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Irish Non-Financial Corporations and the US Private Placement Market

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Abstract

This letter examines the use of an alternative source of funding, known as private placements, for Irish resident non-financial corporations (NFCs). Private placements are fixed-rate bonds arranged privately between an issuer and an institutional investor. The US private placement market is traditionally the primary market for Irish NFCs. As there is no single repository of private placement data, data was obtained from various sources including industry-specific publications and annual reports. Data indicate that since 2003 there have been an estimated 39 deals which involved 22 Irish NFCs. As of Q2 2014, we estimate that the total amount outstanding stood at $10.4 billion, with new issuance exceeding $1 billion per annum in recent years. Private placements have not been included in our published statistics to date, and this new data will help address this gap.

1 Introduction

The Irish non-financial corporations (NFCs) sector has traditionally relied heavily on the banking system for access to credit. Bank deleveraging, combined with more stringent lending conditions, has seen a sharp reduction in bank funding to this sector and an increased interest in direct lending from non-bank institutions to NFCs. Indeed, the reduction in bank lending across Europe has made alternative, non-bank financing streams more appealing.

Private placement markets are one such alternative, which have been used by Irish NFCs. These markets allow an issuer (or a placement agent acting on their behalf) to place a bond directly with a prospective investor without offering these instruments for sale publicly. The largest market for private placements is the US. This market has experienced a period of high issuance in recent years with many non-US issuers, particularly European compa-

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nies, seeking to access funding.

This Economic Letter is structured as follows: Section 2 explains the concept of a private placement debt security and outlines the functioning of the US private placement market; Section 3 outlines the principal sources of funding utilised by Irish NFCs and discusses our methodology in estimating the issuance of private placements by these firms; Section 4 summarises our findings on the issuance of traditional private placements by Irish NFCs, and Section 5 concludes.

2 What are Private Placements

A debt private placement shares characteristics with public bond offerings (debt security) and bank loans. These instruments are arranged bilaterally and typically take the form of fixed rate bonds (Kwan and Carleton, 2004; Lyons, 2013). As these instruments are privately placed, rather than being offered for sale publicly to retail investors, they are not required to be registered with the Securities and Exchange Commission (SEC) in the US. Moreover, unlike a public bond a formal credit rating from a ratings agency is not necessary.

2.1 Credit Market Characteristics

The amounts borrowed by issuers tend to be larger than bank loans and smaller than public bonds, whilst the maturities of private placements are generally longer than those of bank loans but shorter than those of public bonds (Prowse, 1997). These instruments also carry covenant protections in order to control risk and borrowers are subject to significant monitoring by lenders.

2.2 Participant Motivation

Life insurance corporations are the principal investors in private placements in the US, albeit other investors, such as asset managers and pension funds, are also active (Advantus, 2013).

Insurance corporations have the necessary credit underwriting expertise and the capacity to both undertake extensive pre-purchase due diligence and to monitor their investments. Life insurance corporations have also tended to dominate in this market as their long-term, fixed liability needs mean they pursue a buy and hold strategy.

In the case of prospective issuers, they may dislike the level of public disclosure associated with a public bond offering, whereas a private placement allows them to maintain greater confidentiality(Lyons, 2013). Issuers may be unwilling to incur the cost of obtaining, and maintaining, a credit agency rating. Private placements also enable borrowers to diversify their credit sources and to avail of greater flexibility through customised deal structures (i.e. number of tranches, maturity profiles, currency of denomination, etc.)

Finally, NFCs without a long credit history may view the private placement market as a stepping stone for building a reputation to enable future participation in the public bond market.

2.3 The US Private Placement Market

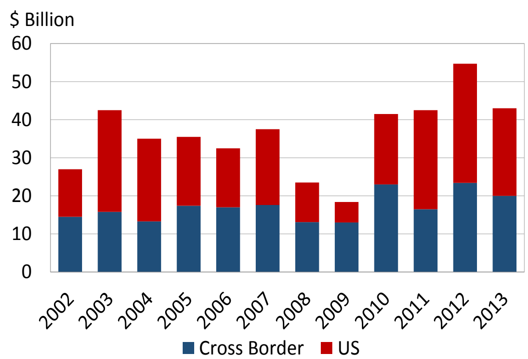
The traditional US private placement market is by far the largest in the world and has grown rapidly in recent years[2] (The City, 2013; Bolger, 2013; Thomson Reuters, 2012).

[2] The traditional market for private placements is different from the Rule 144A, which are non-US bonds issued to US Qualified Institutional Investors (QIBs). The latter has evolved into a quasi-public market that is quite distinct from the former (Prowse, 1997).

Total new issuance amounted to approximately $54 billion in 2012. This represented almost twice the amount of issuance compared to 2009 (Figure 1).

It has been estimated that non-US borrowers now account for up to 50 per cent of securities issued, with one commentator estimating that Irish entities accounted for up to one per cent of annual new issues in the US in recent years (Bolger, 2013).

Figure 1: Traditional US Private Placement Activity, 2002-2013



Source: Bolger,A.(2013).

Finally, there is also a well-developed private placement market in Germany (Schuldschein) primarily used by German public institutions and large NFCs and there is a growing French private placement market. There is no established UK private placement market, in part due to the ease with which prospective borrowers can access the US market (The City UK, 2013). In similar fashion, Irish NFCs have concentrated on the US market. As there is little domestic data on the issuance of private placement debt instruments by Irish entities, the authors have focused on the US market sources for the purposes of this research.

3 Irish NFCs and Debt Private Placements

The data compiled by the authors indicates that issuers are generally blue chip Irish NFCs with a strong export dimension to their operations. These also included three public utilities which have accessed the US market over the period covered here - markets are particularly attracted to these types of companies.[3]

3.1 Overview of Methodology

Given the private, bilateral nature of these transactions there was no single repository of data on all issuance by Irish NFCs in the US. In the absence of a single repository of data, the authors utilised multiple data sources including a number of industry-specific publications and annual reports[4] in order to construct a more complete record for each private placement deal identified.

Finally, the estimates presented here are compiled on the basis of the residency of issuer concept whereby any issuance by an NFC legally constituted and registered in Ireland are considered to be issues by an Irish NFC (BIS et al., 2009).[5]

3.2 Estimated Results

Between 2003 and mid-2014 the data suggests that 22 Irish resident NFCs were involved in 39 private placement deals. In total, nearly $13 billion of funding was accessed by these NFCs

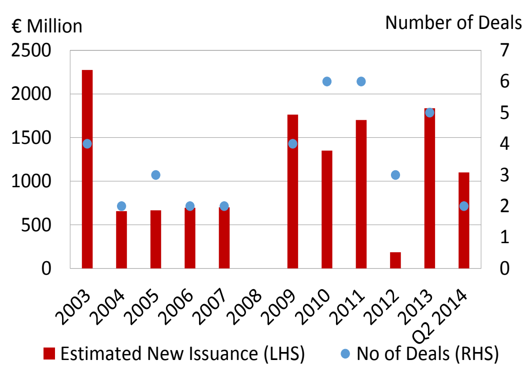
[3]Public ownership may enhance their attractiveness to investors, however the borrowings of these companies do not necessarily enjoy explicit state guarantees (Review Group on State Assets and Liabilities, 2011).

[4]In many cases, use of the US market and the nature of deals are clearly detailed in these reports.

[5]An institutional unit can be resident of one economic territory only and this residence is determined by its centre of predominant economic interest. An issuance by a head office, or subsidiary, located outside of Ireland (even where owned by residents of Ireland) would be considered to be non-resident issues. Issues by head offices located in Ireland and which operate internationally are considered as issues by Irish resident units.

through the private placement channel (Figure 2). During 2008, the data indicates that no deals were arranged between Irish NFCs and institutional investors, potentially due to a lack of investor confidence as a result of the onset of the financial crisis. However, there was a resurgence in activity in 2009 and subsequent years. During 2012, new issuance fell to less than $200 million. The number of deals, however, remained steady and these three deals involved new smaller entrants to the private placement market.

Figure 2: Estimates of New Deals and Issuance by Irish NFCs, 2003-Q2 2014

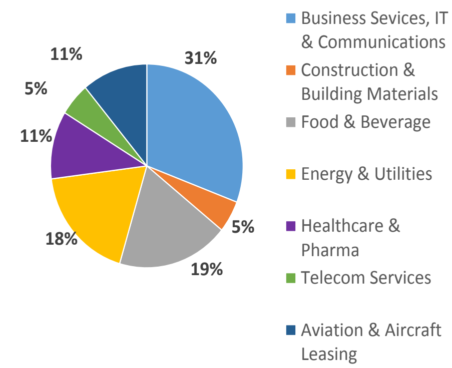


Source: Central Bank of Ireland calculations

Note:(i) The material presented here are estimates and relate primarily to issuance in the US market.

As of Q2 2014, the total private placement funds outstanding stood at $10.4 billion. An analysis of the type of Irish firms utilising this funding source indicate that NFCs involved in Business Services, IT and Communications are responsible for over 30 per cent of the total amount of private placement funds outstanding. Other industries availing of private placement funding include Telecom Services, Food and Beverage and Healthcare and Pharmaceuticals (Figure 3).

Figure 3: Industry analaysis of Total Private Placement Funds Outstanding, 2014



Source: Central Bank of Ireland calculations

Note:(i) The material presented here are estimates and relate primarily to issuance in the US market.

3.3 Overview of Deal Structures

On the basis of data collated, a number of standard characteristics were identifiable. For instance, most of the placements issued by Irish NFCs in recent years were with US-resident investors and the funding tended to be denominated in US$. These funds were generally raised for periods spanning 7 to 15 years and with typical interest rates ranging from 4 to 6 per cent[6].

In some cases, covenants,in the form of restrictions, were placed on measurable financial variables (i.e. interest coverage). For example, in one deal the following applied: the NFC was required to maintain minimum interest cover of no less than 4.5 times, and minimum net worth of $5.1 billion.

Finally, the experience in the US private placement market suggests that many firms undertake a funding journey whereby the private

[6]These are stylised facts for information only and will differ deal-by-deal. For instance, the terms of each funding tranche are usually intermediate to long-term but can be customised to longer or shorter terms (or by currency of denomination).

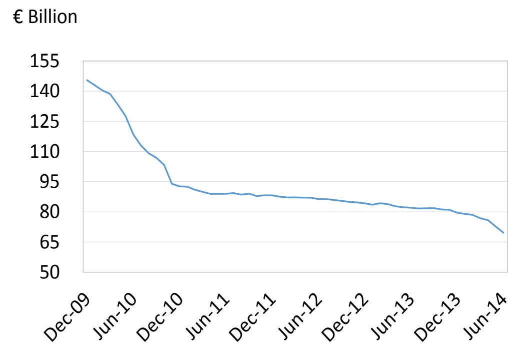
placement market is used as a stepping stone towards future participation in the public bond market. This approach enables issuers to build a reputation and track record that can be leveraged in a future public offering (Advantus, 2013).

This is consistent with the dataset compiled by the authors. The latter shows that a number of Irish NFCs went on to issue public bonds subsequent to utilising the US private placement market.

4 Comparative Funding for Irish NFCs

By mid-2014, total loans advanced to the Irish-resident NFC sector by credit institutions stood at some €70 billion. This represents a fall of 41 per cent over a five-year period (Figure 4). Over the same time period, the Securities Issues Statistics (SIS)[7]suggest the amount outstanding of publicly-issued debt securities for the Irish NFC sector increased very significantly to €7.8 billion.[8] However,the re-domiciling of NFCs to Ireland did influence this trend(Coates and McHugh, 2014) (Figure 5).[9]

Figure 4: Loans to Irish Resident Non-Financial Corporations Dec 2009-June 2014



Source: Money and Banking Statistics, Central Bank of Ireland.

Private placement funding is not included in the SIS series produced by the Central Bank of Ireland as these statistics only refer to public bond offerings.[10]

The estimates presented here suggest that the outstanding amount of private placements stood at $10.4 billion (or €7.6 billion) by 2014. Figure 5 below indicates that the full amount outstanding of Irish NFCs debt securities, whether publicly or privately issued, was therefore approximately €15.4 billion by the second quarter of 2014. This comparison suggests that the published SIS series (approx. €7.8 billion) have tended to under-estimate the indebtedness of Irish NFCs via debt securities by 50 per cent.

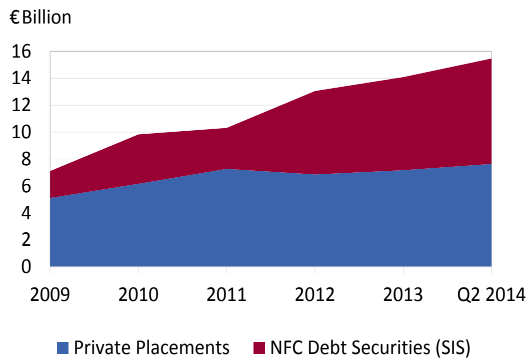
[7]These statistics are compiled from a common database, jointly administered by the ESCB, which contains information on securities with an ISIN (a unique security identifier).

[8]Only a small number of Irish NFCs have issued public debt securities.

[9]In the case of re-domiciled entities, this database generally attributes liabilities (both debt securities and equities) to the Irish-resident (headquartered) parent NFCs. The authors have adopted this approach to any debt private placements identified.

[10]The absence of an ISIN for Irish debt private placements however, means that they are not captured in the published SIS series for NFCs. The SIS release is available here: http://www.centralbank.ie/polstats/stats/sis/Pages/releases.aspx. The SIS series is subject to revisions over time.

Figure 5: Comparison of Debt Private Placements and Public Bond Issuance for Irish NFCs, 2009-2014



Source: Central Bank of Ireland estimates and Securities Issues Statistics.
Notes:(i)The material presented here are estimates and relate primarily to issuance in the US market (private placement data).(ii)The redomiciling of US NFCs to Ireland also played an important role in these trends in recent years (Coates and McHugh, 2014). (iii) The SIS time series above is subject to revisions.

5 Conclusions

Amid the current climate of tighter lending conditions and bank deleveraging, the private placement market can be utilised as a cheaper and more convenient alternative. The US market is the largest and most advanced private placement market.

This letter highlights that Irish non-financial corporations are actively involved in this market with $10.4 billion in private placement funds outstanding by mid-2014. New issuance by Irish NFCs is estimated to have exceeded $1 billion per annum in recent years. This equates to a larger proportion of new issues in the US than has heretofore been posited by market observers(Bolger, A. 2013).

Finally, this Letter provides information on a significant source of funding for Irish NFCs that has not been covered, to date, in our published Securities Issues Statistics.

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