Europe's hybrid bonds: issuance to exceed EUR 22bn this year, highest since 2015

Europe's hybrid bond market is on track for its highest annual issuance volume since 2015 after a slow start to the year as issuers have taken advantage of easy financing conditions and strong investor demand in the third quarter.

Companies issued hybrid bonds worth nearly EUR 21.2bn in the first nine months of the year, almost as much as EUR 22.2bn companies issued for the whole of 2018. A burst of activity in the third quarter has spilled over into the current quarter, with large new transactions from first-time hybrid issuers Infineon Technologies and Germany's rail operator Deutsche Bahn, taking year-to-date volumes to more than EUR 24bn.

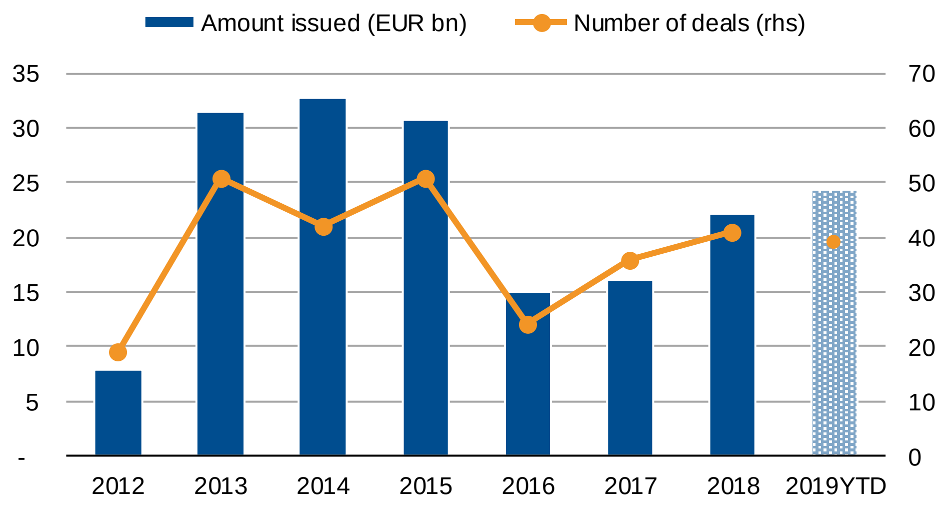
Risk premiums have continued to decline despite the unresolved US-China trade dispute and prolonged uncertainty surrounding Brexit, as central banks have loosened monetary policy in response to signs of more sluggish global economic growth than was expected at the start of the year.

The recent decision by the European Central Bank to resume its bond-buying programme in a continuation of its ultra-loose monetary is likely to provide continued impetus for the hybrid market.

The combination of low, if not negative, interest rates and still buoyant equity markets are powerful incentives for capital-intensive companies to issue hybrid securities – subordinated bonds which blend the characteristics of debt and equity instruments - to diversify their financing mix, refinance maturing hybrid issues and finance recent or planned acquisitions.

The average size of transactions has risen this year compared with 2018. Several companies have raised more than EUR1 billion from single or multiple tranches.

Figure 1: Hybrid debt issuance in Europe in 2019 (year-to-date)



Source: Scope, Bloomberg

Refinancing hybrid bonds due for redemption in the short- to medium-term has continued to be an important source of activity. French telecom company Orange SA issued two hybrid bonds, in April and September, partly to buy back hybrids with upcoming calls in 2021 and 2022.

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Companies keen to preserve borderline BBB investment-grade credit ratings remain the leading issuers, particularly those which have conducted extensive M&A. Merger-related financing is evident in some recent and planned Q4 deals as acquiring companies seek to broaden their financing mix. Tighter credit spreads amid falling sovereign bond yields have also lured new issuers to the hybrid market.

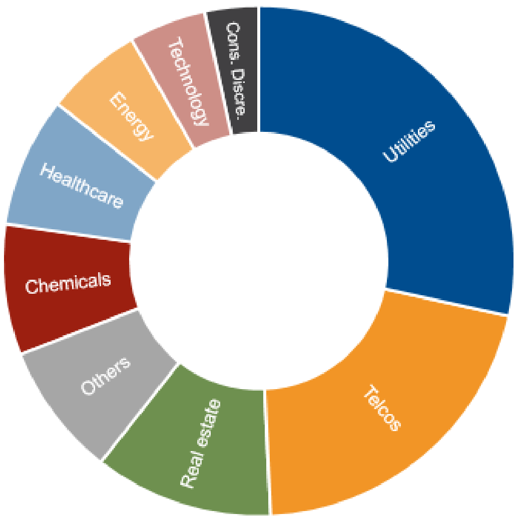
Here is a look at some of the biggest deals so far this year:

- Deutsche Bahn issued its first-ever hybrid on 14 October, in two equal tranches of EUR 1bn.
- Infineon Technologies made its market debut earlier this month, issuing a dual-tranche hybrid for a total value of EUR 1.2bn to partly refinance its proposed USD 8.7bn acquisition of Cypress Semiconductor Corp.
- Vodafone PLC, still digesting its EUR 18.4bn takeover of Liberty Global's European assets, issued a EUR 1.7bn hybrid in April.
- Merck KGaA opted for a EUR 1.5bn dual-tranche issue in June as it financed the USD 6.5bn acquisition of Versum Materials.

Another indication of the maturing of the European market for hybrid bonds is that companies beyond the usual issuers from capital-intensive sectors such as utilities, telecommunications and real estate are tapping the market, such as Infineon.

With the continuation of the ECB's program of quantitative easing, we expect more issuers to tap the hybrid market to benefit from low interest rates contrary to what was expected early in 2019 when issuance volume growth was slowing as many investors were expecting monetary policy to tighten and interest rates to rise.

Figure 2: Hybrid issuance by sectors as of YTD2019



Source: Scope, Bloomberg

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