

Press Release

AlbaCore Credit Market Update: ‘Credit Inflows Accelerate as Yields Decline in Line with Rate Cuts’

David Allen, Managing Partner and Chief Investment Officer, AlbaCore Capital Group

London, 14 November 2024 – Over the past two years, the impact of rising interest rates has been more evident in Europe than in the US. Yet, despite the headwinds, European leveraged finance markets have proven resilient, bolstered by strong and sustained technical demand.

With yields declining in line with rate cuts, inflows into credit funds have accelerated. European high yield has been a key beneficiary of this trend. European high yield funds registered inflows of €1.5bn for the week ending October 16th, this was the highest weekly tally since March 2021, and brings year-to-date inflows to €10.3 billion vs. €2.2bn for full year 2023¹. At the same time, the **European CLO market is on track to see record levels of issuance this year** with year-to-date volume reaching €37.6 billion by mid-October, only €1 billion shy of 2021’s record annual issuance².

Markets Remain Solid

Strong inflows into bond funds and ramping CLOs have created strong demand for paper which has facilitated a wave of repricing activity as issuers have looked to refinance more expensive debt issued over the past few years with an average saving of 56 bps during the quarter³. With 41.28% of the Morningstar European Leveraged Loan Index priced above par as of the end of September the stage was clearly set for further repricing activity which has materialised through October as issuers sought to tap the markets before the US Presidential election, which was expected to usher in a period of volatility.

The strength in the market has not only enabled repricings but has also led to the return of dividend recapitalisations, where companies issue new debt to fund an equity dividend. September saw the largest dividend recapitalisation of all time, when Belron, a UK based provider of auto glass repair, issued over €8 billion of new debt across global bond and loan markets. This debt was partly used to fund a €4.4 billion dividend to shareholders. These recapitalisation transactions are in part a reflection of the **ongoing pressure on Sponsors to return capital to investors** as, according to Bain & Company estimates, 53% of companies in buyout portfolios have been held for four years or longer⁴.

¹ Source: JP Morgan, Bloomberg Finance October 2024

² Source: Pitchbook LCD Global CLO Weekly Wrap 22 October 2024

³ Source: Pitchbook LCD 30 September 2024

⁴ Source: Bain & Company, 11 October 2024

M&A is Picking Up

Long awaited large cap M&A activity has finally begun to pick up. With recent transactions including the £1.8 billion of debt backing CVC's, Nordic Capital's and Abu Dhabi Investment Authority's buyout of Hargreaves Lansdown privately placed in July, the £1.4 billion of debt backing Apollo's buyout of UK delivery company Evri pricing in September and in October the announcements of CD&R's agreement to take a controlling stake in Sanofi's consumer healthcare unit as part of a €16 billion deal. **A return of IPO activity is also expected**, with Blackstone's signalling its intention to list some of its largest investments as strong public equity market performance, driven by enthusiasm over the potential of AI, has paved a way for exits via the public market.

While M&A volumes have clearly picked up from their 2023 levels, activity overall remains muted, as a lack of agreement on pricing continues to impede activity. We do not expect a significant uptick before year-end. However, **2025 may be a more constructive environment for deal making activity as the uncertainty posed by a year of record levels of elections is left behind**. Next year Sponsors will also be able to present a year of clean financials not skewed by the impact of rapidly rising inflation and interest rates.

Senior Direct Lending Remains Attractive for Borrowers

With public markets roaring back to life, they are once again a reliable financing option for borrowers and that has created competition for the private credit lenders that had previously filled the gap. Not unsurprisingly, the tightening spreads in public credit markets have led to some private credit facilities being refinanced in the public market. With a reopening of the syndicated market, Sponsors are running dual processes, where they assess both public and private credit options for their new financing needs, and this has inevitably resulted in spread tightening in private credit as lenders look to remain competitive. Within the highly competitive US private credit market deals pricing wider than S+600, common only a year ago, have all but disappeared.

European private credit has not been immune to this trend and according to Deloitte research as of June, the proportion of European private credit transactions pricing with spreads below 600 bps over the past year was 45%, up from 36% as of the end of 2023⁵. However, **given the more fragmented market in Europe and the focus on all in yield by investors, pricing has remained more resilient in Europe given the lower base rates on the continent**.

A rebound in the syndicated market has not, as some predicted, led to a decline in direct lending activity, with Deloitte tracking 371 new European deals in H1 2024, up 42% during the same period in 2023. A return of public market activity has also not led to a worsening of credit quality in private credit, with leverage in European private credit transactions marginally lower over the year, with 64.5% of deals with leverage 4x or below (up 5.8%) and only 6.4% having a leverage greater than 6x over the past twelve months to June⁶. Despite the strength in public credit markets, we believe that direct lending remains an attractive option for borrowers of all sizes. While supply may ebb and flow between public

⁵ Source: Deloitte Private Debt Deal Tracker Autumn 2024 Update

⁶ Source: Deloitte Private Debt Deal Tracker Autumn 2024

and private markets, **direct lending has firmly established itself as a core part of the corporate financing toolbox due to three key factors: speed and certainty of execution, flexibility, and confidentiality.**

Sponsors value swift execution avoiding the time-intensive syndication process and mitigating pricing risk from market shifts. Flexibility is another draw, as syndicated loan markets are in part constrained by the requirements of the CLO vehicles that comprise much of the broadly syndicated loan investor base. This means for borrowers looking for non-euro debt, looking to raise less than €400m or for features such as delayed drawn facilities to facilitate bolt on acquisitions, public markets are a less natural fit.

Finally, confidentiality is important for many borrowers, particularly those who are privately owned and therefore potentially sensitive to the need to provide broad public disclosure or have a public credit rating. A smaller lender base can also be helpful for management teams, limiting the time spent on the road talking to investors, and freeing them to focus on the higher value task of implementing the business's strategy.

David Allen is the Managing Partner and Chief Investment Officer at AlbaCore Capital Group.



Mr. Allen has more than 30 years of financial services and investment experience, with a focus on the High Yield and Leveraged Finance Markets.

Prior to founding AlbaCore Capital Group, Mr. Allen managed Canada Pension Plan Investment Board's European Principal Credit Fund and was a member of the Investment Committee. Mr. Allen was also a Partner, Investment Committee member and Senior Portfolio Manager at GoldenTree Asset Management, where he established and ran the firm's European presence. Mr. Allen spent a decade with Morgan Stanley in New York and Hong Kong, working across M&A and investment banking before specializing as a High Yield media analyst.

Mr. Allen graduated from the University of California, Berkeley, where he earned a Bachelor of Arts in Economics and was an all-conference rower.

About AlbaCore Capital Group

AlbaCore Capital Group is one of Europe's leading alternative credit specialists, investing in private capital solutions, direct lending, opportunistic and dislocated credit, CLOs, and structured products. Founded in 2016, AlbaCore is part of the First Sentier Investors Group. AlbaCore's investment philosophy is focused on capital preservation and generating attractive risk adjusted returns through the cycle for its investors. AlbaCore manages US \$9.4 billion in AuM⁷ as of 30 September 2024 on behalf of

⁷ AuM is calculated as the sum of the Net Asset Value, undrawn capital commitments, available debt finance and assets of all vehicles managed by AlbaCore.

global pension funds, sovereign wealth funds, endowments, insurance companies, family offices and high net worths around the world.

For more information, visit www.AlbaCoreCapitalGroup.com

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