PILFOR
LENDING SOUNDNESS

March 2020 / 4th Quarter 2019

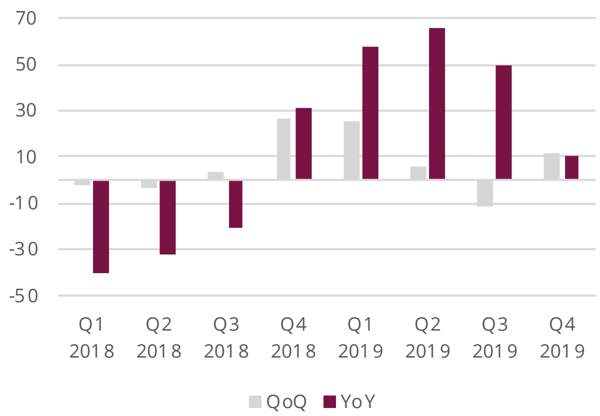
Quarterly Market Insights

24.2.2020

EMEA Financing Environment

During the course of Q4 2019 the ECB and the SNB continued to signal low interest rates and supportive measures in the wake of softening economic outlooks heading into 2020. Credit standards for loans to enterprises remained broadly unchanged during the last quarter of 2019. Bank's risk perceptions continued to show a tightening impact on corporate loans however. Across company size, credit standards increased slightly for loans to SMEs, while remaining broadly unchanged for loans to large companies in Q4 2019. On the demand side, there was a decline for the first time in six years, reflecting the slowdown in economic growth, observed since 2018. Generally speaking, net demand declined for both loans to SMEs and large companies. Pricing spreads for corporate loans tightened by 12 bps QoQ continuing the tightening trend that started in Q1 2019, while widening by 10 bps YoY in-line with the reversed development that commenced in Q4 2018.

Leveraged Loan Pricing Changes EMEA (bps)

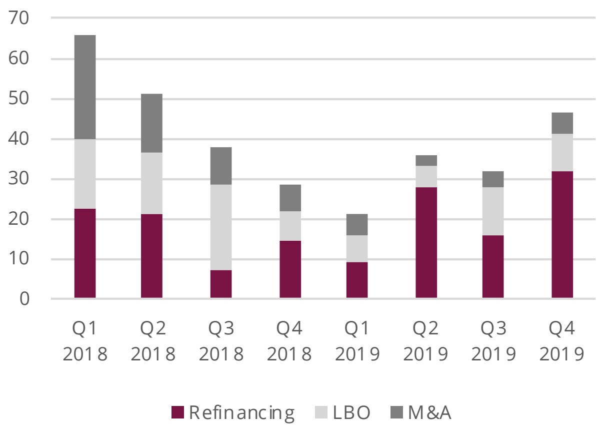


Source: Afme

Loan Market Insights

The softening economic activity left its footprint during 2019, with EMEA leveraged loan issuance dropping from EUR 182.6 bn in 2018 to EUR 143.3 bn in 2019, representing a decline of 21.5%. Q4 2019 witnessed the highest quarterly issuance volume since Q2 2018 coming in at EUR 46.4 bn, up 28.9% QoQ and massive 64.5% YoY. The key driver behind the increased issuance in Q4 2019 is to be found in the sparked refinancing activity accounting for EUR 31.5 bn or 67.9% of total issuance. Leveraged buyout related loan issuance amounted to EUR 9.9 bn, declining from EUR 12.0 bn in Q3 2019 and falling well short from levels seen in 2018. M&A related issuance stood at EUR 5.0 bn in the quarter under review. 98.4% of the leveraged loans issued were 1st lien loans, with the remainder being 2nd lien. The main three sectors in terms of issuance volume were healthcare with 20.3%, telecommunication with 13.8% and publishing with 9.9%, with the remainder being split across 18 other sectors.

Leveraged Loan Issuance EMEA (EUR bn)

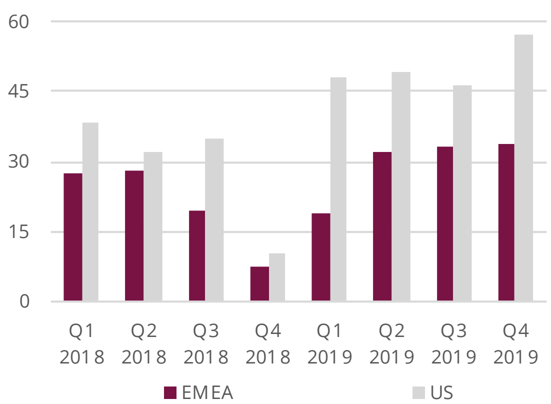


Source: Afme, Dealogic

Debt Capital Market Insights

Despite increasing pressure and market uncertainties, debt markets have held their stance in 2019, albeit with a softening towards year end. EMEA high yield bond issuance totalled EUR 33.9 bn in Q4 2019 across 67 deals, up 8.4% QoQ and nearly four folding YoY. A total of EUR 117.9 bn of high yield bonds were issued in 2019, up a massive 43.1% YoY. The main use of proceeds in Q4 2019 were general corporate purposes amounting to EUR 17.7 bn, up 44.8% QoQ and up more than 5x YoY. Refinancing accounted for EUR 10.1 bn, with M&A accounting for EUR just shy of EUR 3 bn. The three most active sectors in developed markets Europe?? were telecommunications, finance and healthcare accounting for 35.7% of total issuance in Q4 2019. In emerging markets Europe??, the most activity was recorded in finance, transportation and metal & steel accounting for not quite 59% overall. In Q4 2019, average deal size decreased from EUR 576 m to EUR 506 m, representing a decline of 19.5% QoQ but a sharp increase of 46.7% YoY, reflecting the increased deal number and continued high issuance volume.

High Yield Bond Issuance EMEA (EUR bn)



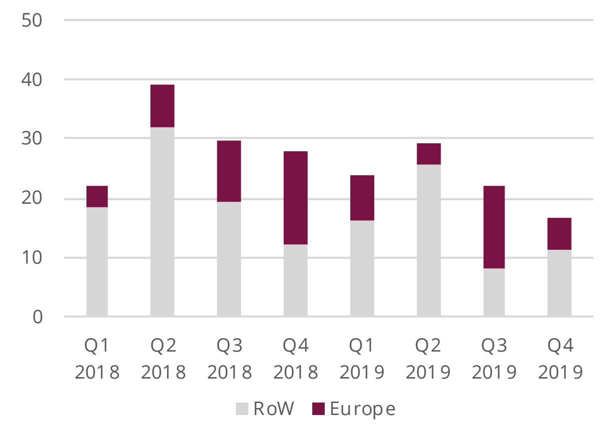
Source: Afme

Private Debt Market Insight

Global private debt fundraising reached EUR 92bn during 2019, down 22.2% YoY from EUR 118.6 bn. Europe recorded a decline of 14.3% YoY to EUR 31.1 bn, while the RoW witnessed fundraising dropping from EUR 82.3 bn EUR 61.2 bn, representing drop of 25.6% YoY. In line with the softening market conditions and the more cautious stance, Q4 2019 fundraising declined by 25.0% to EUR 16.8 bn QoQ and by 38.4% YoY. While fundraising in RoW increased by 2.9 bn in Q4 2019 QoQ, Europe witnessed a sharp drop from EUR 13.9 bn to EUR 5.7 bn. While the number of funds closed reached a new low at 152, the average fund size reached the highest level since 2008 at around EUR 638 m.

Direct lending represented the strongest performance by fund type raising around 57% of total debt at EUR 56.3 bn, followed by Distressed at 12.6% and special situations funds representing 8.5% of total debt raised. With more than EUR 750 bn AuM of which nearly EUR 240bn account for dry powder, private debt is set to continue expanding its role as a major financing source across the corporate landscape.

Global Private Debt Fundraising (EUR bn)

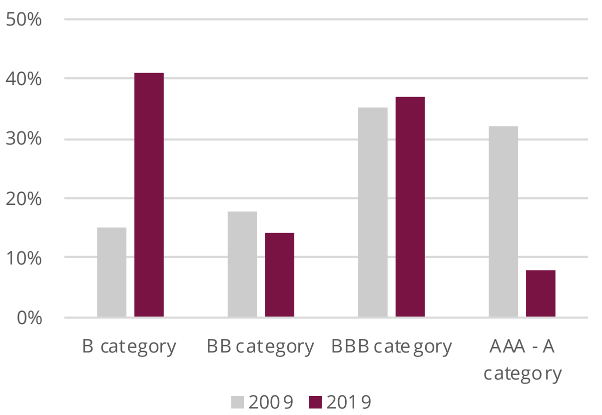


Source: Preqin

Rating Market Insight

2019 marked yet another year of the "B" and "BBB" ratings strongly triggered by the continued abundant liquidity and low interest environment spurring shareholder friendly policies, M&A and especially leveraged buyouts. While 2009 recorded a relatively sound share of investment grade corporate rating of near 70%, this changed dramatically over the ten year period and found its low in 2019, when investment grade corporate ratings fell to just north of 50%, while speculative ratings and especially the "B" class ploughed their share towards 50%. Overall the major trend resting on the aforementioned drivers adds to the global corporate fragility facing substantially higher risks in the event of market turmoil. This will rapidly uncover the high vulnerability of the according credit profiles, translating into even weaker ratings on the one hand, while capital markets will be reluctant to offer a window of opportunity to many corporate issuers, let alone the low rated and high risk ones.

"B" is growing its share across corporate rating classes

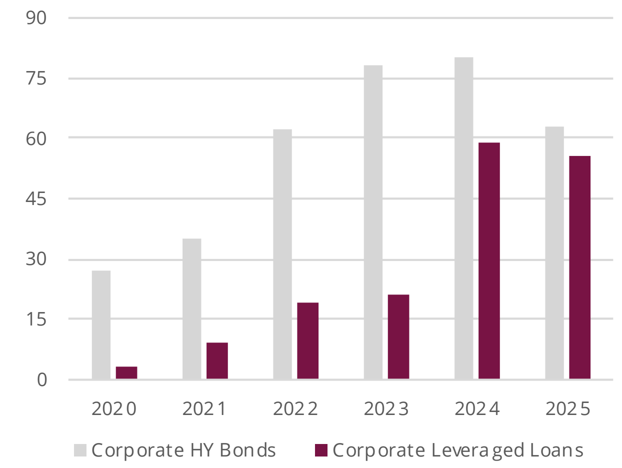


Source: Fitch, Moody's, S&P

Spotlights On

The current low interest rate environment offers an attractive opportunity for larger, transformative and often very shareholder focused financial policies both on the corporate and financial sponsor side in speculative rating area as witnessed during most of 2019 and expected to continue for some time absent any major market turmoil. Combining these aggressive steps with the softening economic and political outlook with increased volatility and less visibility can rapidly turn into a toxic mix for lower rated corporates or leveraged buyouts. In the event of market stress, their relative moderate cash flow capacity on the one hand, and mounts of debt on the other would add further rating pressure potentially triggering a widening market risk. A rating "washdown" of these borrowers could lead to a supply overhang in times of dwindling investor demand. Refinancing needs for 2020 are relatively moderate, while increasing rapidly heading towards 2022 and thereafter.

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

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