Invesco Senior Secured Loans

European Loan Market
Snapshot

Monthly European loan market update: July 2016 (covering June 2016)

Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") posted a total return of -0.60% in June (see Figure 1) with 0.39% o f interest being more than offset by 0.99% o f price decline.[1] The negative performance came entirely in the final week of the month, as the market reacted to the UK's June 23rd vote to leave the European Union.
- While the decline in the secondary market suggests Investors were caught off guard by the Referendum result, the reaction was orderly and the decline in prices fairly muted, particularly in European denominated senior secured loans (SSLs), as they priced-in the heightened economic and political uncertainty. SSLs remain well bid by recently priced Collateralized Loan Obligations (CLOs), being forced to buy in the primary and secondary markets to complete their ramp up. We note that in April, May and June combined, there were €4.6 billion of CLOs issued, well above the average three month period of €3.4 billion over the last twelve months – in fact it was a record quarter for CLO 2.0 issuance.[2]
- Predictably, the reaction in sterling denominated loans was more pronounced. For example, Investor's increased confidence in a 'Remain' outcome resulted in sterling denominated loans within the CS WELLI rallying 3.26% in the w eek before the Referendum, only to decline by 7.90% in the final week of June.[1] The sterling returned -0.48% in June; no twithstanding the intra-month volatility, it's overall return was in-line with European denominated SSLs of -0.45%. [1]
- New primary loan issuance was down 50% y ear-over-year in June despite arranger's best efforts to close deals before the Referendum. Two main obstacles stood in their way. First, Sponsors began increasingly pricing in a 'Remain' vote in tandem with the market, thus believing they could secure better pricing on new deals after the result. Secondly, a significant proportion of the investor base began making commitments subject to a favorable 'Remain' vote. This is not to say that some deals did not get done. Banks for one, remain very competitive sources of capital. Some institutions also chose to play along in order to ramp up before the summer lull. However, the balance of deals are still in the process of sounding out investors for post-Brexit terms. UK centric borrowers and sterling based/denominated issuers will likely be forced to offer significant concessions to re-engage the market.
- The general risk off tone weighed on the riskiest end of the ratings spectrum (CCC), and we also saw a reoccurrence of a theme seen earlier in the year where tighter priced loans (typically BB rated) underperformed their higher yielding (B rated) counterparts. This is a result of CLO managers having to protect their funds' arbitrage (excess spread earned on investments versus that paid on liabilities) given the widening market. Single B rated loans declined by 0.61%, wher eas BB and CCC declined by 0.9% and 2.64% r espectively.[1]
- At the industry level, the negative sentiment was widespread. Whilst naturally volatile sectors such as Energy were down 2.68%, e ven traditionally more reliable segments such as Cable dropped 1.62% giv en their typically more liquid, tightly priced nature.[1]

Fundamentals

- The trajectory of the Eurozone has been put into focus following the Referendum result. The majority of research analysts and economists have lowered their GDP growth expectations for both continental Europe and even more so for the UK. There was already evidence of delayed corporate investment and consumer spending coming up to the vote and are likely to be further restrained given the lack of clarity on what the new relationship between the European Union and UK will be and how long it will take to negotiate. Positively, the European Central Bank remains supportive with the Corporate Sector Purchase Programme (CSSP) active.[3] The Bank Of England has indicated that they will also do whatever it takes to stabilize the markets. Similarly, the UK Treasury is also indicating some forthcoming simulative fiscal policy.
- There were no new defaults in June 2016. Accordingly, the trailing 12 month default rate on the CS WELLI was 0.58% at the end o f the month.[1]

Technicals

- Primary institutional loan issuance reached €2.6 billion over 13 deals in June, a 49% decline on the same month last year as the Brexit, and the resulting 'Leave' vote took its toll on volumes. As a result, year-to-date volume of €21.1 billion (82 deals), resulted in a slight (2%) incr ease as compared to the same six months in 2015.
- Notable loan deals in syndication in the period included:
  - €397 million SSL facilities to support PAI's acquisition of Ethypham, the French headquartered developer, manufacturer and marketer of pharmaceutical products. The tranche is priced at E+5.00% and is sued at €0.995.[2]
  - €250 million SSL facilities to support Investindustrial's purchase of Artsana, the Italian headquartered owner of Childcare brands such as Chicco. The tranche is priced at L+4.50% and issued at €0.99.[2]
  - €230 million SSL facilities to support Advents' refinancing of Unit 4, the Netherlands based cloud-focused software group. The tranche priced at E+4.50% and is sued at €0.995.[2]
- CLO formation in June totaled €1.6 billion issued (4 deals), around twice the €0.8 billion (2 deals) issued in the same month last year. In addition, June CLO issuance was higher than the €1.1 billion average issuance per month over the last 12 months. Discount margins of CLO liabilities widened considerably following the Referendum vote. For example, pre-Brexit BB discount margins were 6.8-6.9% and widened t o 8.00-8.25% immediat ely following the result. They gradually tightened to 7.25-7.50% t owards the very end of the month. Year-to-date CLO volumes stand at €7.2 billion (18 deals), €0.35 billion less than the same period in 2015.[2]
- Based on our understanding of open warehouses and current spread levels on liabilities, we expect around €10 billion of CLO issuance this year, down on the €13.6 billion seen in 2015.[2]

Valuations

- We believe average statistics over a three month basis do not capture the impact of Brexit that occured at the end of the month. In this regard, the market is in the process of finding a clearing level for new deals. We believe it is likely to be a 0.50%-1.00% pr emium to pre-Brexit levels. In keeping with previous months' Invesco European monthly loan market update commentaries, we have provided the usual statistics in the following paragraphs.
- The average lagging three month new issue institutional loan spread was EURIBOR + 4.78%, 15 basis points (bps) lower than May. All-in-Yields were down (0.33%) t o 5.46% due t o both the lower spread as well as a lower Original Issue Discount (OID). Yields on primary single-B rated tranches were 5.6%. Cr edit metrics remained relatively conservative for new deals and were in-line with May levels with first lien leverage and total leverage amounting to 4.3 times and 4.6 times respectively.[2]
- The Credit Suisse Western European High Yield Bond Index total return was -0.46% in June (See Figure 1), outperforming the SSL market, meaning that high yield bonds have now returned 3.48% on a y ear-to-date basis. At the end of June, the Spread-to-3-year take out for SSLs was 5.90% v ersus the European High Yield bond Spread-to-Worst of 6.13%. [2]

Figure 1

Total return (EUR, in %)	Q1 15	Q2 15	Q3 15	Q4 15	2015	Apr-16	May-16	Jun-16	LTM cumulative	YTD cumulative
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	2.22	1.14	0.00	-0.25	3.14	1.35	0.74	-0.60	2.03	2.28
Credit Suisse Western Europe HY Index (EUR-HDG)	2.97	-0.47	-2.07	0.99	1.36	1.85	0.36	-0.46	2.33	3.47

Source: Credit Suisse, as at 30 June 2016. Past performance is not a guide to future returns. An investment cannot be made directly in an index.

1 Credit Suisse Western European Leveraged Loan Index (CS WELLI) as at 30 June2016
2 Standard & Poor's, Loan Market Commentary and Data (LCD) as at 30 June 2016
3 The European Central Bank on 21 April 2016 announced the Corporate Sector Purchase Programme (CSPP), the programme is designed to provide further monetary policy accommodation through the purchase of investment-grade euro-denominated bonds issued by non-bank corporations established in the euro area and help inflation rates return to levels below, but close to, 2% in the medium t erm. For more information about the CSPP, please visit www.ecb.europa.eu

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All data provided by Invesco unless otherwise noted.

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