KBRA DLD Default Forecasts for Liquid Credit: 3.25% ($45B) for HY, 4.5% ($65B) for BSL

KBRA DLD | July 26, 2023

Chart I

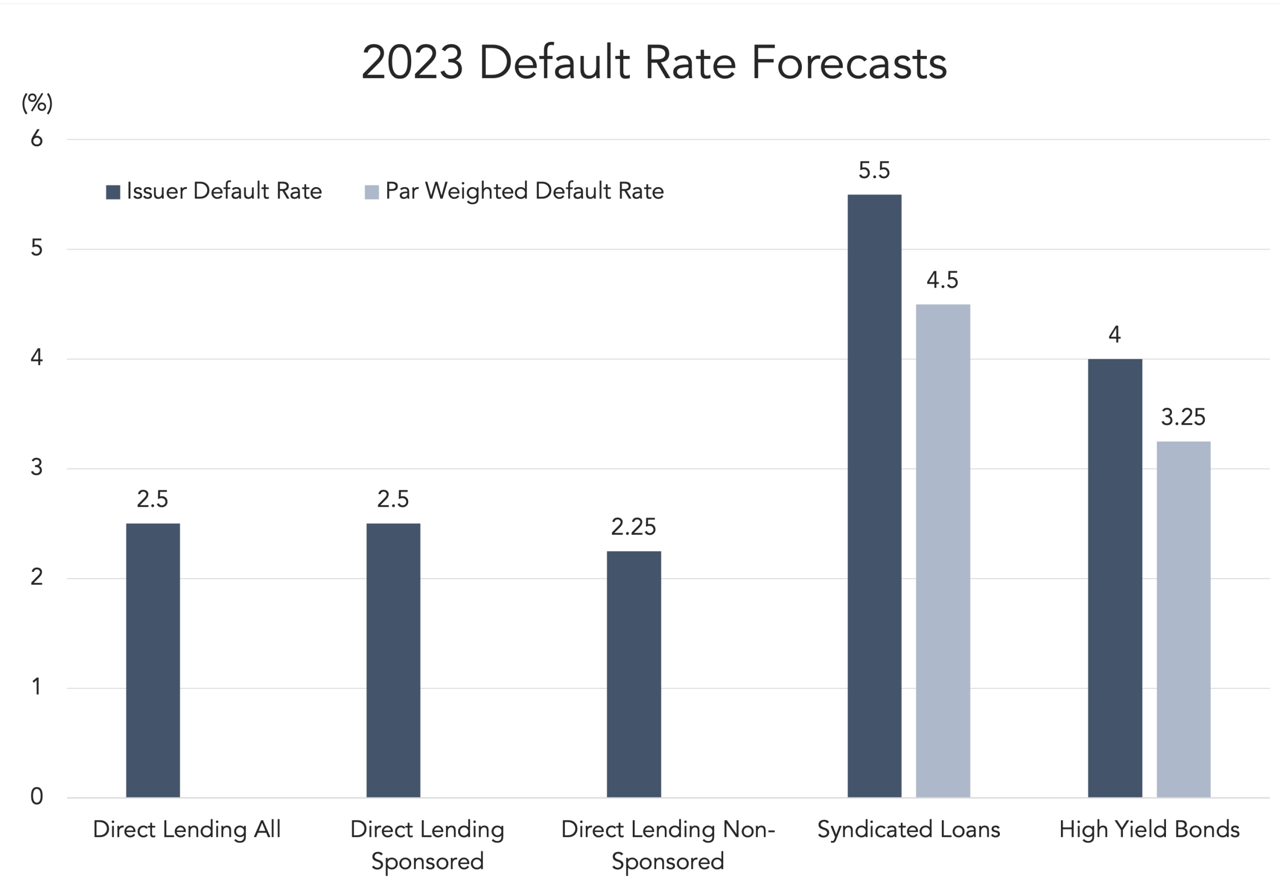
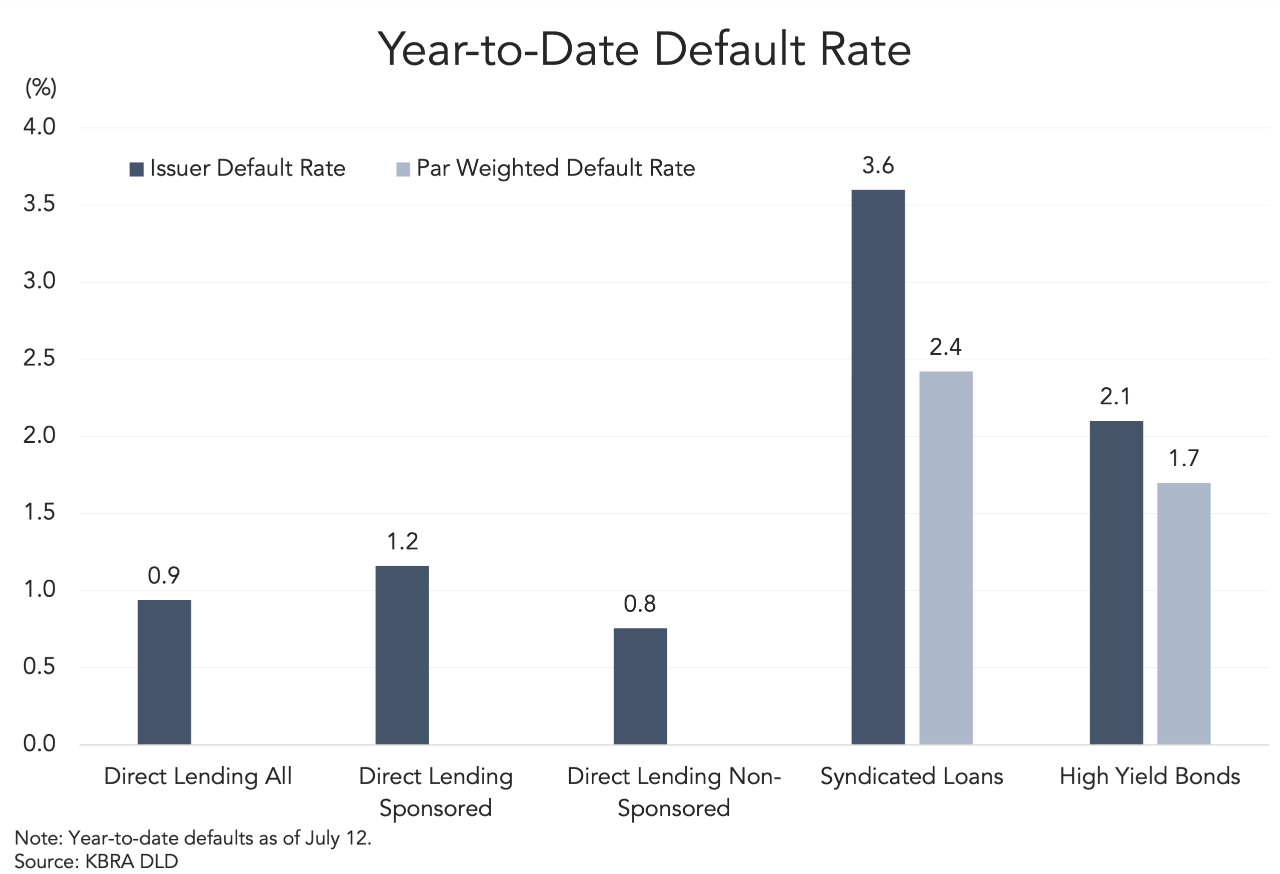


Chart II



KBRA DLD is forecasting a 3.25% default rate by volume (4% by number) for high yield by year end, and a 4.5% rate for syndicated loans (5.5% by number). That equates to nearly $45 billion of HY volume and puts defaulted syndicated loans on pace to surpass $65 billion, which would top the total registered in 2020.

In the months ahead, we expect HY and syndicated loan defaults to mimic the pace seen through the first half of the year. By number, *DLD*'s forecasts call for 35 defaults in HY and 75 across syndicated loans for 2023.

High Yield

For HY, the year-to-date (YTD) default rate stands at 1.6%, equating to $22 billion of volume. Half of that total derives from **Diamond Sports**, **SVB Financial** and **Wolverine Escrow** filing for chapter 11. *DLD* anticipates several distressed debt exchanges to drive the rate over the remainder of the year. Nevertheless, the possibility of the rate finishing at 3% or lower is conceivable if deeply distressed **Ligado Networks** avoids filing for bankruptcy. The telecommunication company received a couple rounds of financing over the past year to avert defaulting.

For HY to finish above 3.25% in 2023, it would require either a) a few companies undertaking distressed debt exchanges earlier than anticipated, or b) a surprise, large bankruptcy. **Bausch Health Companies**, which completed a sizeable distressed debt exchange last September, might have been a candidate, but last week's announcement of a new $600 million finance facility with **KKR** provides additional liquidity.

DLD believes market liquidity is the key factor in how zombie companies survive and that a constructive macroenvironment will keep the HY rate in line with the historical average over the near term. We forecast a slight bump in the default rate to 3.5% for 2024.

The healthcare/pharmaceutical, retail and banking/finance sectors are expected to drive the rate in 2024, potentially producing half of the default volume. Record HY issuance in 2020 and 2021 enabled companies to push out their maturities to 2025 and beyond, but the likelihood of more large-distressed debt exchanges remains high, especially in the telecommunications and cable segments.

Syndicated Loans

For syndicated loans, distressed exchanges/restructurings have become increasingly common with 30% of volume stemming from this type of default since 2019 compared to just 8% from 2007-2018. Distressed exchanges/restructurings account for $10.4 billion of the $35.2 billion of 2023 defaulted volume, contributing to the 2.4% YTD default rate.

Several syndicated loans with outstandings above $1 billion in distressed territory could propel the default rate to 4.5% by year-end 2023. Furthermore, there are significantly more worrisome credits than those found in the HY space, which should result in the syndicated loan market having a higher default rate both in 2023 and 2024. We are calling for a 4% syndicated loan default rate at year-end 2024.

Healthcare/pharmaceuticals, led by **Envision**, account for 22% of YTD syndicated loan default volume. We expect this sector to continue driving the 2023 default numbers, with companies such as **Global Medical Response**, **Team Health**, **US Renal Care** and **Mallinckrodt** serving as some of the larger potential candidates.

For 2024, the healthcare/pharmaceuticals segment is again expected to lead defaults although more could stem from smaller borrowers versus 2023. Technology and leisure/entertainment are also likely to lift default volume in 2024.