chapter 2 | Run Out the Clock (and then Select Your All-Stars)

Short Duration Collateral Benefits and Underwriting Recalibration

Chapter 3 | Whose Assets Are Those, Anyway?

Asset Segregation, Structural Protections, and Choosing Your Borrowing Base

Chapter 4 | Do Not Pass Go, Do Not Collect

Turbo-amortization (After Covenants are Tripped)

Chapter 5 | Drew Bledsoe and Tom Brady

Call on Your Backup Servicer

The End | Happily Ever After

Chapter 1 | Murky but Perky

Our adventure starts with you, your investment portfolio, and the U.S. consumer. Your portfolio is currently heavily weighted towards corporate risk. You'd like to diversify your portfolio and are considering investing in a private ABS strategy focused on lending against pools of consumer and commercial credit assets.

However, the macroeconomic backdrop is murky after years of sustained low interest rates, inflation spikes, and the Fed quickly and steeply raising rates in an effort to cool the economy. Given these factors and a pick-up in consumer spending after an unnatural COVID-19 pandemic-induced spending lull, headlines seem to suggest a huge spike in consumer credit defaults. Are consumers overleveraging themselves due to inflation? Will they be able to pay off their rising debts?

“I am a skeptic. Inflation must have impacted consumers and I keep reading that consumers are overleveraging themselves.” If this is your stance – continue on to Page 2 and examine “The Case for a Healthy Consumer”.

“Yes, I believe the U.S. consumer is healthy and well-positioned to pay off their debt. Consumers have demonstrated resiliency in each of the four prior recessionary periods (i.e., 2020 COVID-19 pandemic, 2008 Great Financial Crisis (“GFC”), 2001 Dot-com recession, and early 1990s recession), the current data shows that consumer savings are still high, and leverage and unemployment are still low. However, what if...?” If you’re in this boat, skip ahead to Chapter 2, on Page 6 and “Run Out the Clock!”

The Case for a Healthy Consumer

We believe U.S. consumer macroeconomic fundamentals are strong across the four major metrics of consumer health: unemployment, savings, leverage levels, and required debt service. We examine each of the metrics below.

Unemployment: U.S. Unemployment Rate Remains Consistently Low

Unemployment, from our perspective, may be the single best predictor of future consumer credit performance. To state the obvious, consumers that do not have steady income from a job are more likely to default on their debts. Further, the rate of change in unemployment – an oft-overlooked metric – is of particular importance: periods of large and sudden job losses generally create meaningful increases in consumer defaults.

For example, during the GFC, U.S. unemployment rose rapidly, nearly doubling over a 2-year period and hitting a peak of almost 10% by December 2009 (Exhibit 1). Not surprisingly, consumer defaults spiked alongside unemployment (albeit less than corporate defaults). The Atalaya white paper “U.S. Consumer vs Corporate Risk – A Case in Misperception” (July 2019) takes a deeper dive into this dynamic during the GFC.

By contrast, the level of unemployment today remains at or near all-time lows, hovering around 3.7% as of December 2023 (Exhibit 2). Moreover, the rate of change has been minimal. The unemployment rate has remained consistently under 4% over the past two years, despite volatility in the broader economy. While economist views differ over whether and by how much unemployment will increase in the short term, few (if any) are predicting a return to GFC levels.

Exhibit 1: U.S. Unemployment Rate (GFC)¹

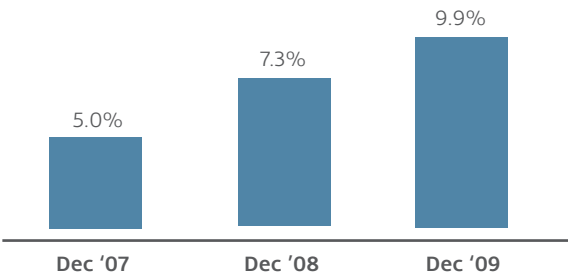
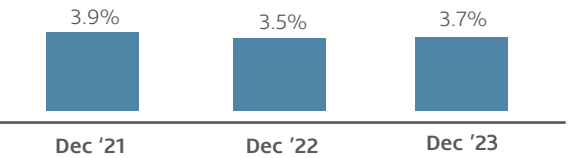


Exhibit 2: U.S. Unemployment Rate (Last Two Years)¹



Savings: Consumer and Household Balance Sheets are Healthy, Even post-COVID

Consumer balance sheets are up 54% from their pre-pandemic historical average (Exhibit 3) despite the inflationary environment witnessed in recent months. This is true even for the lowest income group, who tend to be more affected by inflationary pressures. In fact, given the labor shortages created by the COVID-19 pandemic, wage growth for the lowest income cohort has significantly outpaced inflation since January 2020 (Exhibit 4).

Exhibit 3: Median Deposit Balances²

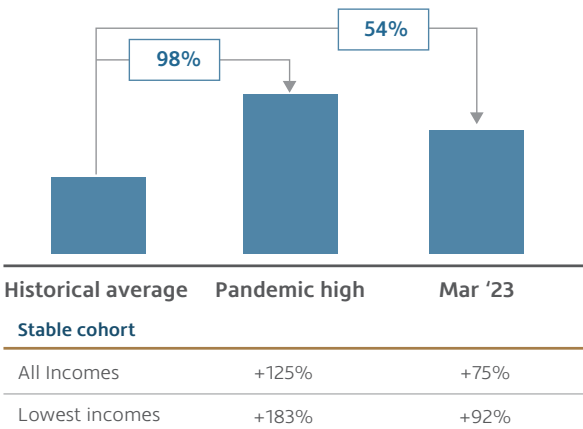
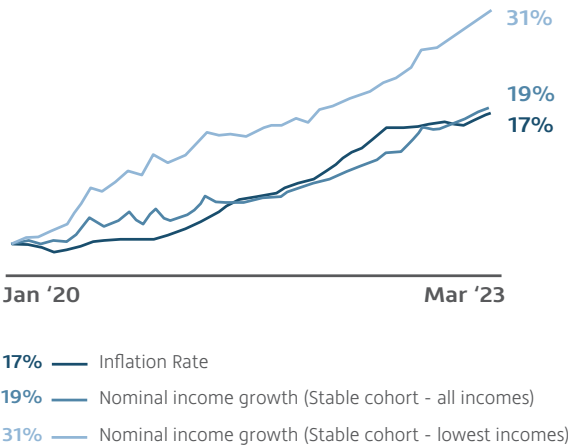


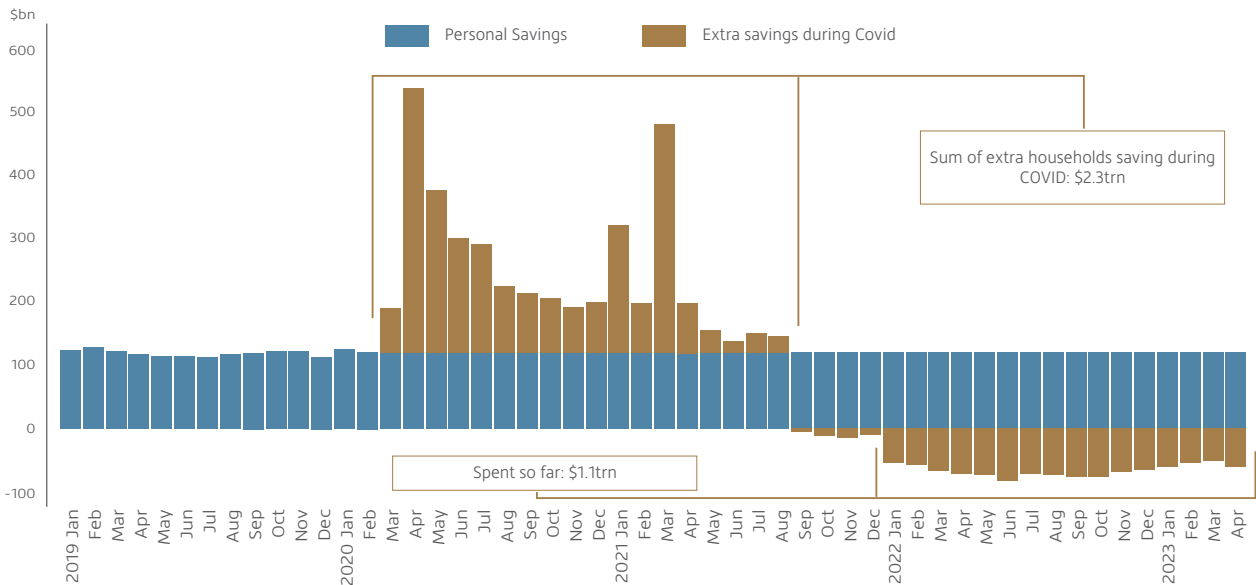
Exhibit 4: Median Nominal Income Growth vs Inflation²



Interestingly, and potentially driven by the government stimulus, households saved approximately \$2.3 trillion during COVID, and have thus far spent less than half of that extra balance. That means households still have \$1.2 trillion more saved than they did pre-COVID (Exhibit 5), providing a meaningful cushion.

1. Source: U.S. Federal Reserve June 23, 2023.
2. Source: JP Morgan Chase & Co., Consumer & Community Banking. Investor Day 2023, April 30, 2023.

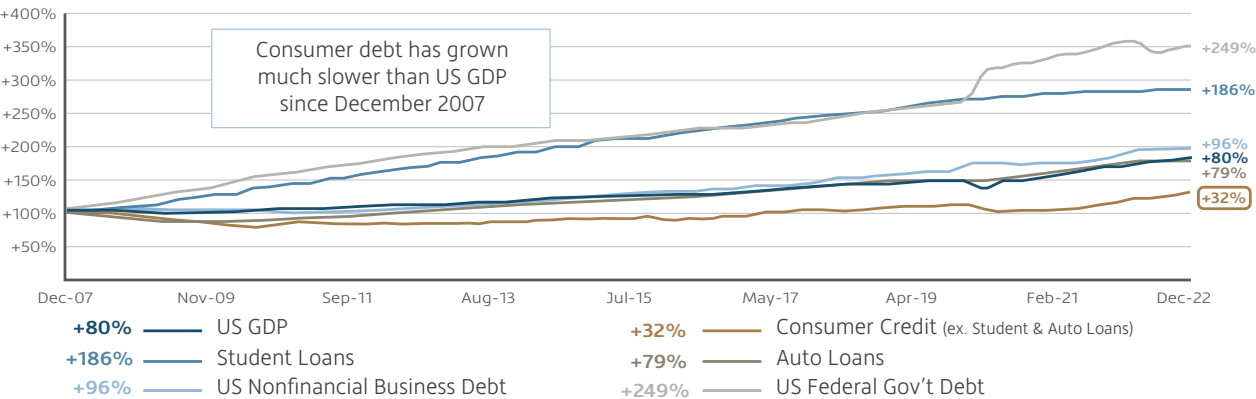
Exhibit 5: Consumer Savings (\$bn)³



Leverage and Required Debt Service: Levels and Ratios Remain Low

Recent headlines have highlighted a notable increase in overall consumer credit usage, especially after a period of muted spending during the COVID-19 pandemic. In examining the data, growth in consumer credit usage excluding student and auto loans has been relatively slow compared to the other debt categories, growing only by 32% since 2007 (Exhibit 6). By contrast, corporate credit has increased by 96% and U.S. government debt has grown 249%.

Exhibit 6: % Growth in Debt by Type (2007-Today)⁴

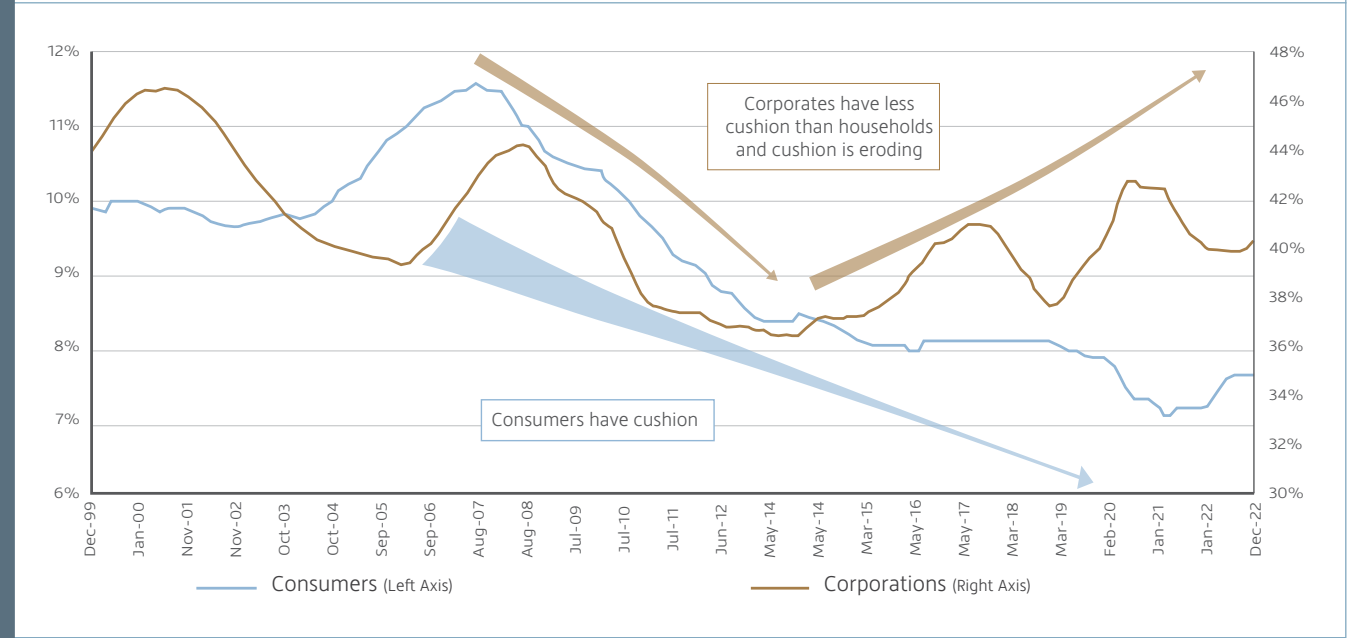


3. Source: Apollo Global Management, Bloomberg, June 2023.
4. Source: Federal Reserve Bank of St. Louis.

Similarly, debt service ratios for consumers (i.e., the share of income used to pay down or manage debt balances) since the GFC remain at historical lows (<8%), while corporate debt service ratios have met or exceeded their pre-GFC levels (>40%) (Exhibit 6). Additionally, when considering the effect of rising interest rates on consumers’ ability to service debt, it is important to remember that the largest consumer financial obligations are typically mortgages and auto loans. These are usually long-

duration fixed rate loans, with typical durations of 30 and 7 years respectively, making it easier for consumers to budget for these consistent, larger obligations. By contrast, corporate balance sheets are typically financed with a mix of fixed and floating rate obligations that are often shorter in duration, generally forcing corporations to refinance into the higher rate environment more frequently than consumers.

Exhibit 7: Consumer vs Corporate Debt Service Ratios⁵



Are you now convinced? With low unemployment, high level of savings, low leverage levels and strong debt service ratios, the U.S. consumer appears well-positioned to pay off their debt.

Will you take the plunge and invest in the consumer and commercial private ABS strategy?

Move ahead to Chapter 2 below: "Run Out the Clock (and then Select Your All-Stars)".

5. Source: Bank of International Settlements, June 2023.

Chapter 2 | Run Out the Clock (and then Select Your All-Stars)

You’re winning. Your portfolio has been generating a consistent ~11% current yield for several periods and you’re feeling like a million bps of alpha. Then *BAAAMMM* – a recession hits you like the comeback of fanny packs – fast, furious, and confusing.

Alas, you’re not afraid. You were a believer in the U.S. consumer given the plethora of supporting data and invested in private ABS secured by consumer and commercial credit assets. It is a complement and diversifier in your otherwise corporate-leaning

portfolio, but you also like that the underlying assets securing the private ABS facility are short in duration and self-amortizing. These features seek to ensure that, when the tides turned, your exposure to credits underwritten before the recession run off relatively quickly and moreover, with each payment period that goes by, you’re receiving principal and interest back from all those thousands (if not, millions) of loans that serve as your collateral. In short (pun intended), you’re feeling like an All-Star and you’re going to run out the clock.

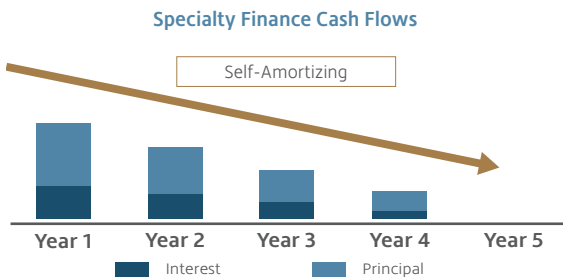
If you’re wondering how exactly the short duration and amortizing nature of the underlying consumer and commercial assets can help you achieve MVP status, see below:

Short Duration

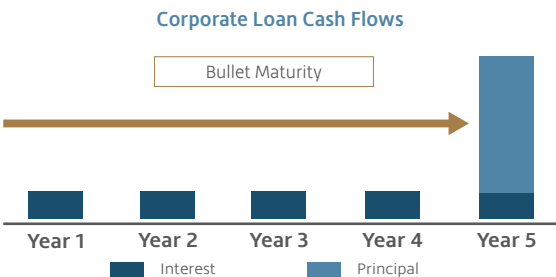
Private ABS lenders that focus on collateral assets such as consumer unsecured (e.g., installment loan and credit card receivables) and commercial (e.g., micro small business loans) generally lend against assets that feature weighted average lives of 6 to 36 months with a median of ~12 months. All loans underwritten within a given month are referred to as a “vintage”. If there are poorly performing vintages in a collateral pool (for example, loans made the month right before a recession), these vintages typically work their way out of the collateral pool fairly quickly.

Amortizing

Consumer and commercial credit assets generally feature amortizing cash flow streams, which means principal (along with interest) is repaid throughout the life of the loan. This acts as on-going risk reduction as the principal shrinks over time, versus a typical corporate loan’s bullet maturity.



Substantially self-amortizing due to profile of underlying assets; reduced exit risk



Reliant on capital markets exit, refinancing, or sale

Being an All-Star is a lot of pressure, but you're not in this alone. The consumer and small business specialty finance platforms you've possibly been lending to are probably watching the game, and they are likely recognizing that they can no longer lend using the underwriting standards of the past. Underperforming assets teach the specialty finance platform how to recalibrate and underwrite new loans with higher credit standards designed to reduce future losses.

Recalibration of Underwriting, aka the "Feedback Loop"

When quality and experienced lending platforms see deterioration in a certain vintage of originated loans, they typically recalibrate rapidly and tighten their underwriting criteria. Many specialty finance platforms have invested in technology that allows them to monitor in near real time the performance of the underlying consumer or commercial loans and adjust credit originations should they see dynamics change. The ability for specialty finance platforms to quickly adjust underwriting standards helps to reduce future losses.

However, you start to notice that corporate defaults are picking up and there are bankruptcies all around. Assets are being seized by various creditors. Your mind starts to wander....

If you are not all that well-versed in how special purpose vehicles ("SPVs") work, head to Chapter #3 below and explore "Whose Assets Are Those, Anyway?"

If you are already well-versed in asset-based lending structures that involve SPVs, skip ahead to Chapter 4: "Do Not Pass Go, Do Not Collect"

Chapter 3 | Whose Assets Are Those, Anyway?

More and more companies are filing for bankruptcy. Creditors are fighting with lenders and equity sponsors to recover whatever value remains. Then, you observe that even some specialty finance platforms have been forced to file for bankruptcy protection. Eeesh...now what? What if one of your borrowers meets the same fate?

Again, perhaps another sigh of relief – the risk in your private ABS facility is almost entirely centered around the performance of your collateral assets (with limited reliance on the continued performance of the operating business – more on this in Chap-

ter #5: “Drew Bledsoe and Tom Brady”). As the secured lender, your private ABS facilities are secured by consumer and commercial credit assets. And not just any assets – these are short-duration, self-amortizing, income-generating assets. In fact, they are segregated into bankruptcy remote SPVs, and because you can never be safe enough, the cash generated by those assets is deposited directly into a “lock box” bank account that you control. The SPV also separates the assets from the operating business, so even in the event the borrower goes bankrupt, you can confidently answer the question “Whose Assets Are Those, Anyway?”.

Bankruptcy Remote SPV

The specific loans are segregated into a bankruptcy remote SPV and the monthly cash flows from the underlying loans (the principal and interest paid by the consumers/small businesses) are deposited directly into a “lock box” bank account that you control.

Cash Controls

The cash flows generated by the collateral assets are generally administered directly by the lender in accordance with a fixed waterfall on a monthly or more frequent basis. Cash waterfalls are generally structured to pay in the below order:

- First, you pay the cost of servicing the portfolio (i.e., the cost to make collections);
- Second, you keep your required interest and fees owed;
- Third, if needed, you retain required principal payments to maintain the stated advance rate against the borrowing base (more on these concepts below); and
- Finally, residual cash flows are paid to the specialty finance platform

You are probably a fan of consumer assets in general if you’ve made it this far. But when originating a private ABS facility to a specialty finance platform, did you know that you can specifically choose the types of consumers in the facility? That’s right – you can hand-pick consumer assets with certain FICO score ranges, unemployment history, duration, etc. These categories make up your “eligibility criteria”, and consumers that fit your eligibility criteria constitute a “borrowing base”. This “borrowing base” typically recalibrates weekly to “retest” the collateral assets against your eligibility criteria, and asset performance covenants measure the performance of your collateral assets against “early warning” levels. Moreover, unlike traditional asset-based lending facilities (e.g., receivables and/or inventory financing, etc.), your collateral assets typically generate income, so your facility’s loan-to-value (“LTV”) naturally decreases over time.



Eligibility Criteria

Private ABS facilities are structured with a set of eligibility criteria that determine which collateral assets are included in the borrowing base (defined further below). Typical eligibility criteria include factors such as minimum FICO score, required employment history, minimum APR, maximum duration, and other relevant standards. If an asset ceases to perform or otherwise ceases to satisfy the lender's eligibility criteria, the lender retains the asset as collateral but stops lending against the now "ineligible" asset.

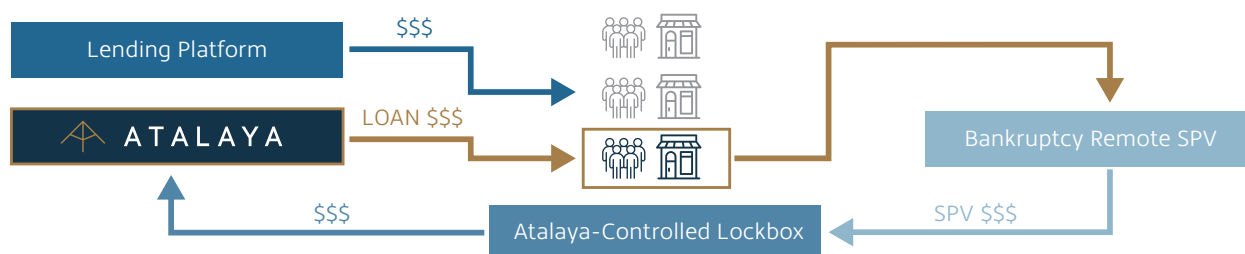
Borrowing Base

In private ABS facilities, the borrowing base refers to the portion of the collateral portfolio against which the lender is willing to lend (i.e., the assets that meet the lender's eligibility criteria). The lender typically calculates the amount of capital it will lend as a fixed percentage of the total unpaid principal balance of assets included in the borrowing base (this fixed percentage is called the "advance rate"). A lower advance rate is more conservative, whereas a higher advance rate is essentially a higher LTV. The lending platform is responsible for the first loss risk capital subordinate to the loan. This subordinate capital (also known as overcollateralization or equity cushion) we believe provides meaningful protection to the private ABS lender because it absorbs all losses generated by the assets before the private ABS lender's return and/or principal are impaired.

Appropriate Asset Performance Covenants

Private ABS lenders typically analyze historical performance to establish appropriate asset performance covenants, which are set at "early warning" levels. These levels are often set well before the point at which the lender risks return degradation or principal impairment. Private ABS lenders typically track cash flows monthly via mandated reporting tailored to track key performance indicators as determined by the investment type. In the event these covenant tests are failed, private ABS lenders can generally cease funding and foreclose on the assets.

Exhibit 8: Structuring a Private ABS Facility



You feel a level of ease, yet wonder what happens if this recession drags on...

Curious to learn what happens if asset performance starts to deteriorate and a covenant gets tripped? Jump to Chapter 4 below "Do Not Pass Go, Do Not Collect"

"Asset performance? Forget that. I'm worried about this platform filing for bankruptcy!" If you are on this team, take a pass on Chapter 4 and instead look down the field for Chapter 5 "

Drew Bledsoe and Tom Brady"

Chapter 4 | Do Not Pass Go, Do Not Collect

This fanny-packed recession is dragging on. The bankruptcies rampant in Chapter #3: “Whose Assets Are Those, Anyway?” have started to impact unemployment and, far from ~3.7% in December 2023, unemployment has reached 2008-levels of over 7%. The consumer is weaker, defaults are ticking up and your facility covenants are getting triggered.

Are you in a pickle? No...not necessarily, because YOU, my friend, have a “Go to Jail” card. As Monopoly aficionados know, the “Go to Jail” card can be a game-changer (pun intended). The receiver does not pass go, and importantly, does not collect \$200.

Similarly, when we pull out the private ABS version of the “Go to Jail” card because covenants have been triggered, the private ABS facility transitions into turbo-amortization. The borrower does not pass go and, forget \$200 – the borrower can’t collect a single dollar until you, the lender, have received both your principal and interest.

Turbo-Amortization

As noted in “Adventure #3: Whose Assets Are Those, Anyway?”, cash is controlled by the lender to the specialty finance platform. The private ABS facility and servicer of assets are paid off first, and then excess cash flows are fed back to the specialty finance platform. When one turbo-amortizes, instead of the typical cash waterfall, every dollar generated by the collateral assets is directed to the private ABS originator and the servicer until fully repaid (inclusive of interest, default interest and fees).

“But wait a second. What if the platform is running out of cash?” If you want to make a change to shake things up, review Chapter 5 “Drew Bledsoe & Tom Brady”

If, however, you are already well-versed in transitioning servicing to the back-up - skip ahead to “The End: Happily Ever After”

Chapter 5 | Drew Bledsoe and Tom Brady

The recession continues, and you're hopeful that you've finally reached its fourth quarter. For one of your private ABS loans, the underlying collateral assets have continued to perform well, and you believe that you're in the clear. When you take a closer look at the reporting, however, you note that the platform tripped a financial covenant and seems likely to file for bankruptcy. Like most specialty finance platforms, this one not only originates the assets but also operates the call center that services the assets (i.e., they are in charge of collections).

Since the platform is in trouble, are you? Your collateral is performing well, so there is a decent chance that you're ok, as long as you have a back-up plan. Thinking of the platform as your starting quarterback (e.g., Drew Bledsoe), how will you find an effective back-up (e.g., Tom Brady) on such short notice?

The good news is that, as a cautious private ABS lender, you prepared for this scenario before you started the game (originated the loan). You selected a third-party specialist in your specific collateral type (the "Back-up Servicer"), and they have been monitoring the performance of your assets alongside your starting quarterback (the lending platform) since the beginning. Now that your starter is unable to keep playing, you simply put in your back-up to finish the game and hopefully protect your lead. In other words, you will transition servicing of the portfolio to the Back-up Servicer who will seek to make collections on your collateral assets until the portfolio is fully liquidated.

Parent Company Financial Covenants

Private ABS lenders typically negotiate for financial covenants that track key metrics related to the specialty finance platform's operating business even though the primary risk in most private ABS loans is the performance of the underlying collateral assets. These financial covenants may set required levels of liquidity, tangible net worth, leverage, and other metrics that provide adequate warning if the platform's operating business is stressed.

Back-up Servicing

In Private ABS investments, third-party back-up servicers are put in place from the outset to monitor the underlying collateral portfolio and, if necessary, expedite servicing transfers in downside scenarios (although, as demonstrated in "Adventure #4: Do Not Pass Go, Do Not Collect", not all liquidations require servicing transfers). Private ABS lenders typically negotiate upfront the rates that will be paid to back-up servicers to ensure such negotiations do not occur under duress and to guarantee that any such transitions occur as quickly as possible. Private ABS lenders typically have several options when selecting back-up servicers that vary depending on the asset type, geography, consumer/small business credit quality, and other relevant factors.

Ready to relax and reflect? Turn to "The End: Happily Ever After"

The End | Happily Ever After

Now that you've completed this adventure scenario, you can exhale and reflect on where you've been. Despite fears about consumer health, you've sifted through the data and taken comfort in the fundamentals of a low and steady unemployment rate, outsized levels of consumer savings, low levels of consumer leverage (relative to U.S. GDP, corporate debt, and U.S. government debt) and low levels of required consumer debt service. The short duration, amortizing nature of your private ABS collateral allowed you to "run out the clock" on recessionary pressures while you took advantage of the rapid underwriting feedback loop to focus only on "All-Star" collateral moving forward.

When the music stopped for platforms in the industry, you took comfort in the decisions you made to focus risk on your collateral assets, including segregating your collateral assets into an SPV, mandating strict criteria for which assets you'd include in your borrowing base, and setting appropriate asset perfor-

mance covenants that ensured your capital would be protected even if your borrowers met the same fate.

When asset performance finally deteriorated to levels that tripped your covenants, you played your "Go to Jail" card and turbo amortized your private ABS loan, sweeping every dollar generated by your collateral assets (net of servicing expenses) until you were fully repaid (inclusive of interest, default interest, and fees).

Finally, when a platform to whom you provided another private ABS loan filed for bankruptcy, you called on your own personal Tom Brady, successfully transitioning to the pre-negotiated Back-up Servicer to collect on your collateral portfolio. We hope you now agree that consumer and commercial private ABS strategies are a compelling investment and an asset class well-equipped to perform across market cycles.

If your wanderlust has given you the itch for more adventures, simply e-mail ir@atalayacap.com.

Seeking to learn more about private ABS structures?

request

"Differentiated Direct Lending" (2018)

Still don't believe that consumers have historically outperformed corporates?

request

"US Consumer vs Corporate Risk - A Case in Misperception" (2019)

Curious about the portfolio advantages of private ABS vs. direct lending?

request

"Strengthen Your Core - Work Your ABS" (2023)

Wanting to keep tabs on the latest with respect to consumer fundamentals?

request

"Tale of the Loan Tape" (2023)

About Atalaya

Founded in 2006, Atalaya Capital Management is a New York City-based private credit and special opportunities investment firm with approximately \$9.6 billion in assets under management. Atalaya invests across specialty finance, corporate, and real estate opportunities and has deployed, in aggregate, more than \$17 billion since inception.

www.atalayacap.com

Contact

Business Development & Investor Relations

General Inquiries: ir@atalayacap.com

Rebecca Chia CAIA
Head of Business Development
and Investor Relations
T: 212 201 1929
rchia@atalayacap.com

Lynn O'Connell CAIA
T: 212 479 8255
loconnell@atalayacap.com

Rebecca Levy
T: 929 677 6259
rlevy@atalayacap.com

Owen Libby CAIA
T: 212 201 1927
olibby@atalayacap.com

Vincent DiGiorgio
T: 212 201 1928
vdigiorgio@atalayacap.com

Alyssa Twomey
T: 212 540 9263
atwomey@atalayacap.com

Britten Harte
T: 212 201 1917
bharte@atalayacap.com

Emily Coutts
T: 212 540 9265
ecoutts@atalayacap.com

Quinn O'Connor
T: 212 277 5574
qoconnor@atalayacap.com

Anthony Adessa
T: 212 479 8256
aadessa@atalayacap.com

Important Disclaimers

The information contained herein ("White Paper") is provided for educational purposes only and is not investment advice or an offer or sale of any security or investment product or investment advice. Offerings are made only pursuant to a private offering memorandum containing important information, which describes risks related to an investment therein and various other important matters. Information contained herein is not intended to be complete or final, and should not form the primary basis for an investment decision.

This White Paper is solely intended to summarize Atalaya Capital Management LP (together, with its affiliates, "Atalaya") current observations and views surrounding the asset class. This White Paper should not be relied upon for any other purpose. Any views and opinions expressed above are those of Atalaya and are based on available information and there is no implication that the information contained herein is correct as of any time subsequent to such date.

Certain information contained in this White Paper may constitute "forward-looking statements" which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "target," "project," "estimate," "intend," "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Forward-looking statements, projections, or opinions contained in the White Paper are provided for information purposes only and general commentary. There can be no assurance that the results set forth in the forward-looking statements, projections, opinions or the events predicted will be attained, and actual results may be significantly different. Also, general economic factors, which are not predictable, can have a material impact on the reliability of forward-looking statements, projections, or opinions. Neither Atalaya nor any of its subsidiaries, affiliates, agents or representatives makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein.

This White Paper includes historical data, projected figures, calculations, and other data that is sourced either by a third party or by Atalaya. Reasonable efforts were made to attribute third party sourced data to its source. Data sourced or calculated by Atalaya was done so in good faith and in a commercially reasonable manner. Atalaya shall not be responsible for data presentation or calculation errors that were made in good faith, including errors in transmission from other sources where such data may be in original or more complete form. Data produced by Atalaya, including any underwritten and projected performance metrics, should not be relied upon for any purpose whatsoever, other than that they are believed to be reasonable as of the date presented. References herein to specific sectors are not to be considered a recommendation or solicitation for any such sector. Past performance is not a guarantee of future results and there can be no guarantee against a loss, including a complete loss, of capital.