Helaba

Focus on: Credit
24 July 2024

Hybrid bonds:
Funding joker for the green transformation



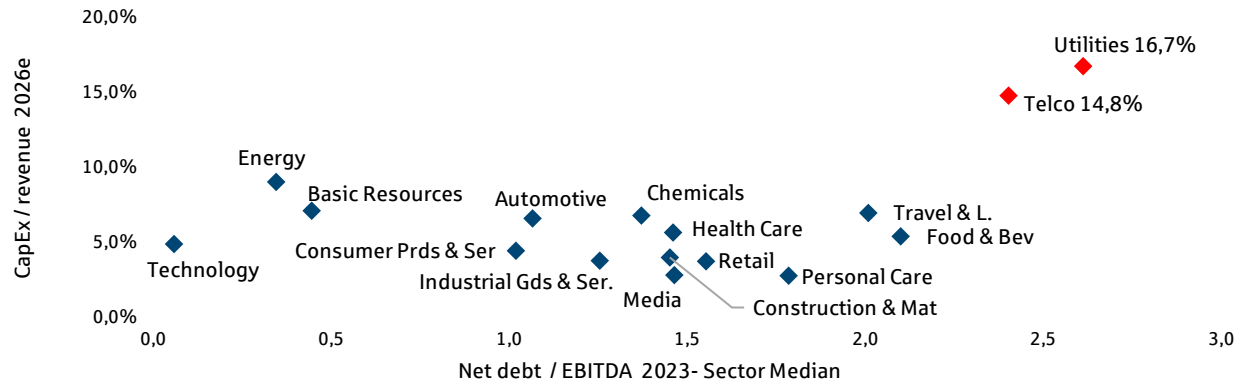
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The green transformation of the economy means that many companies will have to make substantial investments. Particularly in capital-intensive sectors such as telecommunications and utilities, the question is how to finance these expenditures in the future without overstretching debt ratios. In our view, issuing hybrid capital is an effective solution. Especially as the instrument can be excellently structured as a dedicated green bond. The timing also seems favourable at present, given the significant decline in funding costs and the improved pricing compared to alternative forms of funding.

In addition to digitalisation and measures to diversify supply chains, the transformation of the economy towards climate-friendly production will ensure that many companies' capital expenditure will continue to grow in the coming years. In particular, the network-based infrastructure sectors of telecommunications and utilities are groaning under the financial burden of upgrading telephone networks from copper to fibre and investing in alternative energy generation. On average, these sectors have to spend well over 10% of their turnover on capital expenditure (CapEx), and the trend is rising. For the utilities and telecoms companies in the STOXX 600 alone, analysts surveyed by Bloomberg forecast a huge capital expenditure budget of just under EUR 160 billion per year over the next few years. Given the already high debt ratios of these companies, the question is how this spending can be managed without putting too much pressure on their credit profiles.

Utilities and telecommunications: Large funding requirements meet already elevated levarage ratios

Stoxx 600 Sectors: CapEx / revenue (%) and net debt / EBITDA (x-times)*



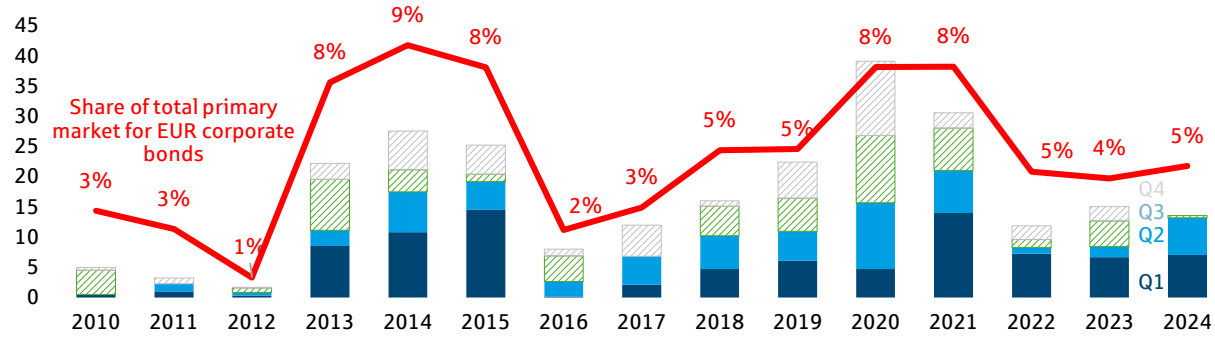
*as of 07.05.2024
Sources: Bloomberg, Helaba Research & Advisory

Hybrid bonds strengthen equity without diluting shareholders

One way to strengthen the balance sheet is to inject equity through a traditional capital increase. However, this route is often blocked because owners are often unwilling or unable to provide fresh funds (partly due to tight public budgets) and would therefore have to accept a dilution of their shareholding. An alternative that avoids these side effects can be the placement of a hybrid bond. If it meets certain criteria, it can be classified as equity on the balance sheet under IFRS accounting standards. In particular, it must be subordinated to all other financial liabilities, coupon payments can be suspended or deferred, and the bond must not have a fixed maturity. The rating agencies also require a very long maturity or the deferral of coupon payments in order to classify the securities, at least in part, as equity. In this case, the equity credit is usually 50% (see **Credit Special - Hybrid Bonds: Shoring up defences in good time**, from 11 November 2020, p. 2).

Demand for hybrid instruments significantly higher than last year

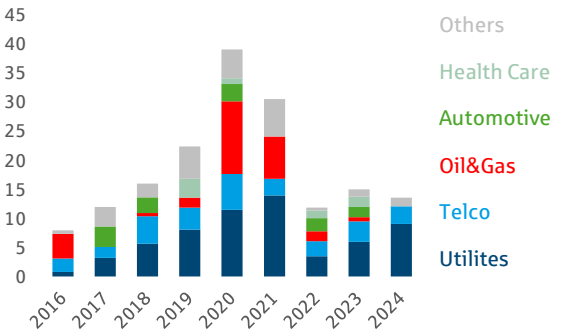
EUR hybrid bonds: issuance volume in EUR billion and share of the primary market for EUR corporate bonds in %*



*as of 15.07.2024
Sources: Bloomberg, Helaba Research & Advisory

Telco & Utilities currently most important sectors

EUR hybrid bonds, placement volume in EUR billion*



*as of 15.07.2024
Sources: Bloomberg, Helaba Research & Advisory

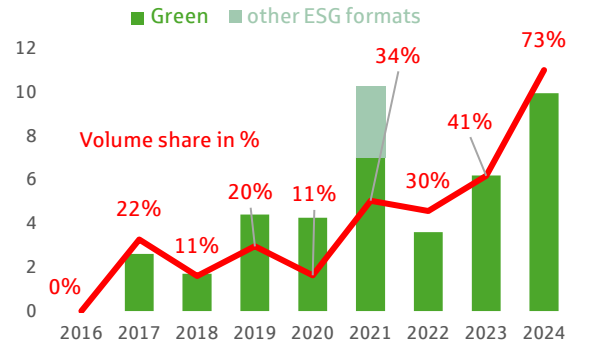
Given its benefits, it is not surprising that the instrument has been very popular, particularly in difficult times such as the coronavirus years, helping to stabilise the credit profiles of some companies when earnings and credit metrics came under pressure. However, the market segment is also currently experiencing a revival. Although its 5% share of the overall primary EUR corporate bond market can still be considered moderate due to its strong dynamics, in absolute terms more hybrid capital was issued in the first half of the year (EUR 13bn) than in the whole of 2022 and almost as much as in 2023.

Green becomes the dominant issuance format in the hybrid space

Given the underlying financing purpose, it makes perfect sense to add a sustainability component to a hybrid bond. The market share of dedicated green financing in the hybrid segment has been growing steadily in recent years, reaching a new record high of 73% of the total placement volume in the first half of 2024. Given the still very high investment needs in the infrastructure-related sector, we expect issues with an ESG component to continue to play a key role.

Green bonds on the rise in the hybrid segment ...

Placement volume of hybrid bonds with an ESG component in EUR bn

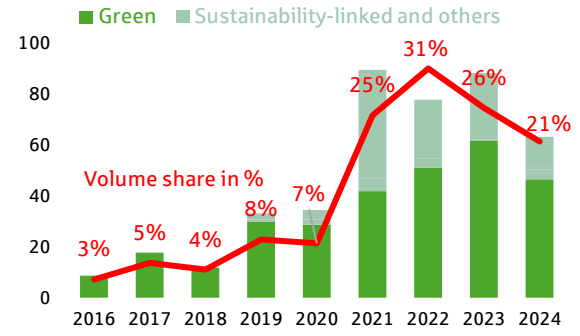


*as of 15.07.2024

Sources: Bloomberg, Helaba Research & Advisory

... contrary to the general market trend

Placement volume of EUR corporate bonds in EUR billion



*as of 15.07.2024

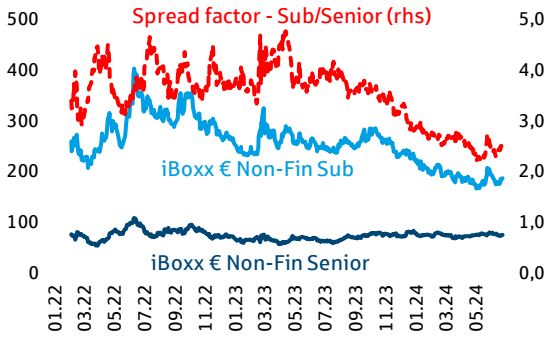
Sources: Bloomberg, Helaba Research & Advisory

Significantly lower funding costs open favourable issuance window

The pick-up in issuance this year was not least due to favourable developments in the funding costs of hybrid bonds. In the second half of the year, risk premiums on subordinated corporate bonds began to fall noticeably. The asset swap spread of the iBoxx € Non-Financials Subordiated is currently only around 40 basis points away from its ten-year low. In contrast, the spreads of unsecured senior bonds have essentially moved sideways. The relative spread ratio iBoxx € Non-Financials Subordinated to Senior is currently only 2.5x, a level last seen for a short period four years ago. Overall, the funding costs of a hybrid placement are likely to be higher than what corporates were able to achieve before mid-2022 due to the rise in base rates. However, they are significantly more favourable than at any time in the last two years. As a result, we believe that the timing for a hybrid bond issue is currently extremely favourable. The high level of oversubscription in many of the recent transactions also shows that this financing instrument is in high demand among investors. Given the uncertain outcome of the current geopolitical crises, it may therefore make sense for some treasuries to implement corresponding refinancing plans as soon as possible.

Subordinated securities with tighter spreads

iBoxx indices: Asset swap spread in bp*

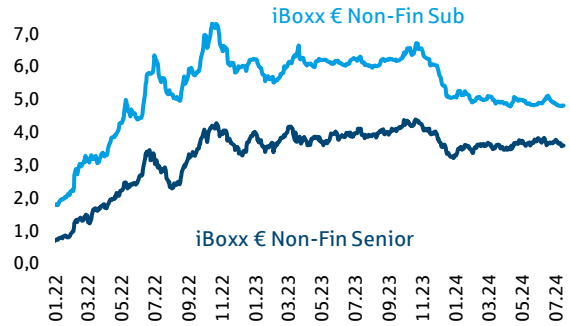


*as of 15.07.2024

Sources: LSEG, Helaba Research & Advisory

Yields at 2-year low

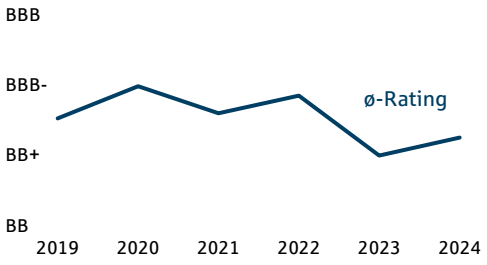
iBoxx indices: Yield in %*



*as of 15.07.2024
Sources: LSEG, Helaba Research & Advisory

Ø rating in the usual range

Volume-weighted average rating of the hybrid bonds *



*If rating available. As of: 15.07.2024
Sources: Bloomberg Helaba Research & Advisory

Selected hybrid placements since the beginning of 2023*

Date	Issuer	Sector	Coupon	first call date	Issuance volume in EUR million	Composite Rating	Green	Current Z-Spread
08.07.2024	EESTI ENERGIA AS	Utilities	7,88	15.07.2029	400	B+	yes	484
20.06.2024	ALLIANDER NV	Utilities	4,50	27.03.2032	500	BBB+	yes	171
11.06.2024	KONINKLIJKE KPN NV	Telecommunications	4,88	18.06.2029	500	BB+	yes	191
05.06.2024	ENGIE SA	Utilities	5,13	14.03.2033	1.035	BBB-	yes	246
05.06.2024	ENGIE SA	Utilities	4,75	14.03.2030	800	BBB-	yes	208
04.06.2024	A2A SPA	Utilities	5,00	11.06.2029	750	BB+	yes	245
23.05.2024	ALSTOM SA	Industrial Gds & Ser	5,87	29.05.2029	750	BB	no	238
21.05.2024	ENERGIAS DE PORTUGAL SA	Utilities	4,75	28.02.2030	750	BB+	yes	209
16.05.2024	TOPSOE AS	Chemicals	6,75	23.05.2029	200	NA	yes	347
04.04.2024	TERNA RETE ELETTRICA	Utilities	4,75	11.01.2030	850	BB+	yes	224
27.03.2024	ORANGE SA	Telecommunications	4,50	15.12.2030	700	BBB-	no	181
25.03.2024	BRITISH TELECOMMUNICATIO	Telecommunications	5,13	03.07.2029	750	BB+	no	212
14.03.2024	ARKEMA	Chemicals	4,80	25.03.2029	400	BBB-	no	202
14.03.2024	TENNET HOLDING BV	Utilities	4,88	21.12.2031	550	BB+	yes	216
14.03.2024	TENNET HOLDING BV	Utilities	4,63	21.03.2029	550	BB+	yes	199
06.03.2024	TELEFONICA EUROPE BV	Telecommunications	5,75	15.01.2032	1.100	BB	yes	264
05.03.2024	ORSTED A/S	Utilities	5,13	14.09.2029	750	BB+	yes	213
20.02.2024	ENEL SPA	Utilities	4,75	28.02.2029	900	BB+	no	210
29.01.2024	PORR AG	Industrial Gds & Ser	9,50	06.11.2028	135	NA	no	453
16.01.2024	ENBW ENERGIE BADEN - WU	Utilities	5,25	23.10.2029	500	BBB-	yes	191
09.01.2024	IBERDROLA FINANZAS SAU	Utilities	4,87	16.01.2031	700	BBB-	yes	184
13.11.2023	VEOLIA ENVIRONNEMENT SA	Utilities	5,99	22.11.2028	600	BB+	no	218
08.11.2023	VAR ENERGI ASA	Oil & Gas	7,86	15.11.2028	750	BB	no	281
02.11.2023	APA INFRASTRUCTURE LTD	Utilities	7,13	09.11.2028	500	BB+	no	233
04.10.2023	ACCOR SA	Travel & Leisure	7,25	11.01.2029	500	BB	no	222
20.09.2023	BAYER AG	Health Care	7,00	25.09.2031	1.000	BB+	no	367
20.09.2023	BAYER AG	Health Care	6,63	25.09.2028	750	BB+	no	345
30.08.2023	TELEFONICA EUROPE BV	Telecommunications	6,75	07.06.2031	750	BB	yes	261
29.08.2023	VOLKSWAGEN INTL FIN NV	Automobiles	7,88	06.09.2032	750	BBB-	yes	309
29.08.2023	VOLKSWAGEN INTL FIN NV	Automobiles	7,50	06.09.2028	1.000	BBB-	yes	241
24.05.2023	VODAFONE GROUP PLC	Telecommunications	6,50	30.05.2029	750	BB+	no	191
05.04.2023	ORANGE SA	Telecommunications	5,38	18.01.2030	1.000	BBB-	no	183
09.03.2023	SANOMA OYJ	Media	8,00	16.03.2026	150	NA	no	318
08.03.2023	ELIA GROUP SA/NV	Utilities	5,85	15.03.2028	500	BB+	no	206
16.02.2023	PURMO GROUP OYJ	Industrial Gds & Ser	9,50	23.02.2026	60	NA	yes	621
25.01.2023	TELEFONICA EUROPE BV	Telecommunications	6,14	03.02.2030	1.000	BB	yes	238
24.01.2023	RED ELECTRICA CORP	Utilities	4,63	07.05.2028	500	BBB	yes	147
19.01.2023	EUROPEAN ENERGY AS	Utilities	10,75	26.01.2027	115	NA	yes	-
18.01.2023	IBERDROLA FINANZAS SAU	Utilities	4,88	25.04.2028	1.000	BBB-	yes	164
17.01.2023	EUROFINS SCIENTIFIC SE	Industrial Gds & Ser	6,75	14.04.2028	600	BB	no	332
16.01.2023	ENERGIAS DE PORTUGAL SA	Utilities	5,94	23.01.2028	1.000	BB+	yes	209
09.01.2023	ENEL SPA	Utilities	6,63	16.04.2031	750	BB+	no	244
09.01.2023	ENEL SPA	Utilities	6,38	16.04.2028	1.000	BB+	no	197

*as of: 22.07.2024
Sources: Bloomberg, Helaba Research & Advisory



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