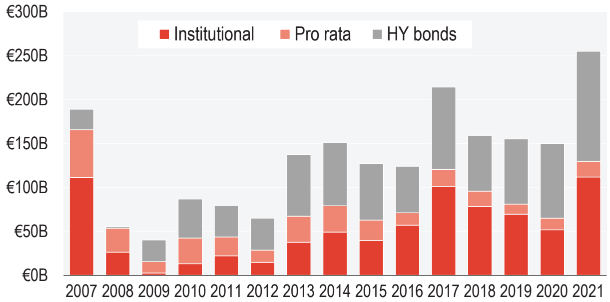
S&P Global

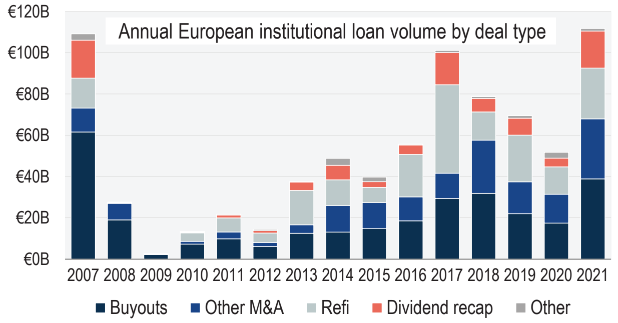
LCD European Quarterly

European leveraged finance issuance set records in 2021…



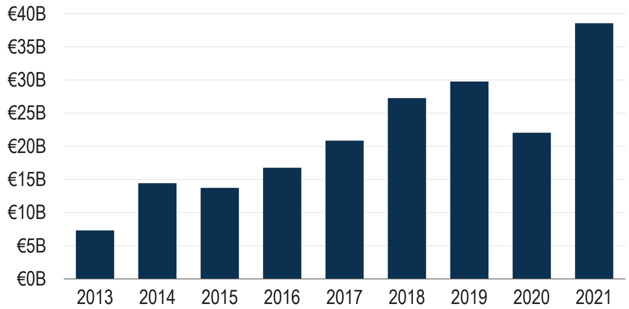
Source: Leveraged Commentary & Data (LCD)
Data through Dec. 31, 2021.

…driven by a strong M&A pipeline and opportunistic activity.



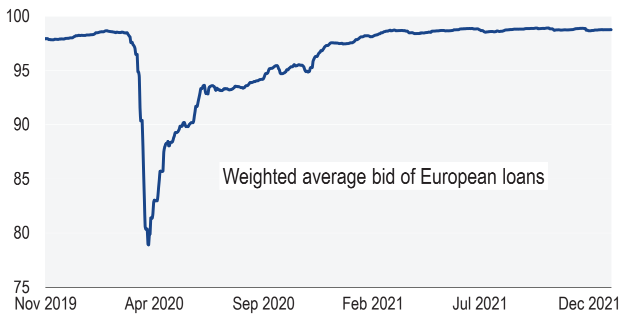
Source: Leveraged Commentary & Data (LCD) Data through Dec. 31, 2021.

CLO new issuance also set an annual record...



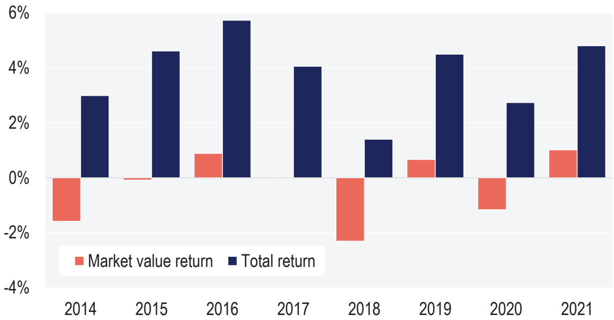
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

...while demand from this product supported secondary pricing...



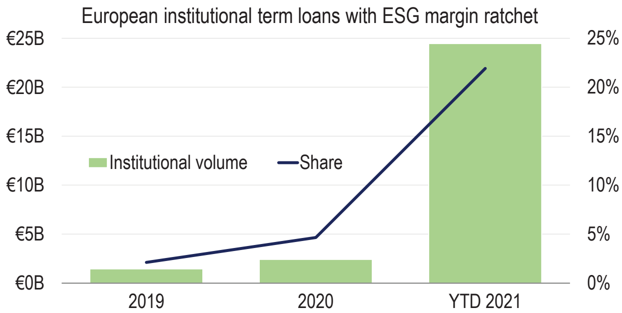
Data through Dec. 31, 2021.
Sources: Leveraged Commentary & Data (LCD); S&P European Leveraged Loan Index.

...and helped boost Index returns.



Data through Dec. 31, 2021.
Sources: Leveraged Commentary & Data (LCD); S&P European Leveraged Loan Index

Meanwhile, ESG features became fully entrenched in Europe.



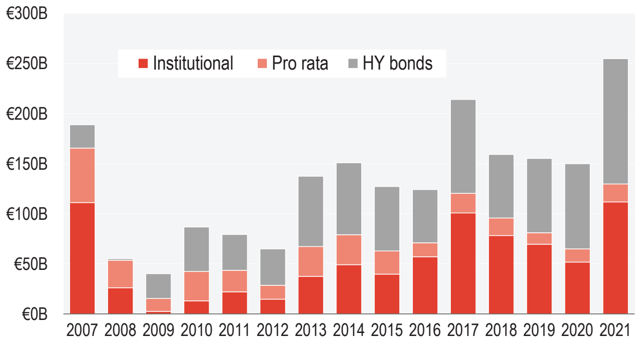
Data through Dec. 16, 2021.
Source: Leveraged Commentary & Data (LCD)

Inside

Leveraged finance volume smashes records in bumper year for European market

European leveraged finance volume shattered records in 2021, with borrowers issuing a breathtaking €254.8 billion of loans and bonds, representing an all-time high for supply. Institutional loan volume reached €111.7 billion, just topping 2007's tally of €111.1 billion, although total loan volume still lagged that year, as pro-rata debt was higher in 2007 at €54.4 billion, compared to just €18 billion in 2021. However, total bond issuance did set a new record in Europe, coming in at a whopping €125 billion.

Chart 1: Annual European leveraged finance volume

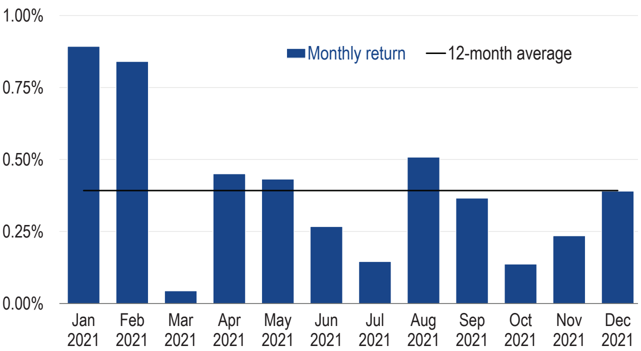


Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Loan investors benefitted from solid income in 2021 with very little volatility, as the S&P European Leveraged Loan Index (ELLI) paid investors 4.81% (excluding currency) for the year, with every month of 2021 showing a positive overall return. Indeed, the year ended on a long positive streak, as December was the 21st consecutive month to register a positive reading.

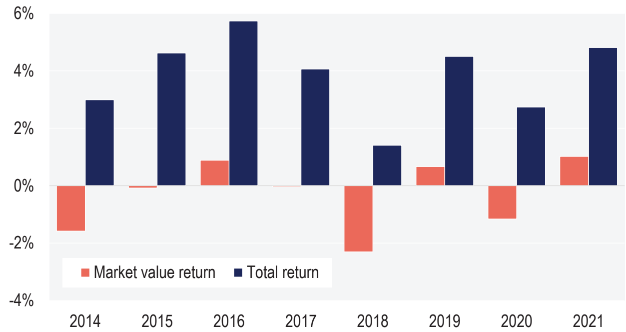
The 2021 return for the Index was more than 2% above the 2.74% return recorded in 2020 — even surpassing 2019's

Chart 2: S&P European Leveraged Loan Index monthly returns



Data through Dec. 31, 2021.
Sources: Leveraged Commentary & Data (LCD); S&P European Leveraged Loan Index

Chart 3: S&P ELLI annual returns (excluding currency)



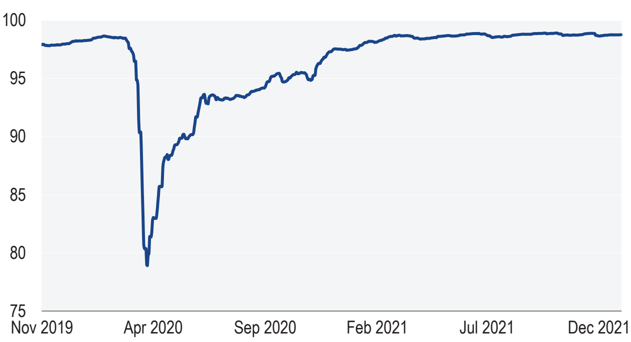
Data through Dec. 31, 2021.
Sources: Leveraged Commentary & Data (LCD); S&P European Leveraged Loan Index

4.50%, which was the highest such return since 2016 (at 5.73%). Unlike the initial downward spike after lockdowns in March 2020, European leveraged loans have broadly been immune to the patches of volatility that hit bonds, and returns on the asset class outpaced both the high-grade and sub-investment-grade fixed income markets.

The year's roster of loans generally held steady around reoffer levels, with nothing falling as far as some deals in high-yield (such as **Standard Profil**, which finished the year quoted around 80 after having priced at par at the end of April).

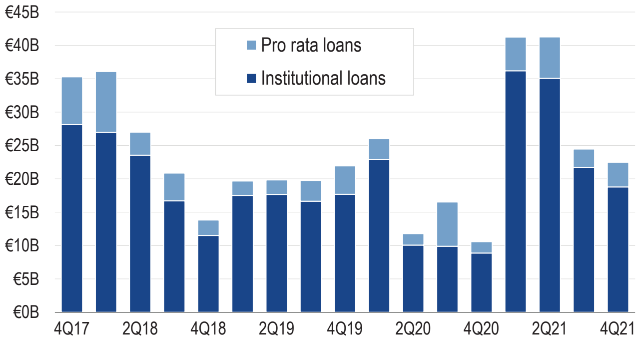
Looking at the ELLI's weighted average bid across 2021, it rose slowly and surely from 97.56 at the start of the year to 98.92, the yearly high reached in October. It then retraced to end the year at 98.77, but to put this in perspective, before 2021 the ELLI had not reached this level since November 2018.

Chart 4: Weighted average bid of European loans



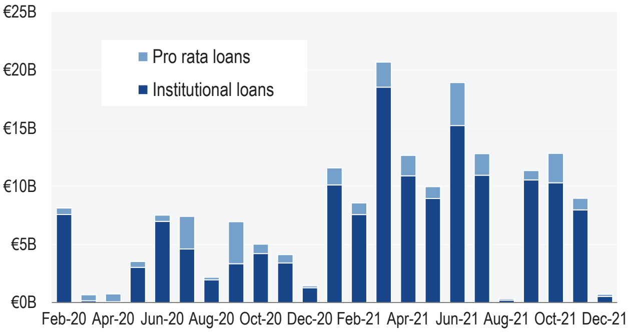
Data through Dec. 31, 2021.
Sources: Leveraged Commentary & Data (LCD); S&P European Leveraged Loan Index.

Chart 5: European new-issue leveraged loan volume — quarterly



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 6: European new-issue leveraged loan volume — monthly



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Buying opportunity

Secondary market softness in the fourth quarter offered a buying opportunity, with CLOs stepping in to pick up any lower offers that resulted from the volatility seen on the last Friday in November. Sources noted that prices fell by no more than three-eighths of a point for non-pandemic-exposed names, and soon adjusted back up on better buying. "Managers pricing CLOs over the last couple of weeks were keen to ramp and take advantage of any weakness in secondary," said one trader. This also provided a good opportunity for those looking to raise cash, and there was strong demand for some chunky BWICs — including a €272 million portfolio sent out in the second week of December.

Quarterly loan volume down, but still strong

In the fourth quarter, jitters over the spread of the omicron variant of COVID-19 at the back end of November failed to unsteady the poise of European leveraged loans, but they did call an early end of big-ticket buyout activity for 2021. Existing add-on borrowers soon stepped up to take advantage of demand, and — helped by a strong run from October — the quarter delivered a respectable volume of €22.5 billion, albeit still the lowest of the year.

October was by far the stand-out month of the quarter, recording total volume of €12.8 billion. This was the third-highest monthly tally of 2021 and brought some signs of market fatigue, with a handful of smaller borrowers forced to sweeten pricing to clear deals. "European loans is a calendar-driven market and it's tough to be out with a more complicated credit at busy times," said a banker.

Even so, the launch of debt backing the Apax Partners-led buyout of **T-Mobile Netherlands** helped carry the market's momentum into November. That deal illustrated the depth of demand for the right credit, clearing at an upsized €2.4 billion — making it the largest single buyout tranche in European loans since **TDC**, another telco, syndicated a €2.7 billion facility in May 2017.

Omicron impacts jumbo deals

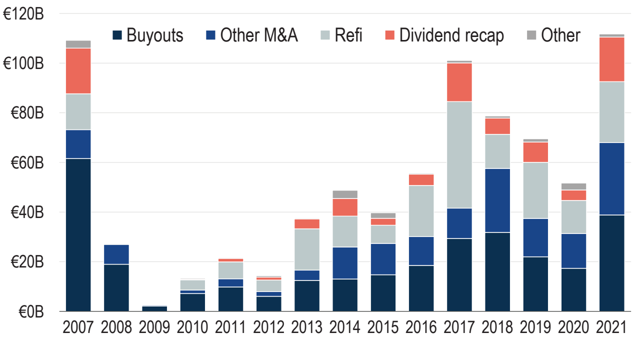
The year could have been even stronger, as more jumbo supply was expected to follow T-Mobile when news of the spread of the omicron variant sent equity and fixed income markets into a tailspin. Not least of these was the mooted £2 billion loan portion of the £5.4 billion debt financing backing CD&R's buyout of **Morrisons**, which had previously been eyed for a November launch but will now be a fixture for early 2022. Beyond this, however, arrangers say that few plans were ultimately disrupted. "Some of what was expected was always going to be for a 2022 launch," said one banker, who nevertheless added that price-focused borrowers would have pushed back plans to wait for calmer times.

Another banker agreed. "Omicron did push some issuers to postpone their plans but after such a strong year I think everyone was ready to draw a line, and there was no real desire to cram activity into December," he said.

M&A supply dominates issuance

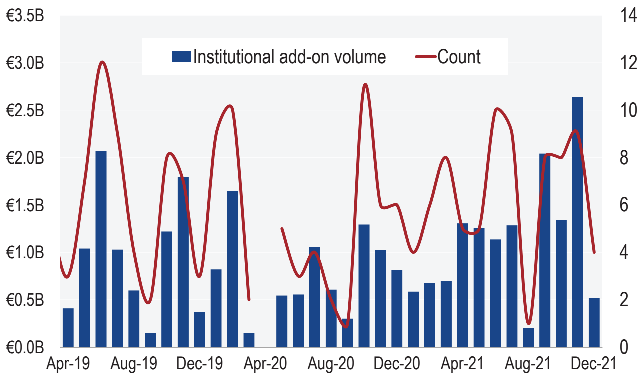
M&A-driven supply dominated 2021 European loan issuance, accounting for €68 billion, or 61% of total institutional issuance. This is the highest level of M&A-fuelled activity since 2007, and highlights the difference

Chart 7: Annual European institutional loan volume by deal type



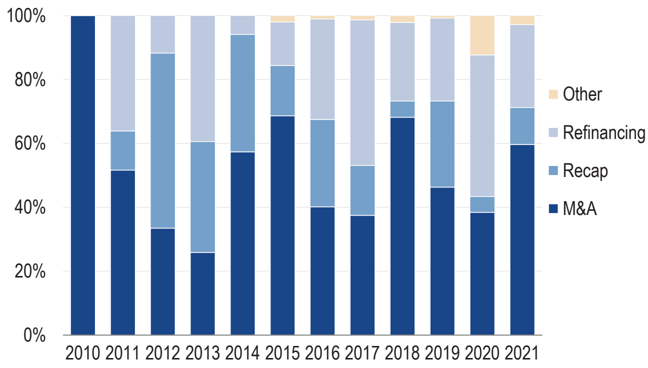
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 8: European institutional add-on loan volume and count



Source: Leveraged Commentary & Data (LCD) Data through Dec. 31, 2021.

Chart 10: European institutional add-on volume by purpose



Source: Leveraged Commentary & Data (LCD) Data through Dec. 31, 2021.

between 2021 and 2017 (the last time institutional volume passed €100 billion), when M&A-driven activity only accounted for 41.1% of institutional loans.

However, borrowers still took advantage of market liquidity for opportunistic deals, with dividend recap transactions accounting for 16.1% of institutional volume — again, the highest such total since 2007. This equates to issuance of roughly €18 billion, which is on par with the €18.4 billion of dividend recap volume from 2007 (16.9% of total institutional volume).

Adding up

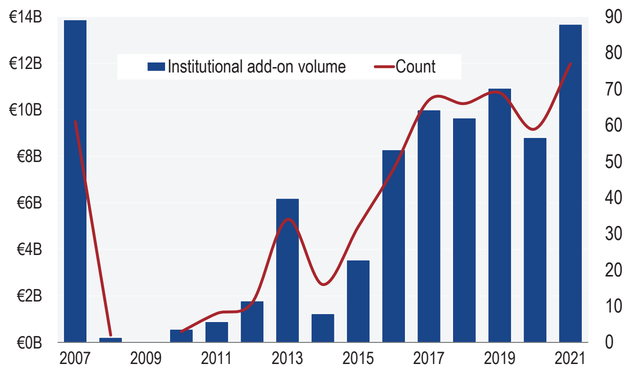
Late in the year there was a surge in add-on activity, with this volume reaching a three-year monthly high of €2.5 billion in November, LCD data shows. Further supply in December from the likes of **Circet** and **Toi Toi & Dixi Group** took total add-on volume for the year to the second-highest on record, just behind the €13.9 billion in 2007. In terms of deal count, 2021 featured more deals, with 77 add-ons comprising €13.7 billion of institutional volume.

The reason behind this late-year business is clear. Not only did the market for buyout loans slow, but firm pricing in CLO liabilities ensured margins held steady for the right names in loans. "The read-across from CLO liabilities to loan margins has been remarkable this year," said one banker in December. For a well-known name such as **Exact Software**, this liquidity meant the KKR-backed group was able to allocate a €340 million term loan well through talk at E+400 with a 0% floor offered at 99.75, in a deal earmarked to fund a dividend and take out second lien debt.

Elsewhere, **Devoteam** removed the original issue discount on the €265 million add-on to its E+450 term loan due December 2027, while French grocer **Casino** increased the size of its add-on to €425 million and priced at the tighter end of talk. In the main, most add-on borrowers used the market to support tack-on M&A, with others funding dividends or supporting refinancings, such as revolver clean-ups.

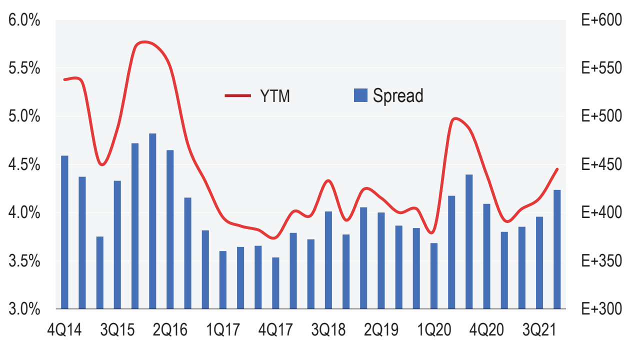
There was also room in the market for first-time borrowers. German packaging group **Syntegon**, which CVC carved out of Bosch in an all-equity deal in 2019, had little trouble when it closed a €1.03 billion recapitalization tight of talk at E+400 with a 0% floor, offered at par. In the main, accounts agree that margins for decent B-flat names have stabilized through the quarter around the E+400 level, with stronger

Chart 9: European inst. add-on loan volume and count — annual



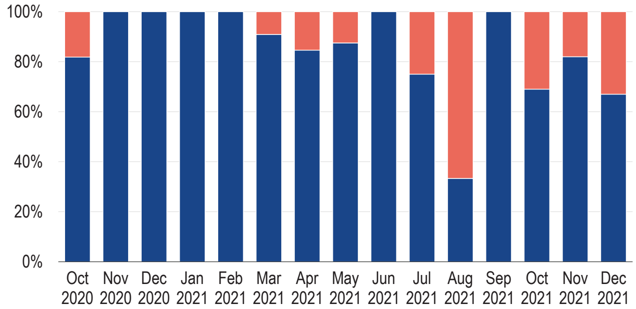
Source: Leveraged Commentary & Data (LCD) Data through Dec. 31, 2021.

Chart 11: Average YTM at issue for single-B euro-denominated TLBs



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 12: Percentage of institutional flexes moving tighter/wider

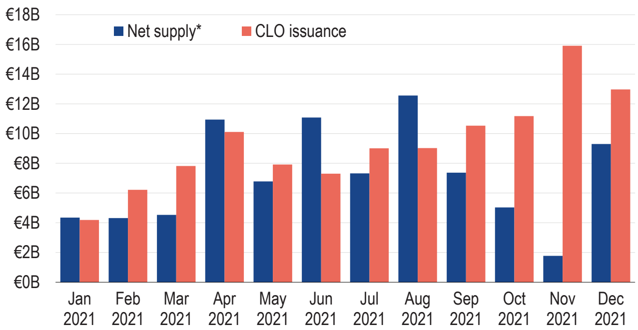


(Chart shows what % of all flexes done in each month moved yield higher or lower)

Source: Leveraged Commentary & Data (LCD) Data through Dec. 31, 2021.

names able to price at E+375. Despite the volatility, average yields and margins for single-B euro-denominated deals fell in the three months to November to E+412 and 4.31%, respectively, from E+415 and 4.38% in October, according to LCD. However, spreads and yields ended the year up from the third quarter, at E+423 and 4.45% compared to E+396 and 4.15%, respectively.

Chart 13: Institutional market net supply vs. CLO issuance (rolling 3M)



* New issues tracked by the Index minus repayments Data through Dec. 31, 2021.

Sources: Leveraged Commentary & Data (LCD); S&P European Leveraged Loan Index

This dynamic is also reflected in flexed levels, as an increasing percentage of price flexes on deals were wider in the latter part of 2021, ranging between 18% and 33% since July (excluding August, when the data was skewed by a lack of transactions). From January to June, moves upward accounted for between none and 15% of total flexes.

With the recent surge in CLO issuance (total priced CLO new issuance reached a record €38.6 billion for full-year 2021) demand on a rolling three-month basis for European loans outpaced supply by the largest margin (at €14.1 billion) in November since LCD began tracking this data in 2013. LCD calculates net supply by tracking new issues into the ELLI minus repayments. In December a supply shortage remained, albeit at a much lesser shortfall of €3.7 billion.

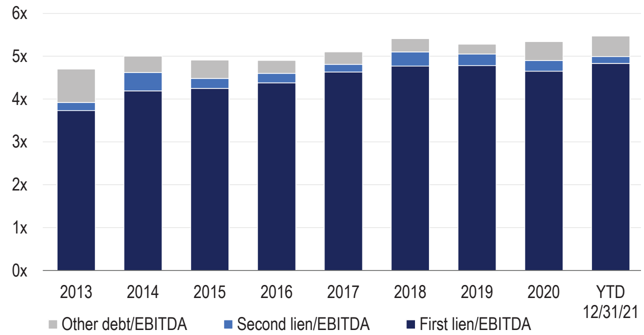
It is therefore somewhat of a surprise that loan spreads and yields ended the year higher than at the end of the third quarter, as demand for assets swelled. This would point to the fact that there are fewer inflows into non-CLO funds in Europe, which typically add to demand for the leveraged loan asset class and are not factored into LCD's supply/demand figure as there is poor visibility on these flows publicly. Investor sources have told LCD that they have seen a pick-up in inflows into these funds since the summer, but that for most of 2021 new demand from these investors was flat.

To this end, bankers have noted that the CLO-demand driven market in 2021 resulted in a situation whereby investors mainly tended to focus on a large-cap core group of liquid names offering yields in the 4% area. As a result, more storied or smaller names have often struggled and had to price up to attract a non-CLO audience. "It is harder to get CLOs to look at a smaller loan even if they are getting a higher price for it," said one arranger. "But once yields move up by 1%-2% from the average, then you open up to a wider group of investors," he added. Another account source agreed: "There is a premium for smaller or more complicated names even if the market still struggles at real differentiation beyond a couple of points," he said.

In November, for example, German education business and first-time syndicated borrower **IU Group** found the going tough with its €500 million term loan recap that eventually priced at E+500 with a 0% floor offered at 98.5, from initial talk of E+450 with a 0% floor at 99.5.

Other areas also remain contentious. **Inovie** ran into a little turbulence in early December with the €775 million fungible add-on to its €773 million term loan due March 2028. On Dec. 7, the firm went out with revisions that widened the margin across the ratchet by 25 bps to take the starting level to E+400 amid concern that the firm's cash generation would soon bring a downward step. In a note, Moody's pointed out that the dividend comes less than a year after a buyout, but after the group generated free cash flow of roughly €200

Chart 14: Average leverage for European loans



Data through Dec. 31, 2021.

Source: Leveraged Commentary & Data (LCD)

million. The dividend funds a total ticket of €332 million for shareholders.

Total leverage rose slightly on transactions in 2021 to 5.47x, from 5.34x in 2020, through it remained below the 5.95x multiple in 2007. Meanwhile, first-lien leverage remained at an all-time high 4.83x, marking a post-crisis structural trend that has not disappeared. Total leverage for sponsor-driven deals was slightly lower at 5.73x, compared to 5.83x in 2020, while total debt-to-EBITDA for buyouts was fairly steady at 5.82x, compared to 5.85x in 2020.

Benign outlook in loans, with jumbos on radar

Looking ahead to 2022, investors and arrangers agree that the market outlook for the loan product is generally benign. Managers say there is evidence that strong returns in 2021 are already encouraging more non-CLO money to enter the fray, especially given the attraction of a floating-rate product in a potentially rising rate environment. "We've certainly seen an increase in reverse-enquiry from accounts looking to invest in loans over the past weeks," said one manager in December.

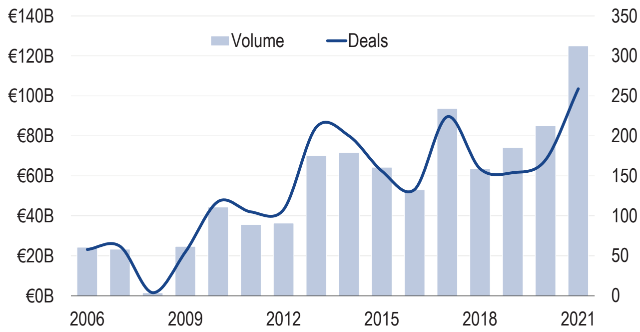
That said, the pipeline for January beyond a few jumbo deals such as Morrisons or **Ekaterra** is far from full, and is some distance away from levels seen in the summer. There is hope, however, that 2022 may bring a return of the mega-buyout after a year when more modest deals dominated in Europe. The largest overall deal package syndicated in 2021 was the roughly $14.32 billion loan and bond financing backing the buyout of U.S.-based **Medline**, which only included a $500 million-equivalent loan for Europe. The largest buyout syndication in Europe in 2021 came from **T-Mobile Netherlands**, which also included a €1.35 billion two-part bond offering alongside the loan. This still does not fall into the global top 20 of large buyout deals, however, and it's necessary to go back to the €7.6 billion debt package supporting the acquisition of **ThyssenKrupp Elevators** by Advent, Cinven and RAG in 2020 for Europe's last true jumbo deal.

Recent M&A chatter such as KKR's ambitious €33 billion tilt at **Telecom Italia** or Patrick Drahi's stake building in **BT Group** suggests the coming year may see a return of mega-ticket deals. Bankers say sponsors in Europe need to act decisively if they want to continue to raise such large amounts of dry powder, while adding buyers will also tend to favour the simplicity of deals in the low single-billions, where they can act alone rather than teaming up under a consortium.

The talk around such large deals reflects a confidence across both the arranger and investor community that conditions should remain benign into 2022. At the very least, loans should continue to outperform bonds in a rising rate environment, even if persistent inflation will ultimately hurt highly levered companies.

"Risk is back," said one manager. "Government intervention, low rates and plentiful liquidity have given the market a free pass through COVID-19, but that will have to come to an end at some point."

Chart 15: Annual European high-yield volume and deal count



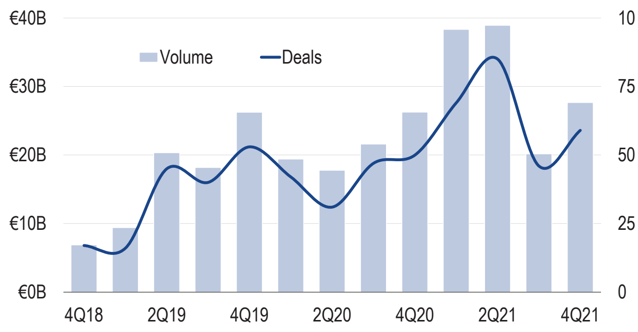
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Stellar year for high-yield bonds

The market sell-off in late November sparked by the omicron variant of COVID-19 might have put off a few potential suitors that were looking to issue opportunistic high-yield bonds heading into the year-end break, but it proved merely a footnote to an otherwise stellar year for both issuance and returns in this asset class. Primary markets may have closed earlier than in 2020, but the lackluster finish to 2021 still left European high-yield supply at a staggering €125 billion, which is 33% ahead of the previous record set in 2017 and 47% ahead of the €85 billion tally notched in 2020.

High-yield bonds sold into Europe in the fourth quarter totaled €27.7 billion, roughly in line with the fourth quarters of 2020 and 2019, which both hosted just over €26 billion of supply. This latest total is also ahead of the €23.2 billion five-year average for fourth-quarter issuance, according to LCD data.

Chart 16: Quarterly European high-yield volume and deal count



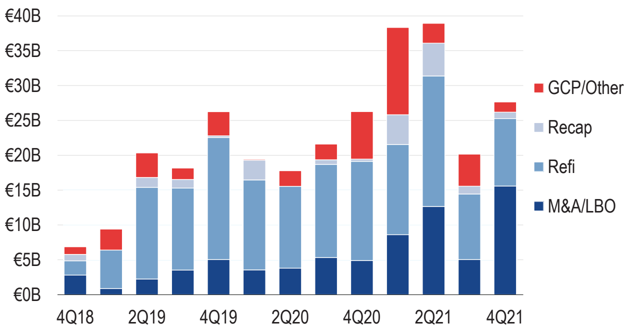
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

October, all over

While this fourth-quarter volume was not out of the ordinary, issuance in October was particularly striking, as European bond supply breached the €15 billion monthly threshold for only the second time since LCD started tracking this data, thanks to a deluge of M&A and leveraged buyout financings. The mark was first exceeded in June, when the monthly volume reached €17.1 billion.

M&A and leveraged buyout activity was in play all year, with the COVID-19 shutdown having stalled deal-making globally, leaving a huge deal pipeline heading into 2021. But it was not until the fourth quarter that this dynamic really began to reshape the bond market, with acquisition-related financings contributing an astonishing €15.6 billion of the quarterly tally. This represents well over half the total issuance in that period and easily sets a quarterly record for European bonds to fund M&A and buyouts. The two closest comparisons were also in 2021, with the first and second quarters of that year producing €8.6 billion and €12.7 billion of M&A-related bonds, respectively.

Chart 17: Quarterly European HY use of proceeds, by volume

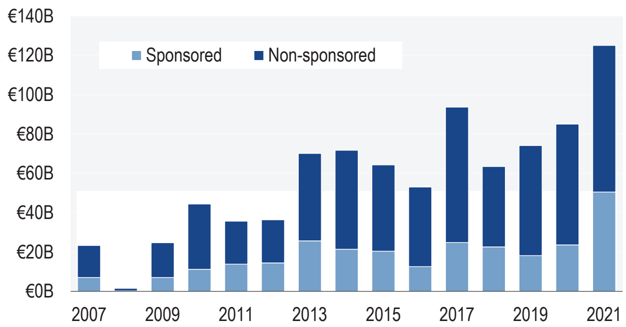


Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

It was also a record-breaking year for sponsor-backed supply, with €50.5 billion of such issuance recorded — well ahead of the €23.6 billion and €18.2 billion recorded in 2020 and 2019, respectively, and making up 40% of the total high-yield bond volume. This same percentage split was also recorded in 2012 — however, that equated to merely €14.5 billion of volume on this measure.

The LBO surge, which has mostly been dominated by mid-sized deals rather than big-ticket buyouts, reshaped the ratings characteristics of Europe's high-yield bond market. With the exception of the first quarter, single-B rated bonds dominated every quarter in 2021, with issuance in this cohort peaking at €21 billion in the second quarter. This ratings category made up 46% of high-yield issuance for the year, marking the first time since 2018 that single-B credits accounted for a greater proportion of total volume than double-Bs.

Chart 18: European high-yield volume



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

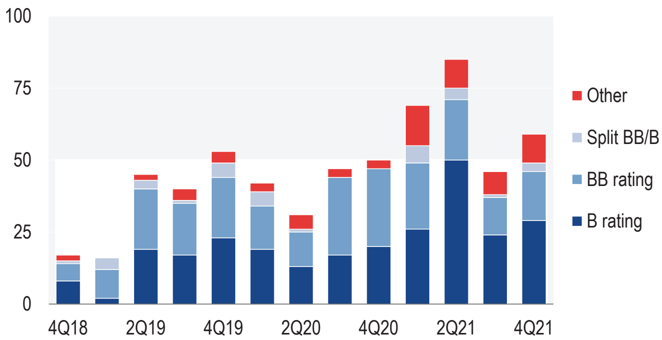
Challenging times

This deluge of challenging credits arrived against the most prolonged difficult backdrop for European high-yield since the start of the COVID-19 pandemic, with one leveraged finance head reporting a "market diversion" between bonds and leveraged loans. The former asset class experienced the full brunt of rising interest rates and re-opening bottlenecks which loomed over the fourth quarter, whereas strong CLO demand protected leveraged loans from the worst of the volatility and gave rise to a series of opportunistic transactions.

It was not until the emergence of the omicron variant that volatility rose to a level high enough for deals to be pulled, however, and even as sponsors tended to leave little on the table in terms of pricing, most LBO financings passed without a hitch.

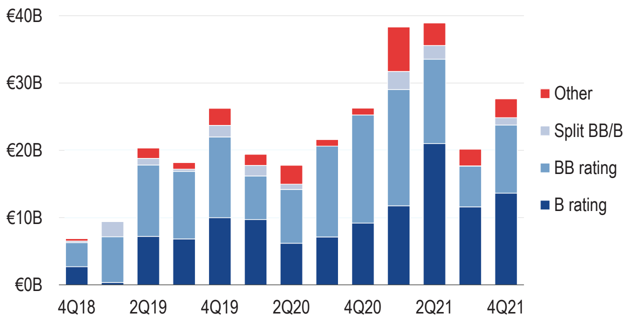
Deteriorating sentiment in some instances forced pricing wider, such as on bonds backing Brookfield's buyout of **Modulaire**, but the general trend in the fourth quarter was that LBO financings performed weakly on the break into the secondary market, reaffirming the buyside consensus that pricing was aggressive. The average yields on the lower rated, single-B loans remained below 5%, however, in the

Chart 19: Quarterly European high-yield count, by rating



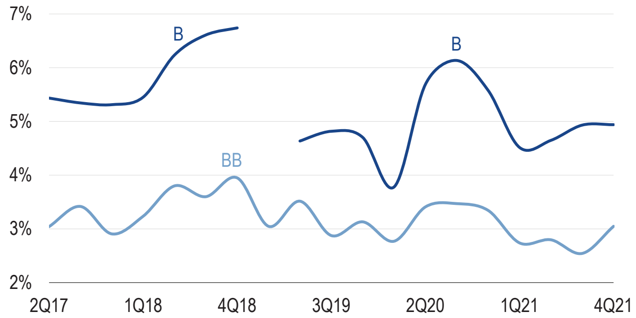
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 20: Quarterly European high-yield volume, by rating



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 21: Average new-issue yields, European HY bonds



Data through Dec. 31, 2021.
Single-B is blank in 1Q19 due to lack of observations for a meaningful average.
Source: Leveraged Commentary & Data (LCD)

fourth quarter, according to LCD, below the 5.58% average for this ratings category in the fourth quarter of 2020.

When deals were forced to delay at the end of November, Apollo-backed Italian packaging group **Reno De Medici**, rated B/B2/B+, still managed to pull off a €445 million offering of five-year floating-rate notes, albeit at the wide end of initial price thoughts and with a larger original issue discount. This was achieved despite investor concerns relating to the borrower's sector, the sponsor and the steep 9x leverage, as well as a significant price correction during book-building which triggered a repositioning of some investors into double-Bs.

On the defensive

While single-Bs dominated the fourth-quarter volume overall, the trend was most noticeable in October, with only **Biogroup**, **Kem One** and Reno de Medici selling single-B rated bonds for M&A funding in November. It was a similar pattern in December, though T-Mobile Netherlands finally emerged from the well-telegraphed buyout pipeline, raising €1.35 billion in secured and unsecured bonds that clearly benefited from scarcity value as both tranches rose on the break, with the €550 million of eight-year unsecured notes rising quickly above 101. U.K.-based grocer **Morrisons** however turned out to be the largest casualty of the omicron variant market jitters and weaker backdrop for sterling issuance, with banks in early December deciding to postpone the £5.4 billion bond and loan financing backing CD&R's takeover of the supermarket group.

For much of November and December then, higher-rated borrowers became the focus of investors' attention as higher premiums in the primary market prompted portfolio managers to increase their participation in new deals and reposition into double-Bs after the LBO deluge in October.

For these more rate-sensitive issuers in the double-B category, looming rate increases provided a clear impetus to come to market, despite new-issue premiums remaining elevated even for seasoned credits.

Prior to October, double-Bs lagged lower-rated credits, and in the fourth quarter, average new-issue yields in the double-B space climbed above 3% for the first time in 2021, according to LCD data. For example, French car-maker **Renault**, which is rated BB+/Ba2, paid 2.5% for a €500 million long-five-year unsecured note in November, which is the same interest rate the company achieved for seven-year paper issued in March.

Rate window

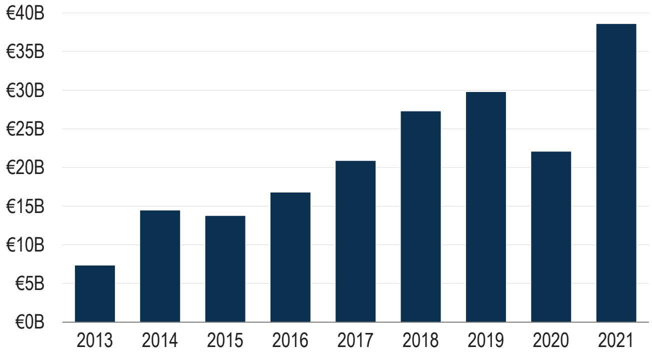
"It was a question of finding the right window," said a banker back in November. "Accounts will focus on the deals that give them more alpha, so LBOs will always garner the most attention versus run-of-the-mill double-Bs."

While funding conditions were not as ripe as in the first and second quarters, bankers reported corporate issuers expressing regret at missing the September sweet spot as sentiment soared heading into October. With much of the committed pipeline of LBOs having come to market by the end of October, this provided a clear window for double-B-rated companies. While borrowers such as **Graphic Packaging** and **Faurecia** issued bonds for widely anticipated M&A financings, for the majority in this ratings bracket, the decision to issue looked entirely opportunistic — and reflected anxiety about rising rates.

This was clearly the case for Paris-listed electrical supplies company **Rexel**, rated BB/Ba2, which chose to refinance its 2026 bonds, not callable until 2023, via the make-whole call provision at 50 bps over Bunds, pricing €600 million of 10-year notes at 2.125%.

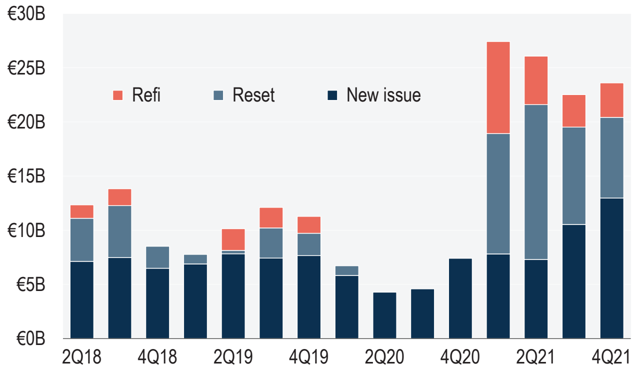
For investors, the market backdrop also made double-Bs an obvious buy, and many of the fallen angel issuers to appear in the fourth quarter — such as **Lufthansa**, Renault, **Accor**

Chart 22: European CLO new-issue volume



Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 24: European CLO volume



Source: Leveraged Commentary & Data (LCD)
Data through Dec. 31, 2021.

and **Teva** — were the beneficiaries of investment-grade accounts filling their high-yield allocations before year-end. For high-yield accounts, the rationale stemmed from the fact that double-Bs outperformed lower-rated bonds in October, and buyers were overweight single-Bs going into November.

"While so far this year [single] Bs have delivered 5.1% of excess returns versus 3.4% in BBs, nearly all the outperformance took place in the first half of the year," wrote Morgan Stanley analysts in the bank's 2022 European credit outlook at the end of 2021. "Returns since the summer have been broadly comparable across the two ratings cohorts."

CLOs join party with annual issuance record

European CLO issuance — along with loan and bond volumes — also broke records in 2021, with total priced new issuance of €38.6 billion for the year eclipsing the €35.5 billion printed in 2006 to set a new annual record. What's more, the last period of the year also set a quarterly record for the CLO 2.0 era, with the market chalking up new deals totalling roughly €13 billion.

In contrast to the first half of 2021 — when the market was awash with CLO resets and refinancings — new issuance has remained at the fore throughout the latter portion of the year, making up just over half the total activity in the second half of the year. As such, the market has now recorded a new CLO 2.0-era quarterly issuance record in consecutive quarters, having priced €10.53 billion during the third quarter.

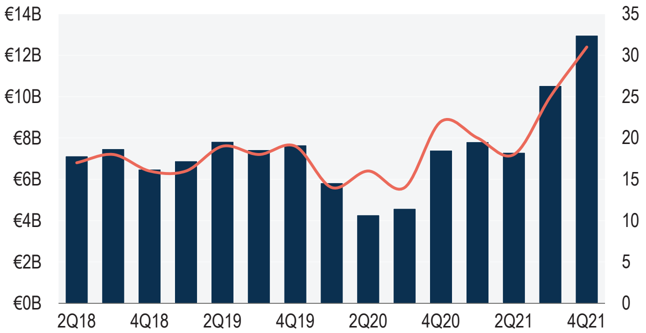
CLOs dominate single-B space

The impact of this uptick in CLO new issuance on the leveraged loan market is clear, given the increasing correlation between the two markets in 2021. Anecdotally, two loan syndicate desks have suggested that CLOs have made up 90% of the buyer base of standard single-B rated euro-denominated loans in 2021 (i.e. those priced at 375-400 bps area) with the trickier, higher-margin names attracting more non-CLO money. "An extra 100 bps tends to unlock sizable pockets of non-CLO liquidity," said one banker at a leading arranging house.

CLO demand also continues to underpin European secondary loans, with the average bid in the European Leveraged Loan Index closing at 98.77 on Dec. 31 (just below yearly highs), with single-B names at 99.22 and double-B names at 99.46.

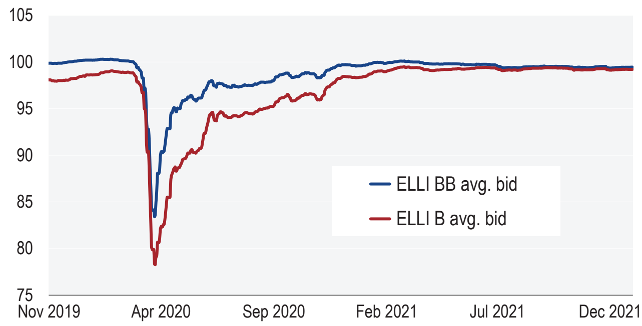
Despite heightened demand from CLOs, primary loan pricing has remained disciplined, and has even trended

Chart 23: European quarterly CLO new-issue volume and count



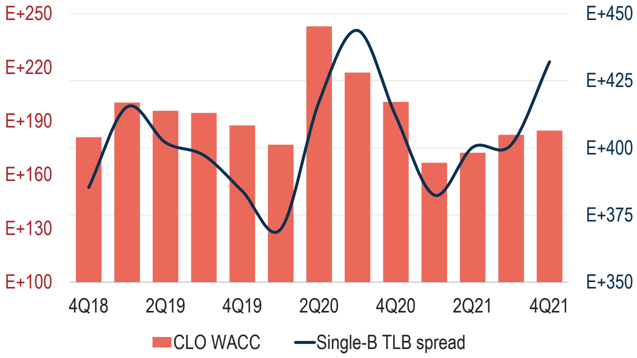
Data through Dec. 31, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 25: Weighted average bid of European loans by rating



Data through Dec. 31, 2021.
Sources: Leveraged Commentary & Data (LCD); S&P European Leveraged BB Loan Index; S&P European Leveraged B Loan Index.

Chart 26: European CLO WACC versus TLB spread



Source: Leveraged Commentary & Data (LCD) Data through Dec. 31, 2021.

wider. For the quarter, the average single-B term loan B spread rose to 432 bps, while the average CLO weighted average cost of capital (WACC) was 185 bps, suggesting — on a rudimentary basis — an excess spread that surpasses the 200 bps said to be required to make CLO managers' equity arbitrage work.

However, views on the attractiveness of the arbitrage at any given point varies from manager to manager. "CLO arbitrage now is better than it was in January, despite liability spreads being wider, owing to the new-issue loan market," commented one manager in November.

A second manager disagreed, however, commenting that the arbitrage became more difficult towards the end of the year: "There's the deals that everyone wants that come in tight, which isn't good for the arbitrage, and then there's the 30% of deals that you don't like — but that's where you get a good margin and OID."

Depth of demand

Possibly the most significant development in the post-summer market, sources note, was the depth in demand for triple-A CLO paper, with some going as far as to assess the market for triple-As in the latter portion of the year as deeper than it was in the first quarter.

An increase in participation from triple-A investors taking smaller tickets — but not necessarily from smaller accounts — allowed deals to be syndicated more widely after the late-summer break, which offered managers a route to tighter pricing at the top of the stack, while those that locked in early for certainty of execution were unable to take advantage of the tightening market.

Three managers — namely CVC, Blackrock and Bridgepoint — scooped triple-A coupons of 94 bps, the tightest level for a triple-A tranche in the post-summer market.

Indeed, sources say that after the summer, the market saw fewer anchor-driven deals, whereas before summer, anchor-driven deals dominated the European CLO landscape, with some anchors requiring higher coupons than others.

However, tightening spreads at the top of the stack were tempered somewhat by the softening of mezzanine notes, given the weight of supply and the shallower pool of investors further down the capital stack, which increasingly played out towards the end of the quarter.

Upward pressure on triple-A spreads also eventually began to factor towards the end of November, with sources noting that the market swiftly moved away from a 94-95 bps context, to 96-99. This widening coincided with broader market disruption from news surrounding the omicron variant, but also came at the tail end of a record-breaking year for issuance, which has kept investors busy throughout.

European CLO ave. coupon across the stack and weighted ave. cost of capital (bps)

Time frame	AAA	AA	A	BBB	BB	WACC
2Q20 (E+)	172	253	322	471	688	243
3Q20 (E+)	136	198	286	400	630	217
4Q20 (E+)	110	180	281	411	642	201
1Q21 (E+)	83	136	223	330	584	167
2Q21 (E+)	87	158	209	314	593	172
3Q21 (E+)	99	169	218	316	607	182
4Q21 (E+)	97	175	225	331	624	185
Change from Q3'21	-2	6	7	15	17	3
Change from Q4'20	-12	-5	-56	-80	-18	-16

Data through Dec. 31, 2021.

Source: Leveraged Commentary & Data (LCD)

As a result, the WACC on new-issue prints has broadly come at a range of 179-192 bps since the start of the fourth quarter (excluding static vehicles and CLOs without a single-B rated tranche), with a few outliers. The tightest print during that timeframe was observed on the €447.5 million CVC Cordatus Loan Fund XXII, which came in at 179.5 bps, according to LCD, while the widest was the €355 million Nassau Euro CLO I (a debut European issue for the U.S.-based platform) which printed at a WACC of 202 bps, and with a triple-A coupon of 105 bps.

General uncertainty around omicron, widening liability spreads and a primary loan market that had pushed previously anticipated big-ticket M&A deals out to 2022 created a logical slowdown for CLO issuance into December.

Screen tests

Positive screening is the next item on the agenda in the European CLO space, with negative screening for environmental, social and corporate governance (ESG) factors in CLOs now firmly market standard in the form of eligibility criteria. ESG scoring — i.e. the scoring of borrowers based on their ESG credentials

— is now either reported by managers, undertaken but not reported, or is in the process of being developed (either internally or alongside a third-party scoring provider).

One of the more recent European CLOs to have been highlighted for its positive ESG considerations is the €404.75 million Fidelity Grand Harbour CLO 2021-1 for FIL Investments International, which encompasses a portfolio test. Under the test, 50% of the portfolio has to be rated A-C, from an internal score ranging from A-E that Fidelity applies across its entire platform, according to sources. The process is understood to be treated similarly to other CLO tests (such as the weighted average rating factor test) on a maintain or improve basis, sources note.

The Fidelity CLO is "aligned" with Article 8 — i.e. funds which promote environmental and social characteristics — under the EU Sustainable Finance Disclosure Regulation, or SFDR. The next step would be for CLOs to officially opt-in to, and be marketed as, Article 8 funds, which some expect to be a key feature of the market over the next year or so.

Great expectations

Going into 2022, sources expect the market to remain focused on new issues. "Managers have been juggling their existing pipelines and addressing the cost of capital on existing deals. There are still resets in the pipeline, but as 2022 progresses the market will lean towards more new issuance," commented a manager.

There are currently an estimated 50-60 CLO warehouses open and ramping, while various market commentators expect European issuance to take centre stage during the start of 2022, as the U.S. market transitions to the secured overnight financing rate (Sofr).

On the macro front, despite growing negative headlines, market participants point to very few headwinds that could filter through to the leveraged loan and CLO markets in the near-term, with those that have spoken to LCD more concerned about the risk of sourcing assets, while remaining bullish on default and recovery rates.

Indeed, volatility in wider markets (including the high-yield asset class) in October did not filter through to the CLO liability market, which sources note was another indicator of investors' preference towards the floating-rate nature of the product.

Nevertheless, there remain mixed views on inflationary and supply chain risks going forward, and the extent to which these have been reflected in companies' third-quarter results. "I don't expect portfolio stats to improve in 2022. While there won't be a wave of defaults, there will be more volatility and the wave of upgrades that people are expecting will take longer," said one manager.

From a structural standpoint, delays to loan settlements will remain an area of interest going in to 2022, with multiple managers now concurring that increased delays are having a material impact on their CLO distributions.

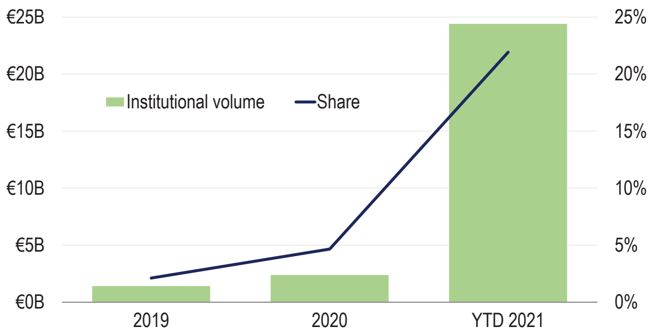
One outcome from this dynamic is a potentially tiering affect between those better able to manage delayed loan payments and those that are less well-equipped, with larger and more-established managers arguably better positioned to leverage their size and profile to chase down and speed up delayed payments.

ESG gains global market share

In 2021, environmental, social and governance elements became solidly embedded in European leveraged finance deals, with sustainability-linked loans and high-yield bonds making up a sizable chunk of total new issuance in each asset class.

But while ESG considerations have become important for borrowers and lenders, just how deals incorporate ESG is still being worked out. The market must ensure that the enthusiastic adoption of ESG provisions does not tip over into "greenwashing," whereby an issuer overstates its green credentials to obtain better financing terms.

Chart 27: European institutional term loans with ESG margin ratchet



Data through Dec. 16, 2021.

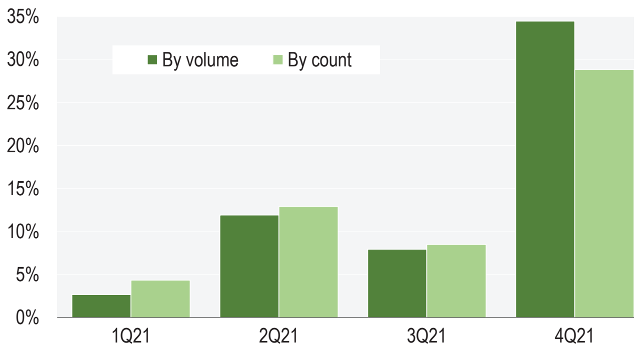
Source: Leveraged Commentary & Data (LCD)

Across high-yield bonds and loans in Europe, transactions with ESG provisions became increasingly prevalent in 2021. Indeed, more than a fifth of both leveraged loans and high-yield bonds in Europe included pricing mechanisms connected to key performance indicators (KPIs) linked to ESG criteria, according to LCD data.

In the U.S., there was an increasing focus on all things sustainable, with green bond activity stepping up to $10.7 billion, from $2.6 billion in 2020.

The use of sustainability-linked high-yield bonds wasn't quite as prevalent, with $5.9 billion of issuance in the year through Dec. 16 carrying a coupon step-up linked to

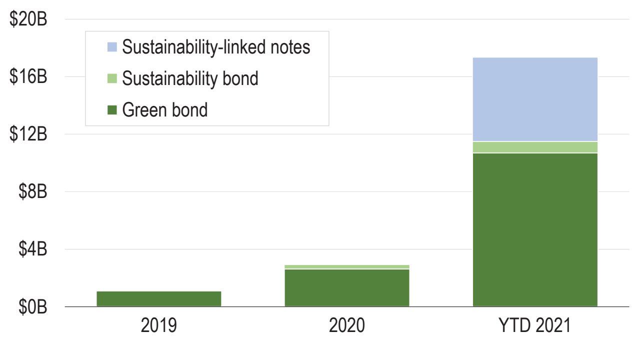
Chart 28: European sustainability-linked HY bond share



Data through Dec. 16, 2021.
Source: Leveraged Commentary & Data (LCD)

ESG-related criteria. However, this is still up from no such issuance in 2020. With market participants reporting a rise in the number of conversations around ESG in the U.S., and a renewed federal focus on the topic, investors in 2022 could see a surge of ESG-linked leveraged loan and high-yield offerings in the region.

Chart 29: US ESG high-yield bond volume



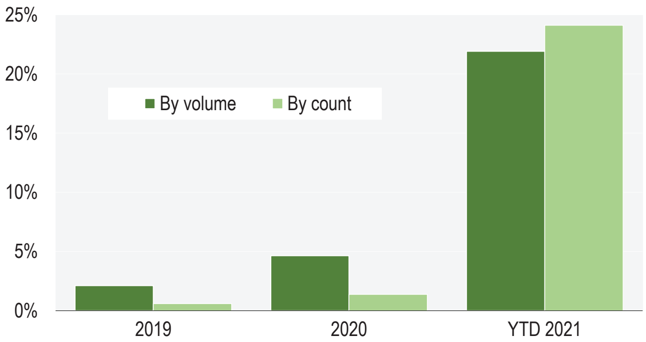
Data through Dec. 16, 2021.
Source: Leveraged Commentary & Data (LCD)

Greenwashing concerns

As the use of these provisions has broadened, fears of greenwashing have crept into the marketplace. There is a long way to go to ensure that the ESG-related targets used for leveraged finance deals are standardized and as transparent as they can be, and market participants point to the current phase as a crucial one for the development of this sector.

"We no longer have to persuade anybody that ESG is important, that's pretty clear," says Sabrina Fox, CEO of the European Leveraged Finance Association (ELFA). "But we're now at this 'adolescent' stage, and we need to make sure the market doesn't go off the rails. We have to be so careful with these provisions. They need to be embraced in a healthy way for the market, and we don't want issuers to be seen to be taking advantage of this trend."

Chart 30: European ESG loan share



Data through Dec. 16, 2021.
Source: Leveraged Commentary & Data (LCD)

Others agree that the speed at which ESG pricing mechanisms have been introduced to the market has resulted in concern that issuers may be setting targets that are not ambitious enough, or that they are not verifying their KPIs in a suitable way.

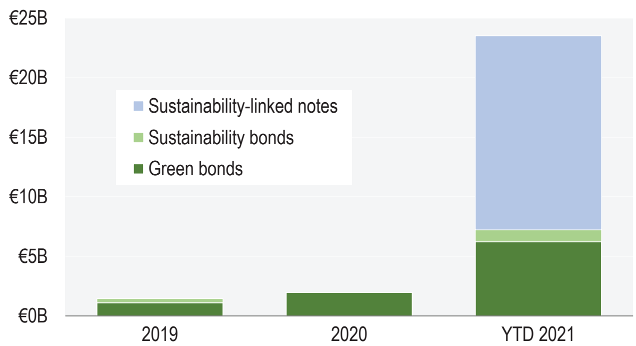
"Our incorporation of ESG needs to improve," says one buyside source. "It's all well and good wanting to buy into greener names, but when they're not really that green it feels like a joke. But maybe it's just because we're at the beginning of the process, and these things are only just starting to bed in."

Marketwide standards

Indeed, industry bodies such as ELFA and the Loan Market Association, or LMA, have been increasingly focused on creating marketwide standards on how ESG KPIs are structured, communicated, verified and tested across all products. In the summer, ELFA and the LMA published a best practice guide to sustainability-linked leveraged loans, and ELFA is now exploring the creation of more best practice guidance on sustainability-linked instruments with other industry bodies.

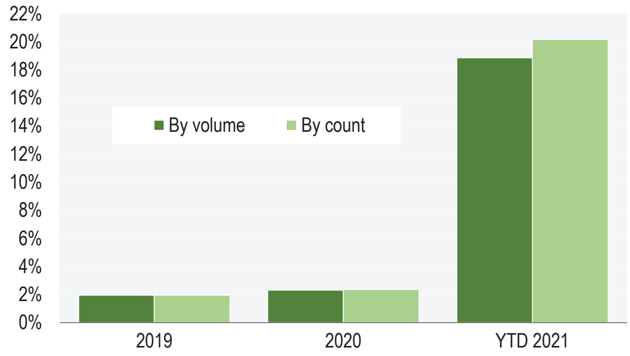
Guidelines such as these will help create more clearly drawn lines around what the market expects of sustainability-linked

Chart 31: European ESG high-yield bond volume



Data through Dec. 16, 2021.
Source: Leveraged Commentary & Data (LCD)

Chart 32: European ESG high-yield bond share



Data through Dec. 16, 2021.
Source: Leveraged Commentary & Data (LCD)

transactions, and will help investors push back against deals that are unacceptable — even in a borrower-friendly marketplace.

"I think the real challenge we have is that the market has embraced sustainability-linked provisions so enthusiastically, and now we need to ensure that they are credible, ambitious, benchmarked, and verifiable," says Fox. "We all want to avoid greenwashing, and this means very careful guardrails around these provisions — and that's what our best practice guides look to achieve."

Sustainability-linked loan volume surges

Sustainability-linked leveraged loans — i.e., those that carry a margin ratchet linked to ESG-related targets — accounted for nearly a quarter of the European issuance by deal count in 2021, or more than a fifth by volume.

This effort equates to €24.5 billion of supply, with the chunky volume share up from just 5% on the same measure in 2020, and 2% in 2019. Indeed, the inclusion of sustainability-linked margin ratchets became almost standardized in some areas of the European loan space, with transactions ranging from mid-market unitranche deals to a €2.4 billion buyout financing from T-Mobile Netherlands BV (the largest single LBO term loan B since 2018), including sustainability provisions.

But while ESG-linked margin ratchets have become more prevalent in the European leveraged loan market, there is a sense that this product is still developing. For some time, certain investors have said they would prefer issuers to face more of a downside if they miss their sustainability performance targets than the potential upside if they achieve them. "There's a question mark over whether we've got it right at the moment by using both a carrot and stick on ESG margin ratchets for loans," said one senior investor. "I don't know whether we might go back on that."

While most ESG-linked leveraged loans completed to date have an equal-sized margin ratchet for when an issuer hits or misses its KPIs, there have been exceptions. Back in March, an €840 million term loan B from vehicle glass repair firm **Belron** to fund a dividend and refinance debt had an ESG adjustment of -7.5 basis points/+10 basis points. And in the U.S. in November, a $1.335 billion term loan B and $100 million term loan C from sustainable waste firm **Covanta** carried 12.5-basis-point margin increases for each of the two key performance indicators not met by the observation date, with no benefit available to the issuer if it were to hit its targets.

Structures whereby only a punitive margin ratchet is available if issuers miss targets — rather than promising a pricing benefit if they achieve their goals — would bring the sustainability-linked loan product more in line with coupon step-ups on sustainability-linked bonds. Investors say this would also make sense as these mechanisms become even more prevalent for borrowers tapping both markets. "If there's an issuer bringing both a high-yield bond and a loan to the market with the same ESG targets utilizing the same criteria, at the moment the step-ups wouldn't be the same," says an investor source. "It'll be interesting to see how that dynamic progresses." However, others note that the asset classes already have their own idiosyncrasies, such as different redemption schedules, and that any difference between ESG provisions available in the two markets is not therefore insurmountable.

Bond bonanza

The variance between the implementation of ESG provisions on high-yield bonds and leveraged loans became more noticeable over the year as the volume and number of sustainability-linked bonds issued in the European market continued to rise. While the product was only launched for the first time back in March — with a €500 million offering from Greece's **Public Power Corp. SA** — €16.3 billion of sustainability-linked bonds were sold in Europe in 2021.

The volume and number of green bonds also stepped up in 2021, and ESG-related high-yield bond issuance accounted for a fifth of deals seen in the market by count. From a standing start in March, the issuance of sustainability-linked high-yield bonds accelerated dramatically throughout the year. In the fourth quarter, sustainability-linked issuance accounted for 33% of European high-yield volume, with 16 deals totaling €9 billion.

What's more, it is not just the volume of sustainability-linked notes that increased in the fourth quarter, but also the range of issuers utilizing this pricing mechanism, with the variety of bond products that incorporate it also expanding.
— David Cox, Taron Wade, Michael Rae, Thomas Beeton, Nina Flitman

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