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Market Trends: High Yield Debt Offerings

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Overview

The High Yield Roller Coaster Continues

The most appropriate word to describe the high yield market in 2016 is volatility. There were some rough patches when few issuers tested the waters—particularly during the first quarter—but over the course of the year, a number of windows opened up with favorable market backdrops for issuing new high yield bonds. For example, in February 2016 the United States saw a meager $8.6 billion of new high yield issuances, whereas April 2016 saw a robust $31.8 billion. The ebb and flow of 2016 was no different from 2015, with $38.4 billion of new high yield issuances in April 2015 and just a sparse [$3.1 billion in December 2015. After record issuance levels in North America and Europe in 2013 and 2014, the high yield market turned volatile in 2015 and into 2016, due in large part to falling oil prices and increased political and financial instability both in the United States and abroad. In the United States, new high yield issuance in 2016 declined for the fourth consecutive year to $229 billion, primarily due to commodity concerns, particularly with respect to defaults in the energy sector, which increased in 2015 and continued to rise in 2016. Throughout the year, investors remained concerned about macroeconomic weakness in many leading economies, the ever-present uncertainly around the timing of interest rate increases, and the potential for continued increased default levels in certain sectors exposed to commodity price unpredictability such as oil, natural gas, coal, and iron ore.

In addition, the Federal Reserve's 2013 guidance to banks regarding limiting credit to finance acquisitions with high debt-to-EBITDA ratios has continued to affect acquisition financing structures in 2016 and dampen the market for high yield bonds used to fund leveraged buy outs (LBOs). This policy has had a particularly disproportionate impact on acquisition financing strategies for private equity firms and their portfolio companies, which have historically relied on financing from banks as the primary source of acquisition funding, with such debt often refinanced in the high yield market. U.S. high yield issuers also grappled with important court decisions that have affected the ability of issuers to restructure their bonds outside of bankruptcy. The high-profile bankruptcy of Caesar's Entertainment in January 2015, for one, gave investors heightened reason to proceed with caution before investing in bonds related to highly leveraged buyouts.

But 2016 also showed signs of promise for a high yield rebound in 2017. Notably, as issuers and investors adjusted to recent interest rate increases in the United States and stimulus measures from the European Central Bank, new high yield issuance volumes increased over the latter part of 2016. Notwithstanding widespread market volatility in December 2015 following the first interest rate increase by the Federal Reserve since the financial crisis, the U.S. economy has continued to expand and unemployment figures have continued to decline. In December 2016, another rate increase by the Federal Reserve signaled confidence in continued growth in the U.S. economy. Such rate increases are expected to continue in 2017. In addition, in the aftermath of the highly contentious U.S. Presidential election, bond yield prices increased significantly, with investors seeming to show initial consensus that the incoming administration and Republican congress could stimulate the U.S. economy if they follow through on their promises to invest in infrastructure, deregulate, and cut corporate tax rates. The effect of the new administration, however, remains to be seen. On the whole, most banks on the street expect an uptick in high yield volume in 2017, with the average consensus forecasting $237 billion in new issuances. In sum, the latter half of 2016 showed a few promising signs of life for the 2017 high yield market.

Notable Transactions

Dell-EMC

During the summer of 2016, Dell completed an offering of $20 billion aggregate principal amount of secured first lien notes and a subsequent offering of $3.25 billion aggregate principal amount of senior unsecured notes to fund its acquisition of EMC, which created the largest privately controlled technology company in the United States. By securing the notes issued in connection with its first offering, Dell was able to obtain an investment grade rating for those notes and a covenant package with traditionally investment grade, covenant-light terms, all while satisfying the steady investor appetite for investment grade rated bonds that the market observed through the first half of 2016 and further satisfying funding conditions necessary to completing the acquisition. Dell's unsecured notes offering, which contained a more traditional high yield covenant package, was rated below investment grade and sold into the high-yield market. Dell closed the acquisition of EMC in September 2016.

Other Megadeals

Dell wasn't the only sizable offering in 2016 as a number of issuers took advantage of favorable windows. In April 2016, Numericable-SFR, a French cable operator and telecommunications services company, issued $5.19 billion of high yield notes in a single tranche, representing the largest-ever issuance of a single tranche of high yield rated paper. A month prior to the Numericable offering, Western Digital, issued an aggregate of $5.3 billion of high yield bonds spread across secured and unsecured tranches to finance its acquisition of rival SanDisk. Other issuances of size included Altice ($4.25 billion), Prime Security Services ($3.14 billion), and Dish DBS ($2.6 billion).

Spin-off Related High Yield Financings

The year also featured a couple of unique high yield financing structures utilized in spin-off related transactions. Olin Corporation, in connection with its acquisition of Dow Chemical's chlorine products business, and Hilton Grand Vacations, in connection with its spin-off from Hilton Worldwide into a stand-alone timeshare business, employed similar high yield offering structures to acquire strategic assets from affiliates and, in turn, retire existing indebtedness owed by such affiliates. The issuing entities in each transaction initially issued high yield notes directly to affiliates (as opposed to investors in regular way transactions) in exchange for certain assets held by such affiliates. The high yield notes were subsequently exchanged by such affiliates in debt-for-debt exchanges with certain financial institutions that held outstanding debt owed by such affiliates. Following the debt-for-debt exchanges, the notes were re-sold by the financial institutions to investors in Rule 144A/Regulation S transactions. Execution of these structures played pivotal roles in achieving tax-free treatment of the larger spin-off transactions.

Deal Structure and Process

The timeline of a typical high yield offering has remained relatively unchanged. An offering is launched by the distribution of what is called the "red" (i.e., the preliminary offering memorandum or prospectus) to investors, which is typically accompanied by a press release announcing the transaction. For debut issuers or a significant transaction, the issuer may then go on the road following launch to meet with investors while the banks are building the book of potential allocations to investor accounts and determining deal pricing. The bankers work with the issuer to determine the length of the roadshow. A formal roadshow can be as short as three days and as long as two weeks depending on the nature of the transaction. Investors may provide feedback through the bankers to the issuer that affects the terms of the particular security, including requesting particular changes to the proposed covenant package. The banks will instruct investor accounts that books close by a certain time on the final day of the roadshow, which is the deadline for submitting an order in the bonds. Once books close, the bankers will schedule a pricing call later that day with the issuer in which the bankers and the issuer will agree to the terms of the deal (i.e., the coupon, issue price, maturity, call schedule, etc.).

After the pricing call, a pricing term sheet is sent to investors to confirm sales and the issuer and underwriters sign the underwriting agreement, pursuant to which the underwriters agree to purchase the securities from the issuer. Once a securities transaction is priced, the securities begin trading. As part of the pricing terms, the parties will also schedule a closing date, which is typically the third business day following the date of pricing (commonly known as a T+3 basis), and the securities offering will close on that date. A secured transaction may close on a T+5 basis and certain deals may close on a T+7 or T+10 basis to accommodate an acquisition or tender offer.

Extensive roadshows are less common in today's market. For a repeat high yield issuer, of which there were quite a few of in 2015 and 2016, launch and pricing are often accelerated to a single day, referred to as a drive by offering. The offering launches before the market opens, followed by a single or several investor calls and pricing later that afternoon. If the market is familiar with the issuer, there is often no need to have a formal roadshow to meet with accounts and, as a result, the process is accelerated.

Over the last few years, issuers seeking to execute high yield bond offerings, particularly in the European Union, have increasingly used non-deal roadshows through which issuers meet with potential investors to introduce their business and financial profile without providing any material non-public information or announcing the intention to execute a particular transaction. After completing such meetings, issuers determine whether or not to proceed with an offering. If they go forward with a transaction, they tend to follow the traditional offering structure described above, subject to any applicable marketing regulations in non-U.S. jurisdictions. Non-deal roadshows are helpful to issuers as they reduce the risk of a failed deal. However, there are many hoops to jump through for both issuers and bankers, including determining the information permitted to be provided at the meetings, when the meetings are held in relation to a formal deal launch, the role of bankers at the meetings, who may attend the meetings, etc.

Deal Terms

High Yield Covenant Packages

Before proceeding to discuss some of the most common covenants and how high yield bonds are generally issued, a few words are in order on the purpose of high yield covenants and how they are structured to function from a big picture perspective.

A Delicate Balance Made to Last

High yield covenants typically seek to strike a delicate balance that requires the collaboration among the various parties involved. On the one hand, the covenants are designed to provide protection for high yield investors against an issuer being able to overextend itself or unwisely use its cash. On the other hand, the covenants must provide flexibility for the issuer to operate its business and grow over the life of the bonds. In other words, the covenants protect the investors' ability to be paid principal and interest on the bonds while preserving the issuer's ability to run its business without undue restrictions.

High yield covenants are designed to last for the entire maturity of the bonds, which is typically seven to ten years. High yield covenants are generally difficult to amend, and so are often more flexible than covenants contained in traditional credit agreements. Unlike bank loans held by a relatively small number of lenders, high yield bonds are typically widely held and high yield investors traditionally do not expect to be approached for consent to amend any of the terms of the bonds, except in special circumstances. In addition, unlike an administrative agent under a typical credit agreement, the trustee under a high yield indenture is not expected to closely monitor or be in frequent contact with an issuer. Amending a high yield indenture requires a formal consent solicitation process that follows an established market practice. If that consent solicitation is coupled with a tender offer for the bonds, the tender offer must also follow the federal securities laws and the specific rules of the Securities and Exchange Commission (SEC) that govern tender offers.

Restricted vs. Unrestricted Subsidiaries

The high yield covenant package is designed to regulate the ability of the issuer and its restricted subsidiaries to service its debt and run its business. Every subsidiary of an issuer is deemed to be a restricted subsidiary. The only way in which an issuer can have an unrestricted subsidiary is to designate it as such. Most issuers of high yield bonds have subsidiaries that provide upstream guarantees. Remember that all guarantors are restricted subsidiaries but, for reasons that vary depending on the issuer's capital structure, not all restricted subsidiaries are guarantors. For example, subsidiaries utilized in connection with securitization facilities are frequently restricted subsidiaries but not guarantors. High yield covenants are typically very flexible in permitting all kinds of transactions between the issuer and its restricted subsidiaries or among the restricted subsidiaries, which is different from typical credit agreements that often provide flexibility only between the borrower and the loan parties (i.e., guarantors) or among the loan parties. Unrestricted subsidiaries are outside of the reach of the high yield covenants, but designating a subsidiary as unrestricted has the following effects:

- The issuer generally is prohibited from counting that subsidiary's net income when it calculates consolidated net income unless the issuer actually receives cash from the unrestricted subsidiary.
- Most interactions between the issuer and its restricted subsidiaries, on the one hand, and an unrestricted subsidiary, on the other hand, must be treated as if they were transactions with an unrelated third party and comply with all the covenants.

Because of these limitations, issuers rarely designate subsidiaries as unrestricted, although they may do so (for example, to consummate a project finance transaction where that subsidiary cannot be subject to the high yield covenants).

Incurrence vs. Maintenance

High yield covenants are incurrence-based tests rather than maintenance tests. In other words, high yield covenants are typically tested only when an issuer or a restricted subsidiary actually wants to do something, like pay a dividend, incur debt, or grant a lien. Most high yield covenants do not require an issuer to meet quarterly maintenance covenants.

Typical High Yield Covenants

While each high yield covenant package is distinct, the main covenants are as follows:

- **Limitation on restricted payments (i.e., the RP covenant).** The RP covenant regulates the amount of cash and other assets that may flow out of the issuer and its restricted subsidiaries. It typically limits cash dividends, the redemption or repurchase of the issuer's capital stock, the redemption or repurchase of subordinated debt obligations, and restricted investments. For a form of RP covenant, see High-Yield Indenture: Limitation on Restricted Payments.

- **Limitation on indebtedness.** The debt covenants regulate how much unsecured debt the issuer and its restricted subsidiaries may incur. For a form of covenant on limitation on indebtedness, see High-Yield Indenture: Limitation on Permitted Indebtedness.

- **Limitation on liens.** The lien covenant regulates how much secured debt the issuer and its restricted subsidiaries may incur. It protects the investors' position in the capital structure by regulating the incurrence of secured debt that may be effectively senior to or *pari passu* to the high yield bonds and ensuring that the high yield bonds will have a senior priority lien on collateral that secures any junior debt. For a form of covenant on limitation on liens, see High Yield Indenture: Limitation on Liens.

- **Limitation on asset sales.** The asset sale covenant establishes guidelines that must be followed in any asset sale and, subject to certain exceptions, permits the issuer or its restricted subsidiaries to use the proceeds either to prepay certain debt or reinvest in the business. If the proceeds are not used pursuant to the guidelines, the issuer will be required to offer to repurchase the high yield bonds from bondholders at par. For a form of covenant on limitation on asset sales, see High Yield Indenture: Limitation on Asset Sales.

- **Limitation on affiliate transactions.** This covenant limits the issuer's and its restricted subsidiaries' ability to enter into transactions with affiliates unless those transactions are on terms no less favorable than would be available for similar transactions with unrelated third parties. For a form of covenant on affiliate transactions, see High Yield Indenture: Limitation on Transactions with Affiliates.

- **Reporting.** The reporting covenant governs the information the issuer must provide to its investors in order to support trading in the securities and to monitor the performance of the issuer. The covenant can vary significantly from issuer to issuer depending on, among other things, whether the issuer is a public or a private company.

- **Merger covenant.** This covenant is principally designed to prevent a business combination in which the surviving obligor of the bonds is not financially healthy, as typically measured by whether the fixed charge coverage ratio (FCCR) of the issuer and its restricted subsidiaries following the transaction would be equal to or greater than the FCCR of the issuer and its subsidiaries prior to the transaction.

- **Future guarantors covenant.** This covenant is designed to make sure that if a subsidiary of the issuer is guaranteeing other debt, the bondholders also receive the benefit of such guarantee.

- **Change of control.** This covenant requires that the issuer purchase the high yield bonds from bondholders at a price equal to 101% if a change of control occurs. A change of control is typically defined to occur when (i) a person or group obtains ownership of 50% or more of the voting stock of the issuer, (ii) a merger or consolidation transaction occurs in which the equity holders of the issuer before the transaction do not represent the majority of equity holders of the surviving entity, (iii) the issuer sells all or substantially all of its assets, or (iv) the issuer adopts a plan of liquidation.

Most of these covenants have built in exceptions capped at specific dollar amounts, commonly known as "baskets," and other exceptions providing the issuer with the flexibility that it needs to operate its business and grow over the life of the bonds. Such exceptions are vast and are often highly negotiated.

For a general comparison of high yield and investment grade covenants, see Covenants: High Yield vs. Investment Grade.

High Yield Deal Terms in 2016: A Look Back

High yield trends and covenant changes during a particular year (whether loosening or tightening) depends on the market backdrop at the particular time of issuing the bonds and the particular industry. In addition, the credit rating of the issuer and other factors, such as the existence of a sponsor, new issuer strategies, and investor familiarity with the issuer always make a difference in the outcome of the overall covenant package. During the course of 2016, the general theme, in line with the lower volume of high yield offerings, has been investors continuing to scrutinize the covenant packages. When investors become more selective and have more time to digest a particular covenant package, they are likely to push for investor-protective changes to the covenant package, leaving it to the issuer to determine whether to accept modifications or potentially pay a higher coupon on the bonds. Sometimes, the changes can be fairly benign, such as tightening a particular basket or tweaking a particular definition. At times, however, the changes can be more drastic, such as a wholesale introduction of a new covenant. This is really a short way of saying that the high yield covenants in 2016 have not changed much, but a couple of items to note:

Change of Control

The change of control covenant continues to be a hot button for investors, especially when it comes to two aspects. First, many definitions of change of control do not contain what is known as the merger prong. That prong provides that, among other things, a change of control includes a merger or consolidation in which the equity holders of the issuer before the transaction do not represent a majority of the equity ownership of the surviving entity. This is typically the prong regulating parent to parent public company mergers. The rationale for excluding it is that the equity ownership in a public company is so diverse that no one would really control the surviving entity. However, an increasing number of investors in 2016 high yield deals requested to include this prong for their protection, whether or not the issuer is public.

The second item that investors have pushed back on is the double trigger change of control concept. This concept has always existed in investment grade bond offerings and has slowly crept into the high yield world. However, during 2016, many investors objected to this concept. In a double trigger change of control provision, a put or obligation to repurchase the bonds is triggered only if there is both a change of control and a ratings downgrade from one or more rating agencies within a specified period following the announcement of the change of control. While this provision is still extremely common in investment grade bond offerings and offerings with cross-over covenant packages (as discussed below), it has received some pushback in typical high yield packages. 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).

Make-Whole Premium

On September 19, 2016, in Wilmington Savings Fund Society, FSB v. Cash America International, Inc., the U.S. District Court for the Southern District of New York granted summary judgment in favor of Wilmington Savings Fund Society, as trustee for the holders of Cash America International, Inc.'s senior notes due 2018, holding that a spin-off by Cash America of a significant subsidiary violated restrictions on asset sales and consequently resulted in an event of default under the indenture governing the notes. See Wilmington Sav. Fund Soc'y v. Cash Am. Int'l, Inc., No. 15-CV-5027 (JMF), 2016 U.S. Dist. LEXIS 127421 (S.D.N.Y. Sep. 19, 2016). The court held that the indenture permitted the trustee to seek to enforce *any* provision under the indenture as a remedy for default, and held in particular that the trustee could require Cash America to pay a make-whole premium (which would ordinarily be payable only in connection with a voluntary prepayment of the notes by the issuer prior to the scheduled maturity of the notes), without requiring the trustee to accelerate the notes. Similar issues were addressed by two other courts in cases involving Momentive as well as Energy Future.

Some issuers started making changes to the default provisions in their indentures to address the issue raised by these cases in late 2016. In particular, these issuers added language to indentures to clarify that redemption premiums will only be payable in connection with voluntary early prepayment of the bonds and will not be payable upon the occurrence of an Event of Default or upon any involuntary acceleration of the bonds. However, in recent months, such changes were denounced by Covenant Review, which is an organization that analyzes covenants on behalf of investors. Covenant Review put out multiple articles saying that these types of changes have led to the "end of covenants", because issuers will simply be able to voluntarily default under their indentures and not have to pay a make-whole or other premium as a result. There were even a handful of deals done in January 2017 where these changes were removed from the covenant package after launch and prior to pricing, due to investor concerns. While the ink is still fresh on this topic and it may take different twists and turns, make-whole premiums may continue to be a focal discussion in 2017.

For additional information on make-whole premiums, see Understanding Anti-Dilution Adjustment Formulas in Convertible Bonds and An Overview of Debt Securities Restructuring Options.

Wholesale Changes

There were a couple of instances of high yield deals in 2016 that launched with one set of covenants and priced with a completely different set of covenants, which is rare. For example, one issuer launched a debt offering with a typical cross-over covenant package, which means that the covenant package had lien, sale-leaseback, change of control, and merger covenants customarily included in investment grade rated covenant packages but did not have the typical debt, restricted payment, and other covenants included in most high yield covenant packages. Given the challenging market backdrop and industry conditions at the time of the launch, investors clamored for a full high yield covenant package. As a result, the issuer, the banks, and their respective counsels were required to negotiate a full high yield covenant package in an 18-hour period and draft a supplement reflecting these covenants in order to be able to price the following day. While it is rare for covenant packages to change so dramatically, the transaction illustrates the challenges issuers may face launching offerings during windows of particularly low high yield volume or tough industry conditions.

Disclosure Trends

High Yield Disclosure Trends in 2016: Increased Scrutiny of Non-GAAP Measures

High yield issuers have long supplemented U.S. generally accepted accounting principles (GAAP) with non-GAAP financial measures, in particular Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) and EBITDA adjusted to exclude certain items (Adjusted EBITDA). Non-GAAP financial measures provide additional information tailored to the particular issuer's business and/or industry in order to help investors better measure issuer performance and evaluate ability to service indebtedness. Regulation G (17 C.F.R. § 244.100 - 102) and Item 10(e) (17 C.F.R. § 229.10) of Regulation S-K set forth the SEC's core framework for the use of non-GAAP financial measures in SEC filings. Principally, the rules require that whenever an issuer publicly discloses material information that includes a non-GAAP financial measure, the issuer must accompany that non-GAAP financial measure with a presentation of the most directly comparable GAAP financial measure and a reconciliation between the non-GAAP measure disclosed and the most comparable GAAP financial measure. The rules seek to bridge the gap for investors by requiring issuers to disclose the adjustments they are making to GAAP financial measures. In May 2016, the SEC issued new and revised guidance regarding the use of non-GAAP measures in registered offering materials and other SEC disclosure documents, which is available at https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm. In addition to providing greater clarity with regard to the use of non-GAAP financial measures, the guidance highlights certain specific concerns of the SEC with respect to the use of non-GAAP financial measures, in particular with respect to presenting adjustments that result in non-GAAP measures that are potentially misleading to investors. The SEC noted examples of potentially misleading non-GAAP measures, such as measures: (i) with adjustments that exclude normal recurring cash operating expenses necessary to operate an issuer's business; (ii) presented inconsistently between periods; and (iii) that exclude certain non–recurring charges but do not exclude non-recurring gains achieved during the same period. In addition, issuers with SEC-registered securities have noticed a substantial uptick in the number of SEC comments focusing on the use of non-GAAP financial measures and related disclosures. The SEC guidance mainly seeks to reinforce prior guidance and not impose new requirements. The SEC is expected to continue to focus on and scrutinize non-GAAP financial measures throughout 2017, with a particular eye to unusual adjustments, which will also impact high yield bonds issued under Rule 144A in an unregistered context because such issuances tend to track most SEC guidance. For further information on non-GAAP measures, see Understanding SEC Regulation of Non-GAAP Financial Measures and Drafting Regulation G Compliant Disclosure.

Industry Insights

Consistent with prior years, issuers' abilities to negotiate covenant packages were to a degree impacted by the overall performance of their respective industries. For example, issuers in the oil and gas space, in light of the rising default rates throughout the industry, were at times forced to accept tighter covenant packages than issuers of comparable credits in other industries. Issuers in the financial services and technology, media, and telecommunications spaces, on the other hand, were more likely to achieve favorable terms and greater covenant flexibility. But while an issuer's industry certainly plays a role in the outcome of a covenant package, it is only one piece of the larger puzzle. Over the years, it has become apparent that private equity backed issuers generally achieve more favorable covenant packages than their industry peers. Other factors, such as the credit rating of the issuer, new issuer strategies, and investor familiarity with the issuer consistently factor in the outcome of the overall covenant package as well.

2017 Outlook

High Yield in 2017: A Look Ahead

The trends in high yield bond issuances change based on the state of the market. When the market is hot and demand for high yield paper is great, issuers and sponsors endeavor to push the envelope in terms of covenant packages. As a result, there tends to be more flexibility in issuer favorable covenants, most frequently expanding the debt, lien, and restricted payment covenants. When the market cools off and demand dissipates, issuers are often forced to accept tighter covenant packages in order to execute transactions. As 2017 begins, volatility once again remains the primary theme, but there are signs that it could be the strongest year in high yield since 2014. Some of the trends that may impact the high yield market in 2017 include the following:

- **The effect of a Trump presidency.** Although Mr. Trump stated that he intends to expand the economy through investment in infrastructure, deregulation (in particular with respect to environmental and healthcare regulations as well as portions of Dodd-Frank), and cutting corporate tax rates, his ability to execute his agenda remains to be seen. The sentiment across the high yield market at year-end 2016 mirrored the bullishness of the equity markets, with estimates for 2017 high yield new issuance as high as $300 billion based on a favorable corporate and economic growth environment. This bullishness, however, has been tempered with uncertainty as to the Trump administration's positions on international trade, border taxes, and the possibility of eliminating the corporate tax deduction for interest expense. While the market waits to see if changes in the corporate and economic environments are actually achieved, there is cautious optimism for growth in the high yield markets during 2017.

- **Volatility.** Since the recession in 2008, there has been an increasing amount of volatility in the high yield market. The global political and macroeconomic environments remain in flux due, among other things, to the ongoing Greek crisis, sluggish growth in China, the recession in Japan, Brexit, and the wider European recovery. And while the results of the recent U.S. presidential election have some investors excited about U.S. growth, the positions and policies of the incoming administration with respect to international trade could have significant impacts on the global economy, in particular in emerging economies, that further exacerbate the volatile high yield markets.

- **The LBO market.** As mentioned earlier, in 2013 the Federal Reserve issued guidance regarding leveraged finance lending that would cap target companies in LBO transactions at high debt-to-EBITDA leverage ratios (a 6x ratio). While merger and acquisition volume remained relatively stable in the wake of the Fed's guidance, the 6x ratio has significantly impacted banks' ability to provide lending as part of acquisition financing structures and has had a chilling effect on leverage buyouts in particular, since many acquired companies tend to be levered over 6x. As a result, the number and average sizes of LBOs continue to decrease during 2016 and this trend may continue into 2017.

- **The Fed and interest rates.** Although the current head of the Federal Reserve, Janet Yelen, has stated that she intends to finish out her term, there is still uncertainty as to whether the Fed's policy toward gradual rate hikes will remain the same. Many investors indicate that they expect additional interest rate hikes over the course of 2017. Uncertainly as to the timing and degree of interest rate hikes may create patches of headwind in the high yield markets.

- **Dry refinancing market.** There are still a few years before a significant number of issuers will reach a maturity wall for high yield bonds requiring refinancing. For example, in 2016, approximately $52 billion of bonds reached maturity. While that number is expected to grow over the coming years to roughly $100 billion in 2017, $140 billion in 2018, and $190 billion in 2019, it is nowhere near the $500 billion maturity wall expected in 2023 or later. Until then, the market will remain largely dependent on opportunistic and strategic issuers.

- **Global recession.** While the majority sentiment on the U.S. economy remains bullish as 2017 begins, certain economists maintain that there is the possibility of a recession. Whether the United States is entering a recession, or whether it will in the next 12 to 18 months or on a longer timeframe, is not known. Furthermore, if there is a recession, it is uncertain as to what the extent or duration will be. As the answers to these questions firm up, the 2017 high yield market will respond.

As of the date of this article, there are promising signs for 2017 with the pipeline starting to fill out, but the year remains ripe with uncertainty. Despite volatility, the high yield market has proven to be resilient and survive the highest of the highs and the lowest of the lows, and in 2017, it will need to be resilient once again.