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Refinancing Risk Emerging in the German SME Bond Market

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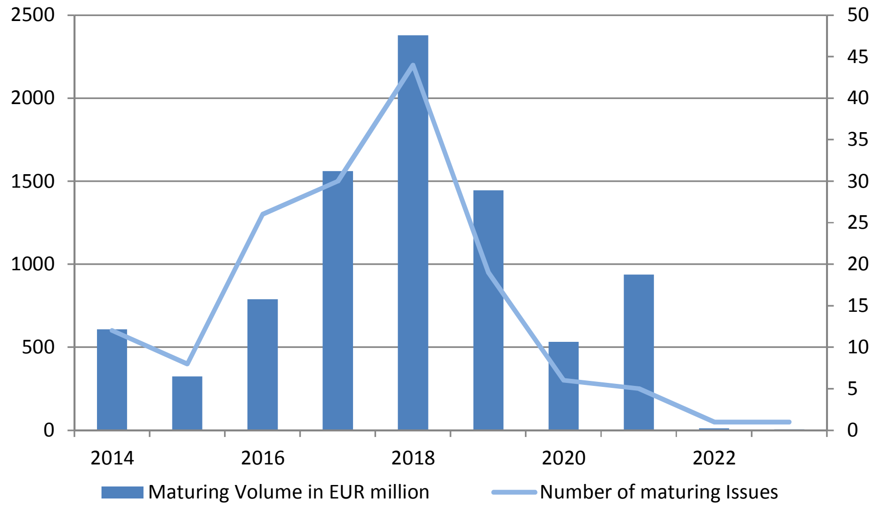
Summary

With a total of EUR5.4bn of debt maturing in the German SME bond market between 2014 and 2018 Scope expects refinancing risk to occur especially in 2017 and 2018 when a total of EUR1.6bn and EUR2.4bn of debt is set to mature.

In order to secure relatively lower interest rates and to successfully place the bonds, Scope expects issuers to increasingly provide collateral and financial covenants. This is currently offered only by an estimated 20% of German SME issuers in their respective bond documentations.

Refinancing might become a problem for those companies with relatively low credit quality and a business model which does not attract equity sponsors. As a consequence some more defaults might occur going forward. This will be in addition to the 23 issuer defaults which were already seen since the opening of the German SME bond market in 2010.

Figure 1: Maturing Bond Volume in the German SME Bond Market



Source : Scope Ratings

Analyst

Dr. Britta Holt

Executive Director

Head of Corporates

+44 (0)203 71449-84

b.holt@scoperatings.com

Press Contact

André Fischer

Communications Manager

+49 (0)30 27891 150

a.fischer@scoperatings.com

Scope Ratings

Lennéstraße 5
10785 Berlin
T: +49 (0)30 27891-0
F: +49 (0)30 27891-100
Service: +49 (0)30 27891-300

info@scoperatings.com
www.scoperatings.com

Significant Upcoming Maturities – Some Early Refinancing Seen

108 bonds are set to mature between 2015 and 2018

Reflective of the relatively low average maturity of bond issuances of 5.2 years, over the next four years to 2018 a total of 108 bond issuances are set to mature in the German SME bond market. Upcoming maturities for 2014 include the EUR20m bond of Maritim Vertriebs GmbH in November and the EUR 2m bond of Acazis AG in December.

Taking advantage of the historically low interest rate environment, some of the SME issuers were able to refinance their upcoming maturities early by tapping the SME bond market.

Historically low interest rates support early refinancing

Supported by the current low-interest environment in the first nine months of 2014 two issuers, Dürr AG and DIC Assets AG, have opted to refinance their maturing debt early. This was done at substantially lower coupons than those previously paid. Dürr AG was able to repay their 7.25% coupon bond maturing in 2015 in September 2014 using the proceeds of a newly issued 2.875% coupon bond. DIC Assets has issued a 4.625% coupon bond in September, 125 bps lower than their bond maturing in 2016, which the issuer is redeeming early this October.

Other issuers opting to refinance early have to offer a slightly higher coupon than the existing one. In exchange for bond holdings maturing in 2015, KTG Agrar AG is currently offering its bondholders a new bond with a coupon of 7.25%, which is 50bps higher than the current coupons. This corresponds to an increase in the credit spread by 170bps for KTG Agrar, from 530bps in 2010 to 700bps in 2014. Also, EYEMAXX Real Estate AG is currently offering its bondholders an 8.0% coupon bond in exchange for their 7.875% coupon bond maturing in 2019.

Relatively high coupons at German SME bond market - reflective of perceived credit risk

In June 2013, the average coupon in the German SME bond market stood at 6.5%, compared to 3.8% for the JP Morgan European High Yield Bond Index in June 2014. This reflects the relatively high perceived credit risk in the market.

Collateral and financial covenants expected to become more common

Going forward Scope expects particularly those SME issuers with a lower credit quality to provide collateral and financial covenants – something which is currently offered only from one in five issuers in the German SME bond market in in their bond documentations.

Refinancing Risk Expected to Result

Refinancing risk might arise - particularly in 2017 and 2018

SME issuers in the German bond market which are likely to face refinancing risk in the next few years are those with a relatively low credit quality and a business model which does not attract equity sponsors, as it does not offer significant growth prospects. Refinancing problems might occur in particularly in the years 2017 and 2018, when a total of EUR 3.9bn of SME bond debt matures (2017: EUR 1.6bn, 2018: EUR 2.4bn).

9 SME bonds currently trade at below 65% of their face value

Although trading might change over time, it is striking that of the 141 bonds which mature between 2014 and 2020 in the German SME bond market there are currently a large number of 9 SME bonds which trade at 65% of below of their face value. On 2 October 2014 Golden Gate GmbH declared insolvency. Before that Golden Gate's EUR 30m bond which was to mature on 11 October 2014 traded at below 65%.

Figure 2: List of Maturing Distressed Bond Maturing and Related Credit Ratings*

Maturity	No of bonds	Rating
2016	2	BB-
2017	4	B+ to CCC
2018	2	B-
2020	1	CCC
Total	9	BB- to CCC

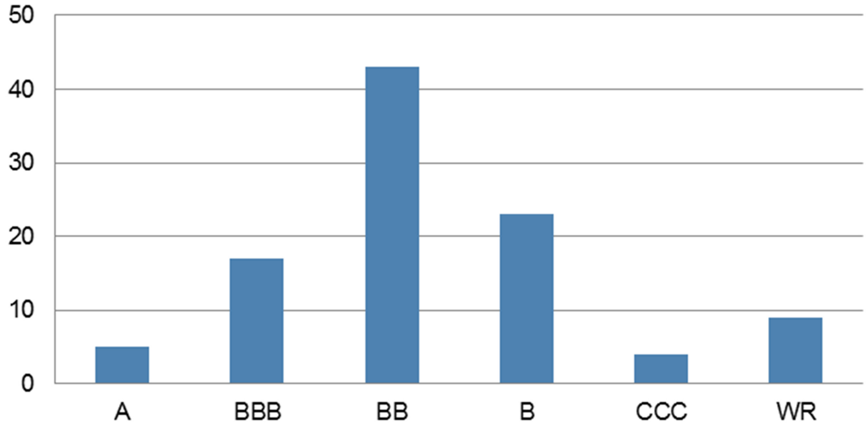
* As of Sep. 9, 2014; rated by any of the rating agencies

Source: Scope Ratings

More than two thirds of bond-related credit ratings are BB category or below

The SME bond market is dominated by high-yield issuers. More than two thirds (76%) of all existing credit ratings from any of the rating agencies related to German SME bonds are currently in the BB rating category or below (see figure 3). The ratings reflect the relatively smaller size of the company. The latter tends to leave the companies' cash flows vulnerable to changes in the economic environment and external shocks.

Figure 3: Rating Distribution of Maturing Bonds*



*As of 18 September 2014, 92 of the 148 bonds outstanding in the German SME bond market were publicly rated by a credit rating agency or had an issuer rating attached, while 63 bonds had no rating attached. Companies with no credit rating tend to be those listed on a stock exchange and thus not required to have a valid rating outstanding.

Source: Scope Ratings, other rating agencies

Disclaimer

Scope Ratings
Lennéstraße 5
10785 Berlin
T: +49 (0)30 27891-0
F: +49 (0)30 27891-100
Service: +49 (0)30 27891-300
info@scoperatings.com

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