

# In the debt markets

## An insight into current market conditions



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“*Uncertainty continues to drive global markets for the year ahead. Eurozone sovereign concerns and global growth outlook will again set the tone for market sentiment this year as volatility remains a central theme.*”

Nick Atkinson  
Partner,  
Debt & Capital Advisory

### CEO & CFO summary

Despite the regular stream of negative news from the UK retail sector, the global macro picture has recently improved with positive data emerging from the US. Markets also appear content for the moment with “Merkozy’s” attempt at solving the Eurozone crisis. However, we expect banks to continue to focus on deleveraging as they prepare for Basel III and look to comply with European Tier 1 capital stress test requirements. The scaling back from sub-investment grade lending by capital-constrained banks appears, to us, to be a permanent feature of the market, not a temporary one, and we recommend companies that have previously relied on bank funding to be prepared for continuing fragmentation amongst liquidity providers.

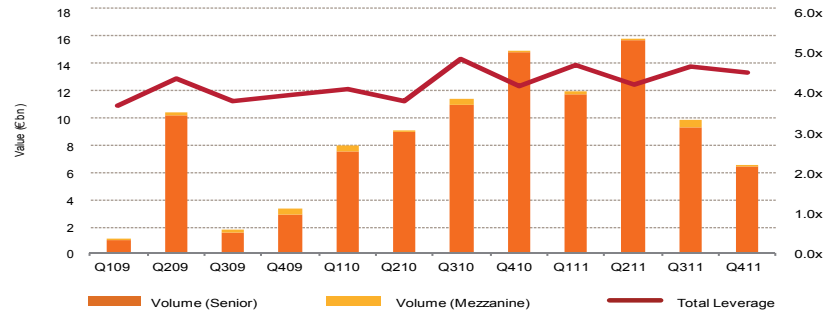
The early year optimism, helped significantly by the ECB Long Term Refinancing Operation that saw almost €500bn of 3 year money lent to European banks with a second opportunity for banks to borrow again in February, appears to have stabilised markets in the near term. More liquidity cannot solve what remains a solvency crisis but will create windows of opportunity that we recommend issuers take advantage of, as we described in our previous release. We expect investors, who remain cautious, to focus on the higher rated, stronger credits, leaving lower rated companies struggling to get their stories heard.

Companies reliant on bank lending, without access to the capital markets, will have limited access to capital. Even companies with a good story to tell will have to be much more creative to meet their financing requirements, exploring the liquidity available in the fragmented alternative credit market. Fragmentation will create challenges for CEOs and CFOs more used to dealing with relationship bankers. As non-bank funders play an increasingly important role in the sub-investment grade space, they offer companies an important source of additional liquidity. This liquidity comes at a higher price point, but it also comes with more flexibility across other commercial terms.

Our Debt Markets and Debt Brokerage businesses are regularly speaking to over 150 investors. As fragmentation continues, reach and scale will be key to accessing this investor base. In these volatile times, we urge CEOs and CFOs to plan early and develop detailed funding contingencies.

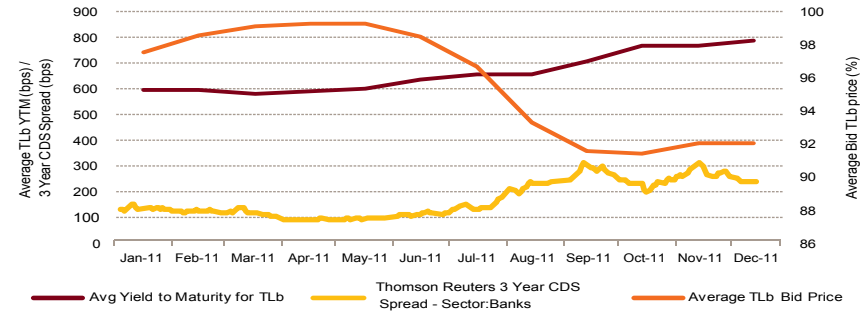
# Leveraged loans

Chart 1: European leveraged loan volume



Source: Standard & Poor's LCD

Chart 2: Comparative analysis of primary and secondary loan pricing



Source: Standard & Poor's LCD, Markit

- The current deal pipeline remains thin. While some optimism for larger deals can be taken from the Orange Switzerland and CPA transactions, we expect the principal area of activity for leveraged loans this year to be more moderately sized club deals.
- Many former European issuers are seeking the consistent and deep liquidity of the US markets over the volatile and illiquid European markets. Taminco and KDG are two recent examples of this, with more likely to follow.
- The lack of new primary activity is giving some hope though to those arrangers with unsold positions from 2011 deals. We understand that sale price talk for these deals remains in the high 80's to low 90's as a percentage of face.
- We expect much activity this year to be driven by the timing of high yield repayments into the loan market. These pay downs may create windows of opportunity for new primary issuance. Technicals will also drive bank appetite for underwriting, with behaviour switching quickly between aggression and caution.
- We continue to see significant liquidity from mezzanine providers and other non-bank / non-CLO accounts. Price remains the biggest obstacle to attracting this liquidity to new primary issuance.

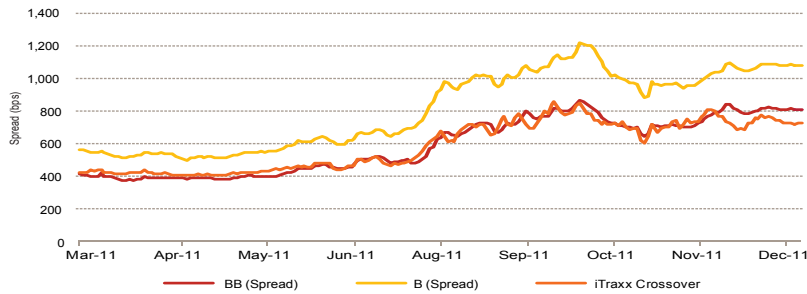
Table 1: Recent leveraged loans

Issuer	Country	Date	Purpose	Deal size (m)	RC (m)	TLA (m)	TLB (m)	Mezzanine (m)	Snr Lev	Total Lev	OID
Sealed Air Corp.	USA	Oct-11	Acquisition	€301			€301 E+450		4.4x	4.4x	97
Firth Rixson	UK	Nov-11	Corp Purpose -add on	£45			£45 L+525		N/A	N/A	96
Eismann	Germany	Nov-11	LBO	€181	€25 E+425	€66 E+425	€90 E+475		3.9x	3.9x	N/A
TeleCable de Asturias	Spain	Nov-11	LBO	€219	€20 E+475	€65 E+475	€114 E+525		3.5x	3.5x	N/A
Stock Spirits Group	Poland	Nov-11	Refinancing	€220	€50 N/A	€170 N/A			2.0x	2.0x	N/A
Merlin Entertainment Group	Denmark	Dec-11	Acquisition - add on	£200			£200 E+500		4.7x	4.7x	97
Taminco	Belgium	Jan-12	Acquisition	€120			€120 L+500		2.1x	3.9x	98
CPA Global	UK	Jan-12	Acquisition	£435	£50 TBD	€75 TBD	£235 TBD	£120 L+1050	4.3x	5.9x	TBD

Source: Standard & Poor's LCD

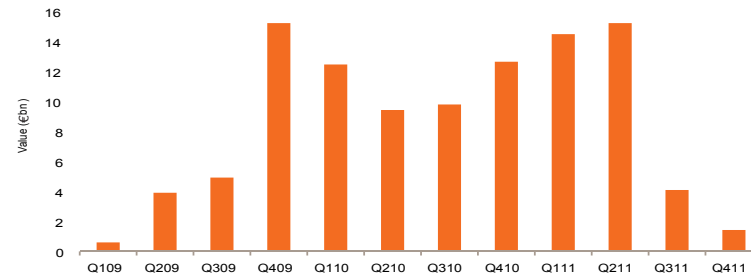
# High yield (HY)

Chart 3: B and BB rated Euro HY Bond secondary pricing



Source: Markit, Bank of America Merrill Lynch

Chart 4: European HY Bond volume (primary issue)



Source: Standard & Poor's LCD

- The twin macro themes of the Eurozone and global growth will continue to be the key determinants of activity in the high yield (HY) market this year.
- Early year bullish sentiment on both these factors, combined with continued strong US market conditions, has created a window for HY issuance, with Polkomtel, a hung bridge from 2011, the first issuer to take advantage.
- Significant retail inflows (\$5.6bn in the six weeks since the beginning of December) continue to create positive conditions for HY issuance in the US, compared to slight negative outflows for European HY funds over the same period.
- European HY investors require new primary issuance to invest their funds. Investors are demonstrating a strong preference for BB credits over lower rated companies.
- We expect European HY conditions to remain volatile and Eurozone uncertainties to cause frequent closures in the market.
- When windows of opportunity do open we expect investors' continued caution to lead first time issuers rated below BB to pay a significant price premium over established issuers and higher rated companies, to the extent liquidity is available at all for these new issuers.
- In deals where debt is below €350m, we expect increasing competition from alternative sources of funding.

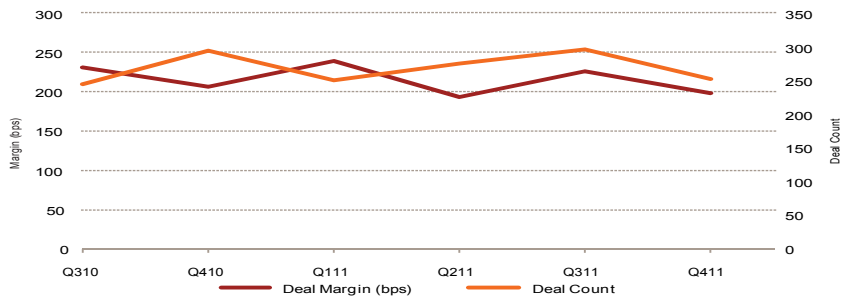
Table 2: Recent HY issuance

Issuer	Country	Date	Purpose	Proceeds (m)	Price %	Yield %	Coupon %	Maturity	Effective Rating (Launch)
Faurecia	France	Oct-11	Refinancing	€350	99.48	9.38	9.38	Dec-16	NR
Heidelberg Cement	Germany	Nov-11	Refinancing	€200	107.50	8.08	9.50	Dec-18	BB
Com Hem	Sweden	Nov-11	Acquisition	€288	94.98	11.75	10.75	Sep-19	CCC+
Taminco	Belgium	Jan-12	Acquisition	\$400	100.00	9.75	9.75	Mar-20	B-
Fresenius	Germany	Jan-12	Acquisition	\$800	100.00	5.63	5.63	Jul-19	BB
Fresenius	Germany	Jan-12	Acquisition	\$700	100.00	5.88	5.88	Jan-22	BB
Ardagh Packaging	Ireland	Jan-12	General Corporate Purposes	\$161	100.48	7.39	7.38	Oct-17	BB-
Ardagh Packaging	Ireland	Jan-12	General Corporate Purposes	\$251	96.36	9.99	9.13	Oct-20	B-
Cable & Wireless	United Kingdom	Jan-12	Refinancing	\$400	100.00	8.94	8.75	Feb-20	BB
FMC	Germany	Jan-12	Acquisition	€250	100.00	5.25	5.25	Jul-19	BB
Polkomtel	Poland	Jan-12	Acquisition	€522	96.27	12.50	11.75	Jan-20	B-
Polkomtel	Poland	Jan-12	Acquisition	\$491	98.10	12.00	11.63	Jan-20	B-

Source: Dealogic

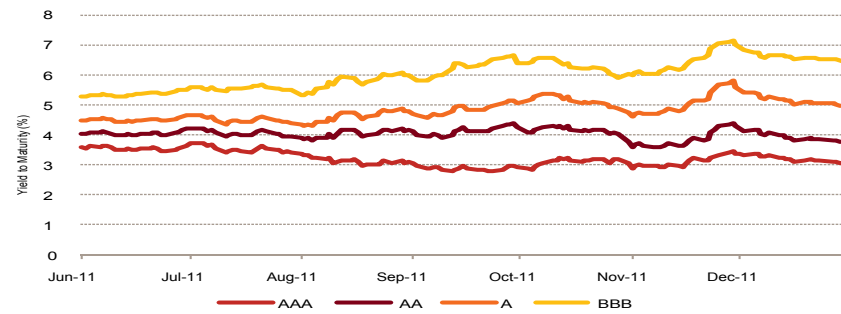
# Corporate loans & bonds

Chart 5: European investment grade average margin over LIBOR/EURIBOR



Source: Dealogic

Chart 6: European corporate investment grade bond yields



Sources: Standard & Poor's LCD

- Reduced bank liquidity has seen a flight to quality, with banks competing aggressively for the strongest credits.
- Higher bank funding costs have not been fully passed onto stronger rated companies as banks look to protect their ancillary fee business.
- Smaller, lower rated companies will find it harder to raise bank funding and we expect pricing to rise for these companies as they typically lack the ancillary business that attracts banks.
- The inter-bank lending market remained seized, but the ECB's three year loans have eased concerns about bank refinancing needs for the current year at least.
- Investors comment on visible stress in portfolio companies as a result of the tough economic conditions with previously stronger performing companies in France and Germany now also being impacted.
- Investment grade corporate bond markets have recovered strongly from the summer 2011 slowdown and volume increased by over 50% from Q3 2011 to Q4 2011.
- US dollar funding from European banks has seen some European issuers, including Tesco and France Telecom, directly access the US markets and pay a currency premium to secure US dollar liquidity.

Table 3: Recent Corporate Bond issuance

Issuer	Country	Date	Maturity Date	Deal value €m	Coupon	Yield to Maturity	Effective Rating (Launch)
Vivendi SA	France	Jan-12	Jul-17	1,243	4.13	4.25	BBB
Repsol International Finance BV	Spain	Jan-12	Feb-19	750	4.88	4.88	BBB+
RWE Finance BV	Germany	Jan-12	Jan-34	725	4.75	4.76	A-
Carrefour SA	France	Jan-12	Nov-16	500	4.38	4.36	BBB+
Clariant Finance (Luxembourg) SA	Switzerland	Jan-12	Jan-17	499	5.63	5.69	BBB-
Valeo SA	France	Jan-12	Jan-17	498	5.75	5.83	BBB-
Northumbrian Water Finance plc	United Kingdom	Jan-12	Jan-42	429	5.13	5.17	BBB+

Source: Dealogic

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