PILFOR
LENDING SOUNDNESS

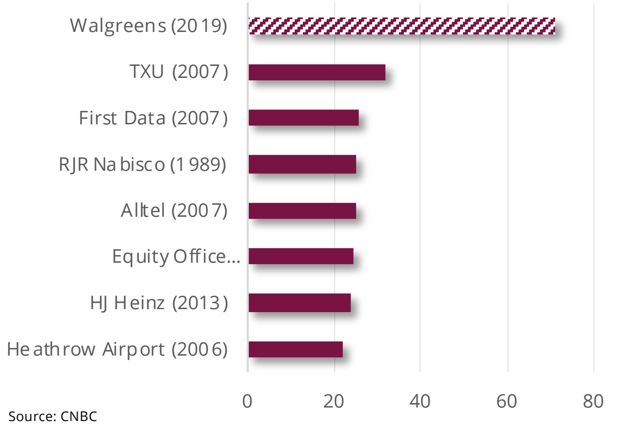
December 2019

Monthly Market Insights

Leveraged buyout market

PE experienced massive capital inflows with mega funds nearly doubling their share to 60% of capital raised. LP's increasingly commit to mega funds, that are expanding their focus onto larger targets such as the recently announced approach by KKR for Walgreens with a potential transaction value exceeding USD 70bn. Since 2014 overall buyout deal value grew to USD 2 tn in Europe / US, with the debt part accounting for over 50% further fueling the leveraged loan and HY bond market. Historically, the "B" segment rather reflected downgrades, however, an increasing number of issuers are assigned first-time ratings in this class with a strong bias to "B-". High tech, consumer products, healthcare and media & entertainment represent the largest shares. Based on the amount of dry powder and continued capital raising, we do not see a near-term end to LBOs, provided the FED and ECB continue on their supportive path, markets hold steady and investors pursue their search for yield.

The largest buyouts in history (USD bn)

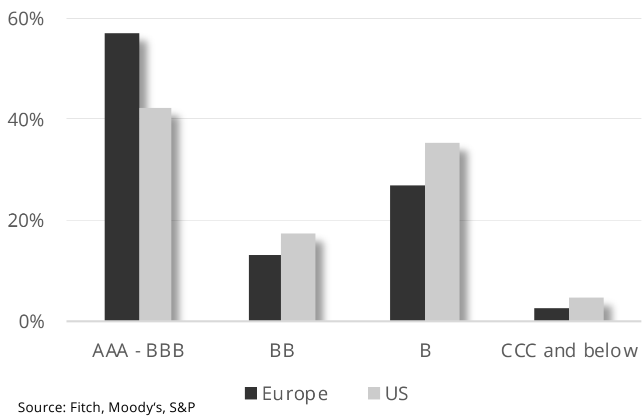


Source: CNBC

Leveraged loan market

The European leveraged loan market has recorded a proliferation of covenant light or "cov-lite" issuance. Cov-lite loans accounted for some 90% of total issuance in Europe in the first nine months of 2019 according to Debtwire. The hunt for yield has clearly boosted the growth in cov-lite lending in Europe's leveraged loan market. Institutional investors currently account for the lion's share of the market. This development has however allowed borrowers to drive loan terms and reduce covenants from around 4.5 on average to a minimum of around 1.3 (commonly: ND / EBITDA). Despite default rates being benign, one question remains: How will cov-lite impact the next default cycle? Borrower's debt coverage capacities - burdened by abundant and cheap debt - have turned more fragile across various sectors. Albeit with a delay, materializing default rates will start to highlight the borrowed time cov-lite loans offered.

The "B" class has considerably increased its share

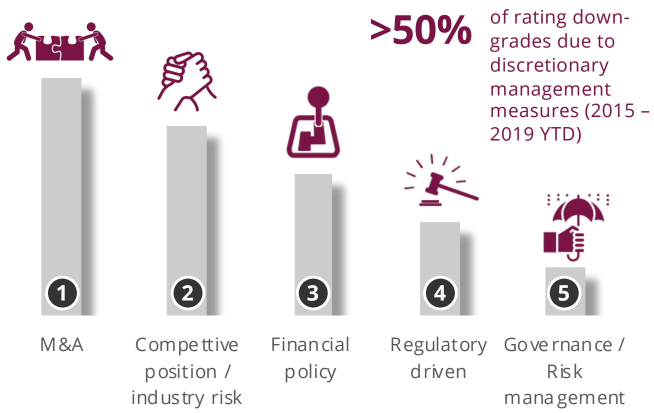


Source: Fitch, Moody's, S&P

Rating market

Despite favourable financing conditions many corporates witnessed recent downgrades resulting in a build-up of the "BBB" category that now represents the largest investment grade corporate class. The main driver for more than half of the downgrades were discretionary management actions relating to M&A and gear-changes towards more aggressive financial policies translating into shareholder friendly policies (i.e. share buybacks and increased dividends) and increased capex spending. The other - non discretionary – main rating downgrade drivers relate to changing competitive landscapes and increased industry risks, regulatory changes and corporate governance / risk management issues. In terms of sectors, utilities, consumer products, health care, and industrials recorded the highest share downgraded for discretionary M&A and financial policy decisions.

Discretionary actions: Drivers of corporate downgrades



Source: Fitch, Moody's, S&P

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

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