Helaba

CREDIT SPECIAL

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Corporate Schuldschein loans – A growth market with sound credit quality

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Over the last few months, the corporate Schuldschein market has once again achieved sound growth rates and continues to attract a large number of new issuers from Germany and abroad. The Schuldschein loan (SSD) is especially popular among small and medium-sized companies due to the comparatively low level of complexity in terms of structuring and documentation requirements. For this reason, most issuers are still not rated by external agencies.

Our analysis demonstrates that SSD issuers without an external rating are in no way inferior in terms of their creditworthiness compared to rated issuers. Moreover, their credit profiles have proven to be relatively stable in the years following a successful placement. In addition, increased activity by non-German companies has so far not had any impact on the sound credit quality of the Schuldschein market. Normally, non-domestic issuers have even better financial profiles than their German counterparts. Overall, our analysis shows that the boom in recent years has not resulted in any significant deterioration in credit profiles on the SSD market yet. In our view, the segment should continue to provide equally solid investment opportunities for investors in the future.

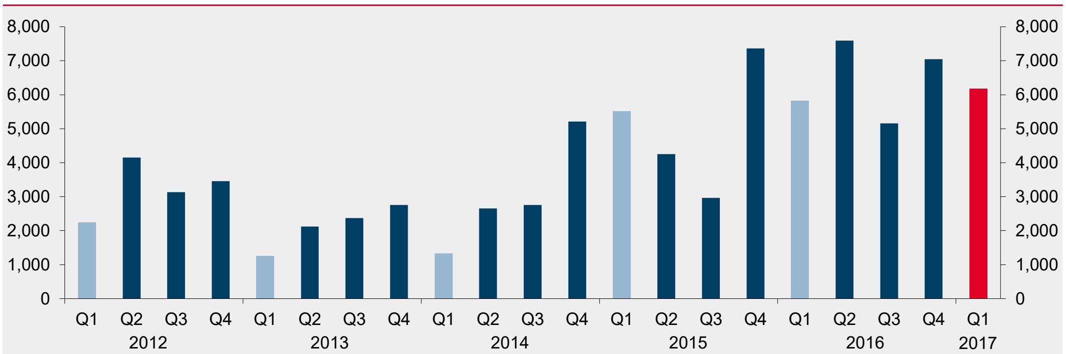
At the same time, however, the growing number of new and as yet less familiar issuers, for whom less detailed financial information is publicly available in many cases, poses additional challenges to interested investors. The need to make investment-related information available in a compressed format that can be processed quickly may well mean that external ratings will gain in importance in the future. With respect to timescale and financial considerations, however, we believe that companies seeking capital will continue to find it more attractive to mainly partner with an experienced and competent bank that can also act as an information intermediary.

SSD rally powers ahead into 2017

With a placement volume of around EUR 6.2 billion, the corporate SSD market achieved its best-ever first quarter in the first three months of 2017. The rapid growth has continued into the second quarter, with a relatively large number of transactions still in the marketing stage. Since refinancing rates remain low and investor demand buoyant, we see a good chance that issuance volume in the segment will hit a new record high in 2017.

As market continues to grow, creditworthiness shifts into focus of investors

Issuance activity by volume (in EUR millions)



Source: Helaba Research

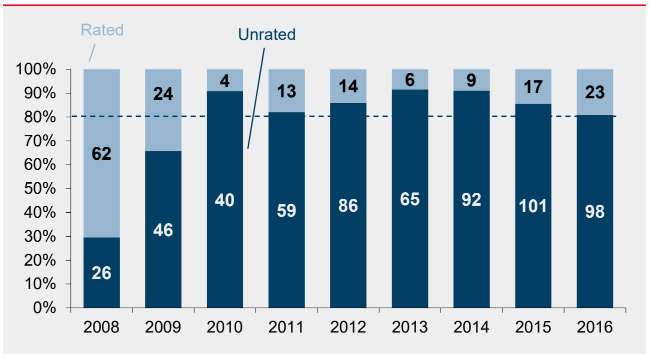
Issuers without external ratings dominate market activity

Unrated issuers dominate the market

In contrast to the corporate bond segment, the SSD market is traditionally a market for unrated companies. In 2016, when Schuldschein transactions reached a record volume of more than EUR 25 billion, 98 issues or 80 % of the total market volume originated from companies that were not rated by an external agency. The only exception was in 2008, when rated issuers gained the upper hand. In our opinion, however, this was mainly due to the challenging market conditions in the euro-denominated bond segment, which encouraged some major issuers to cover a larger proportion of their funding requirement on the SSD market. In all other years, though, unrated borrowers dominated the market.

Rated transactions still in a minority, …

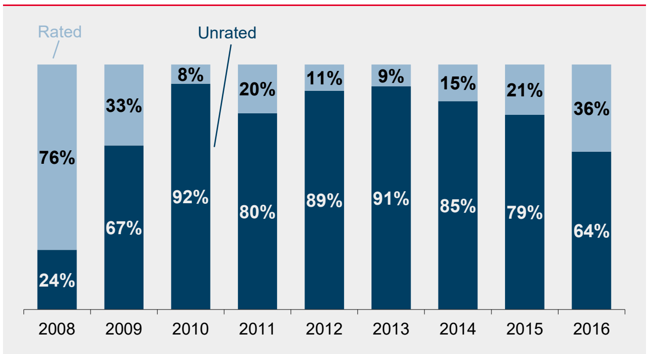
% of placements



Sources: Bloomberg, Helaba Research

… but ensure a slightly higher volume

% of issuance volume



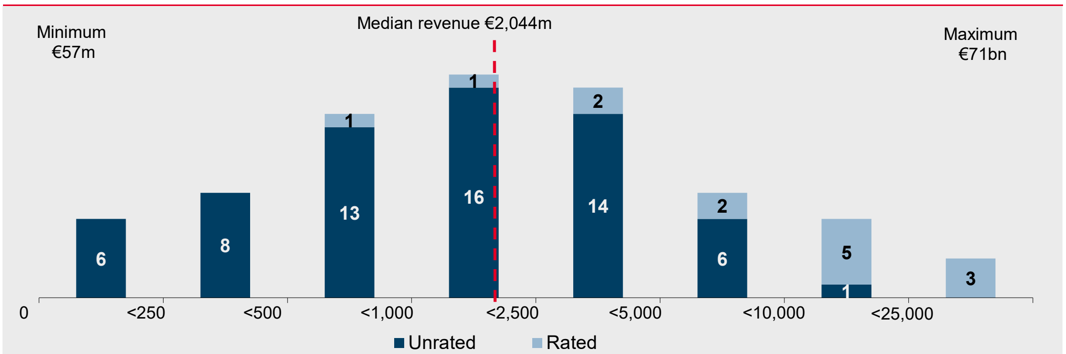
Sources: Bloomberg, Helaba Research

Attractive source of funding for small and mid-sized issuers

The main reason for the predominance of unrated companies can be attributed to the issuer structure of the market. The majority of companies placing SSDs are small and mid-sized firms. In the previous financial year, more than half of SSD issuers generated sales of less than EUR 2.5 billion each. Agency ratings, on the other hand, are more typical for large companies with higher funding requirements.

SMEs dominate SSD market

Number of issuers in 2016* (by volume of sales, EUR millions)



*based on publicly available financial statements (around 80% of SSD universe 2016)

Sources: Bloomberg, Helaba Research

Comparatively low documentation requirements a significant advantage

In our view, the attractiveness of this instrument for small and medium-sized enterprises is related, in particular, to the typical characteristics of Schuldschein loans. For instance, SSDs can be placed on the market with comparatively small loan amounts. Furthermore, the documentation requirements are relatively limited. This ensures that the transaction is faster as well as less complex and that the financial expense is kept to a minimum.

Good creditworthiness even without an external rating

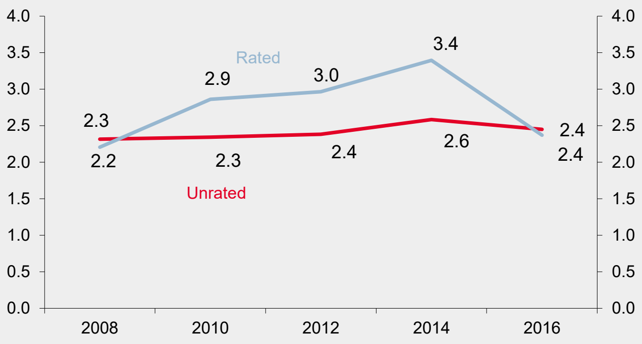
In view of the large number of unrated companies, the question arises as to how to assess their creditworthiness in comparison to companies with an external rating score. In addition, the overall effect of the dynamic growth in placement volume on the credit profile of the SSD market remains to be seen.

Leverage ratio of unrated companies has only risen slightly

For this reason, we calculated the most important credit metrics[1] of net debt / EDITDA, cash flow from operations (CFO) / net debt as well as the equity ratios of companies issuing SSDs in 2008, 2010, 2012, 2014 and 2016. A comparison of earnings-based leverage ratios alone shows that unrated companies scored well. From 2010 to 2014, the median values of the ratio of net debt / EDITDA for unrated companies that we calculated were significantly below those of the rated segment. Furthermore, despite the large number of new issuers, there was no perceptible trend towards higher leverage ratios over the previous ten years. The ratio of net debt / EBITDA, for example, only rose from 2.3x to 2.4x for unrated companies.

Unrated firms with stable debt levels ...

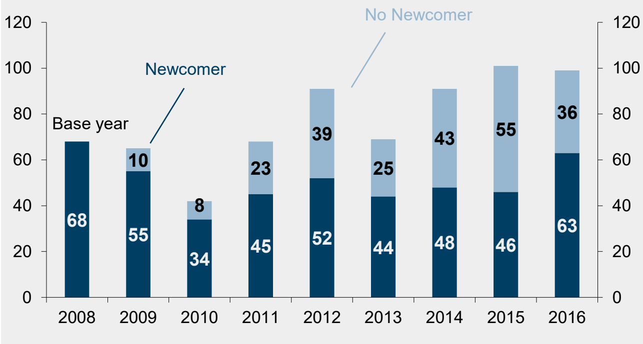
Adj. net debt / EBITDA (median values, x-times)



Sources: Bloomberg, Helaba Research

… despite persistently high number of newcomers

Number of debut and established issuers



Source: Helaba Research

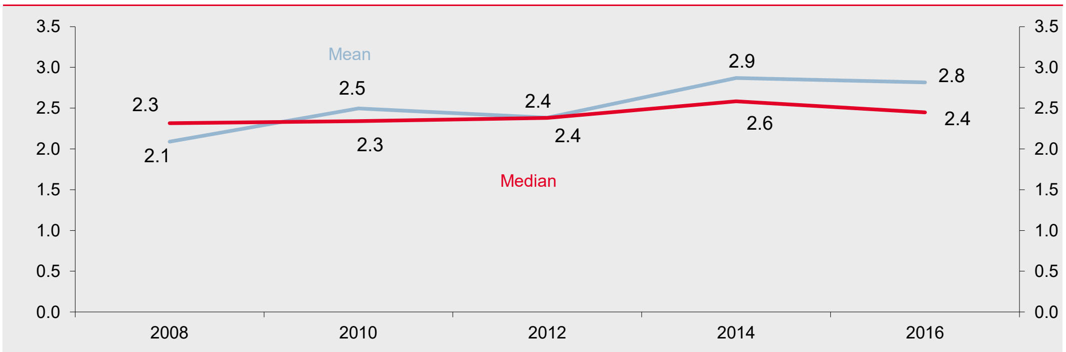
Recent debt levels show minor increase, …

Gap between median and average leverage levels in 2014 and 2016

However, the booming SSD market has also attracted some more highly leveraged companies over the last few years. For instance, in the case of unrated companies, the mean value for net debt / EBITDA has noticeably risen since 2008 in contrast to the statistically less skewed median. This is primarily related to the fact that there were more issuers with a leverage ratio of 3-5x EBITDA tapping the market. While they accounted for a share of 20 % in 2012, most recently as many as a third of companies had a leverage ratio in this range. Nevertheless, a similar development was also observable among issuers with an external rating score.

Rising gap between median and mean values

Adj. net debt / EBITDA (unrated issuers, x-times)



Sources: Bloomberg, Helaba Research

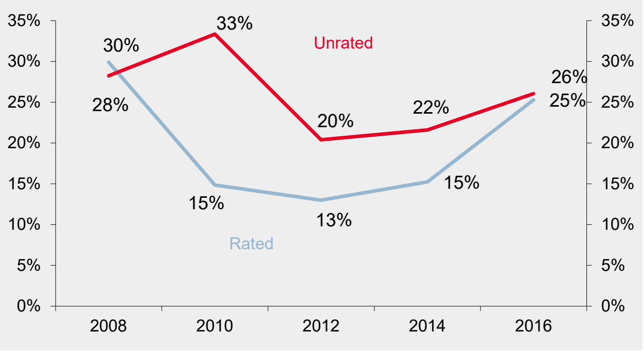
[1] Primarily adjusted for pensions and operating lease obligations

… but no erosion in creditworthiness discernible

The remaining credit metrics that we calculated, however, underline the fact that SSD issuers without an external rating compare well to rated companies in terms of their creditworthiness. For instance, the adjusted credit metric of cash flow from operations / net debt never fell below a median of 20 % in the case of issuers without an agency rating. What is more, it exhibited less volatility than the rated segment and has improved over the last few years. Recently, equity ratios have also been increasing and were always above 30 % in the group of unrated issuers.

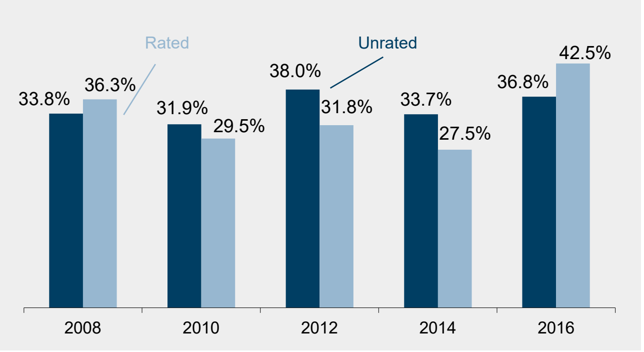
Overall, despite the strong growth on the primary SSD market, we have not discerned any erosion in creditworthiness. Rather, the most important credit metrics have generally tended to show an improvement in recent years and are still on a sound level.

Improved cash flow-based metrics and …
Adj. cash flow from operations / net dent (median values)



Sources: Bloomberg, Helaba Research

… more stable equity ratios in unrated segment
Equity ratio (median values)



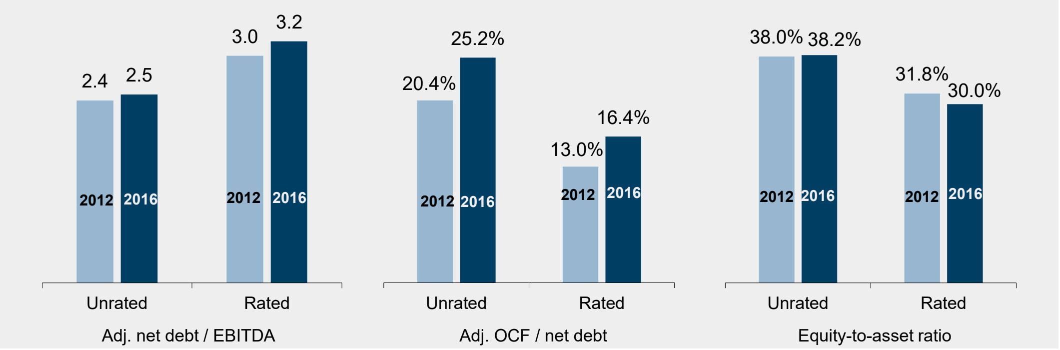
Sources: Bloomberg, Helaba Research

Credit profiles remain healthy even after issuance

No evidence of deterioration in creditworthiness in years after issuance

Moreover, it appears to be the case that the creditworthiness of SSD issuers remains relatively stable, even in the years after placement. We calculated median credit metrics for the comparatively large population of issuers in 2012, both for the year of issuance and four years later. Although this showed a rise in the case of earnings-based leverage ratios of companies with and without an external rating, the cash flow-based metrics registered an improvement in the same period. Capital backing proved to be relatively stable, especially of unrated companies. Overall, our assessment shows that credit profiles in the unrated market segment developed more favourably than in the rated segment.

Medium-term development in credit metrics points to stable trend in credit profiles
Population: SSD issuers 2012



Sources: Bloomberg, Helaba Research

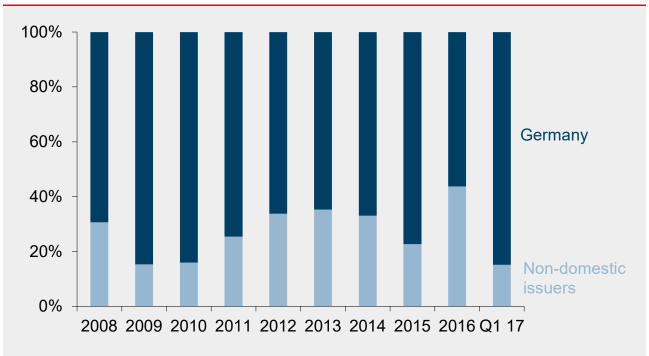
Non-German companies accounted for 40 % of issuance in 2016 for first time

Non-German issuers with growing market shares …

Non-domestic companies have gained significant market share over the last few years. In 2016, almost half of issuers were non-German companies. Moreover, for the first time they accounted for a share of issuance volume of more than 40 %. In the first quarter of the current fiscal year, market volume declined considerably. However, at this time a large number of new SSDs from abroad were still in the marketing stage. That is why we anticipate that non-German issuers will have a strong market presence in 2017, as well. Thus, the trend towards the internationalisation of the Schuldschein market continues unabated. This raises the question as to whether non-German companies have different credit quality structures than domestic issuers.

Share of domestic issuers declining

Issuance activity by country of origin (volume)



Source: Helaba Research

Non-Domestics with higher average sales volumes

Sales (median values in EUR millions)

Sources: Bloomberg, Helaba Research

… and frequently better credit profiles

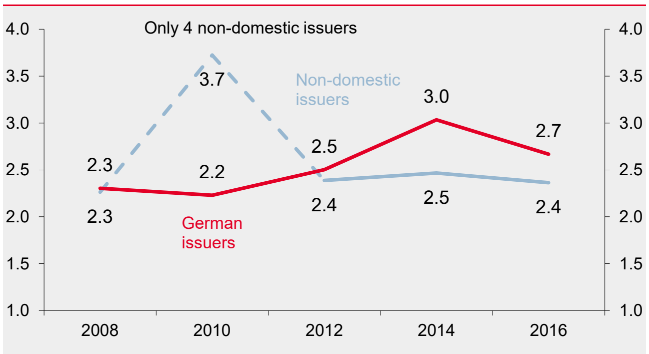
Net debt / EBITDA of foreign issuers on lower level

In the years that we analysed since 2008, it is apparent that non-German SSD issuers regularly have stronger credit metrics than their German counterparts. Median values for the frequently used ratio of net debt / EBITDA mostly hovered within a range of 2.3x to 2.5x in this period and were thus below the level of German issuers. In the exceptional year of 2010, this credit metric rose substantially; however, this figure is only based on four non-domestic issues and, in our view, allows for limited comparisons at best.

The remaining credit metrics that we calculated – cash flow from operations / net debt and equity ratio – serve to underline, in our opinion, the comparatively sound financial profiles of non-German issuers. For instance, with the exception of 2010, non-domestic issuers' internal financing strength was always above that of domestic issuers. Furthermore, capital backing was considerably better in every year. However, the fact that most non-domestic issuers active on the SSD market have so far displayed better credit profiles is probably due to a certain amount of scepticism on the part of investors towards new issuers.

Non-German issuers with lower leverage …

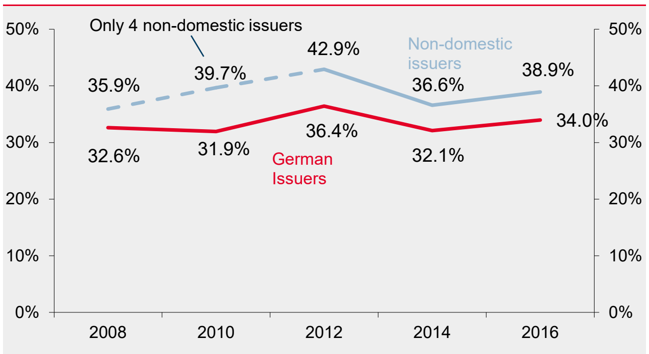
Adj. net debt / EBITDA (median values, x-times)



Sources: Bloomberg, Helaba Research

… and very solid capital backing

Equity ratio (median values)



Sources: Bloomberg, Helaba Research

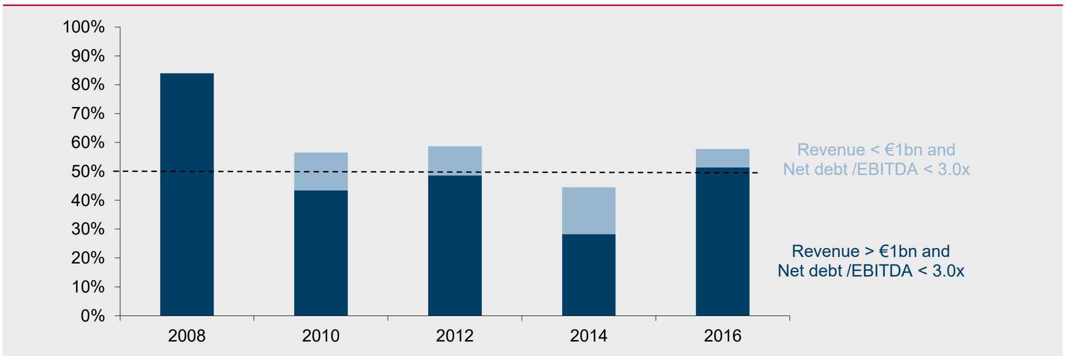
SSD market continues to offer good investment quality

No widespread trend towards worse credit qualities

On the whole, our analysis demonstrates that the boom experienced in recent years has not resulted in any noticeable deterioration in credit quality on the Schuldschein market. In particular, in the market segment of issuers without agency ratings, credit metrics have proven to be relatively stable and were not in any way worse than those of rated issuers. In addition, far from having riskier credit profiles, the rapidly expanding group of non-German issuers tend to stand out with somewhat stronger credit metrics. In our view, the segment should continue to provide equally solid investment opportunities for investors in the future.

Broad range of solid issuers

New issues by investment quality, volume placed in %



Sources: Bloomberg, Helaba Research

Arranging banks more in demand as information intermediaries

Having said that, the growing number of new and as yet less familiar issuers, for whom less detailed financial information is publicly available in many cases, poses additional challenges to interested investors. The need to make investment-related information available in a compressed format that can be processed quickly may well mean that external ratings will gain in importance in the future. With respect to timescale and financial considerations, however, we believe that companies seeking capital will continue to find it more attractive, to mainly partner with an experienced and competent bank that can also act as an information intermediary. ■