Many a little makes a mickle
Schuldschein debt issuance rebounds after nervous first quarter

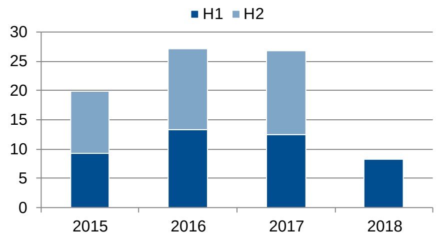
The Schuldschein ('SSD') private-debt market is recovering from a jittery first quarter, with accelerating issuance headed for nearly EUR 20bn this year, helped by a tighter focus on credit quality of issuers, fintech platforms and Nordic placements, says Scope Ratings. The market rebounded in the second quarter. There were at least 50 transactions, taking issuance to more than EUR 8bn in H1 2018, albeit well below levels in the same period in recent years which reflected a meagre first three months of the year when financial troubles at SSD issuers Carillion and Steinhoff weighed on sentiment. Another 25 predominantly small ticket transactions are in the pipeline and set close before the summer break which is an indication of the market's underlying health.

Overall credit quality of issuers in the segment remains solid, partially reflecting the more discerning approach from investors and arrangers after the collapse of Carillion, a UK construction firm, and the generally more volatile performance of financial markets so far this year.

Strong momentum of SMEs and small ticket transactions

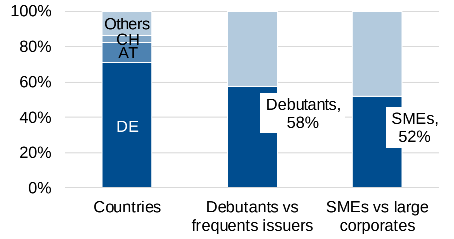
While the placement volume of SSD debt in the first half of 2018 fell 30% short of the volume Scope tracked in H1 2017, the market accelerated during Q2. The deal pipeline is filling out for Q3 2018, primarily through fund raising by small or medium-sized enterprises (SMEs) which already contributed more than half of executed deals during H1 2018. Small-ticket transactions with a median ticket size of EUR 90m have dominated issuance. The trend partially reflects growing use of debt-placement platforms for small volume transactions as an alternative to bank financing.

Figure 1: SSD placements (EUR bn)



Source: Bloomberg, Scope

Figure 2: Structural features in H1 2018



Source: Scope

Investors back in the driver's seat?

Turbulence in bond markets in Europe this year, related in part to political uncertainties in Italy, Spain and Germany, have strengthened the private debt segment, from Scope~s perspective. At the same time, the credit quality of Schuldschein issuers seems to have improved on average. The experience of Carillion and Steinhoff chastened investors, hence a number of cancellations (e.g Adva, Ledvance, Austriacard), more frequent inclusion of covenants in addition to pricings at the upper end of the pricing range or even adjustments to the proposed pricing, as in the case of Telefonica, VW Immobilien and Jost Werke.

Outlook: Scope sticks to EUR 20bn forecast for 2018

Scope reiterates its expectations of around EUR 20bn in placed SSD debt in 2018. It would require a handful of big ticket transactions above the EUR 500m for the market to significantly exceed such a level. We believe that the market will gather new momentum with a pick-up in non-German/Austrian deals and the fresh stimulus provided by digital platforms which make arranging SSD placements quicker and cheaper, though attention needs to be paid to associated risks.

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Schuldschein goes digital

Strong momentum for platforms

Several new Schuldschein deals arranged via fintech platforms such as credX, vc trade, Debtvision, Synd-X or FinnestPro were a feature of the first half. Such digitalisation implies the full arrangement of the deal via the platform in question, including negotiation between arranger and issuer, marketing of the deals among a group of investors and deal allocation to investors. Prominent large Schuldschein issuers such as Deutsche Telekom, Grenke and utilities Entega and Verbund have successfully tapped the market using digital platforms. Other deals via such platforms from a mixed group of companies including apparel maker Puma, agricultural trading and services firm Baywa and Falkensteiner Michaeler Tourism Group (rated B/Stable by Scope) should close before the summer break.

Digitalisation to provide stimulus to SME lending

Scope believes that the increasing role of fintech platforms could lead to an additional stimulus for the SSD segment:

- First, the digitalisation of a SSD transaction can save time and money, an advantage particularly for small deal sizes. Austrian utility Verbund claimed it shortened its marketing period by two weeks and saved around 40% of transaction costs for its EUR 100m SSD issue placed by vc trade compared with a non-digitalised transaction. From Scope's perspective, this could well be a trigger for more, smaller ticket sizes of EUR 50m and below which would typically be issued by SMEs.

- Secondly, a greater audience of investors, particularly outside of Europe, could be addressed through the subscription on such platforms. This could provide another stimulus for European corporates, particularly SMEs, which could broaden their funding sourcing to investors outside the market where they are well known.

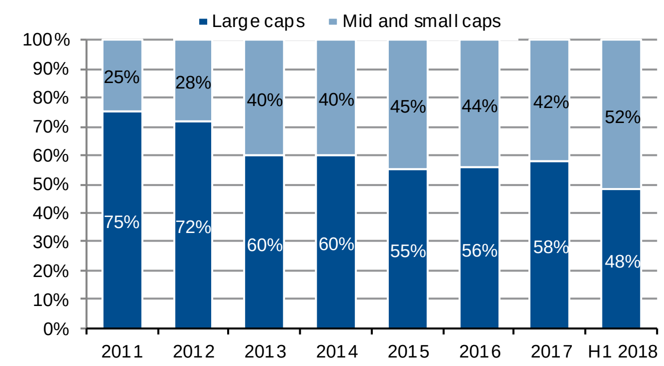
A note of caution: In case issuers want to place debt on their own via a platform, investors need to become even more diligent in their credit analysis, particularly when less well-known issuers intend to use a digital platform.

SMEs dominating the market

More than 50% issued by SMEs

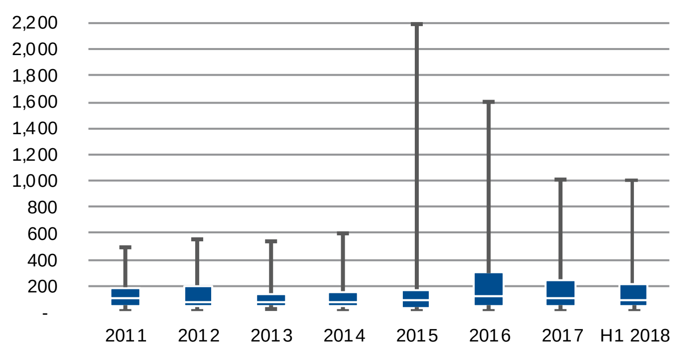
Scope notes that for the first time more than half of SSD deals have been launched by corporates which are classified as SMEs by Scope (annual revenue of less than EUR 1bn). With the prevalence of smaller companies, it is no surprise that the average volume of new transactions has fallen, with a median ticket size of less than EUR 100m and around a quarter of deals at EUR 50m and lower.

Figure 3: SMEs vs large caps (measured in number of transactions)



Source: Scope

Figure 4: Range of ticket sizes in EUR m (box plots)



Source: Scope

SSD roll-out to Nordics?

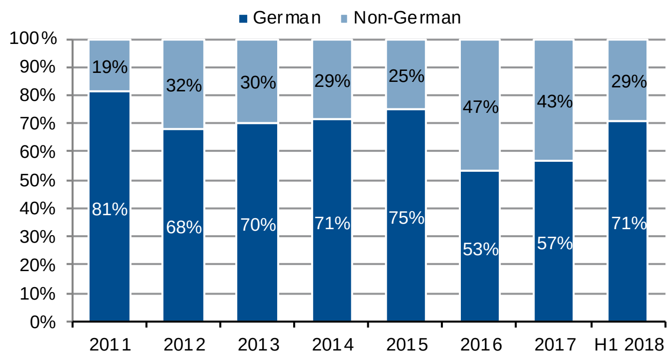
H1 2018 dominated by German issuers

Scope notes that non-German SSD transactions have been scarce this year. While non-German deals accounted for roughly 30% of deals in H1 2018, one feature was a number of first-time issues from Nordic companies including Finnish conglomerate Wihuri, Danish Agro, and Danish Crown. Nordic banks SEB, Danske and Nordea also emerged as new SSD arrangers. More Nordic deals are in the pipeline for Q3 2018 such as another placement for NAC Aviation and a debut issue from Finnish shipbuilder Meyer Turku.

Scandinavia offers a decent amount of appropriate SSD issuers

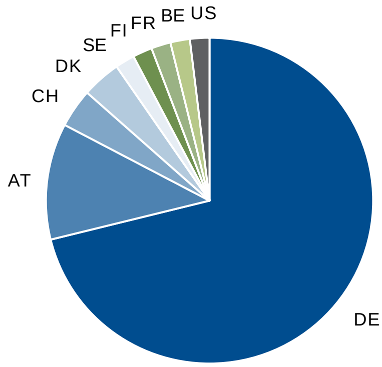
Nordic companies are no strangers to non-bank borrowing, but the SSD segment has attracted few issuers in the past, with just around 10 different issuers over the past 10 years. Scope believes that the Nordic region offers a wide array of companies with credit profiles suited to SSD issuance, so 2018 could prove to be the start of a longer-term trend.

Figure 5: Domestic versus international SSD issuers (measured in number of transactions)



Source: Scope

Figure 6: H1 2018 split of SSD transactions (measured in number of transactions)



Source: Scope

Average coupon indicates BBB-/BBB credit quality of issuers

Median pricing at stable level

Scope reiterates that there have not 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 ten years. In fact, despite the shaky market environment coupon increases of IG-rated issuers of public bonds and the preponderance of SMEs which usually command a high risk premium, the median spread above the reference rate for a 5-year tranche remained at a low 100 bps (derived from a sample of 36 transactions in H1 2018) – comparable to issues in H2 2017, but still lower than in H1 2017 (118 bps).

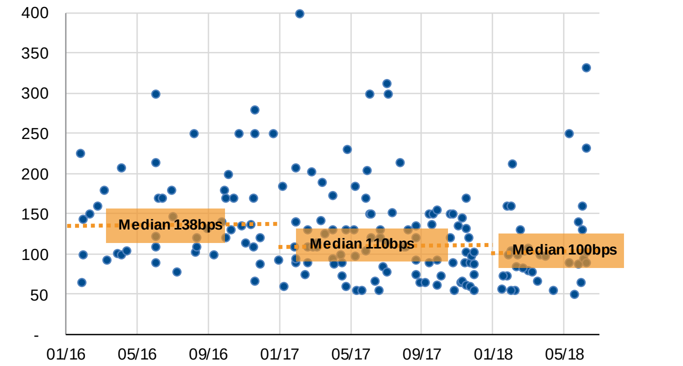
Such low spread compares with an average credit quality of BBB-/BBB when compared to public bond issues in H1 2018. From Scope's perspective, the continuously low average pricing could reflect two different trends:

- Predominance of German issuers which historically pay lower spreads than non-German SSD issuers;
- Improved average credit quality among new issuers or less companies with much weaker than average credit quality of new companies coming to the market.

Median leverage in crossover territory

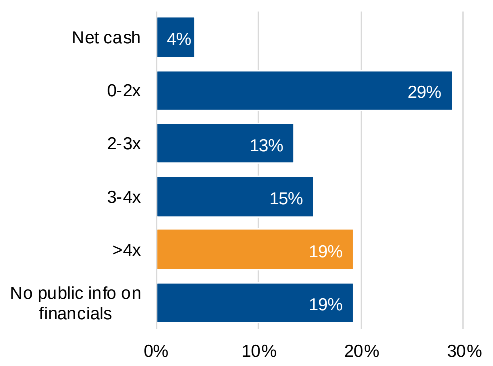
To test the second idea, Scope has had a deeper look at the issuer's leverage[1] in the business year ahead of the SSD placement[2]. Median leverage among over 40 issuers, for which financial data is publicly available, stands at 2.7x which indicates a financial risk profile in the crossover credit-rating area. While this is similar to the median leverage of 2.7x among over 60 issuers during H1 2017 when Scope did this exercise, Scope recognises that the proportion of highly-indebted corporates with a leverage of more than 4.0x has been reduced remarkably (see also Scope's research 'Has pricing reached the floor?').

Figure 7: Spreads above reference rate of 5Y-tranches of SSD (in bps)



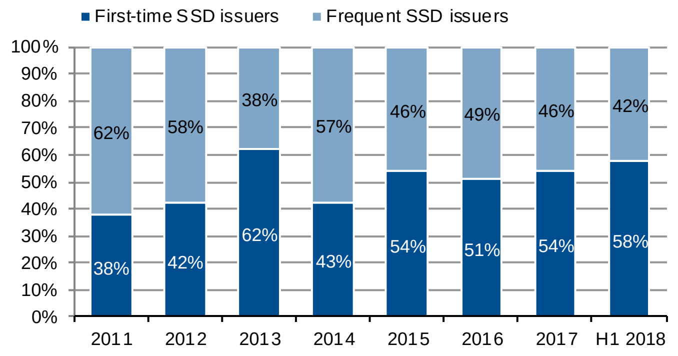
Source: Bloomberg, Scope

Figure 8: LTM Adjusted debt/EBITDA of SSD issuers in H1 2018



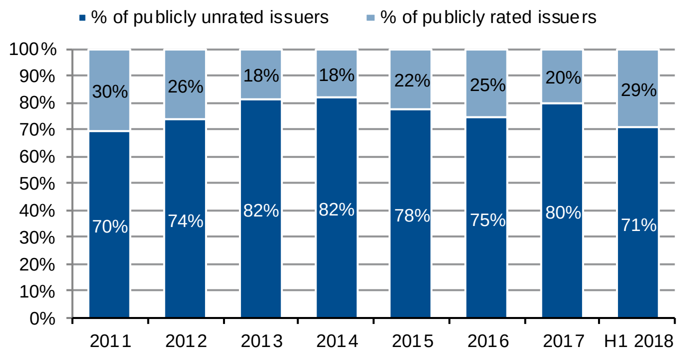
Source: Companies' latest annual reports, Scope

Figure 9: Frequent issuers vs. market debutants (measured in number of transactions)



Source: Scope

Figure 10: Share of publicly non-rated issuers (measured in number of transactions)



Source: Scope

[1] Leverage as measured by the companies' Adjusted net debt dividend by adjusted EBITDA. Adjustments primarily relate to unrestricted cash, pension provisions and off-balance sheet operated leases.

[2] In order to partially assess the SSD issuers' credit quality with regard to their financial risk profiles, Scope has compiled the balance sheet data for more 40 corporates which have closed an SSD during H1 2018 (more than 80% of issuers). Financial data refers to either the issuing company or the ultimate parent company which is likely to guarantee the debt issued by the subsidiary. Leverage data refers to the latest available balance sheet date, which was mainly 2017 but, in some cases, is still 2016. Lacking financial data for the remaining SSD issuers was mainly related to limited partnership corporates ('Kommanditgesellschaften'), classified as SMEs.

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