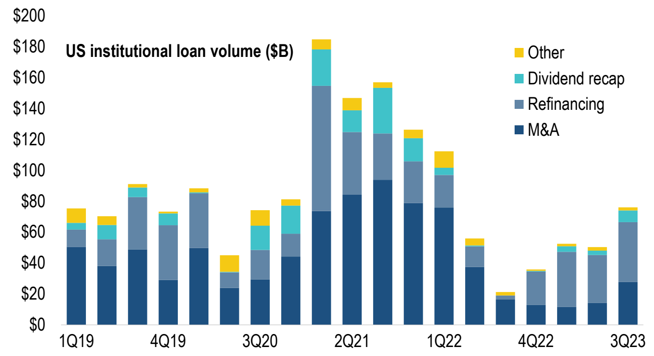
PitchBook | LCD

US

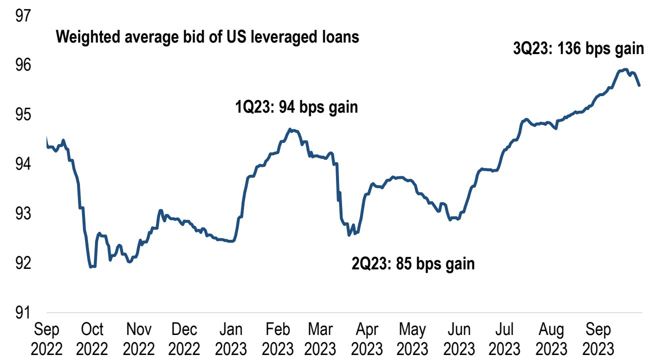
Credit Markets Quarterly Wrap

New issuance in Q3 hits highest mark since rate-hike onset in 1Q22...



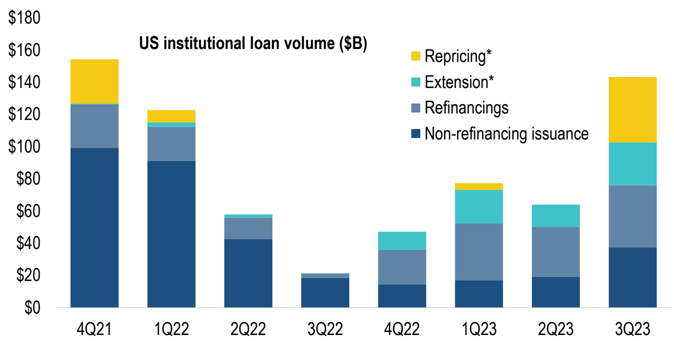
Source: PitchBook | LCD • Data through Sept. 30, 2023

...accompanied by a strong rally in the loan trading market.



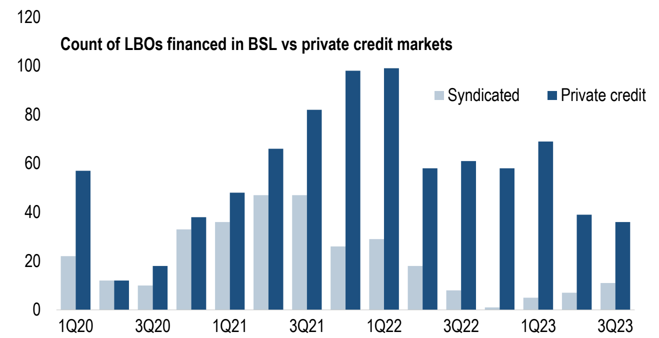
Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Sept. 28, 2023

The increased investor appetite fuels opportunistic loan issuance.



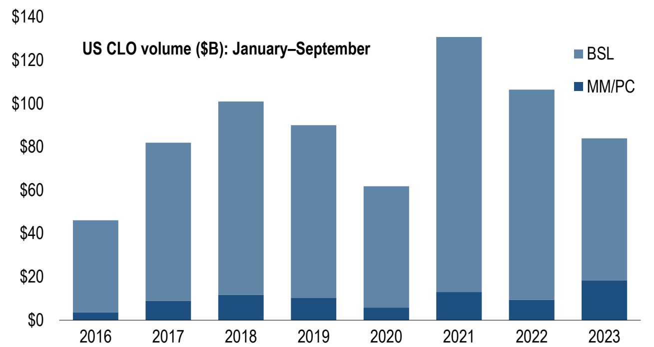
Source: PitchBook | LCD • Data through Sept. 30, 2023
*Reflects repricings and extensions done via an amendment process only

The BSL market even regains some ground, versus private credit...



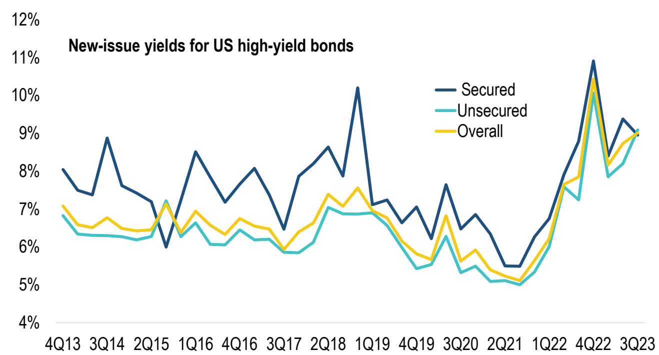
Source: PitchBook | LCD • Data through Sept. 26, 2023
Private credit count is based on transactions covered by LCD News

...while middle market/private credit CLO activity grows.



Source: PitchBook | LCD • Data through Sept. 30, 2023

In high yield, issuance picks up but blistering costs remain.



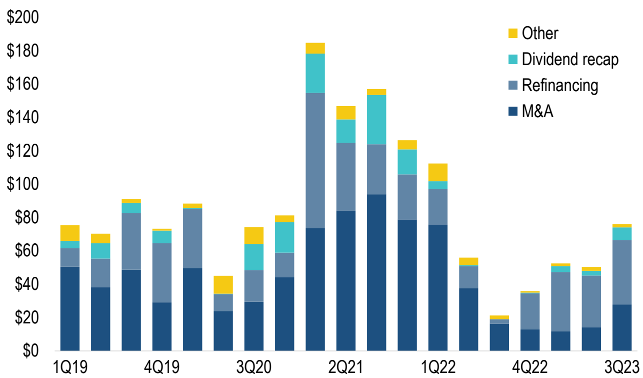
Source: PitchBook | LCD • Data through Sept. 30, 2023

Market recaps

Leveraged loan issuance rallies; repricings return

The leveraged loan primary market continued to recover in the third quarter as new-issue institutional volume totaled $76.0 billion, the highest mark since the current cycle of Fed rate hikes began in the first quarter of 2022.

Chart 1: US institutional loan volume ($B)



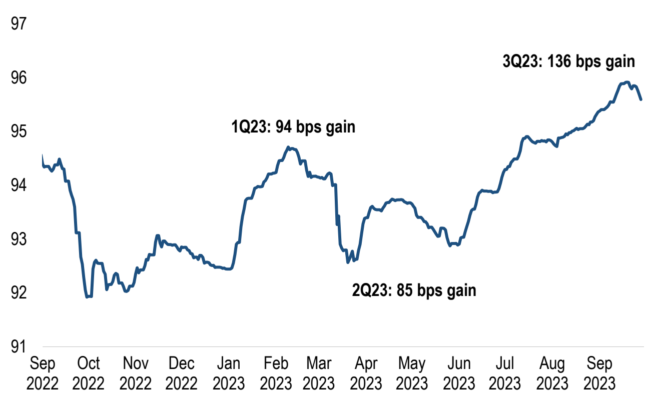
Source: PitchBook | LCD • Data through Sept. 30, 2023

Increased issuance came as risk sentiment improved and a sustained secondary market rally lifted the weighted average bid of US leveraged loans to a 2023 peak of 95.91 on Sept. 19, the highest since May 2022 and up 168 bps from the end of the second quarter.

Investor demand as measured by CLO issuance and loan fund flows grew to $29.0 billion, from $14.9 billion in the second quarter, in large part due to positive retail fund flows after five consecutive quarters in the red.

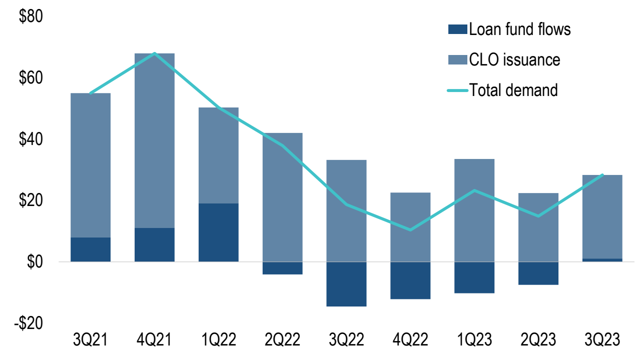
CLO issuance increased to $28.0 billion, from $22.4 billion in Q2.

Chart 2: Weighted average bid of US leveraged loans



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Sept. 28, 2023

Chart 3: US leveraged loan market – measurable investor demand ($B)



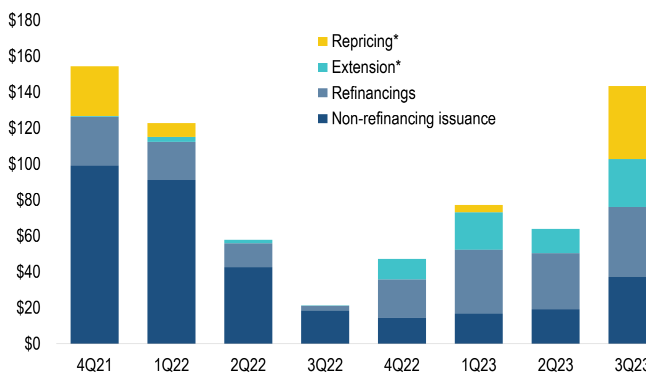
Sources: PitchBook | LCD; Morningstar Direct • Data through Sept. 25, 2023
Fund flows data includes monthly reporters.

Breaking total volume down by purpose, refinancings led the way for the fourth straight quarter, at $38.7 billion. That's the third consecutive quarter featuring $30 billion or more of refinancings, which hasn't happened since the first nine months of 2021. The $37.4 billion of non-refinancing activity marks a high since the second quarter of 2022.

Repricing and amend-and-extend transactions, which don't factor into overall new issuance data, also reflected increased market activity. Volume of these transactions was higher than at any point since the first quarter of 2021. Extension activity reached a post-Global Financial Crisis high, at $26.6 billion, up from $13.7 billion in Q2, and repricings surged to their highest level since the first quarter of 2021, at $40.7 billion.

All told, primary market activity including extensions and repricings totaled $143 billion, a seven-quarter high.

Chart 4: US institutional loan volume ($B)



Source: PitchBook | LCD • Data through Sept. 30, 2023
*Reflects repricings and extensions done via an amendment process only

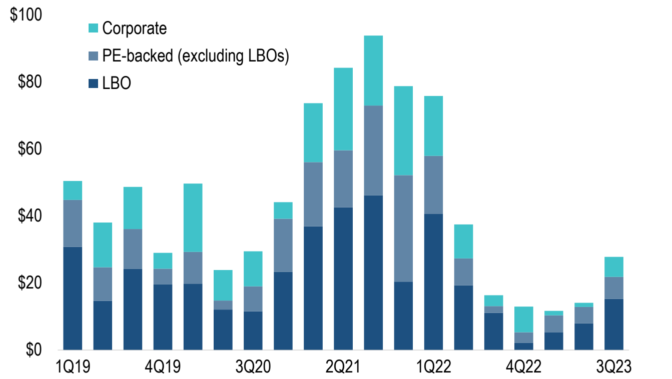
Increasing overall volume was driven by LBO/M&A issuance that reached a five-quarter high of $27.8 billion. Specifically, new loans issued to support LBOs tallied $15.3 billion, representing 55% of the volume.

That is the third straight quarter of increasing supply in this category and the most since the second quarter of 2022, when there was $19.3 billion.

Most of that was bunched in a post-Labor Day barrage led by a blowout deal for **Worldpay** (BB/Ba3/BB) that was increased to $5.2 billion after launching at $3.4 billion, and a $2.7 billion deal for **Syneos Health** (B/B1/B+) that was upsized from $2 billion.

These transactions were among 12 total broadly syndicated loans to finance LBOs that investors were pitched during the quarter, the most since the second quarter of 2022.

Chart 5: US institutional loan volume backing M&A ($B)



Source: PitchBook | LCD • Data through Sept. 30, 2023

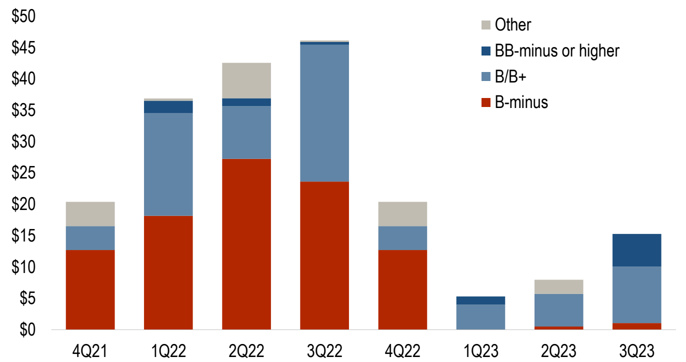
A note about that September rush — total volume of $38 billion was the highest monthly output since January 2022. Of that total, 61% was not related to refinancing, which was the highest share of 2023.

New LBOs have leaned toward higher ratings, including Worldpay, which carries an issuer rating profile of BB/Ba3/BB.

In the year to date, 95% of the LBO volume is from issuers carrying ratings of at least B/B+, which is up from 44% in full-year 2022.

In fact, there were only three LBO deals in 2023 that were from issuers rated B-minus: **Cvent** in Q2 and **Fogo de Chão** and **Aramsco** in Q3.

Chart 6: US LBO institutional loan issuance volume by borrower rating ($B)



Source: PitchBook | LCD • Data through Sept. 30, 2023

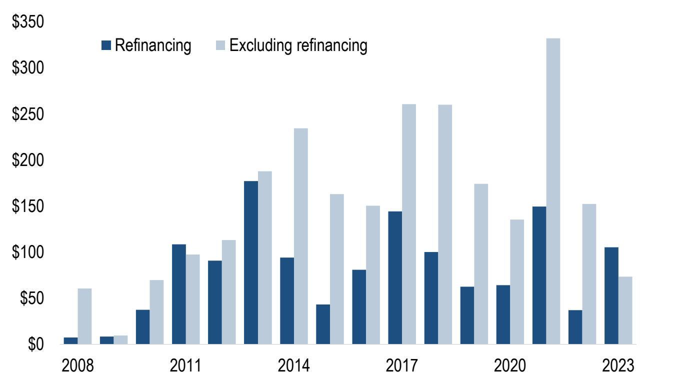
Total sponsored M&A — LBO plus tack-on acquisitions — rose for the third straight quarter, to $21.8 billion, the highest reading since $27.3 billion in the second quarter of 2022.

Despite the promising uptick in acquisition-related financing, the market still badly lags historical comparable periods. The $179 billion issued through the first three quarters is the lowest output since 2010, when $107 billion was issued over the same period.

While refinancing volume is relatively strong — only four years since the Global Financial Crisis have had more issuance over the first three quarters than the $105 billion this year — non-refinancing volume is in a trough not seen since, again, 2010.

In the year to date, non-refinancing volume is just $73.4 billion, versus $152 billion over the same period in 2022 and a peak of $332 billion in 2021.

Chart 7: Year-to-date institutional loan volume ($B)

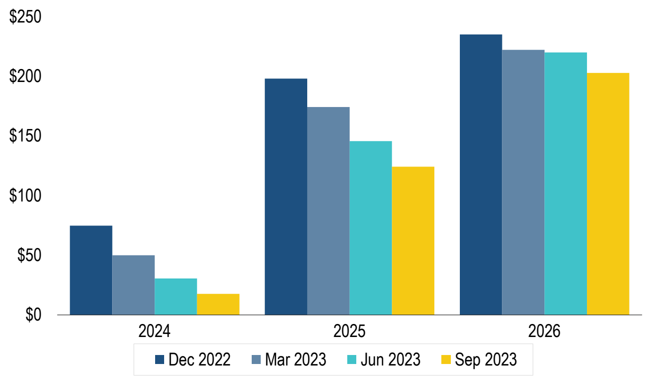


Source: PitchBook | LCD • Data through Sept. 30, 2023

With the heavy refinancing and extension activity, borrowers have collectively made progress addressing the loan maturity wall.

As it stands, 2024 institutional loan maturities have been reduced from $74.9 billion at the end of 2022 to $17.6 billion as of Sept. 29, a drop of 76%, based on the Morningstar LSTA US Leveraged Loan Index.

Chart 8: US leveraged loan maturity wall, 2024-2026 ($B)



Sources: Morningstar LSTA US Leveraged Loan Index; PitchBook | LCD • Data through Sept. 29, 2023

Most of this progress was made by higher-rated issuers; the B/B+ cohort cut 2024 outstandings by 96%, to $1.2 billion, and the BB-minus or higher bucket dropped 97%, to less than $300 million.

There was more work to do for issuers with B-minus or lower ratings, as outstandings here came down by just 64%, to $13.8 billion.

Some progress was also made, to a lesser extent, on 2025 maturities, which stood at $124 billion as of Q3, down from $198 billion on Dec. 31, 2022, a reduction of 37%. Again, while B/B+ and minimum BB-minus cohorts were down 64% and 39%, respectively, in the year to date, the B-minus bracket was reduced by only 17% and stood at $59.8 billion as of Sept. 29.

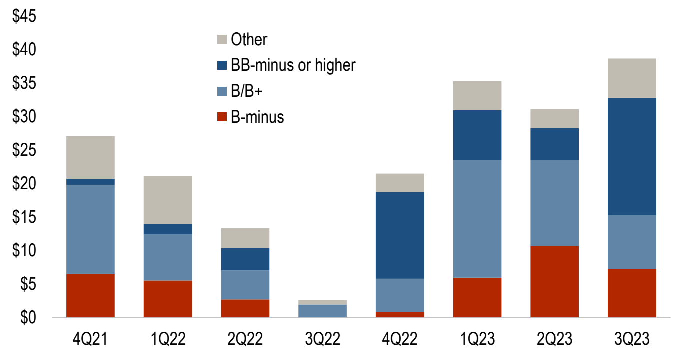
Refinancing/Recap

As mentioned, refinancings kept pace in the third quarter. Total volume in the third quarter was $38.7 billion, the highest quarterly figure since the $40.5 billion in the second quarter of 2021.

Within this category, higher-rated issuers took up a larger share of the total compared to the two prior quarters as spreads fell to their lowest levels since 2021.

This included a benchmark $5.175 billion term loan B from **Restaurant Brands** that was the largest single tranche issued in a refinancing, regardless of rating, since the last time the company tapped the market in 2019.

Chart 9: US refinancing institutional loan issuance volume by borrower rating ($B)



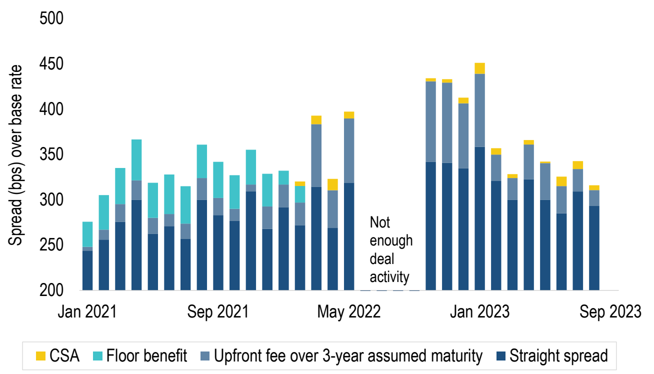
Source: PitchBook | LCD • Data through Sept. 30, 2023

Leveraged loan maturities by issuer rating

	2024 maturities			2025 maturities		
	9/29/2023	12/31/2022	Change from December	9/29/2023	12/31/2022	Change from December
B- or lower	$13.8B	$38.0B	-64%	$59.8B	$71.9B	-17%
B / B+	$1.2B	$25.9B	-96%	$27.3B	$76.4B	-64%
BB- or higher	$0.3B	$8.3B	-97%	$27.9B	$45.8B	-39%

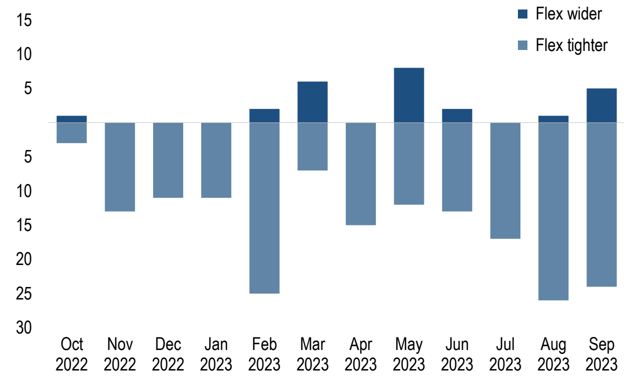
Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Sept. 29, 2023

Chart 10: All-in new-issue spread of BB/BB- issuers



Source: PitchBook | LCD • Data through Sept. 28, 2023

Chart 11: Count of US leveraged loan flexes



Source: PitchBook | LCD • Data through Sept. 30, 2023

Issuance from borrowers rated BB-minus or higher was $17.6 billion, more than the prior two quarters combined and the most for any quarter since the first quarter of 2021.

At the same time, the all-in new-issue spread for BB/BB- issuers — including the upfront fee and CSA, if any — tightened to 284 bps, the lowest since January 2021 and down from 451 bps in January this year.

At 273 bps, the straight spread was its tightest since April 2022.

For B/B+ rated issuers, the all-in spread hit its intra-year low at 445 bps, down slightly from 446 bps at the end of Q2 and more than a point below 554 bps in January.

The straight spread was 400 bps, off the 2023 low of 392 bps touched in May but also decidedly lower than the 453 bps to start the year in January.

Given the reduced clearing levels for new issues it's unsurprising that pricing flexes continued to favor issuers in Q3. Indeed, in the third quarter, pricing tightened during syndication for 67 tranches, while pricing widened on just six tranches.

That leaned even more in borrowers' favor than in Q2, when 40 deals tightened, versus 10 that were pushed wider.

The post-Labor Day rush of M&A issuance cleared out a swath of deals from the shadow calendar.

Investors expected opportunistic transactions to fill the gap, which indeed is happening in the wake of Worldpay and Syneos, with repricings emerging in late September.

Repricing volume in the third quarter is $42.7 billion, including $40.7 billion done via an amendment, the most the market has seen since 1Q21.

Dividend recapitalizations also picked up in Q3.

Loans issued to fund a dividend to sponsors totaled $7 billion in the quarter, the highest level since 4Q21.

Through three quarters in 2023, the total is $12.1 billion, more than double such issuance in 2022.

While the increased activity is notable in comparison to recent periods, it's still far off the pace from peak periods.

By comparison, in 2021 a whopping $73.2 billion of dividend-related volume hit the loan market, or 18% of total sponsored issuance that year. Before volume dropped off in 2022, the market averaged $35.9 billion of annual dividend-related issuance from 2015-2021.

Total volume (excluding repricings via amendment)					
	2023	Change from 2022	3Q23	Change from 3Q22	Change from 2Q23
LBO	$38.6B	-55%	$19.9B	20%	72%
M&A (non-LBO)	$39.4B	-63%	$18.1B	-24%	59%
Total M&A	$78.1B	-59%	$38.0B	-6%	66%
Refinancing	$139.7B	-6%	$45.1B	65%	-5%
Dividend	$14.8B	168%	$8.2B	1000%+	177%
Other	$13.2B	-61%	$3.0B	-71%	-51%
Total	$245.8B	-35%	$94.3B	21%	19%
Institutional volume					
	2023	Change from 2022	3Q23	Change from 3Q22	Change from 2Q23
LBO	$28.5B	-60%	$15.3B	38%	91%
M&A (non-LBO)	$25.0B	-57%	$12.5B	139%	105%
Total M&A	$53.6B	-59%	$27.8B	70%	97%
Refinancing	$105.3B	184%	$38.6B	1375%	24%
Dividend	$13.9B	160%	$7.6B	1000%+	169%
Other	$5.9B	-66%	$2.0B	-8%	-13%
Total	$178.7B	-6%	$76.0B	259%	51%
Pro rata volume					
	2023	Change from 2022	3Q23	Change from 3Q22	Change from 2Q23
LBO	$10.1B	-31%	$4.7B	-15%	30%
M&A (non-LBO)	$14.4B	-70%	$5.6B	-70%	6%
Total M&A	$24.5B	-61%	$10.2B	-57%	15%
Refinancing	$34.4B	-69%	$6.4B	-74%	-61%
Dividend	$0.8B	519%	$0.7B	N/A	337%
Other	$7.3B	-55%	$1.0B	-88%	-74%
Total	$67.1B	-65%	$18.3B	-68%	-37%

Source: PitchBook | LCD • Data through Sept. 30, 2023

— Jon Hemingway

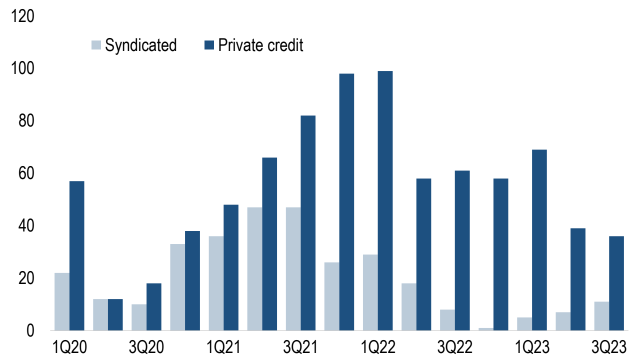
Finastra, Hyland lead big-ticket private credit refis of BSL deals

There was an immediate sense in the leveraged finance markets that the third quarter would be different from the first half of 2023, or all of 2022.

The third quarter kicked off with news of GTCR's buyout of **Worldpay** from FIS (NYSE: FIS). Private credit providers were notably absent from the deal (granted, the issuer was relatively highly-rated, at double-B, but it was a marquee LBO transaction nonetheless). The debt package was initially launched at up to $9.4 billion. In the end, the borrower issued a larger dollar loan and bond and a smaller sterling bond tranche than first guided, including a $5.2 billion, S+300 (0.5% floor) seven-year term loan when the deal priced in September. Goldman Sachs was left lead on the sterling bonds and euro term loan while JP Morgan was left lead on the dollar bonds and loans.

Similarly, other deals followed in the syndicated market in the third quarter, which market participants were watching carefully. One was **ION Corporates**' $500 million first-lien term loan due July 2030 (Sofr+425, 0% floor, OID of 96), led by BNP Paribas. Proceeds of that deal for the financial software company will fund a refinancing and dividend payout. Another was **BANGL LLC**'s $350 million, 5.5-year term loan B (Sofr+450, 0% floor, OID 98) through Barclays and Investec. That financing included a $50 million senior secured super-priority revolver. Proceeds will support the expansion of BANGL, a large-scale pipeline system that transports NGL (natural gas liquids) barrels from the Permian Basin to Gulf Coast fractionation and purity markets.

Chart 12: Count of LBOs financed in BSL vs private credit markets



Source: PitchBook | LCD • Data through Sept. 26, 2023
Private credit count is based on transactions covered by LCD News

What was apparent in the third quarter of 2023 is that the deals that were closing, as the broadly syndicated loan market enjoyed a reopening, skewed toward higher-rated credits. This development supports the view that the private credit and BSL markets will co-exist in the long term. Potentially, private credit could be the go-to market for deals that are unrated, or have riskier structures such as recurring revenue loans.

"Private equity likes having optionality," said Chris Flynn, president of First Eagle Alternative Credit. Like other market participants, he believes financial sponsors will keep both the private credit and syndicated loan markets going in order to have the best possible pricing and structures available to them, at all times.

The trend of private credit absorbing many transactions, which has accelerated since 2020, appears set to continue.

"There's quite a bit of room for mega-cap deals to move to private credit," said Jim Fellows, chief investment officer of First Eagle Alternative Credit and head of the firm's tradable credit team. Flynn and Fellows were speaking at a media breakfast in Midtown Manhattan on Sept. 26.

Private credit remains a popular strategy for asset managers. New platforms and partnerships continue to appear as companies figure out ways to bolt on private credit strategies.

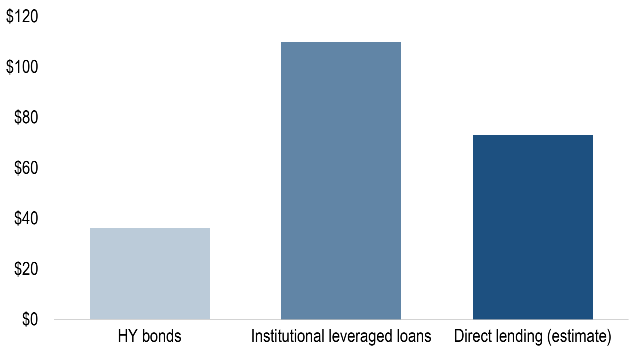
Man Varagon became a new name to know — Man Group in July announced its agreement to acquire Varagon Capital Partners, a private credit manager with $11.8 billion in AUM. The acquisition is Man Group's first significant expansion into the US private credit markets. Man Group said it would pay $183 million in cash to the existing owners of the firm — Aflac, Corebridge, AIG, and former members of Varagon's management team. The three companies will be eligible for additional payments of up to $93 million if they maintain existing capital commitments over a nine-year period. Man Group will fund the purchase with internal resources. CEO Walter Owens will continue to lead the firm.

Others are revving up too. Also in July, Jefferies Credit Partners announced plans to launch a private placement of a business development company (BDC) with roughly $1.7 billion of capital to invest in private credit. A subsidiary of the Abu Dhabi Investment Authority committed to a $625 million anchor equity investment. Comvest Credit Partners, the direct lending platform of Comvest Partners, announced the final close of its latest flagship fund with $2 billion in equity commitments. Comvest Credit Partners VI (CCP VI) will provide senior debt financing to mid-sized North American companies, with deal sizes of up to $250 million, investing in both sponsored and non-sponsor-backed companies.

But that's not all for new entrants. In September, Centerbridge Partners and Wells Fargo & Company launched Overland Advisors. The platform of at least $5 billion will lend to non-sponsor North American middle market companies. The investable capital includes $2.5 billion in equity commitments, anchored by the Abu Dhabi Investment Authority and British Columbia Investment Management Corporation. Many private credit providers have heretofore focused on sponsor finance. This is an example of some lenders turning to new, previously untapped realms in search of investment opportunities.

Market participants say that private credit is here to stay. In an LCD webinar on July 12 entitled "US Leveraged Loan/ Private Credit Webinar: Has the market retreated to Financial Crisis levels?" participants were asked: "What best describes the relationship between private credit and the traditional syndicated loan market, at year-end, and in 2024?" The poll showed a strong belief that private credit will be the leader in buyout financing through the rest of this year and the next. In addition, according to LCD's latest US Leveraged Finance Survey, conducted in September, leveraged credit fund allocations are expected to favor private credit.

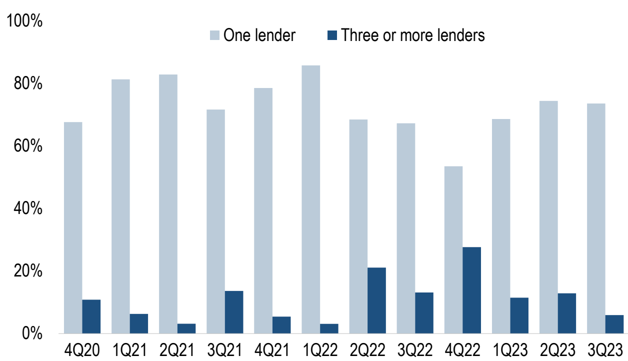
Chart 13: New-issue volume for PE-backed borrowers: YTD ($B)



Source: PitchBook | LCD • Data through Sept. 26, 2023
Direct lending analysis is based on transactions covered by LCD News

That year-end prognostication regarding LBO financing may well come to pass.

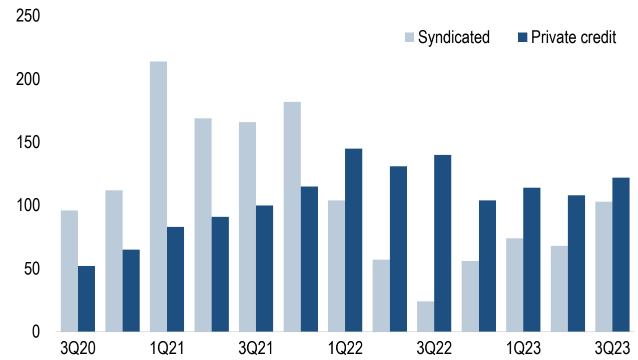
Chart 14: Share of LBOs financed in private credit market



Source: PitchBook | LCD • Data through Sept. 26, 2023
Analysis is based on transactions covered by LCD News

Notably, it's not only buyout loans being done in the private credit market.

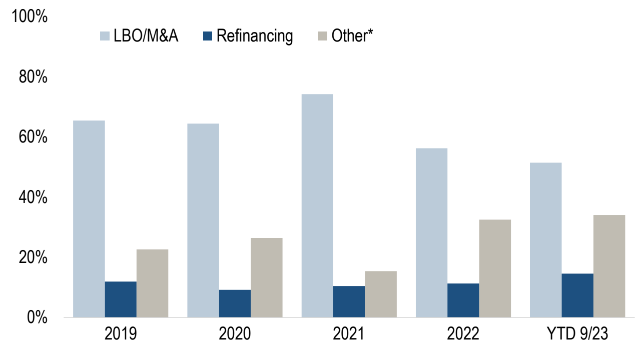
Chart 15: Count of non-LBOs financed in BSL vs private credit markets



Source: PitchBook | LCD • Data through Sept. 26, 2023
Private credit count is based on transactions covered by LCD News

LCD data shows that the private credit transactions in 2023 have covered a range of uses — including buyouts, add-on acquisitions, recapitalizations, and dividends. That is, borrowers have turned to private credit for deals that those same companies and private equity sponsors had previously executed in the syndicated loan market.

Chart 16: Private credit deal share by use of proceeds, based on count



Source: PitchBook | LCD • Data through Sept. 26, 2023
*Other category includes recapitalizations, growth, working capital, or unspecified uses
Analysis is based on transactions covered by LCD News

Indeed, by several measures there were major wins for private credit in the third quarter.

One was **Finastra**. Finastra's landmark $4.8 billion unitranche credit facility, which supports the company's refinancing of broadly syndicated term loans due June 2024, was the largest takeout of an institutional loan by private credit on record by a large margin, according to LCD. Alongside Finastra's record loan is a $500 million revolving credit facility. Lenders included Blue Owl, Oak Hill Advisors, Ares, HPS Investment Partners and KKR, and potentially others, according to market sources. Pricing on the credit facility was S+725 with an OID of 98. The borrower had a $375 million revolver that expires in March 2024 and $4.1 billion in first-lien term loans due June 2024. The loan has been on investors' radars due to a near-term maturity.

Notably, the transaction included $1 billion of preferred equity from Vista Equity Partners, market sources said. Finastra was formed via the June 2017 merger of Misys group and D+H Corp. Morgan Stanley led a cross-border financing package. The company provides lending, payments, treasury and universal banking solutions.

Moreover, the Finastra unitranche term loan was the largest private credit facility, excluding add-ons to initial loans, on record, based on LCD reporting, topping the $3.75 billion senior secured term loan that backed the buyout of Zendesk by Hellman & Friedman and Permira last year.

Not to let Finastra get all the attention, **Hyland Software** quickly followed, refinancing its syndicated loans. The borrower closed a $3.4 billion unitranche financing, in yet another example of the inroads private credit is making into the traditional, bank-led leveraged loan market. Hyland Software's unitranche facility included a $3.25 billion term loan and, interestingly, a $150 million multi-currency revolver. Golub Capital was administrative agent, left lead arranger and joint bookrunner. Other participants in the financing were funds of Ares Management Credit, Blue Owl Capital, Goldman Sachs Asset Management, Oak Hill Advisors, GIC, PSP, Ontario Teachers' Pension Plan, Morgan Stanley Private Credit, Neuberger Berman Private Debt, CDPQ, Thoma Bravo Credit, HarbourVest Partners, Stone Point Credit and Jefferies Credit Partners, according to market sources.

The Hyland Software financing was covenant-lite, market sources said. It's worth noting that the transaction included no new equity. Recall that Finastra included $1 billion of preferred equity from Vista Equity Partners.

Proceeds will refinance, dollar-for-dollar, Hyland Software's outstanding syndicated debt consisting of a first-lien loan, a second-lien loan and a revolving credit facility, and pay transaction fees and expenses. Hyland Software was last in the syndicated market with incremental term loans to finance an acquisition in March 2021. A $550 million second-lien loan was repriced at that time. The Ohio-based company provides an enterprise content management platform to corporate clients worldwide. It has been a portfolio company of Thoma Bravo since 2007.

Hyland Software, rated B-minus, has a $2.56 billion first-lien term loan due in July 2024 outstanding, as well as a $670 million second-lien loan due July 2025. The 2024 facility was the largest in the 2024 cohort left to address (in terms of current amount outstanding) as of Sept. 15. The Morningstar LSTA US Leveraged Loan Index currently tracks $20 billion of loans coming due in 2024, but this amount will decrease significantly once the Hyland Software repayment is finalized.

And in a late-quarter filing, a $6.2 billion senior secured credit facility emerged for **Integrity Marketing**. Proceeds were for a refinancing of the company's debt by Harvest Partners, according to an SEC filing. The transaction included incremental debt. Blue Owl was administrative agent, and remains one of the largest lenders in the deal, according to the lender. Details were scant as the quarter drew to a close. The original debt dated from 2019. In 2019, Owl Rock Capital, Crescent Capital, and Antares Capital were joint lead arrangers and joint bookrunners on $945 million of financing supporting Harvest Partners' investment in Integrity Marketing. The deal has increased significantly since then, market sources say.

— Abby Latour

2023 direct lending deals refinancing broadly syndicated term loans

Company name	Date	Debt amount ($M)	Current sponsor	Last BSL deal date	Lender(s)
Hyland Software	Sep 2023	3,400	Thoma Bravo	Mar 2021	Golub, Ares, Blue Owl, Goldman Sachs Asset Management, Oak Hill Advisors, GIC, PSP, Ontario Teachers' Pension Plan, Morgan Stanley Private Credit, Neuberger Berman Private Debt, CDPQ, Thoma Bravo Credit, HarbourVest Partners, Stone Point Credit, Jefferies Credit Partners
Trinseo SA	Sep 2023	1,077	Not Sponsored	Mar 2021	Angelo, Gordon & Co, Oaktree Capital Management, Apollo Global Management
Finastra	Aug 2023	5,300	Vista Equity Partners	Oct 2019	Blue Owl, Oak Hill Advisors, Ares, HPS Investment Partners and KKR, and potentially others
Sabre Holdings	Jun 2023	700	Not Sponsored	Aug 2022	Affiliates of Centerbridge Partners
Melissa & Doug	Apr 2023	260	Not Sponsored	Jun 2018	N/A
RR Donnelley	Mar 2023	1,250	Chatham Asset Management	Jan 2022	Apollo led; deal syndicated to key LPs and partners

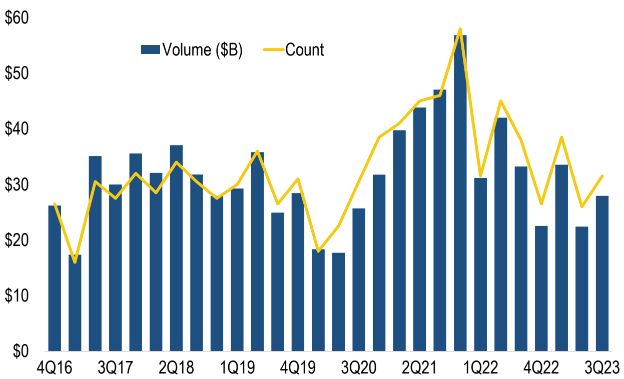
Source: PitchBook | LCD • Data through Sept. 20, 2023 • Table is based on LCD News reporting

CLO issuance picks up as arbitrage conditions improve

US CLO issuance picked up during the third quarter as spreads tightened and managers were able to affordably ramp up long-standing CLO warehouses.

Third-quarter CLO issuance of $28 billion was up from $22.4 billion in the second quarter, though it fell short of the $33.2 billion from the third quarter of 2022.

Chart 17: US CLO issuance – quarterly



Source: PitchBook | LCD • Data through Sept. 30, 2023

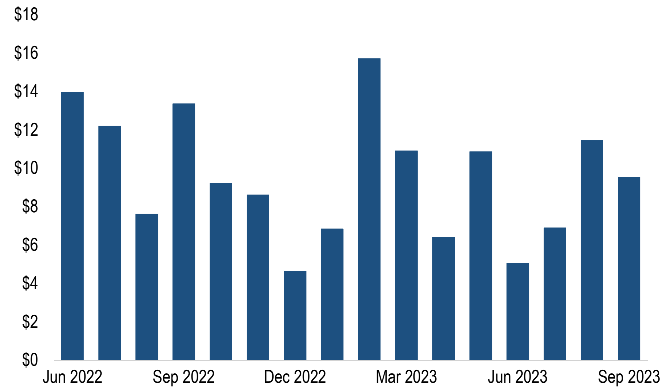
"What we've witnessed in the third quarter is a catch-up of some lagging issuance through the second quarter of the year," said Erik Miller, partner and co-head of the CLO business of Canyon Partners, which itself priced its first CLO of 2023 in July via Goldman Sachs.

The primary deals included a number of "latent" warehouses from the previous 12 months that were able to achieve enough equity arbitrage to satisfy investors, Miller added.

The 2023 issuance total of $83.9 billion trailed last year's third-quarter-end volume of $106.4 billion by 21%. Full-year 2022 issuance was $129 billion.

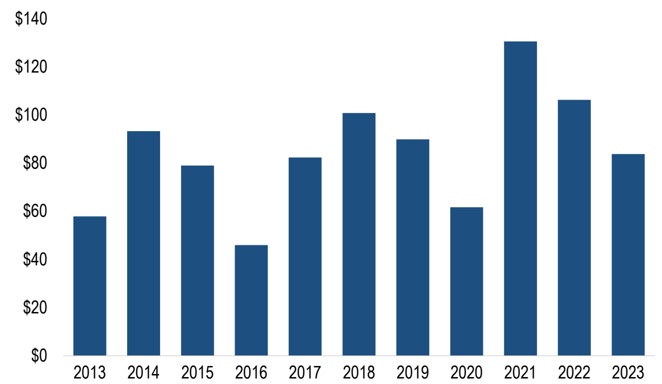
A large percentage of the third-quarter 2023 volume arrived in August ($11.5 billion). After an early dry spell, September's activity picked up, as 14 new-issue transactions priced in the Sept. 19-30 period to bring the monthly volume to $9.6 billion.

Chart 18: US CLO issuance ($B) – monthly



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 19: US CLO issuance ($B) – January through September



Source: PitchBook | LCD • Data through Sept. 30, 2023

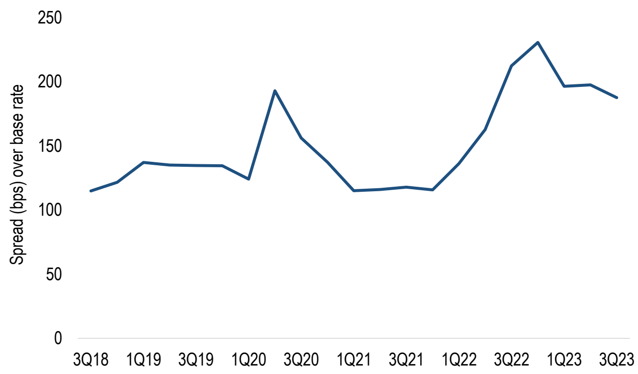
"Managers who have captive equity funds are still printing out transactions," said Laila Kollmorgen, managing director and CLO tranche portfolio manager for PineBridge Investments.

Spread conditions

Average AAA spreads on US BSL CLOs tightened to 188 bps in the latest quarter, from 198 bps in the second quarter and 231 bps at year-end 2022.

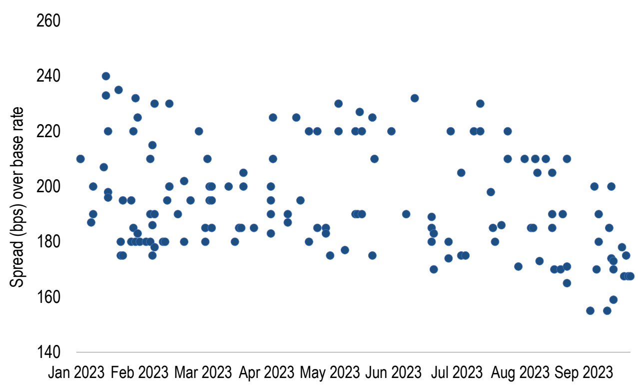
The weighted average coupon cost was 260 bps, down 15 bps from the second quarter.

Chart 20: Average US CLO AAA spread



Source: PitchBook | LCD • Data through Sept. 30, 2023 • Excludes middle-market CLOs

Chart 21: US CLO AAA coupon



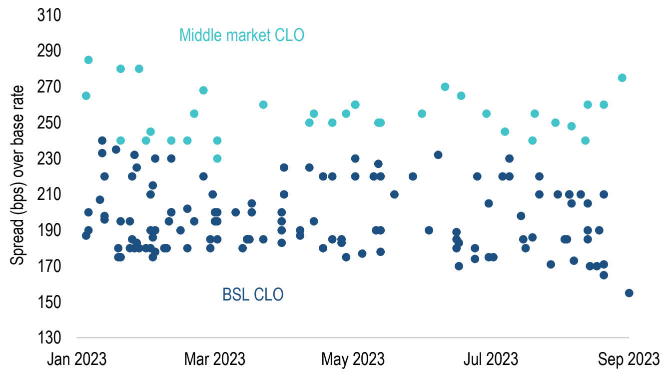
Source: PitchBook | LCD • Data through Sept. 30, 2023 • Chart excludes middle-market and static CLOs

US CLO average coupon & weighted average cost of capital (bps)						
Time frame	**AAA**	**AA**	**A**	**BBB**	**BB**	**WACC**
4Q21 (Libor+)	116	172	217	325	660	172
1Q22 (Sofr+)	136	192	233	348	702	193
2Q22 (Sofr+)	163	233	294	411	756	224
3Q22 (Sofr+)	212	302	400	533	834	282
4Q22 (Sofr+)	231	322	415	582	850	299
1Q23 (Sofr+)	196	261	335	541	825	270
2Q23 (Sofr+)	198	273	336	549	853	275
3Q23 (Sofr+)	188	262	317	501	796	260
Change from 2Q23	**-10**	**-11**	**-19**	**-48**	**-57**	**-15**
Change from a year ago	**-25**	**-40**	**-83**	**-32**	**-38**	**-22**

Source: PitchBook | LCD • Data through Sept. 30, 2023

Middle market CLO AAA spreads ranged from 230-275 bps during the quarter.

Chart 22: US CLO AAA coupon – MM vs BSL



Source: PitchBook | LCD • Data through Sept. 30, 2023 • Chart excludes static CLOs

The impact of manager tiering lessened during the quarter, with the top-tier of issuers with 20 or more CLOs printed between 2011 and 2022 scoring an average AAA spread of 174 bps, compared to 197 bps for the lower tier of managers with fewer than 10 CLOs issued during the same period. The 24 bps difference tightened from the second-quarter basis of 32 bps.

Average AAA spread (bps) of BSL CLOs with 5-year reinvestment period				
Quarter	**Top tier**	**Middle tier**	**Bottom tier**	**Difference between top and bottom tier**
2Q22	156.2	158.7	167.7	11.4
3Q22	202.1	214.3	216.5	14.4
4Q22	218.1	230.0	N/A	N/A
1Q23	186.4	199.2	204.7	18.3
2Q23	185.7	212.8	218.0	32.3
3Q23	173.5	196.3	197.3	23.8

Source: PitchBook | LCD • Data through Sept. 30, 2023

Top tier = 20 or more CLOs issued between between 2011 and 2022

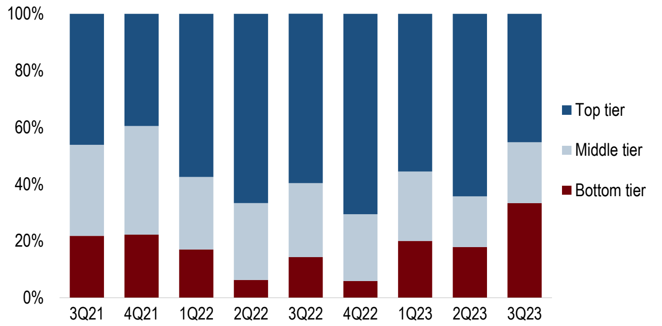
Middle tier = between 10 and 19 CLOs issued between 2011 and 2022

Bottom tier = fewer than 10 CLOs issued between 2011 and 2022

The bottom tier of managers took up a larger share of primary-market deals during the quarter, accounting for 33% of all deal activity compared to 18% in the second quarter.

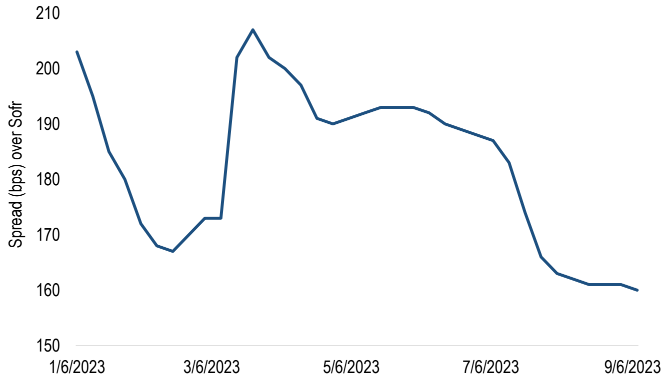
Four debut issuers priced deals during the quarter.

Chart 23: US CLO new-issue count share by manager experience



Source: PitchBook | LCD • Data through Sept. 30, 2023
Top tier = 20 or more CLOs issued between 2011 and 2022
Middle tier = between 10 and 19 CLOs issued between 2011 and 2022
Bottom tier = fewer than 10 CLOs issued between 2011 and 2022

Chart 24: CLO AAA spread in secondary



Sources: Bloomberg; Palmer Square CLO Indices; Barclays Research • Data through Sept. 8, 2023

The tightening spreads have supported a rebound in refinancing and reset activity for outstanding CLOs, with $9.89 billion across 24 portfolios repriced so far in 2023. All but four of those transactions were refinanced or reset since July.

Year to date, seven US CLOs have been refinanced with new terms on existing debt securities totaling $2.7 billion. Seventeen CLOs with a collective notional value of $7.2 billion have gone through a reset.

The lack of refinancing activity in most of 2022 and through the first half of 2023 resulted in a large segment of deals failing to obtain extended periods for call protection and reinvestment.

According to data research and financial tech firm KopenTech, 1,764 outstanding CLOs with a notional value of $838 billion had either passed or were within three months of the conclusion of a non-call end date in August. But the most likely candidates for resets or refinancings were limited to 53 deals, or 2% of the outstanding volume of CLOs.

Most of these deals are among the estimated $20 billion in static and short-term CLOs issued from July-December 2022 that included AAA spreads exceeding 200 bps.

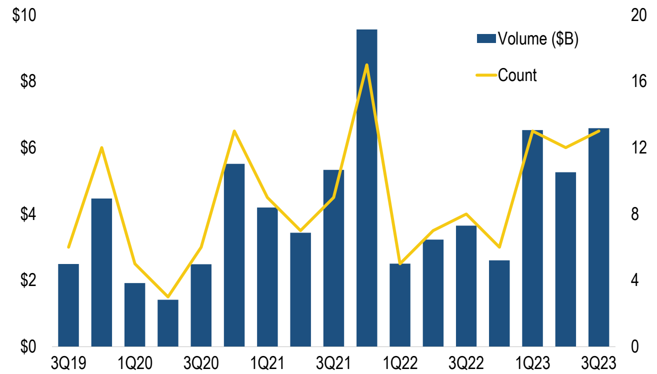
“Barring a massive spread rally, refi and resets will be limited,” KopenTech stated in a research report this month.

Middle market momentum

Middle market and private credit CLO issuance of $6.6 billion across 13 deals was up slightly during the third quarter, aided by a belt-buster $1.33 billion vehicle issued by Golub Capital’s GC Investment Advisors that priced Sept. 25.

The deal was the largest CLO to print — BSL or MM — in more than three years.

Chart 25: US middle market CLO issuance



Source: PitchBook | LCD • Data through Sept. 30, 2023

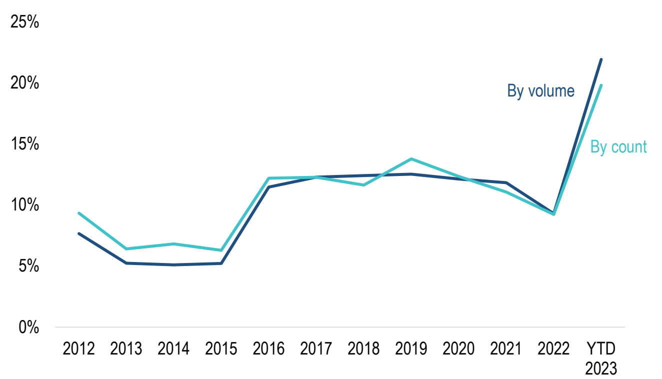
Middle market issuance maintained an approximate 22% market share against BSL CLO activity, adding up to $18.4 billion so far in 2023.

Meanwhile, seven of the 10 largest issuers in the year to date have priced both BSL and middle market/private credit CLOs.

That compared to just two top managers in 2022 that had dual BSL/MM platform activity.

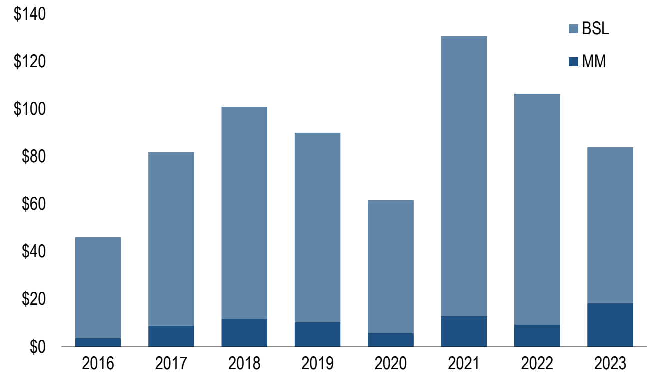
“Private credit continues to grow in general,” said Edwin Wilches, managing director and co-head of PGIM’s fixed-income securitized products. “They will need to come to capital markets. And I think the Street’s just slowly trying to retrain the buy side to look at middle-market deals.”

Chart 26: US middle market CLO share of total CLO issuance



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 27: US CLO volume ($B): January–September



Source: PitchBook | LCD • Data through Sept. 30, 2023

League tables shuffle

Unlike recent years, when historically active issuers like Blackstone and Neuberger Berman dominated deal volume, 2023 has been headlined by issuers of both BSL and middle market CLOs, and as well as new managers that have worked the cost of platform launches (and resulting spread premiums) into their startup costs, according to market observers.

GC Investment is sitting atop the market's league tables as the busiest CLO issuer with six deals totaling $4.32 billion, per LCD data.

Also active were Bain Capital Credit with five deals totaling $2.35 billion, Blackrock with $2.22 billion across five deals and Palmer Square Capital Management with five deals totaling $2.22 billion.

LCD has tracked seven first-time issuers in the year to date, including four during the third quarter (Katayma Loan Management, Wellington Management CLO Advisors, Atlantic Avenue Management and Warwick Capital CLO Management).

Noted league table leaders from previous years like Blackstone, PGIM, and Credit Suisse have been more selective in 2023 amid the difficult pricing conditions that have made deals for most of the year unattractive for equity returns.

Blackstone, which priced 15 deals totaling $8.3 billion last year, has limited itself to just one primary market deal in 2023 (the $599 million Juniper Valley Park CLO) and priced none during the third quarter.

Neuberger Berman Loan Advisors (which priced six deals in 2022 totaling $3.4 billion) was on the sidelines for 2023 until pricing its first transaction of the year in August.

But its $404.7 million Neuberger Berman LaSalle Street Lending CLO 1 was underwritten outside of the standard broadly syndicated network buoying the CLO market.

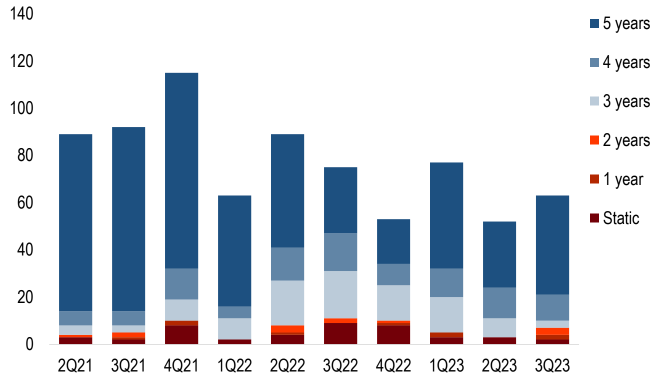
Instead, co-arrangers SMBC Nikko Securities and Citigroup launched Neuberger Berman's new LaSalle Street platform as a shelf to structure portfolios of "lightly" syndicated loans underwritten by a limited network of large lenders.

Deal terms

The share of deals with fully standard five-year reinvestment periods also widened in the latest quarter from second-quarter levels, rising to 42 by count from 28 in the prior period.

Eight deals were priced with limited reinvestment periods of three or fewer years in the latest quarter, while two CLOs were priced as static deals.

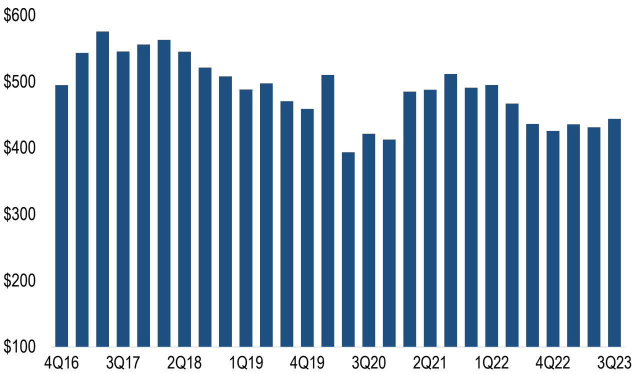
Chart 28: US CLO count by reinvestment period



Source: PitchBook | LCD • Data through Sept. 30, 2023

The dearth of new loan supply limited the average deal size for CLOs in the third quarter to $430 million (excluding Golub Capital's $1.33 billion vehicle), the lowest reading since the fourth quarter of 2022, and down from $431 million in the second quarter. Including Golub's mega deal, the third-quarter average was $444 million.

Chart 29: US CLO average vehicle size ($M)



Source: PitchBook | LCD • Data through Sept. 26, 2023

Loan supply

With net supply at a near standstill, the pool of outstanding loans held in CLOs is likely to shrink due to redemptions.

This quarter, a trio of large loans left the syndicated market and moved into private credit.

The average bid price of US loans rose in the third quarter to 95.59 as of Sept. 28, from 94.29 on July 1, based on the Morningstar LSTA US Leveraged Loan Index. CLO AAA spreads tightened in the secondary market to 160 bps on Sept. 8, from 187 bps in the first week of July, based on CLO indices from Palmer Square Capital Management.

PGIM's Wilches said one reason for the tight loan supply is the loss of some share of speculative-grade borrowers to the high-yield bond market.

According to LCD's data, $20.4 billion of institutional loans have been repaid with high-yield bond proceeds so far this year, vs just $3.2 billion in all of 2022.

Defaults/Downgrades

Interest rate hikes by the Fed have weighed heavily on weaker corporate borrowers in 2023, and that trend is not likely to dissipate.

"We expect lower rated issuers to struggle in the coming months as they contend with a double-whammy of interest rate pressures and worsening operating performance as the economy slows," Moody's said in a research report on Aug. 18.

Of keen interest to managers during 2023 has been limiting exposure to CCC rated borrowers to deflect risk on defaults that could trip up credit quality requirements on deals.

According to S&P Global Ratings, the average BSL CLO CCC bucket increased in August, and about one-third of 533 CLOs tracked in S&P's US index exceeded the 7.5% threshold for CCC rated issuers as of Aug. 31

CLO metrics remain stable with the average overcollateralization test cushion at 4% as of Sept. 14 (compared to 4.8% a year ago), according to Fitch, while just 1% were failing to meet junior OC test requirements — resulting in some note amortization in certain deals.

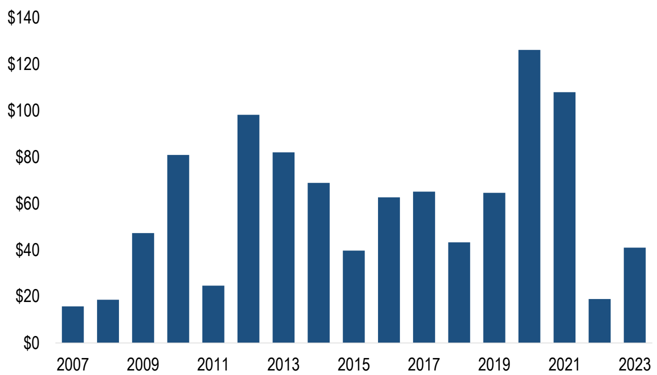
— Glen Fest

High-yield issuance pace quickens, blistering costs persist

An outburst of September high-yield issuance — including the biggest output for any two-week period since November 2021 — fleshed out otherwise lean summertime volume late in the third quarter, though activity remained heavily weighted to issuers operating under ticking clocks to secure fresh funds.

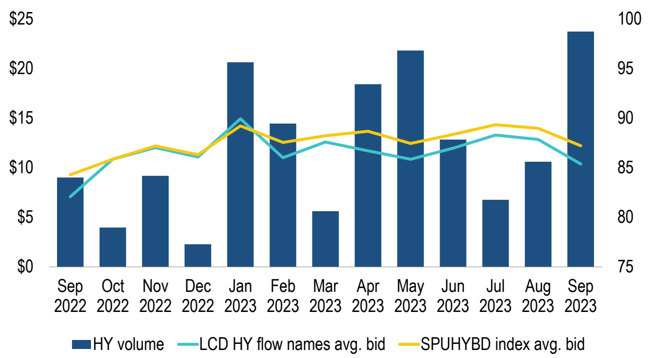
Meanwhile, the high-cost environment and range-bound prices continue to keep opportunistic borrowers mostly at bay.

Chart 30: US high-yield bond issuance ($B), Q3



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 31: Monthly HY issuance volume ($B) and secondary pricing

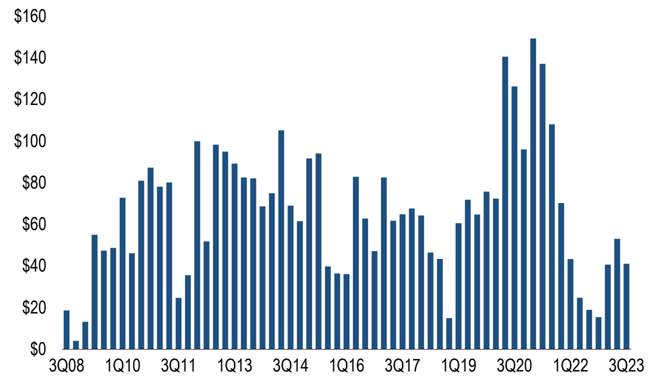


Sources: PitchBook | LCD; S&P US High Yield Corporate Bond Index • Volume data through Sept. 30, 2023
Secondary pricing data through Sept. 28, 2023

Issuance for the quarter topped $41 billion, weighted to deals clearing the market post Labor Day.

That padded an ongoing revival in activity year-over-year, after volume in the third quarter last year ($18.9 billion) was the lowest for the period since 2008.

Chart 32: US high-yield bond volume ($B), quarterly



Source: PitchBook | LCD • Data through Sept. 30, 2023

Volume of $135 billion over the first three quarters pulled further ahead of last year's glacial issuance pace amid rapid Fed rate hikes.

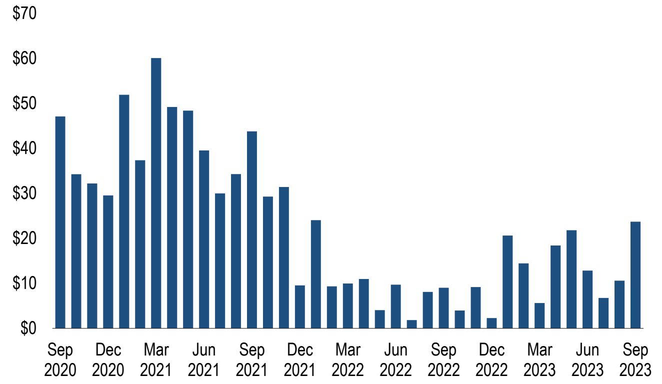
Issuance swung from an all-time high of $464.5 billion in 2021 to a 14-year low for annual volume of $102.3 billion in 2022.

As well, September 2023's issuance marked the seventh double-digit monthly total of the first nine months this year.

Last year, there were just two double-digit monthly totals, in January and April.

September also featured the most consistent activity since the final quarter of 2021, as issuers completed new-issue pricings during 75% of market sessions.

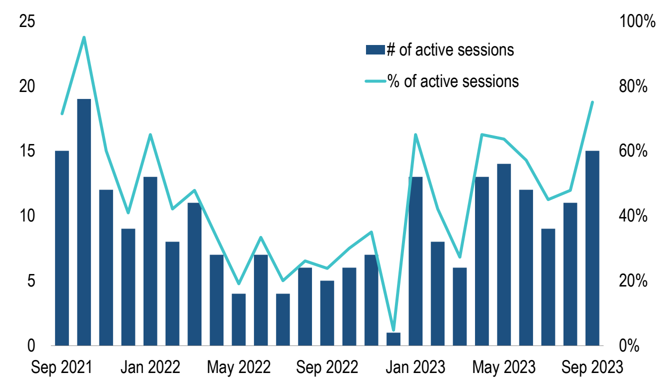
Chart 33: US high-yield issuance ($B), monthly



Source: PitchBook | LCD • Data through Sept. 30, 2023

In September 2022, issuers utilized less than 24% of the month's available sessions.

Chart 34: Active HY bond sessions per month



Source: PitchBook | LCD • Data through Sept. 30, 2023

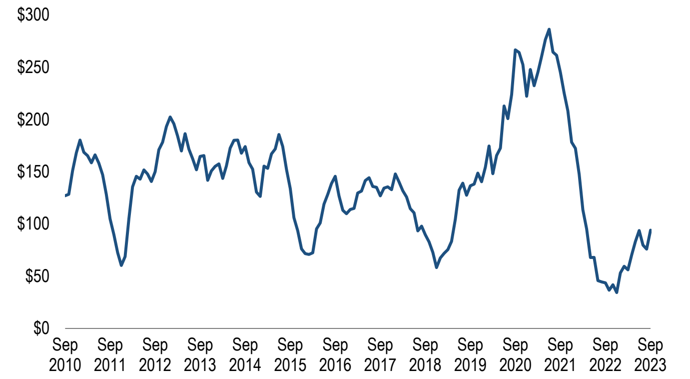
But while issuance may be rising from last year's low base, there are plenty of cracks still evident in this year's foundations: 1) sputtering liftoff; 2) blistering costs; 3) urgent needs, heavy pledges; 4) limited opportunism; 5) shorter maturities. We will examine each in turn.

Sputtering liftoff

Looking at issuance on a six-month rolling basis, volume this year has consistently bested the $34.3 billion inked over the back half of 2022, which marked the weakest output since the Global Financial Crisis.

Still, the $94 billion through Sept. 30 was more than $200 billion less than the all-time peak ($286 billion) recorded over the first half of 2021.

Chart 35: Rolling 6-month US high-yield bond issuance ($B)



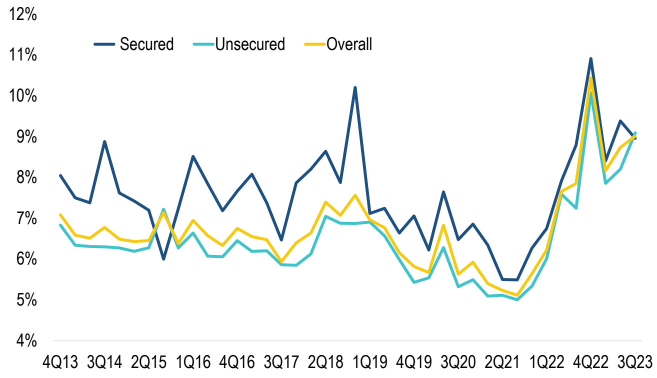
Source: PitchBook | LCD • Data through Sept. 30, 2023

Blistering costs

Average clearing yields were pointed higher in the third quarter, at 9.01%, from 8.73% in the second quarter and 8.16% in the first quarter. While down from a decade high of 10.44% in the fourth quarter last year, costs remain substantially elevated versus a 5.32% annual average in 2021, including an all-time low quarter reading at 5.11% in the third quarter that year.

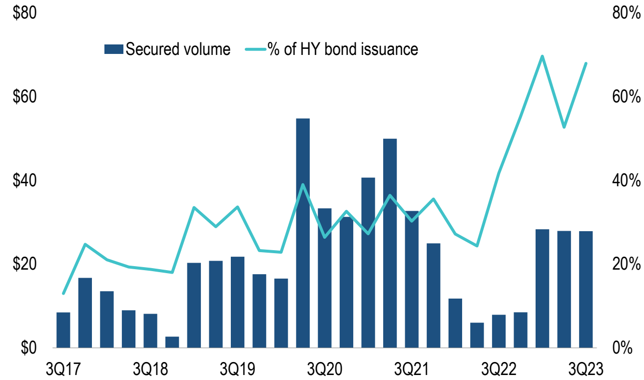
The third-quarter average includes **Viasat**'s $733.4 million of 7.5% senior notes due 2031, which priced at an OID of 65 to yield 15.423%, or the highest clearing yield for any cash-pay senior issue since January 2010, according to LCD. Excluding Viasat, the average yield is 8.90%, still elevated relative to the first half of this year.

Chart 36: New-issue yields for US high-yield bonds



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 37: Secured HY bond volume ($B)



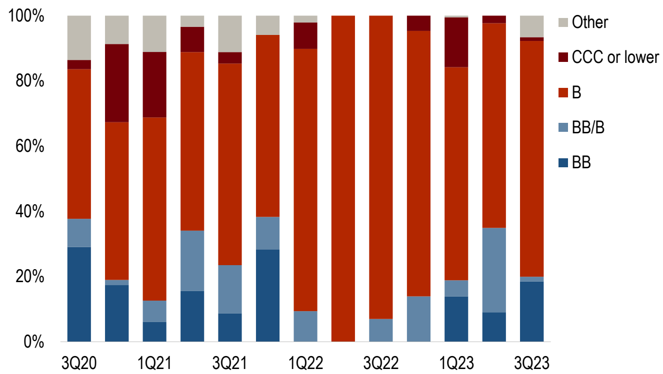
Source: PitchBook | LCD • Data through Sept. 30, 2023

Unsecured high-yield bonds with highest yield post GFC

Borrower name	Trade date	Sector	Yield
Ryerson Inc	Jan-10	Metals & Mining	16.32%
ViaSat Inc	Sep-23	Telecom Equipment	15.42%
Bluewater Holding BV	Oct-22	Aerospace & Defense	15.30%
Digicel Ltd	Mar-09	Telecom	15.00%
Station Casinos Inc	Feb-12	Gaming & Hotel	14.94%
Rue 21 Inc	Oct-13	Retail	14.90%
Nielsen Company	Jan-09	Services & Leasing	14.50%
Intertape Polymer Group Inc	Jun-22	Forest Product	14.36%
Wesco Aircraft Hardware Corp	Nov-19	Aerospace & Defense	13.76%
Kansas City Southern Inc	Mar-09	Transportation	13.75%
Warner Music Group	Jul-11	Entertainment & Leisure	13.75%

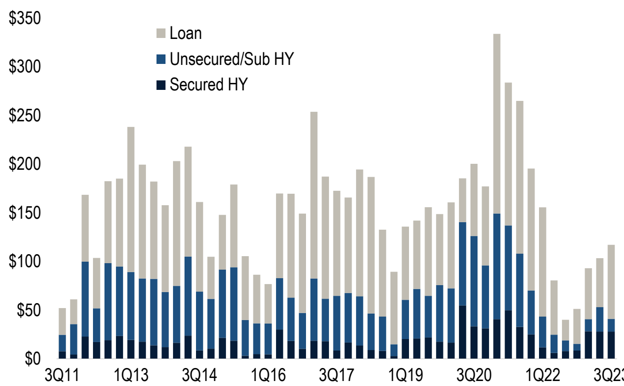
Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 38: Secured high-yield bond issuer rating (by volume)



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 39: US leveraged finance volume ($B)



Source: PitchBook | LCD • Data through Sept. 30, 2023

Urgent needs, heavy pledges

Atypically high amounts of issuance this year include collateral backing, largely from borrowers at the lower end of the credit spectrum addressing M&A/LBO funding deadlines or looming refinancing needs.

For the year to Sept. 30, the volume of new-issue bonds secured by collateral ($84.1 billion) had already more than doubled 2022's $34.2 billion full-year total. By issuer rating, nearly 72% of the secured bonds issued in the third quarter stemmed from single-B borrowers.

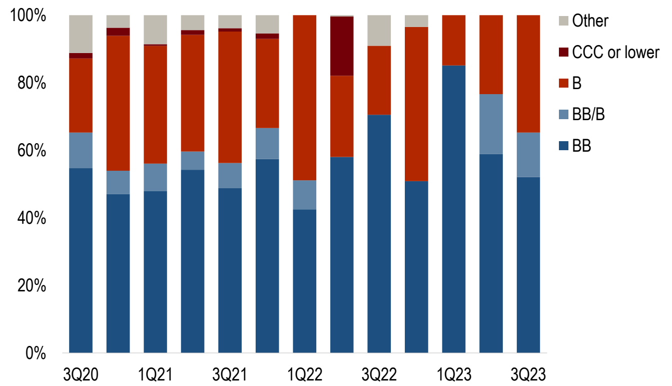
Limited opportunism

Even as secured volume inflates, unsecured issuance — which traditionally is the fast lane for high yield, particularly for seasoned and higher-rated borrowers — remains at historic lows.

Unsecured volume accounts for just 37% of total supply this year, a precipitous drop from nearly 75% last year.

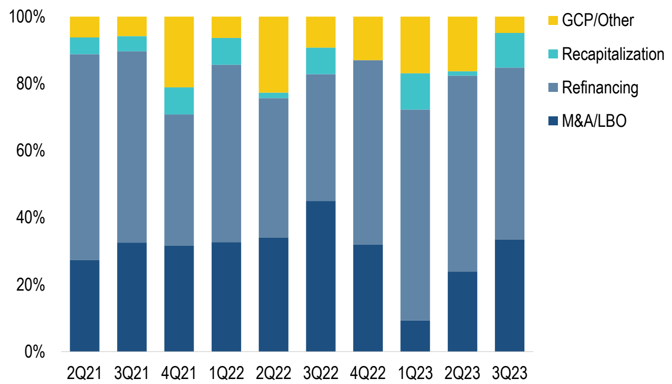
The prior low share for unsecured issuance, post the GFC, was 67% in 2019.

Chart 40: Unsecured high-yield bond issuer rating (by volume)



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 41: US high-yield use of proceeds (by volume)



Source: PitchBook | LCD • Data through Sept. 30, 2023

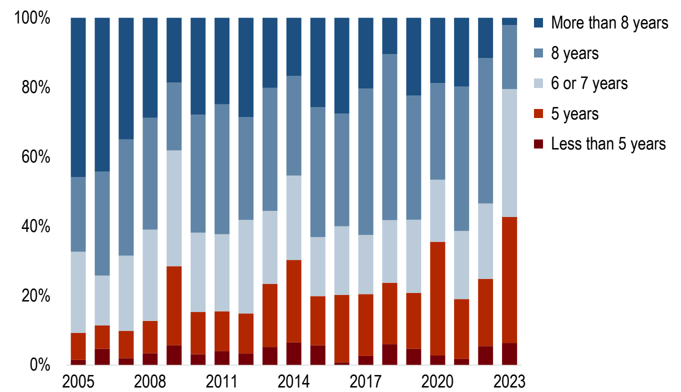
Shorter maturities

High costs are also deterring issuers from stretching their funding horizons, which may contribute refinancing risks in the years to come.

Across 190 tranches of new bonds priced this year, just four have carried a maturity date of longer than eight years, which is — by far — the slimmest volume of long-dated deals on record.

In 2021, for instance, there were 114 tranches of long-dated deals on the books by Sept. 30, as issuers pounced on historically low funding costs.

Chart 42: US HY bond tenor share by count, Jan. 1 – Sept. 30



Source: PitchBook | LCD • Data through Sept. 30, 2023

Deals dated five years or less, conversely, have accounted for just over 43% of all tranches placed so far this year, which tops the prior all-time high for that YTD span (36%), which was recorded in 2020 as issuers bridged cash flow disruptions from the pandemic with generally shorter-dated instruments.

Such shorter-dated deals accounted for about a quarter of last year's placements, and just 19% of the deals priced in 2021.

— John Atkins

LCD US Leveraged Finance Survey: Funds continue to favor private credit

The leveraged loan trading market has been on a tear this year — the Morningstar LSTA US Leveraged Loan Index has achieved equity-like returns in 2023 as interest rates have soared to levels not seen since before the Global Financial Crisis.

On the flip side, this performance is supported by a languishing new-issue market, which, in running at 14-year lows, has taken a back seat to secured funding in the high-yield market, and increasingly, private credit.

In light of the impressive secondary market rally, and with borrower companies increasingly turning to private credit to finance transactions that in the past would have been done in the syndicated loan market, LCD asked a roster of buyside, sellside and advisory accounts for their view on what to expect going forward.

Will fund allocations targeting leveraged credit favor private credit, or broadly syndicated markets? Will credit conditions tighten, or ease?

Some of the headlines:

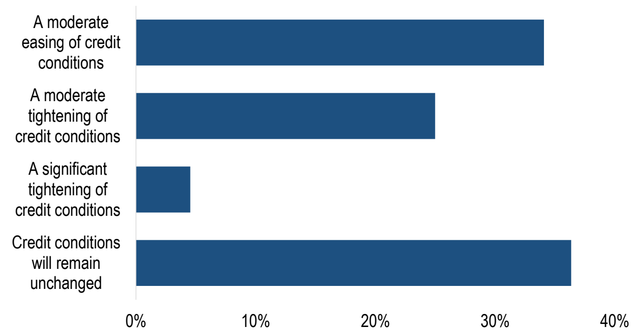
- Inflation is not expected to fall below the 2% Fed target in the year ahead;
- Leveraged credit fund allocations are expected to favor private credit;
- Leveraged loans are projected to outperform high yield in Q4;
- The loan default rate is expected to fall between 2.50-2.99% a year from now.

See also our [interactive graphic of the survey results](#).

In terms of credit conditions for leveraged companies funding via broadly syndicated loans and high-yield bonds in 4Q23, 36% of respondents said they expect credit conditions to be unchanged, 34% said they expect a moderate easing of credit conditions, and 25% saw a moderate tightening in the final leg of 2023.

Sentiment here has shifted. In the Q2 reading, nearly half (48%) of survey respondents saw a moderate tightening of credit conditions for leveraged companies funding via broadly syndicated loans and high-yield bonds in the 2H23.

Chart 43: What credit environment do you expect leveraged companies to face in 4Q23?



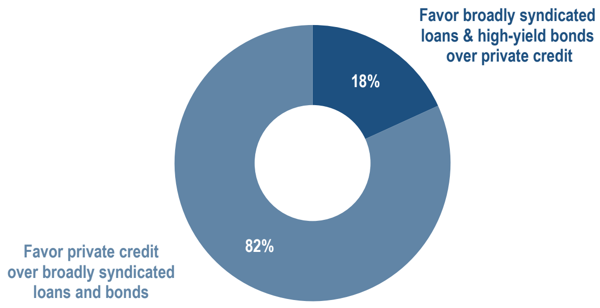
Source: PitchBook | LCD • Data through Sept. 25, 2023

In a new survey question, respondents were asked, in the year ahead, whether they expect fund allocations targeting leveraged credit to favor broadly syndicated loans and high-yield bonds over private credit, or vice versa.

Perhaps unsurprisingly, given that private credit has been taking market share from the broadly syndicated loan market at an accelerated pace over the past several years, an overwhelming majority, at 82%, believe fund allocations targeting leveraged credit will favor private credit over broadly syndicated loans and bonds.

The results indicate that the trend (as LCD data shows) of private credit transactions financing loans that in the past would have been done in the syndicated loan market — including refinancings and buyout deals — will continue to accelerate in the year ahead.

Chart 44: What do you expect fund allocations targeting leveraged credit to favor?



Source: PitchBook | LCD • Data through Sept. 25, 2023

Nevertheless, as one loan underwriter commented, "Banks hit the brakes in [the first half of the year] and [will now] have pressure to add assets so volume will increase, credit conditions will loosen, and leverage will creep up."

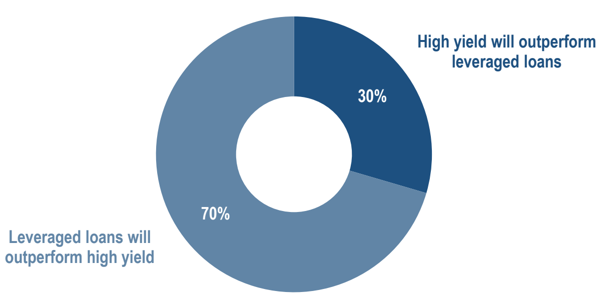
Amid what has been a stellar year for leveraged loans in the secondary market, a significant majority believe floating-rate loans will outperform high-yield bonds in the fourth quarter.

At the time of polling, the year-to date return of the Morningstar LSTA US Leveraged Loan Index had crossed an impressive threshold, topping 10%. It has been the strongest year for the asset class since 2009, when the leveraged loan market was recovering from the steep losses of the Global Financial Crisis. High-yield bonds, by comparison, had returned 6.45% as of Sept. 22.

Leveraged loan returns have surged as interest rates climbed to levels not seen since before the GFC, contributing to significant interest returns for the floating-rate asset class, and as the limited new-issue supply has supported secondary prices.

In terms of survey results, 70% said leveraged loans would continue to outperform high-yield bonds in the fourth quarter, up from 52% in the Q2 read.

Chart 45: Will leveraged loans or high-yield bonds outperform in 4Q23?

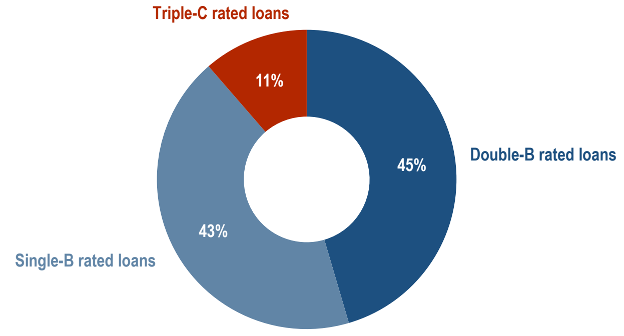


Source: PitchBook | LCD • Data through Sept. 25, 2023

In another new question this quarter, LCD asked respondents which ratings bracket in leveraged loans will outperform in Q4. Results were evenly split between double-B rated loans (45%), and single-B rated loans (43%). Only 11% said triple-C rated loans would outperform.

This would be a reversal of recent trends. Triple-C rated loans, which account for roughly 7% of the index, were up 2.01% in August, the fifth consecutive monthly gain. In the year to date this cohort has gained 13.23%, putting it far ahead of double-B and single B sub-indices, and reversing the 12.24% loss in 2022.

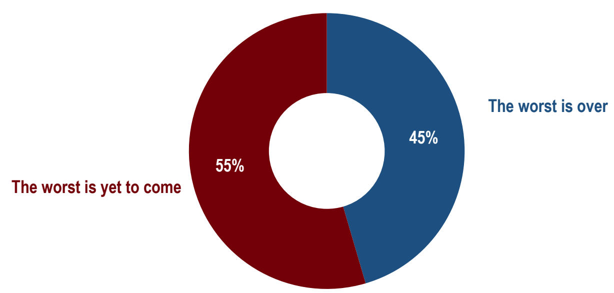
Chart 46: Which rating bracket do you predict will outperform in 4Q23?



Source: PitchBook | LCD • Data through Sept. 25, 2023

Respondents remained steadfast in their view on market volatility, with 55% believing that the worst of the volatility is ahead of us, in line with 57% in the Q2 reading, but down from 80% in Q1.

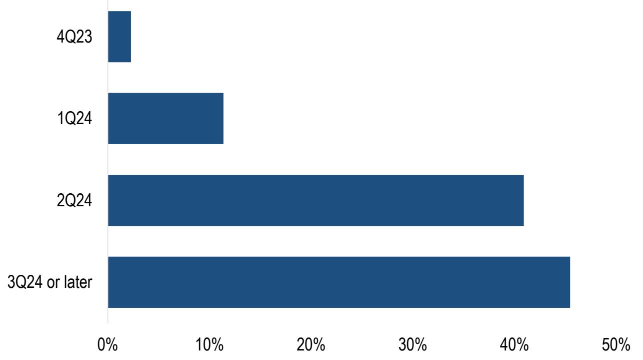
Chart 47: What is your stance on volatility in the leveraged credit markets?



Source: PitchBook | LCD • Data through Sept. 25, 2023

As for when Fed policy makers will begin cutting rates, 45% of survey respondents said the Fed would not cut rates until the third quarter of 2024. In the Q2 reading, 55% said the Fed would not cut rates until at least the second quarter of 2024.

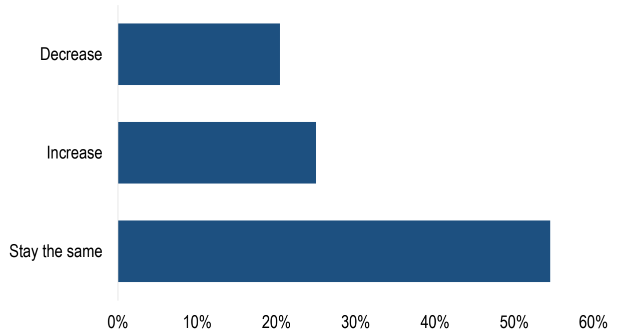
Chart 48: When do you expect the Fed will begin cutting rates?



Source: PitchBook | LCD • Data through Sept. 25, 2023

Regarding leverage multiples for buyouts, 55% of respondents said leverage will remain at similar levels in the fourth quarter. A year ago, 60% of respondents said they expected leverage multiples of buyouts to decrease.

Chart 49: What do you predict for the average multiples of buyouts in 4Q23?



Source: PitchBook | LCD • Data through Sept. 25, 2023

Despite an improving macro backdrop, with expectations growing for a soft landing and lower inflation, and despite rallying secondary market valuations, respondents remain wary of deteriorating fundamentals impacting credit portfolios.

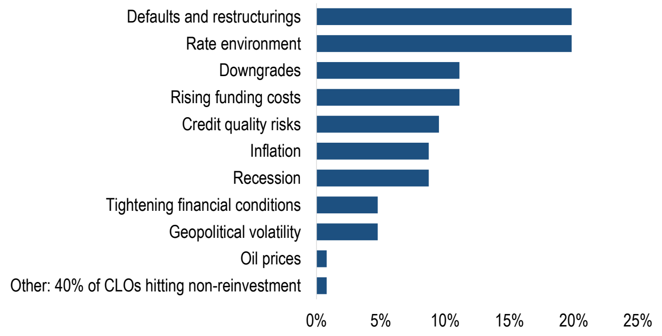
Results show survey participants, in equal measure at 20%, believe defaults & restructurings and the rate environment will most likely impact credit portfolios in the next six months.

Downgrades and rising funding costs followed, each at 11%.

In the Q2 survey, defaults and restructurings was the top answer, at 20%, after receiving just 5% of votes in the Q1 survey.

The rate environment took second billing in Q2, at 15% of the total votes.

Chart 50: Which of the following will most likely impact leveraged credit portfolio performance over the next six months?



Source: PitchBook | LCD • Data through Sept. 25, 2023

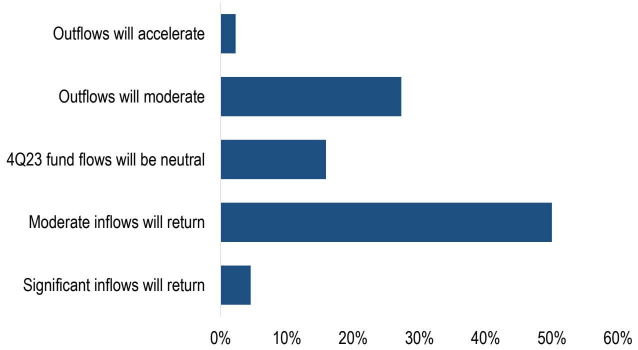
To gauge expectations on the technical landscape in the quarter ahead, LCD asked market professionals their views regarding retail demand for leveraged loans.

The results showed significant improvement in sentiment, with 50% expecting moderate inflows to return in the fourth quarter.

In the Q2 survey, 47% said they expected outflows would moderate in the third quarter, and 28% expected moderate inflows to return.

As it turned out, a modest $91 million inflow to ETF and loan mutual funds in August broke a 15-month streak of net withdrawals from the asset class, with the pace of withdrawals easing throughout the quarter, according to Morningstar data.

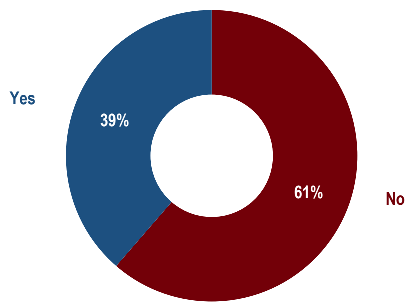
Chart 51: What are your expectations for leveraged loan investor fund flows in 4Q23?



Source: PitchBook | LCD • Data through Sept. 25, 2023

Reflecting expectations for the return of market volatility, 61% said they believe the Morningstar LSTA US Leveraged Loan Index has not hit its lows of the cycle.

Chart 52: Has the Morningstar LSTA US LLI hit its lows of the cycle?

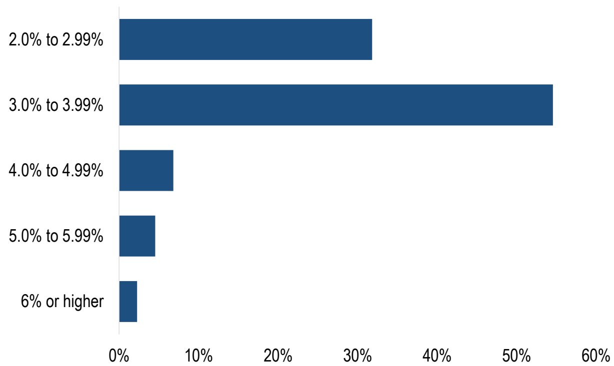


Source: PitchBook | LCD • Data through Sept. 25, 2023

Regarding inflation, the majority (55%) of respondents expect it to be 3.0-3.9% a year from now. Almost 32% think inflation could fall to 2.0-2.9%.

No respondents said they expected inflation to fall below the Federal Reserve's 2% inflation target.

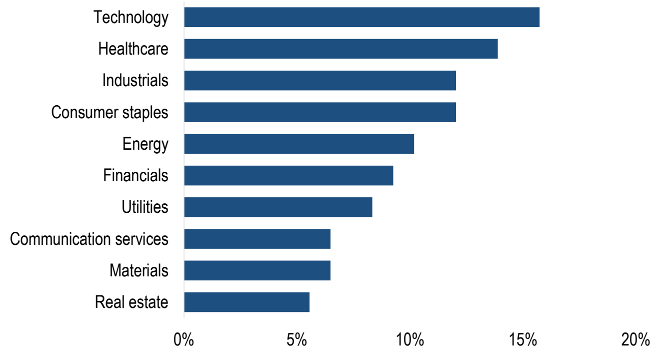
Chart 53: Where do you expect inflation to be one year from now?



Source: PitchBook | LCD • Data through Sept. 25, 2023

Polling shows Technology and Healthcare — the two sectors with an outsized index share and share of distressed loans — also took the most votes for sectors that would most likely outperform in the next six months, with a respective 16% and 14% of responses.

Chart 54: Which market sectors will outperform in the next six months?



Source: PitchBook | LCD • Data through Sept. 25, 2023

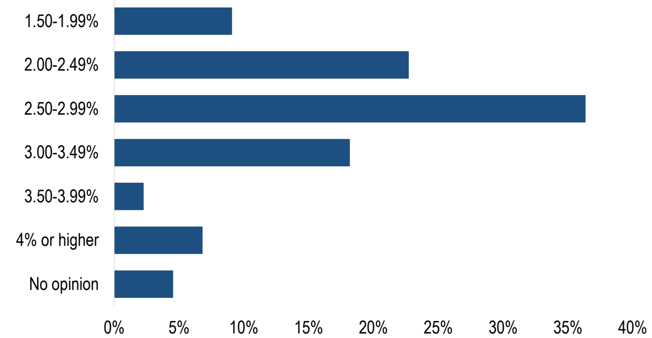
Finally, with leveraged loan default rates rising roughly 100 bps over the last 12 months, LCD once again asked respondents where they think the default rate will be one year from now.

Their 12-month forward forecast for leveraged loan defaults was unchanged from the Q2 survey, at between 2.5% and 2.99%.

At the 2.75% midpoint, this would push the loan default rate slightly above its 2.70% historical average.

At the end of August, the default rate by amount of the Morningstar LSTA US Leveraged Loan index dipped 20 bps, to 1.55%, from 1.75% in July.

Chart 55: What do you predict the US loan default rate will be one year from now (9/30/2024)?



Source: PitchBook | LCD • Data through Sept. 25, 2023

— Rachelle Kakouris

Opportunistic deals on the horizon in Europe

European leveraged finance markets ended the third quarter in the healthiest state since Russia's invasion of Ukraine in February 2022. Going into the fourth quarter, however, the lack of M&A will challenge supply to meet the level of demand, which could open the way for more opportunistic supply to follow.

Worldpay promised to be the main event for the autumn and the group showed what is now possible for well-structured sub-investment-grade borrowers as it closed the $8.4 billion drawn financing backing its GTCR carve-out in a week. The final deal, however, was heavily weighted toward the US, leaving a €500 million term loan and a £600 million bond for Europe.

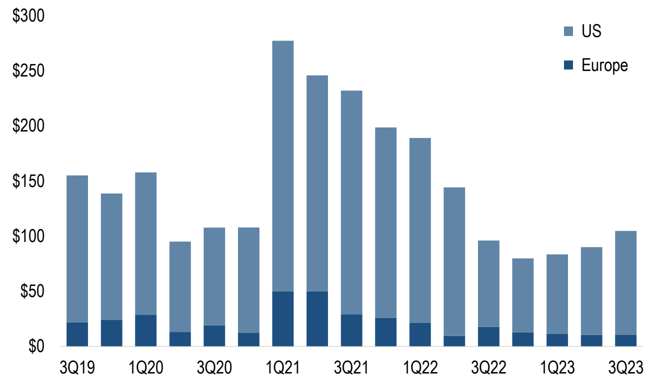
These tranches were both smaller than initially outlined in Europe, though this was not down to any lack of demand for the euros from the BB/Ba3/BB rated name. On the loan, final pricing of E+325 at 99.50 was tighter than the E+350-375 and 98.5 guided at launch, and suggests levels that are probably only around 50 bps or so away from pre-war levels. "Worldpay has the type of scale and recurring revenues that make it ideal for leverage," said one source.

But it's not just Worldpay. Pricing on Sept. 25 of the €700 million, non-fungible add-on from **Cegid** closed at E+375, with a 99.5 OID, and brought a margin level unseen in Europe for a fully syndicated B-flat style credit since **Dorna** closed a €975 million recap in early February 2022. Final pricing for Cegid compares with initial margin guidance of E+425-450, and is just 25 bps away from the firm's core €800 million term loan that allocated in July 2021, at 99.

B+/B2 rated Cegid is a strong and popular name, so it might well have been able to push the margin to E+325 at the height of the market before Russia's invasion of Ukraine. The war in Ukraine continues, but with the rate-tightening cycle in the Eurozone and UK seemingly at or near its top, risk appetites are returning. The average bid in the Morningstar European Leveraged Loan Index (ELLI), for example, has been on a near unbroken upward trajectory since the summer.

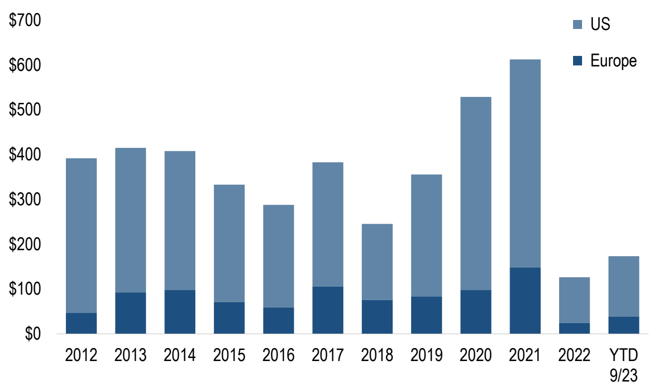
For loans, this strength is driven by technical factors as much as it is based on any fundamental faith in the global economic outlook. Seven CLOs for a total of €2.8 billion priced in September, with a further 15 said to be lining up to print before year-end.

Chart 56: Global new-issue loan volume ($B), quarterly



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 57: Global new-issue bond volume ($B), annual



Source: PitchBook | LCD • Data through Sept. 30, 2023

On the other side of the equation, primary volume — as it has done all year — continued to disappoint. Total institutional loan supply (excluding extensions) in Europe stands at €20.4 billion for the year through September. In bonds, LCD counted 91 deals for €35.95 billion in Europe to the end of September, up from 49 deals for €17.5 billion by the same point in 2022.

September featured a few other M&A deals in market, including the €600 million term loan backing PAI's buyout of **Infra Group** that closed at E+400 and 99.50, in from E+450 at 99.50 at talk. Also out is the €350 million term loan backing Apax and Fremman Capital's buyout of **Palex Medical**.

But bankers agree there is not a significant stock of LBO supply ready to follow, and the majority of the pipeline will be out or through market by early October.

What's more, many of the expected September processes have been pushed out to January. One banker said the total M&A pipeline going into the third quarter stood at no more than €2 billion, which compared to €40 billion plus in September 2021. "It feels like it's going to be a grind into the new year," said one manager.

There are still extensions. These have led activity all year, tallying €32.1 billion this year through September. Extensions have addressed much of the refinancing need through to 2025, though some chunky examples still remain.

Sponsors have also started to look further out, and Blackstone-backed building material distributor **BME**, for one, launched a partial extension of its term loan B due October to December 2029 in September. The construction and building materials sector delivered mixed results through the second quarter, so investors agreed the move to address a 2026 maturity — at least in part — made sense from a risk management perspective. Other borrowers with 2026 requirements may be slower to move, and the focus is still likely to be on the remaining 2025 needs, sources reckon.

In high-yield, bond-for-bond refinancings dominated activity in the quarter, with companies mostly targeting bonds due 2024 and 2025. There is also more evidence of higher-rated issuers looking to move away from loans, amid increasingly favorable funding costs for bonds.

For example, BB/Ba3 rated Dutch rental-equipment group **Boels** in September priced a €400 million debut European high-yield offering of long-five-year secured notes at 6.25% to repay and cancel a €200 million portion of its term loan due February 2027, and repay roughly €132 million in revolver drawings. This deal marked the first instance of the refinancing of a syndicated institutional term loan with a debut euro high-yield bond since **Polynt** priced a €1.3 billion cross-border bond deal back in October 2021 to refinance loans following the takeover of the group by Black Diamond, according to LCD.

Refinancings are unlikely to be enough to feed demand in either bonds or loans, so opportunistic moves are likely. For Cegid, the deal is the first significant dividend request for European loans since February, when **Eviosys** and **Ineos Quattro** both priced. Sponsors say they are now working with banks on how to generate deal flow in the absence of near-term M&A, and other dividend deals will follow.

Repricings are also brewing, and **Nord Anglia** closed the first European deal in more than 19 months on Sept. 21. This trimmed 50 bps from the private school group's euro margin to E+425, and it allocated at par. It was also followed swiftly by **Galileo Global Education**, which went further to trim 75 bps of a July 2028 term loan to E+400.

This suggests that anything trading well in secondary and paying E+450 plus could be vulnerable for a repricing over the next couple of months. These deals will keep the lights on for investment banks, but won't help CLOs battling to make the arbitrage work. Here investors put the WACC for an average new CLO at roughly 260 bps, and when putting on top the usual required 200 bps of excess spread the economics look challenging for managers, especially with a secondary loan market where an increasing proportion of performing names are quoted at par or higher.

LCD data shows the average spread and yield for euro-denominated single-B deals finishing the quarter at E+455 and 9.13%, which compares with E+453 and 9.11% at the end of the second quarter. OIDs are moving from an average of 97.52 for July to 98.08 for September.

Similarly in bonds, yields for both single-B and double-B rated newly issued European deals fell in the three months to Sept. 15, compared with the second quarter. The decline is more notable for the more interest-rate sensitive double-B segment, where average yields stood at 6.13% — the lowest level for this cohort since the second quarter of 2022, when markets effectively closed.

— David Cox

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