Credit Benchmark®

Survival of the Fittest in the Leveraged Loan Market

September 2021

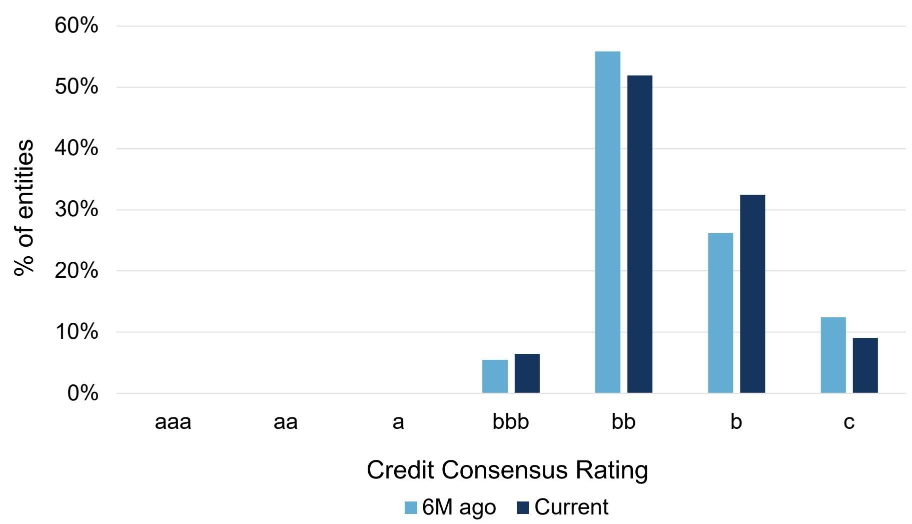
The $1.2trn Leveraged Loan market continues to grow, with S&P showing new issuance in the sector running at double the volume recorded a year ago. Mergers and acquisitions are a key driver in this growth, especially driven by private equity buyouts of existing firms.

But there are fears that investors in the broader high yield space are not being properly compensated for the risks . Moody's data shows that, compared with typical non-investment grade borrowers, the default rate for private equity backed firms was significantly higher in 2020-21; the pandemic has taken its toll on heavily indebted companies.

But recent private equity investments have focused on firms that have weathered the pandemic with stable revenues and strong cash flows. This could boost the average credit quality of leveraged loan assets, but the latest consensus credit data shows a more mixed picture.

Figure 1 shows the 6M change in credit distribution for 154 companies in the leveraged loan sector.

Figure 1: 6M Change in Credit Distribution for 154 Companies in Leveraged Loans Sector



This year, there has been a modest decrease in the **bb** category, and a corresponding increase in the **b** category; but the **c** category has dropped while the **bbb** category shows a slight increase. This is consistent with the overall damage caused by the pandemic but shows signs that leveraged loan portfolios may be at the beginning of a credit upgrade.

Figure 2: Leveraged Loan Issuers: 1-Month Upgrades vs. Downgrades

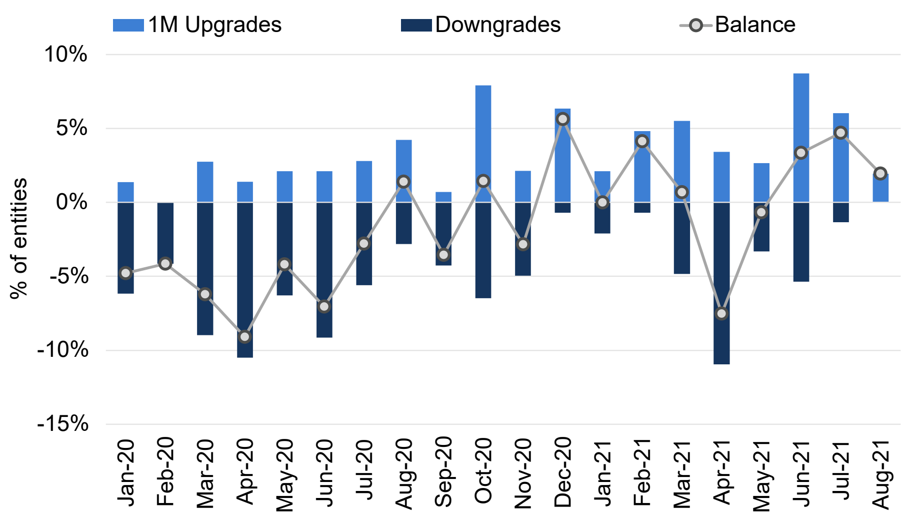
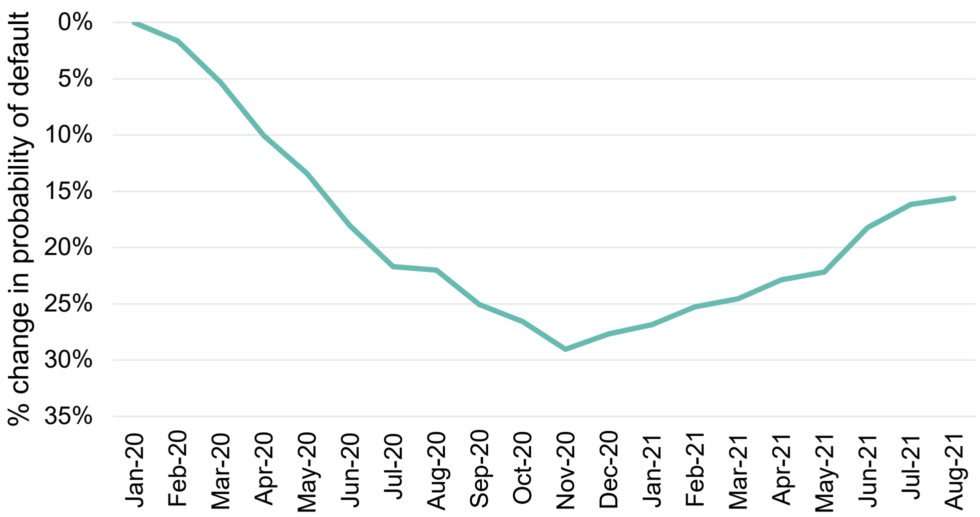


Figure 2 shows the pattern of upgrades and downgrades over the past 20 months.

The sharp recovery since April 2021 (a record for downgrades in this period) seems to have run its course; upgrades and downgrades are currently close to being balanced.

Figure 3 (overpage) shows the resulting trend in average credit risk.

Figure 3: Leveraged Loan Issuers: Average Credit Risk



The pandemic pushed average default risk for leveraged loan issuers up by nearly 30%; it has since recovered about half of that and continues to improve.

The latest consensus data shows a two-way credit pull in the leveraged loan market – there were certainly some significant downgrades earlier this year, but there are recent signs that portfolios are being restructured with a focus on increased credit quality.

Detailed consensus credit data for the 154 issuers in this sample is now available on Bloomberg.

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