Information for professional investors

Aggressive liability management activity pushes defaults higher

Fixed income | May 2024

Tom Southon
Head of High Yield Research, EMEA

- **Higher default rate driven by a growing trend of aggressive liability management activity among over-levered issuers, increasing the risk of balance sheet restructuring events**
- **Bifurcation of credit rating buckets continues with CCCs trading at very distressed levels. Given the spread difference between CCCs and single Bs is close to +1,300bps and a 31-point difference in price, from a valuation perspective the more severe outlook is largely priced-in**
- **Our forward 12-month and 24-month par-weighted default forecasts are now in line with the long-run average speculative grade default rate**

Our par-weighted default rate forecast for European High Yield is 4.0% for the forward 12-month period and 8.3% for the forward 24-month period. Excluding hybrid issuers, the default rate increases to 4.7% over 12 months and 9.6% over 24 months. This compares to a LTM (last 12 months) default rate, to December 2023, for Europe of 3.5% , and a recent peak through the Covid-19 pandemic of 6.9% . For context, Moody's calculates a long-run average global speculative grade cumulative default rate of 4.1% and 8.2 % over 12 and 24 months respectively.

Our headline forecast is notably higher versus six months ago, increasing from 3.9% to 8.3% over the forward 24-month period. The increasing prevalence of aggressive liability management exercises (LME) has been the primary driver of this, with a number of issuers announcing plans to proactively address their capital structures – for example, SFRFP and Intrum. This has had the effect of pulling forward restructuring activity and, as a result, we now take a more cautious near-term view of over-levered issuers' default prospects, even if there is not an immediate liquidity trigger.

We believe this elevated default risk for over-levered credits is largely priced-in at the market level. The spread pick-up for CCCs versus single-Bs is close to 10-year wides at +1,300bps (circa twice the 10-year average), while in price terms there is a circa 31-point differential. While our par-weighted 24-month default expectation is 8.3%, it falls to 6.3% when weighted by market value.

Sector commentary[1] (also see Figure 1)

TMT The sharp increase is mostly driven by two specific situations in the form of Atos, which is included in Technology, and Altice France (Telecoms). Atos has entered a conciliation process with stakeholders as it failed to dispose of assets and faces increasing liquidity needs. Altice France is a different story: the main shareholder has raised the spectre of a discounted liability management exercise, effectively holding off using proceeds from asset sales to delever the company until creditors agree to discounted exchanges.

Real estate The increased default forecast largely reflects issuers moving closer to maturity walls. Adler Group, Peach and SBB stand out here.

Leisure An improvement in the leisure default estimate is largely attributable to Spanish firm Codere being removed post March 2024's announced notice of restructuring. Aside from this, the gaming subsector has proved relatively resilient to date.

Capital goods The forecast uplift relates to two over-leveraged issues in the packaging space: Ardagh Group, which includes the ARGID, ARDFIN and AMPBEV tickers, and Klöckner Pentaplast. We consider both to have unsustainable capital structures, but previously viewed the default risk to be lower due to the amount of time left to maturity. However, in March it was reported that Ardagh had hired advisers to review liability management options. Apollo, a private equity firm, has since provided a stop-gap facility to deal with Ardagh's 2025 maturity. However, the group has a large volume of maturities in 2026 and 2027 which could be problematic. Klöckner was also recently rumoured to have hired advisers.

Financial services The increased default expectation within financial services is primarily driven by the debt-collector issuers Intrum and Lowell. In the case on Intrum, the company has confirmed it intends to undertake some form of LME and we expect this to result in a discounted debt exchange. We also see this as a risk for Lowell, given challenged market access, and note that all its bonds mature within our 24-month forecast period.

Retail The retail forecast has improved slightly. This is primarily due to EG Group's successful refinancing in 2023. There has also been a general improvement in the default outlook for a selection of higher quality issuers including Avolta, Co-op and M&S.

Utilities The increase in default risk in the sector is driven by Thames Water whose Kemble bonds have now defaulted. However, we see that situation as idiosyncratic.

[1] All commentary from company reports, as at May 2024. Mention of a stock is not a recommendation to buy or sell

Figure 1: Columbia Threadneedle HY default forecast (12- and 24-month, sector & rating bucket)

12-Month Forecast	Oct-23	Apr-24	Change Q/Q
By sector			
Automotive	0.7%	1.4%	0.7%
Basic Industry	1.1%	1.5%	0.3%
Capital Goods	1.8%	5.7%	3.9%
Consumer Goods	1.8%	2.7%	0.9%
Energy	1.9%	1.8%	-0.1%
Financial Services	1.1%	11.2%	10.2%
Healthcare	2.7%	2.6%	0.0%
Insurance			
Leisure	4.8%	2.7%	-2.1%
Media	1.1%	0.0%	-1.1%
Real Estate	3.8%	6.6%	2.8%
Retail	4.0%	3.6%	-0.4%
Services	1.5%	1.7%	0.1%
Technology & Electronics	0.5%	27.2%	26.7%
Telecommunications	0.3%	5.1%	4.8%
Transportation	1.4%	0.5%	-0.9%
Utility	0.2%	1.4%	1.3%
By rating bucket			
BB	0.9%	1.0%	0.1%
B	2.0%	7.2%	5.2%
CCC	3.9%	13.8%	9.9%
Total	**1.5%**	**4.0%**	**2.5%**
Total excl hybrids	1.7%	4.7%	3.0%

24-Month Forecast	Oct-23	Apr-24	Change Q/Q
By sector			
Automotive	3.5%	3.8%	0.4%
Basic Industry	4.2%	6.3%	2.0%
Capital Goods	4.4%	16.0%	11.6%
Consumer Goods	5.8%	6.3%	0.6%
Energy	5.6%	4.9%	-0.6%
Financial Services	4.6%	20.1%	15.5%
Healthcare	5.9%	5.7%	-0.2%
Insurance			
Leisure	8.8%	5.5%	-3.3%
Media	3.5%	2.4%	-1.1%
Real Estate	8.9%	16.6%	7.7%
Retail	6.9%	6.8%	-0.1%
Services	4.1%	4.7%	0.7%
Technology & Electronics	1.7%	28.9%	27.2%
Telecommunications	0.8%	10.3%	9.5%
Transportation	3.4%	1.5%	-1.9%
Utility	0.3%	1.5%	1.1%
By rating bucket			
BB	2.8%	2.9%	0.1%
B	4.7%	14.2%	9.5%
CCC	8.6%	24.7%	16.1%
Total	**3.9%**	**8.3%**	**4.3%**
Total excl hybrids	4.4%	9.6%	5.2%

Source: Columbia Threadneedle Investments' analysis, as at April 2024

Important Information
For use by professional clients and/or equivalent investor types in your jurisdiction (not to be used with or passed on to retail clients). For marketing purposes.
This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. Investing involves risk including the risk of loss of principal. Your capital is at risk. Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. International investing involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable. The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This document and its contents have not been reviewed by any regulatory authority.

In Australia: Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) and relies on Class Order 03/1102 in respect of the financial services it provides to wholesale clients in Australia. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws.
In Singapore: Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore.
In Hong Kong: Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058.
In Japan: Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association and Type II Financial Instruments Firms Association.
In the UK: Issued by Threadneedle Asset Management Limited, No. 573204 and/or Columbia Threadneedle Management Limited, No. 517895, both registered in England and Wales and authorised and regulated in the UK by the Financial Conduct Authority.
In the EEA: Issued by Threadneedle Management Luxembourg S.A., registered with the Registre de Commerce et des Sociétés (Luxembourg), No. B 110242 and/or Columbia Threadneedle Netherlands B.V., regulated by the Dutch Authority for the Financial Markets (AFM), registered No. 08068841.
In Switzerland: Issued by Threadneedle Portfolio Services AG, an unregulated Swiss firm or Columbia Threadneedle Management (Swiss) GmbH, acting as representative office of Columbia