SKY HARBOR
CAPITAL MANAGEMENT
Responsible Investing for a Sustainable Future

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SKY Harbor Weekly Briefing

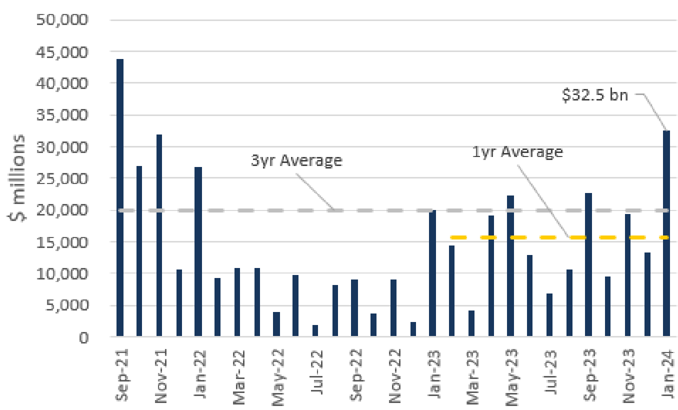
Issuance Strikes Back

Primary market activity accelerated in January, with monthly gross issuance up meaningfully from anemic levels in ’22 and ’23. This rebound comes at a pivotal time, with markets demonstrating resilience despite lingering concerns that rates will remain higher for longer. In this *Weekly Briefing*, we take a closer look at January issuance, with a focus on premiums (historically average) and the relative aggressiveness of management teams (quite limited).

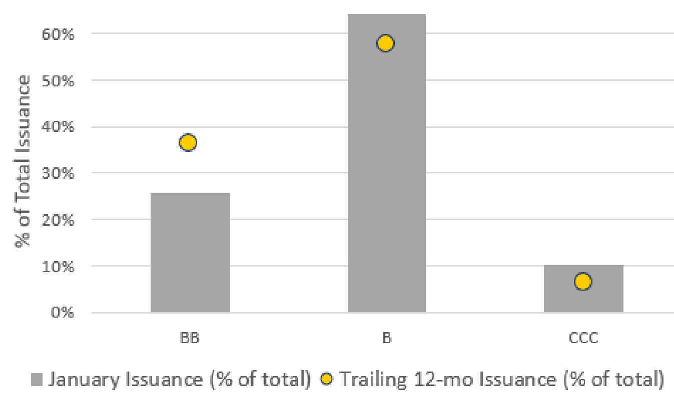
A January Rebound

January gross issuance exceeded $32bn, representing the highest volume month since September ’21, and coming in nearly twice the trailing 3-year average. Additionally, issuance has remained robust in February, with the monthly total running at a similar pace thus far. Importantly**, investor appetite for lower-rated credit is on the rise, alleviating prior concerns that more speculatively levered capital structures would need alternative solutions to meet financing needs**. In fact, the proportion of single-B and CCC-rated deals in January exceeded their trailing 12-month share, directionally consistent with recent upside surprise to the Senior Loan Officer Opinion Survey on Bank Lending standards (see our prior *Weekly Briefing* here).

January New Issuance Highest In Over 2 Years
monthly data



Issuance Skewed Toward Lower-Rated Credit
Jan '24 data

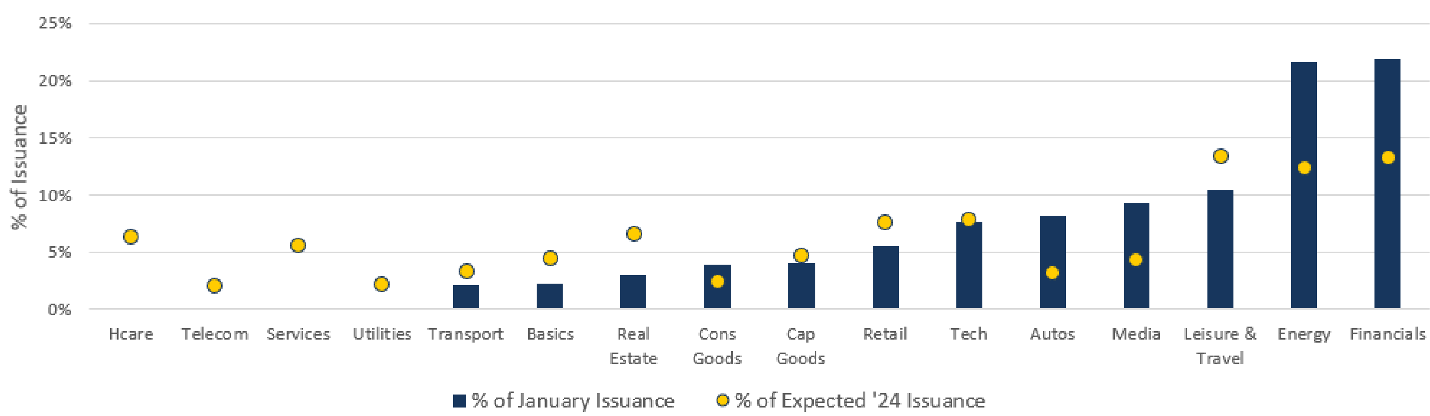


Source: SKY Harbor, BofA Merrill Lynch, Bloomberg

Sector Resilience

In typical fashion, primary issuance has come in waves, with the Financials and Energy sectors particularly active to start the year. However, **we have noticed little to no sustained impact on secondary market trading levels based on new deal proliferation**. In past analyses, we have found that strong sector performance typically leads to added issuance as bankers and management teams look to be opportunistic. This at times has led to investor fatigue, with sector comps often suffering as new debt crowds out interest in existing issues. In our view, investor anticipation of heightened issuance given an approaching maturity wall, and limited net new issuance (most deals are purely for refinancing) have muted downside thus far.

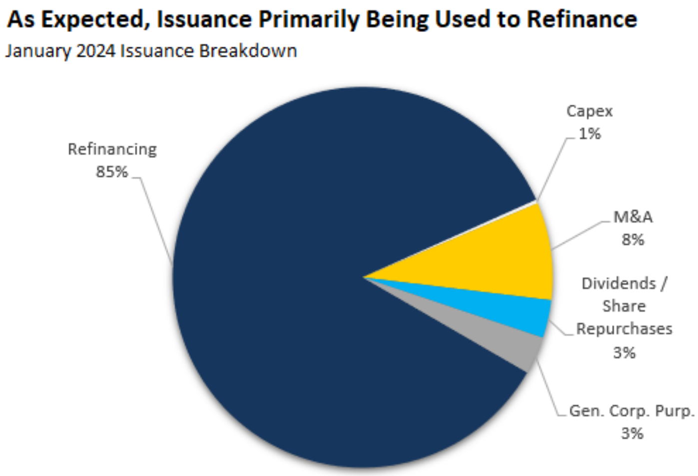
Issuance Disproportionately High in Energy and Financials; Expect More to Come in Leisure and Healthcare
note: expected issuance based on debt due within 24 months

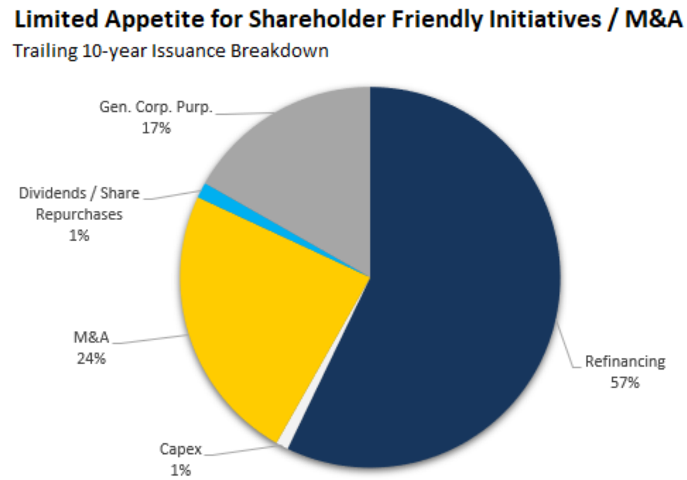


Source: SKY Harbor, BofA Merrill Lynch, Bloomberg

Management Teams Remain Conservative

The boost in primary market activity has not, at least yet, led to increased aggressiveness among corporate management teams. As demonstrated below, **85% of all new issuance in January was for refinancing, well above the trailing 10-year average** (~ 57% of issuance). We think the lack of shareholder friendly activity thus far makes sense, as such options appear costly (index yields remain top quartile in nature), and equity indices continue to set fresh highs. Relative to FY23, we have not yet seen any meaningful uptick in debt issued to support acquisitions or buyouts, but suspect that category may trend upwards as management teams grapple with limited organic growth opportunities in coming quarters.



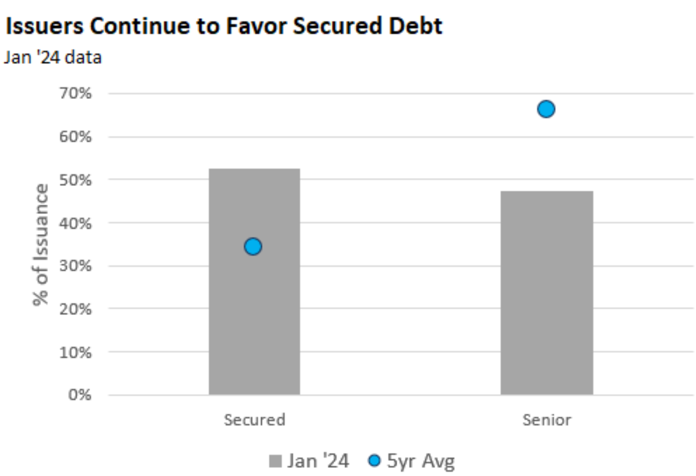


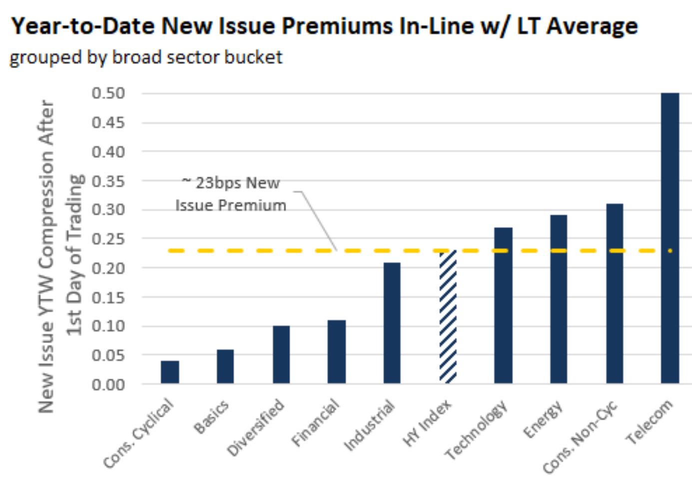
Source: SKY Harbor, BofA Merrill Lynch, Bloomberg

More Debt, Average Premiums

In a *Weekly Briefing* entitled "Notes from the Road – Miami Edition" from early October '23, we highlighted that secured issuance penetration of primary market activity was at a 20-year high (then 59%), running at nearly 3x the long-run average of 21%. In January '24, **secured issuance remained elevated at 53%, all in an effort for issuers to utilize unencumbered assets to temper the average cost of debt uptick** when unsecured obligations issued in a near-zero risk free rate environment come due.

At the same time, **premiums offered to investors to incentivize participation in new deals are merely average (~ 23 bps)** despite the strong uptick in overall volume (as a note, we calculate premiums by comparing coupon levels – adjusted for the presence of original issue discounts – to yields at the conclusion of the first day of secondary market trading). A strong desire for existing holders to roll into the new issue and elevated asset manager cash balances have likely contributed to this dynamic, which in general continues to signal strength in primary markets.





Source: SKY Harbor, BofA Merrill Lynch, Bloomberg

Chipping Away

Though not yet a pattern, we are encouraged by primary market strength thus far in 2024, and continue to view the chipping away of the maturity wall as a positive for high yield market sentiment. We remain cognizant that new issue fatigue could eventually pressure secondary market levels, but elevated manager cash balances and lack of net new debt have thus far kept things in balance. For now, we continue to find value in new deals, both from the perspective of average price concessions as well as the opportunity to avoid secondary market bid-ask spreads.

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