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Terming Out Is Good for Credit Health

Shobhit Gupta
+1 212 412 2056
shobhit.gupta@barclays.com
BCI, US

James K Martin
+ 1 212 412 2345
james.k.martin@barclays.com
BCI, US

Bradford Elliott, CFA
+1 212 526 6704
bradford.elliott@barclays.com
BCI, US

September has begun with a spate of corporate issuance, already producing the largest amount of supply in a single week on record. As has been the case all year, issuers favored longer tenors, with over 60% of the non-financial issuance yesterday coming in 10y and longer paper, as they monetize the low level of long-dated yields by terming out debt (Figure 1).[1] Several companies, such as CVS, Hartford, and Lincoln National, had already tendered for short-dated debt with proceeds of longer-dated issuance in August (see *Caught in a Low Yield Vortex*) and the trend continued in the first days of September. For instance, concurrent with the issuance of 30y debt, Unum launched a tender offer targeting shorter-dated bonds, including its 2021 notes.

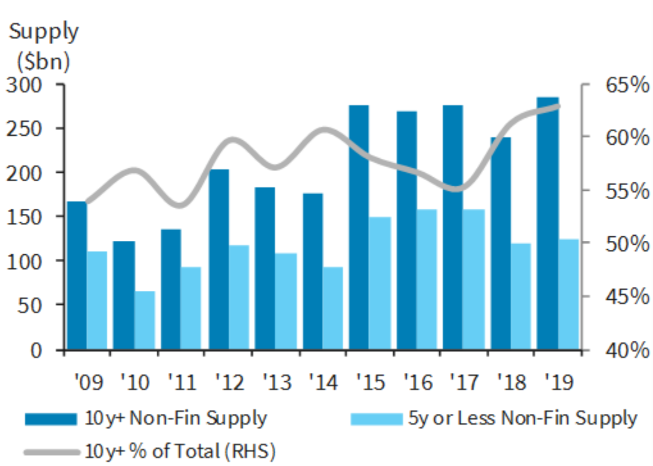
As a result of the issuance bias toward longer tenors, the average maturity of the US Corporate index has continued to increase; it is up from 10.7 years to 11.5 years in 2019. Combined with the decrease in risk-free yields, this has meant that the duration of the index has increased almost one year, from 7.0 to 7.9 (Figure 2). Indeed, with corporates favoring the long end of the market, the fraction of non-financial corporate debt maturing in 10+ years has increased to above 40% now, up over 5pp over the past five years (Figure 3).

While the longer duration means that the exposure to any yield change is higher, corporates terming out debt should be a credit positive fundamentally. Increasing the average maturity of debt lowers the reliance on funding markets in the medium term, likely affording companies a longer timeline to meet any fundamental challenges, as well as providing more stable funding costs.

Despite the fundamental improvement, terming out debt does not change leverage metrics (if total debt remains unchanged) and is unlikely to result in any rating upgrades. For investment grade corporates, rating agencies do not usually factor in the debt maturity profile, as repayment of debt is generally not a concern for IG companies. However, the amount of short-dated debt has been a driver of spreads, especially for the lower-rated segments of the IG market. In *Beyond Leverage: Fundamental Factors That Matter*, we showed that BBB credits with a high amount of short-dated debt (as a percentage of free

FIGURE 1

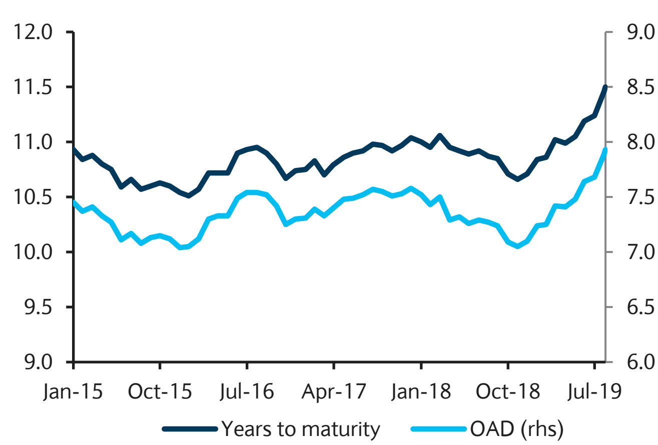
Non-financial 10y+ Issuance versus <5y Issuance since 2009



Note: Supply is through September 3 for each year.
Source: Bloomberg, Barclays Research

FIGURE 2

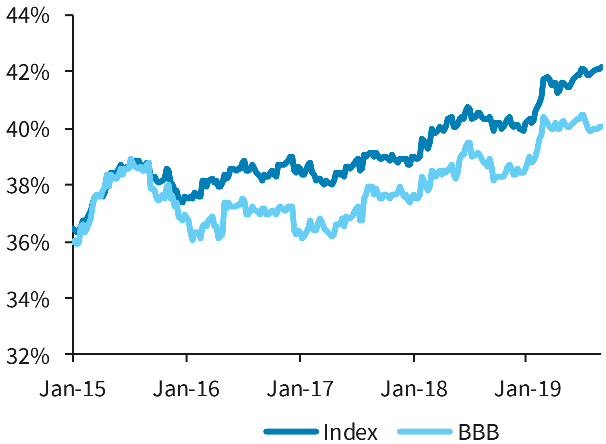
Average Life and Duration of the Credit Index Has Risen Sharply



Source: Bloomberg, Barclays Research

[1] Based on supply through Wednesday, September 4.

FIGURE 3
Fraction of Non-financial Debt with 10y+ Years to Maturity



Source: Bloomberg, Barclays Research

FIGURE 4
Coefficients for 10y BBB OAS Move in 2018

	Coefficient	p-value
Intercept	72bp	0%
Ratings (bp per Notch)	12bp	1%
% of Debt Maturing in More than 10y	-31bp	9%

Note: Companies with at least $2bn in debt. Source: Bloomberg, Barclays Research

cash flow) underperformed peers during 2007-08. Companies needing to refinance debt came under pressure, owing to concerns about the cost and availability of funding in a challenging market environment.

It appears that even in more moderate sell-offs, the debt distribution profile is an important driver of returns. We look at the spread widening of 10y BBB non-financial corporate bonds in 2018, when the overall index was 60bp wider. We explain spread moves using two variables: the rating (BBB+, BBB or BBB-) and the fraction of the issuer's total debt maturing in more than 10 years. Figure 4 shows the results of the regression. For every notch below BBB+ rating, credits widened about 12bp more. Corporates with a high portion of 10y+ debt significantly outperformed. A coefficient of -31bp implies that a company with only long-dated debt (ie, 100% debt has a 10y+ maturity) would have widened about 30bp less than a corresponding credit with only shorter-dated paper, all else equal.

The maturity extension in the non-financial universe should be an overall positive for valuations, likely limiting the downside in a sell-off. From a single-name positioning standpoint, it also suggests that investors should favor companies with a higher proportion of long-dated debt. Combining this with our preference for BBB/BBB- debt, Figure 5 shows select BBB credits that have a high proportion of long-dated debt (as % of their overall debt outstanding) and are rated overweight/market weight by our analysts.

FIGURE 5
10y Bonds of BBB/BBB- Non-Financials with a High Proportion of 10y+ Debt

Ticker	Rating	Total Amt Outstanding ($bn)	Percent of 10y+ Debt	10y Bond	OAS (bp)
KMI	BBB	$25.1	58%	4.3s of 2028	150
T	BBB	$89.6	58%	4.35s of 2029	138
DOW	BBB	$13.1	56%	4.8s of 2028	145
DISCA	BBB-	$13.4	46%	4.125s of 2029	176
SHW	BBB	$7.2	46%	2.95s of 2029	120
ETP	BBB-	$34.1	45%	5.25s of 2029	193

Note: Companies with at least $5bn in debt outstanding Source: Bloomberg, Barclays Research

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T 4.35 03/01/29 (USD 111.97, 04-Sep-2019)

DISCOVERY COMMUNICATIONS LLC, A/CD/D/J/K/L/M/N
DISCA 4 1/8 05/15/29 (USD 106.76, 04-Sep-2019)

DOW CHEMICAL CO/THE, A/CD/D/J/K/L/M
DOW 4.8 11/30/28 (USD 114.71, 04-Sep-2019)

ENERGY TRANSFER OPERATING LP, A/CD/D/J/K/L/M
ETP 5 1/4 04/15/29 (USD 114.62, 04-Sep-2019)

KINDER MORGAN INC/DE, CD/CE/D/J/K/L/M
KMI 4.3 03/01/28 (USD 109.59, 04-Sep-2019)

SHERWIN-WILLIAMS CO/THE, CD/CE/J
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