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Private Placements on the Rise for German Mid-Sized Corporates

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Investors increasingly investing in issuances by mid-sized companies

While private placements ("Schuldscheindarlehen") have long been an established financing instrument for larger corporates, Scope has observed a surge in private placement issuances from mid-sized and smaller companies. Scope expects solid mid-sized German corporates to continue resorting to these and other types of privately placed debt, driven by:

- their need for financing and wish to diversify funding sources;
- the maturity of bank and (domestic) capital market financings over the next few years;
- limited documentation and reporting requirements and the possibility to customise the debt issuance;
- lower structuring and issuance costs compared to a public placement; and
- institutional investors' appetite for corporate credit and the yield in the private placement market.

Growing interest in private placements from mid-sized corporates

From January 2010 to September 2014, Scope observed 126 debt transactions via private placements in Germany by companies with a turnover of less than EUR 2bn. The issuance volume of these companies in this time period amounted to EUR 8.7bn. This transaction volume compares to EUR 41.5bn of placed corporate debt in the German "Schuldscheindarlehen" market over the same horizon.

Credit quality around investment-grade

In its analysis, Scope observed that only 30% of the issuers had a public credit rating at the time when the private placements were issued, with these ratings mainly being in the low investment grade and high sub-investment grade area. The majority of the unrated issuers are either household names or companies operating in industries with little exposure to cyclicality, such as the utility and real estate industries, and Scope assumes that such issuers either carry a non-public credit rating or are deemd of a credit quality which is around the above described BBB-rating category. Scope concludes that the observed credit quality in the private placement market is a reflection of the credit appetite of institutional investors such as insurance companies, pension funds, savings banks and other institutional fixed-income investors, which are seeking to invest in credits at or around the investment grade threshold.

Intransparent market

Given the limited documentation and standardisation required of issuers of private placements, the German private placement market is relatively intransparent. Transparency could be improved through more standardised documentation requirements, a comprehensive collection of transaction data (volumes, maturities, coupons, structures, etc.) and a higher percentage of issuers rated by rating agencies.

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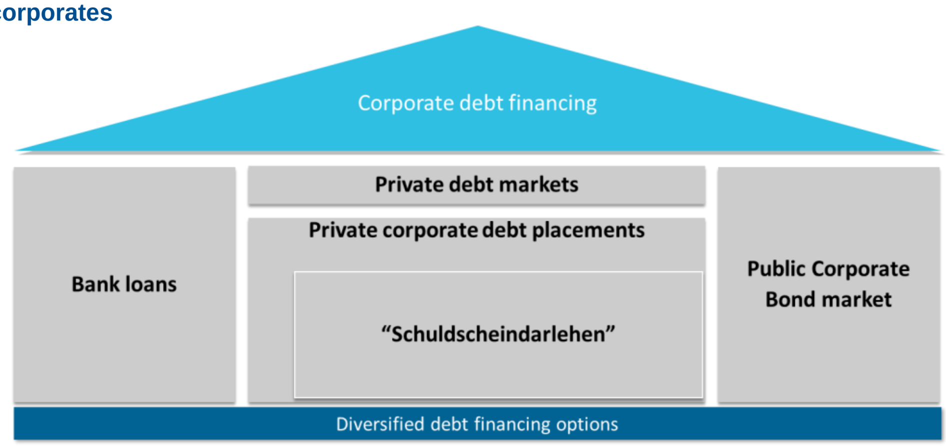
Private placements tap a new market segment

Private placements by German mid-sized corporates on the rise

Heterogeneous market lacks transparency

Private placements of corporate debt are non-standardised products. They range from so-called ‘‘Schuldscheindarlehen’’ to privately listed corporate bonds. The market for these products is heterogeneous and not very transparent.

Figure 1: Private placements as an alternative financing instrument for mid-sized corporates



Source: Scope

Private placements increasingly popular as an alternative to bank and capital market financing

Historically, a financing instrument for governments and large corporates (defined here as corporates with an annual turnover of more than EUR 2bn), private placements are increasingly being used for financing by German mid-sized companies (annual turnover of EUR 100m-EUR 2bn) and certain small-sized corporates (annual turnover of less than EUR 100m). This trend is boosted by the scarcity of bank liquidity for small- and mid-sized German corporates and the fact that investors are searching for alternative assets. As such, the volume of private placements by mid-sized corporates increased significantly between 2010 and September 2014 compared to the EUR 41.5bn German corporate “Schuldscheindarlehen” market.

126 private placements with a total volume of EUR 8.7bn placed by German SMEs between January 2010 and September 2014

Scope observed 126 private placements of German mid-sized corporates between January 2010 and September 2014 with a total issuance volume of EUR 8.7bn. The average issuance had a maturity of 5.5 years and a volume of EUR 50m to EUR 100m.

Figure 2: Private debt placement activities of German issuers (EURm)

* Due to the intransparancy in the market for private placements Scope cannot guarantee that all transactions have been identified

Source: Scope, BayernLB Research

More involvement of institutional investors in the financing of mid-sized corporates

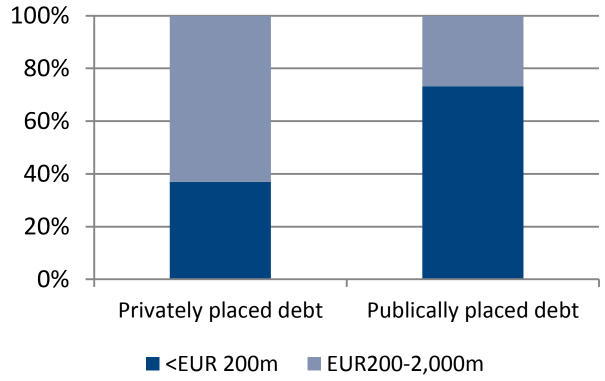
Scope observes that with private placements on the rise for mid-sized and smaller corporates, institutional investors are becoming involved in the financing of mid-sized companies. So far, institutional investors – insurers, pension funds, savings banks and other professional fixed-income investors – participated in SME financing only to a very limited extent. Scope estimates that they are invested in less than 20% of the bond volumes originally issued in the public German SME bond market.

Private placements require solid credit quality

Private placements require solid credit quality

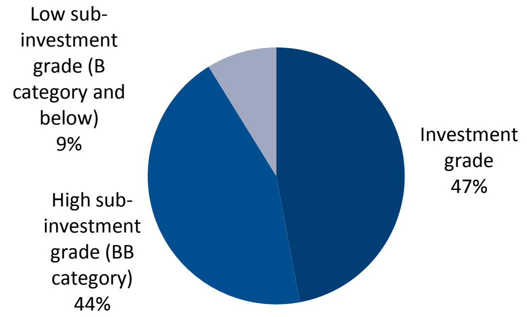
Contrary to the US, a public rating is not a prerequisite to issue into the European private placement market. Scope notes that only 30% of private placement issuers in its data sample have a public credit rating. Such issuers tend to have either investment grade ratings or have ratings in the BB range. This credit quality bias is driven by the investment criteria of institutional investors such as insurers, pension funds, savings banks and other institutional fixed-income investors, who tend to invest in stronger credit qualities at the top end of sub-investment grade or even investment grade. This also explains why the private placement market is dominated by mid and large caps, as these tend to have more stable cash flow generation and better credit ratings than smaller companies.

Figure 3: Size of SME corporate debt issuers in terms of latest annual revenues



Source: Scope

Figure 4: Ratings distribution* of publicly rated private placements



* Rating assigned at placement date

Source: Scope

Limited transparency to be improved

Given the limited documentation and standardisation requirements on the private placement market, transparency—particularly for mid-sized issuers—could be improved through:

- standardised documentation requirements,
- a comprehensive collection of transaction data (volumes, maturities, coupons, structures, etc.) and
- a stronger coverage of issuers through credit ratings.

Private placements as an alternative instrument for SME refinancing and further debt diversification

Proceeds predominantly used for refinancing purposes

With high refinancing needs emerging over the next few years in the SME bond market (see Scope's study Refinancing Risk Emerging in the German SME Bond Market), several SMEs conducted private placements for refinancing purposes.

Figure 5: Advantages and disadvantages of private debt placements

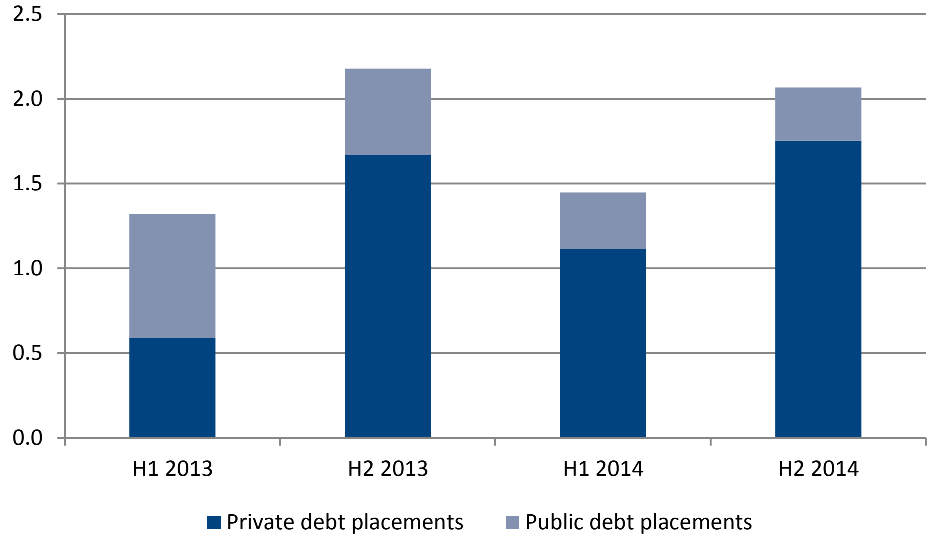
Advantages	Disadvantages
• Flexibility in terms of customised debt structures (volume, maturity, coupon(s)) • Low issuance costs • Limited reporting requirements before and after issuance • Diversification of funding sources Possbilities for bilateral re-negotiations of refinancing	• A fairly intransparent market • Stricter covenant structures • Illiquid secondary market

Private placements gaining ground on public SME bonds

Private placements favoured over new publicly listed bonds due to negative SME bond sentiment

Scope believes that private debt placements by mid-sized corporates have become even more important in 2013 and 2014 due to the negative investor sentiment in the German SME bond market. This follows nine issuer defaults in 2013 and another nine in mid-November 2014.

Figure 6: Issuance of public vs. private debt by SME issuers since 2013 (in EURbn)



Source: Scope

22 issuers of public SME bonds opted for an additional private debt placement

Scope has identified 22 mid-sized corporates that recently opted for a private placement following a public bond issuance. Prominent examples include Grand City Properties S.A. (Apr 2014), HELMA Eigenheimbau AG (Mar 2014), Katjes International GmbH & Co. KG (Mar 2012), Sanha GmbH & Co. KG (Jan 2014) and Semper idem Underberg GmbH (Jul 2014).

Tap issues increasingly backed by private placements

Scope Ratings also recorded 10 private tap issues of publicly listed SME bonds with a combined volume of about EUR 430m during the first nine months of 2014. Scope estimates that these companies opted for a private placement in order to avoid the disstressed public German SME bond market. Most notably companies such as Grand City Properties S.A. (Apr 2014), Metalcorp B.V. (May 2014), Helma Eigenheimbau (Mar 2014) and Adler Real Estate (Jul 2014) fall into this category. Subsequently defaulted companies such as Günther Zamek Produktions- und Handelsgesellschaft mbH & Co. KG (Feb 2013) and getgoods.de AG (Oct 2013) have directly placed debt for institutional investors in 2013 with tap issues.

Outlook

Scope believes that private placement of corporate debt will be increasingly used as an alternative financing option for mid-sized corporates. It allows for a diversification of funds, entail fairly limited reporting requirements and relatively low issuance costs. Private placements are expected to become a viable financing alternative, particularly for mid-size issuers who wish to avoid the distressed market sentiment for publically listed corporate bonds in Germany. For the lower end of the credit spectrum, also made up by the smaller mid market companies, Scope expects the private placement market to be rather unaccessable, with the lack of refinancing opportunities putting further pressure on this segment of the German SME market.

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