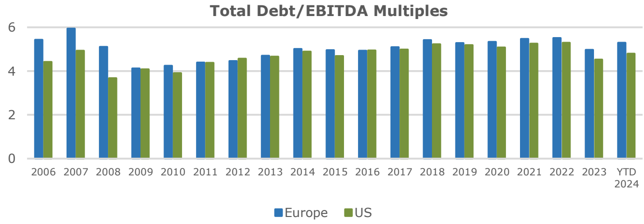
Monthly Spotlight

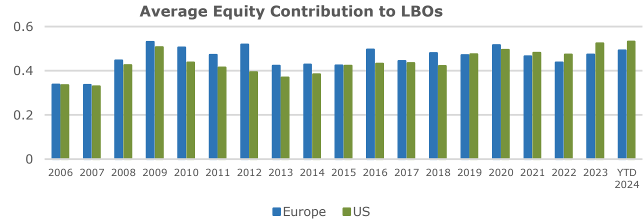
Leverage in syndicated loans had peaked in 2022

The syndicated loan market shows better credit metrics as compared to 2022 when interest rates started to spike. In the interim, some of the weakest companies suffered a default or went through a restructuring, but most companies were able to adapt to the new challenging economic market environment.

On the one hand, leverage metrics, measured in terms of Total Debt/EBITDA, decreased during 2023 reaching 5x in Europe and 4.5x in the U.S. Despite a slightly higher increase in Europe, current levels are still well below 2022 figures (top chart).

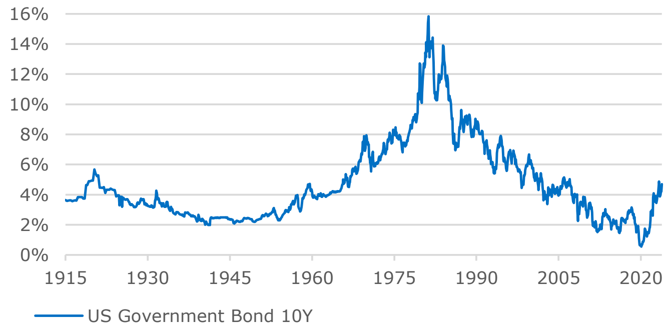
On the other hand, the equity cushion required in LBO transactions is at historical highs in the U.S. (53%) and at reasonably strong levels in Europe (49%) as of March 2024. This buffer improves the company's credit profile and increases security for lenders (bottom chart).



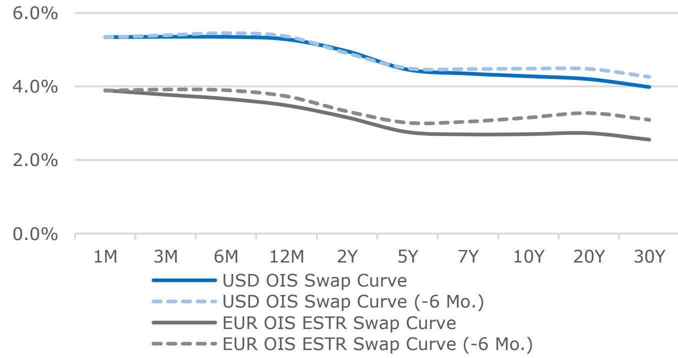


Rates Perspective

1) Historical US Treasury Yield: 10-year US government bond yield reached its 100-year low in 2020.

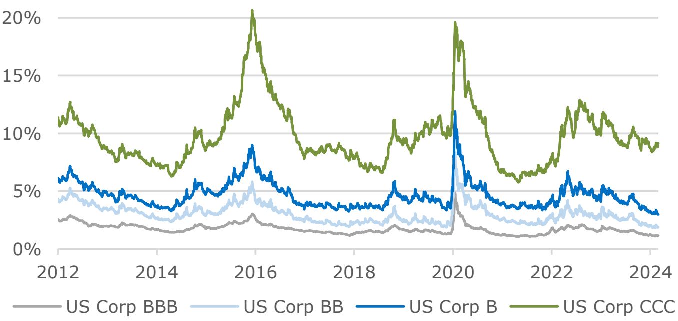


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.

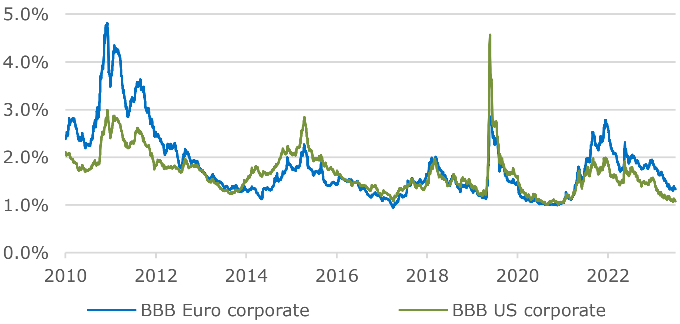


Corporate Perspective

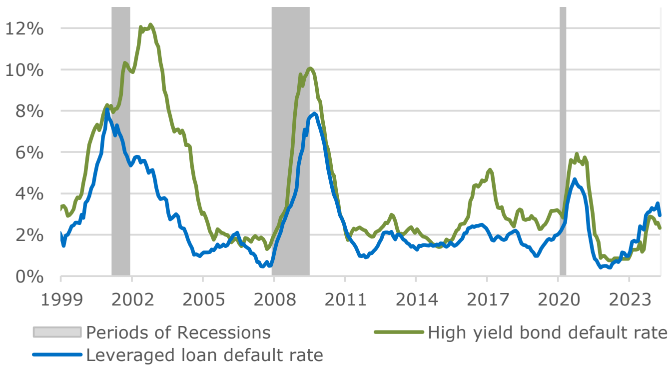
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



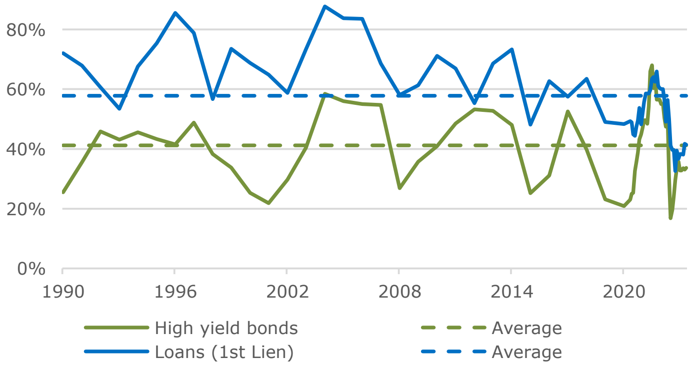
4) EU vs US: Since 2022 EU credit spreads (OAS) have remained wider than in the US.



5) Default Rates: HY bond default rates are structurally higher (Ø4.1%) vs. loans (Ø2.6%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø58%) vs. high yield bonds (Ø41%) due to lower severity.



OAS spread change overview across major credit asset classes - as of month end

US corporates by rating (bps)

	curr	Δ month
AAA	36	-1
AA	49	-1
A	77	-1
BBB	114	-1
BB	189	+2
B	299	-12
CCC	916	+64

Global high yield (bps)

	curr	Δ month
US HY	318	+6
EU HY	350	-2
Asia HY	596	-14
EM HY	508	-23

spread tightening (positive price action)
spread widening (negative price action)

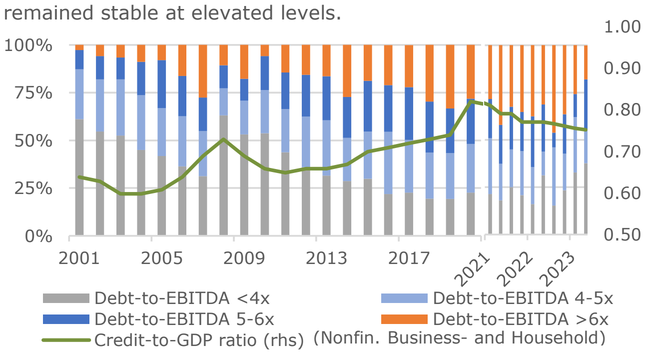
CDS spreads (bps)

	curr	Δ month
CDX IG - US	54	+2
iTraxx IG - EU	56	+2
CDX HY - US	357	+27
iTraxx XO - EU	318	+21

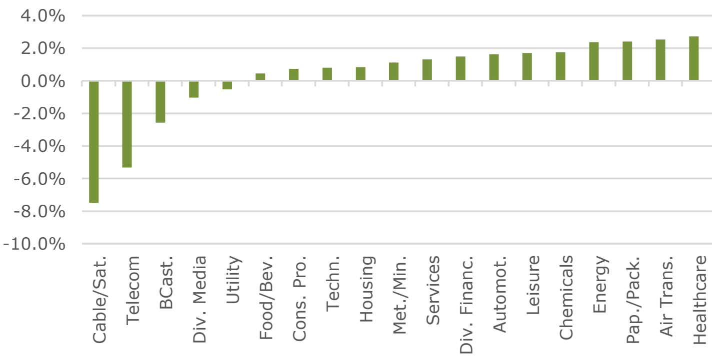
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	938	-5
CLO AAA	655	-10
CLO BBB	920	-5
CLO BB	1192	-38

7) US Leverage: Debt-to-EBITDA ratio of US companies remained stable at elevated levels.

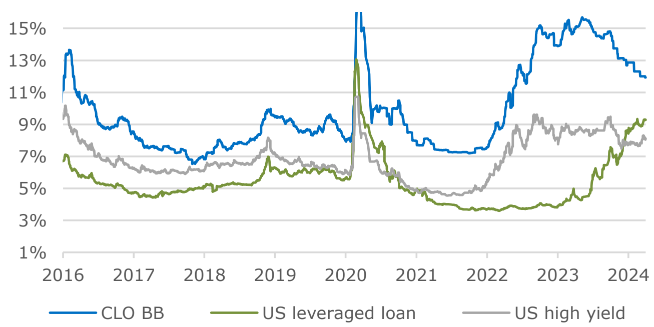


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors, with leisure outperforming significantly.

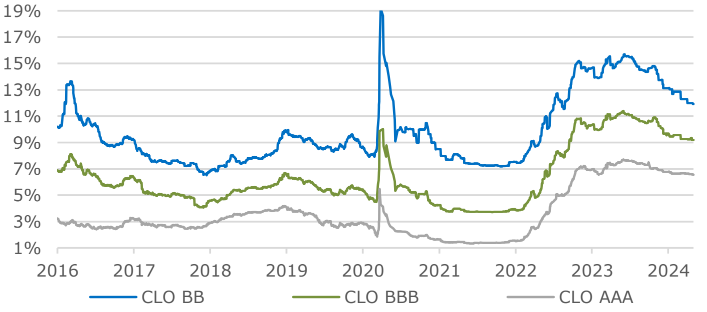


Alternative Perspective

9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



10) CLO Yields: CLOs offer an attractive yield premium over bonds and Loans.



11) Asia vs. US: Asian IG spreads have tightened thanks to gradual post-COVID recovery and US inflation easing.

12) Capital vs IG: Capital Securities structurally earn a premium vs. US IG bonds. Capital Securities are dominated by the financial sector.

Education Corner - Series: AIM Credit Analysis (3)

Capital Expenditures (CapEx)

Last month, we discussed the variables to find Net Working Capital needs and how to calculate the Operating Cash Flow. This month we focus on the other vital metric to reach the Free Cash Flow and evaluate Capital allocation decisions from the management team.

CapEx, abbreviation for Capital Expenditures, are the investments that a company undertakes to maintain or expand its productive capacity. Even so, it is a diffuse concept and one in which we again find many accounting interpretations.

Investments in CapEx increase the fixed asset base on the balance sheet. In turn, these assets are depreciated over time in the P&L account, diminishing earnings. And it is in the CF statement where we can estimate how much of this CapEx is necessary to maintain the current operating structure (Mainteinance CapEx; E.g. PP&E), and how much the company invests in assets which will generate superior returns over the long term (Growth CapEx; E.g. M&A).

Capital Expenditures

Balance Sheet	**Assets: PP&E, Intangible assets.**
Profit & Loss Statement	**D&A: Sometimes used as an approximation of Maintenance Capex.**
Cash Flow Statement	**Cash Flow From Investing Activities: Purchase and Proceeds from PP&E, M&A.**

US Loan Index Total Return - Attractive Long Term Yield Generation

List of Abbreviations

Capital Securities (Or preferred securities): Are fixed income securities combining features of bonds and preferred stocks.

CDS: Credit default swaps transfer credit event risk to another party in exchange of a perdiodically paid premium. CDX index covers the US IG-, iTraxx the EU IG- and iTraxx crossover (XO) the EU HY market.

CLOs: Collateralized loan obligations are structured finance securities collateralized predominantly by a large pool of different loans.

Default Rate: Number of defaulted corporate issuers of leveraged loans and high yield bonds.

Loans: Are syndicated, public tradable loans. Synonyms are «syndicated loans», «loans», «leveraged loans» and «bank loans».

OAS: Option-adjusted spread is the yield difference of an interest paying security to the risk free rate considering embedded options.

TIPS: Treasury Inflation-Protected Securities are US government linked to the US CPI Urban Non-Seasonally Adjusted.

Up-/ downgrades: Rating actions of Moody's and S&P of up-or downgrades of US high yield bond issuers denominated in USD.

Up-/ downgrade ratio: Number of upgrades of total rating actions.

Recovery Rates: Bond issuer-weighted recovery rates express the principal and accrued interest on defaulted debt that can be recovered in percentage of face value. Example:

Expected loss rate if US HY defaults were 10%: 10% ./. Estimated average recovery rate of ~30% = -7%; Example for Loans:

Expected loss rate if US Loan defaults were 10%: 10% ./. Estimated average recovery rate of ~65% = -3.5%;

Data and Price Sources

Alpinum Investment Management	Federal Reserve Bank of St. Louis	Palmer Square indices
Bank of America Merrill Lynch indices	Markit CDS indices	Preqin
Bloomberg	Moody's Investors Service	S&P
The Federal Reserve	J.P. Morgan	Federal Housing Finance Agency
US Census Bureau		

Disclaimer

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