PILFOR

LENDING SOUNDNESS

2nd Quarter 2020

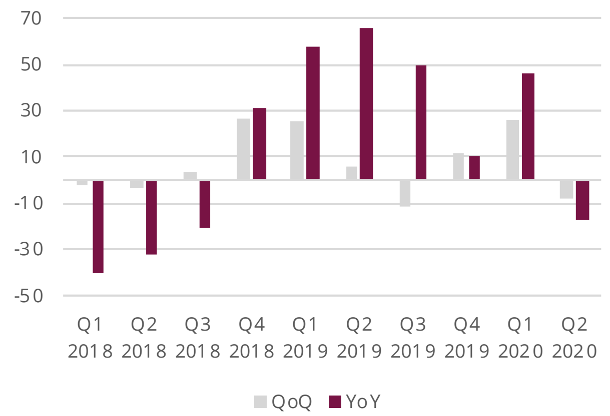
Quarterly Market Insights

21.7.2020

EMEA Financing Environment

The COVID-19 pandemic battered European (and global) leveraged loan and high yield markets in Q1 2020. Unprecedented actions taken by the ECB, FED, BOE and their peers combined with large-scale government programs to stabilize the economy, markets, investors and above all companies resulted in a rebound far from what could have been expected just days before. With the recovery driven by investors' hopes in the secondary market, the primary market very shortly after recorded open (re-)financing windows initially set in the investment grade area, heading further into Q2 also in non-investment grade. Not surprisingly spread levels returned to much lower levels and found themselves trending towards pre-crisis levels in June. Markets found themselves recuperating from Q1 crisis on the back of massive intervention programs, while fundamentals had just begun to deteriorate, setting the stage for a global decoupling of markets and fundamentals.

Leveraged Loan Pricing Changes EMEA (bps)

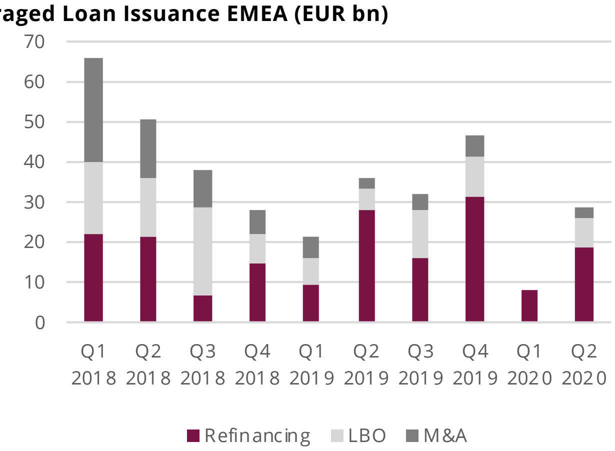


Source: Afme

Leveraged Loan Market Insights

Following a relatively decent issuance activity at the beginning of 2020, parts of February and March witnessed pretty much a free-fall. RCFs provided the first line of defence causing a rapidly growing number of sponsor-backed and other leveraged companies requesting or drawing down facilities. The aforementioned large-scale stabilization programs initiated by central banks and governments built the desired traction and also lend massive comfort in the leveraged loan market. This is evident by the fact, that H1 2020 issuance volume stood at EUR 37.2 bn, just shy of H1 2019 EUR 39.5 bn levels. Given the marked slump in March and April, the recovery in issuance is more rapid than expected in the wake of the ongoing crisis. Easing market conditions enabled the placement of a number of high profile LBO transactions that found themselves stuck on the books of a number of banks with the outbreak of the pandemic. Q2 results will likely offer some trigger potential.

Leveraged Loan Issuance EMEA (EUR bn)

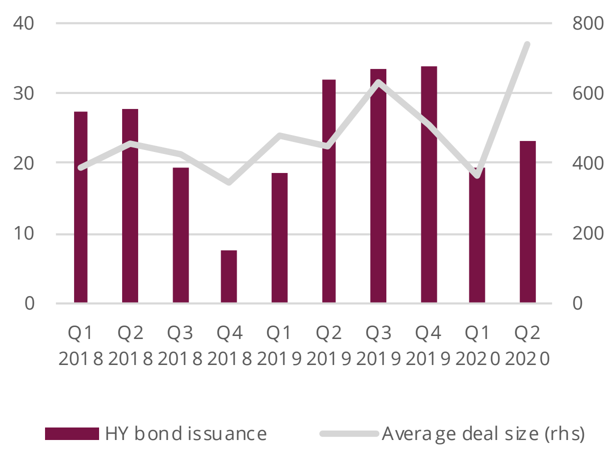


Source: afme, Xtract

Debt Capital Market Insights

IG issuance levels in Q2 2020 were the highest on record up to date in Europe reaching EUR 225 bn, spurred by central bank support. Average deal sizes of IG bonds stood at near EUR 1 bn, some 43% above 2019 levels, indicating the high issuance activity of large firms. HY bond issuance witnessed a strong comeback reaching EUR 16.1 bn in June and in excess of EUR 23bn for Q2 2020. Average deal size rose from EUR 0.5 bn in 2019 to a stunning EUR 0.9 bn across the 18 deals recorded in June. This also suggests, that nearly all but the largest corporates remain or have even increase their reliance on bank-, government program or in some cases alternative lending. The ECB included bonds issued by "fallen angels" as eligible for collateral in credit operations with the ECB, lending them ample support. In line with the rebounding HY issuance activity, spreads recovered from their March highs of 866 bps to just north of 510 bps end of Q2 2020, while still remaining 200 bps above beginning of 2020 levels. Delayed default rates have postponed spread-widening, while not preventing further down the road.

High Yield Bond Issuance EMEA (EUR bn)

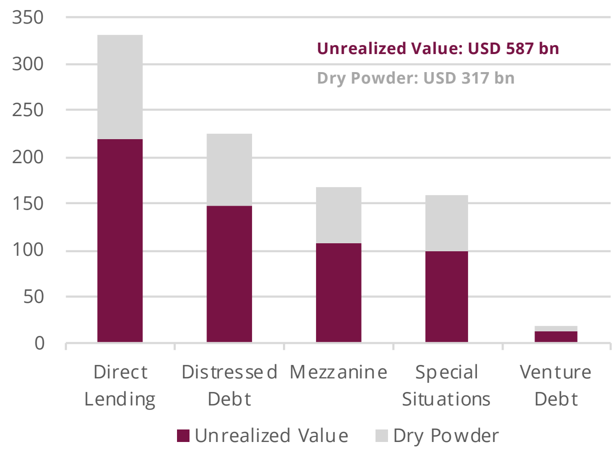


Source: afme, LCD

Private Debt Market Insight

Private debt fundraising experienced a rally in Q2 2020, following a marked decline in Q1. Capital raised stood just north of EUR 30 bn split across 49 funds. Funds with a European focus accounted for around EUR 8 bn, well below the US focussed funds accounting for just shy of 70% of total capital. Direct lending funds raised just north of EUR 8 bn, while special situations funds took the lion's share at north of EUR 11 bn. Distressed debt focused funds raised nearly EUR 9 bn in Q2. Private debt investors are preparing larger commitments over the next 12 months, while focussing on larger and established funds. Despite the continued pandemic, direct debt assets under management stand at a record high indicating the confidence investors put into the asset class to deliver adequate returns amid rising opportunities. Given the significant number of defaults expected over the next couple of months in the wake of the pandemic, we expect the amount of dry powder to decline as it is put to work, especially by funds focussing on distressed and special situations.

Private Debt Unrealized Value & Dry Powder (USD bn)

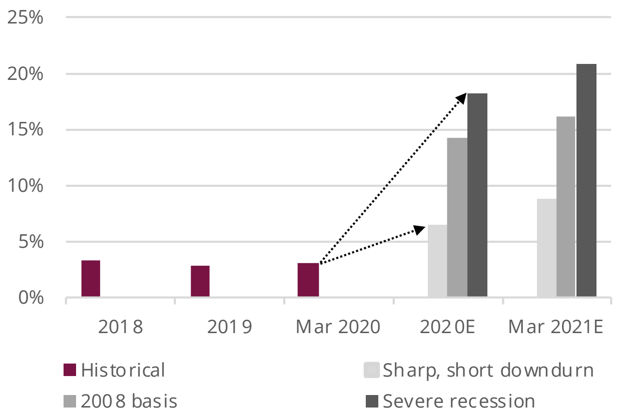


Source: Preqin, IPE (30.6.2020)

Rating Market Insight

While markets posted stellar performances during Q2, rating agencies turned to a historical stance on evaluating their portfolios of rated companies and downgrading and / or changing rating outlooks. The most negatively impacted sectors by number of issuers include banks, capital goods, energy, retailing, consumer products, media & entertainment and transportation. In terms of debt affected banks took the biggest hit followed by sovereigns and with a gap automotives. The unprecedented rating actions also triggered a massive shift across rating classes, further cementing the "B" class' no. 1 position accounting for more than 40% across all classes affected by the pandemic. This skew just underlines the heightened risk and low immunity of the rated issuer universe towards further negative shocks. A prolonged recovery of the economy or toppling large-scale issuers could likely be the base of further negative ratings actions in addition to the looming negative rating outlooks.

Speculative global default rate projections – 3 scenarios

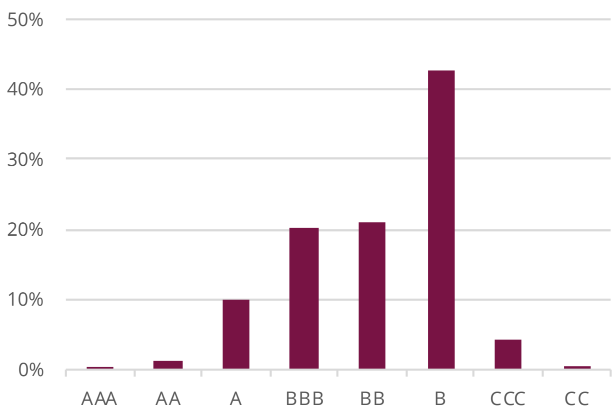


Source: Fitch, Moody's, S&P

Beware when fundamentals catch up with markets

Following Q1 2020 results, investors were tuned in on a "forgive" mode aided by the massive central banks and government support programs. As we move further down the lane, the "forgive" mode is likely being pushed aside by the demand for more visibility and an understanding where management teams and their companies are heading to. With the global GDP set to decline by nearly 5% in 2020, top-line growth and stabile margins are part of history widely reflected by rating actions but contrary to what capital markets and valuation levels are currently suggesting. A withdrawal of supportive policy measures, a return to temporary changed insolvency regimes and a revival of business courts are likely to spur subdued insolvency rates by Q3 2020 until well into H1 2021, especially for SMEs that found wide-spread supportive measures during the initial phase. Liquidity will undoubtedly prove key for companies in absence of a rapid and wide-ranging recovery.

Corporate & Sovereign issuers affected by rating class



Source: FMoody'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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