

Schuldschein private debt: jumbo deals surge Market on course for record issuance in 2022

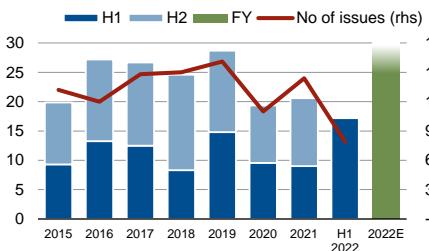


The Schuldschein private-debt market attracted an unexpectedly large number of issuers so far this year, with active first-half deal-making continuing in July and August, leaving full-year issuance headed toward a record EUR 30bn.

Completed deals plus those currently being in the marketing already amount to around EUR 21bn, exceeding annual activity in 2020 and 2021 when Schuldschein issuance fell back from the 2019 pre-pandemic record of around EUR 29bn. First-half issuance was at around EUR 17.5bn from 80 transactions (based on closing dates).

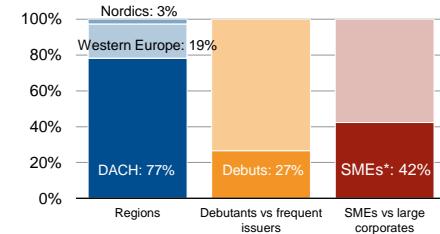
The private-debt segment is again demonstrating its appeal in uncertain times as activity dries up in the market for European non-financial corporate public bond issuance. Placed public debt volumes fell 38% in Jan-Jul compared with the same period in 2021. Schuldschein issuance is likely to slow in the second half of the year after many issuers have tapped the market to refinance deals at favourable rates. Schuldschein coupons, though typically less elastic than on those on public debt markets, are sure to follow bond-market yields higher in due course.

Figure 1: Market rebounds:
Schuldschein issuance volume EUR bn (lhs); number of issues (rhs)



Source: Bloomberg, Refinitiv, Scope Research

Figure 2: Schuldschein activity by region, deal frequency, company size
Percentage of issuers in H1 2022



* Companies with recurring revenues of less than EUR 1bn classified as SMEs

Source: Scope

Mix of macro-economic uncertainties offer market upside and downside

The significant presence of SMEs on the market has in the past raised concerns about credit quality, but so far this year there have been no defaults or selected defaults related to Schuldschein issuance – despite worries about the impact of the pandemic and supply chain disruptions on European companies which have been superseded by the economic side-effects of the Russia-Ukraine war and energy-price crunch.

Investors still need to be alert about credit quality considering the large number of unrated SMEs and larger cyclical companies with limited pricing power that have tapped the private-debt market. They face the significant challenges of rising inflation, higher interest rates, surging energy prices and supply disruptions related to the war in Ukraine and lingering industrial supply-chain bottlenecks to say nothing of slower-than-expected economic growth. This unfavourable set of circumstances will likely curtail new issuance in the months ahead, though not as severely as the pandemic did in 2020/21. Overall, the Schuldschein's appeal as an alternative to public bond markets remains intact.

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Median deal size up to around EUR 150m

Jumbo deal driving up the volume

Schuldschein is for every deal size

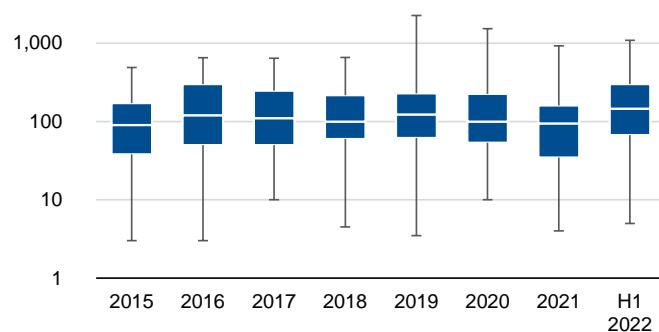
Surge in jumbo deals underpins buoyant volumes

Big-ticket deals from a variety of companies across Europe and mostly, but not exclusively, from capital-intensive sectors have underpinned activity in the private-debt segment so far this year, thereby bringing up the average deal ticket size to around EUR 150m (median) from just about EUR 100m on average in 2020/21. Volatile financial market conditions have lured large frequent Schuldschein issuers back to the private-debt segment instead of placing similar volumes as a corporate bond.

German real estate firm Vonovia AG led the jumbo deals with a EUR 1bn issue. Discount supermarket operator Lidl AG raised EUR 850m, while Belgian IT company Etex NV raised EUR 800m, with German flavours and fragrances company Symrise AG and international steel producer ArcelorMittal SA in EUR 750m deals. Other large deals included a EUR 655m issue from Switzerland-based cement producer Holcim Ltd and EUR 600m issues Austrian furniture retailer XXXLutz Group KG, German technology group Körber AG and Swiss utility Axpo Holding AG. Other jumbo deals have already been closed in H2 2022, such as EUR 477m from Asklepios Kliniken GmbH & Co KGaA and EUR 382m from Otto GmbH & Co KG.

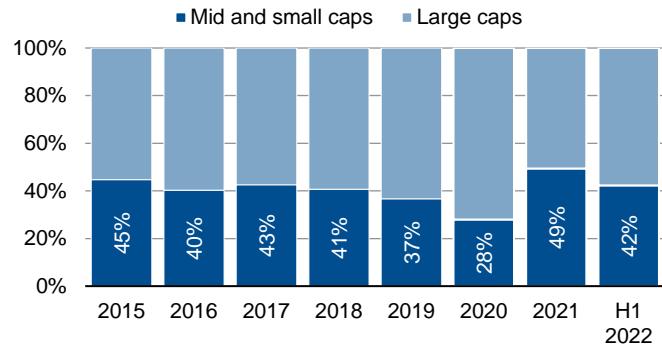
However, the variety of issuers that have tapped the private-debt segment this year is a reminder that the Schuldschein retains its appeal for small and medium-sized enterprises (SMEs) as well as large multinational corporations. Deal size has ranged from EUR 5m to EUR 1bn, with SMEs accounting for a significant proportion of issuers.

Figure 3: Bigger deals: Schuldschein placements, EUR m (log scale)



Source: Scope Ratings

Figure 4: Issuers by size (measured in number of transactions)



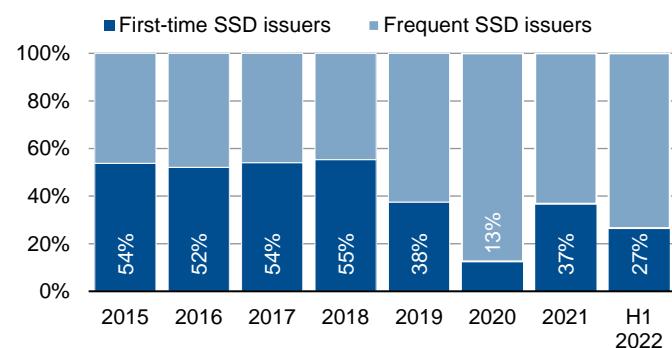
Source: Scope Ratings

SMEs feature strongly among debutant issuers

The Schuldschein has also attracted around 30 debutants so far this year (slightly more than 20 with placed deals in H1 2022), more than double the number of debutants which tapped the market in 2020. Among them non-German debutants such as Austria's CA Immobilien Anlagen AG, Sweden's Samhallsbyggnadsbolaget i Norden AB, the Netherlands' Kendrion NV, Switzerland's SIG Combibloc Services AG and Peach Property Group AG. A significant share of the deal volume from Schuldschein debutants comes from SMEs which provided more than 60% of the deals. While such high share of SMEs raises some concerns, most deals were undertaken by mid-sized real estate companies or utilities which typically are more resilient during shakier economic conditions.

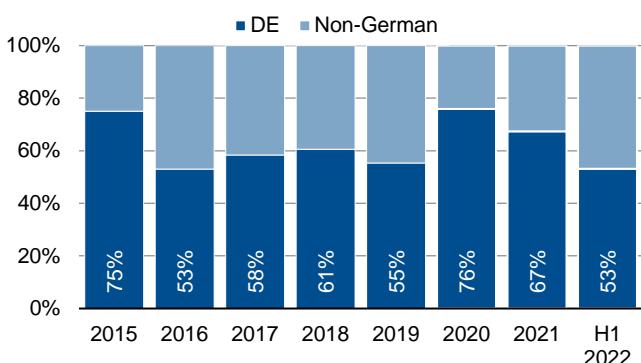
Issuer trends shift in post-pandemic private-debt fund raising (measured in number of transactions)

Figure 5: Debut issuers more hesitant, but...



Source: Scope Ratings

Figure 6: ... more non-German issuers tap market



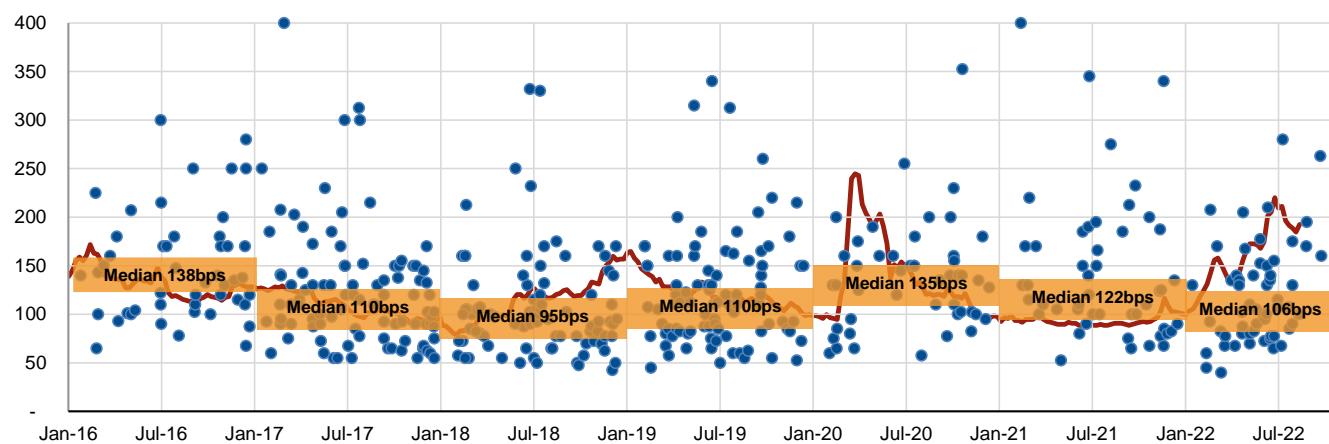
Source: Scope Ratings

Schuldschein demonstrates appeal of competitive private-debt coupons

Private-debt market coupons remain attractive for now

The Schuldschein segment's appeal leading to a steady dealflow in 2022, contrary to the public bond market, is certainly related to its reputation for less volatile pricing. Average Schuldschein pricing has proved very favourable for issuers so far in 2022 even at more attractive levels than last year, judging by the median spread above mid-swap for five-year euro-SSD tranches of about 106 bps (median from 56 SSD deals with information of the spread of a five-year SSD euro-tranche). While the upward pressure on risk premia has shown some inertia over the past few months, the development of risk spreads will certainly follow to some extent the uptick of risk premia in the public bond market, particularly when liquidity risk might come under renewed scrutiny. Tighter monetary policy is leading to less easy financing conditions even for bonds issued by solidly rated companies, a trend in bond-market sentiment that will rub off on the private-debt market as it usually does as shown by the increasing risk premia over the past two to three months. Nonetheless, the segment's inertia on that matter is likely to provide continued stimulus for new transactions, particularly from frequent bond issuers which seek full or partial refinancing which might be pricier to do by tapping the public bond market.

Figure 7: Spreads on 5Y EUR tranches of SSD debt in bps compared with average corporate bond spread measured by Bloomberg Pan European Aggregate Corporate Average OAS (red line, rhs)



Source: Scope Ratings

ESG issuance continues to grow fast

Investor demand triggers higher final deal sizes over launch size

Figure 8: ESG-linked SSD volumes surge

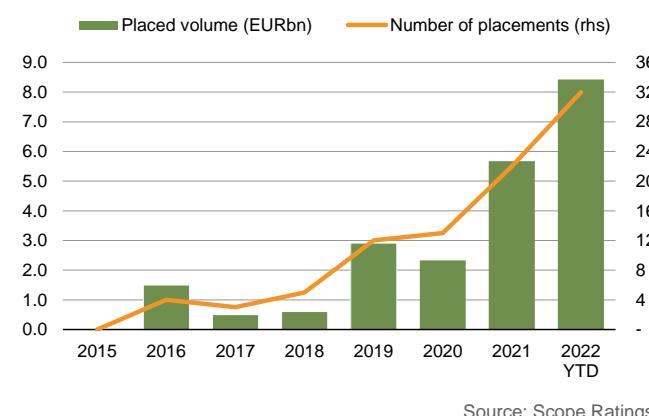
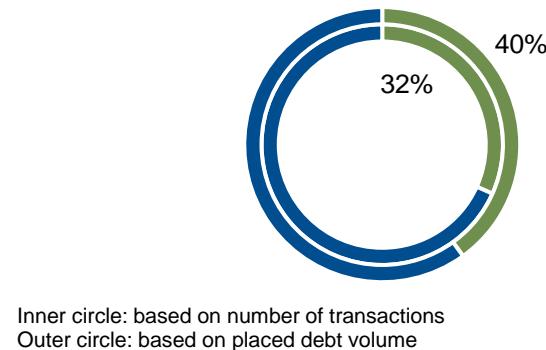


Figure 9: Big-ticket ESG-deals feature so far this year



Source: Scope Ratings

Sustainability-linked Schuldschein are most common, though there are some green and social deals (such as the deals from CA Immobilien, Badenova or Samhallsbyggnadsbolaget i Norden). Not every company is able to dedicate bond proceeds to a specific green or social project, so it is easier to embed broader key performance indicators (KPIs) linked to sustainability into the documentation. Most of the deals are simply tied to an ESG rating from an external provider. If there are quantitative KPIs, they tend to relate to greenhouse-gas emissions, clean energy generation and energy efficiency or other indicators such as training, water usage, social housing, and work safety. IT developer All for One Group has taken an innovative approach, placing a Schuldschein embedded with an 'ESG-bridge' that allows the company to tie the interest rate retroactively to a yet to-be-defined ESG-related KPI. While the link to an existing ESG rating is convenient, linking a deal to measurable KPIs provides more substance and credibility and helps counter the problem of greenwashing.

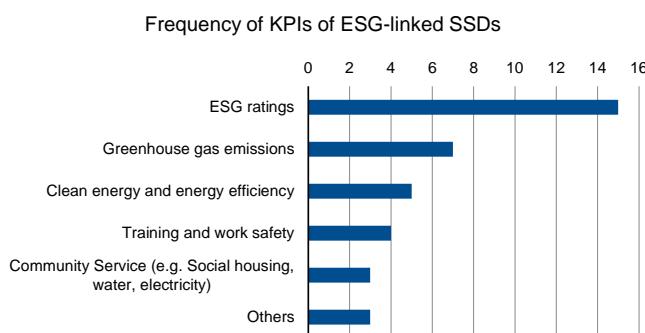
Heavy investor demand for ESG-linked deals

A big discrepancy between ESG-linked Schuldschein debt and public bonds is that the reference point is usually an ESG rating for the Schuldschein which is rare for public bonds which tend to embed specific ESG-relevant KPIs (see [Scope's Research on ESG-linked bonds](#)).

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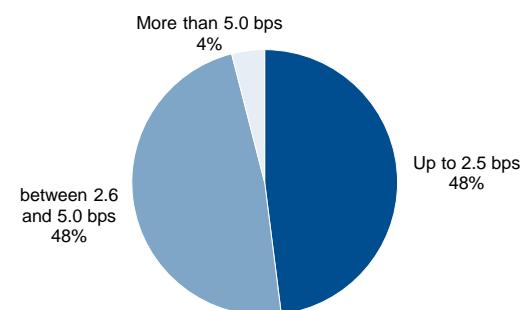
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Figure 10: Frequency of KPIs used in ESG-linked Schuldschein deals 2022 YTD



Source: Scope Ratings

Figure 11: Limited coupon step-up on average in case KPIs would not be reached (based on ESG-linked Schuldschein deals 2022 YTD)



Source: Scope Ratings

Very limited coupon step-ups on average

On average, ESG-linked Schuldschein deals only embed a coupon step-up of about 3 basis points on average. This is significantly lower than what we see for ESG-linked bonds which usually have double-digit basis point coupon steps in the region of 25-75 basis points. The only exceptions are Swiss Axpo and France's Faurecia which have offered significant coupon step-ups so far.

Smoke and mirrors... and reputational risk

Low coupon steps might not provide much of an incentive and can be seen mainly as a marketing gimmick. Indeed, the many deals with a penalty of only 2.5 to 5 basis points looks like "smoke and mirrors" to us. Coupon steps of this order do not really matter in terms of the issuers' interest burden when the monetary penalty on a multi-million debt position for not meeting a KPI is just a few thousand of euros.



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