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Barclays Tuesday Credit Call

Debt-Funded M&A: The Bad, the Ugly, and the Good

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Agenda

- **Presenter**
  - Shobhit Gupta, Head of US Credit Strategy
- **Credit Trading**
  - Ben Schaefer, US HY CDS Trading
  - Yoni Gorelov, Head of US HG Trading
  - Dan Krasner, US HG Trading

Conference Call Information

Tuesday, 7:45am (EDT)

Conference ID: 4297079

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Replay: Live.barcap.com

➔ Credit

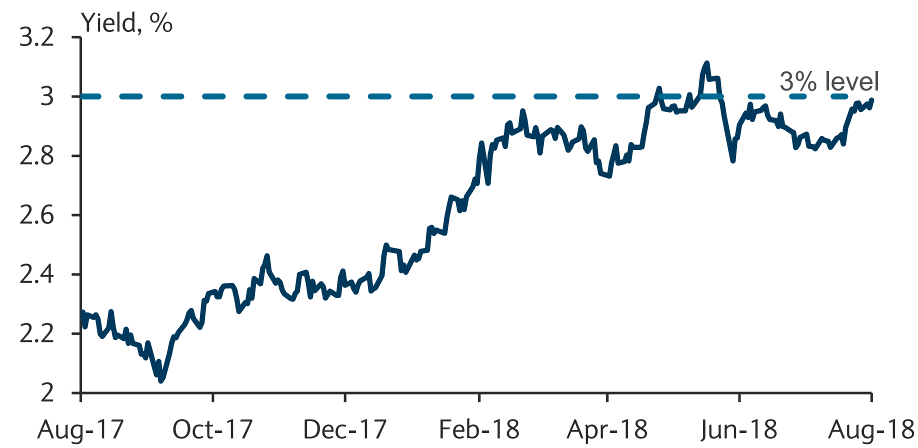
➔ Conference Calls

US credit was unchanged to modestly tighter in what was a busy week for central bank policy decisions

Markets Last Week

	3-Aug	Δ Week	Δ YTD
US Inv Grade	109 bp	-1 bp	16 bp
US High Yield	$98.64	$0.24	($2.27)
CDX.IG	59 bp	1 bp	2 bp
Itraxx Main	64 bp	3 bp	10 bp
CDX.HY	$107.14	$0.13	($0.85)
Itraxx Crossover	294 bp	12 bp	25 bp
10yr Treasury	2.95%	-1 bp	54 bp
5yr Treasury	2.81%	-3 bp	61 bp
S&P 500	2840	0.8%	6.2%
Euro Stoxx 600	389	-0.7%	0.0%
Dollar Exchange Rate Index	95.16	0.5%	3.3%
WTI Crude Oil	68.49	-0.3%	13.4%
Gold Spot	1215	-0.8%	-6.7%

10y UST Flirting With 3% Again



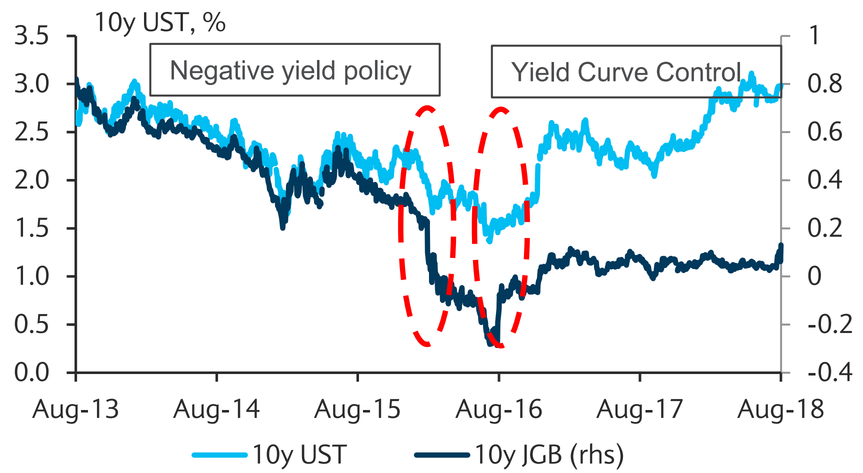
Central Bank Bonanza

Date	Action	Barclays Comment
BOJ Mon Jul-30/31	1. Maintain current low yields until it can assess impact from consumption tax hike 2. Greater flexibility around long-term yield	"Decision did not indicate any policy bias… provides greater flexibility, two-way freedom regarding long-term yields"
Fed Wed Aug-1	1. Kept rate unchanged	"The Fed stuck to the view that labor market is strong… two further rate hikes this year, in Sept and Dec"
BOE Thu Aug-2	1. Hiked policy rate 25bps to 0.75% 2. Hinted more hikes to come	"Data will eventually fall short of BOE's forecast"

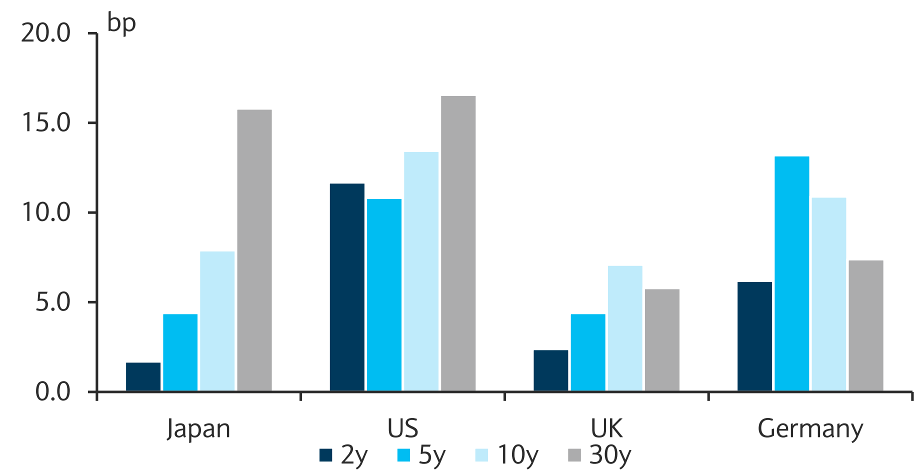
Source for all charts: Bloomberg, Bloomberg Barclays Indices, Barclays Research

JGBs have led the move higher in rates; future BOJ policy tightening could weaken demand for US IG from JPY-based investors

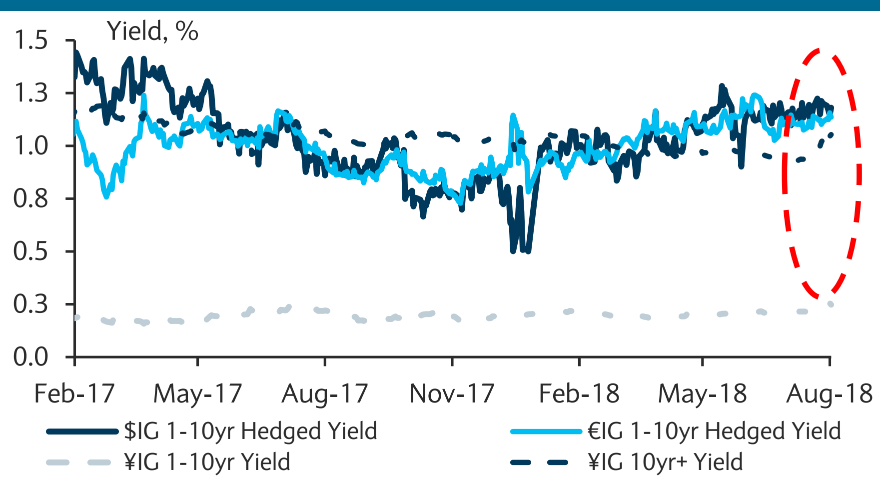
10y UST Broke 3% As JGBs Jumped



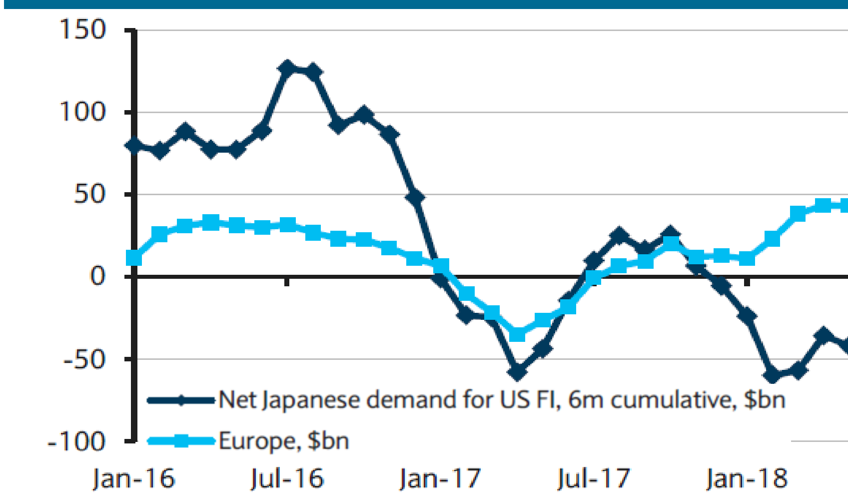
DM Rates One-Month Change



Local Credit vs. Hedge Adjusted Yield



Shifting Demand of Japanese Investors



Note: For more details, see "More Balanced Growth Lies Ahead," July 27 2018. Source for all charts: University of Michigan, Haver Analytics, Barclays Research

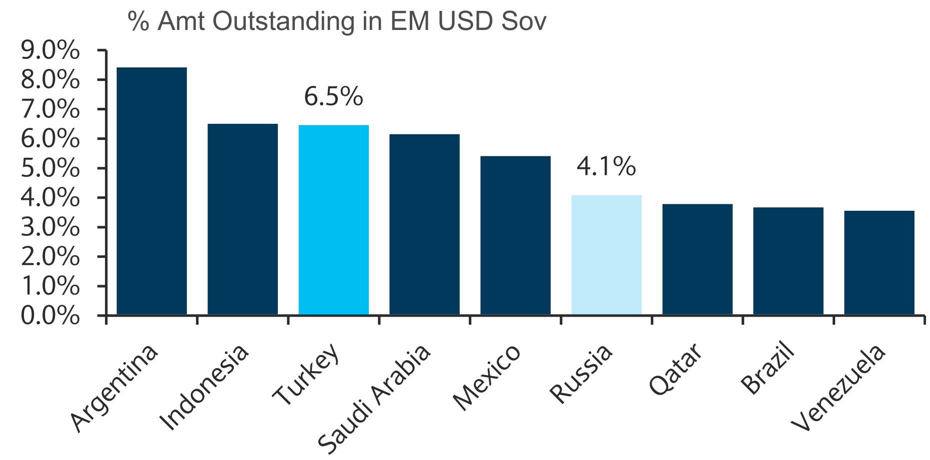
EM credit investors are focused on escalating tensions with Russia and Turkey due to sanctions

Escalating Tensions and Ramifications

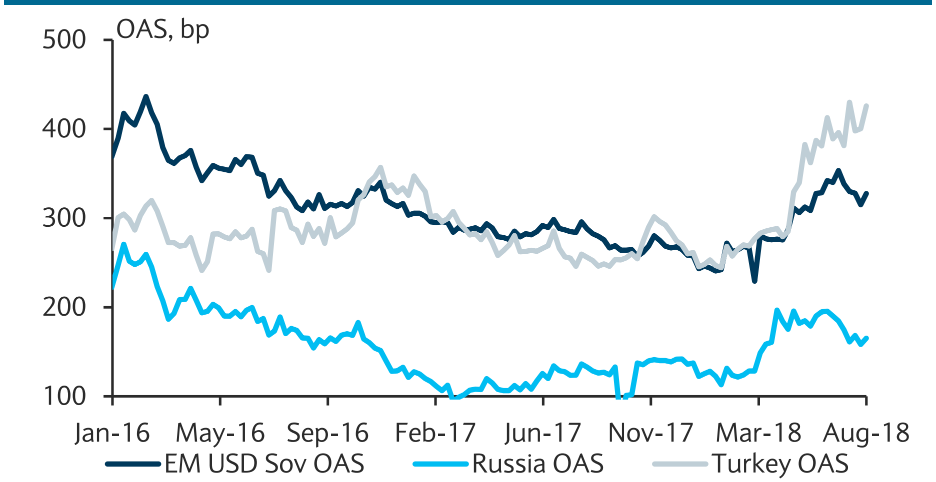
Russia	
Event	Bipartisan group of US Senators introduced draft bill proposing new sweeping sanctions on Russia, including measures against Russia's new sovereign debt
Effect	1. If implemented, RUB and OFZs (local currency debt) will bear the brunt of sanctions. Investors will find comfort with USD debt given Russia's strong FX reserves and supportive technical (shrinking market). 2. Draft also proposes additional sanctions on "oligarchs" and further targets the energy sector, reinforcing our US recommendations for both Russia Basic Industries and Russia Energy & Infra sectors

Turkey	
Event	The US designated two Turkish government officials Special Designated Nations (SDN), after Turkey refused to release Pastor Andrew Brunson, marking a clear escalation in bilateral relations (no immediate consequence on any Turkish USD issuers)
Effect	Although recent US sanctions may have a limited direct economic effect, indirect effects may still be non-negligible, given Turkey's large external funding needs. For the banks, we believe the key risks would come through the FX volatility channel at this juncture

Weights in the EM USD Sov Index



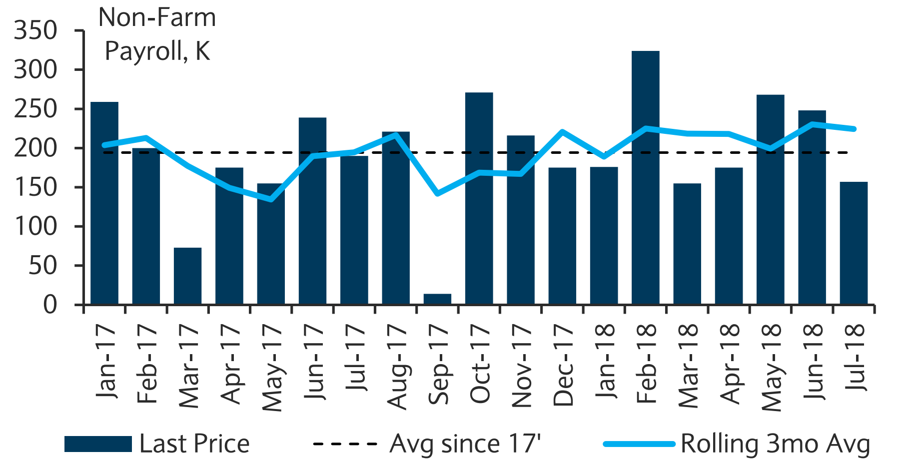
Performance of Turkey & Russia Sov Debt



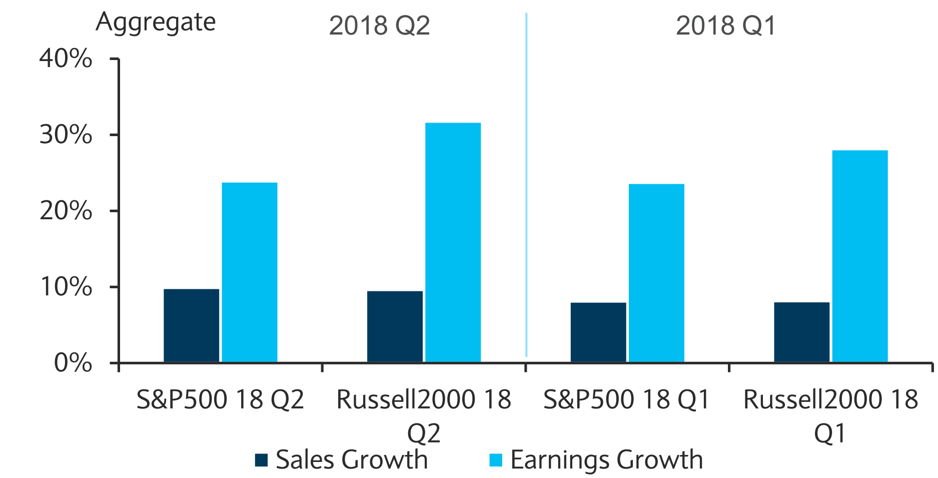
Note: Light blue shading denotes applied sanctions, grey shading denotes a key development. For more details, see "More Balanced Growth Lies Ahead," Aug 3 2018.
Source for all charts: Barclays Research

In the US, macro and fundamental data remain constructive. Payrolls are still at a healthy level and Q2 earnings growth has been robust

Payrolls Missed but Still at Healthy Level

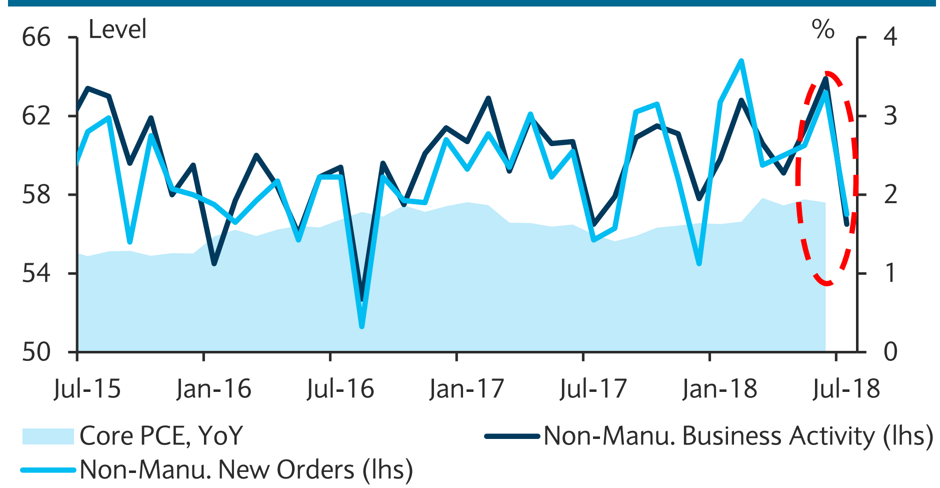


Strong y/y Growth in Earnings and Sales



Wages Gain Modest in Comparison

Non-Manu. ISM Down but Still Good



*For ISM Surveys, readings greater than 50 indicate expansion. Source for all charts: US Bureau of Labor Statistics, ISM Survey, Barclays Research

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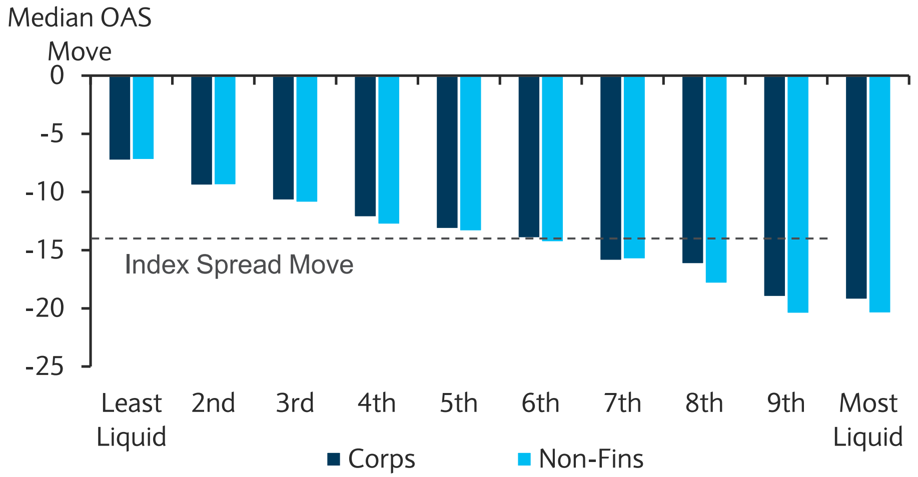
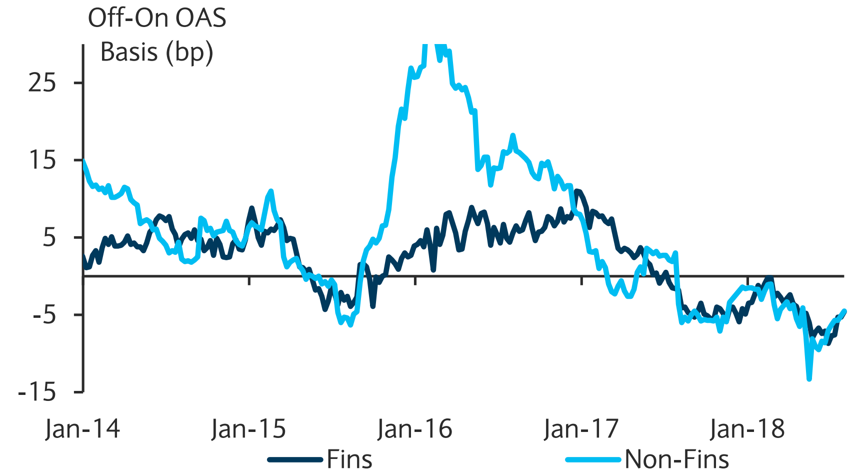
Improving technicals helped drive strong $IG performance in July; liquid bonds outperformed, but we continue to favor on-the-run paper

The Most Liquid Bonds Led the July Rally…



…Yet Off-the-Runs Still Trade Tight to On-the-Runs*



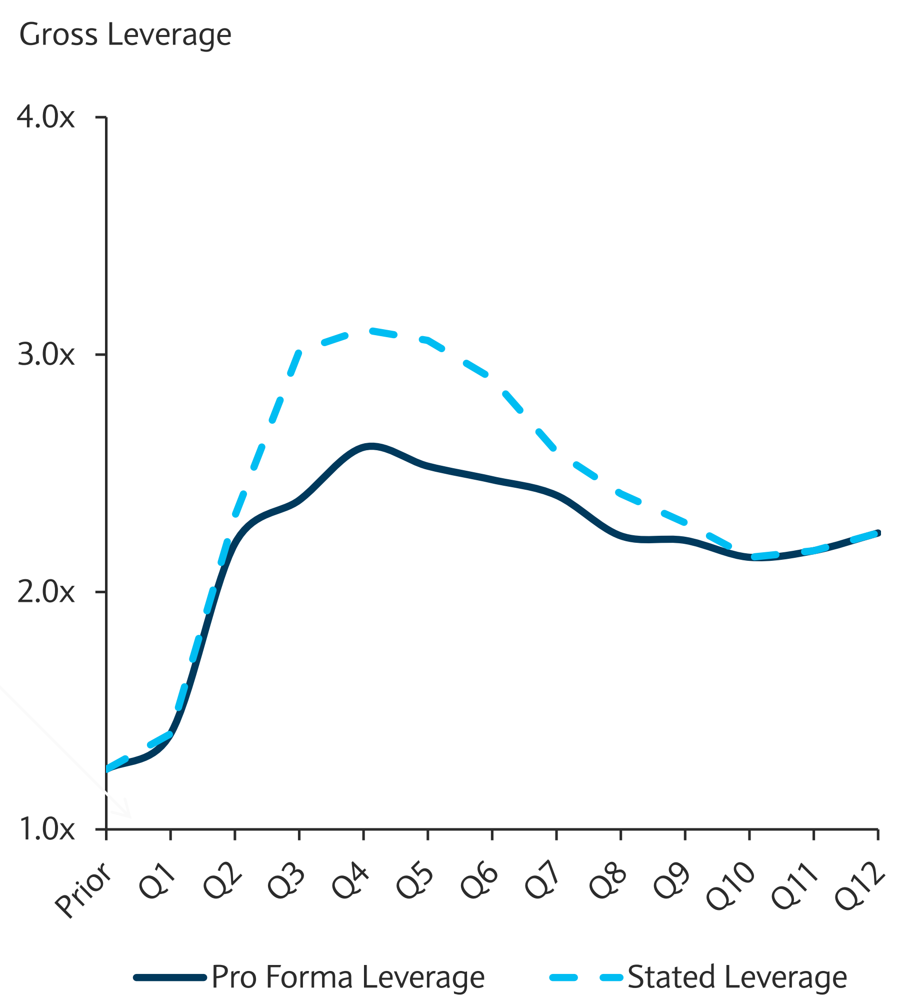
Select Swaps Out of Off-the-Runs into On-the-Runs**

	Swap out of Off-the Run Security			Swap into On-the Run Security			
Ticker	**Security**	**Price**	**OAS (bp)**	**Security**	**Price**	**OAS (bp)**	**OAS Diff. (bp)**
T	4.75s of 2046	90.50	230	5.15s of 2046	94.64	241	11
CL	2.3s of 2022	97.39	21	2.25s of 2022	96.35	31	10
CSX	3.8s of 2046	91.07	122	4.3s of 2048	97.61	132	10
HSBC	4s of 2022	101.3	85	3.033s of 2023	96.6	93	8
LLOYDS	3s of 2022	97.7	95	2.907s of 2023	95.6	102	7
GM	3.95s of 2024	97.74	148	3.5s of 2024	94.70	153	6
CBS	2.5s of 2023	93.96	109	2.9s of 2023	95.09	115	5

*On-the-Run bonds are defined as those issued in the past one year, while off-the-run paper was issued more than one year ago. **Prices and spreads are bid-side and meant to be indicative. For more details, please see "Turnover Leads Tightening in July", August 3, 2018. Source for all charts: Bloomberg, Bloomberg Barclays Indices, Barclays Research

M&A continues to be a source of concern for credit investors. Leverage following debt-funded M&A tends to remain elevated even after 3 years

Gross leverage following an acquisition



Single-As Tend to Keep Leverage Elevated

For more details, see "M&A Deleveraging Stuck in the Slow Lane," Aug 3, 2018. Source for all charts: Factset, Barclays Research

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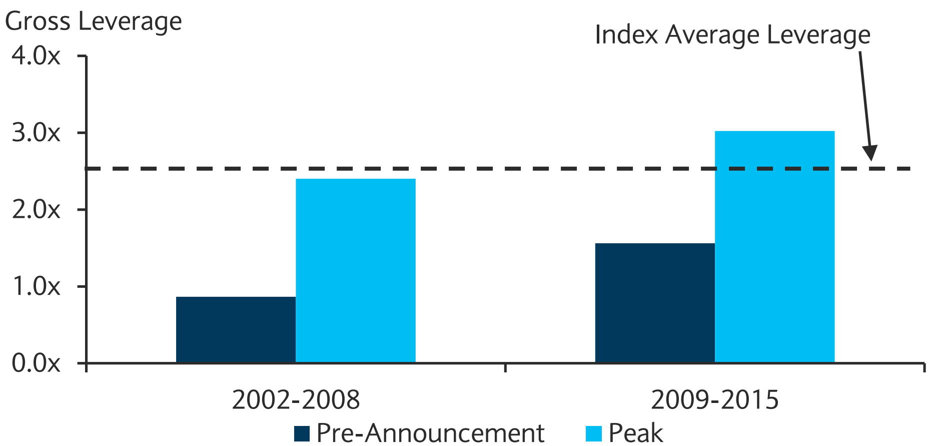
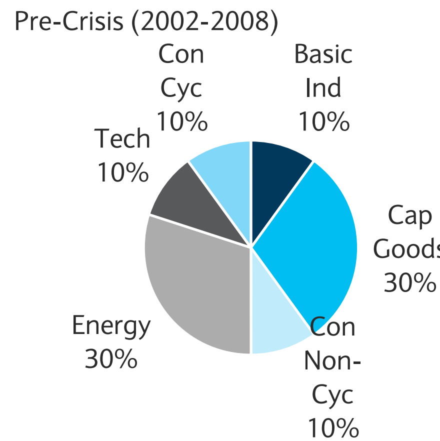
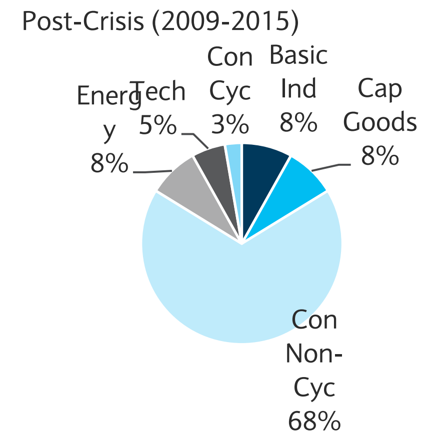
Starting leverage of acquirers has been higher post-crisis, but rating agencies have been more lenient

Starting Leverage of Acquirers

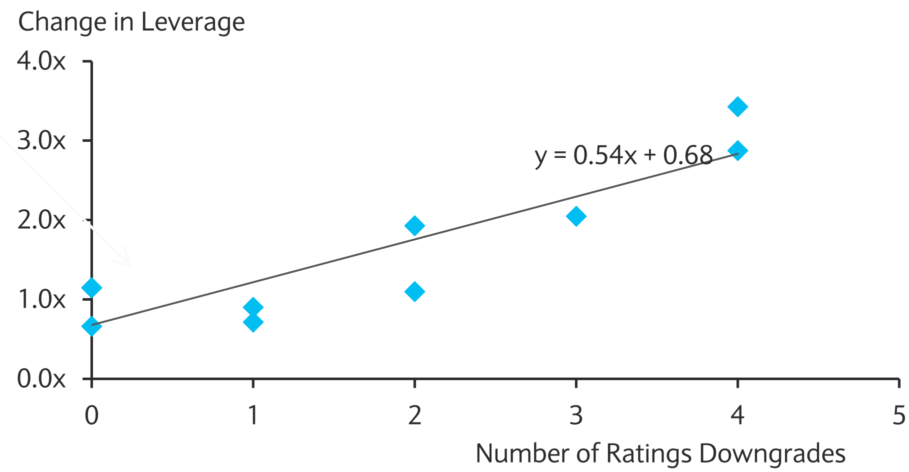


Sector Breakdown

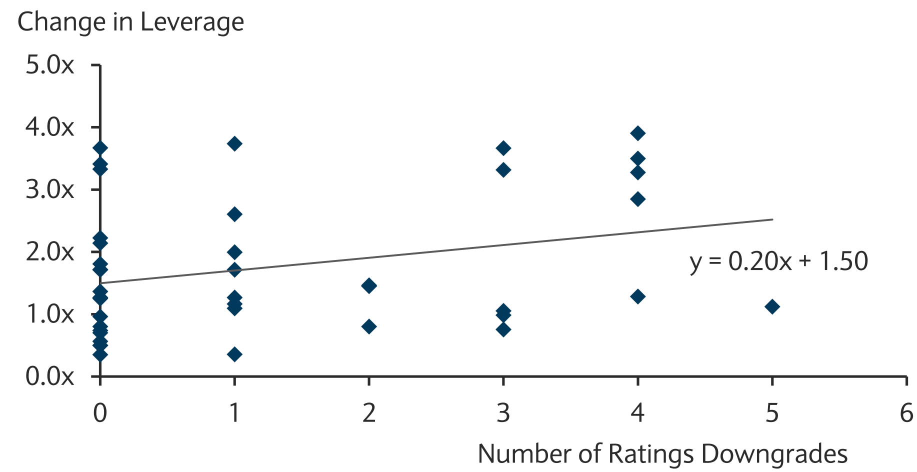




Leverage and Downgrades Had a Stronger Correlation Pre-Crisis…



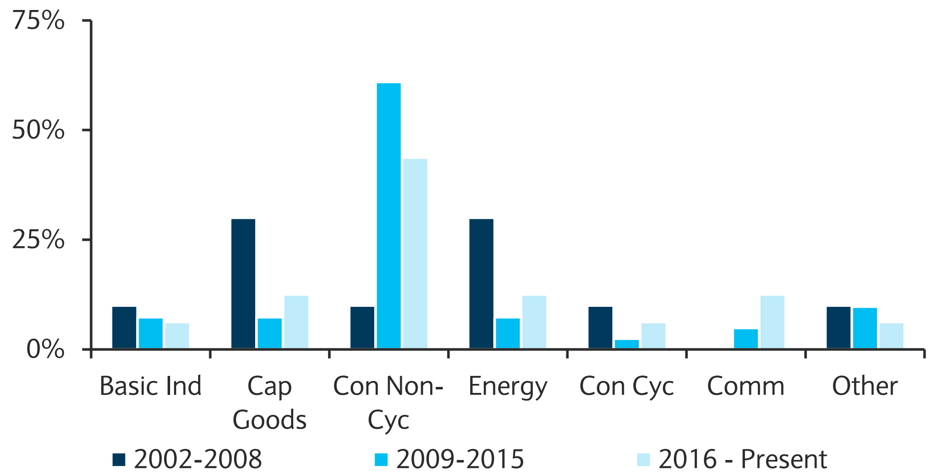
…Than They Do Post-Crisis



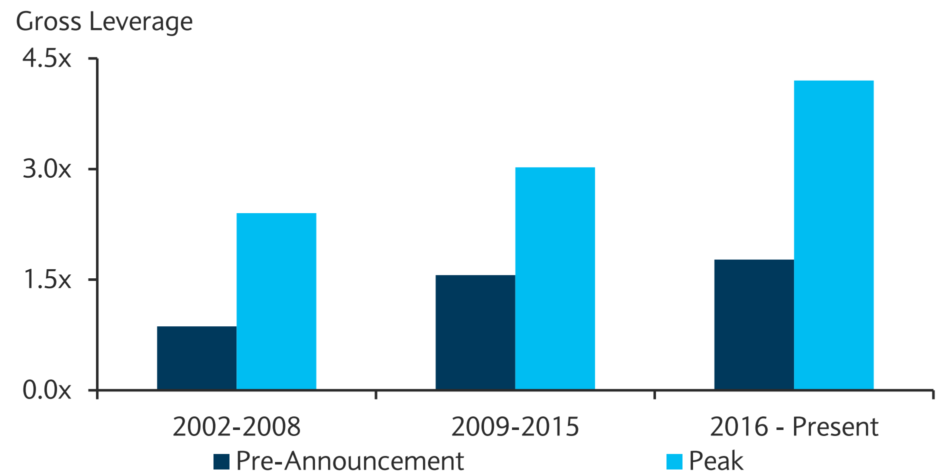
For more details, see "M&A Deleveraging Stuck in the Slow Lane," Aug 3, 2018. Source for all charts: Factset, Barclays Research

The defensive nature of recent acquirers should limit downside, but a change in the rating agencies' reaction function poses a risk

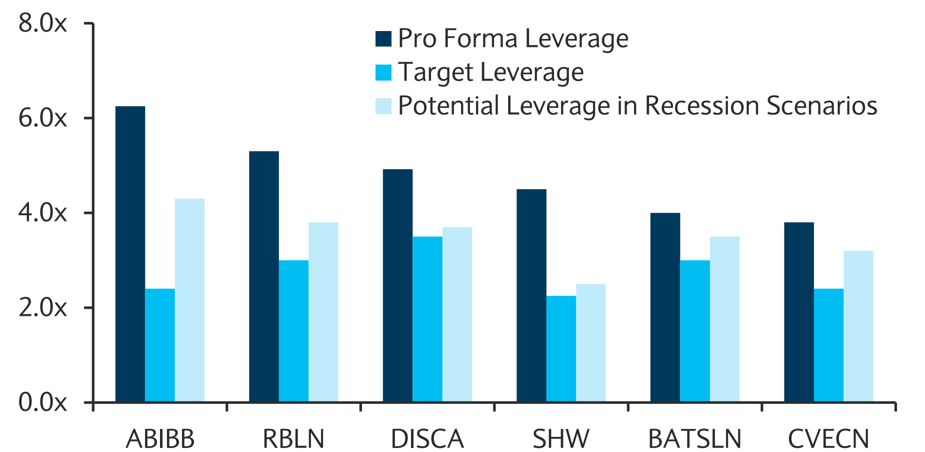
Current Cohort in Perspective by Sector



Current Cohort in Perspective by Leverage



Deleveraging in a Recession



Thoughts on Ratings Agencies' Actions*

From our fundamental analyst Priya Ohri-Gupta, CFA:

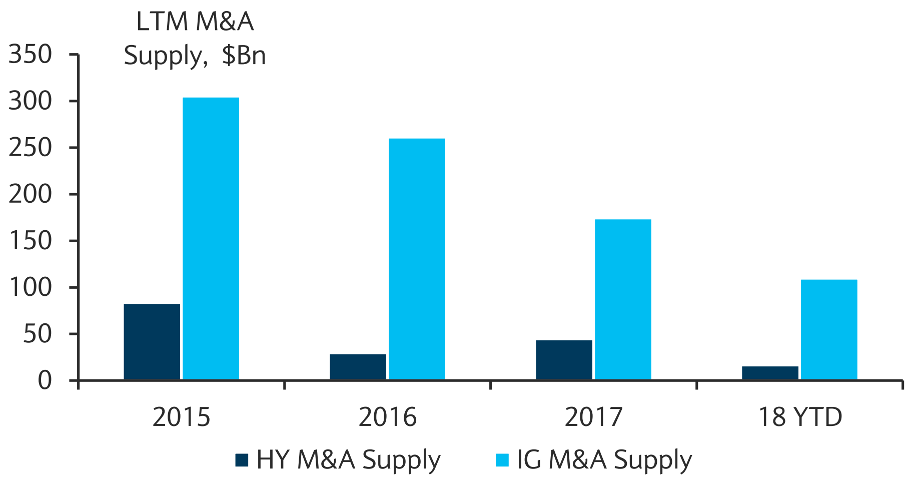
Newell Brands (NWL) Review for Downgrade – "If it had been known at the time of the deal that the company could potentially need four years to deliver on its leverage commitment, the company potentially may not have retained its IG rating."

Conagra (CAG) Review for Downgrade – "We think that rating agency tolerance for leveraging consolidation could be close to its limits… While company commentary had stated that the financing was structured to maintain solid IG ratings (which usually means mid-BBB ratings), reports from the agencies point to an outcome that could be shaded towards low BBB"

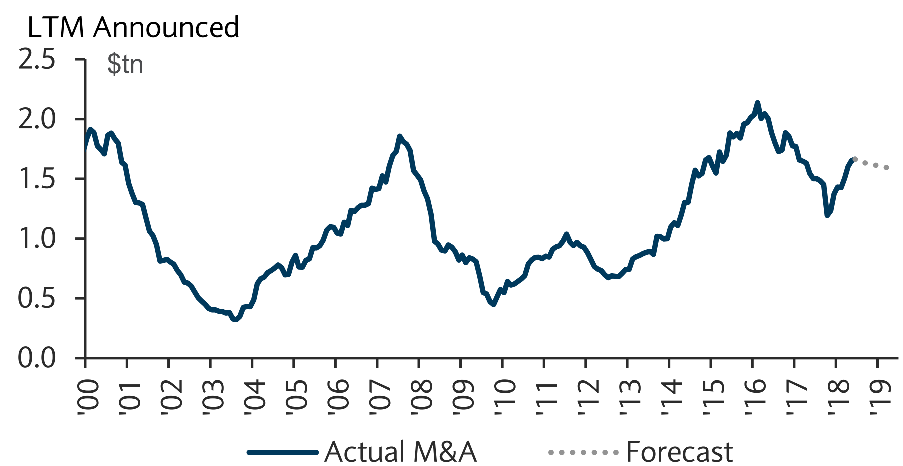
*excerpt from our fundamental analysts' research report "Newell Brands (NWL): Assessing the Potential Upside/Downside", and "General Mills (GIS) and Conagra (CAG): Consolidation Stays in Focus", 28 June, 2018. For more details, see "US Credit Focus: Deleveraging Post-M&A: Implications in the case of a credit downturn " 26 January 2018. Source for all charts: Barclays Research

Cheap financing has driven debt-funded M&A, but it should be less prevalent in the future…

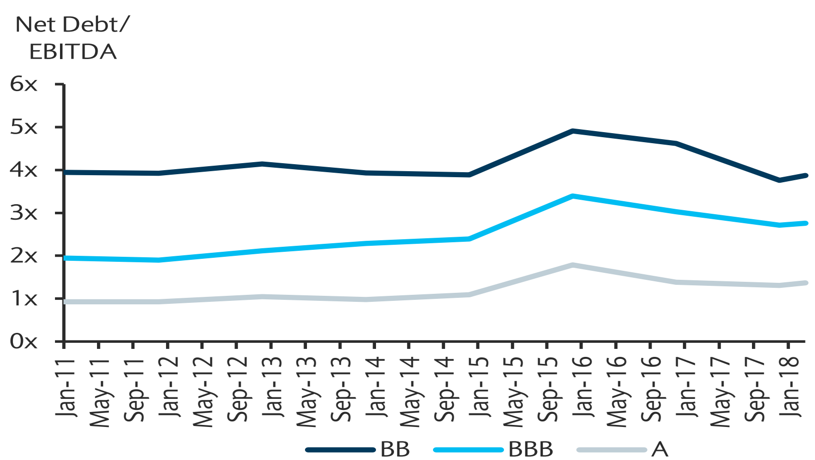
LTM M&A Supply HY vs. IG



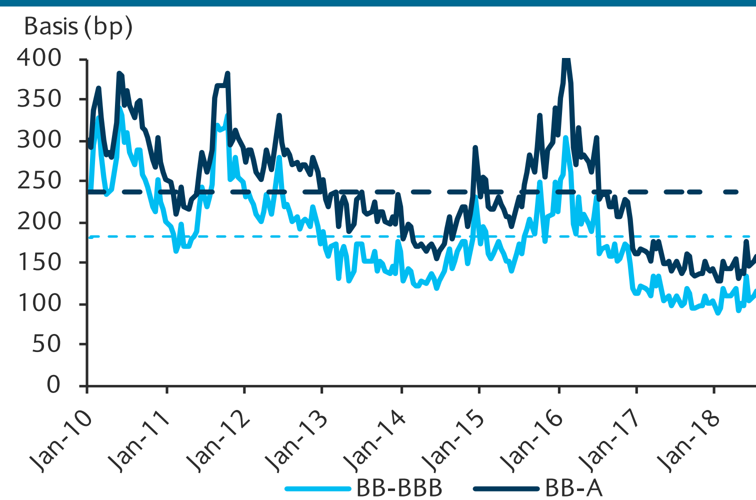
M&A Activity Forecast



Net Leverage by Ratings*



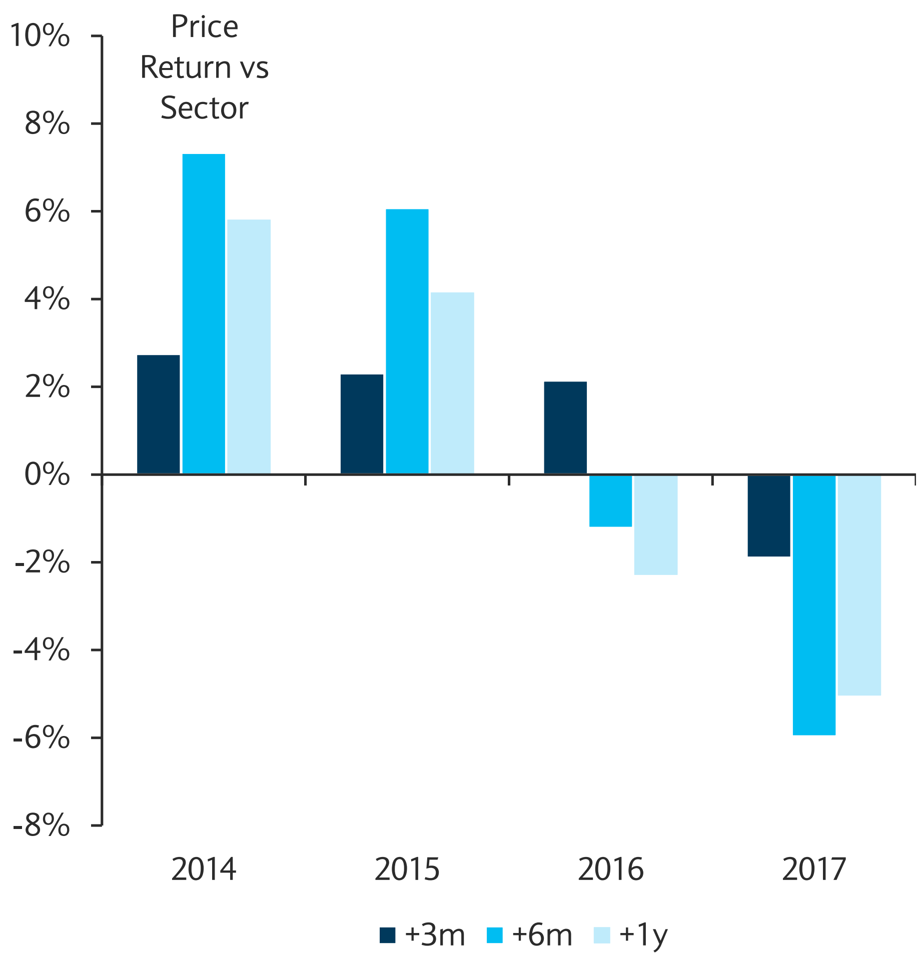
Intermediate BB-BBB and BB-A Basis**



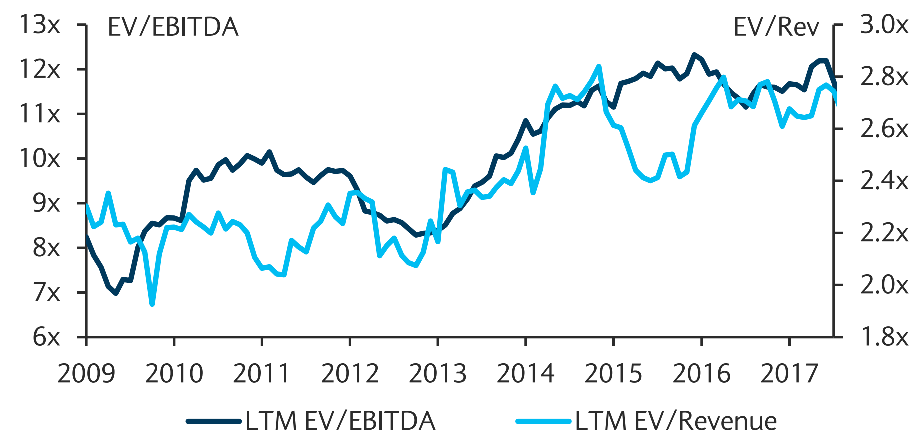
*Market value weighted. **Dotted lines show the average since 2010 of the respective series. For more details, see "Debt-Funded Acquisitions Lose Their Luster," July 27, 2018.
Source for all charts: CapIQ, Factset, Compustat, Bloomberg, Barclays Research

… Because companies are not being rewarded for debt-funded deals anymore, while equity-financed transactions have done better

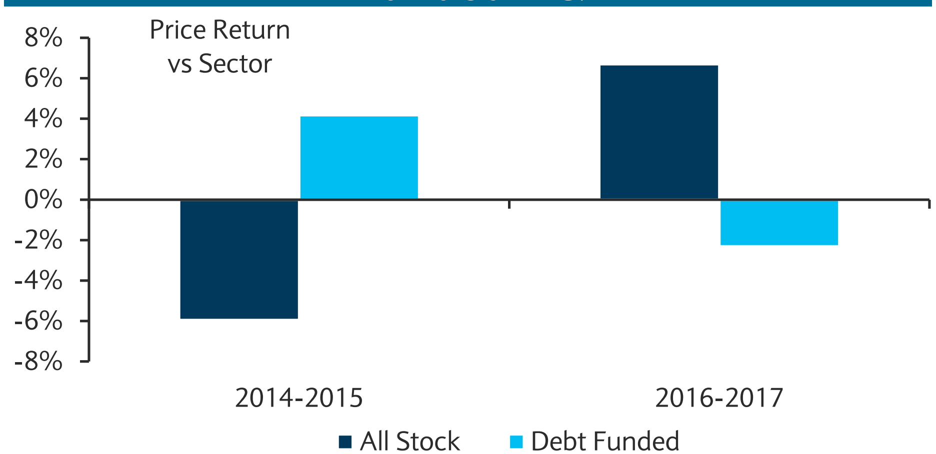
Equity Performance of Debt-funded M&A vs Sector Post-Announcement*



Historical Multiples Paid for M&A Deals



1y Equity Performance of All Stock vs. Debt-funded M&A



*Our sample is naturally biased toward equities with higher credit quality, which have underperformed the broader market since 2016. 2017 deals announced within the past twelve months show to-date performance instead of +1y. For more details, see "Debt-Funded Acquisitions Lose Their Luster," July 27, 2018.
Source for all charts: Bloomberg, Bloomberg Barclays Indices, Barclays Research

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Summary

- US credit was unchanged to modestly tighter in what was a busy week for central bank policy decisions
- JGBs have led the move higher in rates; future BOJ policy tightening could weaken demand for US IG from JPY-based investors
- EM credit investors are focused on escalating tensions with Russia and Turkey due to sanctions
- Improving technicals helped drive strong $IG performance in July; liquid bonds outperformed, but we continue to favor on-the-run paper
- M&A continues to be a source of concern for credit investors. While the starting leverage of acquirers has been higher post-crisis, rating agencies have been more lenient
- The defensive nature of recent acquirers should limit downside, but a change in the rating agencies' reaction function poses a risk
- Cheap financing has driven debt-funded M&A, but it should be less prevalent in the future, as companies are not being rewarded for debt-funded deals anymore even as equity-financed transactions have done better

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Important Disclosures

Materially Mentioned Issuers/Bonds

AT&T INC, Market Weight, A/CD/CE/D/FA/J/K/L/M/N
Representative Bond: T 4 3/4 05/15/46 (USD 91.00, 03-Aug-2018)
T 5.15 11/15/46 (USD 95.04, 03-Aug-2018)

CBS CORP, Market Weight, CD/CE/D/J/K/L/M/N
Representative Bond: CBS 4.6 01/15/45 (USD 92.60, 03-Aug-2018)
CBS 2 1/2 02/15/23 (USD 94.06, 03-Aug-2018)
CBS 2.9 06/01/23 (USD 95.32, 03-Aug-2018)

COLGATE-PALMOLIVE CO, A/CD/CE/D/J/K/L/M
CL 2 1/4 11/15/22 (USD 96.55, 03-Aug-2018)
CL 2.3 05/03/22 (USD 97.34, 03-Aug-2018)

CONAGRA BRANDS INC, A/CD/CE/D/E/J/K/L/M

CSX CORP, CD/CE/J
CSX 3.8 11/01/46 (USD 90.90, 03-Aug-2018)
CSX 4.3 03/01/48 (USD 98.15, 03-Aug-2018)

GENERAL MOTORS FINANCIAL CO INC, Overweight, A/CD/D/E/J/K/L/M/N
Representative Bond: GM 3.85 01/05/28 (USD 93.21, 03-Aug-2018)
GM 3 1/2 11/07/24 (USD 95.00, 03-Aug-2018)
GM 3.95 04/13/24 (USD 97.78, 03-Aug-2018)

HSBC HOLDINGS PLC, Market Weight, CD/J/K/M/N
Representative Bond: HSBC 3 06/30/25 (EUR 109.23, 03-Aug-2018)
Representative Bond: HSBC 4 1/4 03/14/24 (USD 99.96, 03-Aug-2018)
Representative Bond: HSBC 6 1/2 07/07/23 (GBP 118.88, 03-Aug-2018)
HSBC 3.033 11/22/23 (USD 96.34, 03-Aug-2018)
HSBC 4 03/30/22 (USD 101.63, 03-Aug-2018)

LLOYDS BANKING GROUP PLC, Market Weight, A/CD/CE/D/I/J/K/L/M/N
Representative Bond: LLOYDS 1 11/09/23 (EUR 99.75, 03-Aug-2018)
LLOYDS 2.907 11/07/23 (USD 95.89, 03-Aug-2018)
LLOYDS 3 01/11/22 (USD 97.80, 03-Aug-2018)

NEWELL BRANDS INC, Market Weight, CD/CE/D/J/K/L/M/N
Representative Bond: NWL 3.15 04/01/21 (USD 98.82, 03-Aug-2018)
Representative Bond: NWL 3.85 04/01/23 (USD 98.50, 03-Aug-2018)
Representative Bond: NWL 4.2 04/01/26 (USD 96.55, 03-Aug-2018)

All pricing information is indicative only. Prices are sourced from Thomson Reuters as of the last available closing price at the time of production of the research report, unless another time and source is indicated.

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Explanation of the Barclays Research Corporate Credit Sector Rating System

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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.

Market Weight (MW):

For sectors rated against 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 the Bloomberg Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be in line with the six-month excess return of the relevant index.

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.

Underweight (UW):

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Sector definitions:

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Sectors in U.S. High Yield Research are defined using the sector definitions of the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index and are rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index.

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Sectors in Asia High Yield Research are defined on Barclays Live and are rated against the Bloomberg Barclays EM Asia USD High Yield Corporate Credit Index.

Sectors in EEMEA and Latin America Research are defined on Barclays Live and are rated against the Bloomberg Barclays EM USD Corporate and Quasi Sovereign Index. These sectors may contain both High Grade and High Yield issuers.

To view sector definitions and monthly sector returns for Asia, EEMEA and Latin America Research, go to https://live.barcap.com/go/research/EMSectorReturns on Barclays Live.

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For all High Grade issuers covered in the US, Europe or Asia, and for all issuers in Latin America and EEMEA (excluding South Africa), 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.

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Coverage Suspended (CS): Coverage of this issuer has been temporarily suspended.

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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.

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For all issuers in South Africa, the credit rating system is based on the analyst's view of the expected total return over a six-month period of the issuer's rand-denominated fixed rate notes or floating rate notes (as applicable) relative to the South African Credit Fixed Market Index (CFIX95) or the South African Credit Floating Market Index (CFL020), respectively.

Overweight (OW): The analyst expects the six-month total returns of the issuer's rand-denominated fixed rate notes or floating rate notes (as applicable) to exceed the six-month expected total returns the South African Credit Fixed Market Index (CFIX95) or the South African Credit Floating Market Index (CFL020), respectively.

Market Weight (MW): The analyst expects the six-month total returns of the issuer's rand-denominated fixed rate notes or floating rate notes (as applicable) to be in line with the six-month expected total returns the South African Credit Fixed Market Index (CFIX95) or the South African Credit Floating Market Index (CFL020), respectively.

Underweight (UW): The analyst expects the six-month total returns of the issuer's rand-denominated fixed rate notes or floating rate notes (as applicable) to be below the six-month expected total returns the South African Credit Fixed Market Index (CFIX95) or the South African Credit Floating Market Index (CFL020), respectively.

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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Explanation of the Barclays EM Sovereign Credit Issuer Rating System

Overweight (OW): The analyst expects the three-month excess return of the country's index eligible bonds to exceed the three-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

Market Weight (MW): The analyst expects the three-month excess return of the country's index eligible bonds to be in line with the three-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

Underweight (UW): The analyst expects the three-month excess return of the country's index eligible bonds to be less than the three-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

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