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(High Yield) Bonds – A Growing Trend in the European Energy Sector?

Last month, we published an article on High Yield Bonds by German Real Estate Companies in which we noted an increasing convergence / overlap between traditional real estate finance, leveraged finance and debt capital markets products, including in the form of high yield bonds. This trend, however, is not just confined to the real estate sector and also certainly not to just German issuers / borrowers.

In this article, we want to highlight a steady stream of high yield bond offerings by a diverse range of issuers across the European energy sector, including oil and natural gas companies, refiners, service / engineering companies as well as utilities / power companies.

The very largest and/or more highly rated companies in the sector have been accessing the debt capital markets for years at very attractive terms. Recent examples of such offerings include the offering of €1,000,000,000 1.375% senior notes due 2029 by Total SA (Moody's: Aa3; S&P: A+; Fitch: AA-) in October 2017 and the offering of €650,000,000 1% senior notes due 2025, at an issue price of 99.671%, by Eni SpA (Moody's: Baa1; S&P: BBB+) in September 2017. These large, established, investment-grade rated (and fairly diversified) issuers have long been able to access the debt capital markets through their euro medium-term note (EMTN) programs or commercial paper (CP) programs.

However, as we have stressed before, access to the debt capital markets is not reserved for just the very large and investment-grade rated companies anymore, as demonstrated by successful recent high yield offerings in the energy sector almost across the full range of the sub-investment grade spectrum from Caa1/CCC+ to Ba1/BB+.

Oil and Gas Companies

Recent high yield bond offerings by oil and gas companies include the offering of $750,000,000 5.00% Senior Notes due 2026 by globally integrated midstream and downstream oil group Puma Energy Holdings Pte. Ltd (Moody's: Ba2; Fitch: BB) in January 2018 and the offering of $725,000,000 8% Senior Notes due 2022 by Nostrum Oil & Gas PLC (Moody's: B2; Fitch: B), an independent oil and gas enterprise engaged in the exploration and production of oil and gas products in North-Western Kazakhstan, in June 2017.

Refiners

Recent high yield bond offerings by European refiners include the offering of €250,000,000 6.375% Senior Secured Notes due 2022 by Northern German refiner Raffinerie Heide GmbH (Moody's: B3; S&P: B) in December 2017 and the offering of €350,000,000 3.25% Senior Notes due 2022 by Greek refiner Motor Oil (Hellas) Corinth Refineries S.A. (unrated?) in April 2017.

Service / Engineering Companies

Recent high yield bond offerings by service / engineering companies in the energy sector include the offering of $750,000,000 7.875% Senior Notes due 2026 by offshore drilling contractor Nobel Corporation plc (Moody's: B2; S&P: B+) in January 2018, the offering of $340,000,000 9.5% Senior Secured Notes due 2022 by Welltec A/S (Moody's: B2; S&P: B-), a provider of robotic well intervention services and innovator in various well completion products, in November

2017, the offering of €400,000,000 3.875% Senior Secured Notes due 2022 by global developer and manufacturer of onshore and offshore wind turbine generators. Senvion Holding GmbH (Moody's: B2; S&P: B+) in May 2017, the offering of $375,000,000 9.125% Senior Notes due 2022 by offshore support vessel and marine solutions provider Topaz Marine S.A. (Moody's: B3; S&P: B-) in July 2017 and the offering of $535,000,000 9.875% Senior Secured Notes due 2022 by offshore drilling and engineering company KCA Deutag. (Moody's Caa1; S&P: CCC+; Fitch: CCC+) in March 2017.

Power Companies / Utilities

A recent example of a high yield bond offering by a power company / utility are the concurrent offerings of £225,000,000 4.75% Senior Secured Notes due 2024 and €350,000,000 4% Senior Secured Notes due 2025 by Irish utility company Viridian (Moody's: B1; Fitch: BB-) in September 2017.

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The most common use of proceeds in these offerings is the refinancing of existing indebtedness, but possible uses also include the funding of capital expenditures, acquisitions, special dividends/distributions to the issuer's shareholders, general corporate purposes or any combination thereof.

The benefits for those eligible companies that do decide to opt for a bond offering , investment-grade or high yield, include the opportunity to secure long-term financing at often attractive (and typically fixed) interest rates and with a bullet maturity, increased operational and financial flexibility through typically less onerous covenants (and typically no financial maintenance covenants), potential flexibility to issue unsecured / junior debt (at the HoldCo-level) as well as the opportunity to potentially significantly expand their investor base.

Unfortunately, size does matter when it comes to accessing the debt capital markets, and mere size is even something that the rating agencies will consider in assigning a particular rating. Due to a combination of the requirements of key institutional high yield investors, internal requirements of the underwriting banks active in the European high yield market and the comparatively higher transaction expenses (including for legal advisers, rating agencies, auditors, ……) for a traditional high yield bond offering compared to a credit facility, the minimum offering size for a "proper" high yield offering is normally about €200-250 million (as a rough rule of thumb), but may be lower depending on the specific circumstances. This, however, does not mean that smaller companies (or companies with lower financing requirements) cannot access the debt capital markets at all, but they may only be able to do so at less attractive terms, both in economic terms (i.e. higher coupons and shorter tenors) and in terms of more onerous covenant packages.

Obviously, irrespective of any credit ratings assigned to a particular issuer, an upstream oil or gas exploration company or specialist offshore drilling company, with strong exposure to potentially volatile commodities markets represents a very different investment case compared to a refiner, downstream oil or gas company or a utility. Apart from absolute size, a more diversified business (both in terms of geography and products/services) may face less scrutiny from investors than a highly specialized and/or single-asset company, although a strong position in an attractive (niche) market or other unique features can also a be a big selling point. It will then be incumbent upon the issuer, with the support from its financial and legal advisers, to properly highlight any such strengths (and other factors that might differentiate the issuer from other companies in the sector) when engaging with the rating agencies and potential investors.

While the European high yield market experiences regular ups and downs, it had a very robust start in 2018, with high yield bond yields remaining near record lows by historical standards and certain bond terms having become progressively more issuer-friendly over the last few years.

For more information generally about high yield bonds, please click on the following link to obtain a PDF copy of the 4th European Edition of our High Yield Bonds – An Issuer's Guide. As with earlier editions, the Guide is primarily intended for (first-time) issuers of high yield bonds.

For further information or advice or to request a hard copy of the Guide, please contact Bernd Bohr or your usual contact at Mayer Brown.

Learn more about our High Yield Bonds, Capital Markets and Energy practices.

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