PILFOR
LENDING SOUNDNESS

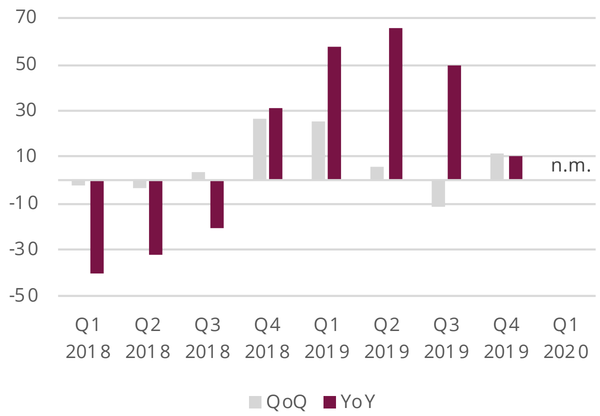
1st Quarter 2020

Quarterly Market Insights

7.4.2020

EMEA Financing Environment
The COVID-19 pandemic has battered European (and global) leveraged loan and high yield markets, sending valuations to decade lows and shutting (re-)financing windows. The sell-off began in late February as risk aversion started to increasingly pouring into equity markets and hampered various sectors, before turning into a full-scale market shutdown and secondary rout in largely throughout March. The secondary market slump had a direct impact on primary markets, with the syndication market shutdown, leaving banks sitting on deals just north of EUR 18 bn underwritten just some months ago. The most prominent transaction was the LBO of Thyssenkrupp's Elevator Technology Business that got stuck on the way to the planned syndication. In-line with leveraged loans the HY market witnessed massive spread widenings on the one hand and consequently forced the primary market to close for (re-)financings falling well short of issuance volume seen a year ago.

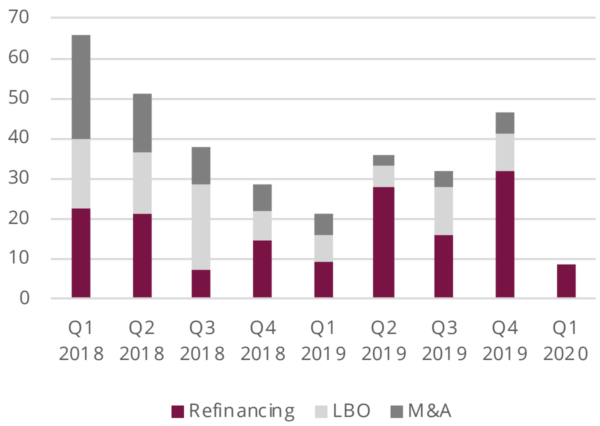
Leveraged Loan Pricing Changes EMEA (bps)



Source: Afme

Leveraged Loan Market Insights
The extent and duration to which the European leverage loan market and its participants was impacted in Q1 2020 was unique. While January noted decent issuance volumes (ca. 98% of Q1), February faced a severe free-fall, followed by March with zero issuance. This development forced issuers to draw on other source of liquidity where possible. RCFs provide the first line of defence causing a rapidly growing number of sponsor-backed and other leveraged companies requesting or drawing down facilities. For some this was and continue to is a precautionary measure, for others it gets rapidly apparent that existing back-up lines to see them through the market drought expected to last well into 2020. There is a bifurcation between companies having rushed to draw down their RCF in full, and those planning strategically in wake of maintenance covenants. Breaches of these covenants could spur default rates during 2020. Drawing-down later, could mean postponing covenant testing.

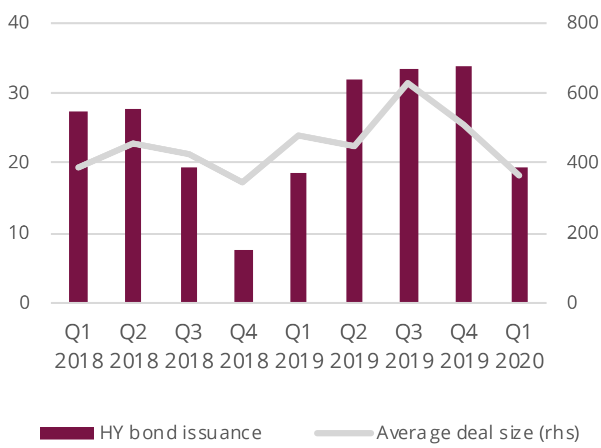
Leveraged Loan Issuance EMEA (EUR bn)



Source: afme, Xtract

Debt Capital Market Insights
2020 witnessed a good start with HY bond issuance reaching solid volumes in January, followed by a continued – and towards end of February – sharp slump with the market window being closed well into March. This was pretty much witnessed in the secondary market, where high yield credit was hit hard given the massively heightened risk aversion of investors with a thorough sell-off across the market, albeit sharper in more vulnerable sectors related to travel and retailing, as well as in energy as the oil price plummeted reaching bottom low levels. The massive interventions by central banks helped in brining some relief in terms of liquidity. Somewhat unexpectedly some HY issuers in fact managed to issue bonds making use of the tail-wind created by a rush of strong IG issuers to secure liquidity during the shortened (re-)financing market window. In terms of usage, refinancing clearly dominated to drive issuance activity, followed by liquidity & other uses and only a small share was allocated to M&A. The "B" class continued to be the most prominent rating class with "BB" picking up slightly.

High Yield Bond Issuance EMEA (EUR bn)

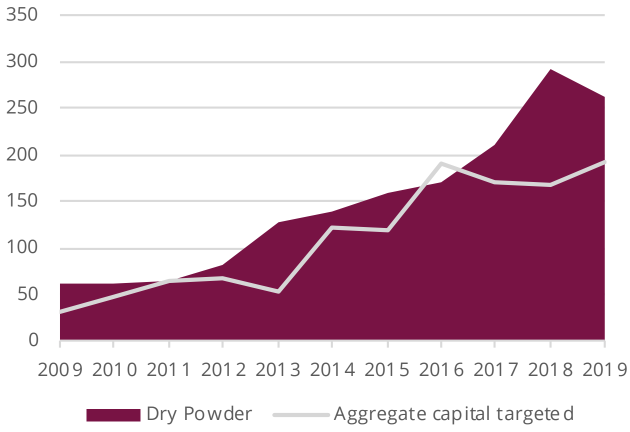


Source: afme, LCD

Private Debt Market Insight

Prospects for 2020 were looking good for Private Debt at the beginning of the year both in terms o funds in market but also from further growth and expansion as a very welcome and highly tailored financing solution to companies. Funds in market targeted north of EUR 190 bn in January with deal flow looking good. As market volatility struck and risk aversion sparked, riskier asset classes started to suffer and deals were put on hold. However, as credit is drawn and interest rates remain low, bank balance sheets will likely deteriorate from heightening leverage, duration and risk weighted assets. Banks will therefore have to respond by reducing financing availability at a time when companies are in search of liquidity. This bank retrenchment will be a product of the current crisis similar to 2008 and thereafter. It therefore seems very likely that non-bank lenders will move into the spotlight and find a very attractive market by means of filling the resulting financing gap. In these times not the typically higher cost is of key interest, but the availability of dry powder, flexibility, speed and tailored structure.

Global Private Debt Dry Powder (EUR bn)

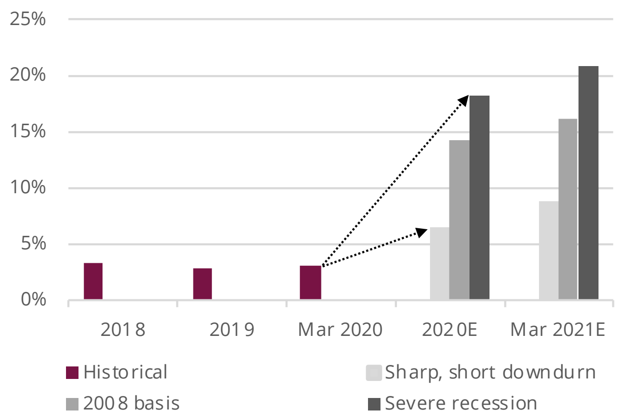


Source: Preqin, IPE

Rating Market Insight

Nothing pointed towards the looming development that evolved in February and massively heating up in the course of March 2020 in terms of negative rating actions relating to COVID-19. The ratio of IG ratings to N-IG corporate ratings dropped from around 2.3x in 2009 to some low 1x at the end of 2019, offering the gloomy picture of the deteriorated average rating level corporates entered the economic storm with during Q1 2020. As the size and impact of the pandemic grew and continues to do so, ratings were downward adjusted by the ratings agencies with the largest toll taking part in the speculative universe, regionally North America followed by EMEA recorded the major share of negative rating actions, while automotive, airlines, tourism, hotels & restaurants, and non-food retail took the biggest hit so far. Corporate default rates, having ended 2019 at below 3%, are now expected to reach up to 10% and speculative grade issuers up to 14% or even 18% in the case of a severe recession.

Speculative global default rate projections – 3 scenarios

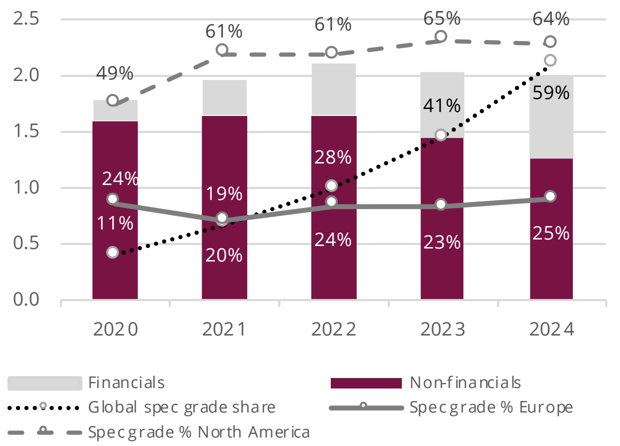


Source: Fitch, Moody's, S&P

Spotlights On: Cash Burn Rate & Liquidity - Solvency

If Q1 2020 gave a glimpse of the global impact the current pandemic has on brining corporate cash flow more or less to a halt within days, and forcing management's focus on its cash burn rate and available liquidity. The far-reaching shock witnessed especially mid March uncovered the vulnerability of the equity markets that could only be comforted by harsh and unseen interventions by central banks not reflecting the effective underlying impact the pandemic has on fundamental valuations. These actions were rapidly followed by corporate loans made available by governments as a kind of first aid help targeted especially at SMEs and in a second step and by means of different programs at larger corporates. Considering deteriorated average corporate rating levels, the massive growth in corporate debt and the lack of nearer term cash flow generation visibility governments and central banks will have to be running on full engines to lend sufficient support to both the debt and equity markets heading further into 2020.

Corporate global debt maturities (EUR tn)



Source: Fitch, Moody's, S&P

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

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