Schuldschein market
Private-debt segment faces credit concerns after bumper issuance in 2017

The Schuldschein (SSD) market notched up record volume of around EUR 27 bn in new issuance last year, slightly more than in 2016. However, there were deals from around 150 issuers, up sharply from around 115 in 2016, which like last year were diverse in their country of origin and sector. Despite fewer jumbo issues, typically those worth more than EUR 500m, the data point to a private-debt market whose depth and breadth show that it has continued to mature, proving itself to be less reliant on fund raising by larger German companies than in the past.

Such a robust performance may be hard to repeat this year. The narrowing in average spreads across the SSD market through 2017 contrasts with recent financial difficulties at high-profile issuers – notably Carillion of the U.K. and Steinhoff of South Africa/Netherlands – which could refocus investor attention on credit quality.

That would put borrowers less in the driving seat than investors for first time in a several years. Scope expects the market to remain resilient, with the value of deals set to exceed EUR 20bn in 2018, though activity is unlikely to match the levels of last year and the year before, while spreads should widen.

There is still potential for growth. Investor appetite for private debt is visible in that around 63 non-German companies tapped the market last year, with debut issues from East European, Middle Eastern and Asian companies. The SSD market has become a true pan-European private-debt segment. It is also one that in its more mature form has yet to go through a full credit cycle.

Figure 1: SSD placements

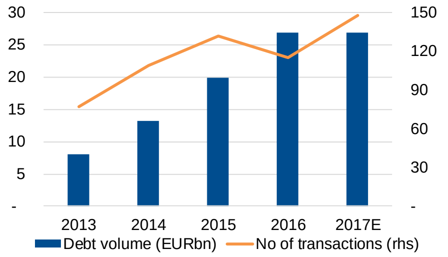
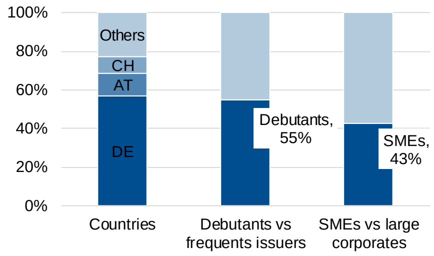


Figure 2: Structural features in 2017E



Source: Bloomberg, Scope

Alarm Bells

Defaults or debt restructurings among SSD issuers before 2017, typically from companies which raised funds in relatively small amounts, have had little impact on overall demand (see figure 5 on p.3). Scope believes that this might be somewhat different in the aftermath of the financial troubles at construction company Carillion and retail conglomerate Steinhoff last year, for three reasons:

- First, the two companies raised relatively large amounts of money, EUR 730m in the case of Steinhoff.
- Secondly, any restructuring of the Carillion and Steinhoff debt would involve a larger group of international investors than has typically been the case in the past. There are more than 50 investors in each deal so it might turn out to be difficult to restructure the debt. Any restructuring of SSD debt requires the unanimous agreement of investors as opposed to a simple majority required in the case of listed bonds or syndicated loans.

Analysts

Sebastian Zank, CFA
+49 30 27891 225
s.zank@scoperatings.com

Business Development

Dr Florian Stapf
+49 30 27891 149
f.stapf@scoperatings.com

Press

André Fischer
+49 30 27891 147
a.fischer@scoperatings.com

Related Research

2018 Corporate Outlook: Mature Credit Cycle with Signs of Exuberance, Nov 2017

Has Pricing Reached the Floor?, Jul 2017

Demand Bright, Pricing Tight, January 2017

German market for corporate ‘Schuldschein’ opens up to non-investment grade issuers, Jun 2015

Scope Ratings AG

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

- Lastly, the short time between SSD issuance and a credit event might raise questions about how the creditworthiness of these companies was assessed in the first place.

As Scope has argued (see German market for corporate 'Schuldschein' opens up to non-investment grade issuers from 2015 and Has Pricing Reached the Floor? from last July), investors need to be careful in assuming the high credit quality of the SSD market in the past will automatically apply in the future when there are many new entrants often with different characteristics from earlier issuers. Despite the market's long history, it hasn't experienced a full credit cycle since becoming more diverse by sector and geography.

Outlook for 2018

Placement volumes expected to exceed EUR 20bn but to fall short of 2017 volumes

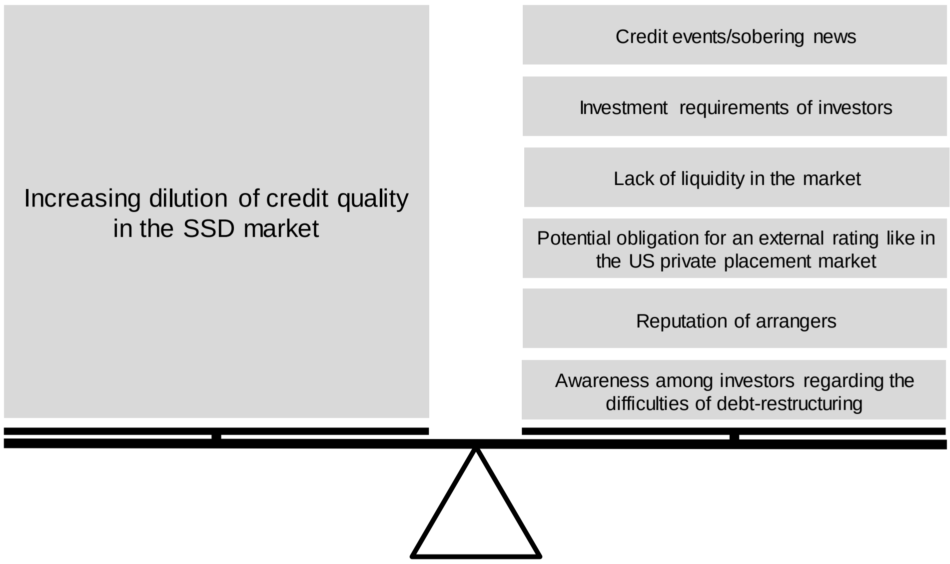
Scope believes that refinancing will drive activity this year as will continued interest from new non-German issuers, following the lead of those which successfully tested the SSD waters in the past few years. Nevertheless, we have become more conservative on the outlook for transaction volumes. The issue of credit quality signaled by recent credit events may cast a shadow over the SSD segment this year despite its resilience even at moments of bearish sentiment in public capital markets. Placement volumes should exceed EUR 20bn, but lag the levels of 2016 and 2017. Overall, we believe that the SSD segment will become more balanced, better reflecting the demands of investors and becoming less of a borrower's market then in the recent past.

Keeping the balance in the market

Originators, issuers and investors share an interest in a healthily balanced market

Scope believes that the market will find its balance between offering yield to investors without diluting average credit quality any further. Originators, issuers and investors retain large interest in a functioning market, particularly in light of the limited liquidity for and 'hold-to-maturity' character of SSD deals. As more than 80% of SSD issuers remain publicly unrated (see figure 11), diligent scrutiny of new deals/issuers is required. We believe that most recent credit events are a wake-up call for arrangers and investors not to rush into deals or alternatively think about the use of external, independent credit ratings. At the same time, overall investor interest in private debt remains strong.

Figure 3: Balancing credit quality in the SSD market



Source: Scope illustration

Average pricing has come down further, but should be on the rebound

Highlights of 2017

In another year of wide diversity among issuers in the SSD market, we highlight the most striking transactions of 2017 in terms of geographies, tenors, deal sizes and coupons/spreads (see figures 6-10 on p.4). Contrary to our expectations in summer 2017, median coupons above the reference rate (i.e. EURIBOR) on an SSD tranche with a tenor of 5 years has narrowed even further from 118 bps in H1 2017 to 110 for the full year (see figure 6) despite the continued trend towards non-German, small and mid-sized issuers and issuers with a comparatively high leverage of above 4x. Given the most recent warning signals, Scope reiterates its thesis that coupons should be on the rebound in 2018.

Figure 4: Outstanding/uncommon SSD transactions in 2017

Outstanding/uncommon criteria	Examples
Issuers from growing SSD markets in SEE, Asia and the Middle East	AmRest (PL), Etihad Airways (UAE), Globe Trade Centre (PL), Goshawk Aviation (IR), International Investment Bank (RU), MOL Hungarian Oil And Gas (HU), O2 Czech Republic (CZ), Sherwin-Williams (US), Sumimoto (JP)
Very long term SSD with a maturity of more than 10 years	Amprion, Bühnen der Stadt Köln, Eurogate, EWE, Flughafen Hamburg, GWH Wohnungsgesellschaft, Nassauische Heimstaette Wohnstadt, Neuland Wohnungsgesellschaft
Rather high coupons (>200 bps above reference for 4 or 5y maturity)	Alfmeier Präzision, Cargolux, DEMIRE, Eterna, Ecom Agroindustrial, Instone, HELMA Eigenheimbau, Zech Group
Very small transactions (<EUR 40m)	Alfmeier Präzision, AmRest, AustriaCard, BHS Corrugated Maschinen-und Anlagenbau, Eterna, HELMA Eigenheimbau, International Investment Bank, Globe Trade Centre, Holzwerkstoffe Vertriebsholding, International Investment Bank, Mabanaft, Rath
SSD innovations	SSD transaction conducted with blockchain technology: Daimler Green SSDs: Mann+Hummel, Meggle, Repower

Source: Scope Research

No true credit cycle seen yet in the SSD market

Troubled SSD issuers with publicly known credit events

Scope notes that there haven't been many more than a handful of cases of troubled SSD issuers among the more than 500 which have tapped the market in the past 10 years. But that is no room for complacency. Scope argues that the SSD market hasn't yet experienced a true credit cycle despite its long history. For one thing, before 2012, the market was still small, sometimes with less than 50 deals a year. For another, companies with lower credit quality also tended to stay clear of the market, particularly during 2008 and 2009 when debt financing was scarce for less solid corporates. We will have to see how more recent SSD issuers, particularly those with high-yield or cross-over credit quality issued between 2015 and 2017 which have to some extent diluted the segment's average, perform over the next few years, particularly if overall economic activity cools and the long-running bull market ends, (see also Scope's corporate outlook 'Mature Credit Cycle with Signs of Exuberance').

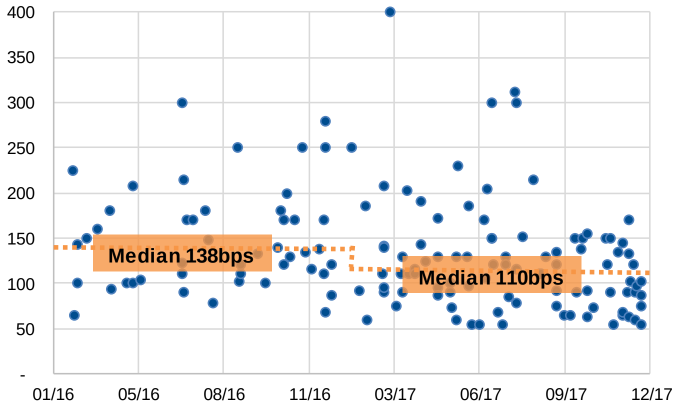
Figure 5: Troubled SSD issuers

Issuer	Credit Event	Size of SSD	SSD issued in …	Credit event in …
Steinhoff	Allegations on fraud and potential debt restructuring	EUR 730m	2015	2017
Carillion	Debt restructuring	GBP 112m	2017	2017
Tom Tailor	Covenant reset	EUR 80m	2013	2016
Premier Oil	Debt restructuring	USD 130m	2013	2016
Scholz	Selective Default	EUR 480m in total from 3 issues	2006/07/08	2016
Mox Telekom	Default	EUR 19m	2011	2014

Source: Scope Research

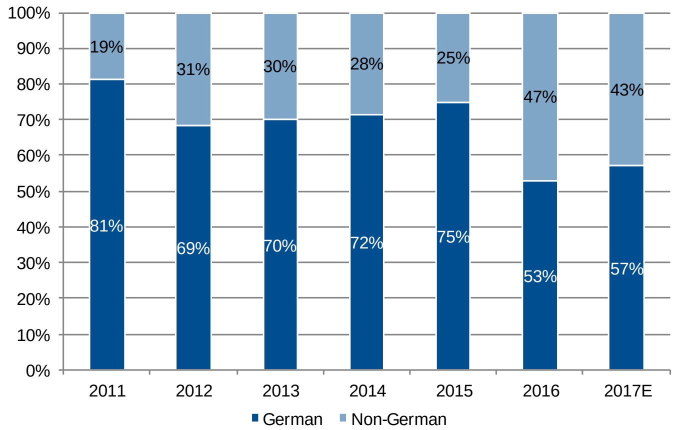
Market Statistics

Figure 6: Spreads above reference rate of 5Y-tranches of SSD



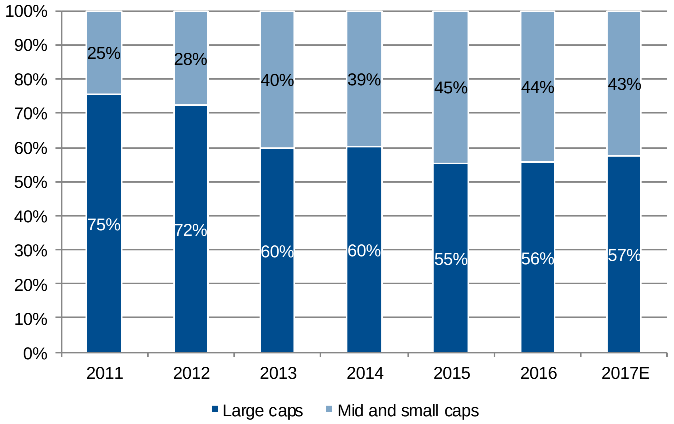
Source: Bloomberg, Scope

Figure 7: Domestic versus international SSD issuers – number of transactions



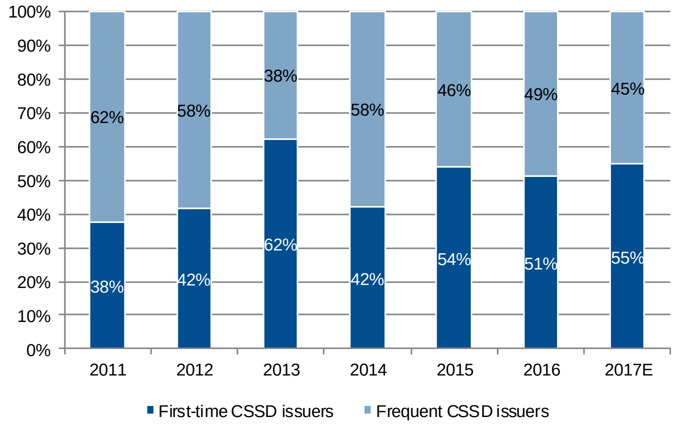
Source: Bloomberg, Scope

Figure 8: Large caps vs SMEs



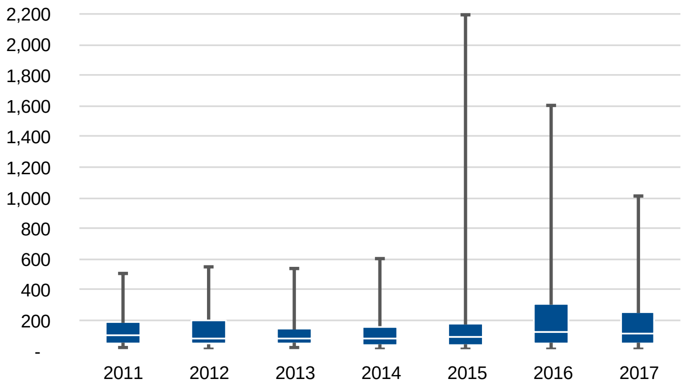
Source: Bloomberg, Scope

Figure 9: Frequent issuers vs. market debutants



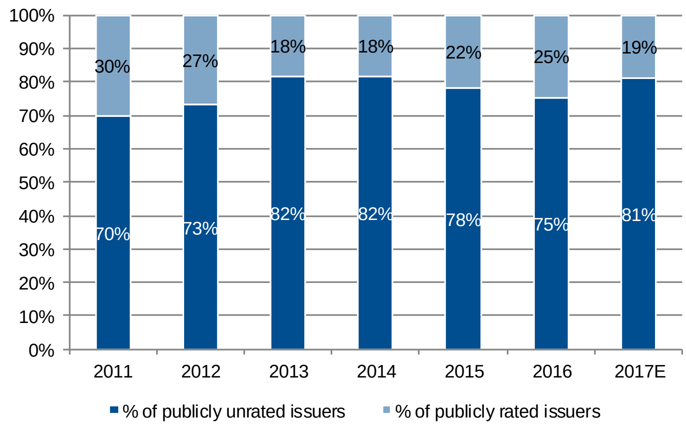
Source: Bloomberg, Scope

Figure 10: Range of ticket sizes in EUR m (box plots)



Source: Bloomberg, Scope

Figure 11: Share of non-rated issuers



Source: Bloomberg, Scope

Scope Ratings AG

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Paris

33 rue La Fayette
F-75009 Paris

Phone +33 1 82 88 55 57

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com

www.scoperatings.com