

Penn Capital Credit Update

Don't forget the Rising Stars - January 2019

In 2019, much attention has been drawn to the pending bankruptcy of Pacific Gas & Electric (PG&E). PG&E, previously rated BBB, will likely default by month end and therefore never become a constituent of the ICE BofA ML family of High Yield (HY) indices. Their \$17b of bonds, which Penn Capital has never owned, will not count as additional supply for the market. This default was the second-largest ever “jump-to-default” bond event from an investment grade company without at least first entering the HY market. The largest such event was Lehman Brothers in 2008 while the third largest event was Enron in 2001.

It is important to note the HY market has experienced net positive rating actions since the beginning of 2017 and also in 2019. Since the beginning of 2017, the HY market witnessed almost \$50b of net rising stars (face value, investment grade (IG) upgrades minus IG downgrades). During the first half of January 2019 alone, three high profile rising stars were newly minted, including two 2006-era leveraged buyouts (LBOs). The largest name in the ICE BofA ML US High Yield Index (as of 12/31/18), HCA, had more than half of its bonds

(\$13b) upgraded to IG. First Data, the second-largest Technology company in the index, announced it was being acquired by Fiserv, including \$5b of debt. Finally, Teck Resources, the third largest Metals & Mining company in the index and a 2015-era fallen angel, was upgraded to IG.

Against a backdrop of concern in the aftermath of the PG&E situation, Penn Capital felt obligated to highlight the importance of the rating agency actions, which have been quite positive, not just in 2019 but also since 2017. According to J.P. Morgan, the issuer-weighted upgrade-downgrade ratio has only been higher in 1996 and 2010. The positive rating action in the HY market is a reaction to past improvement in credit fundamentals, as the HY market rests near post-Lehman lows in total leverage (loans & bonds). Importantly, the PG&E situation is credit-specific related to a natural disaster and is not an indication of broad credit cycle deterioration.

Should you have any questions or wish to discuss further, please contact Penn Capital at 215-302-1500 or email info@penncapital.com. Thank you.

Specialists in capital structure investing

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