Market Trends 2020/21: Investment Grade Debt Offerings

A Practical Guidance® Practice Note by
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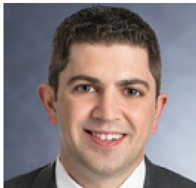

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This practice note explores market trends regarding investment grade debt offerings in 2020, including notable transactions, popular deal terms, industry insights, and the market outlook for 2021. Certain market trends and major issuances from the 2020 U.S. investment grade bond market are highlighted below, as well as practical considerations for certain terms of investment grade bond offerings in light of these trends. In 2020, COVID-19 left a considerable impact on the investment grade market, resulting in record issuance volumes in the U.S. and globally. Debt markets in 2021 were off to a strong start as issuers took advantage of the continuing low interest environment, but it remains to be seen whether 2020 levels can be matched or exceeded, with record-high cash balances on corporate balance sheets and increasing inflation expectations in the U.S.

For additional information on investment grade debt offerings, see Top 10 Practice Tips: Investment Grade Debt Offerings. For general information regarding debt offerings, see Corporate Debt Securities in U.S. Capital Markets.

Overview

The U.S. investment grade bond market accelerated significantly in 2020 with the number of deals over 40% and total volume over 60% higher than 2019, initially driven by liquidity needs as the COVID-19 pandemic unfolded. After the Federal Reserve announced a suite of liquidity programs in late March 2020, confidence returned to the debt markets, and corporate yields began falling. This environment resulted in record issuance volumes, exceeding already strong volumes in previous years. A total of 1,532 U.S. investment grade bond offerings closed during 2020, with a total volume of $1.864 trillion. This compares to 1,073 and 1,005 offerings and a total volume of $1.152 trillion and $1.157 trillion for the years ended December 31, 2019, and 2018, respectively, or a 42.8% increase in the number of deals and a 61.8% increase in total volume compared to 2019. The U.S. investment grade bond market comprised 10.9% of the global investment grade bond market in 2020 in terms of number of offerings, an increase from 8.3% in 2019. In terms of proceeds, the U.S. investment grade bond market comprised 38.7% of the global investment grade bond market, an increase from 29.2% in 2019.

Investment grade bonds have a rating of Baa3 or higher from Moody's Investors Service or a rating of BBB- or higher from Standard & Poor's or Fitch Ratings Inc. They are considered attractive investments for risk-averse investors (e.g., institutional investors) who prioritize liquidity. This is due to the greater certainty that the issuer, typically a company with an established operating history and credit, will be able to make timely payments to investors and avoid defaulting on their obligations under the bonds. In exchange for the greater certainty of payment, investment grade bonds typically have

lower interest rates and less restrictive covenants than sub-investment grade bonds. For additional information on credit ratings, see Credit Rating Process and Credit Rating Agencies, Credit Ratings Categories for Long-Term Debt Chart, and EU Regulatory Regime for Credit Rating Agencies.

Notable Transactions

In April 2020, Boeing Co. completed a $25 billion notes offering, the largest U.S. investment grade notes offering of 2020 and the sixth largest on record, exceeding AT&T Inc.'s $22 billion offering in 2017, but behind Verizon Communication Inc.'s $49 billion offering in 2013, Anheuser-Busch InBev Finance's $46 billion offering in 2016, CVS Health Corp.'s $40 billion offering in 2018, AbbVie Inc.'s $29.948 billion offering in 2019, and Comcast Corp's $27 billion offering in 2018. The deal helped Boeing raise capital to cope with short-term funding constraints brought on by the COVID-19 pandemic.

Other notable U.S. investment grade bond issuances in 2020 included:

- Oracle Corp's $19.953 billion offering
- T-Mobile US Inc.'s $18.895 billion offering
- AT&T Inc.'s $12.466 billion offering
- Verizon Communications Inc.'s $10.989 billion offering
- Walt Disney Co.'s $10.984 billion offering

Deal Terms

Covenants

Practitioners and issuers should be mindful of the differences in terms as bonds move up and down the investment grade chain, from high-yield to crossover credits to investment grade. A crossover bond sits on the line between investment grade and high-yield (typically BB- through BBB). Depending on whether a credit is moving up or down the credit spectrum, the issuance may have terms that are either better (if the issuer is moving up the credit spectrum) or worse (if the issuer is moving down the credit spectrum) than similarly rated and more stable credits. Bonds with crossover credits, particularly those nearer to high-yield credit status, may have covenant packages more similar to those provided for high-yield bonds than investment grade bonds. This may include highly restrictive negative incurrence covenants, which typically limit the issuer's ability to incur indebtedness, incur liens, make investments, pay dividends to equity holders, service junior debt, transact freely with affiliates, and merge or sell assets. Investment grade bonds typically limit restrictive covenants to limitations on liens, mergers, and sale of all assets. However, certain issuers which have attained credit ratings higher up in the investment grade spectrum are able to reduce the limitations imposed by these covenants even further, and certain investment grade issuers have been able to limit their covenant package to a restriction on their ability to merge or sell substantially all of their assets. Practitioners representing issuers in the crossover space should ensure that the indenture governing the issuer's bonds contains provisions for certain covenants (such as the limitation on investments) to fall away if the bonds achieve higher investment grade status. For a general comparison of high-yield and investment grade covenants, see High Yield vs. Investment Grade Covenants Chart. For more information on high-yield offerings, see Market Trends 2019/20: High Yield Debt Offerings, Top 10 Practice Tips: High Yield Debt Offerings, and Financial Definitions in High-Yield Indentures.

Liens Covenant

Investment grade issuers have historically been able to have the covenant limiting new liens only apply to liens on principal property. The definition of principal property varies from deal to deal and is often highly negotiated. The definition may be limited in such a way to exclude certain of the issuer's material corporate assets, or an issuer may not in fact have any principal property, thus mitigating the impact of the limitation. Furthermore, the limitation applicable to principal property is often worded to permit liens on such property up to an amount not to exceed a certain threshold (typically 15%) of the issuer's consolidated total assets or consolidated net tangible assets, in addition to other carve-outs. For a form of lien covenant in a high-yield indenture, see Limitation on Liens Covenant (High-Yield Indenture).

Make-Whole Redemption

Optional redemption features, which had historically been a rarity for investment grade bonds, have matured. The investment grade market generally permits early redemption at a make-whole premium up to a certain point, at which time the bonds become callable at par. Make-whole premiums are calculated from a formula based on the net present value of future interest payment on the bonds (that will not be paid because of the early redemption) combined with the outstanding principal on the bonds. As a result, many issued investment grade bonds are callable at par for a period generally ranging from one month (up to 5-year maturities), three months (5- to 10-year maturities), and

six months (more than 10-year maturities) prior to their maturity. Many crossover bonds tend to follow the high-yield early redemption convention, which typically implements a make-whole premium for half the maturity of the bonds, with decreasing premiums to par for a period of time before maturity. For bonds with a par call, the remaining payments are typically being discounted to the par call date, rather than to the redemption date. For additional information on make-whole premiums, see Anti-dilution Adjustment Formulas in Convertible Bonds and Debt Securities Restructuring Options.

Equity Clawback

An equity clawback provision allows for the redemption of bonds using the proceeds from an equity offering during certain periods in the life of the bonds. Typically, equity clawback provisions allow for redemption of up to 35% of the bonds for the first three years after issuance at par plus accrued and unpaid interest. Equity clawback provisions have been a mainstay in high-yield indentures and a feature of some crossover bonds, but were not typical in the investment grade space. That has changed over the last few years to some extent. While still atypical for investment grade bonds, the continuing emergence of the equity clawback in investment grade bonds has provided issuers with greater redemption flexibility.

Change of Control Put

The principal function of the change of control put is to allow bondholders to exit the credit in the event the issuer is acquired or merged by giving the bondholder the option to put the bonds back to the issuer at 101% or 100% of the principal amount. Traditionally, investment grade bonds had a double trigger change of control which triggers the put right upon a change of control and a below investment grade rating event. Typically, the ratings downgrade must occur within a specified period of time following the public announcement of the change of control transaction. High-yield bonds typically only have a single trigger tied to the occurrence of a change of control, which gives prospective bondholders greater flexibility to remove themselves from a credit they might deem to differ materially from their initial investment. The vast majority of investment grade bonds that have a change of control put have a double trigger mechanism. In recent years, the market saw the issuance of a large number of investment grade bonds without a change of control put at all. With the market trending in that direction, investment grade issuers and their outside counsel should consider to push to omit a change of control put entirely from their newly issued bonds. If the bonds provide for a change of control put, "cleanup" calls have become increasingly common, where the issuer has the right to redeem, at its option, any bonds that were not put to the issuer by the holders. For an example of a change of control provision in a Rule 144A debt offering, see Indenture (Rule 144A and/or Regulation S Debt Offering). For an example of a change of control provision in a convertible note, see Convertible Note (Seed-Stage Startup).

Floating Rate Bonds

Until 2017, the London Interbank Offered Rate (LIBOR) fallback provisions in floating rate bonds addressed the possibility of a temporary cessation of LIBOR. Market practice shifted decisively, with documentation expressly contemplating permanent discontinuation, when the UK Financial Conduct Authority announced its intention to stop compelling banks to submit rates for the calculation of LIBOR by the end of 2021. During 2020, U.S. issuers predominantly adopted the hardwired fallback approach recommended by the Alternative Reference Rate Committee of the Federal Reserve Bank of New York (New York Fed), in which the Secured Overnight Financing Rate (SOFR) will replace LIBOR as the base rate for the notes if LIBOR is discontinued. SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. treasury securities, and has been published by the New York Fed since April 2018. Corporate issuers that have implemented a SOFR fallback include Exxon, Hewlett Packard, and Walt Disney, in addition to financial institutions. Recently, most large financial institutions have issued notes directly linked to SOFR (rather than using SOFR as a fallback to LIBOR) from issuance or, in the case of fixed-to-floating rate bonds, beginning on the reset date to the floating rate. These issuances increasingly utilize the New York Fed's newly created SOFR Index to calculate the quarterly coupon payment.

Green/Sustainable Bonds

Although sustainable debt has continued to account for a small part of the overall debt market in 2020, approximately 32 sustainable bond offerings closed during 2020, with a total volume of $29 billion, with increased volumes anticipated for 2021 as policymakers seek a sustainable recovery from the pandemic. The key differences between green bonds and traditional bonds are primarily in the areas of use of proceeds, reporting, and independent verification of applicable sustainability criteria.

Industry Insights

Issuers in the financial services industry and the energy and power industry were the most active investment grade issuers in the United States in 2020, consistent with prior years. The consumer products and services and industrials sectors saw an increase of 75.6% and 45.3%, respectively, in offerings from 2020 to 2019. The real estate sector saw a decrease of 20.2% in offerings from 2020 to 2019. The largest offerings of 2020 came from issuers in the aerospace and defense industry (e.g., Boeing Co.); tech industry (e.g., Oracle Corp.); and telecommunications industry (e.g., T-Mobile US Inc., AT&T Inc., and Verizon Communications Inc.).

U.S. Investment Grade Bond Offering by Industry						
Industry	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Financial Services	393 (217 banks)	439 (206 banks)	382 (140 banks)	438 (133 banks)	414 (140 banks)	571 (202 banks)
Energy and Power	126 (39 oil and gas)	138 (21 oil and gas)	159 (29 oil and gas)	241 (58 oil and gas)	245 (60 oil and gas)	274 (62 oil and gas)
Real Estate	52 (43 REIT)	66 (58 REIT)	90 (78 REIT)	59 (49 REIT)	124 (104 REIT)	99 (90 REIT)
Industrials	52 (27 transportation and infrastructure)	46 (26 transportation and infrastructure)	55 (24 transportation and infrastructure)	69 (32 transportation and infrastructure)	75 (38 transportation and infrastructure)	109 (36 transportation and infrastructure)
Consumer Products and Services	44	33	57	36	45	79

Market Outlook

Although some continuity has returned to the debt markets over the past several months with issuers taking advantage of the low interest environment, the effects of COVID-19 and governmental actions as the pandemic subsides on both issuers and underwriters in the investment grade bond market will need to be watched carefully. It remains to be seen whether 2020 levels can be matched or exceeded, with record-high cash balances on corporate balance sheets and increasing inflation expectations in the U.S.

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Ari Blaut is a partner in the firm's leveraged finance, restructuring and capital markets groups. Ari maintains a broad corporate practice advising clients on a wide range of financing transactions, including bank financings, high yield bond issuances, "PIPE" transactions, debt restructurings, liability management, creditor representations and joint ventures. Ari has particular expertise in leveraged finance, acquisition finance and strategic credit transactions. Ari regularly acts for clients in connection with arranging committed debt financing (both bank and bond) for mergers and acquisitions.

Some of Ari's significant representations in the past year include, among others, advising (i) AT&T on its $40 billion debt financing for its pending acquisition of Time Warner, (ii) Tesoro on its $4.1 billion debt financing for its pending acquisition of Western Refining, (iii) Eastman Kodak in connection with its "PIPE" transaction with Southeastern Asset Management and (iv) the ad hoc committee of Key Energy's unsecured note holders in connection with financing matters related to the acquisition of Key Energy through its prepackaged Chapter 11.

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