Pricing bottoms out in European loan market

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LONDON, Feb 27 (LPC) –The European broadly syndicated loan market has reached a pricing floor, bankers say, settling after a surge in demand for loans drove a wave of repricings earlier this year.

A benign market backdrop, based on soft landing scenarios and envisaged rate cuts, set the foundation for soaring demand for syndicated loans, which was turbo charged by strong CLO formation since the beginning of the year.

The positive narrative enabled CLOs, the dominant buying force for leveraged loans, to record significantly improved funding costs. The average pricing on Triple A rated tranches hit a 20-monthy low in February at 150bp, according to LPC data.

Borrowers have also seen pricing for leveraged loans come in materially. However, bankers said pricing in the BSL market has plateaued and is unlikely to head south again unless the funding costs for CLO squeeze in even more.

“Now we are stabilising and finding a floor, we are seeing if CLO liabilities tighten further before we can see BSLs tighten again,” said a leveraged finance banker.

Recent leveraged loan prints from existing issuers rated B2/B stood at around 400bp over Euribor with a 99 OID. French insurer broker April, for instance, a credit known to the BSL market, is marketing its €1.2bn loan refinancing at 400bp-425bp over Euribor and a 99.5 OID.

Spreads for new buyouts and acquisition add-ons have been marketed wider, from 450bp to over 500bp.

“For where we are right now, it’s a pretty good market,” said a second leveraged finance banker. “There’s no question about the fact that a sponsor will try to throw out terms [favourable to them], but my expectation is you’ll see a little bit of pushback.”

Those deals that priced below 400bp attracted comment among investors.

Lenders say those cases, including German energy metering firm Techem, which priced its €1.8bn amend and extend exercise at 375bp over Euribor and at par, were exceptional cases. Investors are on alert for any similarly aggressive manoeuvres.

“Some deals touched on 375bp, but that made a lot of people quite uncomfortable, and they didn’t really trade that much on the break either," said a CLO fund manager. "Now there’s been more than enough pushback by people saying ‘Look, 400bp at par is enough, we won’t go below than that.’"

Bankers say the current pricing level in the BSL market works well for the maths behind a CLO fund's arbitrage, and expect that phenomenon to be sustained for some time.

“People can create a portfolio in the mid-400s, using that spectrum from 400bp-500bp and then adding a few deals at 500bp or more," said a third leveraged finance banker. "It works for the market, but it doesn’t feel like that will squeeze in any more."

Investors expect spreads in the second half of the year will tighten inside their current level as CLO issuance increases in order to seize on long-awaited new paper supply.

“We are seeing huge demand in CLOs right now and it is realistic to think that CLO Triple A spreads could reach 120bp this year,” Stamatia Hagenstein, portfolio management, structured credit CLO at Lupus Alpha said.

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