Market View
Corporate pre-financing: another brick in the wall

Date 28 March 2024

Author Ugnius Litvinskis

At a glance

– Economic optimism and expected rate cuts drive increased investor confidence, facilitating favourable conditions for bond refinancing.

- Companies have taken advantage by selling record amounts of new debt into a resilient market and reducing looming maturity walls.
- Companies such as Pinewood Studios, Dell and RAC have all refinanced existing bonds recently.

What a difference a year makes in bond markets. Last year, as billions of dollars' worth of debt neared maturity dates, many borrowers faced potentially debilitatingly high refinancing costs, raising fears of widespread defaults. But these fears are abating, leaving companies rushing to sell debt in a resilient bond market.

To understand the dynamics happening in fixed income markets today, we should look back to late 2020 and 2021, when financing conditions were very good for companies seeking to issue bonds. Interest rates were at record lows, allowing companies to raise debt very cheaply. The amount of debt issued was substantial and created a significant so-called maturity wall due in 2025 and 2026 – when a substantial portion of a company's debt is set to mature within a short period. This potentially causes problems for the issuer who may not have the funds to repay and may also face difficulties refinancing the debt when it comes due. Global debt maturities rose from nearly $2 trillion in 2024 to a peak of $2.78 trillion in 2026, with the greatest risk sitting with the lowest rated debt, according to S&P Global.[1]

Fears of maturity wall loom large

These fears of the looming maturity wall mounted further in late 2022 and 2023, when central banks began raising interest rates in earnest around the world to combat inflation. High interest rates were threatening to increase borrowers' costs significantly upon refinancing at a time when high inflation was hurting profit margins and cashflow. This raised questions about how issuers would repay their debts during heightened economic uncertainty, and also whether there would be enough demand from investors to replace old issuance with new bonds.

Refinancing trend

However, we are witnessing a different dynamic unfolding in bond markets this year. A brightening economic outlook and the expectation that central banks will begin cutting interest rates this year has led to increased investor confidence. In turn, this has helped improve financing conditions as investors are looking to lock-in the high yields currently on offer. Taken together, these factors have caused corporate credit spreads to tighten significantly, resulting in the current environment being very conducive for companies to issue new debt.

Indeed, the cost of refinancing bonds from riskier borrowers is the lowest since May 2022, and for investment-grade firms, it's the lowest since the summer of 2022, when central banks started their rapid interest rate hiking cycle.[2]

Borrowers are taking advantage of this by refinancing their bonds - which is when a company replaces an existing bond with a new bond to take advantage of better terms, such as lower interest rates or longer maturity periods. Refinancings are typically done to repay debt coming due near term. However, we are currently seeing a significant number of 'pre-financings' as well, with large outstanding amounts due in 2025 and 2026 being targeted. In these cases, the funds raised from new bond issuance are used to tender a whole host of bond maturities – a tender offer is when the issuer offers to repurchase some or all its outstanding bonds at a specified price.

Tearing down the maturity walls

One example of a company refinancing recently is Pinewood Studios, the British film and television studio. Pinewood had £750 million of debt due next year, a substantial amount for the studio where the James Bond, Harry Potter and Star Wars franchises were filmed. It initially sought to issue £500 million, but given high demand, it was able to sell £750 million of six-year notes, which will go towards paying down the entirety of its debt due next year.

Dell is another company that has taken advantage of attractive opportunities to refinance and tender some of its outstanding debt. In 2021, it issued $7 billion worth of bonds, all of which were coming due in 2026. Concerns about Dell's ability to pay down this debt mounted after demand for laptops and PCs fell post-pandemic. However, Dell's infrastructure business has benefited from the artificial intelligence (AI) boom, and earlier this month, Dell issued a $1 billion bond with proceeds used to reduce the 2026 maturity. This follows $2.7 billion of total debt reduction in 2023, including $1.5 billion in tender offers. As a result, the amount of debt outstanding due in 2026 has been reduced to $4.2 billion, which represents a much more manageable amount when it finally comes due (although we continue to expect further pre-financing of this specific maturity).

RAC, a British roadside assistance and insurance company, has also sought to reduce debt over the last two years, and managed to lower their 2025/26 maturities as well, most recently by refinancing a £140 million term loan facility with a £205 million one, with the difference being used towards a £115 million tender offer for its 2026 bonds. Other companies refinancing their debt in similar fashion include AB InBev and British American Tobacco.

Uncovering opportunities in bond markets

Companies have made substantial progress in lowering their debt due in 2024. Although escalating maturities in coming years, particularly for speculative-grade debt (BB+ or lower), will put pressure on financing conditions as demand for funding increases for these companies,[3] the risks are reducing significantly as companies reduce their debt and pre-finance well in advance.

As active managers, we do intensive research to uncover these opportunities, which vary depending on the company, investment grade status and quality of the bonds. We aim to identify whether it makes sense to tender and invest in new bonds, or possibly worth tendering and investing in bonds from another issuer. If you are considering a fixed income portfolio, please get in contact to speak to one of our advisors.

[1] S&P Global Ratings, https://www.spglobal.com/ratings/en/research/articles/240205-credit-trends-global-refinancing-maturity-wall-looms-higher-for-speculative-grade-debt-12991317

[2] Bloomberg

[3] S&P Global Ratings, https://www.spglobal.com/ratings/en/research/articles/240205-credit-trends-global-refinancing-maturity-wall-looms-higher-for-speculative-grade-debt-12991317