AEGON **INSIGHTS**

Throw on your swimsuits, the distressed pool is heating up

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As we dive into the distressed debt market landscape, it's hard to ignore the early movers in the post-Covid wave of amend and extend (A&E) and liability management exercise (LME) transactions that had stabilized and seemingly bought time to recover.

However, in recent months (and even more so in recent days), those same companies appear to be again feeling the heat as markets across asset classes reset and the fundamental erosion associated with Trump's tariff policy materializes.

As a result, significantly more opportunities are emerging to buy good businesses with broken balance sheets and many more are likely to appear during the next 6 to 12 months, especially in cyclical sectors.

The post-COVID A&E and LME wave: A Recap

Remember those companies that jumped right into A&Es and LMEs after the pandemic? They worked–kind of. They were fast, cheap and it kept them out of bankruptcy. Yet many of those deals extended maturities but didn't reduce enough debt (or any) and in some cases even layered on more. Additionally, to the frustration of creditors, there was often a reshuffling of lien priority and the interest burden often also increased in the higher-rate environment. For many, the combination has sparked weakened liquidity, debt serviceability issues and investors less keen on throwing additional lifelines (many companies no longer have the ability to raise new capital).

Now, those maturity walls that once seemed so far away are suddenly in plain sight (or the company has burned through a significant amount of liquidity). And a lot of these businesses aren't in much better credit shape than they were when they initially launched their debt restructurings.

Put simply, they bought time but didn't fix the underlying balance sheet problems. And now with the extreme market volatility, their demise seems to be accelerating.

Early restructurings under pressure

So what does the opportunity set currently look like?

Delving into just the LME subset, among the total of 103 LME transactions since the first quarter of 2022 through the fourth quarter of 2024, the average trading price of loans in those LME names is 68 cents on the dollar (excluding super senior/new money loans), with the average price decline for those loans nearly 10% in the last six months.[1]

Exhibit 1: US leveraged loan defaults: Trailing 12-month count

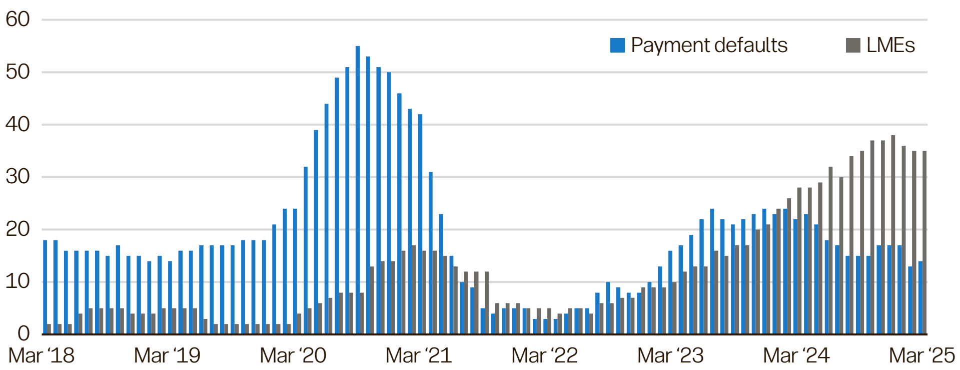
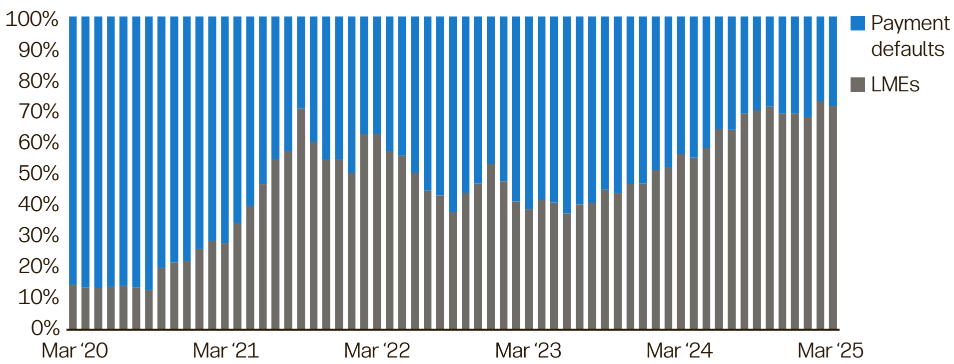


Exhibit 2: Dual-track default rate: LME share



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index. Data through March 31, 2025

Many of these situations share a common theme: initial fixes that proved insufficient. Those companies temporarily stabilized post-LME, but as the uncertainty surrounding the economy in the wake of the Trump tariffs seems to add fuel to the fire, these firms' structural flaws are resurfacing. This resurgence of pressure highlights a critical juncture where these restructurings are on the edge once again and could provide opportunities for savvy investors to capitalize on their inevitable slide.

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The pressure cooker: CLO resets and the CCC crunch

What initially squeezed these companies recently was a wave of collateralized loan obligation (CLO) resets. It was like a tidal wave of forced selling, stemming from CLOs trimming down their CCC exposure. Now, in addition, the expected fundamental erosion associated with Trump's tariff policies may well push even more credits to lower rating levels.

This, in turn, would likely increase the need for CLO managers to keep this crucial portfolio segment in check—to the extent that they are thinking

[1]Sources: Aegon Asset Management, Bloomberg, Octus. Data as of April 2025.

ahead. Should this occur and relentless selling continues, it would place additional pressure on the prices of those debt instruments that were already skating on thin ice.

And guess which companies are returning to the spotlight? Those initial A&E and LME adopters who failed to materially improve their fundamental credit profile—particularly in situations where managers are also suffering from name fatigue and their hopes of material price recovery isn't happening any time soon.

So now you have companies with looming maturities, still less-than-perfect credit profiles and a wave of technical selling knocking down their debt prices to below recovery values. That's not a great spot—for them. But it can provide an ideal setup for opportunistic investors looking to buy good companies with bad balance sheets.

The silver lining

Here's the good news for those eyeing distressed opportunities: The power has shifted. Lenders are in a much better spot if fundamental weaknesses persist. Companies facing looming maturities, still less-than-perfect credit profiles and a wave of technical selling knocking down their debt prices can provide a significant opportunity for astute investors. When LMEs are no longer an option because covenants have more restrictions post-LME or A&E, lenders can have more control and face less risk of being strong-armed into unfavorable deals.

And the LME risk that once dragged implied valuations through the mud? The associated pricing pressure remains, but the LME-associated risk is a thing of the past. Fortunately for lenders, valuations have stayed low, which can create an exciting hunting ground for distressed investors.

Going forward, for investors, the situation could provide a dual-path opportunity to either help the current owners get their act together and bring the business back on track. Or to step in and often take over the whole show at highly attractive creation values.

Seizing the moment

The potential upside is hard to ignore. The disciplined restructuring and more restrictive covenants can provide a buffer of security, while the current state of some of these companies can present opportunities to get in at very attractive valuations. Add in the pricing pressure stemming from the recent tariffs and valuations may well be driven still lower, which would make these companies' debt cheaper and more attractive. It is creating a perfect storm for distressed debt investors looking for bargain opportunities.

All that said, no opportunity comes without risk. Not every company in this bucket will survive or thrive—some may well end up in liquidation if their business models are fundamentally broken. Diligence is key: An investor must pick the right horses (i.e., those with viable core businesses, even if they are overleveraged). However, the key point is that the risk/reward profile is much improved compared to a few years ago. The disciplined restructuring and restrictive covenants put a floor on the downside that simply wasn't there during the chaotic early pandemic days.

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The bottom line is that the first wave of post-Covid A&E and LME deals patched up a lot of companies and bought them time. Now the tide has gone out and is exposing which of those fixes were temporary. Fortunately, this time around, lenders have the upper hand at increasingly attractive entry points.

With tighter covenants, cleaner control dynamics and a wave of motivated sellers, the market appears tee'd up for smart distressed plays. As we said at the outset, it may well be time to put on your bathing suits.

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