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# World's Problems Stall High Yield Market

By Matthew Sheahan
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Eight deals have been pulled from the high yield primary market this month. But unlike February's slowdown, this spate of yanked deals has been caused by larger fears about the state of the economy and is potentially more problematic.

The companies that failed to price offerings in February did so because they could not convince investors to buy at the prices promised by the banks, market participants say. Once the issuers adjusted their expectations and the market settled, some of those deals returned and were successfully executed. But what is causing investors to balk at deals now, sources say, is not pricing as much as fear about the economy and the state of the economic recovery.

"It's a totally different market than what you saw in February. It's global market volatility and economic skittishness that's causing people not to buy new issue paper," said **Mathew Van Alstyne**, head of research with **Odeon Capital Group**. "Investors are just not buying this type of paper during this volatile period. In February, there was still a lot of optimism. When you're in an uncertain market, it's not a time to be adding risk to the balance sheet."

The current trend began in early May when **Essar Steel**, **Jones Apparel**, **Americold Warehouse** and **Penske Auto Group** all pulled issues within a four-day span. The most recent company to call off a high yield bond offering is **Titan International**, which last Thursday pulled a $150 million deal and will fund its current tender offer using cash on hand. Just prior to that, Las Vegas-based **Allegiant Travel** yanked a $250 million offering of senior notes due 2017, and about a week prior to that **Regal Entertainment Group** pulled a $250 million bond issue, citing unfavorable market conditions. The Knoxville, Tenn.-based movie theater owner had planned to price the bonds as an add-on to its existing $400 million in 8.625% senior notes due 2019. While Regal postponed its bond deal, its $1.25 billion term loan B is still in the works.

During the February slowdown, seven deals were pulled from the market, though several of those, including **Bombardier** and **New World Resources**, returned to price successfully.

Meanwhile, the loan market has seen three deals pulled since late April: **Cedar Fair**, **DS Waters** and **Genband**, which together total $1.75 billion. DS Waters also pulled a $475 million bond offer at the end of April and Cedar Fair's $500 million bond offer did not price as expected May 26.

Today's investor uncertainty has may causes. Take your pick: the Greek and European debt crises, continued equity market volatility, concern over the shape of financial regulatory reform being debated in Congress, tensions between North and South Korea, everything short of a plague of locusts or raining blood.

But **Brendan White**, a portfolio manager with **Fort Washington Asset Management**, also points out that the quality of the deals being brought to market has declined over time. A glance at the deals priced in April confirms this. Of the 84 bond tranches priced in that month, only 11 of them, or 13%, were rated in the double-B or Ba by the two large rating agencies.

"As this rally continued to age, lower quality deals continued to come to market," White said. "As the access to capital increased, in many respects, the impact of volatility was compounded by the quality of deals that came to market. These deals were going to be tough deals to begin with. These are not pristine deals that are being pulled."

Technical Depression

The week ending May 21, high yield spreads widened the furthest they have in a single week since March 2009, according to a report published by **JPMorgan**. The speculative grade corporate spread reached 711 bps on May 21, its widest level since early March, according to **Standard & Poor's**.

White says that given the state of the market before the latest volatility, it's not surprising that issuers pulled junk bond deals. "Even higher quality companies would have trouble bringing a deal today at a price to their liking," White noted. "If you don't need financing, there's no reason to bring it to the market. The buyers are not there right now." Odeon's Van Alstyne notes that some bonds will certainly continue to price, but bankers will have to get creative to move some of the paper during the current economic climate.

Other portfolio managers, such as **Jason Lazarus** of **Intrepid Capital**, agree and stress that larger bond deals, in the $500 million and above range, will become even rarer with spreads as wide as they are now. Lazarus notes that companies were taking advantage of low coupons to refinance debt, but will now likely wait out the market unless it's absolutely necessary to refinance.

"Most of the new issue market has pushed off until July or August, or until this stuff settles down a bit," added **Lorenzo Newsome**, president and chief investment officer of **Xavier Capital**. "Some of the calendar we expect probably won't materialize. Rates have moved away from where issuers want to get things done."

As evidenced by outflows from high yield bond funds, investors are dodging volatility and putting more money into Treasurys right now. High yield bond funds experienced two consecutive weeks of outflows totaling more than $2 billion by May 19, according to **Lipper FMI**.

Despite this setback and increased sensitivity to economic volatility, junk bond investors are still confident that 2010 can be, if not another record year for high yield new issues, then at least a very good year. New issues were on track to beat 2009 by earlier this month, and bonds will continue to price at slower pace and then pick up once economic issues are resolved.

"High yield is still a favorable asset class right now," said **Brent Olson**, a portfolio manager with **Three Peaks Capital Management**. Despite the technical setbacks and overall economic volatility, the default picture for high yield bonds has improved since last year and junk bonds represent a less volatile asset class than equities, he said. "It's important for people to remember, when you're seeing the equity implosion out there, that high yield as an asset class is less volatile. If you look at the last mini-implosion, you've seen the equity market off about 10%, and that's for the month of May. We've seen the high yield market off about 4.5%."

The market's "good use of its calendar" to refinance debt spoke well for its relative stability and the default situation will continue to improve despite the larger economic volatility taking away some of its upside, he added. "High yield is the asset class to be in right now."