

# European High-Yield Bond Market: Slowdown Expected in 2015



## European High-Yield Bond Market Growth to Slow in 2015

Scope expects the number and volume of European high-yield bond issues to continue growing in 2015, albeit at a slower pace than in 2014 given the worsening economic outlook.

The deteriorating economic perspective is reflected in investors' increased risk perception: the credit spread for European high-yield issues has widened since June 2014, peaking at a 12-month high of 583bp in December 2014.

In the current low interest rate environment, Scope expects investors to continue investing in higher rated issues with lower default rates. This was already the case in December 2014 when the median credit rating for new issues improved to a high of BB-, compared to a median rating of B for the full year.

## 2014 – a Record-Breaking Year for European High-Yield Bonds

The 18% YoY growth in the European high-yield bond market (at constant exchange rates - CER) led to a record EUR 107bn in bond issuance in 2014. Growth was driven by record low coupons across all rating categories during the year and investors' limited options for higher yields elsewhere. The main issuers in 2014 came from the telecom and automotive industries.

## 2014 Early Refinancing Wave to Abate

Some 49% of 2014 bond issues were carried out for refinancing purposes. In particular issuers that had issued at comparably higher coupons exercised their call-options in 2014 to refinance early. Since January 2009, a total of EUR 53bn (14% of the issued bond volume) has been called. The large majority of early calls - a staggering EUR 41bn of bond volume - occurred in 2014. Half of the volume called in 2014 (EUR 21bn) was subsequently refinanced via new bond issues in 2014 at a coupon that was lower by an average 366bp.

At-end December 2014, 547 callable bonds were still outstanding for a total of EUR 185bn. Scope nevertheless expects refinancing to slow in 2015, dampening growth in the high-yield bond market because since June 2014 the rise in credit spreads for issues in all rating categories has made early refinancing more costly.

## Default Rates Expected to Remain Low in 2015

With coupons at a six-year record low in 2014 and new issuers benefitting from better credit quality since August, Scope expects the issuer default rate in the European high-yield market to remain low in 2015. Of the bonds issued since 2009, Scope observed 10 defaults in 2014, compared with 16 in full-year 2013. This corresponds to default rates of 1.52% and 3.63%, respectively, on the bonds outstanding at the beginning of each year. The cumulative six-year default rate of 12% observed for those bonds in 2014 was lower than Scope's 20% idealized six-year probability of default for B+ rated bonds. The gap between current default rates and Scope's idealized probability of default should, however, narrow if market conditions deteriorate.

Scope's definition of European high-yield issuers follows that of Dealogic. It includes 1042 high-yield bonds issued within Europe between 2009 and 2014. The definition excludes sovereign, sub-sovereign, and supranational parent issuers, as well as ABS/MBS issuers, but also banks, funds, finance companies and insurers. Historical data is reported in Euro using the exchange rate at the time of issuance. Ratings are the lowest for each bond at issuance as reported by the AFME European High-Yield bond report.

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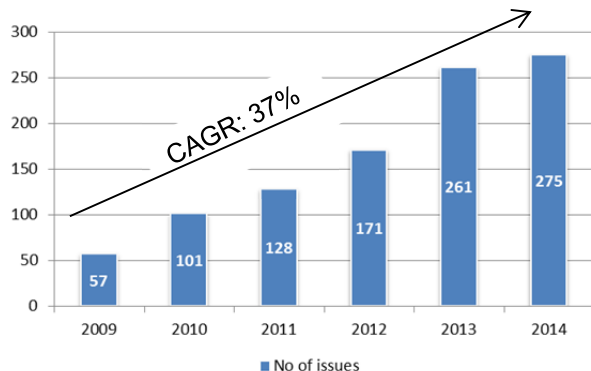
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## High-yield bond issuance volume in Europe tops the EUR 100bn mark in 2014

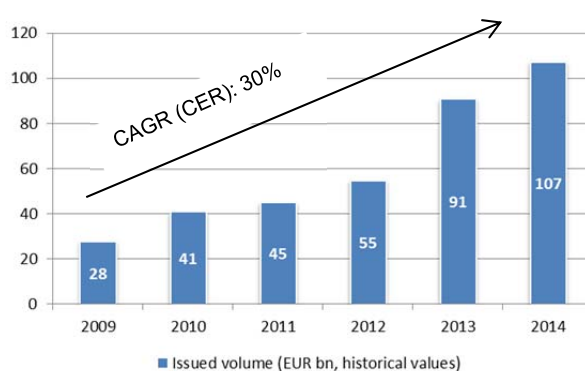
European high-yield issuance volume stood at a record EUR107bn in 2014, up 18% YoY at constant exchange rates, exceeding the EUR 100bn mark. At the same time, the number of issues rose 5% YoY.

**Figure 1: No. of European high-yield bond issues**



Source: Scope, Bloomberg, AFME

**Figure 2: Volume of European high-yield bond issues**

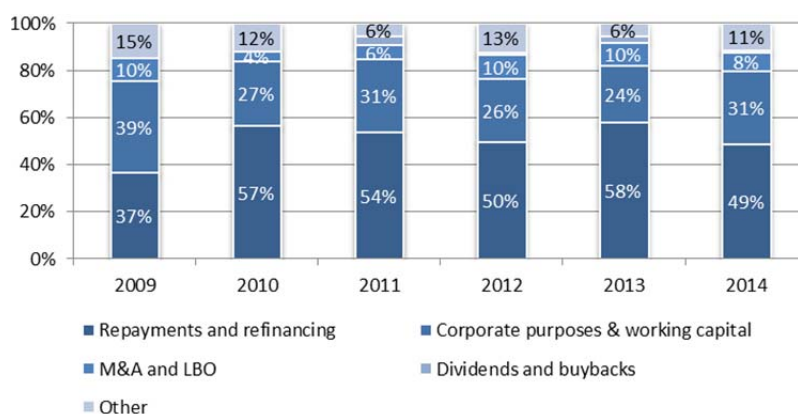


Source: Scope, Bloomberg, AFME

## Growth in the European HY bond market driven by debt refinancing

While some of the largest bond issues were driven by M&A activities, debt refinancing was the main motivation for bond issuance in 2014. Issuers took advantage of the low interest rate environment in 2014, in which median coupons in all rating categories were at their lowest levels in six years (see Table 3 on page 7). In 2014, 49% of total high-yield bond volume was thus used for refinancing purposes (31% of bond volume was issued to fund general corporate purposes, 8% to finance M&A, 1% for dividends and share buybacks and 11% for other purposes - Bloomberg data) (see Figure 3).

**Figure 3: Use of bond proceeds since 2009**

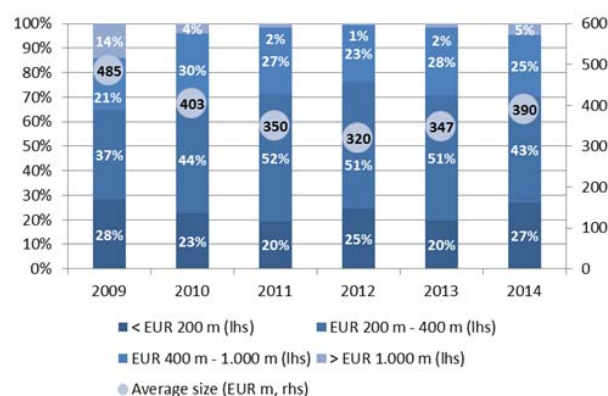


Source: Scope, AFME, Bloomberg

## Automotive and Telecoms accounted for a major share of 2014 bond issuance

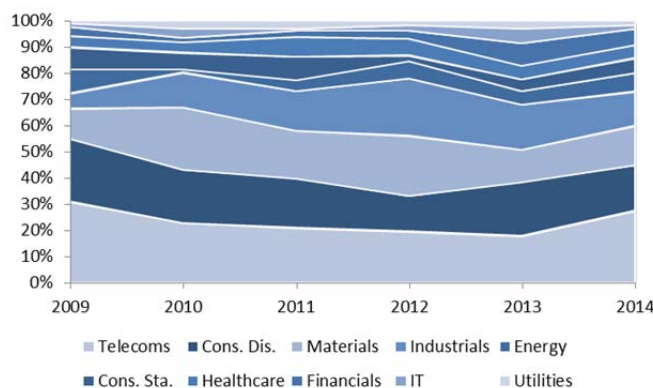
Sector-wise, in 2014 volumes in the European high-yield bond market were driven by the automotive and telecommunication sectors, which issued bonds to finance M&A activity and restructuring. Together, the two sectors accounted for more than a third (36%) of total European high-yield issuance volume in 2014, but only for 15% of the total number of issues (40 out of a total of 275, up 5% YoY).

**Figure 4: Size of bond issues (2009-2014)**



Source: Scope, Bloomberg, AFME

**Figure 5: Share of the 10 GICS sectors in European high yield bond issues (2009-2014)**



Source: Scope, Bloomberg, AFME

### Larger issuances seen in 2014

In 2014, the Top 10 issues were dominated by large, frequent issuers (see Table 1). This suggests some cautiousness on the part of European high-yield issuers in 2014, with larger, bond-financed M&As only pursued by issuers with capital market experience. M&A and refinancing activities have boosted the average issuance size in 2014 to EUR 390m, up from EUR 347m in 2013.

The largest issuer in 2014 was VimpelCom Ltd.'s subsidiary Wind Acquisition Finance S.A ('Wind'). Wind issued two bonds in April and July 2014 with volumes totaling EUR 9.9bn to extend Wind Group's debt maturity profile and lock in annual interest cost savings. The second and third largest issuers in 2014 were Altice SA and its subsidiary Numericable SAS. In May 2014, Altice SA and Numericable SAS issued a total of EUR 12bn to finance Altice's acquisition of French SFR SA and Omer Telecom Ltd in France for EUR 17bn. Altice SA also agreed in December 2014 to buy Portugal Telecom SGPS SA for EUR 7bn in cash. The combined bond issues of Altice SA and Numericable SAS in May represented 11% of total issue volume in 2014.

**Table 1: Largest issuers in 2014**

Rank	Issuer	2014 (EUR m)	% of total	Sector
1	Wind	9,953	9%	Telecoms
2	Numericable SAS	7,876	7%	Telecoms
3	Altice SA	4,174	4%	Telecoms
4	Ardagh Glass Ltd	3,122	3%	Materials
5	Schaeffler AG	3,064	3%	Automotive
6	Fiat Group Automobiles SpA	3,022	3%	Automotive
7	AerCap Ltd	1,876	2%	Leasing
8	CNH Industrial NV	1,700	2%	Industrials
9	Unitymedia KabelBW GmbH	1,561	1%	Telecom
10	Oswestry Ltd	1,520	1%	Consumer Staples
Top 10 issuers		37,867	35%	
Other issuers		69,280	65%	
<b>Total</b>		<b>107,148</b>	<b>100%</b>	
Of which Telecoms		29,929	28%	
Of which Automotives		8,406	8%	

Source: AFME, Bloomberg, Scope

**Table 2: Largest issuers in 2013**

Rank	Issuer	2013 (EUR m)	% of total	Sector
1	Fiat Group Automobiles SpA	2,865	3%	Automotive
2	Schaeffler AG	2,818	3%	Automotive
3	Liberty Global Plc	2,711	3%	Telecoms
4	Koninklijke KPN NV	2,024	2%	Telecoms
5	NXP NV	1,709	2%	IT
6	Activision Blizzard Inc	1,690	2%	IT
7	Peugeot SA	1,600	2%	Automotive
8	Alcatel Lucent SA	1,597	2%	IT
9	Altice SA	1,501	2%	Telecoms
10	VimpelCom Ltd	1,491	2%	Telecoms
Total 10 largest		20,006	21%	
Other issuers		73,196	79%	
<b>Total</b>		<b>93,202</b>	<b>100%</b>	
Of which Telecoms		16,276	18%	
Of which Automotives		9,328	10%	

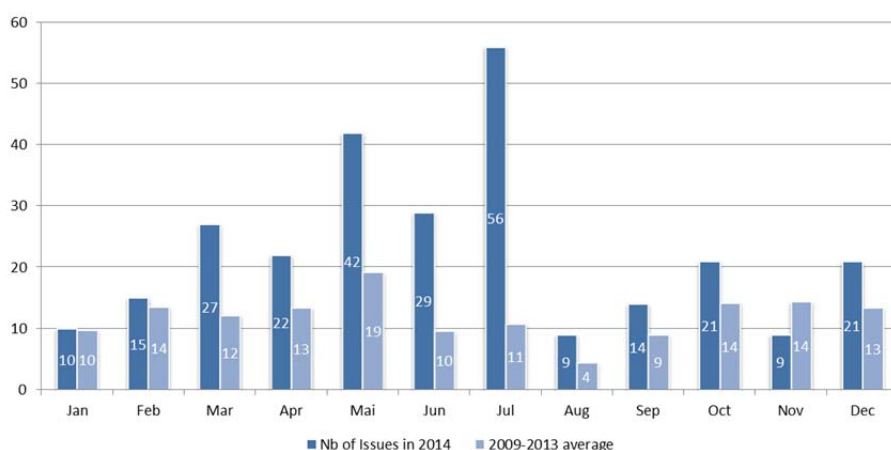
Source: AFME, Bloomberg, Scope

### Slower market growth expected to continue

European high-yield issuance stood at a record EUR 107bn in 2014, up 18% YoY at CER, exceeding the EUR 100bn mark, while the number of issues grew by 5% YoY. Restrained by the eroding economic outlook since June 2014, growth in both volumes and the number of issues recorded in 2014 fell short of 2009-2014 CAGR of 30% and 37%, respectively.

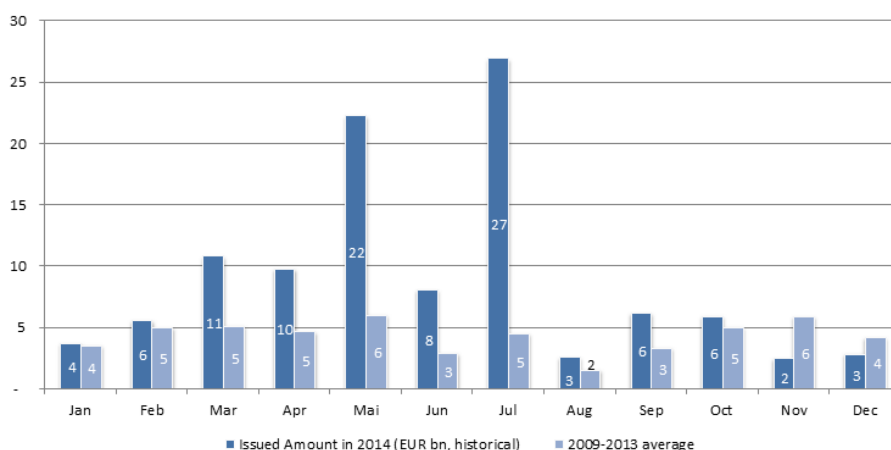
For 2015 Scope expects growth in the European high-yield bond market to continue at a lower pace than in 2014. Since August 2014, the number and volume of new bond issues have been more in line with the historical monthly averages seen from 2009 to 2013 (74 issues in August to December 2014 compared with 50 on average for the August to December periods between 2009 and 2013), and well below the figures observed at the beginning of the year (see Figures 6 and 7).

**Figure 6: Number of bond issues per month in 2014**



Source: Scope, Bloomberg, AFME

**Figure 7: Volume issued per month in 2014 (EUR bn)**



Source: Scope, Bloomberg, AFME

## Early Refinancing Wave to Abate in 2015

100 bonds were called by 60 issuers in 2014

In 2014, 49% of bond issues were carried out for early refinancing purposes. In particular companies that had issued bonds with higher coupons exercised their call-options in 2014 to refinance early. Since January 2009, a total of EUR 53bn has been called early. Scope identified 100 bonds that were called by 60 different issuers in 2014.

Refinancing wave expected to abate in 2015

The vast majority of early calls on bonds issued since 2009 - for a staggering EUR 41bn - took place in 2014. Some 78% of the bonds called in 2014 were scheduled to mature between 2015 and 2018. Thanks to historically low interest rates, 50% of the called volume (EUR 21bn) was subsequently refinanced by 20 issuers via new bond issuance in 2014 at a coupon that was lower by an average 366bp. This was mostly attributable to lower credit spreads, since the ratings of both the refinanced and the refinancing bonds were broadly the same.

At end-December 2014, 547 callable bonds were still outstanding for a total of EUR 185bn. Scope nevertheless expects refinancing to slow in 2015, dampening growth in the high-yield bond market as since June 2014 the rise in credit spreads for issues in all rating categories has made early refinancing more costly.

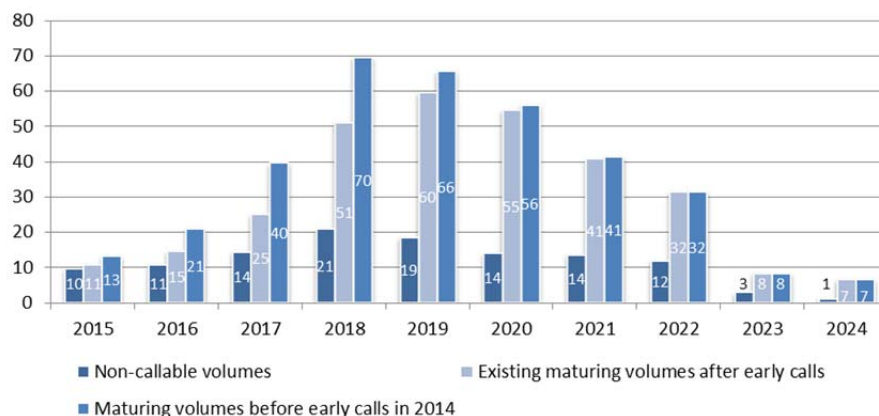
**Table 3: Bonds called and refinanced in 2014**

Issuer name	Amount called (EUR m)	Coupon outstanding (%)	Call date	Initial maturity	Amount issued (EUR m)	New coupon rate (%)	Issue date
ArcelorMittal SA	501	8.75	20.02.2014	25.03.2019	750	3.00	25.03.2014
					600	2.88	04.07.2014
Ardagh Glass Plc	300	9.25	16.01.2014	01.07.2016	307	6.25	05.02.2014
	1,206	7.38	21.08.2014	15.10.2017	2,295	4.25 – 6.00	03.07.2014
Boparan Holdings Ltd	791	9.78 - 9.88	23.07.2014	30.04.2018	1,022	4.38 - 5.50	07.07.2014
Care UK Ltd	298	9.75	01.08.2014	01.08.2017	640	5.55 - 8.05	17.07.2014
Dometic Gorup AB	202	12.75	11.07.2014	04.05.2019	314	9.50	26.06.2014
EuropCar SA	250	9.75	18.08.2014	01.08.2017	350	5.13	31.07.2014
Grifols SA	635	8.25	31.03.2014	01.02.2018	719	5.25	12.03.2014
Inmarsat Plc	437	7.38	04.07.2014	01.12.2017	731	4.88	04.06.2014
Jaguar Land Rover Ltd	1,148	7.75 - 8.12	15.05.2014	15.05.2018	324	9.38	31.01.2014
					488	5.00	08.07.2014
					319	4.25	31.10.2014
Matalan Ltd	536	8.8 - 9.623	12.06.2014	31.03.2017	604	6.80 - 8.80	02.06.2014
Numericable SAS	585	8.75 - 12.38	21.05.2014	15.02.2019	7,876	4.875 - 6.25	08.05.2014
Ocean Rig UDW Inc	346	9.50	13.05.2014	27.04.2016	363	4.75	26.03.2014
Ontex Group NV	280	4.75	16.07.2014	15.04.2018	250	4.75	14.11.2014
Piaggio & CSPA	150	7.00	09.06.2014	01.12.2016	142	4.63	24.04.2014
R&R Ice Cream Plc	350	8.38	05.06.2014	15.11.2017	385	4.25 - 5.5	14.05.2014
					255	4.75	26.06.2014
Schaeffler AG	1,080	6.75 - 8.75	14.05.2014	15.02.2019	2,005	2.75 - 4.25	14.05.2014
Unitymedia KabelBW GmbH	2,095	8.88	07.11.2014	01.12.2019	561	6.13	22.10.2014
Virgin Media Ltd	982	7.00	14.04.2014	15.01.2018	1,102	5.5 - 6.25	28.03.2014
	689	6.50	22.05.2014	15.01.2018			
	791	8.88	24.10.2014	15.10.2019			
Wind SA	3,412	11.75 - 12.25	15.07.2014	15.07.2017	3,780	7.00 - 7.38	23.04.2014
	3,209	7.38	25.07.2014	15.02.2018	6,173	4.00 - 4.75	10.07.2014
Xefin Lux SCA	300	8.00	03.06.2014	01.06.2018	325	Floating	03.06.2014

### Some refinancing risk in 2018 and 2019

The maturing volume of bonds issued since 2009 will peak in 2019 at EUR 60bn (2016: EUR 15bn, 2017: EUR 25bn, 2018: EUR 51bn). Depending on economic developments, the 2019 maturity peak could prove challenging for some of the lower rated issuers.

**Figure 8: European high yield bond maturity schedule for issues since 2009 (EUR bn)**



Source: Scope, Bloomberg, AFME

### Improved credit quality but a growing number of unrated issues

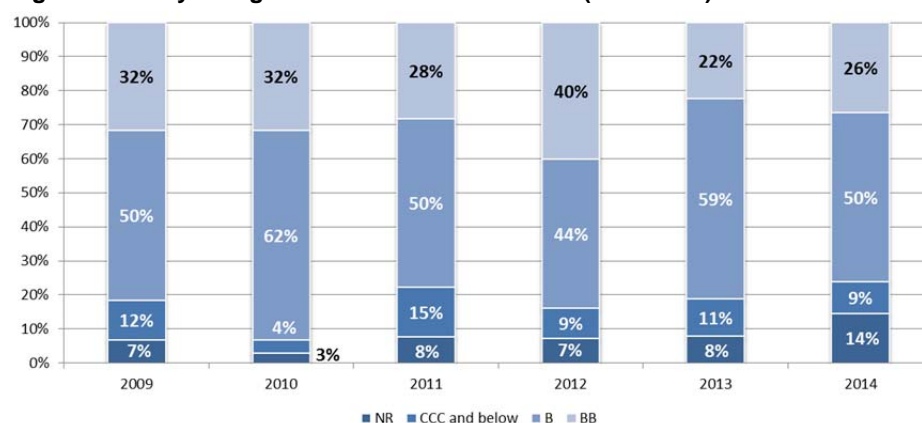
The median rating for European high yield issuers was B in 2014 (2013: B-). Scope has observed an improvement in the credit quality of issues since September 2014, with the median rating for new issues having peaked at a high BB- in December 2014.

Entities rated CCC and below stopped entering the market in September 2014.

Despite the credit quality improvement in the European high-yield market, the median coupon for new issues has increased since August 2014, reflecting heightened investor scrutiny since mid-2014.

In 2014, investors showed significant confidence in unrated corporate issues, which accounted for 14% of 2014 issuance (40 issues), compared with 8% in 2013 (22 issues). Non-rated issues were from companies with a solid credit profile such as Jaguar Land Rover, which had an issuer rating of (BB-) at the time of issue, and Wendel SA, whose BB+ issuer rating at the time of issue was upgraded to BBB- in July 2014. The median coupon for these non-rated, high-yield bonds was 3.88% in 2014, the lowest average coupon for unrated issues of the past six years.

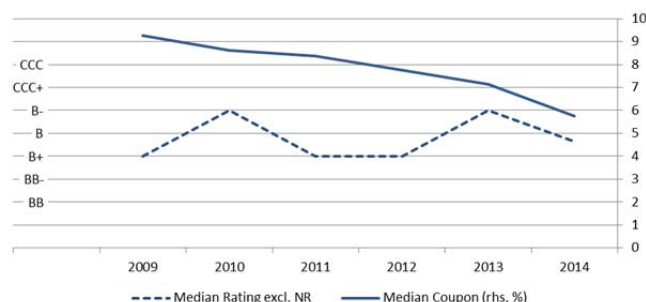
**Figure 9: Yearly rating distribution for new issues (2009-2014)**



Source: Scope, AFME, Bloomberg

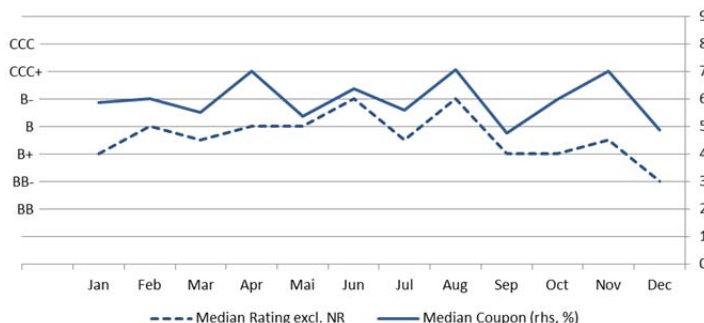


**Figure 10: Median rating and coupon per year (2009-2014)**



Source: Scope, Bloomberg, AFME

**Figure 11: Median rating and coupon per month in 2014**



Source: Scope, Bloomberg, AFME

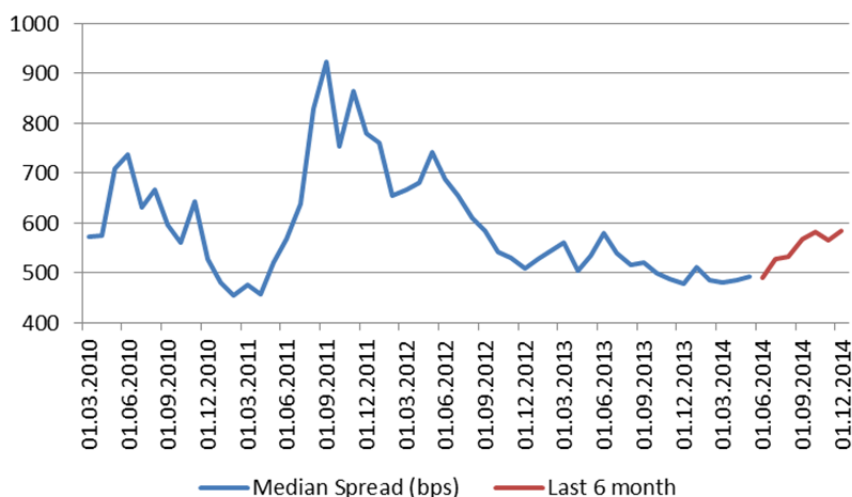
### Credit spreads are widening after a record low in June 2014

### Spreads increase after a record low in June 2014

At end-December 2014, the median credit spread peaked at 583bp - the highest since August 2012. This follows on a median credit spread of 400 bp in the first six months of June 2014 - the lowest since 2009.

The 130 basis-point rise in credit spreads since June 2014 reflects investors' increased risk perception, which may have been fed by the sudden Phone4U default in the UK in September 2014, which came as a surprise to the market. This is compounded by the fact that the economic recovery is taking more time than expected. The EU commission revised its 2015 growth forecast for the EU to 1.3% in November, down from 1.6% in spring.

**Figure 12: Median credit spread on outstanding high-yield bonds issued since 2009**



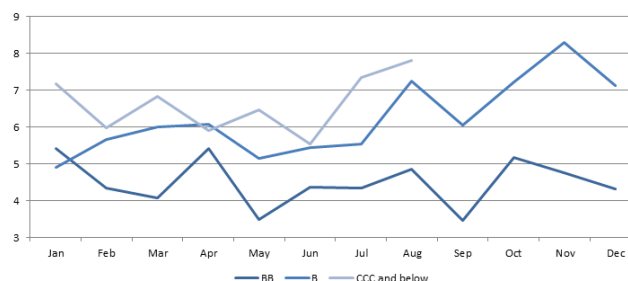
Source: Scope, AFME, Bloomberg

**Table 4: Median coupon rate per rating category since 2009 (as a %)**

Median Coupon						
	2009	2010	2011	2012	2013	2014
NR	8.88	8.75	9.75	8.81	8.00	3.88
CCC and below	10.00	9.50	10.75	11.56	8.44	7.75
B	9.50	9.00	8.50	8.75	7.50	6.25
BB	7.32	7.19	6.50	5.75	5.38	4.38
<b>Median</b>	<b>9.25</b>	<b>8.63</b>	<b>8.38</b>	<b>7.75</b>	<b>7.13</b>	<b>5.59</b>

Source: Scope, Bloomberg, AFME

**Figure 13: Monthly average coupon of bonds issued in 2014 (as a %)**



Source: Scope, Bloomberg, AFME

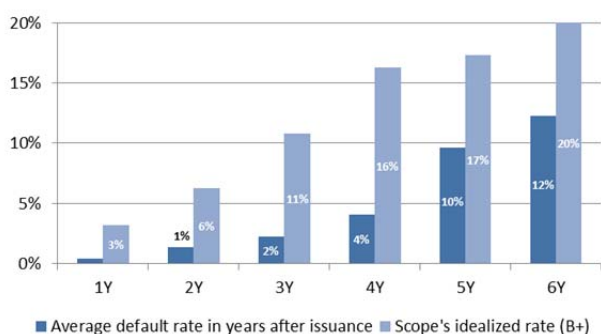
## Historically Low Default Rates – Some Refinancing Risk Remains

### 2014 default rates below historical average and set to remain low in 2015

Driven by the low interest rate environment, in 2014 the default rate on bonds issued since 2009 was 1.52%, down from 3.63% in 2013.

In 2014, Scope observed a total of 10 defaults on bonds issued since 2009, versus 16 for full-year 2013. The cumulative six-year default rate of 12% observed for these bonds in 2014 was well below Scope's idealized 20% six-year default probability rate for B+ rated bonds, despite the fact that the median rating of bonds issued since 2009 was B+. The low default rate observed was shaped by the low interest rate environment. The gap between current default rates and the historic idealized probability of default could, however, narrow if market conditions deteriorate and credit spreads widen, making it difficult for lower rated companies to refinance successfully.

**Figure 14: Observed cumulative default rate by bond age since 2009 and B+ idealized default rate**



Sources: Scope, AFME, Bloomberg

**Table 5: Observed cumulative default rates by year of bond issue since 2009**

Cumulative default rate per year			Year of default					
Year of Issuance	Bonds Issued	2009	2010	2011	2012	2013	2014	
2009	57	1.75%	1.75%	1.75%	5.26%	12.28%	12.28%	
2010	101		0.00%	0.00%	0.00%	2.97%	6.93%	
2011	127			0.00%	0.79%	3.15%	3.94%	
2012	171				0.00%	3.51%	4.09%	
2013	261					0.00%	0.77%	
2014	275						0.73%	

Sources: Scope, AFME, Bloomberg

**Table 6: Default rate on bonds outstanding**

Default rate on bonds outstanding	2010	2011	2012	2013	2014
Bond outstanding (beginning of the year)	56	157	281	441	660
Number of defaults	0	0	3	16	10
<b>Default rate on bonds outstanding</b>	<b>0.00%</b>	<b>0.00%</b>	<b>1.07%</b>	<b>3.63%</b>	<b>1.52%</b>
Bonds issued	101	127	171	261	275
Bonds matured, called or defaulted	0	3	11	42	126

Source: Scope, Bloomberg, AFME



## Appendix

**Table 7: Transition of bond ratings**

Rating transitions	Latest rating										
Rating at issuance	BB+	BB	BB-	B+	B	B-	CCC+	CCC	CCC-	CC	Total
BB+	<b>95%</b>	0%	3%	2%	0%	0%	0%	0%	0%	0%	100%
BB	8%	<b>87%</b>	3%	2%	0%	0%	0%	0%	0%	0%	100%
BB-	0%	7%	<b>79%</b>	11%	2%	0%	1%	0%	0%	0%	100%
B+	0%	1%	7%	<b>84%</b>	8%	0%	0%	0%	0%	0%	100%
B	0%	0%	1%	6%	<b>89%</b>	1%	1%	0%	0%	0%	100%
B-	0%	0%	0%	1%	6%	<b>80%</b>	10%	3%	0%	0%	100%
CCC+	0%	0%	0%	0%	0%	9%	<b>85%</b>	6%	0%	0%	100%
CCC	0%	0%	0%	0%	0%	0%	8%	<b>88%</b>	4%	0%	100%
CCC-	0%	0%	0%	0%	0%	0%	0%	0%	<b>100%</b>	0%	100%
CC	0%	0%	0%	0%	0%	0%	0%	0%	0%	<b>100%</b>	100%

Source: Scope, AFME, Bloomberg



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