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Private placement markets offer a source of funding that can be a useful alternative or addition to bank financing. Ben Poole examines the options

There has been a functioning US private placement (USPP) market for more than 50 years, and a large number of European and UK corporates have taken advantage of it over that time. The market has proved to be particularly attractive since the global financial crisis struck in 2008, creating an uncertain funding environment for businesses.

In August 2010, FTSE 100 business software company Sage had a large revolving credit facility that it was planning to refinance. Feeling exposed to the bank market, the company wanted to diversify its sources of funding and its eyes shifted across the pond.

"We still wanted to use the bank market, but we didn't want to have all our eggs in one basket," says John Swift, Sage's group treasurer. "We looked at the USPP market and felt that it could be a good additional source of financing."

Five years ago, a maximum three-year term was usual for revolving credit facilities, whereas Sage wanted a five-year facility. "The USPP market was still open at this time, despite all the economic turmoil, and five-year money was quite comfortably available in that market," notes Swift. "This allowed us to maintain the longer maturities that we wanted, as well as diversify away from bank financing."

A number of banks operate in the USPP market in an agency capacity, which was beneficial to Sage upon entering the market. "We were confident of receiving good support from the banks that we chose as agents," says Swift. "Even though this was a new market for us to enter, we felt comfortable that we would have good support and advice there. Additionally, this was an opportunity to get the Sage credit understood by a new set of debt providers, with a view for us being able to approach them for additional funding in the future."

Benefits and considerations

Using a private placement market can have a positive knock-on effect on other forms of funding. For Sage, its initial successful foray into USPP led

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to an oversubscribed refinancing of its revolving credit facility in August 2010. "Having the private placement investors support us and provide us with cash helped us to get our revolving credit facility in what was still a difficult time for financing," says Swift. "We understand we were one of the first corporates at that time to get a five-year deal, rather than a three-year deal, which was the norm at that time."

As part of the process of entering the USPP market, the National Association of Insurance Commissioners (NAIC) assigns a credit rating to the corporate – on a scale covering NAIC1, NAIC2 and NAIC3. This can have additional benefits to corporates outside of the USPP market. "Sage has been allocated an NAIC2+ rating," explains Swift. "This has helped us, as banks can see that an external body had given us quite a strong rating."

Most of the big banks can act as an agent for corporates in the private placement market. From an ancillary business point of view, this is a high-profile area for banks, with league tables ranking the amount of business they are doing. In this climate, corporates can come under pressure from relationship banks to choose them as an agent.

"My advice when choosing which relationship bank or banks to use as an agent in the private placement market is to run a very transparent process," says Swift. "Give them all the opportunity to bid for this business, and then choose the one or two agents that you would like to use. This is the best way, because if you simply award the business to a couple of your relationship banks, you could generate pressure on your relationships with the banks that missed out. A level playing field and a transparent process will really help to avoid this scenario."

Another factor to consider when entering a private placement market is the time and energy that senior management will need to put in when you go out to investors. For example, it is advisable that the CFO devotes some time to present on the roadshow. Also, when investors come to the business on a due diligence visit, the CFO and other members of the senior management team need to be involved. They should present to the investors and give them a good, all-round understanding of what the company does.

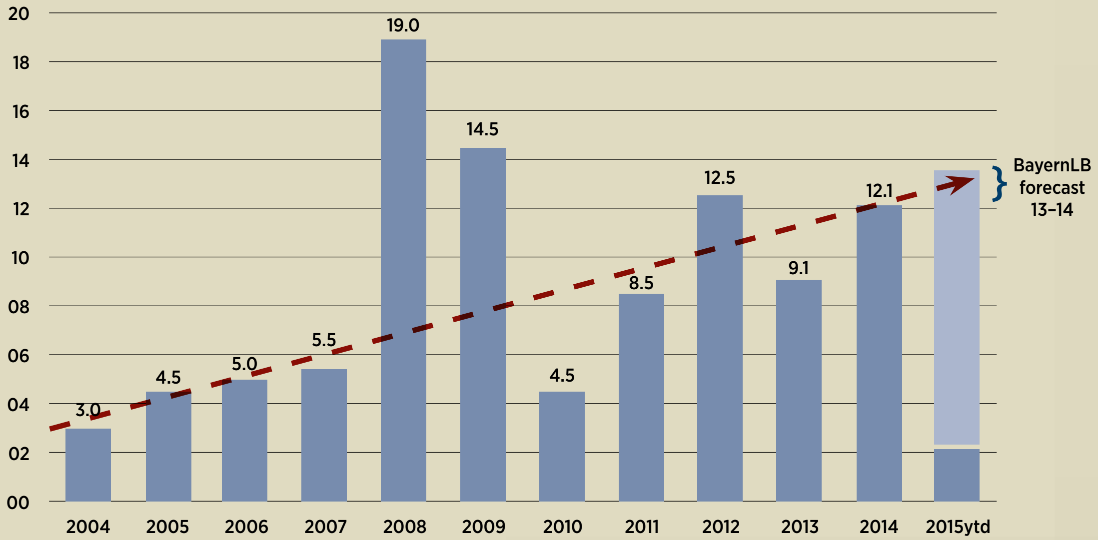
"You need to prepare a good investor memorandum so that the investors have the latest information on the company to base their credit analysis on," says Swift. "We have now done three of these. I have found that, over time, you get to know what the investors need, and you get help from your agents as well, so it becomes an easier process."

The Schuldschein option

While the private placement market in the US is long established, it is not the only option that exists for corporates. In January 2015, the German-based Schuldschein private placement market set a new benchmark with a transaction that was almost twice as big as the previous market record. The deal, for automotive company ZF, as it prepared >

Positive growth trend on the corporate Schuldschein market continues

New issuance column in €bn, year-to-date volume for 2015 and BayernLB forecast for the full year



Source: BayernLB Research; BayernLB Bond Syndication; BayernLB Debt Capital Markets Origination

Some key findings from the ACT working group report on developing a UK private placement market (2012)

There is a clear demand for a UK private placement market from borrowers, as evidenced by the number of UK issuers making use of the US market.

For investors, the instrument theoretically provides an attractive interest-bearing investment with a medium-term maturity (typically five to 12 years). It also provides a diversification of credit risk away from the larger mainstream issuers of international bonds.

Private placements are not particularly liquid, but arguably this should not be too large a problem for insurance firms and pension funds that have longer-term investment horizons.

The embryonic UK private placement market is just too private, with lack of visibility on new transactions and, indeed, some confusion even exists as to what forms of borrowing come under the heading of private placements.

In order to bring the UK in line with overseas private placement markets, some work is needed to create a more standardised, off-the-shelf product that would be more straightforward to sell to both issuers and investors. A distinct asset class could be created and with much-improved visibility.

for the acquisition of a US company, was valued at approximately €2.2bn for the one transaction. That was far in excess of the previous Schuldschein record set in 2008 for car maker BMW, which reached €1.35bn. "This new benchmark shows that there is a lot of liquidity and that investors are keen to invest a significant amount in the market," says Paul Kuhn, head of debt capital markets origination corporates at German bank BayernLB. "Investors of all sizes come to the market, starting from €500,000 and going up to €150-200m for one transaction, depending on the total size and volume of the transaction, and the size and credit quality of the issuer."

The Schuldschein market is concentrated on investment-grade credit. Notably, during the biggest crisis in the debt capital markets in 2008, the market remained open. Indeed, new issuance in the corporate Schuldschein market spiked in that year, reaching €19bn. "The greater the uncertainty in the bond market, the more likely it is that Schuldschein will be requested by investors and issuers," says Kuhn. "Issuers like it as they are not willing and able to pay significant spread levels that other markets might require in a difficult environment. Investors like it because they don't have mark-to-market for Schuldschein, as it is a loan. It is booked as a receivable on the balance sheet of the investor, and therefore they do not need to look into secondary market prices."

The biggest differences between the USPP and Schuldschein markets can be seen in the investor base. The USPP market has a base of 30 to 35 active investors that are able to take significantly high amounts for a very long period – out to 15 to 20 years. At present, the Schuldschein market could not match this.

The number of investors in the Schuldschein market is greater than in the USPP, with approximately 300 investors being active. But the investors buy different volumes. "In Germany, there are around 420 savings banks and around 200 of these buy Schuldschein on a more or less active basis, 100 of which are very active," says Kuhn. "The ZF financing attracted more than 200 investors for one single deal, so the diversification of the investor base is much stronger than in a USPP."

The intensity of the documentation also differs between the two markets. In the USPP market, the documentation can be between 100 and 200 pages in length. In contrast, the Schuldschein market has documentation of around 10 pages, since it is based on the German civil code. "The documentation is simple," says Kuhn. "It includes the interest rate, the repayment terms and maybe one or two additional financial covenants, depending on the specific case."

Pan-European private placement market

In addition to the Schuldschein market, there are positive signs for the future of a pan-European private placement (PEPP) market. In February 2015, a Pan-European Private Placement Working Group, led by the International Capital Market Association (ICMA), released a *Pan-European Corporate Private Placement Market Guide*. The guide defines characteristics of a PEPP, details the core issuers and investors in the market, describes market expectations and defines best practices. It also includes standard summary terms for discussion between borrowers and investors. The guide links to standard model framework documentation for loans that the Loan Market Association published in January 2015.

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"The Pan-European Private Placement Working Group is a consolidation of a number of other active working groups, each of which had a common goal of progressing development in this market on a pan-European level," says Katie Kelly, director, market practice and regulatory policy at ICMA. "There has been a lot of buy-side involvement, as well as official sector input."

There are also moves in the UK to establish an active private placement market. In December 2012, the ACT published a report from a working group that it had chaired to look at how a UK private placement market could be developed to provide an alternative funding technique for corporates. (See box, opposite.)

The report found numerous barriers to a PP market developing, but recent government announcements suggest that these could be overcome. Chancellor George Osborne included a potential private placement incentive in his Autumn Statement last year that would create a new, targeted exemption from withholding tax for interest on private placements.

At the time of the announcement, ACT CEO Colin Tyler praised the move, saying: "We hope that this will also encourage other EU member states to follow this step, thereby avoiding artificial and costly listing requirements. Mid-sized commercial and industrial firms need real, cost-effective, easily understood and deliverable funding alternatives."

"We are examining the fine details of the Autumn Statement announcement," says Kelly. "We have progressed a long way in the past year, but there is still a lot of work to do. But there is political will at an official sector level to get behind a PEPP market, which also fits in with the Capital Markets Union agenda proposed by the European Commission."

Since the variety of private placement markets available to corporates is expanding, a natural concern would be that this could stretch the investor base too thinly. Market participants do not think this is likely, however.

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"A pan-European private placement market would be complementary to national, existing markets," says Kelly. "In terms of its reach, it is aimed at medium-sized borrowers who are unrated or who may otherwise represent the sub-investment/investment grade crossover, doing mainly unlisted transactions."

Kuhn agrees, noting that national private placement markets or a pan-European market would be "complementary" to the Schuldschein.

Certainly, having a greater range and availability of investors would make all private placement markets even more appealing to corporates. "If there was a UK market or a pan-European market with a different set of investors in it to the US market, it would be interesting, as it is always good to diversify your sources of funding," says Swift. "Another market would increase competition. If you had more investors out there providing funding, hopefully that would help to drive the pricing down and maybe some of the terms would be better as well."

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