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Press Release

Credit Market Update: 'The Syndicate Strikes Back'

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London, 2 May 2024 – The European leveraged loan market came roaring back to life in Q1, with €23bn of new supply[1] - the most since Q2 2021. As technical demand from CLOs and improved risk sentiment led to spread tightening, it triggered a wave of refinancing activity and new issuance in the market.

Private Credit's Role in a Resurgent Syndicated Market

With the average new issue spread for single B issuers falling to 425 bps, approximately 50 bps tighter than levels in Q4 2023[2], multiple private credit borrowers returned to the syndicated market. According to LCD research, by the end of March 2024, the market had seen roughly €4.2 billion of private credit facilities refinance in Europe's broadly syndicated market. Many of these borrowers have experience in the public market and it's not surprising that they've returned to refinance more expensive debt taken out during the more challenging market environment of the past two years.

However, we believe that the private credit market will remain a core source of financing for borrowers. While the public market may offer tighter pricing, it comes with the cost of lower certainty of execution, longer timelines, less flexibility, and more robust public disclosure. **Private credit will continue to appeal to sponsors who value the more bespoke terms that this market can offer which enable deals to be structured to best suit the needs and profile of the company** through features such as delayed draw facilities, Payment-In-Kind toggles and greater leverage where appropriate.

Private credit removes the need to manage relations with dozens of lenders, which is particularly valuable in competitive, or time sensitive, processes such as bolt-on acquisitions or public-to-private acquisitions, allowing sponsors and management to prioritize ongoing operational performance. **Private credit markets have also shown resiliency through periods of volatility, issuance has been less sensitive to market shocks compared to high yield bonds and syndicated market.**

The strength of the public market is also likely to be positive for private markets. The lack of M&A activity has been limiting supply and has led to European sponsors sitting on record levels of dry powder[3]. This, coupled with pressure to realise older investments and return capital to LPs, should help encourage M&A activity, bringing new supply to both public and private credit markets.

[1] Source: Pitchbook LCD as of 31 March 2024
[2] Source: Pitchbook LCD as of 31 March 2024. Based on the TLB spread at close (including flexes), the OID and base rate floor (if any)
[3] Source: Preqin Pro, 31 December 2023. European Private Equity has been defined as the combined total of the following Preqin Europe-based categories: Buyout, Venture (General), Growth, Early Stage, Early Stage: Seed, Early Stage: Start-up, Secondaries, Expansion/Late Stage, Balanced, Turnaround, Hybrid and PIPE.

Junior Credit: Our Focus on the "Three Cs"

AlbaCore's investment process is founded on the "Three Cs": Credit, Convexity and Catalyst. When assessing junior credit opportunities, we are selective and seek to ensure that they offer a combination of fundamental credit strength, return convexity, and have a clear catalyst to trigger a realisation of our investment.

Credit: At an individual borrower level, we're focused on their volume growth potential. While many borrowers have been able to increase revenues over the past few years through increasing prices, this is ultimately not a sustainable source of longer-term growth. Given the impact of the pandemic, which was followed by supply chain disruption and inflationary pressures, some borrowers have been left over levered. Borrowers will need to achieve volume growth to right size these capital structures. Therefore, **we are cautious on names in low growth sectors that have become over levered, as we struggle to see a clear path for organic de-leveraging**.

Convexity: Given the higher interest rate environment, the total return potential of senior credit has improved and therefore **junior credit must offer an attractive premium and upside potential to remain desirable**. Depending on underlying credit quality this may equate to a mid-teens yield on junior credit, a rate at which the trade-off between funding via junior debt versus equity becomes less clear cut. We've recently seen more junior credit activity in the US market. With limited opportunities in Europe, pricing on junior credit for strong credits is relatively tight and lacks features, such as warrants, that provide the potential for incremental upside. Given these dynamics, **we see more value in senior credit and await a pickup of M&A which will bring more junior supply to the market**.

Catalyst: Given that junior credit instruments typically have a relatively long legal maturity, **ensuring there is an appropriate catalyst of its realisation, be that a sale of the company or a refinancing, is crucial**. For this reason, in the current market environment, we are cautious of transactions with portability features, which remove the requirement for repayment on a sale of the business, and dividend recapitalisations where junior credit is raised to enable a return of equity to the sponsor. As M&A activity has stagnated over the past few years, sponsors are facing growing pressure to return capital to LPs. A dividend recapitalisation is one way a sponsor can achieve this. However, as a junior creditor this is detrimental in that it reduces the pressure on the sponsor to complete a sale of the business which would act as a catalyst to repay the junior debt.

Is Trouble in Large Capital Structures a Risk or Opportunity for CLOs?

While the first quarter experienced a marked improvement in risk sentiment, the closing weeks saw a series of headlines that indicated that time was running out for some of the biggest names in the market. With Amend & Extend activity dominating markets last year, most borrowers addressed near term maturities. However, a small minority has been unable to access the market, with unsustainable capital structures and encroaching maturities. In recent weeks a string of announcements from some of the largest borrowers in the market indicated that these issues were being realised.

The most notable headline came from French telecoms provider Altice France. **With €24 billion of debt outstanding and 2025 maturities approaching, the need for material deleveraging was well known by the market**. However, on their Q4 earnings call the Company confirmed that assets, including Altice Media, which were in the process of being sold, had been designated as unrestricted subsidiaries and therefore are no longer subject to asset sale covenants. This means that in theory there are now no contractual limitations on how Altice France may choose to deploy the proceeds from these sales and proceeds could be used to pay dividends rather than pay down debt.

As Altice is ubiquitous across CLOs, with the name featuring in 94% of the European CLOs[4], attention turned to the market consequences of a potential default. However, the potential impact on CLO debt tranches is minimal with the strong structural protections, diversification of collateral and lack of forced sale mechanisms that would require CLOs to realise mark to market loses limiting the impact on these tranches. The greater impact would be borne by equity tranches which are designed to take the first loss in the event of a default.

We believe the risk return profile on equity tranches is attractive, however we had been cautious to deploy capital during Q1 as we felt that market pricing hadn't been reflecting the potential for some of these well signalled credit issues to play out. An increase in headline defaults, coupled with broader market uncertainty to ongoing interest rate volatility and geopolitical stress, could create **interesting opportunities to deploy capital in the coming months as prices of equity and lower rated tranches react to these headlines despite no material increase in the underlying credit risk.** We believe it is important when investing in CLOs to have the correct structure to weather this volatility and flexibility to deploy across rating categories.

Within our portfolios, having last year favoured Triple-B tranches which were trading at highly dislocated levels, recent spread tightening has lowered their total return potential. Therefore, **we are looking to rotate some of our investment grade exposure into sub-investment grade tranches** and are well positioned to take advantage of any weakness in pricing in lower rated instruments on the back of these headlines.

David Allen is the Managing Partner and Chief Investment Officer at AlbaCore Capital Group.

Mr. Allen has more than 30 years of financial services and investment experience, with a focus on the High Yield and Leveraged Finance Markets.

Prior to founding AlbaCore Capital Group, Mr. Allen managed Canada Pension Plan Investment Board's European Principal Credit Fund and was a member of the Investment Committee. Mr. Allen was also a Partner, Investment Committee member and Senior Portfolio Manager at GoldenTree Asset Management, where he established and ran the firm's European presence. Mr. Allen spent a decade with Morgan Stanley in New York and Hong Kong, working across M&A and investment banking before specializing as a High Yield media analyst.

Mr. Allen graduated from the University of California, Berkeley, where he earned a Bachelor of Arts in Economics and was an all-conference rower.

About AlbaCore Capital Group
AlbaCore Capital Group is one of Europe's leading alternative credit specialists, investing in private capital solutions, opportunistic and dislocated credit, CLOs, and structured products. Founded in 2016,

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[4] Source: AlbaCore analysis April 2024

AlbaCore is part of the First Sentier Investors Group. AlbaCore's investment philosophy is focused on capital preservation and generating attractive risk adjusted returns through the cycle for its investors. AlbaCore manages **US$ 9.6 billion in AuM[5] as of 30 December 2023** on behalf of global pension funds, sovereign wealth funds, consultants, insurance companies, family offices and endowments around the world.

For more information, visit www.AlbaCoreCapitalGroup.com

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[5] AuM is calculated as the sum of the Net Asset Value, undrawn capital commitments, available debt finance and assets of all vehicles managed by AlbaCore.