PILFOR

LENDING SOUNDNESS

November 2019 / 3rd Quarter

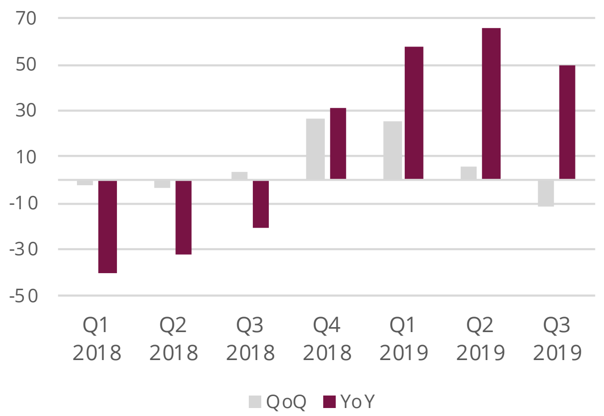
Quarterly Market Insights

28.11.2019

EMEA Financing Environment

The continued stance of the ECB with rates likely to remain low until 2023 at least with clear implications for the SNB to follow suit offers favourable financing conditions for a wide range of borrowers both in the public and private markets. While refinancing was the main financing driver during 2019, low interest rates and tight bond spreads are likely to encourage market participants to undertake larger, more aggressively structured acquisitions and leveraged buyouts with leverage metrics reaching new highs for the remainder of 2019 and heading into 2020. If this materializes, the development would raise the risk of growing defaults and lower recovery levels as cash flows decline and the cycle turns. Aware of these developments banks in Europe have started to slightly tighten their credit standards for corporate loans with the trend likely to continue as we move forward. At the same time capex investments seem to be facing a slower pace reflected by slowing bank loan demands.

Leveraged Loan Pricing Changes EMEA (bps)

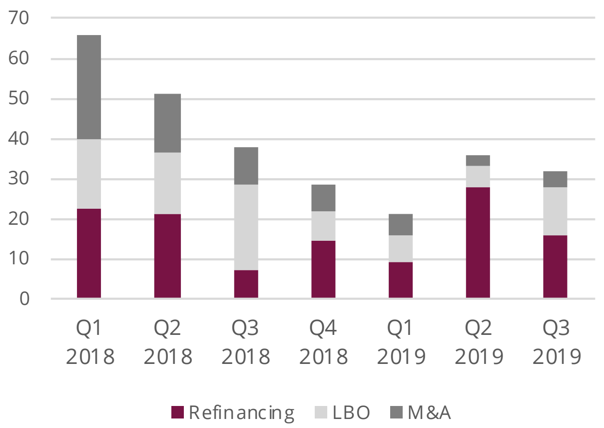


Source: Afme

Loan Market Insights

Low economic growth driven by a number of major uncertainties has marked 2019 so far. Global loan volumes dropped to EUR 2.9tr. Non-investment grade facilities witnessed a decline of their share to shy of 39%, down from nearly 45% underpinning the lower appetite for risky debt. In EMEA Brexit had a major impact on loan markets recording a decline of 26% YoY. As such the UK, up to now recording the highest volumes, has fallen behind France and Germany and marks the lowest point since 2012. EMEA loan volume declined by 29% to EUR 135bn affected by a share reduction of financial sponsors falling from more than two thirds to just above 50%. New leveraged M&A related financings declined by more than 40% with the number of LBO's falling by a third YoY. By 2024 a total of EUR 1.4tr EMEA loans will mature of which some EUR 0.5tr are non-investment grade. Some EUR 300bn of leveraged loans by financial sponsors will mature with Technology taking the largest share.

Leveraged Loan Issuance EMEA (EUR bn)

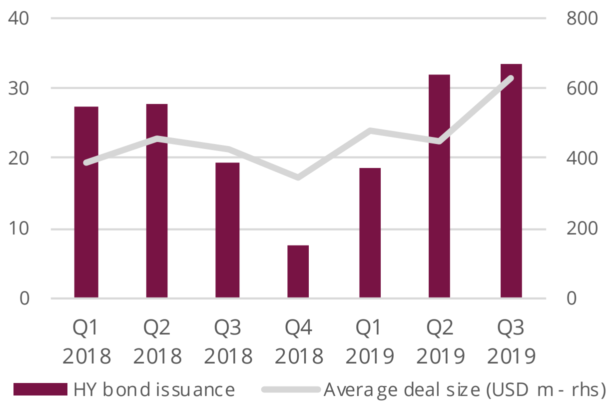


Source: Afme, Dealogic

Debt Capital Market Insights

Despite increasing pressure and market uncertainties, debt markets have held their stance totalling EUR 4.9tr of global issuance in 9M 2019, the second highest over the last ten years. Global average amounted to north of EUR 300m setting a decades record. Issuance in EMEA declined to EUR 1.6tr during 9M 2019, down 6% YoY highlighting the challenges European markets face. ECB's policy of holding interest rates low to support the economy has led US issuers to tap the euro market adding issuance volume across credit quality classes. Issuance of High Yield bonds in EMEA reached EUR 76bn, up 12.3% YoY with Q3 2019 clearly marking the strongest quarter in 9M 2019. Average deal size increased by a strong 39.2% near to EUR 600m compared to Q2 2019 also outpacing average IG issue size. The most active sectors in terms of issuance volume were telecommunications, finance and metals & steel. General corporate use accounted for the leading use of proceeds.

High Yield Bond Issuance EMEA (EUR bn)

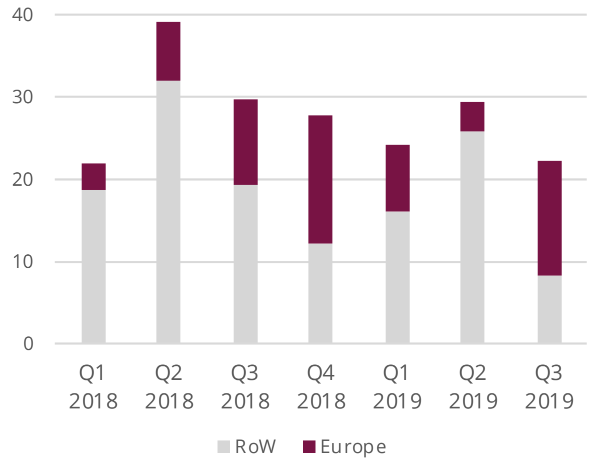


Source: Afme

Private Debt Market Insight

Global private debt fundraising reached EUR 61bn during 9M 2019, down 16.8% but only down 3.7% compared to 9M 2017. Q3 2019 recorded a sluggish EUR 20bn capital raised across 24 funds with average fund size reaching a record EUR 830m in the wake of increasing global risks and investor's perception of potential peaks reached. However, as was the case in Q4 2018, Q4 2019 could well result in yet another good quarter in terms of fundraising in the wake of major capital flows from the public to the private markets. Direct lending represented the strongest performance by fund type raising EUR 44bn in 9M 2019, followed by Mezzanine and special situations funds. With more than EUR 690bn AuM of which nearly EUR 295bn account for dry powder, private debt is set to continue its role as a major financing source in the corporate landscape not only in the US but rapidly in Europe. Funds are increasingly targeted at markets across Europe enjoying the highest focus heading into 2020 and likely to become an increasingly important alternative to Europe's mid-market landscape.

Global Private Debt Fundraising (EUR bn)

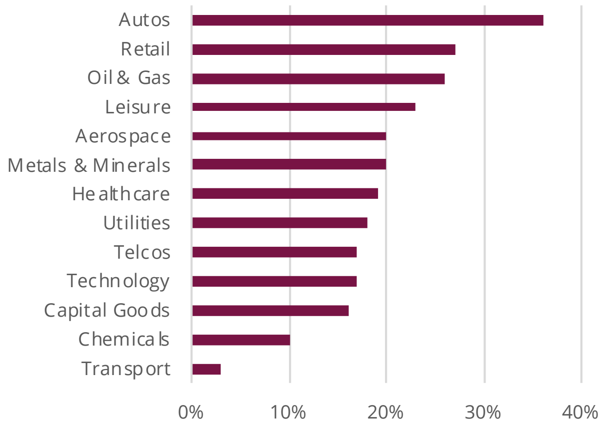


Source: Preqin

Rating Market Insight

The continued and partially increasing political and macroeconomic uncertainties are tearing into corporate results albeit at varying degrees and speed. Besides this the risk of a no-deal Brexit continues to weigh in certain sectors across Europe fuelling additional uncertainty. Generally speaking, rating actions across Europe have slowed, holding the balance as of now, though downgrades are picking up for non-financial speculative grade corporates especially in retail, capital goods, media / entertainment, metals, and oil & gas. Negative outlooks are outweighing positive outlooks across sector averages. The European speculative corporate default rate remained sticky at around 2% over 9M 2019, signs of heading towards the long-term average of 3% are materializing heading into 2020. Key risks to look out for that could accelerate negative rating developments are no-deal Brexit, trade issues, leveraged finance, oil prices and changing corporate financial policies (i.e. M&A)

Negative Rating Outlook across Sectors EMEA (S&P)

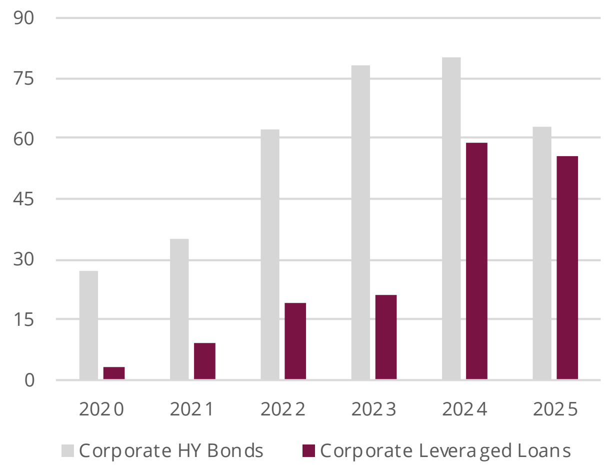


Source: Fitch, Moody's, S&P

Spotlights On

The current low interest rate environment offers an ideal base for larger, transformative and often more aggressive financial policies both on the corporate and financial sponsor side in lower credit quality areas as witnessed during 9M 2019 and expected to continue as we head into 2020. Adding these more aggressive strategies to the less favourable economic and political outlook with increased volatility and less financial forecasting visibility can rapidly turn into a toxic mix for lower rated corporates or leveraged buyouts that might well be faced with dwindling cash flows on the one hand, and mounts of – despite being cheap when took on to the balance sheet – debt on the other further negatively pressuring ratings. A rating "washdown" of these borrowers could lead to an overhang in supply of low-rated and partially cov-lite debt facing investors switching to "risk-off" and "quality-on" mode. While refinancing is not expected to hit a wall in 2020, major volumes are looming as we head into 2021 and beyond potentially proving a major challenge for lower rated issuers and their sectors.

Corp. HY Bond & Lev. Loan Maturities EMEA (EUR bn)



Source: Fitch, Moody's, S&P

Sources used in this report include afme, Dealogic, Fitch, Moody's, Pitchbook, S&P

PILFOR is an independent and specialized debt & capital advisor establishing and optimizing funding access - financial flexibility - financing costs

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