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Categorizing CCCs

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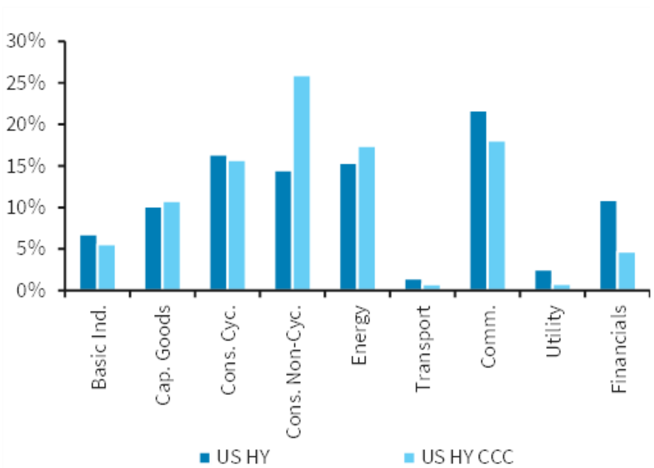
As US high yield and investment grade index spreads bounce along at year-to-date tights, market participants are increasingly looking for pockets of value and dislocations in credit markets, as many are hesitant to make a broader directional call after the strong 1Q total return performance. One common topic of conversation is the significant underperformance of CCC bonds on a beta-adjusted basis, with year-to-date total returns for CCCs (7.64%) roughly in line with those of BBs (7.49%) and the entire US High Yield Index (7.62%). In addition, given that CCCs have shrunk to 14% of the high yield market, broad-based statements about the rating bucket are difficult to make given the higher prevalence of idiosyncratic risk drivers in this cohort.

For the first nine months of 2018, CCCs outperformed as investors dipped down in credit quality in light of the supportive macro growth picture. Allocations to CCCs also helped offset the headwinds to total returns from rising Treasury yields in credit portfolios with smaller coupons elsewhere (*CCC Compression in Context*). This year's backdrop is significantly different, as fewer investors are concerned about an outsized increase in Treasury yields and growth concerns top the list of investor worries (see the most recent *Global Macro Survey*), helping explain some of the underperformance.

With the macro environment unlikely to provide a catalyst for CCCs to rally, we dig deeper into the constituents to see if characteristics of the current cohort can help explain performance. Figure 1 compares the sector representation of CCCs on a par-weighted basis with the broader high yield market. Consumer non-cyclical names represent 26% of the CCC cohort, far exceeding their 15% representation in the broader High Yield Index. Much of this skew is created by healthcare, with Tenet (THC) and Community (CYH) two of the largest CCC issuers.

FIGURE 1

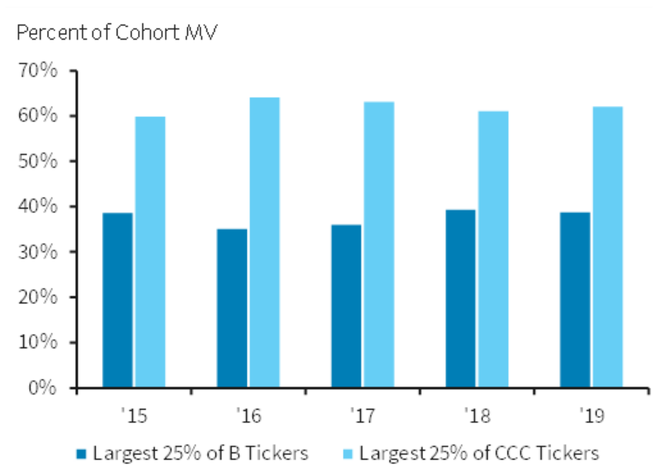
Compared with the Overall High Yield Index, CCCs Are Skewed More Toward the Consumer Non-Cyclical, Energy, and Capital Goods Sectors



Source: Bloomberg Barclays Indices

FIGURE 2

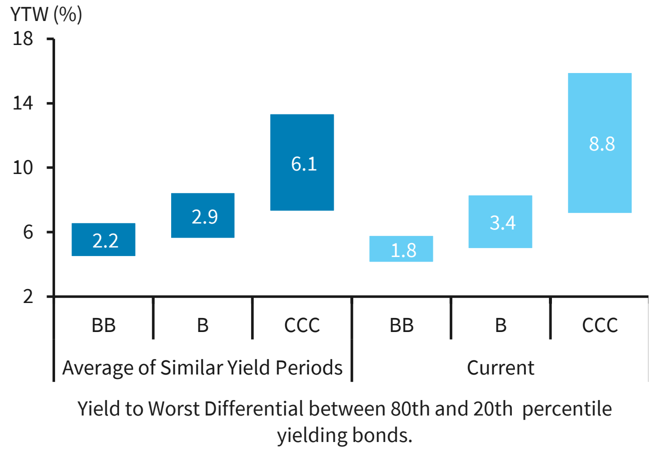
CCCs Are Significantly More Concentrated by Ticker Than Single-Bs



Source: Bloomberg Barclays Indices

FIGURE 3

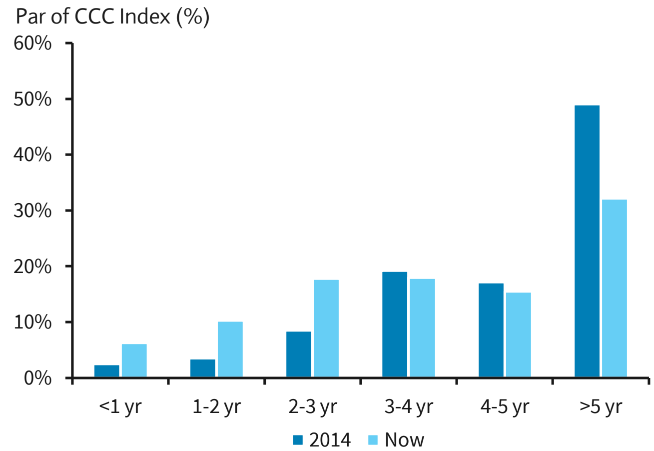
Yield Dispersion for CCCs Is Elevated Compared with Other Periods of Similar Overall Yields, but That Is Not the Case for BBs and Bs



Note: Shaded areas represent the range of YTW between the 20th and 80th percentiles of bonds in each rating cohort. Source: Bloomberg Barclays Indices

FIGURE 4

The Near-Term CCC Maturity Wall Is Larger Now Than at the End of 2014



Source: Bloomberg Barclays Indices

In addition, the concentration of the CCC bucket by ticker highlights the importance of single-name selection. Figure 2 shows the percent of market value that the largest 25% of tickers represent for the single-B and CCC cohorts. The largest 25% of tickers (50 tickers) make up 62% of CCC market value, while the largest 25% of single-B tickers (113 tickers) make up just 39% of single-B market value. This greater concentration has been fairly consistent across time.

Dispersion is also a differentiator for CCCs in 2019. Figure 3 shows the range between the 20th and 80th percentiles of bonds ordered by yield to worst in each rating bucket. The dark blue boxes show the average dispersion range during previous periods when both the index and the CCC bucket had yields similar to today (plus or minus 1%), while light blue indicates the current range of dispersion. The most notable difference today is the wider dispersion in the CCC bucket, with a yield differential of 8.8% between the 20th and 80th percentiles, compared with 6.1% on average in prior comparable periods. Conversely, the year-to-date rally in BBs driven by investors' preference for high-quality high yield has resulted in BB dispersion that is below the historical average. This highlights that the CCC market is increasingly divided into haves and have nots, as highlighted below in conjunction with Barclays' fundamental analysts.

For all the investor caution toward CCCs, we note that CCC issuance year-to-date as a percent of overall high yield primary market volume is actually in line with the average of 15% over the past five years. But as shown in Figure 4, the maturity wall for CCCs is notably higher over the next three years than it was at the end of 2014, prior to the last time credit concerns associated with a China-led global slowdown surfaced. This suggests some refinancing vulnerability for select issuers if concerns about a global slowdown accelerate and result in a rationing of capital. It also helps explain the wider range of yields, as short-dated discount bonds are likely to have the highest yields even if they are not fully distressed.

Furthermore, the subordination element of CCCs provides some information on investors' views about recoveries. Specifically, the CCC bonds of issuers with both CCC bonds and higher-rated debt (either BB or B and presumably structurally senior) have an average price of $84.5, compared with an average of $91 for CCC-rated bonds with no higher-rated bonds from the same issuer. Also, the YTW basis between these two groups is the highest of the post-crisis period, implying that investors are pricing the potential for lower recoveries for CCCs bonds that have bonds with structurally senior claims than for those that do not.

Finally, we find that roughly one-third of CCC issuers are public companies, consistent with post-crisis levels, but lower than the approximate 58% of high yield issuers that are public. This makes identifying equity cushions more difficult and eliminates a potential avenue to raise capital.

These data support our conclusion that single-name selection is probably more important for the CCC universe than normal, and the relative lack of publicly available financial data requires other approaches to augment credit views. As a result, in conjunction with our fundamental analysts, we have categorized select large CCC issuers that have at least $1bn of CCC debt outstanding in Figure 7 below. Sticking with the theme of haves and have nots indicated by our analysis, we bucket these issuers based on business/industry backdrop, as well as their leverage characteristics. Within each of the six buckets, we have mapped the issuers based on current weighted yield to worst and duration (OAD). We have also differentiated between cyclical (blue) and non-cyclical (green) sectors.

We find that certain issuers stand out relative to others in the same location on the matrix. We highlight some of those credits, specifically those that our fundamental analysts rate Overweight (Figure 5) or Underweight (Figure 6) on the following page.

FIGURE 5

Select CCC Credits That Our Fundamental Analysts Rate Overweight

Ticker	Cpn	Maturity Date	Px ($)	YTW (%)	Sector	Analyst	Rating	Commentary
ATCNA	7.750	5/15/22	101	7.2	Wireless	Daniel Rekrut	OW	We have confidence in the 2022 notes being repaid/refinanced in the near/medium term given the significant cash balances throughout the broader capital structure.
BWY	7.250	4/15/25	95	8.3	Packaging	Brian Lalli	OW	Despite weaker-than-expected 4Q18 earnings, BWY management remains focused on EBITDA improvement in 2019/20 through synergy realization, with future FCF to be applied to gross debt reduction.
ENDP	5.75 5.375	1/12/22 1/15/23	96 82	7.5 11.5	Pharma	Rishi Parekh	OW	While event risk related to opioid litigation remains an overhang for Endo, we feel that current yields are attractive and believe they do not reflect certain structural considerations relative to other CCCs.
FLXACQ	6.875 7.875	1/15/25 7/15/26	96 97	7.7 8.5	Packaging	Brian Lalli	OW	Following the recent acquisition of Waddington, we expect Carlyle-owned FLXACQ to commit to deleveraging over the next 2-3 years as EBITDA/FCF improve y/y with cost savings and M&A synergies.
MDR	10.625	5/1/24	87	14.3	Oil Field Services	Paul Chambers	OW	While somewhat priced in, we see potential for further uplift to the extent that MDR can demonstrate operational improvement into the second half of 2019 while cleanly executing on its asset sale processes.
NEWALB	8.00	5/1/32	90	9.3	Super-markets	Hale Holden	OW	We are Overweight rated on New Albertsons 2031s as an attractive spread pick up to the ALBLLC notes, despite its weaker position (i.e. lower ratings) in the Albertson capital structure.
PBH	6.375	3/1/24	103	5.5	Consumer Products	Hale Holden	Not Rated	We view Prestige Brands (PBH) as an attractive high quality B/CCC crossover. We think the company is committed to its lower leverage targets and believe there is the potential for an upgrade out of the CCC category.
PETM	7.125	3/15/23	78	16.7	Retailers	Hale Holden	Not Rated	We continue to like the secured portion of the PetSmart structure post-amendment changes.
RIG	7.5	1/15/26	99	7.6	Oil Field Services	Paul Chambers	OW	These notes, along with the 7.25% 2025s, are at the back end of RIG's guaranteed series, benefitting from guarantees by subsidiaries holding at least 85% of fleet value.
TSLA	5.30	8/15/25	86	8.1	Auto-motive	Chris Wang	OW	Despite disappointing 1Q production release, the company is projected to deleverage to ~2.5x by the end of 1H19, and along with meaningful balance sheet flexibility and scaling of the production, we would add exposure at lower levels ($84/8.5% YTW) and believe it should trade closer to B index level in the next 6-9 months.

Note: Includes bonds that are rated CCC and below.
Source: Barclays Research

FIGURE 6

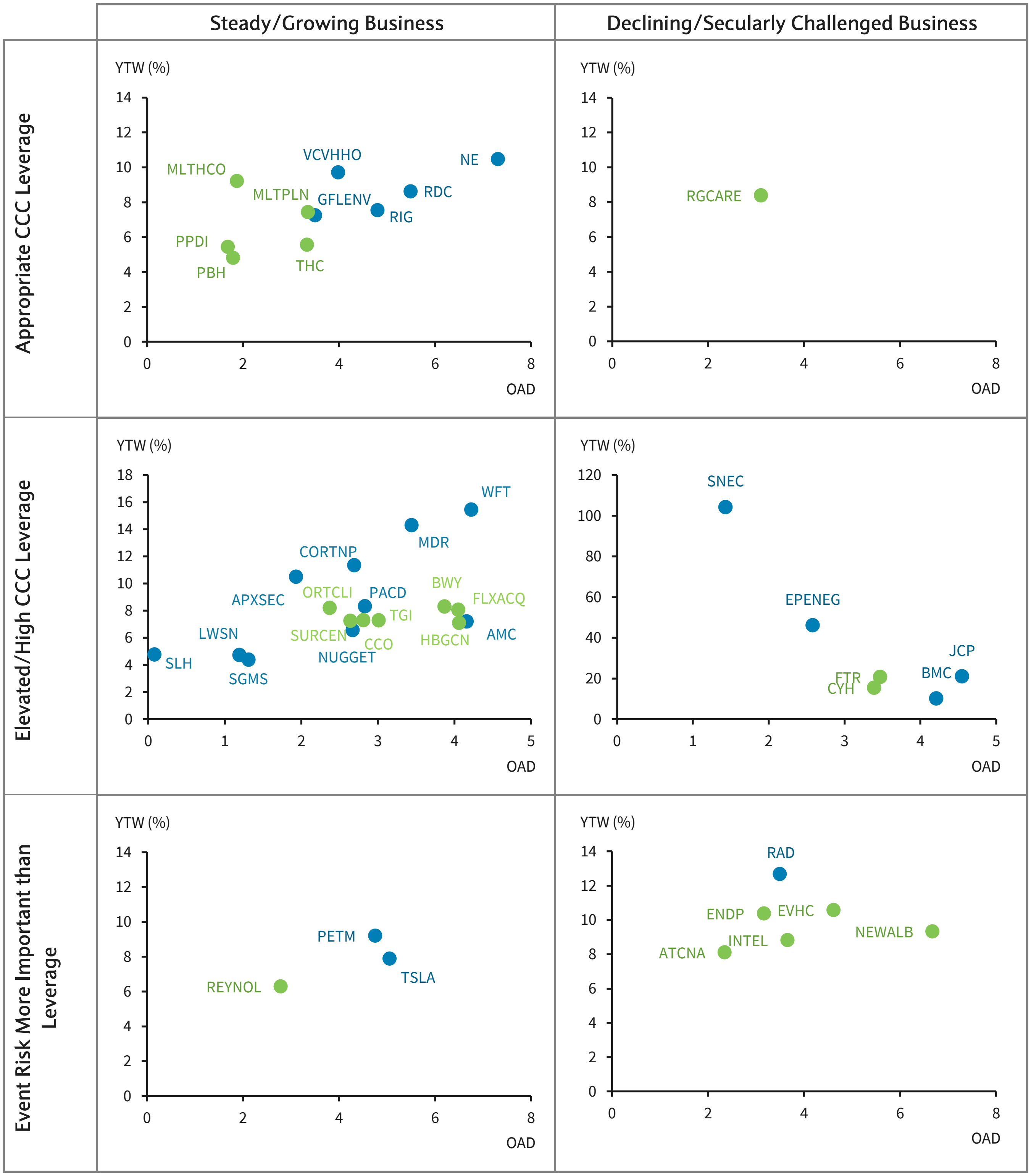
Select CCC Credits That Our Fundamental Analysts Rate Underweight

Ticker	Cpn	Maturity Date	Px ($)	YTW (%)	Sector	Analyst	Rating	Commentary
APXSEC	7.625	9/1/23	85	12.2	Consumer Cyclical Services	Gregg Price	UW	APX's leverage is elevated, and interest coverage is significantly worse than other CCCs. In addition, the company's strategy is coupled closely with professional security monitoring, which has struggled to grow for years, is being challenges by DIY services, and has recently sparked significant competition.
CYH	6.875 11.0 8.125	2/1/22 6/30/23 6/30/24	68 83 75	23.2 15.7 15.1	Healthcare	Rishi Parekh	UW	While yields on the structure are clearly high and although the company may exchange the 2022s with secured debt over time, the limits may cap upside and could reprice the structure. Leverage is high, and the business faces challenges due to the high cash burn. We are Underweight the Community structure aside from the 2021s.
JCP	7.625 8.625	3/1/97 3/15/25	34 59	22.1 21.2	Retailers	Hale Holden	UW	We remain Underweight rated on JCP second- and first-lien structures. Similar to most of retail, we expect a difficult first quarter.
SURCEN	6.75	7/1/25	92	8.3	Healthcare	Rishi Parekh	UW	Although Surgery Center should benefit from the growing business in which it operates, the company has elevated leverage and limited cash flow. As a result, we are Underweight.
UNIT	8.25 7.125	10/15/23 12/15/24	90 87	11.1 10.3	Wirelines	Jeff Harlib	UW	We are Underweight UNIT 8.25% 2023s and 7.125% 2024s. We believe there is uncertainty about Windstream's bankruptcy process, challenges in diversifying Windstream exposure, limited excess liquidity, and future refinancing risk with a revolver maturity in 2020 and other secured/unsecured debt maturing in 2022-24.

Note: Includes bonds that are rated CCC and below.
Source: Barclays Research

FIGURE 7

Select Largest CCC Issuers Categorized by Our Fundamental Analysts



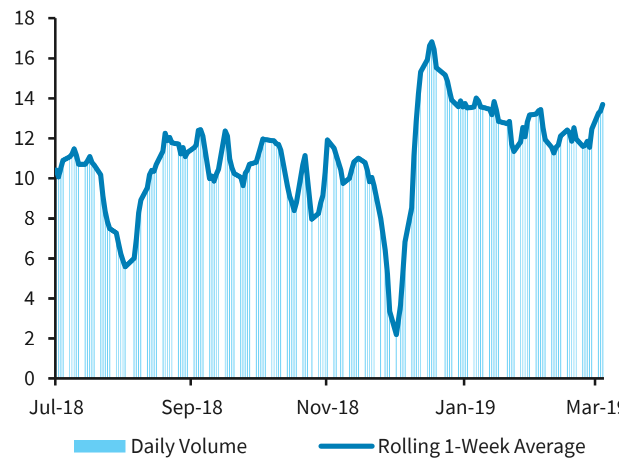
Cyclical sectors, in blue, are automotive, consumer cyclical services, diversified manufacturing, environmental, gaming, independent energy, leisure, oil field services, restaurants, retailers, and technology.

Non-cyclical sectors, in green, are aerospace & defense, cable satellite, consumer products, healthcare, media entertainment, insurers, packaging, pharmaceuticals, supermarkets, wireless, and wirelines.

Note: Limited to bonds rated CCC only.

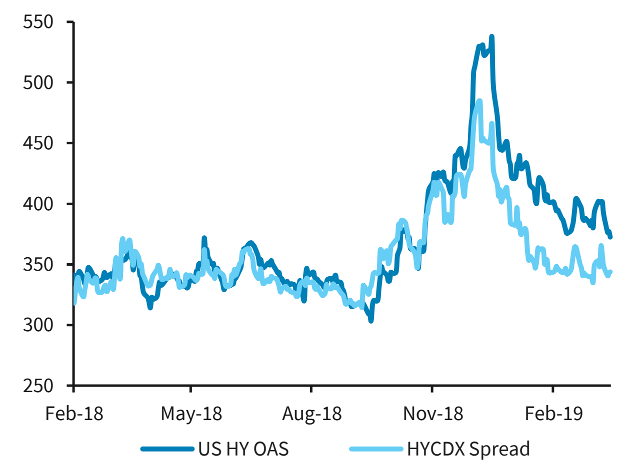
Source: Barclays Research

High Yield Average Institutional Trade Volume ($bn)



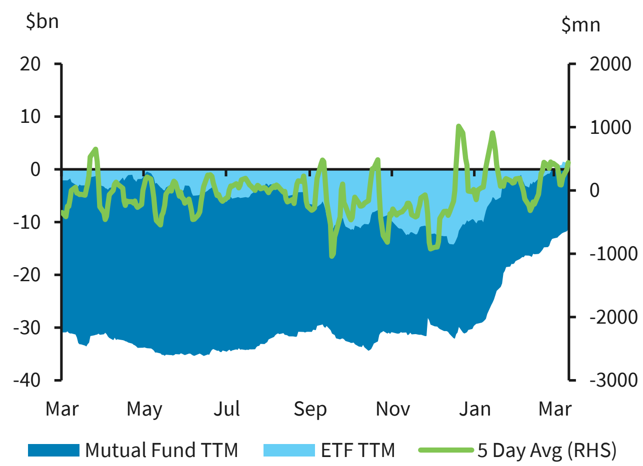
Note: Includes both registered and 144A volumes. Source: FINRA TRACE

On-the-Run HYCDX versus US High Yield Index (bp)



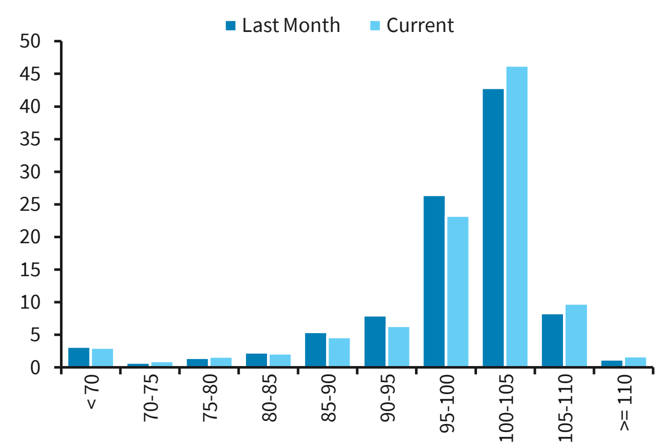
Source: Barclays Research

Flows to High Yield Mutual Funds and ETFs



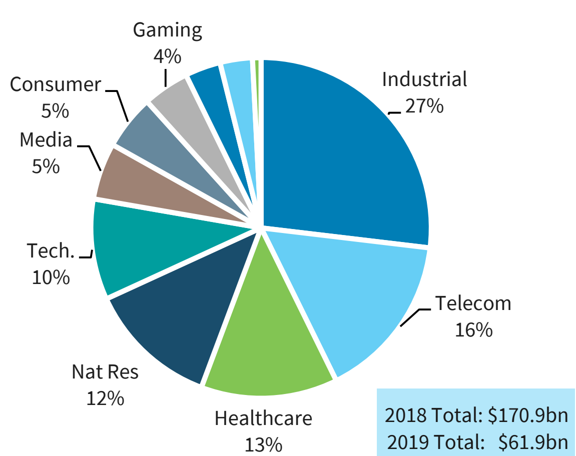
Note: Daily reporters only. Source: EPFR

High Yield Index Price Distribution by Par (%)



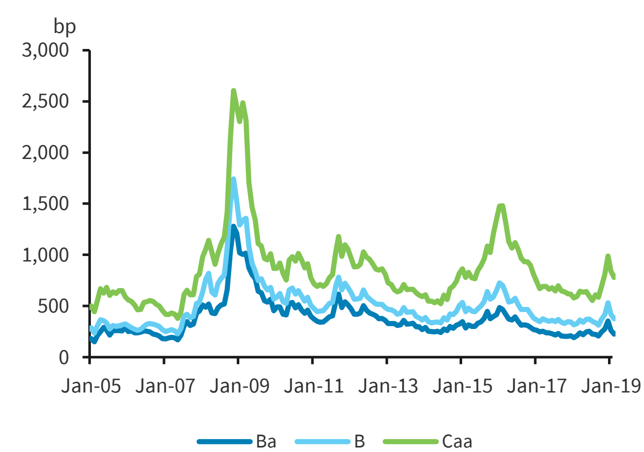
Source: Barclays Research

High Yield Supply by Sector



Note: 2019 new issue data as of April 4.
Source: Bloomberg Barclays Indices

High Yield Spreads by Credit Quality



Source: Bloomberg Barclays Indices

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Materially Mentioned Issuers/Bonds

ALTICE LUXEMBOURG SA, CD/D/E/J/K/L/M
ATCNA 7 3/4 05/15/22 (USD 100.38, 03-Apr-2019)

APX GROUP INC, CD/J
APXSEC 7 5/8 09/01/23, Underweight (USD 84.63, 03-Apr-2019)

BWAY HOLDING CO, CD/J/K/M
BWY 7 1/4 04/15/25, Overweight (USD 95.00, 03-Apr-2019)

CHS/COMMUNITY HEALTH SYSTEMS INC, CD/J/K/M
CYH 11 06/30/23, Underweight (USD 82.50, 03-Apr-2019)
CYH 6 7/8 02/01/22, Underweight (USD 67.50, 03-Apr-2019)
CYH 8 1/8 06/30/24, Underweight (USD 75.75, 03-Apr-2019)

ENDO FINANCE LLC / ENDO FINCO INC, CD/J/K/M
ENDP 5 3/8 01/15/23, Overweight (USD 81.25, 03-Apr-2019)

ENDO FINANCE LLC, CD/D/J/L
ENDP 5 3/4 01/15/22, Overweight (USD 95.25, 03-Apr-2019)

FLEX ACQUISITION CO INC, CD/J
FLXACQ 6 7/8 01/15/25, Overweight (USD 96.25, 03-Apr-2019)
FLXACQ 7 7/8 07/15/26, Overweight (USD 97.00, 03-Apr-2019)

JC PENNEY CORP INC, CD/D/J/K/L/M
JCP 7 5/8 03/01/97, Underweight (USD 33.50, 03-Apr-2019)
JCP 8 5/8 03/15/25, Underweight (USD 58.50, 03-Apr-2019)

MCDERMOTT TECHNOLOGY AMERICAS INC / MCDERMOTT TECHNOLOGY US INC, CD/D/J/K/L/M/N
MDR 10 5/8 05/01/24, Overweight (USD 86.50, 03-Apr-2019)

NEW ALBERTSONS LP, CD/D/J/K/L/M

NEWALB 8 05/01/31, Overweight (USD 90.50, 03-Apr-2019)

PETSMART INC, CD/D/E/J/K/L/M/N
PETM 7 1/8 03/15/23 (USD 76.75, 03-Apr-2019)

PRESTIGE BRANDS INC, CD/D/E/J/K/L/M/N
PBH 6 3/8 03/01/24 (USD 102.63, 03-Apr-2019)

SURGERY CENTER HOLDINGS INC, CD/J/K/M
SURCEN 6 3/4 07/01/25, Underweight (USD 92.63, 03-Apr-2019)

TESLA INC, CD/CE/E/FB/J/K/L/M
TSLA 5.3 08/15/25 (USD 87.38, 03-Apr-2019)

TRANSOCEAN INC, A/CD/D/J/K/L/M/N
RIG 7 1/2 01/15/26, Overweight (USD 99.00, 03-Apr-2019)

UNITI GROUP LP / UNITI FIBER HOLDINGS INC / CSL CAPITAL LLC, CD/J/K/M
UNIT 7 1/8 12/15/24, Underweight (USD 86.50, 03-Apr-2019)

UNITI GROUP LP / UNITI GROUP FINANCE INC / CSL CAPITAL LLC, CD/J/K/M
UNIT 8 1/4 10/15/23, Underweight (USD 92.63, 03-Apr-2019)

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For sectors rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Barclays Pan-European High Yield Finance Index or the Bloomberg Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to exceed the six-month total return of the relevant index.

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For sectors rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Barclays Pan-European High Yield Finance Index or the Bloomberg Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be in line with the six-month total return of the relevant index.

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Explanation of the Barclays Research Corporate Credit Rating System

For all High Grade issuers covered in the US, Europe or Asia, and for all issuers in Latin America and EEMEA, the credit rating system is based on the analyst's view of the expected excess return over a six-month period of the issuer's index-eligible corporate debt securities* relative to the expected excess return of the relevant sector, as specified on the report.

Overweight (OW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to exceed the six-month expected excess return of the relevant sector.
Market Weight (MW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be in line with the six-month expected excess return of the relevant sector.
Underweight (UW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be less than the six-month expected excess return of the relevant sector.
Rating Suspended (RS): The rating has been suspended temporarily due to market events that make coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.

Coverage Suspended (CS): Coverage of this issuer has been temporarily suspended.
Not Covered (NC): Barclays' fundamental credit research team does not provide formal, continuous coverage of this issuer and has not assigned a rating to the issuer or its debt securities. Any analysis, opinion or trade recommendation provided on a Not Covered issuer or its debt securities is valid only as of the publication date of this report and there should be no expectation that additional reports relating to the Not Covered issuer or its debt securities will be published thereafter.

For all High Yield issuers (excluding those covered in EEMEA or Latin America), the credit rating system is based on the analyst's view of the expected total returns over a six-month period of the rated debt security relative to the expected total return of the relevant sector, as specified on the report.

Overweight (OW): The analyst expects the six-month total return of the debt security subject to this rating to exceed the six-month expected total return of the relevant sector.
Market Weight (MW): The analyst expects the six-month total return of the debt security subject to this rating to be in line with the six-month expected total return of the relevant sector.
Underweight (UW): The analyst expects the six-month total return of the rated debt security subject to this rating to be less than the six-month expected total return of the relevant sector.
Rating Suspended (RS): The rating has been suspended temporarily due to market events that make coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.
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Where a recommendation is made at the issuer level, it does not apply to any sanctioned securities, where trading in such securities would be prohibited under applicable law, including sanctions laws and regulations.

*In EEMEA and Latin America (and in certain other limited instances in other regions), analysts may occasionally rate issuers that are not part of the Bloomberg Barclays U.S. Credit Index, the Bloomberg Barclays Pan-European Credit Index, the Bloomberg Barclays EM Asia USD High Grade Credit Index or Bloomberg Barclays EM USD Corporate and Quasi Sovereign Index. In such cases the rating will reflect the analyst's view of the expected excess return over a six-month period of the issuer's corporate debt securities relative to the expected excess return of the relevant sector, as specified on the report.

Distribution of ratings assigned by Barclays Corporate Credit Research at the bond level:
22% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 59% of bonds with this rating category are investment banking clients of the Firm; 71% of the issuers with this rating have received financial services from the Firm.
56% have been assigned Market Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 51% of bonds with this rating category are investment banking clients of the Firm; 77% of the issuers with this rating have received financial services from the Firm.
22% have been assigned an Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating; 43% of bonds with this rating category are investment banking clients of the Firm; 70% of the issuers with this rating have received financial services from the Firm.

Explanation of the Barclays EM Sovereign Credit Issuer Rating System
Overweight (OW):
The analyst expects the six-month excess return of the country's index eligible bonds to exceed the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.
Market Weight (MW):
The analyst expects the six-month excess return of the country's index eligible bonds to be in line with the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.
Underweight (UW):
The analyst expects the six-month excess return of the country's index eligible bonds to be less than the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.
Rating Suspended (RS):
The rating has been suspended temporarily due to market events that make coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity.

Distribution of ratings assigned by Barclays Emerging Markets Sovereign Research at the issuer level:
35% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 25% of issuers with this rating category are investment banking clients of the Firm; 67% of the issuers with this rating have received financial services from the Firm.
35% have been assigned Market Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 25% of issuers with this rating category are investment banking clients of the Firm; 75% of the issuers with this rating have received financial services from the Firm.
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