Leveraged Finance News

July 1, 2013

SECTION: NEWS; Pg. 1 Vol. 3 No. 26

LENGTH: 938 words

HEADLINE: High Yield 'Bloodletting' Will Yield to Calm

BYLINE: MS

BODY:

The high yield bond market took a big hit at the end of the second quarter as investors scrambled to prepare for rising interest rates.

But that may not be all bad. Many participants feel the junk bond market had gotten ahead of itself and was due for a correction. Lower prices could even help fuel M&A, eventually bringing more deal volume.

June was the slowest month for new deal volume since 2011. U.S. high yield new issue volume totaled $7.1 billion for June as of June 25, which put it on course to be the slowest month since December 2011, which saw $10.1 billion in total issuance. The average monthly volume for the first five months of the year is $37.6 billion.

The average price for bonds rated BB dropped to an average of 101.16% of par by June 24 from an average price of 107.56% of par on May 24, according to JPMorgan. For single-B rated bonds that average price moved to 101.08% of par from 106.38% of par. Yields, which move inversely to prices, increased to 7.16% as of June 24 from 5.64% on May 24.

"There has been a fair amount of bloodletting," said a New York-based high yield banking executive.

The second quarter proved to be the Dr. Jekyll and Mr. Hyde of recent junk bond new issue history. Junk bond volume in May totaled $55.2 billion in new issues, the busiest month ever in junk bond history. Global new issue high yield bond volume reached a record $270.3 billion in the first half of the year, an increase of 50% over the $180 billion raised year-to-date in 2012. It is an 8% increase from the previous half-year high of $247.2 billion raised in the second half of last year. Global leveraged finance volume totals $1.05 trillion year-to-date, according to a June 24 report by Dealogic. This represents a 35% increase over the $776.8 billion raised in the same time period last year.

Despite these record volume numbers for the first half of the year, leveraged finance markets have slowed considerably since reports from the Federal Reserve indicated a coming end to its bond-buying program.

"I think we were bubble-ish in a lot of asset classes," said Jim Probert, head of Americas **investment** grade capital markets for Bank of America Merrill Lynch, at a press briefing on June 25. "A few good things may come out of this. You might even see M&A activity increase once volatility subsides. ...

Given the movement has been so rapid, we will probably get to that place sooner than expected."

Prices on junk bonds have continued to drop considerably in the weeks since the Fed first indicated it may begin curtailing or "tapering" its bond buying program.

The average spread to benchmark for global high yield bonds was 528 bps in the second quarter, a 23% decrease from the 683 bps in Q2 2012 and the lowest quarterly benchmark average since the second quarter of 2011 reached 524 bps. The average tenor fell to 6.9 years in Q2 from 7.2 years in Q2 2012, which was the lowest average of any quarter since Q3 2009's 6.6 years.

High yield investors don't see this pullback as all bad. "I believe the high yield market is consolidating itself similar to the equity markets," Mark Tauber, managing director of capital markets with Los Angeles-based firm CapitalSource, said in an email. "Some pullback was necessary and creates a more long term, healthier environment that is sustainable."

Tauber said that the pullback gives a silver lining in the form of better deals that are conforming to new market norms. "We have been watching a number of deals that were attractive from a business perspective but the financing packages and/or pricing and structures were significantly off market and didn't make sense from a risk vs. return perspective. As things pulled back, deals had to flex upwards, resulting in a more appropriate capital structure, more market pricing, and better overall opportunities for CapitalSource to consider," he noted.

Despite the tremendous reduction in activity, deals continue to come to market and get priced. Deal flow never froze completely, though there hasn't been a coupon lower than 6% price on the new issue market since May 20, according to KDP **Investment** Advisors.

"A perfect storm is brewing for the junk bond world," John Riley, president and chief strategist with Dallas-based Cornerstone **Investment** Services, said in an email. "With volatility and rising rates there could be a wave of issuance, as long as the mutual funds have the cash they'll be buyers. If mutual funds are hit with a lot of redemptions they will not have the money to buy. Issuers then may raise rates to attract the real junk buyers. No one's going to want to be that guy."

And the nature of the deals on the primary may shift, with more mergers and acquisitions making their way to the market, since the opportunistic refinancing rates are no longer available, the stable credit environment and need to get deals done may give preponderance to M&A deals. Companies that can see past the volatility will still find space on the market for their deals, investors note.

"I believe the M&A market will pick up this year, and that will lead to busier loan and high yield market. I think this activity will come on post Labor Day," said Tauber.

Speaking at the June 25 press briefing, three BofA executives stressed that the current market correction is a technical correction and not a major disruption to the economy or the state of financial markets, despite the steep sell-off.

"What issuers will conclude, with our help, is that these are still good rates," said Stephan Jaeger, head of Americas high yield capital markets for BofA. "We're still open for business and willing to help put money to work."

URL: http://www.bankloanreport.com/

LOAD-DATE: July 1, 2013

Focus: **investment** (Exit FOCUS™)
View: Full

Date/Time: Wednesday, October 15, 2014 - 12:01 PM EDT