Corporate 'Schuldschein': M&A activities and first-time issuers driving the market

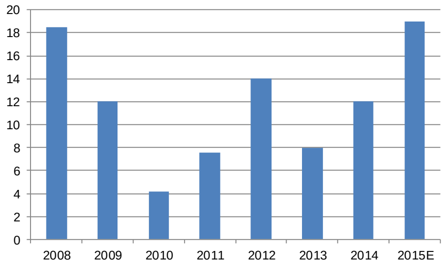
Special comment

The market for German corporate 'Schuldschein' ('CSSD') is thriving, with 2015 marking a new record. According to LBBW Research, total market volume in 2015 reached roughly EUR 19bn[1], outpacing transaction volumes in 2014 by around 60%. While overall volume has strongly been driven by M&A-linked transaction, Scope sees the staggered volumes as a result of the increasing popularity of this alternative debt instrument among new players: i) on the supply side, with over 50% of CSSDs from first-time issuers, ii) on the demand side, with a rising share of international investors, and iii) among transaction banks, which have strengthened their activities in the segment. For 2016 Scope expects an evenly strong demand for CSSD. This will be due to the growing appeal of this lean financing instrument for first-time issuers – also from non-German markets – in addition to previous issuers needing to refinance old CSSDs.

Share of first-time issuers above 50%

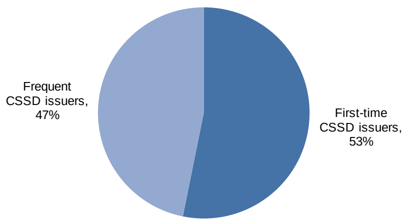
The increasing usage of CSSDs as an alternative corporate financing instrument signals not just the ongoing emancipation from traditional bank financing, but also the financing vehicle's appeal. Scope highlights that the market segment's growth is driven strongly by first-time issuers, representing more than 50% of all new issues in 2015. Particularly, mid- and small-sized corporates, with annual turnovers of below EUR 1bn, represent an increasing share of first-time issuers (over 40% in 2015).

Figure 1: Total volume of CSSD issues (EURbn)



Source: Thomson Reuters 2008-2014, LBBW 2015E Scope Ratings

Figure 2: Split between first-time and frequent CSSD issuers in 2015



Source: Scope Ratings

Increasing internationalisation at all levels

The appeal of CSSDs is underpinned by the regular oversubscription of order books for new offerings. Moreover, Scope recognises an increasing establishment of this instrument among non-German issuers and investors. While this is the result of the CSSD's compelling advantages, this can also be attributed to the increasing transaction activities among non-German investment banks.

Outlook 2016

The EUR 625m CSSD issue of HeidelbergCement AG already gave a good impression about the market sentiment in 2016. While it is difficult to forecast placement volumes for the market as the total volume is often driven by jumbo – partially M&A-driven – transactions, Scope believes the market segment will remain in good shape. In Scope's view, volumes will again be stimulated by activities of mid-sized, first-time issuers, as well as by issuers returning to the market which seek to refinance the maturing five-year and seven-year CSSD tranches which had been issued in 2009 and 2011 respectively.

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[1] While the market is not very transparent, Scope has compiled data of 79 CSSD transactions totaling EUR 15.7bn in 2015 from publicly available information, which represents more than 80% of the total market volume.

Increasing internationalisation: issuers, investors and transaction banks

Segment increasingly established, not only in times of lack of traditional debt financing…

Contrary to the large CSSD volume of EUR 18.5m in 2008, which was driven by the lack of conventional, corporate debt financing through bank loans or bonds during the credit crunch, Scope believes the CSSD's current momentum is due to continued establishment of the debt instrument among potential issuers. The new record volume of this German private debt placement market is also outstanding compared to the relatively low volumes of the Euro-PP segment, assumed to have placed only EUR 4bn in 2015.

… but also among non-German issuers

While the designated European segment for private debt placements remains primarily exploited by French, and a few Italian, corporates, the CSSD continues to enjoy strong momentum among non-German issuers. According to Scope's data sample for 2015, almost 30% of issued CSSD loans were placed by non-German corporates, with those from Austria and France leading the pack.

Rising market penetration of non-German DCM desks

Scope believes this trend is due not only to higher attention from non-German investors, but also the rising activities of non-German DCM desks and the hunt for yield of institutional investors. Whereas the CSSD arena has traditionally been dominated by German regional state banks (Landesbanken) such as BayernLB, LBBW, Helaba or NordLB, with savings and co-operative banks (Sparkassen and Volksbanken) as primary investors, non-German banks such as BNP Paribas, HSBC and Unicredit are increasing the competition against old incumbents. However, Scope believes that due to the large pool of potential CSSD candidates, competition for new mandates is still fairly relaxed.

Oversubscription: high excess demand in the traditionally quality segment may weaken transparency

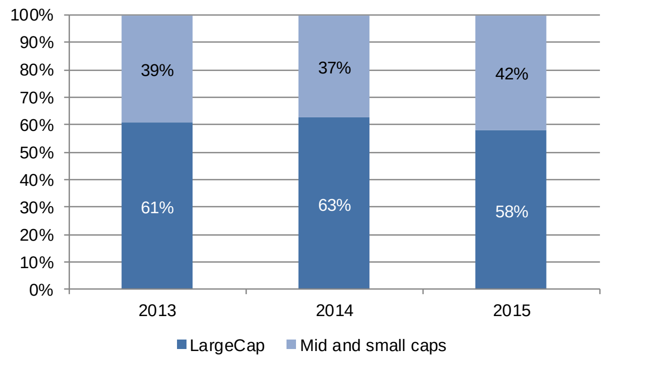
These new players naturally entail access to additional investor groups. Along with the internationalisation of issuers and transaction banks, Scope observes a growing base of institutional investors seeking CSSD exposure. However, the resulting excess demand not only results in the regular top-up of initial ticket sizes and a persisting squeeze of margins, but may also weaken the transparency in the sector.

Everybody wants CSSD, despite restricted transparency

Roughly three-quarters of issuers remain publicly unrated

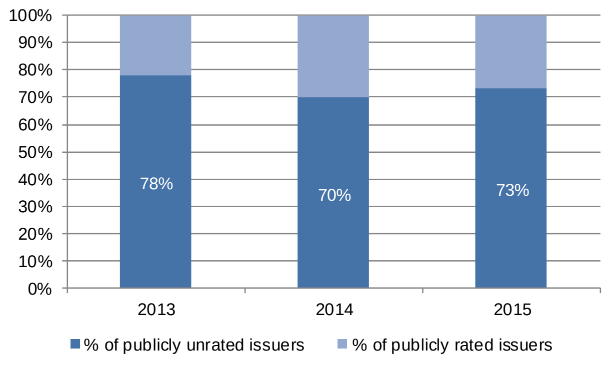
Scope notes that in the past, companies needed a first-class rating to issue CSSDs. Now, with the ever-increasing share of mid- and small-sized corporates[2] entering the market (over 40% in 2015), transparency on credit quality has declined, as smaller, and often non-public, issuers generally provide less credit insight. Scope highlights that roughly three-quarters of active issuers in the market remain publicly unrated.

Figure 3: Increasing share of mid-sized issuers



Source: Scope Ratings

Figure 4: Share of publicly unrated issuers remains high



Source: Scope Ratings

[2] Scope defines small and mid-sized corporates as companies with an annual turnover of less than EUR 1bn.

Even in the quality segment, issues need diligent scrutiny

Scope recognises that the lack of transparency surely offers some pick-up of spreads compared to the rated market. Even so, Scope highlights that investors should be aware of the credit quality they buy into. Relying solely on the internal ratings of transaction banks could be dangerous due to the potential conflicts of interests. While in many industries corporate size is not an essential credit driver per se, investors are advised to diligently scrutinise the credit quality of CSSD issuers. The simple product type 'CSSD' does not automatically guarantee investment exposure to an investment-grade name. (please see Scope's research on the credit quality of publicly unrated CSSD issuers from June 2015 – German market for corporate 'Schuldschein' opens up to non-investment grade issuers).

Outlook 2016

Market to remain in good shape

While it is difficult to forecast placement volumes for the market as the total volume is often driven by jumbo – partially M&A-driven – transactions, Scope believes the market segment will remain in good shape. The transaction pipeline of DCM desks appears to be fully loaded. Scope believes volumes will again be stimulated not only by activities of mid-sized, first-time issuers, but also by issuers returning to the market to refinance maturing five-year and seven-year tranches of CSSDs issued in 2009 and 2011 respectively.

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