



# Credit markets update

**KPMG Corporate Finance LLC Insights**

Q2 – 2019

# Trends in the credit markets

## Economic activity in Q2 2019



**U.S. economic growth remains strong.** This is highlighted by Q1'2019 GDP growth of 3.1%. However, a potential downward revision of consumer spending data could suggest that the GDP growth momentum will be difficult to maintain.<sup>(1)</sup>

- Slowing global growth and weak inflation are also clouding the outlook for the rest of the year, prompting the U.S. Federal Reserve to contemplate a reduction in short-term interest rates in the months ahead.
- The decline in yields reflects investor expectations that a recession may be looming, and that central banks will continue to lower rates to counter an economic downturn.



**High yield volume increased.** Volume increased by 19% to \$132 billion in Q2'2019 from \$111 billion for the same period last year.



**Leveraged loan volume declined.** Volume decreased by 37% to \$239 billion in H1'2019 volume, compared with \$372 billion for the same period last year.

## Key observations:



**Loan volume was significantly lower in H1'2019.** This was driven by (a) decline in buyout activity as valuations are relatively high; and (b) investors expecting further rate declines, causing a capital shift from loans (float rate) to high yield bonds (fixed rate).

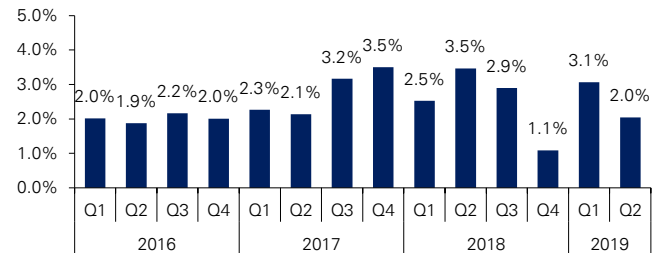


**Borrowers are motivated to issue bonds to lock in low rates,** given the continuing decline in yields.

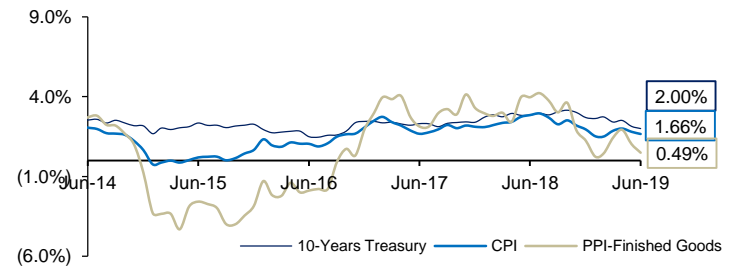


**Competition among lenders is creating an optimal issuance environment for borrowers** in terms of lower rates, higher leverage levels, and more favorable covenants.

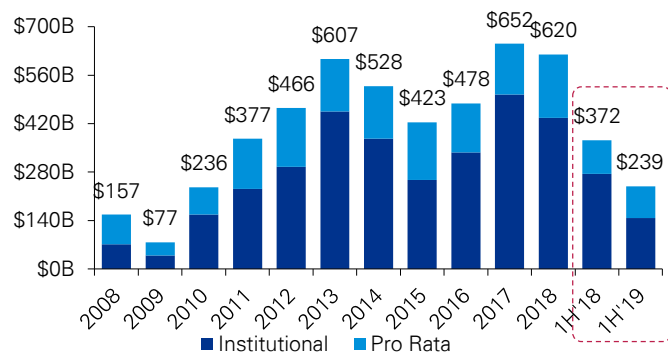
## GDP Growth - annualized change (%)<sup>(1,2)</sup>



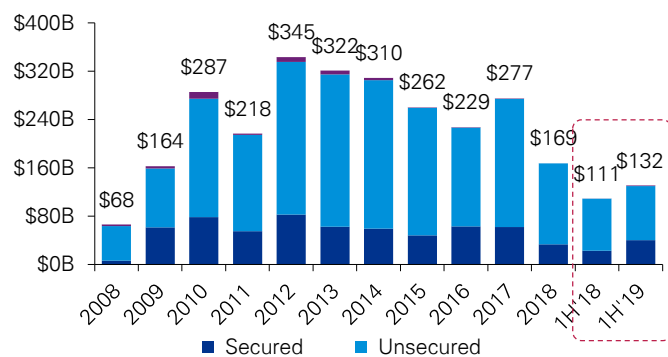
## CPI, PPI and 10-YR Treasury<sup>(2)</sup>



## New issue leveraged loan volume – annual (\$bn)<sup>(2)</sup>



## High Yield Bond Issuance – Annual (\$bn)<sup>(2)</sup>



(1) Q2'2019 estimates expected to be released by [ ] on [date].

(2) Sources: Capital IQ, Federal Reserve Bank of St. Louis LCD Quarterly Leveraged Lending Review: 2Q 2019, and Interactive High Yield Report 2Q 2019

# What's new in the credit markets:

## **LIBOR is set to retire and banks need a new rate benchmark**

In light of the news that the London interbank offer rate (LIBOR) will end by the end of 2021, there is an intense focus on replacing it. Across the world, regulators are suggesting alternative rate benchmarks, and in the United States, the SEC has provided guidance as well. What's common about the new recommended rate benchmarks is their use of actual transactions as a benchmark rather than survey data which served as the foundation for LIBOR. Regulators hope that a more factual approach can prevent rate manipulation.

In the United States, the Secured Overnight Finance Rate (SOFR) has become the recommended option, but there is some concern about the stability of this rate causing some to wonder if multiple benchmarks will be needed to accurately set rates moving forward. Another option, the Sterling Overnight Interbank Average (SONIA), which uses overnight risk-free rates that are compounded in arrears, is also viewed in a positive light by many regulators.

With rate uncertainty looming in the future, banks and borrowers can be proactive today in order to avert future challenges around rates.

## **Floating rates present challenges**

The elimination of LIBOR leaves the interest rate charged on floating rates in a state of uncertainty. Standard loan documents often do not address what happens in the event LIBOR becomes unavailable, which could result in confusion for borrowers and lenders. And when they do address the issue, prime rate is used in lieu of LIBOR, frequently not adjusting the interest rate spread. As a result the borrower will likely face a higher rate.

## **Best practices for addressing LIBOR in standard loan documents**

Loan documents should identify a replacement benchmark for when LIBOR becomes unavailable, and provide an adjustment of the interest rate spread based on the difference between LIBOR and the replacement benchmark. This approach will maintain the interest rate both the borrower and lender intended on initially.

## **Next steps for borrowers and lenders**

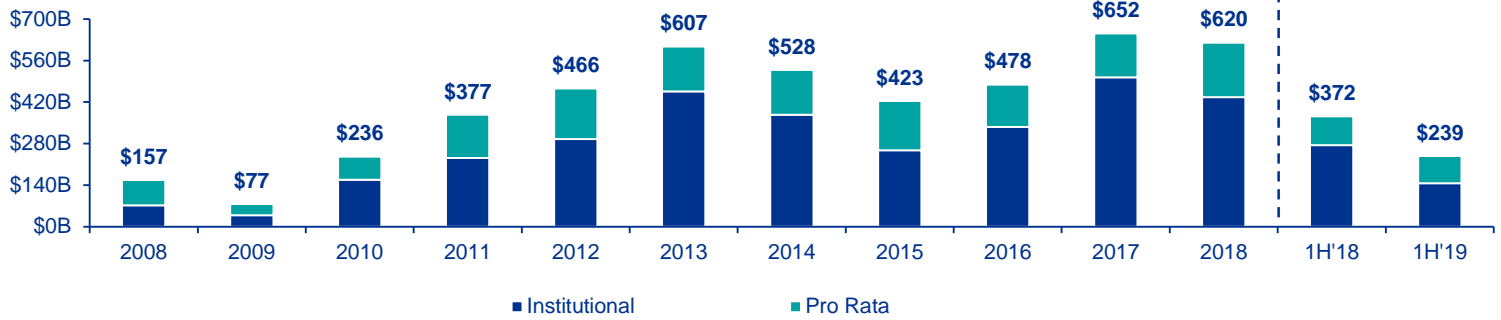
Borrowers and lenders should review their loan documents (including any interest rate swap agreements) to determine which loans utilize LIBOR as a benchmark. For loans that use LIBOR as a benchmark:

1. Determine if they include objective triggers for switching to a replacement benchmark.
2. If they do not, identify an appropriate replacement benchmark.
3. Adjust the interest rate spread to maintain the parties' intended rate. If these provisions are not included, the parties should amend the loan documents accordingly.

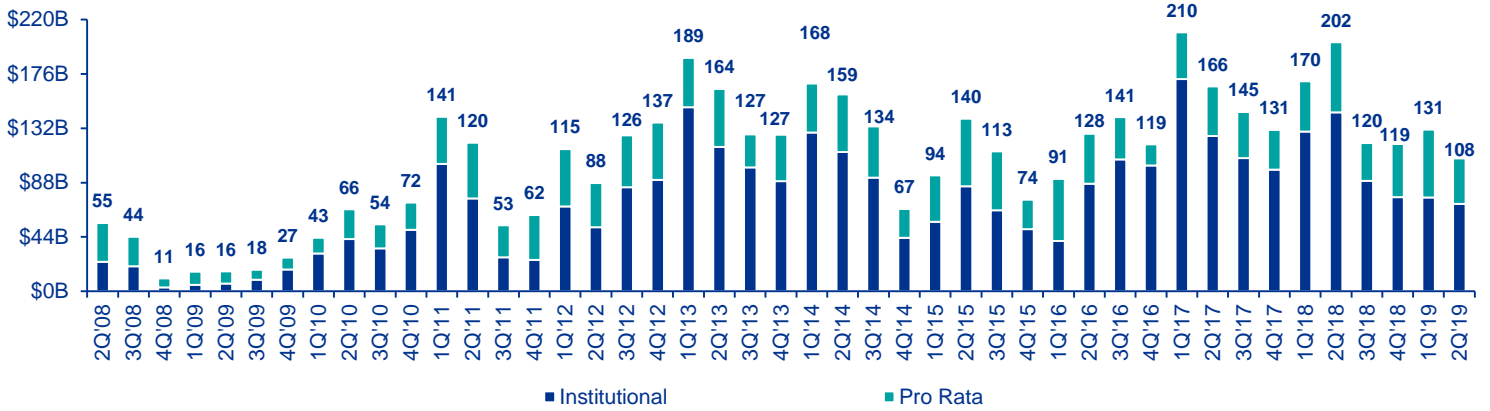
Whether it's a new or existing loan agreement, borrowers should be taking the appropriate steps to address the retirement of LIBOR. It is important to consult with your advisors to conduct an assessment of the financing situation and a full review of the agreements - to address potential issues down the road.

# Leveraged Loans

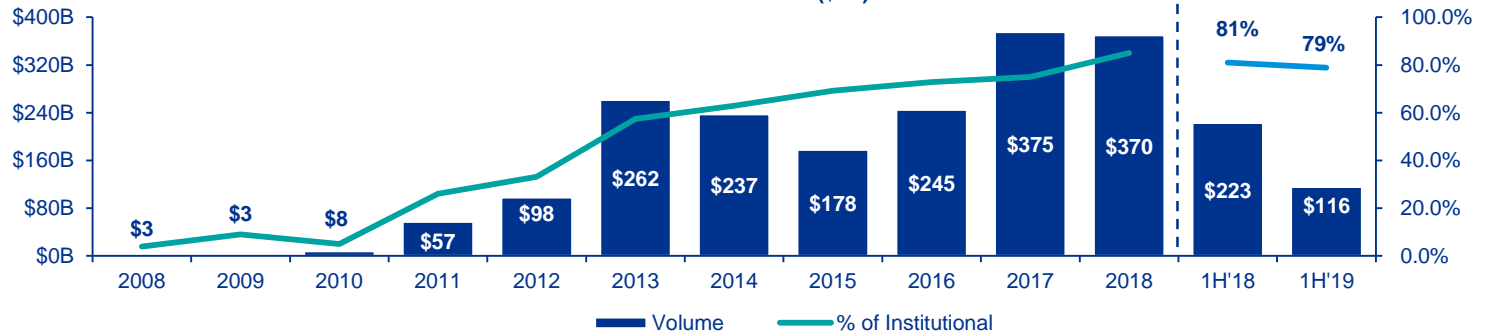
New Issue Leveraged Loan Volume - Annual (\$bn)



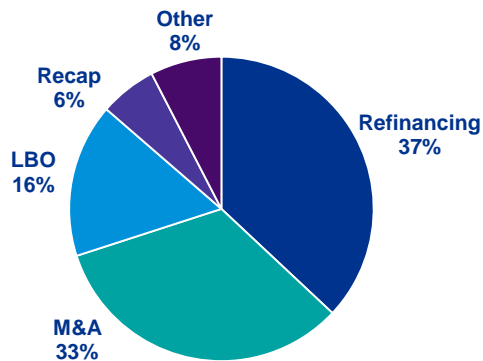
New Issue Leveraged Loan Volume - Quarterly (\$bn)



New-Issue Cov-Lite Loans (\$bn)

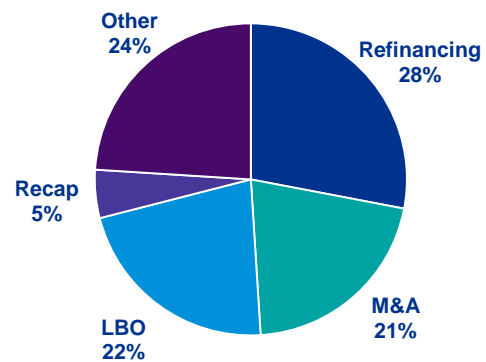


Leveraged Loan Issuance by Purpose - 1H'18



Total Volume: \$372B

Leveraged Loan Issuance by Purpose - 1H'19

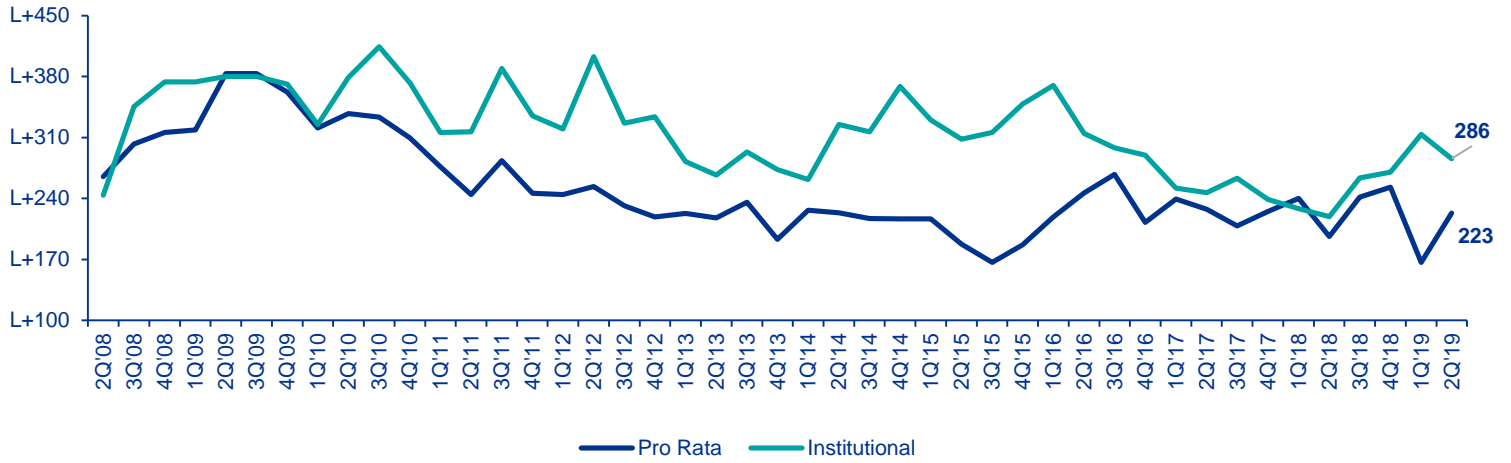


Total Volume: \$239B

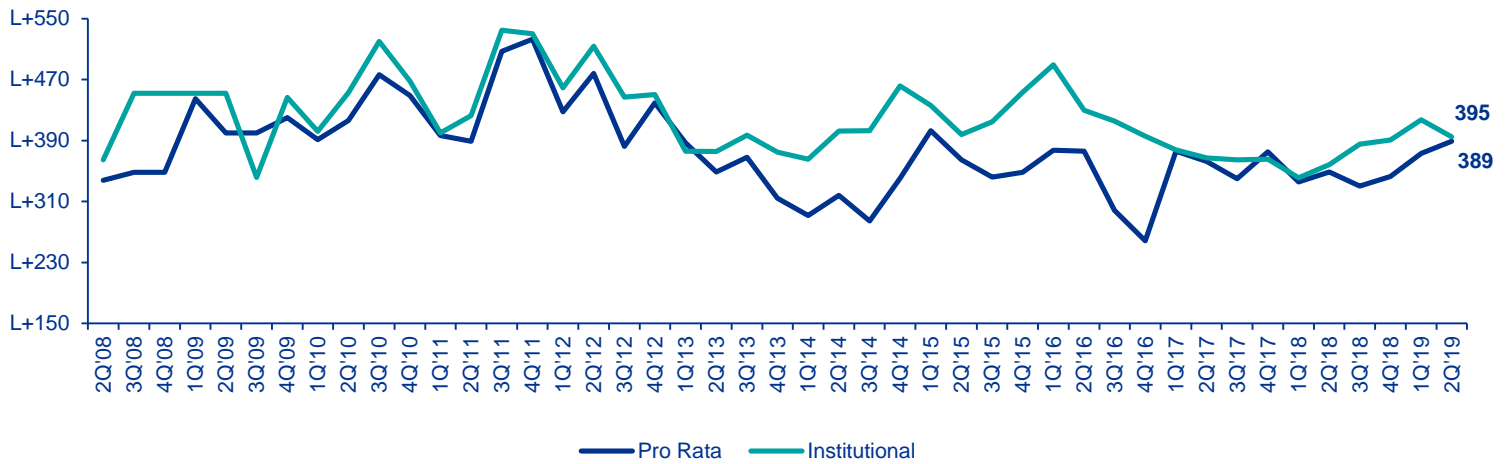
Source: Standard & Poor | Leveraged Commentary & Data.

# Leveraged Loans (continued)

New Issue First Lien Spreads BB/BB- - Quarterly



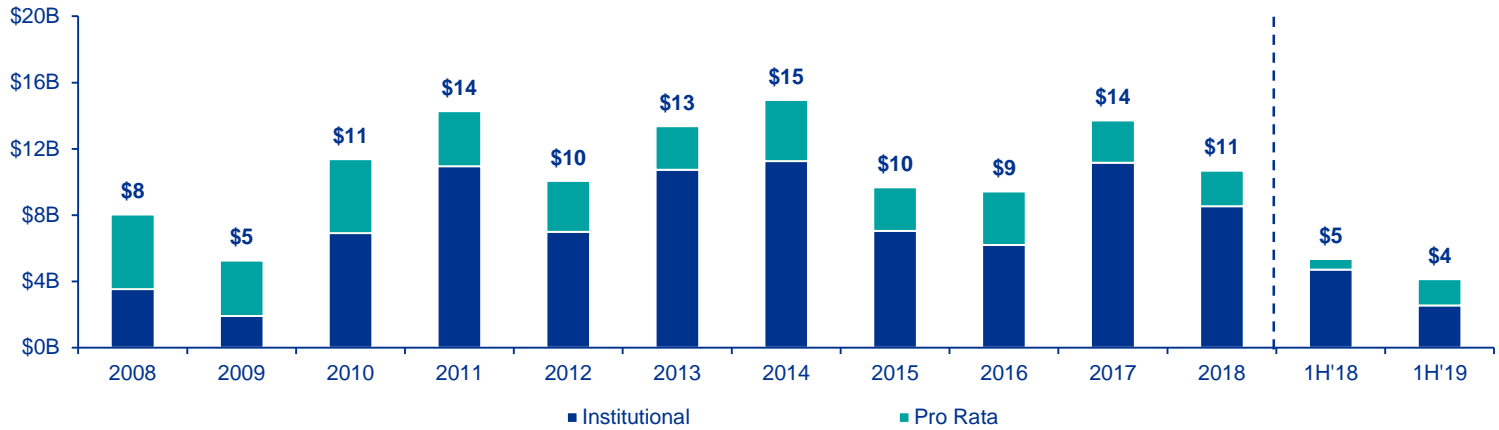
New Issue First Lien Spreads B+/B - Quarterly



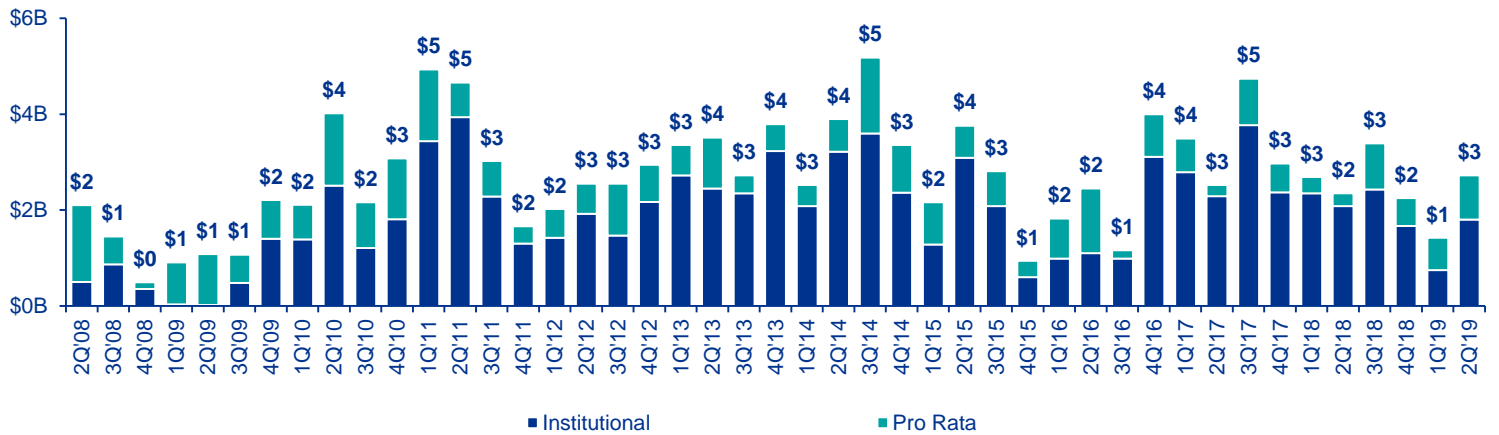
Source: Standard & Poor | Leveraged Commentary & Data.

# Leveraged Loans – Middle Market

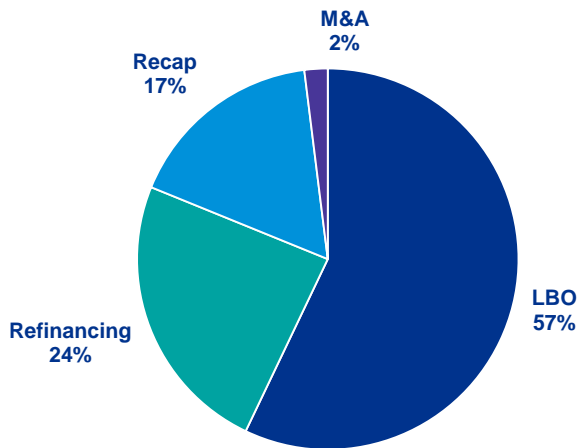
Leveraged Loan Volume- Annual (\$bn)



Leveraged Loan Volume- Quarterly (\$bn)

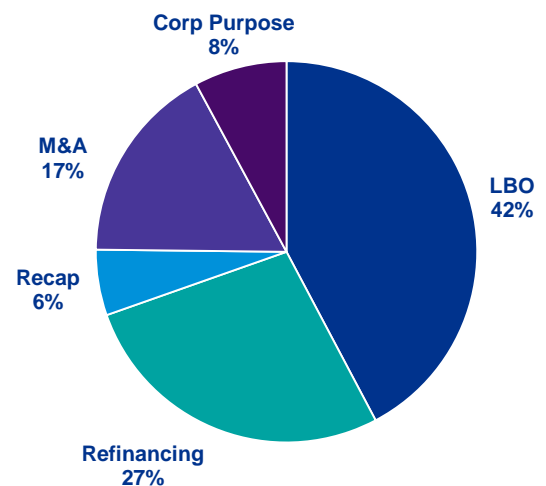


Total New-Issue Volume by Purpose - 1H'18



Total Volume: \$5.3B

Total New-Issue Volume by Purpose - 1H'19

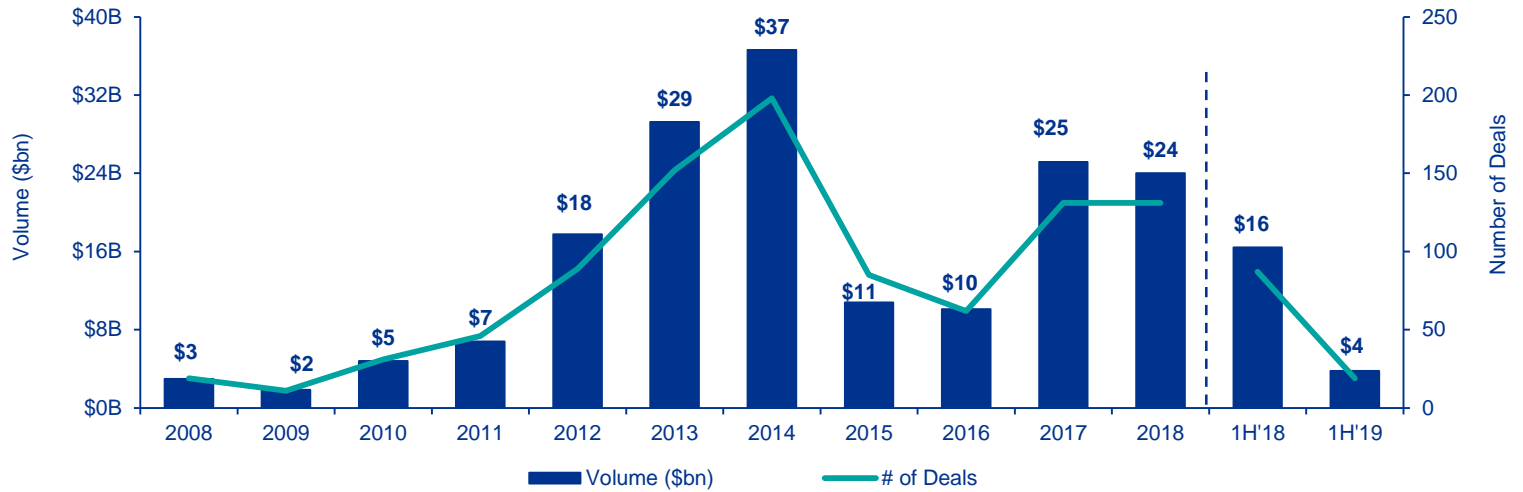


Total Volume: \$4.1B

Source: Standard & Poor | Leveraged Commentary & Data.  
 Note: Middle market refers to companies with EBITDA of \$50 million or less.

# Second-Lien Loans

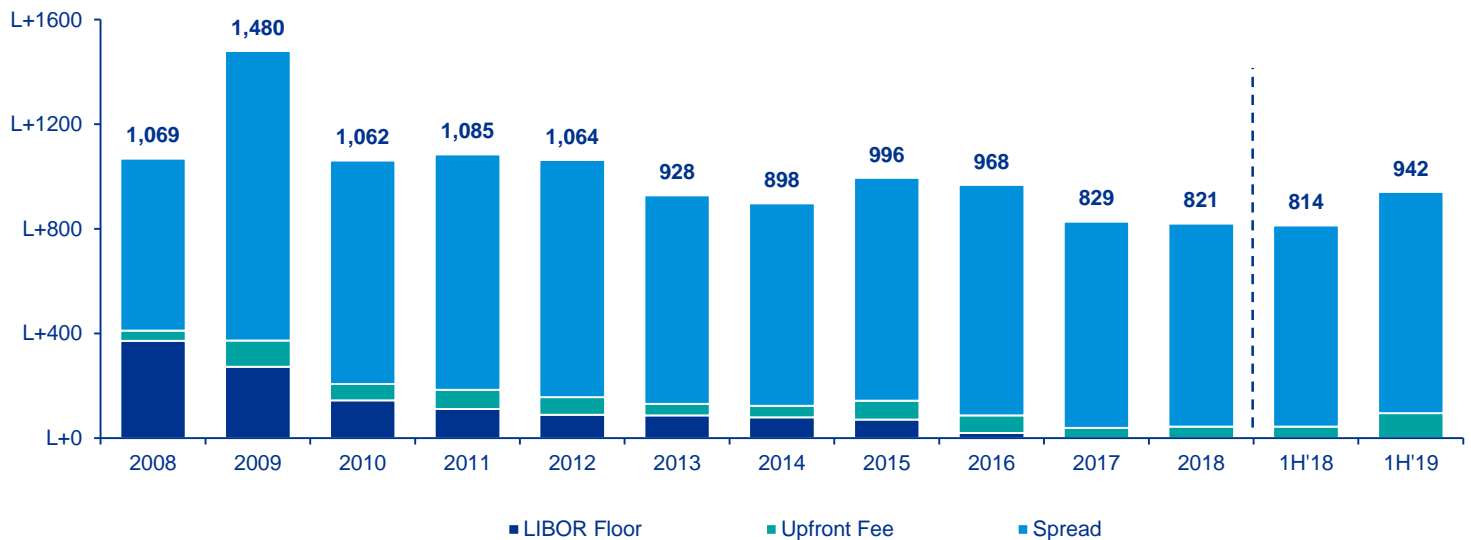
Second-Lien Loan New-Issue Volume - Annual (\$bn)



Second Lien Loan New-Issue Volume - Quarterly (\$bn)



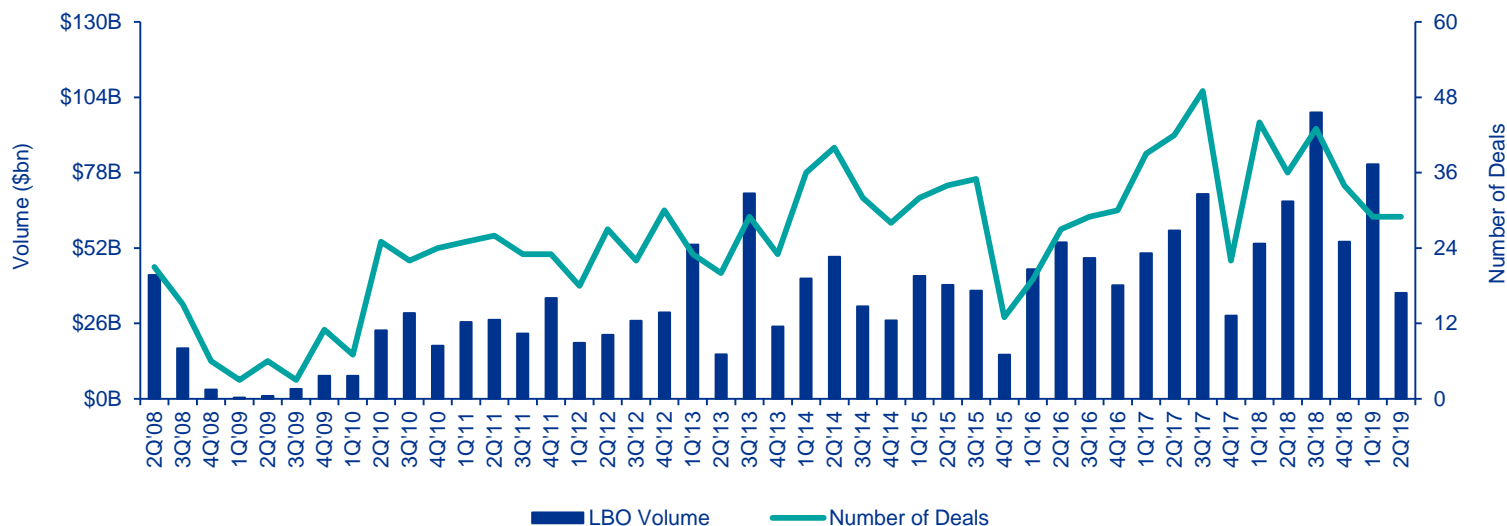
Average New Issue Second-Lien Spreads



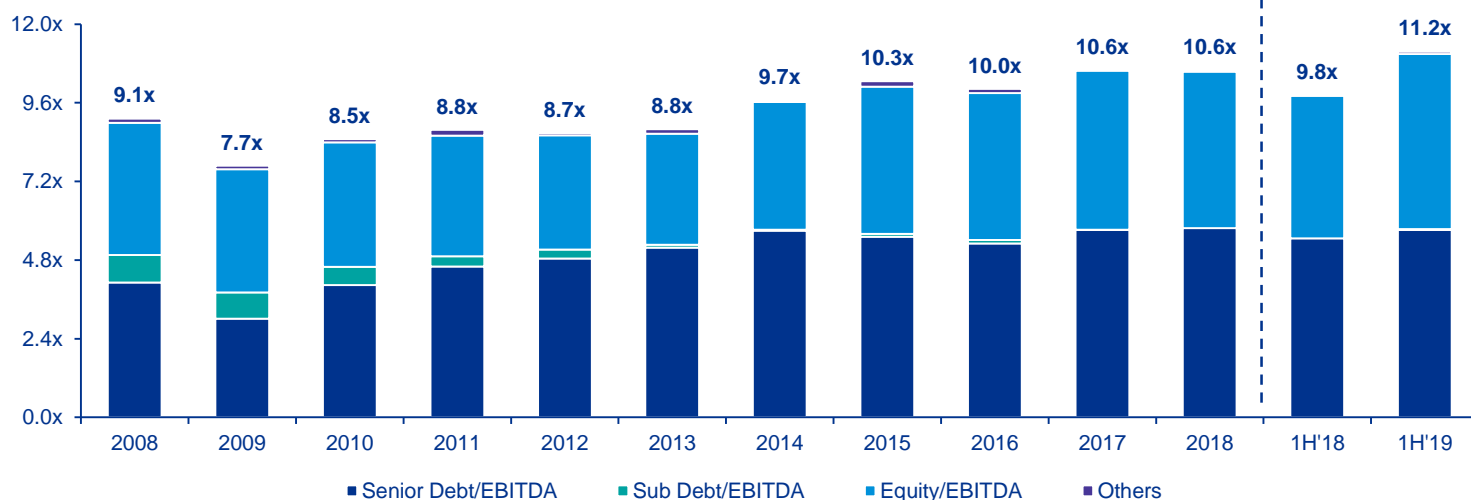
Source: Standard & Poor | Leveraged Commentary & Data.

# LBO Summary

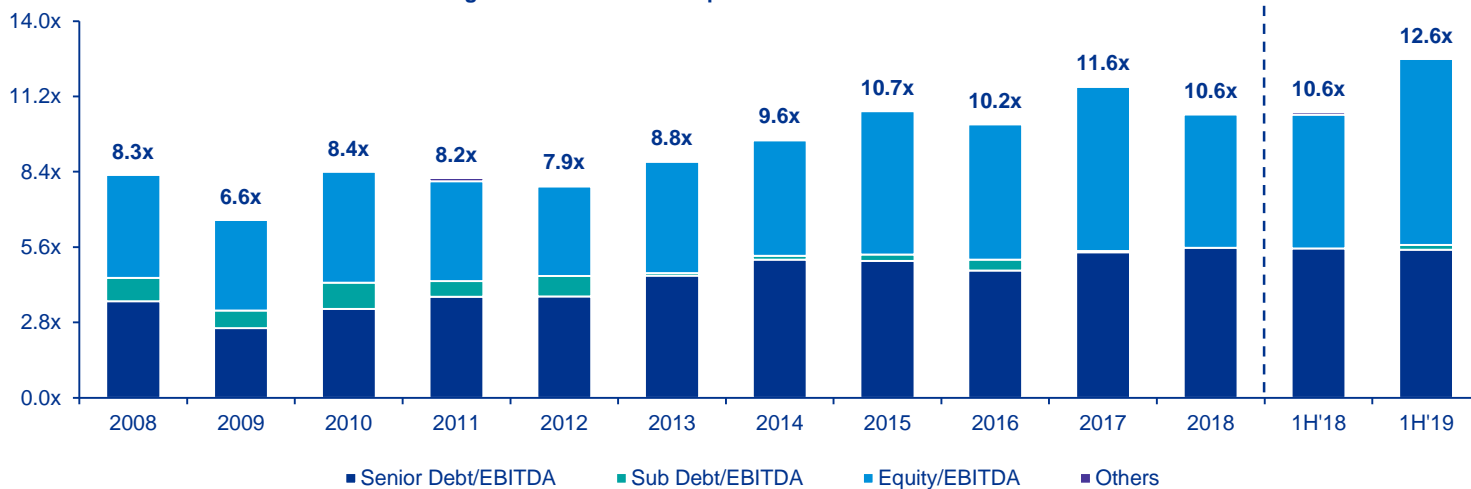
LBO Transaction Volume - Quarterly (\$bn)



Average Purchase Price Multiple - All LBOs



Average Purchase Price Multiple - Middle Market LBOs<sup>(1)</sup>



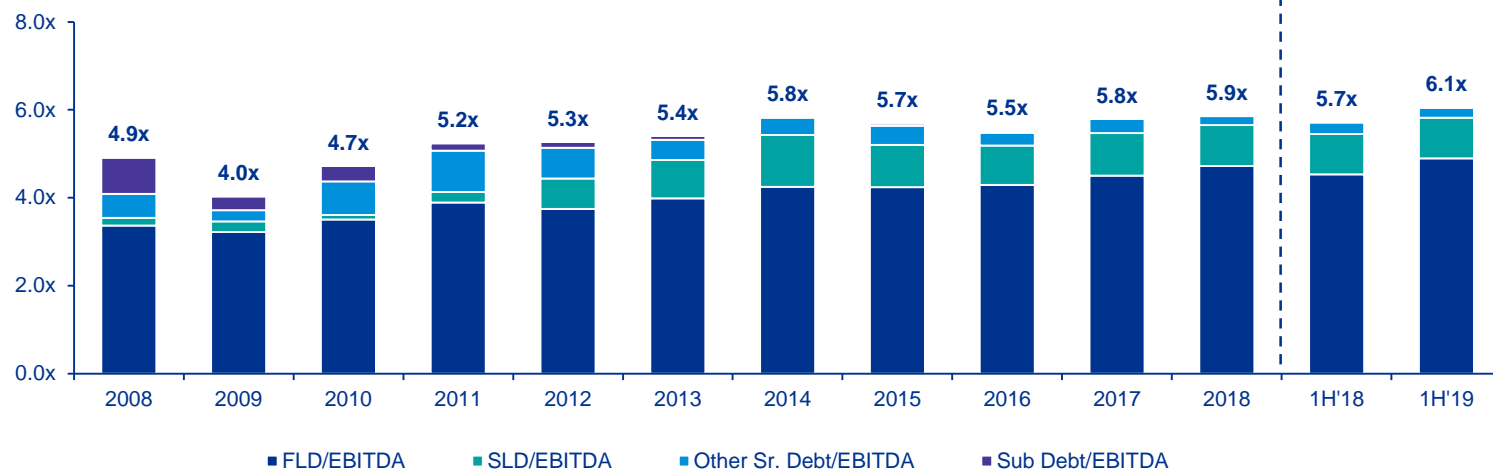
Source: Standard & Poor | Leveraged Commentary & Data.

<sup>(1)</sup> Middle market refers to companies with EBITDA of \$50 million or less.

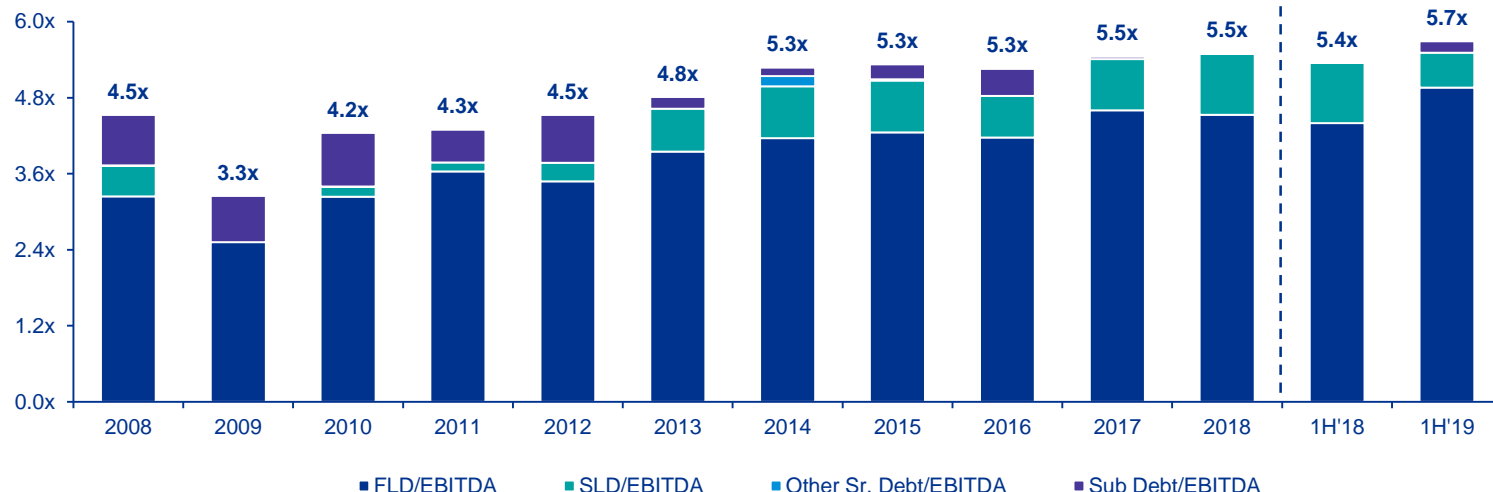


# LBO Summary (continued)

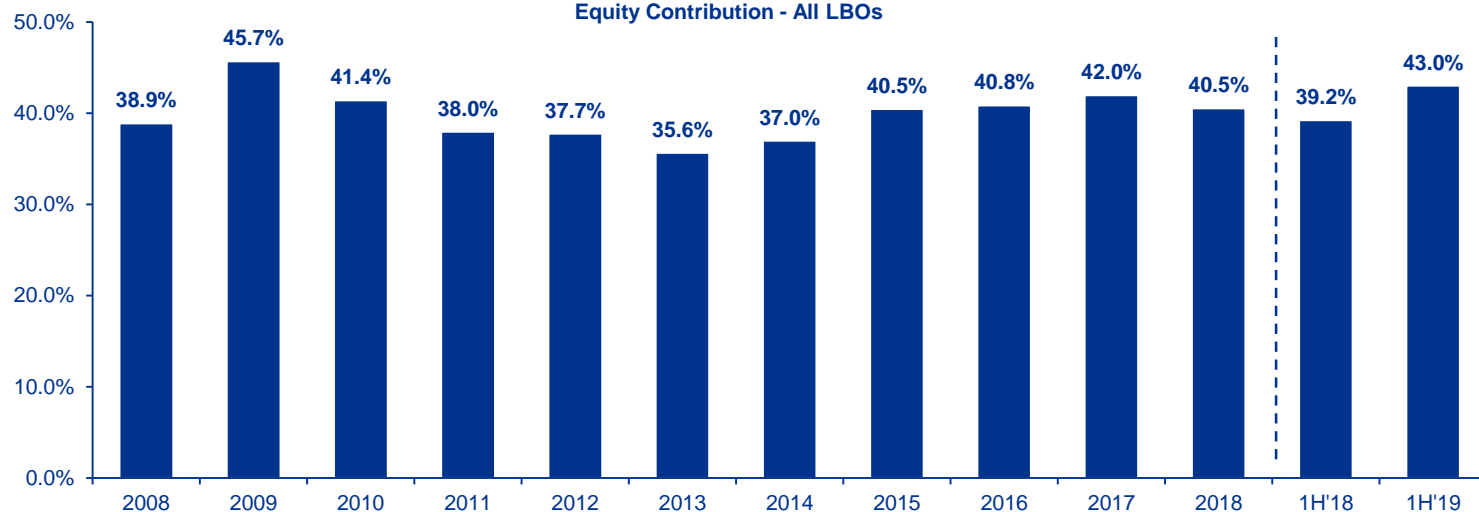
Average Debt Multiples of Large Corporate LBO Loans<sup>(1)</sup>



Average Debt Multiples of Middle-Market LBO Loans<sup>(2)</sup>



Equity Contribution - All LBOs



Source: Standard & Poor | Leveraged Commentary & Data.

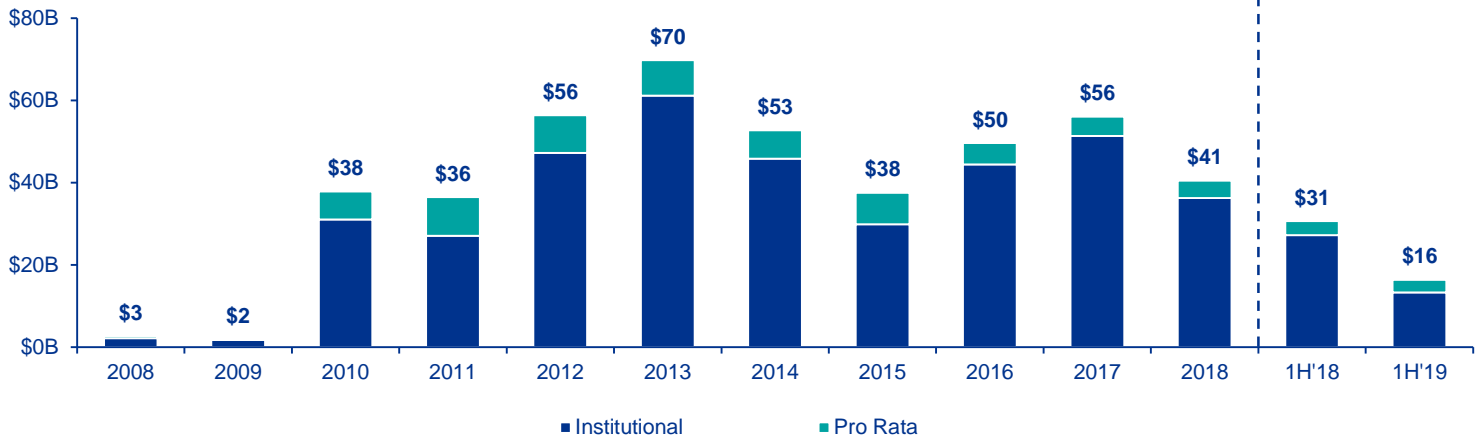
<sup>(1)</sup> Large corporate refers to companies with EBITDA of more than \$50 million.

<sup>(2)</sup> Middle market refers to companies with EBITDA of \$50 million or less.

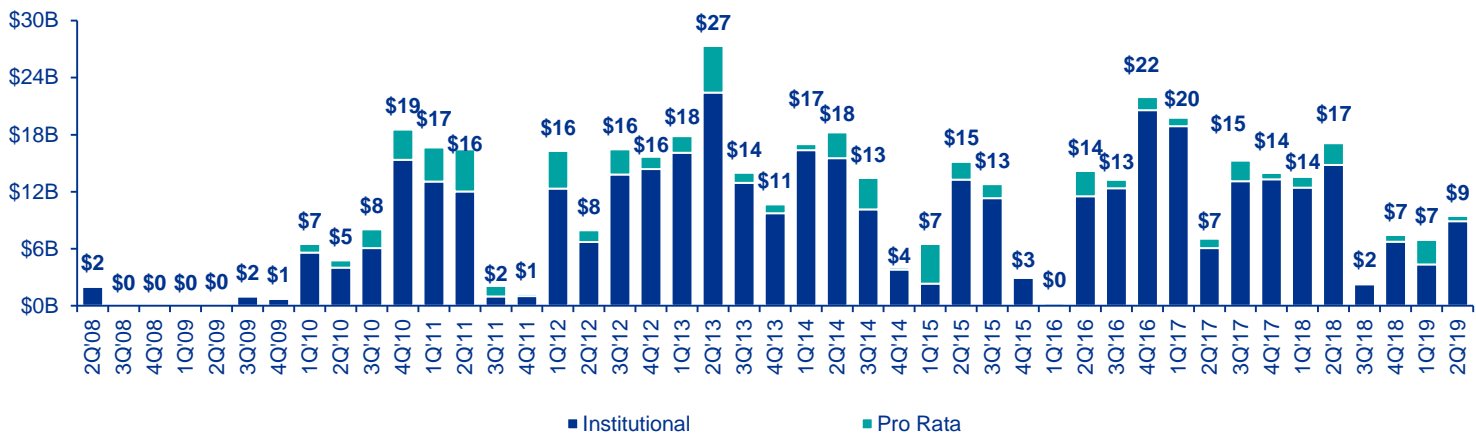
<sup>(3)</sup> LTM 1Q'19 average debt multiple of middle-market LBO loans.

# Dividend Recapitalization

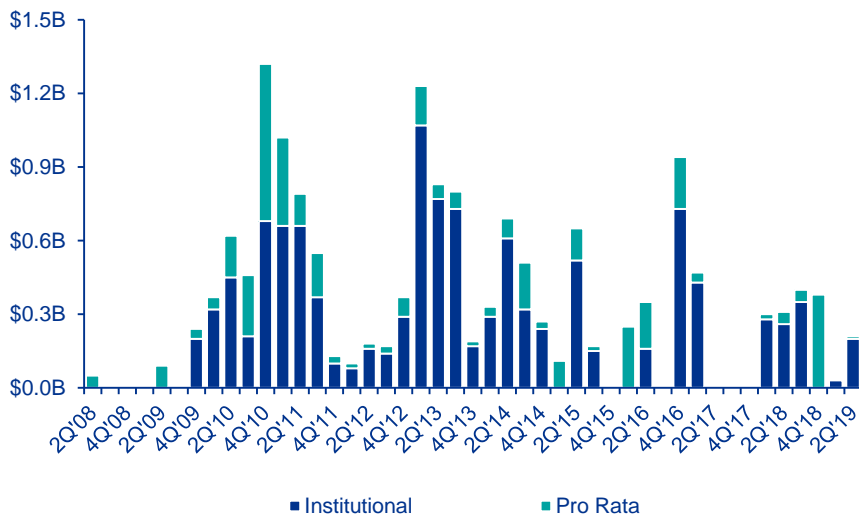
Dividend or Stock Repurchase Loan Volume- Annual (\$bn)



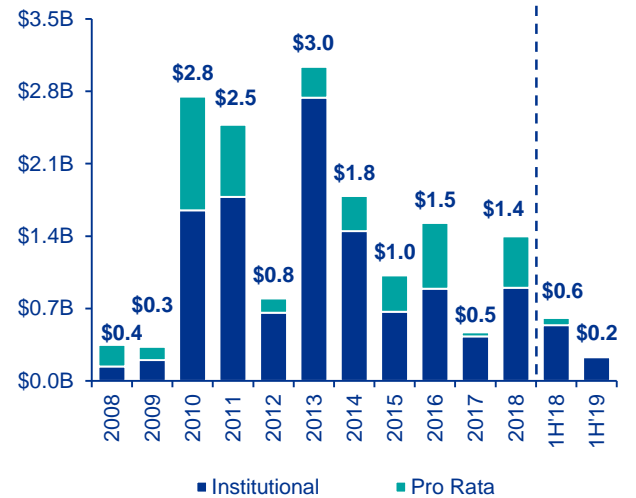
Dividend or Stock Repurchase Loan Volume- Quarterly (\$bn)



Middle-Market Dividend Related Volume- Quarterly (\$bn)



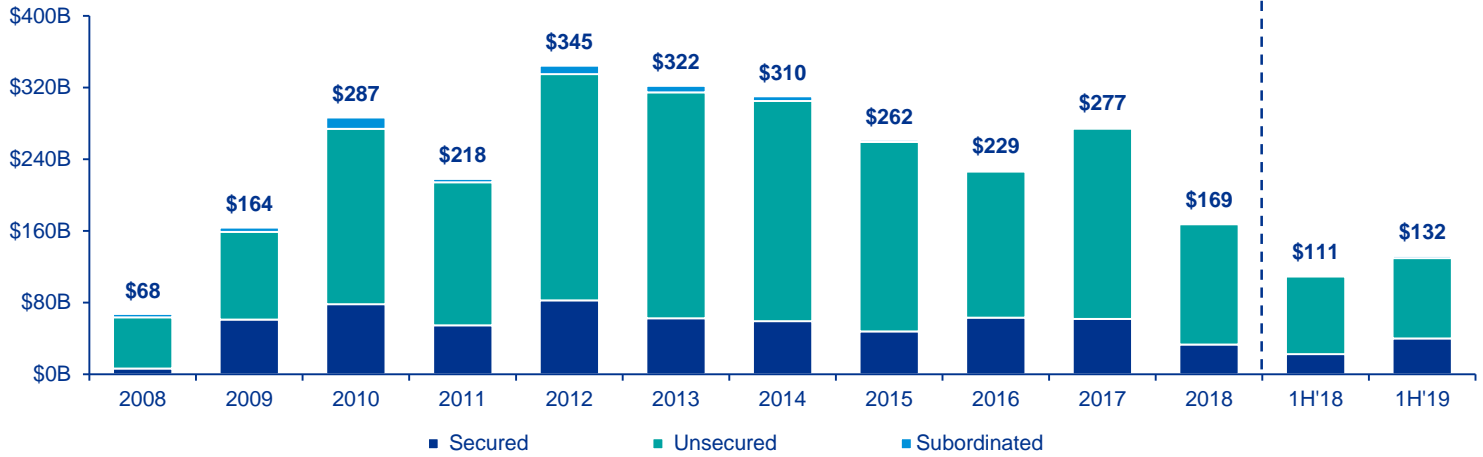
Middle-Market Dividend Related Volume- Annual (\$bn)



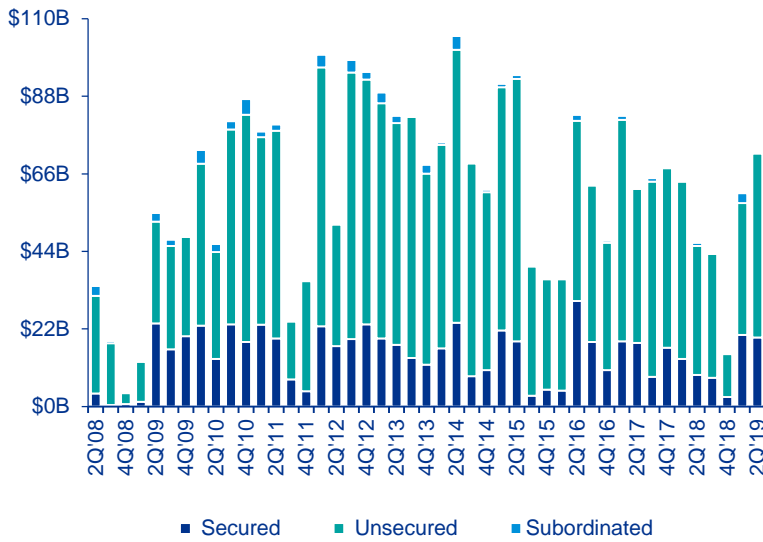
Source: Standard & Poor | Leveraged Commentary & Data.

# High Yield Bonds

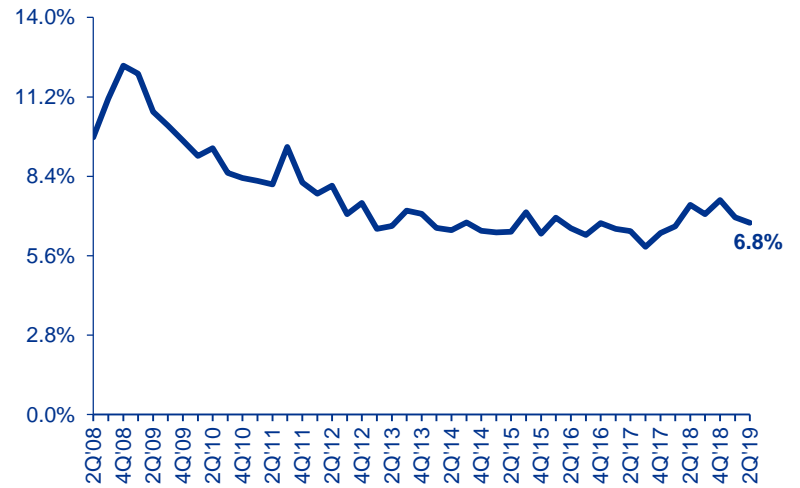
High Yield Bond Issuance – Annual (\$bn)



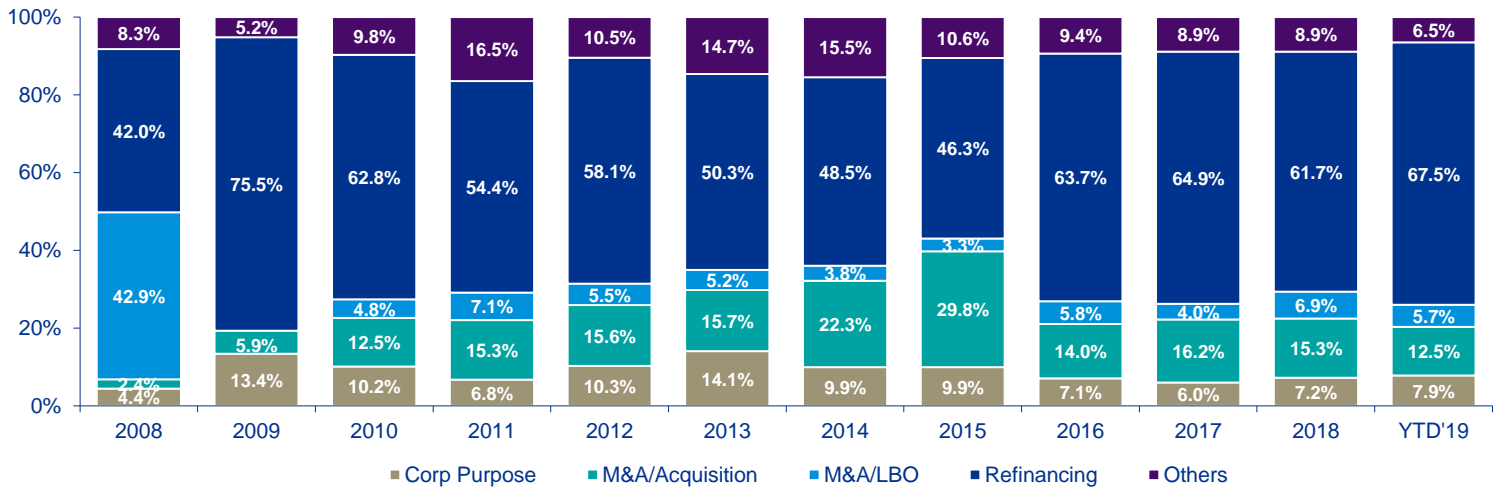
High Yield Bond Issuance – Quarterly (\$bn)



New issue High yield Bond yield to Maturity



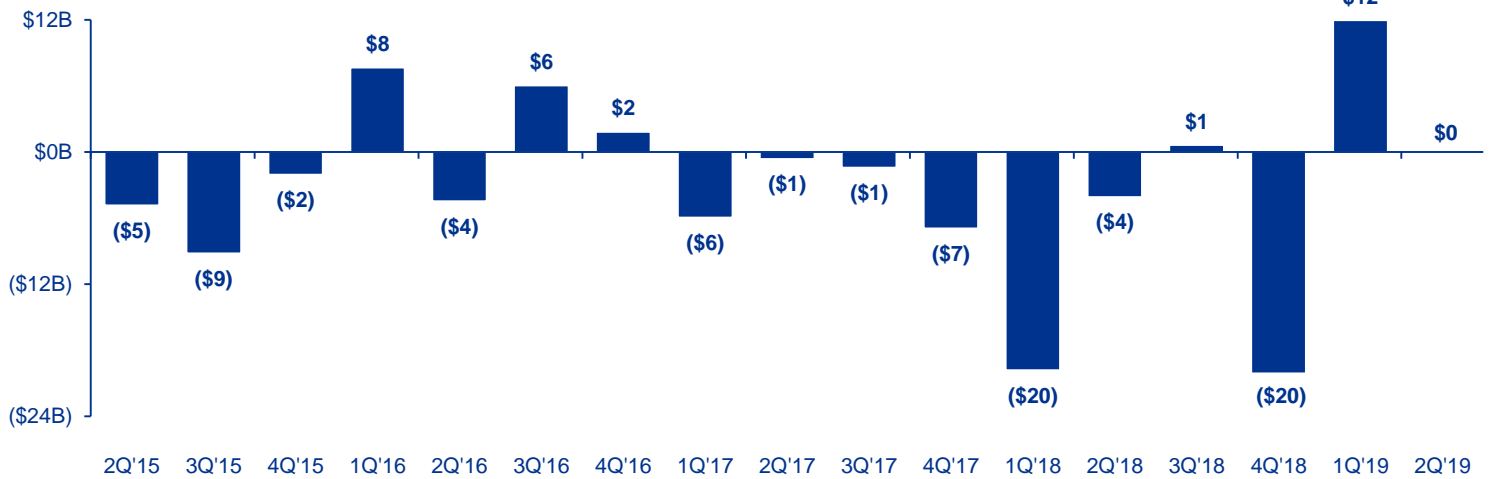
High Yield Bond Issuance by Purpose



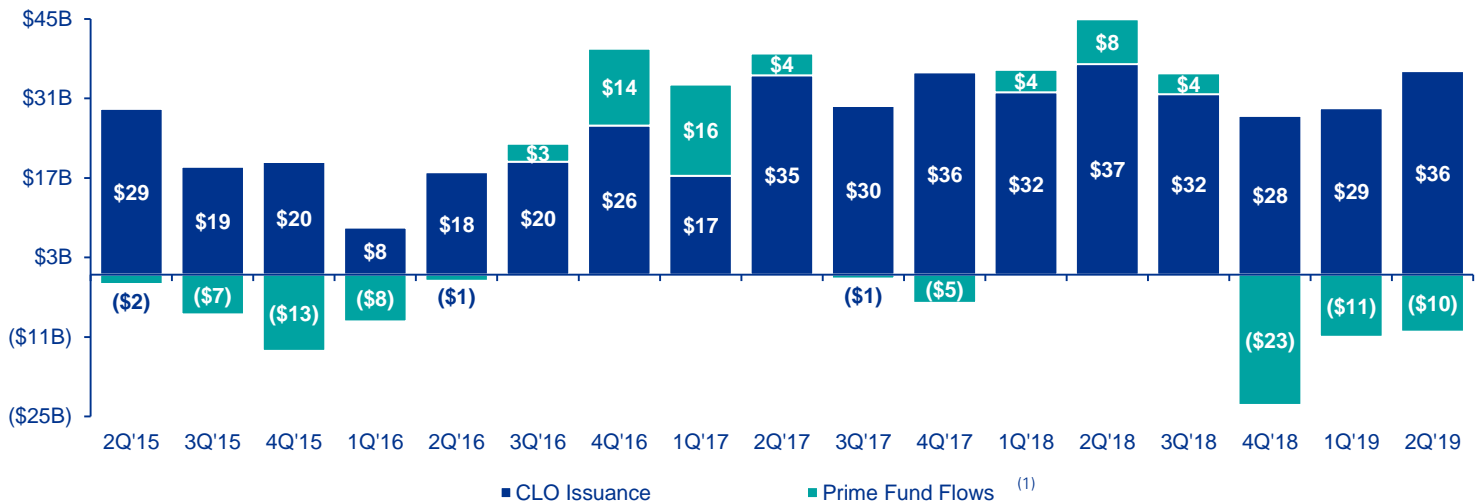
Source: Standard & Poor | Leveraged Commentary & Data.

# Funds Flows

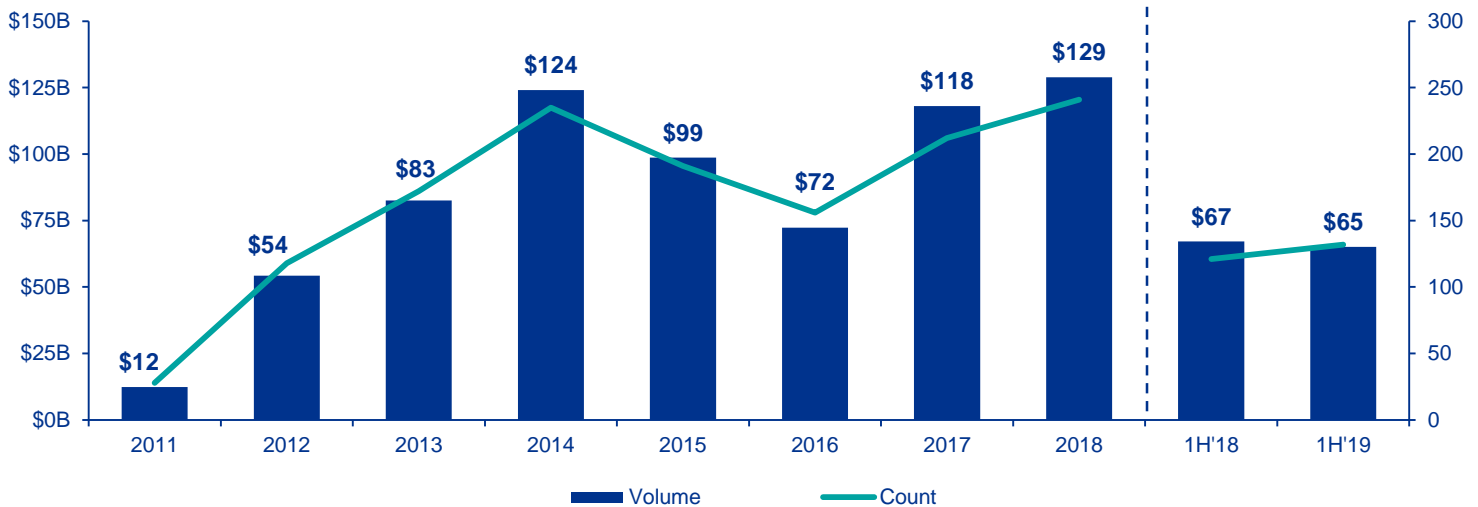
Flows into High Yield Bond Funds - Quarterly (\$bn)



Flows into Leveraged Loan Funds - Quarterly (\$bn)



Annual CLO Volume (\$bn)

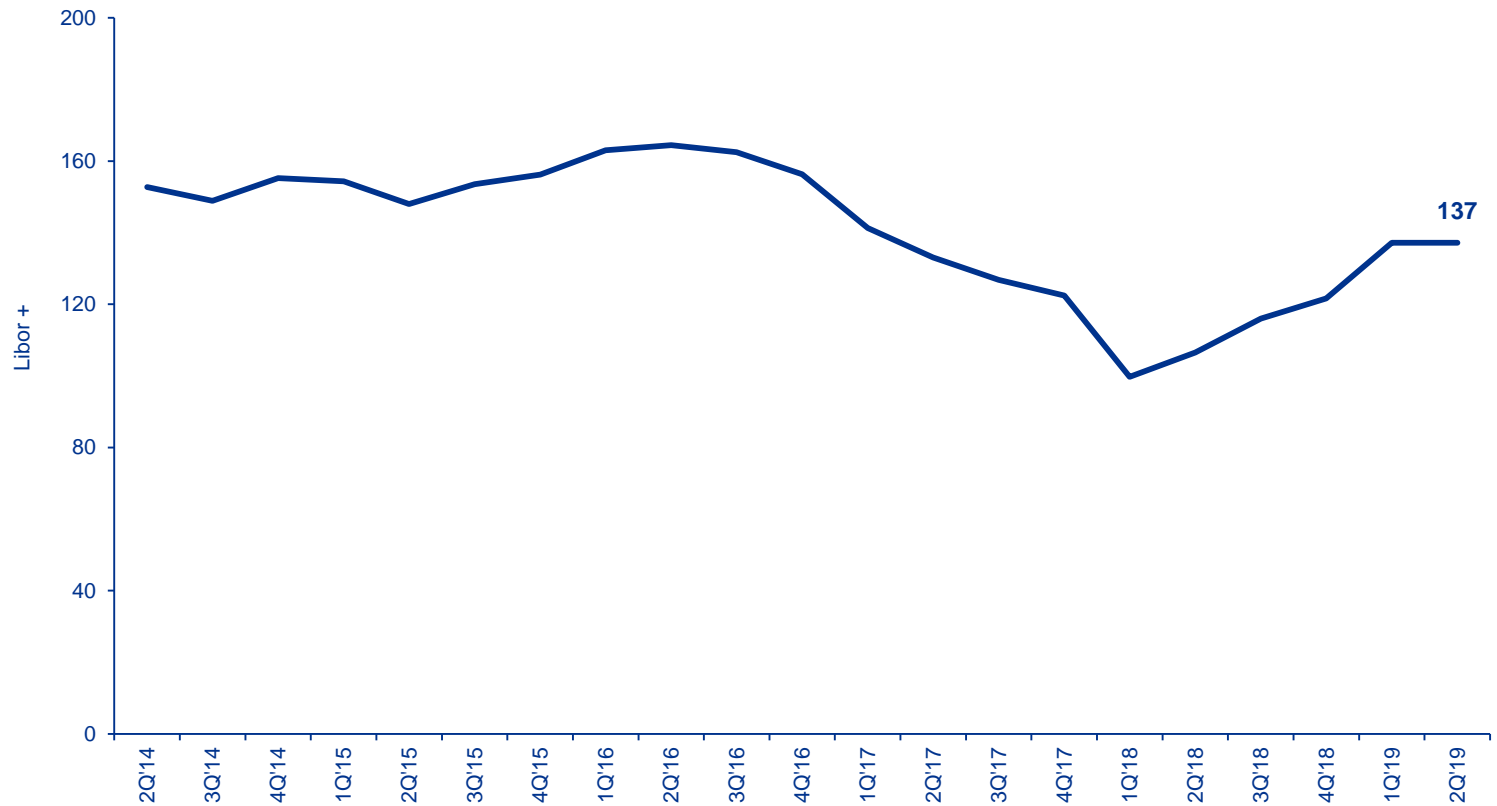


Source: Standard & Poor | Leveraged Commentary & Data.

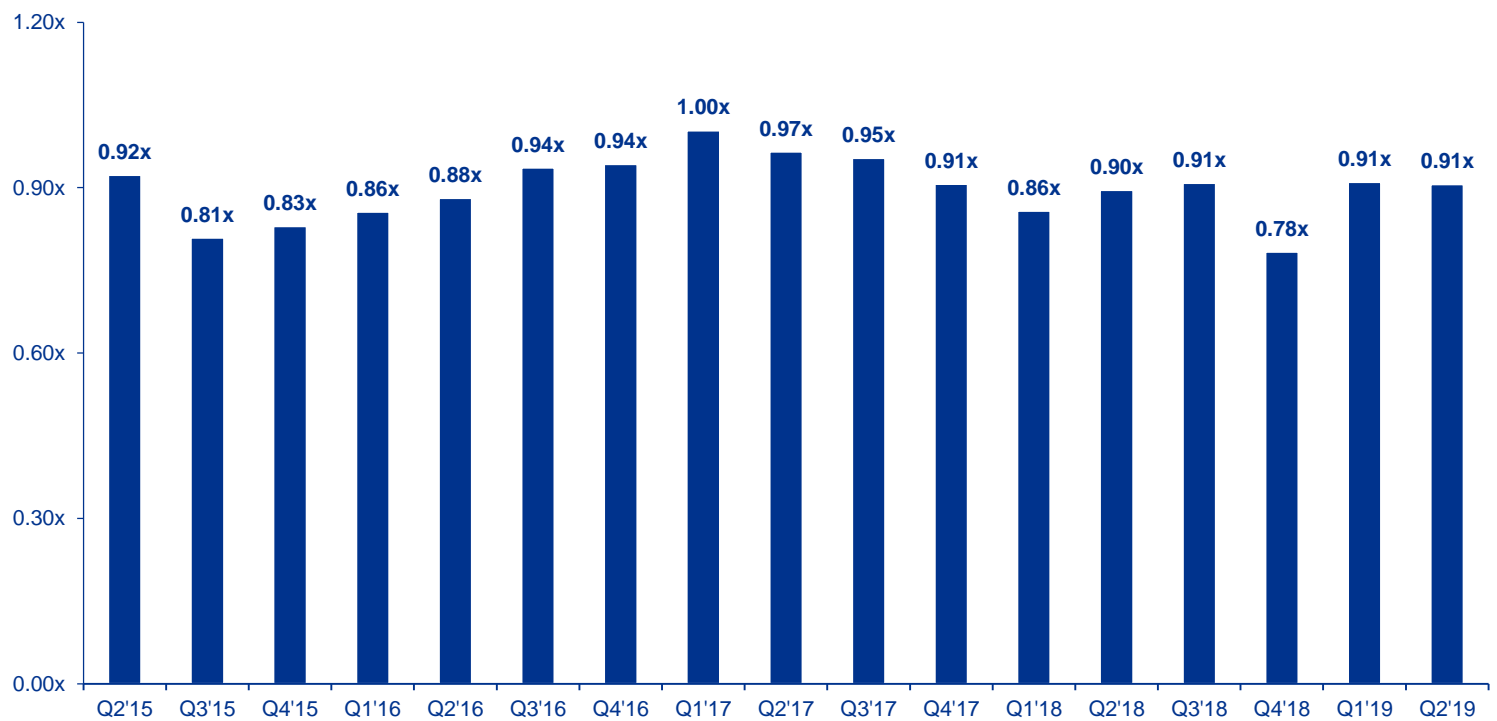
(1) Prime Funds Flows represent funds flows from loan participation mutual funds.

# Funds Flows (continued)

U.S. CLO Spreads



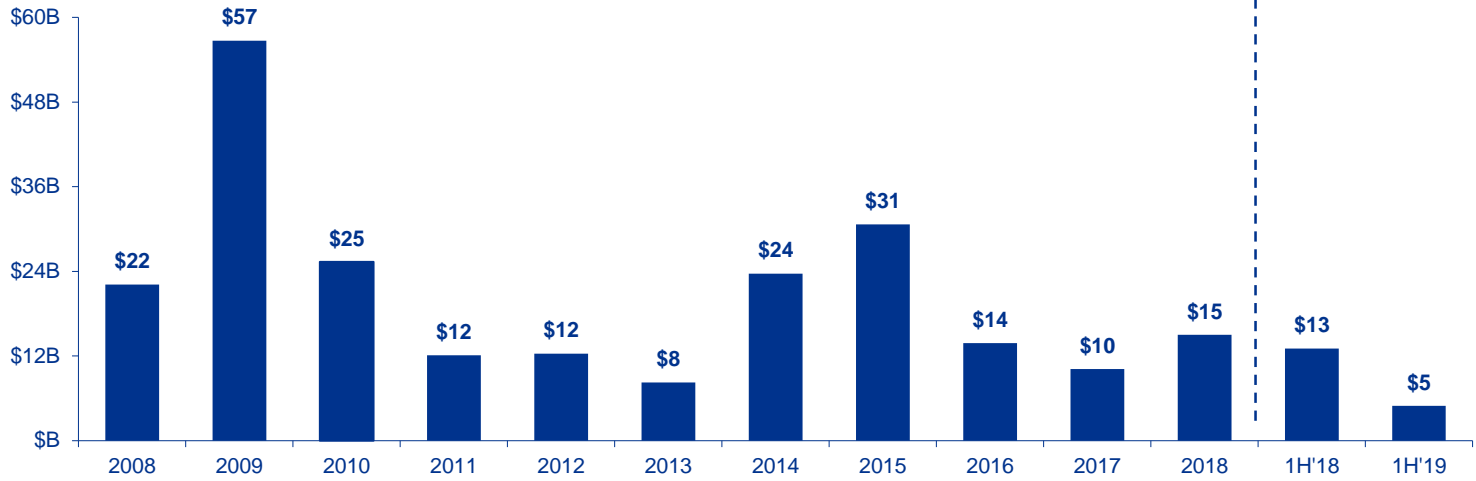
Public BDCs - Price to Book Value Multiple - Quarterly



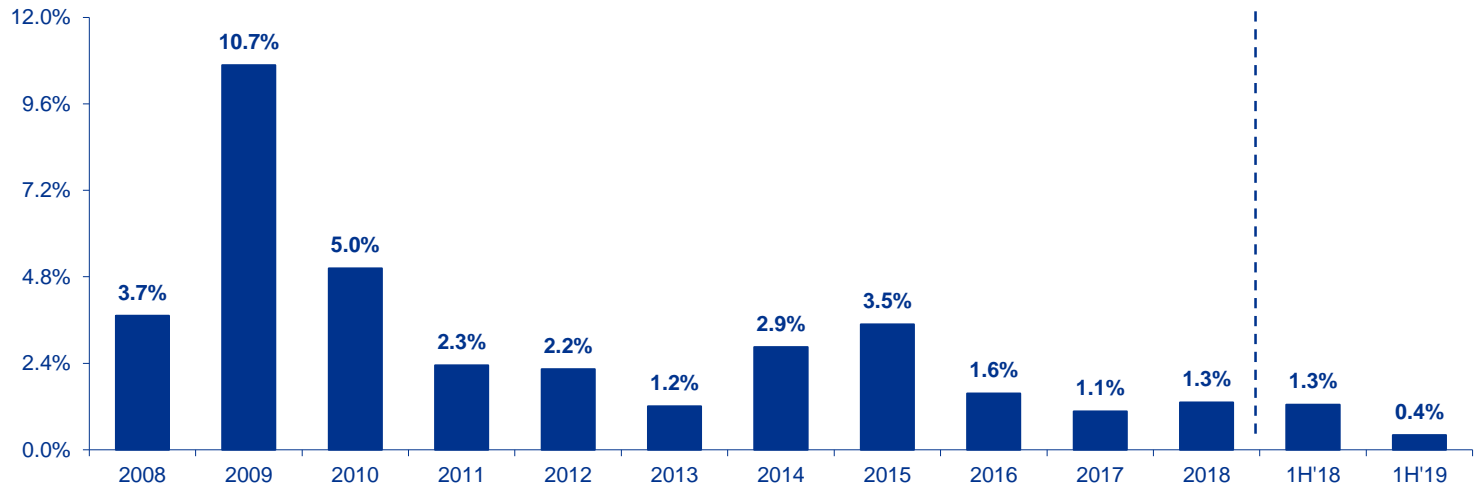
Source: Standard & Poor | Leveraged Commentary & Data.

# Distress and Defaults

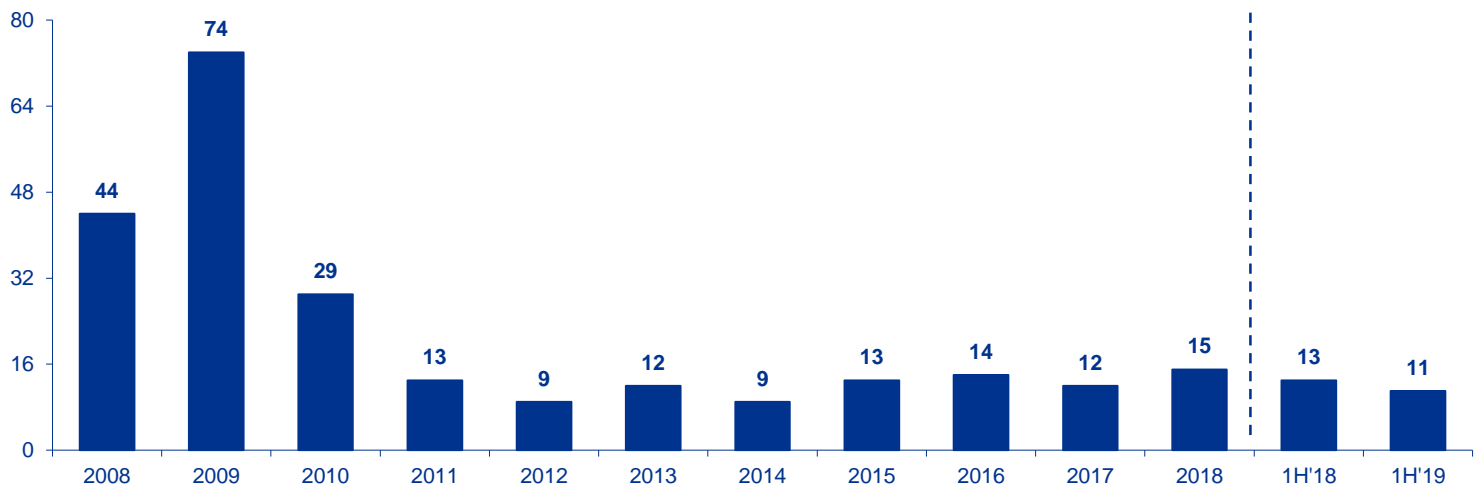
Par Amount of Leveraged Loans in Payment Default or Bankruptcy (\$bn)



Percent of Outstanding Leveraged Loans in Default or Bankruptcy



Number of Issuers in Payment Default or Bankruptcy



Source: Standard & Poor | Leveraged Commentary & Data.



# KPMG Investment Banking – Capital Advisory

## Capital Advisory Practice

We are a leading global financial advisor with real time knowledge of the capital markets. We advise on a wide range of transactions involving both debt and equity, including raising financing for acquisitions, buyouts, dividend recapitalizations, growth capital, special situations, and DIP and exit financing in bankruptcies

We maintain close relationships with debt, mezzanine and equity capital providers, including banks, BDCs, specialty finance companies, insurance companies, family offices, credit and equity funds and other private investors

## Primary Service Offerings

















Debt and equity capital raises

- Senior debt financing, refinancing or amendments
- Acquisition and growth capital
- Dividend recapitalizations and minority buyouts
- Mezzanine/junior subordinated financing
- Structured and minority equity
- Project financing
- Capital for special situations, including bankruptcies

## Value Added Advisor

- Unbiased and objective advice
- Local market insight with strong relationships across all tranches of capital
- Experienced deal team
- Flexible and innovative approach
- Fully integrated service offering
- KPMG global advisory network

## Capital Advisory Transactions

  <p><b>Debt Advisory</b></p> <p>Acted as the exclusive financial advisor to Smartlink in connection with securing a new credit facility</p> <p><b>Not Disclosed 2018</b></p>	  <p><b>Debt Advisory</b></p> <p>Acted as the exclusive financial advisor to The Markets in connection with refinancing a senior secured asset-based revolving credit facility</p> <p><b>Not Disclosed 2018</b></p>	  <p><b>Debt Advisory</b></p> <p>Has completed a capital raise (senior debt and equity co-investment) to fund the acquisition of 1 Priority Environmental Services</p> <p><b>Not Disclosed 2018</b></p>	  <p><b>Debt Advisory</b></p> <p>Acted as exclusive financial advisor to Razzoo's, Inc. in a debt capital raise</p> <p><b>Not Disclosed 2017</b></p>
  <p><b>Debt Advisory</b></p> <p>Acted as financial advisor and placement agent to Heckler &amp; Koch on a refinancing</p> <p><b>\$170 million 2017</b></p>	  <p><b>Debt Advisory</b></p> <p>Financial advisor and placement agent to Burke America Parts Group in a capital raise</p> <p><b>\$72 million 2016</b></p>	  <p><b>Debt Advisory</b></p> <p>Acted as financial advisor in raising acquisition for the purchase of Irvin Automotive, a subsidiary of Takata</p> <p><b>\$175 million 2016</b></p>	  <p><b>Debt Advisory</b></p> <p>Acted as financial advisor to TriVero Group on raising acquisition financing for the purchase of BTM Company</p> <p><b>\$21 million 2015</b></p>

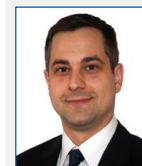
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