

Focus on: Credits 12 October 2023



Corporate Schuldschein: Prejudices are out of place

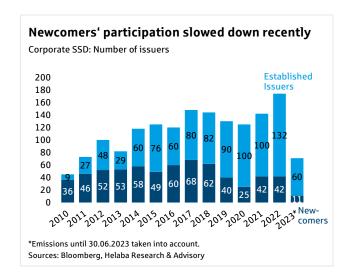


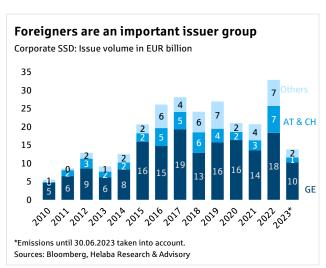
Ulrich Kirschner, CFA Senior Analyst T 069/91 32-28 39

The Schuldschein market has attracted an increasing number of new entrants in recent years. In particular, the growing number of non-German issuers has been an important driver of the market. Recently, however, the dynamic development of issuance in this segment has come to a halt. One of the main reasons for this may have been the difficulties experienced by the French nursing home operator Orpea. The question on many investors' minds is this: Have too many new issuers with weaker credit profiles entered the market in recent years, and have foreign companies in particular led to a dilution of the previously solid credits in the segment? Our analysis shows that there has been no structural deterioration in credit quality in the Schuldschein market to date. On the

contrary, the segment continues to offer investors a broad selection of companies with financial structures that are adequate for investment grade. This is particularly true for foreign issuers and newcomers. Nevertheless, careful credit analysis remains an indispensable part of the investment process.

In recent years, the number of companies active in the Schuldschein market has increased significantly. There has also been a clear growth in volumes. Newcomers to the Schuldschein market have contributed to this development, accounting for almost a quarter of the placing companies last year. In particular, companies from outside Germany flocked to the market. Thanks to a record volume of more than EUR 14 billion, their share was just under 45 %. However, the restructuring of Schuldschein Frequent Borrower Orpea has recently made many investors cautious. As a result, the new issuer ratio fell to 15 % in the first half of 2023, its lowest level to date. The volume placed by foreign companies fell to around 25 % at EUR 3.6bn. In addition, no French address has yet dared to enter the market with a public transaction.

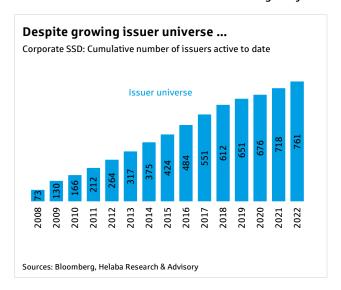


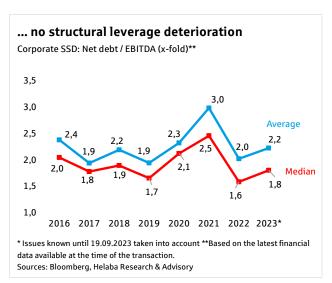


Leverage ratio - a key indicator of credit quality

We have examined whether the current increased investor caution towards the above issuer groups can be objectively justified by structural changes in the credit quality structure in the Schuldschein market. As the vast majority of Schuldschein issuers do not have a public agency rating and in some cases publish only limited financial information, the evolution of the credit qualities active in the Schuldschein market is not easily observable. We have

therefore used the widely utilized ratio of net debt to EBITDA as a proxy for credit quality and calculated average or median values for the issuers active during the year.

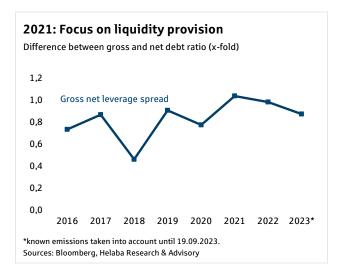




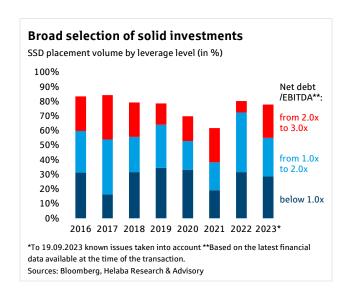
Debt ratios typically in narrow ranges

Since 2008, the median net debt/EBITDA ratio has generally fluctuated between 1.6x and 2.3x. Only in 2021, the

year of the crisis, the ratio was slightly higher at 2.5x, but even then it remained below the critical level of 3x. In that year, the Corona crisis in particular put a lot of pressure on the earnings of many companies. At 14 %, the proportion of issuing companies with a leverage ratio of more than 5.0x was significantly higher than in previous years. Given the uncertain environment, these companies may have been particularly keen to secure their liquidity by raising new funds. The fact that the difference between gross and net leverage reached its highest value in 2021 also shows, in our view, that securing liquidity was one of the main motives for Schuldschein transactions this year: Apparently, some players accepted higher gross leverage in order to maintain more balance sheet liquidity as part of a forward-looking financial policy.



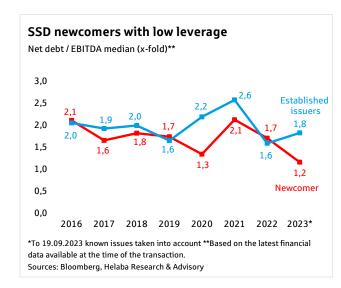
Majority of issuers with investment-grade-adequate debt levels



By 2022, however, issuers' average debt levels had returned to more normal levels after the crisis-induced spike. In addition, the median net debt/EBITDA ratio reached 1.6x, the lowest level on record. In our view, there is no evidence of a broad-based, structural deterioration in credit quality in the Schuldschein market. The vast majority of corporates continue to have robust credit profiles. In 2023, more than 75 % of corporate placements came to market with an investment-grade-adequate debt ratio below 3.0x - a normal level by historical standards. The Schuldschein therefore continues to offer investors a broad selection of corporates with sound financial structures.

Debut issuers also usually convince with good figures

This is particularly true for the newcomers to the Schuldschein market. Since 2016, the median leverage ratios of this subgroup have not been substantially higher than the multiples of the established issuers in any year. In four of the last seven years, debut issuers even had significantly better leverage ratios – including in the crisis years 2020 and 2021. The leverage ratio is currently at a low level of 1.2x. A look at the distribution of issuance volume across different debt categories also underlines the solidity of the segment. More than 90 % of recent issuance by newcomers has been by companies with a leverage ratio of 3.0x or less. This was slightly above the general market average.



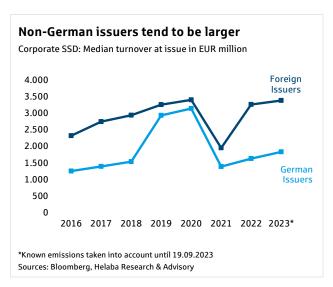


High level of debt also rather unusual for foreign issuers

In the wake of Orpea's restructuring, investors have recently been much more critical of foreign issuers and especially of the otherwise quite active French issuers – an attitude that is difficult to understand given the solid financial profiles of these companies. In contrast, the French nursing home operator has had very high leverage relative to the overall market in all of its years as an active Schuldschein issuer (2012 to 2022). On average, the ratio of net

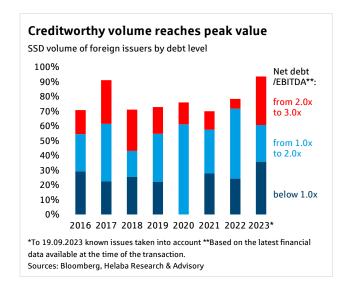
debt to EBITDA, including all loan liabilities, was more than 8.0x during this period, which is usually a clear indication of a sub-investment grade credit quality with a correspondingly higher probability of default. Such a high level of debt is by no means common for foreign or French issuers of Schuldscheindarlehen.

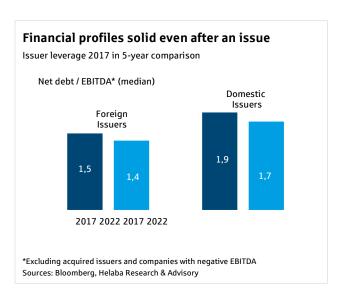




Blanket caution against foreign issuers unfounded

The median leverage ratio of all foreign issuers has in most recent years been even lower than that of German companies, despite the fact that they tend to be larger and therefore offer their investors a better business profile. In the current year, the median leverage ratio of foreign companies is 1.2x. This is the lowest level so far, although the ratio has already risen somewhat compared with the first few months of the year. Obviously, under the impression of market uncertainty in recent months, those companies whose above-average financial profiles enabled a smooth transaction process ventured into the market. Overall, more than 90% of the foreign issuance so far has offered net debt ratios of 3.0x or less. In addition, the issuers have very solid credit ratings beyond the transaction date. We looked at the dynamic leverage ratio over time for the 125 issuers that came to market in 2017. Result: Both the foreign and domestic issuer group had a lower median net leverage ratio after 5 years than at the time of issuance. At 1.4x, the net debt/EBITDA ratio of foreign issuers was also significantly lower than that of domestic companies.





Newcomers and foreign issuers offer even broader selection of solid addresses

It has been shown that domestic and foreign newcomers to the market tend to have similar or even better credit quality than the total universe of SSD issuers. A purely origin-based differentiation in risk assessment is therefore not very useful. The best method of assessing investment risk remains case-by-case credit analysis.



Here you can subscribe to our newsletter: https://news.helaba.de/research/

Publisher and editorial office

Helaba Research & Advisory Editorial: Stefan Rausch Responsible: Dr. Gertrud R. Traud Chief Economist/ Head of Research & Advisory Neue Mainzer Str. 52-58 60311 Frankfurt am Main T +49 69 / 91 32 - 2024

Internet: www.helaba.com

Disclaimer

This publication has been prepared with the utmost care. However, it contains only non-binding analyses and forecasts of current and future market conditions. The information is based on sources that we consider reliable, but for whose accuracy, completeness or timeliness we cannot assume any liability. All statements made in this publication are for information purposes only. They must not be understood as an offer or recommendation for investment decisions.