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European Debt and Equity Markets Resilient in Face of Turbulent Year

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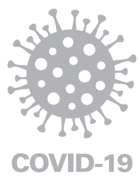
The European debt and equity markets shrugged off the impact of a nearly total shutdown due to COVID-19 at the end of the first quarter of 2020 to rebound with strong performances in the second half of the year. As activity resumed in the late spring, a number of key trends emerged, involving covenant flexibility in high-yield bonds as well as resilient equity markets in the face of both COVID-19 and the impact of pending Brexit regulation.



High-Yield Debt: The strong start to 2020 for the European high-yield market, in which bonds regained their market share from the loan market, came to an abrupt halt in March 2020, when governments imposed restrictions due to the COVID-19 pandemic. Markets began returning to life in May and June, leading to a very strong year for European high-yield issuance. An increase in default rates in 2020 reflects at least in part the impact of COVID-19 and the measures taken in response to the outbreak, but this increase did not dampen market enthusiasm for high-yield issuance. Strong volumes in the second half of 2020 were due in part to central bank bond repurchase activities intended to mitigate the impact of the pandemic and the search by investors for yield in a low-interest-rate environment. For issuers, low interest rates presented an opportunity to refinance bonds and loans, and increase liquidity.

Investment-Grade Bonds: European investment-grade bond issuance was strong and there was an increase in 2020 compared to 2019, including significant issuance in the second quarter driven by low interest rates and COVID-19 uncertainty, which led many companies to seek to raise additional liquidity to be prepared for contingencies.

Equity Issuance: Equity markets also showed strength in response to the pandemic and the unpredictability it brought, with many listed companies accessing them for liquidity. IPOs in Europe rebounded in the second half of 2020 after that market was effectively closed in the first half of the year in response to COVID-19.

Outlined below are a number of key trends from 2020.

European High-Yield Markets: Flexibility in Covenants

2020 saw a continuation of the trend of evolving high-yield covenants in Europe. These included increasingly flexible "baskets" and other exceptions for additional debt and dividends as well as other transactions traditionally restricted by high-yield bonds, such as asset sales.

There were instances in which investors called for changes in covenants after the deal was launched, and in some cases issuers responded with "tighter" covenants on terms that investors considered too flexible, for example flexibility to incur debt or make restricted payments. However, instances of investor pushback on deal terms remained the exception, and for the most part the markets showed strong demand for new bond issues, giving issuers flexibility in terms of the covenant packages they offered.

The trend was not all in the issuers' favor. A few new bond issues included increased investor protection by limiting the ability of issuers to move assets, particularly intellectual property, to unrestricted subsidiaries that were not subject to indenture covenant restrictions.

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European IPOs Show Strength in Unusual Market Circumstances

The European IPO market showed strength in the face of uncertainty stemming from both COVID-19 and Brexit. There were 191 IPOs in Europe in 2020 resulting in proceeds of $26.54 billion, compared to 127 IPOs for proceeds of $23.44 billion in 2019, according to Bloomberg.

When the IPO market returned in the second half of 2020, companies and advisers reacted to the practical limitations on the IPO process with virtual drafting meetings and roadshows. The virtual IPO marketing process even provided some improvements on the traditional one; reduced travel meant increasing the number of potential meetings and decreasing the time associated with traditional IPO roadshows.

While the U.S. IPO market was significantly influenced by the remarkable year for IPOs of SPACs, this trend was not seen to the same degree in Europe; SPAC IPOs represented approximately 53% of IPO volume in the U.S. in 2020, whereas SPACs represented only a small percentage of IPOs in Europe. However, the U.S. SPAC trend did impact the European IPO market, with some European businesses opting for mergers with U.S. SPACs instead of a traditional IPO. (See "The Year of the SPAC.")

Brexit Impact

The United Kingdom left the European Union on January 31, 2020, but with many of the rules governing the relationship between the U.K. and the EU left to further regulation to be put in place by the end of 2020. The two parties reached an agreement on December 24, 2020, and the regulations became effective on January 1, 2021. In 2020, the capital markets accepted the uncertainty, with sterling-denominated corporate bond issuance — including high-yield and investment-grade — increasing in 2020 compared to 2019. IPOs on the London Stock Exchange (LSE) were down in 2020 as compared to 2019, which itself saw a decrease from the previous year. In all, 17 IPOs listed on the LSE in 2020, according to Barclays.

Outlook

With the European high-yield market showing no signs of slowing down, market conditions bode well for a strong start to 2021. An increase in M&A in Europe will help to continue this trend, with issuance in 2020 dominated by companies looking to refinance or raise capital for general corporate purposes. (See "2021 Forecast for UK M&A and IPOs: Delayed Gratification?")

IPO markets also show no signs of slowing down, and it remains to be seen whether the U.S. trend in SPAC IPOs will transfer to Europe, with early signs showing the European markets starting to embrace the SPAC trend.