STANDARD
&POOR'S

Global Credit Portal
RatingsDirect®

June 16, 2010

Leveraged Finance:

Wave Of Debt Coming Due May Wash Away Some U.S. Speculative-Grade Borrowers

Corporate Ratings:
John J Bilardello, Managing Director, New York (1) 212-438-7664; john_bilardello@standardandpoors.com

Table Of Contents

Potential For Rising Interest Rates

Recent Credit Quality Improvement May Not Be Sustainable

Finding Financing

Sovereign Credit Crises Pose A Risk

Related Research

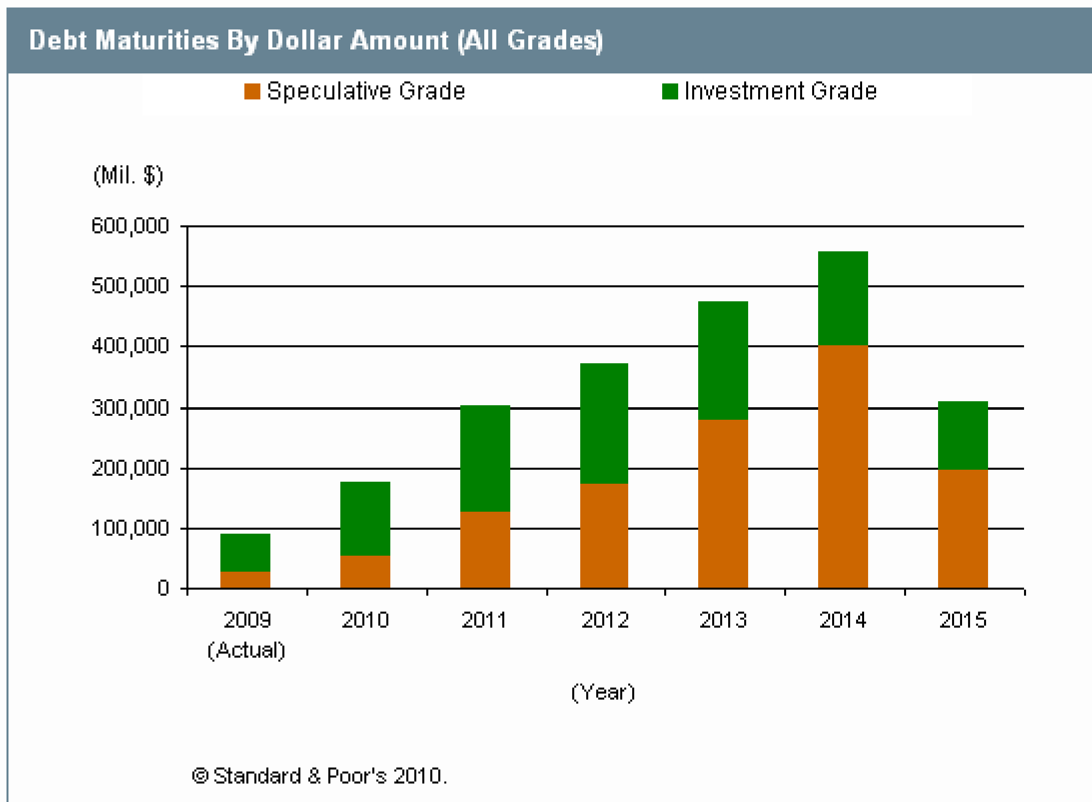
Leveraged Finance:

Wave Of Debt Coming Due May Wash Away Some U.S. Speculative-Grade Borrowers

U.S. nonfinancial corporate borrowers have more than $1.7 trillion in Standard & Poor's rated bonds and loans maturing in 2011 to 2014. We believe that some companies at the low end of the ratings scale may find it difficult to refinance at the rates they'll need for long-term survival, if they can find financing at all.

The debt crisis in Greece and lingering concerns that the U.S. economy may slip back into recession have heightened investors' risk aversion in recent weeks. In our view, very low market demand for collateralized debt, combined with U.S. banks' own refinancing needs, makes it apparent why the credit markets have once again tightened after a significant bounce back in the early part of 2010.

The total debt coming due for rated U.S. borrowers will climb steadily through the next four years, peaking at more than $550 billion in 2014, after what Standard & Poor's Ratings Services views as more manageable levels through the end of next year (see chart). More importantly, as this wave of refinancing surges, we expect the proportion of debt in the speculative-grade category ('BB+' and lower) to continue to grow. The amount of speculative-grade debt coming due next year accounts for about 41% of the total, on a dollar basis. That percentage grows to 46% in 2012, climbs to 58% in 2013, and jumps to 72% in 2014.



"We believe that many borrowers at the low end of the ratings scale will encounter serious hurdles to their refinancing needs in 2013 and 2014," said Standard & Poor's Managing Director John Bilardello. "Unlike investment-grade entities, for which the main issue is the rising cost of capital, speculative-grade borrowers may find that financial institutions and investors are wary of lending to them."

A large majority of the 2014 maturities are issues sold in 2007 in conjunction with leveraged buyout (LBO) transactions, which explains the growing proportion of speculative-grade borrowers with debt coming due. In fact, approximately 71% of the speculative-grade debt due in 2014 was issued in 2007 by 53 companies in headline-making LBOs.

Potential For Rising Interest Rates

Many low-rated borrowers took advantage of the greater availability of credit in the second half of 2009 and early 2010 to extend their maturities, even if for just a few years. That window of opportunity abruptly began to shut last month, when speculative-grade debt issuance tumbled to less than a quarter of what it was in April, as the cost of financing rose significantly. According to Standard & Poor's Global Fixed Income Research (GFIR), speculative-grade rated companies issued just $5 billion in bonds in May, down from about $22 billion the month before (see "Wider U.S. High-Yield Spreads Constrain New Bond Issuance," June 2, 2010). At the same time, speculative-grade composite spreads surged to more than 660 basis points (bps) after reaching a two-year low of 553 bps at the end of April.

Although fed funds futures indicate that a majority of traders expect the Federal Reserve to keep benchmark interest rates at historical lows through the U.S. summer, discussion by market participants about the likelihood of a rate hike has increased. The central bank itself fueled such speculation in February, in our view, when it surprised markets by raising the discount rate on loans the Fed makes directly to banks by a quarter of a percentage point, to 0.75%. And while the Fed said at the time that borrowing costs would remain "exceptionally low" for an "extended period," we believe any change in interest rates would almost certainly bring rates higher--barring a sudden and severe second slump in the U.S. economy.

Recent Credit Quality Improvement May Not Be Sustainable

We should note, however, that we expect the recent economic recovery to strengthen. Standard & Poor's Chief Economist David Wyss has forecast U.S. GDP growth of 3.3% this year, 2.8% next year, and 2.8% in 2012. We believe this rate of expansion will boost corporate profits and cash flows, which would help many issuers pay down debt and, potentially, bolster their credit quality. This would be especially notable given that approximately one-quarter of U.S. rated bond issuers currently have either a negative outlook or are on CreditWatch with negative implications.

Indeed, the number of issuers with negative outlooks or CreditWatch listings continues to decline, as does the number of corporate defaults. At the end of May, the U.S. speculative-grade default rate had fallen to an estimated 6.7% from a high of 11.3% in November of last year, according to GFIR (see "Global Corporate Default Update," June 11, 2010). Still, we believe that this recent apparent improvement in credit quality is fragile and may not ultimately be sustainable.

"While many companies shored up their balance sheets and took advantage of favorable rates and accessible credit

markets earlier in the year, we don't really expect speculative-grade companies to enjoy a broad, sustained improvement in credit quality," Mr. Bilardello said.

In our view, speculative-grade issuers have made progress in pushing out their bond and loan maturities so far in 2010. But rather than go through refinancings, borrowers have, in many cases, relied on so-called amend-and-extend deals, in which they typically make a concession--such as accepting a smaller credit line--in exchange for a longer maturity. In the first five months of this year, leveraged loan issuers pushed out or eliminated about $78 billion of institutional loans through bond issuance, amend-and-extends, and repayments, according to Standard & Poor's Leveraged Commentary & Data. With corporate defaults eliminating another $5 billion of loans scheduled to be repaid through 2014, the amount outstanding shrank 12% in the first five months of the year.

We view refinancing risk to be most prevalent among consumer-dependent companies and others that were hit hardest by the recent economic recession. For example, restaurants and retailers have $8.9 billion in debt coming due in 2011, another $12 billion in 2012, and $16.9 billion maturing in 2013. Meanwhile, media, entertainment, and leisure companies have $17.7 billion coming due in 2011, $36.5 billion in 2012, and a full $50.6 billion maturing in 2013.

Finding Financing

Assuming that economic conditions continue to improve, Standard & Poor's believes that comparatively strong speculative-grade companies will find ways to refinance their debt. At the same time, many of those we rate 'B-' or lower may not, depending on conditions in the credit markets. Sustained GDP growth may help to once again whet investors' appetite for speculative-grade bonds. But we believe the market for institutional loans may be less accessible, given that the use of collateralized loan obligations (CLOs) as a major source of financing is no longer as available as it was in 2002-2007, when CLO managers repackaged and sold more than half of the institutional loans that came to market.

Also, as U.S. banks continue their efforts to restore their balance sheets, they may minimize the risk in their loan portfolios and keep a tight rein with regard to lending. We believe this may mean stricter covenants and higher borrowing costs for those companies that can get financing. Many banks have already bolstered their own financial profiles, paying back funds from the government and reestablishing their own financing sources. But since the recent credit crisis curbed their ability to offload risk through securitization, we believe that many banks may still have more risk exposure than they would like.

Sovereign Credit Crises Pose A Risk

In our view, the biggest risks to the availability of credit for U.S. speculative-grade corporate borrowers are the effects that sovereign credit crises in Europe may have on the U.S. and global economies. Investor doubts about Greece's ability to service its debts initiated the recent risk aversion we've seen in the U.S. credit markets, and doubts about Italy, Spain, and Portugal have only added to this tentativeness.

"The problems in Greece and other countries--and their impact on global economies--are the types of factors that investors need to monitor, because they will affect companies' ability to borrow," Mr. Bilardello said.

Related Research

CreditMatters TV video titled, "Can Speculative-Grade Borrowers Withstand The Wave Of Debt Coming Due?", dated June 21, 2010.

Special Report

Click on the links below to see other articles in "Corporate Refinancings: The Trillion Dollar Question."

Click this link to go to the Special Report Archive.

Near-Term Refinancing Needs Are Lower For North American Chemical Companies

U.S. Telecom And Cable Near-Term Debt Maturities Are Both Modest And Manageable

For Now, U.S. Financial Institutions Seem Poised To Manage Upcoming Corporate Loan Maturities

How Far Can Leveraged Loan Borrowers Kick Maturities Down The Road?

Refinancing Risk Remains The Main Threat To The Credit Quality Of European Speculative-Grade Companies

Why Refinancing Risk Is Moderating For The U.S. Packaging Sector

Billions Are Coming Due For The U.S. Utility And Power Sector, But Paying It Back Should Be Manageable

Copyright (c) 2010 by Standard & Poor's Financial Services LLC (S&P), a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.
No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P. The Content shall not be used for any unlawful or unauthorized purposes. S&P, its affiliates, and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.
Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.
S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.
S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

The McGraw-Hill Companies