Industrial Investment Banking Weekly Round-Up

Real-Time Capital Markets Perspectives

Week Ending July 3rd, 2020

KeyBanc Capital Markets

Real-Time Capital Markets Perspectives

- The U.S. Consumer Confidence Index surged to 98.1 for the month of June, which was far above May's reading of 85.9 and economists' expectations for a reading of 91.0
  - Consumers have been responding positively to the reopening of the economy, falling unemployment claims, and the launching of a monetary stimulus package which caused the index to soar
    - May's consumer spending numbers offered positive news, as it rose a record 8.2% for the month, more than doubling previous all time highs
- Private payrolls rose ~2.4 million in June, which was slightly below economists' expectations for an increase of 2.5 million however, May's numbers were revised substantially from an initially reported loss of ~2.8 million to a gain of ~3.1 million
- Jerome Powell testified in front of Congress on Tuesday and raised concerns about economic uncertainty caused by a spike in coronavirus cases across regions of the U.S.
  - Mr. Powell was concerned about states reopening too quickly and the inherent risks that come along with it, such as the potential for states to close down a second time
    - Powell reiterated the Fed's commitment to helping the economy by using the nine emergency lending programs that have been established to assist companies and states to recover from the economic fallout
- Coronavirus cases have continued to surge across regions of the U.S., with a rise in hospitalizations having the potential to halt the reopening process
  - More than 48,000 new coronavirus cases were recorded across the nation on Tuesday, a daily record; the rise in cases has led more states to increase restrictions and halt reopening plans
    - Arizona shut down bars, movie theaters, gyms and water parks on Monday, while Texas, Florida, and California closed beaches and bars in some locations

Debt Capital Markets

- The debt markets experienced volatility throughout the week as states reported halting reopening plans
  - This caused secondary markets in both the leveraged loan and high yield markets to face increased instability, yet despite this volatility, the markets continued to press through with deals
  - The market for investment grade and crossover pro rata loan issuers remained open for shorter maturities with pricing premiums
- Through the first half of the year the high grade market saw $1.2 trillion in total issuance; this is the busiest first half of the year that the high grade bond market has ever seen, and will likely exceed all-time annual highs this July
- Even with the increased uncertainty brought on by COVID-19, the U.S. institutional market prevailed, moving forward with liquidity deals for M&A and LBO transactions that were executed pre-Covid-19
  - Select middle market leveraged loan transactions are being completed, albeit at lower leverage levels, requiring amortization, and an ask by top lenders for greater fee opportunities
- The high yield market remained active this week ahead of the July 4th holiday, with a total of $5.8 billion expected to price
  - June set a new monthly high yield record, exceeding the $60 billion mark and seeing $65.4 billion price – the prior record dated back to September 2013
  - Secondaries came in weaker this week as negative fund flows put downward pressure on the market
    - The high yield market reported the largest one-day outflow on record of $2.3 billion

Equity Capital Markets

- Equity issuance in June finished at another consecutive record month of issuance for U.S. companies, with over $80 billion raised in equity and equity linked securities
  - Companies continued to take advantage of stock price recovery amidst future economic uncertainty
    - The surge in equity-linked issuance in the latter portion of 1H2020 has resulted in the highest issuance volume for any half-year period
- Trading volumes remained relatively stable this week as summer is historically a slower part of the year for the market along with the approaching holiday weekend
  - The market has been "range bound" and choppy this week as the tug-of-war between optimism over reopening and uncertainty caused by the recent uptick in cases continues

Sources: Bloomberg, CNBC, LCD, NYT, U.S. Commerce Department, WSJ, KeyBanc Capital Markets

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- The Fed's opinion on economic recovery is mixed, as optimism about promising economic data is contrasted by a significant uptick in coronavirus cases across the country
  - Lael Brainard, a Governor of the Federal Reserve, raised concerns about the economic risks associated with an increase in coronavirus cases and warned that the U.S. economic recovery may take longer than expected
  - Conversely, James Bullard, President of the St. Louis Federal Reserve, expressed cautious optimism for the U.S. economic outlook, stating that decreased unemployment and increased economic activity is possible as markets continue to adapt to the coronavirus
- The U.S. Consumer Price Index rose by 0.6% in June, which is the largest spike the index has seen in the past 8 years and higher than economists' expectations of a 0.5% increase
  - This uptick represents a return to normal prices as the economy begins to recover and businesses reopen
    - However, the underlying trend suggests that inflation should remain at manageable levels, as the Consumer Price Index rose 0.6% in the last 12 months, which was the smallest year-over-year rise since 2015
  - The U.S. Producer Price Index fell (0.2%) in June, compared to economists' expectations of a 0.4% increase, pointing to subdued inflation as rising energy costs were offset by a decrease in demand for services
- The Fed stated that manufacturing production jumped by 7.2% in the U.S. for the month of June, substantially higher than economists' expectations of a 5.6% increase, signaling that the U.S. economy continues to recover
  - Industrial production which measures the output of factories, mines and utilities rose a seasonally adjusted 5.4%, much higher than the anticipated increase of 4.0%
- The U.S. reported 67,417 new coronavirus cases on Tuesday, an all-time record, prompting states to implement new restrictions
- Weekly jobless claims totaled 1.3 million, higher than economists' estimates of 1.25 million, as Americans continue struggle with the economic impact of the coronavirus

Debt Capital Markets

- Activity within the debt markets slowed dramatically following the 4th of July and markets saw another volatile week, as coronavirus cases continued to surge across regions of the U.S.
  - The investment grade bond market saw $10 billion of issuance this week, reaching only half of the total issuance that was expected
  - Many issuers are in a "blackout" right now, as this is an historically slow time of year for the debt markets; however, as we move into August and September, issuance is expected to increase and a total of ~$1.6 trillion of issuance is anticipated for the year
  - Several pre-COVID M&A and LBO jumbo deals pushed through in previous weeks, causing institutional markets to slow due to a drop in activity
    - Institutional volume totaled $1.6 billion for the week and focused shifted to refinancing and liquidity enchaining activities
- The secondary market remained fairly stable throughout the week, but the market did see a bit of pressured selling, as CLO's tried to comply with OC and WARF tests
  - Retail mutual funds reported a $245 million outflow, and year to date net outflows totaled $16.3 billion
  - New CLO deals continued to price under recent trends, such as smaller deal size, shorter reinvestment periods and lower leverage
    - Regulatory backdrop with amendments to the Volcker rule should start to increase issuance throughout the rest of the year

Equity Capital Markets

- Following a record month of ECM issuance in June, the IPO markets remained strong, while secondary offering activity slowed
  - Secondary offerings have slowed as companies endure corporate blackouts with the start of earnings season
- Nearly half of this of this year's IPOs have been upsized, including the banking software firm nCino Inc., which priced Monday and set the best first day performance of the year at 195%; KeyBanc Capital Markets served as a joint bookrunner on the transaction
- The S&P 500 surpassed the 200 day moving average and has attempted to regain COVID losses as earnings season beings
- A developing theme in the markets ahead of earnings has been the shift of investors and companies to focus more on long-term operations and guidance
  - This is a shift away from last quarter when companies could freely pull guidance and a majority of the focus was on capital levels for the next 9-12 months

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- As coronavirus cases rise and unemployment remains inflated, it is likely that another coronavirus relief bill will be enacted in the near future
  - U.S. weekly unemployment claims rose by an adjusted 109,000 to ~1.4 million for the week ending July 18th, marking the first time filings have risen in nearly four months as some states rolled back reopening's because of the coronavirus pandemic
  - House Speaker and Minority leaders Pelosi and McCarthy told reporters that they tentatively expect Congress to approve legislation for another relief bill by the end of the first week of August
  - Senate Republicans announced that they had reached a tentative $1 trillion dollar stimulus plan with the White House on Wednesday, while Minority leader Schumer communicated he doesn't believe this will be an adequate quantum of funds
- U.S. retail sales surged 7.5% in the month of June as the economy continues to recover, which is substantially higher than economists' expectations of a 5.0% increase
  - Retail sales continue to recover as businesses begin to reopen and coronavirus restrictions are lifted
  - The massive surge in retail sales follows May's record increase of 18.2%, signaling that the U.S. economy continues to recover; economists' attributed the strong recovery in retail sales to the government providing increased unemployment benefits
  - Despite the positive news, U.S. economists' fear that the strength of the economy can weaken considerably if states are forced to shut down a second time in response to the surge in coronavirus cases
- The Senate banking committee approved the appointment of Judy Shelton and Christopher Waller for two seats on the central bank's board of governors on Tuesday

Debt Capital Markets

- New loan issue activity slowed late last week as only a few M&A financings were announced in sectors largely less affected by the coronavirus shut-downs
  - However, the launch of Epicor's $2.75 billion dividend recapitalization transaction marked the first dividend deal since February
  - The market for investment grade and crossover pro rata loan issuers remain open for shorter maturities with pricing premiums
  - The U.S. institutional market for new issue loans was stable, with $6.9 billion in issuance between 6 issuers driven by M&A and opportunistic deal flow
- With slower primary issuance and earnings blackouts, the secondary loan market has been more active, however, the focus largely remains on OC tests, market optimism and a rally in CCC loan prices
  - New CLO deals continued to price under the revised trends seen over the past several weeks of smaller deals, shorter reinvestment periods and lower leverage
    - Amendments to the Volcker Rule are expected to increase issuance over the remainder of this year as four CLOs priced for a total of $1.5 billion last week
- The investment grade loan market continues to push forward through uncertainty as arrangers and investors set a higher bar and raise costs associated with allocating capital
  - Primary loan market activity has slowed down from the initial round of shoring up short-term liquidity, but issuers continue to access and return to the bond markets for longer term liquidity needs
- High yield bonds fell for a second straight week as investors weigh increased optimism over a COVID-19 vaccine against the economic fallout from a continued rise in cases across the U.S.
  - High yield bond yields and spreads ended the week at 6.96% and 655 bps last week, falling 62 bps and 59 bps from recent highs on June 29th

Equity Capital Markets

- As the earnings season enters its busiest period, secondary offering activity remains light as companies impose a blackout period through the quarter's earnings announcement or subsequent 10-Q or 10-K filings
  - Second quarter earnings have come in more bullish than expected as ~70% of S&P 500 companies beat analyst expectations
  - The Industrial sector has performed particularly well in the second quarter with companies such as Equifax and Watsco beating consensus revenue estimates by 3.96% and 6.41%, respectively
- Pershing Square Tontine Holdings Ltd. raised $4 billion in the largest IPO ever by a SPAC, which was followed by the third-best start among this years' blank check listings after jumping 6.5% in its Wednesday (7/22) debut

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Sources: CNBC, Reuters, The Washington Post, WSJ, KeyBanc Capital Markets

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- On Tuesday, the Federal Reserve announced that it will extend its lending programs until the end of the year, which will continue to help businesses, governments and individuals navigate the post-pandemic economy
  - Treasury Secretary Steve Mnuchin reiterated the government's commitment to supporting the economy through the extension of these lending programs
- Senate Republicans released details about their ~$1 trillion stimulus package on Monday, however, the relief package hangs in the balance as Republicans and Democrats continue negotiations
- On Wednesday, the Federal Reserve decided to keep benchmark interest rates near zero until the economic fallout from the coronavirus subsides
  - Jerome Powell, Chairman of the Federal Reserve, expressed concerns over the state of the U.S. economy and its future outlook as coronavirus cases rise
- The U.S. coronavirus death toll surpassed 150,000 on Wednesday, as hard-hit states continue to see a spike in deaths
- U.S. Gross Domestic Product (GDP) contracted by a record 32.9% in the second quarter, which is less than economists' expectations of a 34.7% decline, however, this still represents the largest drop of all time
  - Prices for domestic purchases, which is an indicator of inflation, fell 1.5% in the second quarter after rising 1.4% in the first quarter
  - The U.S. Consumer Confidence index fell to 92.6, lower than economists' expectations of 94.5
- Orders of U.S. made capital goods increased the most in ~2 years in the month of June, while shipments continue to accelerate
  - Orders for non-defense capital goods, which is a proxy for business spending plans, jumped 3.3% last month following May's 1.6% increase; core capital goods orders still remain 3.2% below their pre-pandemic level
- Weekly unemployment claims totaled 1.43 million, representing the second straight week that initial claims have increased and the 19th straight week that claims were greater than 1 million

Debt Capital Markets

- The technical imbalance in the leveraged loan market caused by the summer slowdown is leading to a favorable issuers market as marginally higher leverage and tighter pricing makes issuance more attractive in the secondary market
  - Activity remains light in the primary market with only $1.7 billion of institutional loans issued over the past week, down from $6.1 billion in the week prior
  - While new money activity is light across the ratings spectrum, issuers are trying to solve for M&A activity that was put to rest when the pandemic ramped up
- The leveraged loan middle market has slowly started to open with the pipeline standing at $2.72 billion, as a number of both new and existing names have hit the market
  - Lenders and investors alike are anxiously tracking the performance of these raises, providing a barometer for appetite in a market that has been largely shut down for the last several months
- High yield issuance slowed this week, ahead of a heavy earnings calendar and corporate blackouts
  - Six deals priced for $4.2 billion by Thursday, with two other issues set to price before the end of the week highlighted by Graham Packaging's $510 million senior note issuance and Summit Materials' $700 million senior note issuance
  - The investment grade market remains slow during the summer months but is expected to pick up in September as investors take advantage of record coupons and attractive rates (The market saw ~$21 billion in issuance this week)

Equity Capital Markets

- Stocks experienced a volatile week as investors continue to focus on earnings while digesting an uptick in coronavirus cases, the potential for a coronavirus vaccine and the chance for a new spending bill
- As the earnings season now enters its busiest period, secondary offering activity remains light as companies impose a blackout period through the quarter's earnings announcement or subsequent 10-Q or 10-K filing
  - One third of S&P 500 companies have reported earnings, with 85% beating expectations, far above the historical beat rate of 73%
    - The industrial sector has performed especially well with 87% of companies who have reported earnings beating expectations
- A record quantum and volume of SPAC issuance occurred in July, with 14 SPACs raising $7.1 billion

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Sources: CNBC, NASDAQ, Reuters, WSJ, KeyBanc Capital Markets