EUROPEAN ACQUISITION FINANCE DEBT REPORT 2014

EXECUTIVE SUMMARY

Welcome to DLA Piper's European Acquisition Finance Debt Report 2014. This report, now in its fifth year, presents detailed results of our survey of over 250 debt providers, advisors, sponsors and corporates active in the European acquisition finance debt market. It also includes extracts from interviews with numerous senior dealmakers.

2013 was a busy year, with a surge of refinancing activity leading to an increase of over 25% in deal volume, according to Dealogic. In fact, the quantum of refinancings was so significant that, for the first time in many years, the number of refinancing transactions exceeded primary deals.

The majority of our survey respondents expect deal activity in 2014 to increase for a second consecutive year. However, this will need to be underpinned by the high level of refinancing activity in 2013 being maintained and an uptick in new money deals as the Eurozone continues to recover.

Deal activity aside, 2013 will long be remembered for the influx of alternative lenders offering a diverse range of new structures. Private debt funds have had the most profound impact on the European market, participating in over 50 deals in 2013, a significant increase on 2012.

This is creating new challenges and opportunities for traditional lenders as the lending landscape changes and becomes more competitive than it has been for many years. While alternative lenders will undoubtedly continue to gain market share in 2014, we expect traditional lenders to remain active. Many are responding by forming joint ventures with private debt funds to offer larger tranches of debt, whilst others are simply investing super senior debt alongside private debt funds.

2013 will also be remembered for the influx of new investment capital into the European high-yield market. We expect this trend to continue this year. However, a large chunk of liquidity will exit the European market when the sizeable number of collateralised loan obligation (CLO) funds raised in 2006-2007 hit the end of their reinvestment window. This issue remains a concern despite the number of successful new CLO issuances which launched in 2013.

2013 brought increased activity, liquidity and competition. Whilst confidence in the recovery across Europe remains fragile, the market levers look favourable to support a further step forward in 2014. However the continuing shortfall in new money activity, increasing leverage, looser covenants and reduced pricing could dampen activity – and that means cautious optimism continues to be the most favoured approach.

If you have any questions about the findings in this report, or would like to explore how DLA Piper can assist your organisation, please feel free to contact Alexander Griffith whose details are listed at the end of this report.

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CONTENTS

THE FINANCING LANDSCAPE IN 2013 4

- Refinancings drove upswing in deal activity
- New money deals remained rare
- Deal activity to accelerate in 2014

A DEEPER AND MORE DIVERSE DEBT MARKET...................................... 6

- Alternative debt providers to increase liquidity in 2014
- The rise of the private debt fund
- A record year for high-yield
- Tapering may also reduce liquidity at the top end of the market

A MORE AGGRESSIVE FUNDING ENVIRONMENT 10

- Pressure on margins and pricing to continue in 2014
- Banks' caution likely to be tested in 2014
- The charge of the covenant-lite brigade

COUNTRIES IN FOCUS 12

- UK: Improving economy to drive increase in new money deals
- Germany: Deal activity will increase if M&A market continues to pick up
- Scandinavia: Poised to upset the deal rankings in 2014
- France: An uncertain outlook for 2014
- Spain: Growing confidence drives uptick in deal activity
- Italy: Corporate M&A underpins increase in deal activity
- Turkey: Great potential but political unrest will hinder activity in 2014

KEY CONTACTS 22

ABOUT THE RESEARCH 23

THE FINANCING LANDSCAPE IN 2013

REFINANCINGS DROVE UPSWING IN DEAL ACTIVITY

Last year was notable for a resurgence in deal activity across Europe after a stagnant six years. Some 367 acquisition finance debt deals totalling €183 billion were executed in Europe in 2013, a 27% increase in volume on the 288 deals totalling €138 billion in 2012, according to data compiled by Dealogic.

This was underpinned by a 35% surge in the number of refinancing transactions. In fact, for the first time in many years, the number of refinancings exceeded primary deals. This was driven by the refinancing of legacy leveraged buyouts (LBOs) structured in 2007 and 2008 with five to seven year debt structures and short-term funding arrangements agreed during the financial crisis.

"2013 saw an improvement in dealflow across Europe relative to previous years," confirmed Mike Dennis, Partner at Ares Capital Europe. "Refinancings in part are being driven by deals that were financed during the 2006-2008 market peak coming to term thereby driving a contractual requirement to refinance. We have also seen demand for dividend recaps increase partly by pending sponsor fundraises. In addition, we believe people are generally feeling better about the economic environment and are therefore more comfortable about increasing the debt leverage on some of their investments."

NEW MONEY DEALS REMAINED RARE

While the volume of refinancings increased significantly in 2013, new money deals remained rare. Only 98 leveraged and management buyouts totalling €39 billion were completed in 2013, a 3% decrease on the number of buyouts in 2012. This is in sharp contrast to the expectations of survey respondents 12 months ago, when secondary and tertiary buyouts were expected to be more frequent than refinancing transactions.

The absence of primary and secondary dealflow is in some ways surprising given the amount of money private equity funds have at their disposal and the high levels of liquidity. Indeed private equity firms targeting Europe had $265 billion of uninvested capital at the end of 2013, the largest sum since 2009, according to data compiled by Preqin.

However the vital ingredient missing was investor willingness to sell. As Graeme Delaney-Smith, Managing Director – Head of European Direct Lending and Mezzanine Investments at Alcentra, explains, this is being driven by a mismatch between buyers' and sellers' price expectations and a widely envisaged resurgence in the IPO market.

"Part of the problem is the price expectations of exiting investors," he

"Refinancings in part are being driven by deals that were financed during the 2006-2008 market peak coming to term thereby driving a contractual requirement to refinance."

said. "They have a number in mind and will just do a refinancing if they don't get it. Many investors are already well beyond their normal three to four year holds, and once you are seven to eight years in you might as well wait a bit longer. The strong IPO market has also resulted in some investors not selling at the larger end as they are planning to chance their arm with an IPO."

DEAL ACTIVITY TO ACCELERATE IN 2014

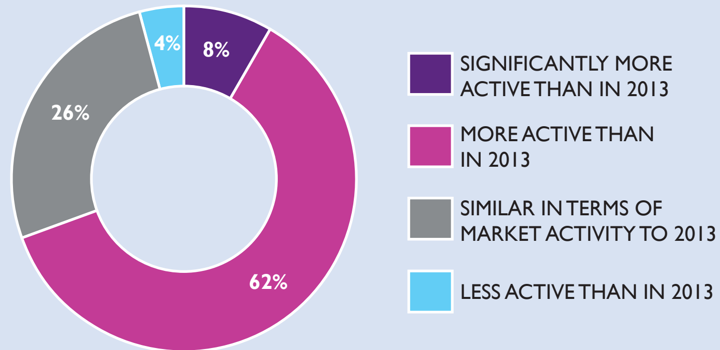
The outlook for the European acquisition finance debt market looks much healthier at the beginning of 2014 than it did 12 months ago – 70% of our 2014 survey respondents expect deal activity to increase this year compared with 51% of survey respondents the previous year.

This will be driven by a continued high number of refinancing transactions in addition to an increase in M&A activity. Primary deal activity should accelerate due to the strengthening macroeconomic environment in the UK and Germany, Europe's largest LBO markets.

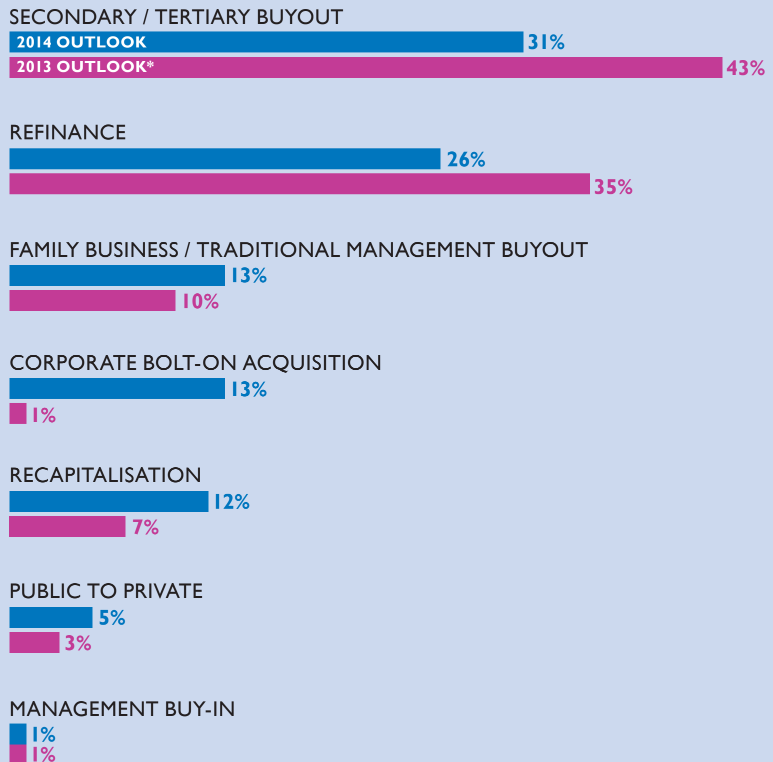
Indeed the UK's Office of Budget Responsibility (OBR) upgraded the UK's economic growth forecast for 2014 from 1.8% to 2.4% in December 2013, a significant step up on the 1.9% GDP growth in 2013. Similarly Germany's central bank upgraded its 2014 growth forecast in December 2013 to 1.7% from 1.5%. This is expected to rise to 2.0% in 2015.

Like last year, survey respondents expect secondary and tertiary buyouts to be the most common deal type in 2014, followed by refinancings and management buyouts.

HOW ACTIVE DO YOU EXPECT THE EUROPEAN ACQUISITION FINANCE DEBT MARKET TO BE IN 2014?



WHICH OF THE FOLLOWING DEAL TYPES DO YOU EXPECT TO BE THE LARGEST BY VOLUME (DEAL NUMBERS) IN 2014?



A DEEPER AND MORE DIVERSE DEBT MARKET

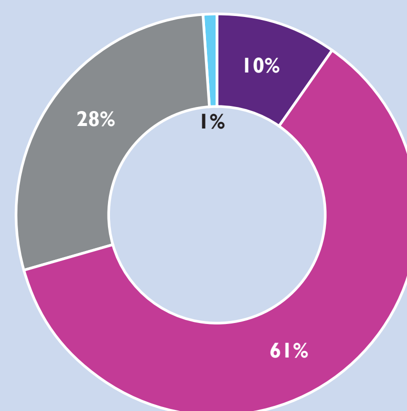
ALTERNATIVE DEBT PROVIDERS TO INCREASE LIQUIDITY IN 2014

The most profound change in the European acquisition finance debt market in 2013 was the rapid influx of alternative sources of capital, including private debt funds, bond funds, institutional investors and private wealth managers. Combined with gradually improved liquidity among traditional lenders, sponsors now have access not only to greater liquidity but also to a more diverse array of financing providers offering a wide range of different structures. This represents a marked change to the market just three years ago, when realistically the only alternative to pure senior was a senior plus mezzanine structure.

The European acquisition finance debt market now seems to be firmly set on a path towards a US-style funding environment, where for a long time non-bank lenders have accounted for the majority of corporate lending. "We think the UK market is moving rapidly towards a US funding model," confirmed Fenton Burgin, Partner – Debt Advisory, at Deloitte. "In the US probably 30% of corporate capital comes from banks. In Europe, the market is 85%-90% bank financed. This is declining rapidly and will continue to do so in 2014 and beyond."

The emergence of alternative sources of capital has been driven by multiple factors. Firstly, traditional bank lenders are increasingly restricted by external regulations such as Basel III and internal compliance requirements, especially if they are government owned. In addition, the continued low interest rate environment has resulted in a lot of money, particularly from the US, flowing into the European leveraged finance market as it represents a sound alternative to more mainstream investment classes. But perhaps most importantly, many new investors have entered the market simply after having witnessed the relative successes of the early non-bank market entrants.

HOW DO YOUR ACQUISITION FINANCE LENDING TARGETS FOR 2014 COMPARE WITH 2013?



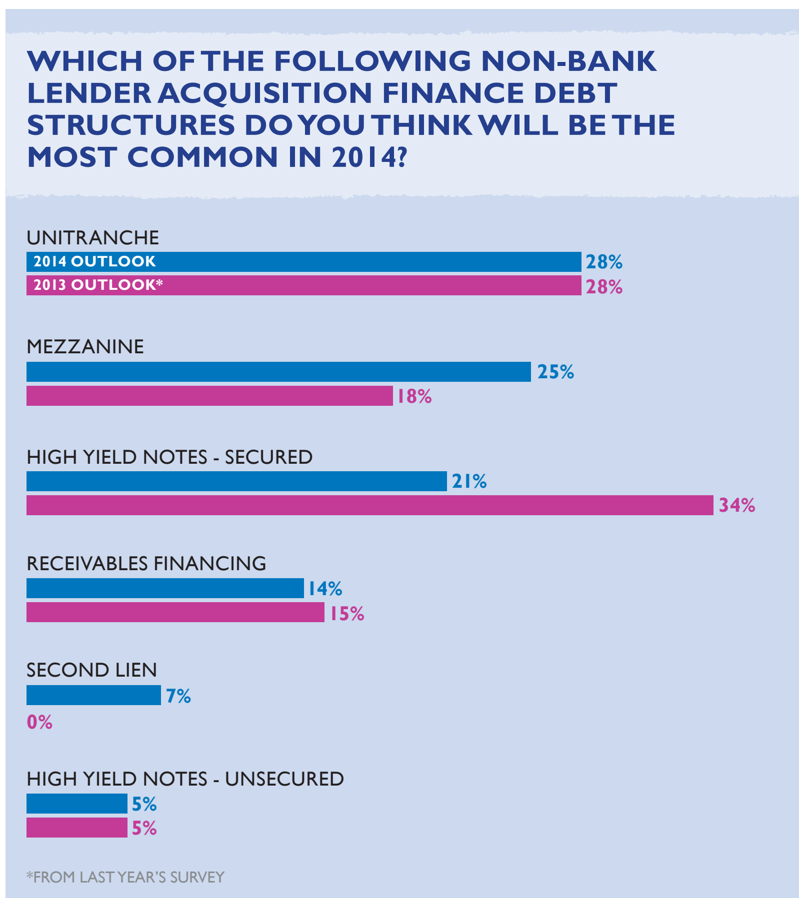
> "In the US probably 30% of corporate capital comes from banks. In Europe, the market is 85%-90% bank financed. This is declining rapidly and will continue to do so in 2014 and beyond."

Survey data underlines the extent to which liquidity is expected to improve in 2014 due to the influx of alternative lenders. Over 70% of lenders surveyed for this report have higher acquisition finance lending targets for 2014 compared to 2013.

THE RISE OF THE PRIVATE DEBT FUND

Private debt funds promoting unitranche structures have had the most material impact on the European acquisition finance debt market in 2013. Interviewees report that over 50 deals involving private debt funds were completed in 2013, a significant increase on 2012. Given the sheer volume of private debt funds raised and in the pipeline, this trend should accelerate in 2014.

"2013 was really a break out year for private debt funds," confirmed Max Mitchell, Fund Manager at ICG. "Over 30 have either raised money or are in the process of raising money as investors see the attractions of the asset class. At the same time there has also been a significant step up in investment activity by the private debt funds as borrowers seek alternative sources of liquidity. The really interesting thing will be to see how the direct lending market develops over the next two to three years and to see who will be the successful long-term platforms and who falls away."



As outlined in the graph to the left, survey respondents expect unitranche structures, which combine senior and subordinated debt into one debt instrument, to be the most common non-bank acquisition finance debt structure in 2014, followed by mezzanine debt and high-yield secured notes.

It appears that the impact of private debt funds in the mid-market has been so significant because they offer sponsors advantages over traditional senior or senior plus mezzanine structures. Respondents have identified the following:

- **Higher leverage:** Unitranche structures can enable sponsors to inject greater levels of leverage into deals than is achievable with senior only structures. Unitranche structures also sometimes offer comparable (or even higher) leverage ratios to senior plus mezzanine structures at a similar price point, while claiming to avoid the complications of inter-creditor issues between senior and junior lenders. Survey respondents expect the average leverage ratio in 2014 to be 4.9x for deals using unitranche structures, 4.7x for senior plus mezzanine structures and 3.4x for senior only structures.

- **Larger hold sizes:** Unitranche funds can invest and hold up to £150 million of debt per deal, sometimes more. This is significantly larger than the £25-£30 million average individual holds offered by conventional mid-market lenders. The larger hold size immediately reduces execution complexity by reducing the number of arranging participants.
- **Low amortisation:** Banks typically require 30%-40% of the term debt to be repaid in semi-annual instalments. By contrast unitranche structures have low and often zero amortisation, enabling sponsors to invest more operational cash in the business.
- **Greater flexibility:** Private debt funds can sometimes be more flexible than banks on structures, covenants and pricing. "There is simply more openness to consider the merits of a particular structure within the context of a deal and to insert bespoke clauses," explained Owen Verrier-Jones, Managing Director at GE Capital. "The banking community has a more one-size-fits-all approach and will not be flexible on clauses, even if they don't really make a lot of sense."

There are of course some drawbacks to the unitranche structure. Most importantly, there is some uncertainty amongst the sponsor community over how private debt funds will approach a deal in default, especially given the larger share of the capital structure they hold. This is most likely a natural anxiety as most private debt funds are relatively new market entrants with a limited track record.

"Some private equity firms are genuinely concerned about how private debt funds will respond in a default situation," explained Richard Roach, Managing Director, Financial Sponsors UK at RBS Structured Finance. "As with any new entrant into an established marketplace there will always be a degree of concern or nervousness as to how long that entrant will stay in the market for and how they will behave in the event of a problem. I have spoken with several private equity firms that have raised this issue."

In addition, some sponsors have expressed concern as to the extent of the "deep pockets" that debt funds will have should further investment be required as many fund structures, on their first raising, are capped at moderate amounts.

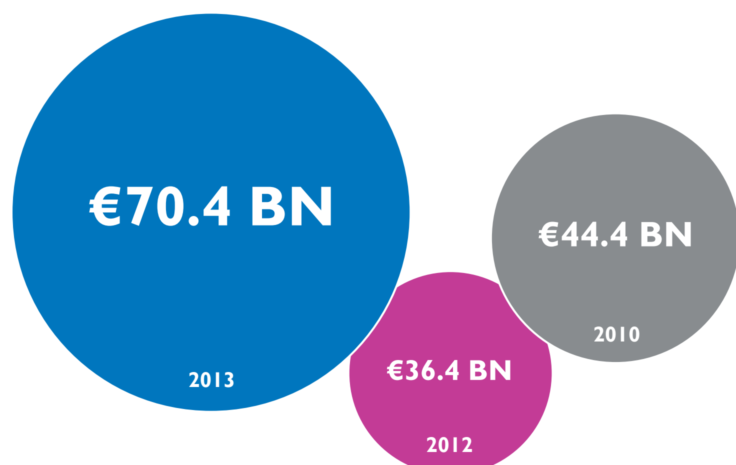
A RECORD YEAR FOR HIGH-YIELD

2013 has been notable for the influx of US high-yield investors into Europe in response to a decline in returns in the US. European issuers have certainly taken advantage of this – some 212 bonds totalling €70.4 billion priced in 2013, a significant increase on the roughly 100 bonds issued per year between 2010 and 2012, according to S&P Capital IQ LCD. The €70.4 billion of new issuances also far exceeds the €36.4 billion issued in 2012 and the previous record high of €44.4 billion in 2010.

"There is a glut of liquidity in the larger market driven by both global capital

> "There is a glut of liquidity in the larger market driven by both global capital flows searching for yield and a shortage of deals. Clearly high-yield also brought a whole new pool of liquidity to the larger deal space in 2013."

EUROPEAN HIGH-YIELD ISSUANCE



SOURCE: S&P CAPITAL IQ LCD

flows searching for yield and a shortage of deals," explained James Ranger, Co-Head of the Acquisition Finance Mid Markets Team at Lloyds Bank. "Clearly high-yield also brought a whole new pool of liquidity to the larger deal space in 2013. It was definitely the biggest year for high-yield that we have ever seen. Capital has flowed, particularly from the US, into high-yield funds that will dip in and out of the market, but currently are showing strong demand and less volatility than historically."

Despite 2013 being a record year for high-yield issuances, survey respondents anticipate this structure will only be the third most common non-bank lender acquisition finance debt structure in the mid-market in 2014, behind unitranche and mezzanine.

High-yield is not only a structure for the larger end of the market. "The record expansion of the European high-yield market has created new opportunities for smaller, first-time or lower-rated issuers," noted Tony Lopez, high-yield partner at DLA Piper. Indeed UK private member club Soho House raised £115 million through a 9.125% five year bond in October 2013, while UK debt purchaser Marlin Financial secured £150 million in July 2013 via a 10.5% bond due to mature in 2020. Respondents commented that bonds can be attractive in the mid-market as they are comparable to the unitranche structures in terms of leverage, pricing and size, but come without financial covenants.

On the flipside a large chunk of liquidity will exit the top end of the market this year when the large number of collateralised loan obligation (CLO) funds raised in 2006-2007 come to the end of their reinvestment window. That said, the European CLO market recovered strongly in 2013, with 20 new CLO funds totalling €7.4 billion issued, according to S&P Capital IQ LCD. No CLOs were issued in 2012. However this in no way compensates for the swathe of CLO funds that will leave the market by the end of this year.

New CLO fund issuance will struggle to meet the heights of the pre-crisis years due to new regulatory requirements. For example the Volcker Rule, which banks will have to comply with by July 2015, prohibits banks from using their own funds for certain trading activities, including the holding of CLOs as currently constructed. Many will have to sell their CLO holdings to ensure compliance.

TAPERING MAY ALSO REDUCE LIQUIDITY AT THE TOP END OF THE MARKET

There is a real question mark regarding the possibility that some of the liquidity that has entered the European market in 2013 will dry up as a result of US Federal Reserve's tapering programme – monthly asset purchases decreased by $10 billion from $85 billion to $75 billion in January 2014 and by a further $10 billion from February 2014.

In Europe, tapering is unlikely to impact the mid-market, since many of the private debt funds have committed funds with a five to seven year investment window. However, activity may slow at the top end of the European market, where many of the new entrants are diversified funds with the ability to switch between asset classes rapidly.

"The big question is whether these non-traditional sources of finance will be available forever," explained Andrew Tully, Head of Structured Finance – Financial Sponsors, London, at Santander Corporate Banking. "With record low interest rates there is a lot of cash tied up in the world that is looking for a return. This is fuelling the bond market and the unitranche fund market. I would speculate that funds may change tactics when interest rates rise."

A MORE AGGRESSIVE FUNDING ENVIRONMENT

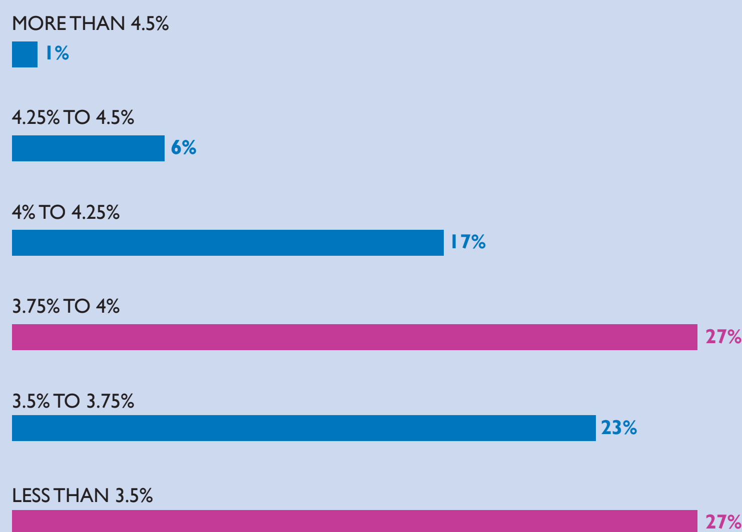
PRESSURE ON MARGINS AND PRICING TO CONTINUE IN 2014

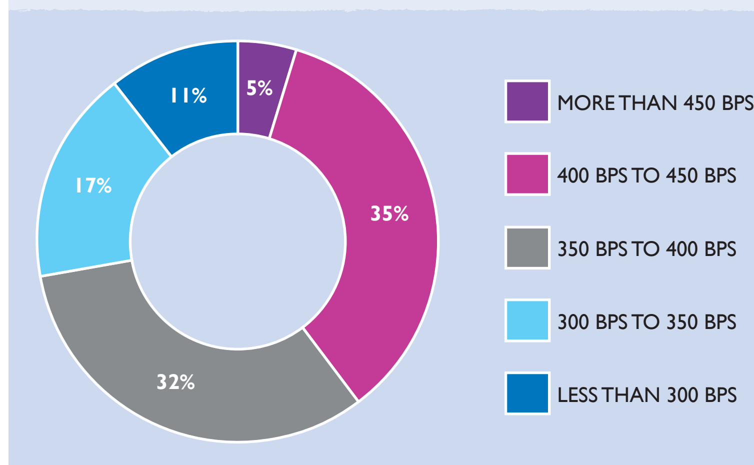
Greater liquidity goes hand in hand with more aggressive structures and pricing, so it is no surprise that margins and arrangement fees have reduced significantly in the past 12 months. The impact has been much more pronounced at the top end of the market, where high-yield bonds are currently being priced 100-200 basis points tighter than at the beginning of 2013 for equivalent rated debt. In the mid-market, dealmakers report that margins and fees have reduced by 25 basis points in the past 12 months.

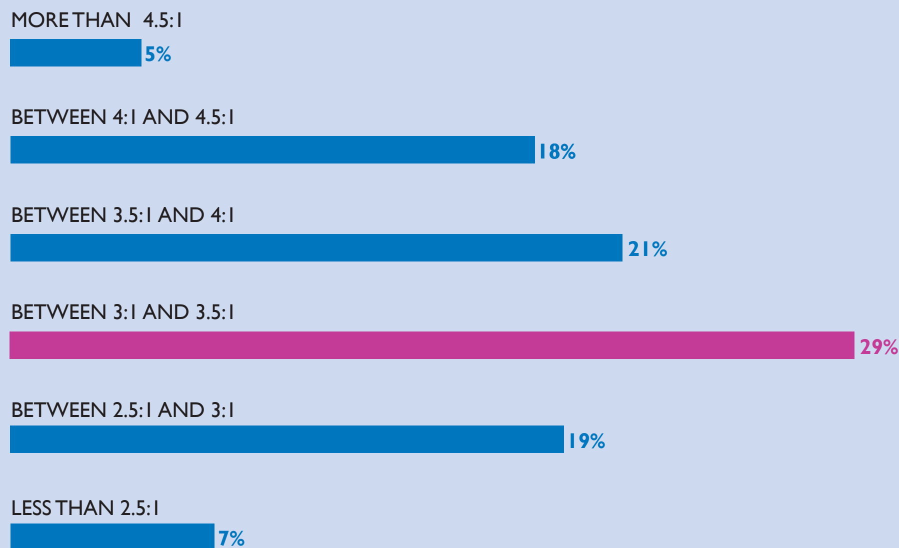
Survey respondents forecast further pressure on margins and pricing during 2014. Over three quarters (77%) expect senior debt arrangement fees to be below 4% in 2014, a significant increase on the 26% that shared this view in last year's survey. Likewise, survey respondents expect margins to continue to decline in 2014 – 60% expect senior debt margins to be less than 4% in 2014, a marked increase on the 11% anticipating sub-4% margins in last year's survey.

BANKS' CAUTION LIKELY TO BE TESTED IN 2014

The increase in liquidity during the past 12 months has also put pressure on leverage, with interviewees and survey respondents reporting an increase in leverage by between half a turn and a full turn of EBITDA during the past 12 months.







The risk appetite of banks looks set to be significantly tested in 2014, with survey respondents expecting further upwards pressure on senior debt leverage – almost a quarter (23%) of survey respondents expect leverage to be over 4x on average in 2014, compared with 16% of respondents in last year's survey and 1% of survey respondents two years ago.

"It absolutely depends on the deal, but for a strong mid-market deal we are seeing the highest level of senior leverage since 2008," confirmed James Ranger. "Banks are not delighted with this, but they have to be aggressive to play in this market."

THE CHARGE OF THE COVENANT-LITE BRIGADE

An additional consequence of increased liquidity is the expected emergence of covenant-lite structures, which have long been a feature of the US market. In Europe, there is most potential for this to occur in deals above £200 million, where arrangers typically sell on debt tranches to more liquid investors that are less focused on tight covenant packages.

In such deals it is likely that two-covenant packages will become the standard and that four-covenant packages will become quite rare. It will naturally take longer for covenant-lite structures to become a feature of the mid-market, as lenders have to hold loans.

However, as Ciara O'Neill, Managing Director at DC Advisory, explains, there are already some signs that this is emerging. "BC Partners decided to turn its back on Europe and issue in the US to get a covenant-lite financing package for their acquisition of Mergermarket," she said. "This is the first time this has happened for a UK mid-market deal. There will be a push to start dropping maintenance covenants in European loan packages to ensure dealflow doesn't leave the European market altogether. I think it will start at the larger end with the safe or utility-type credit but then it will filter down and I think deals like Mergermarket are very telling."

> "There will be a push to start dropping maintenance covenants in European loan packages to ensure deal flow doesn't leave the European market altogether."

UK

IMPROVING ECONOMY TO DRIVE INCREASE IN NEW MONEY DEALS

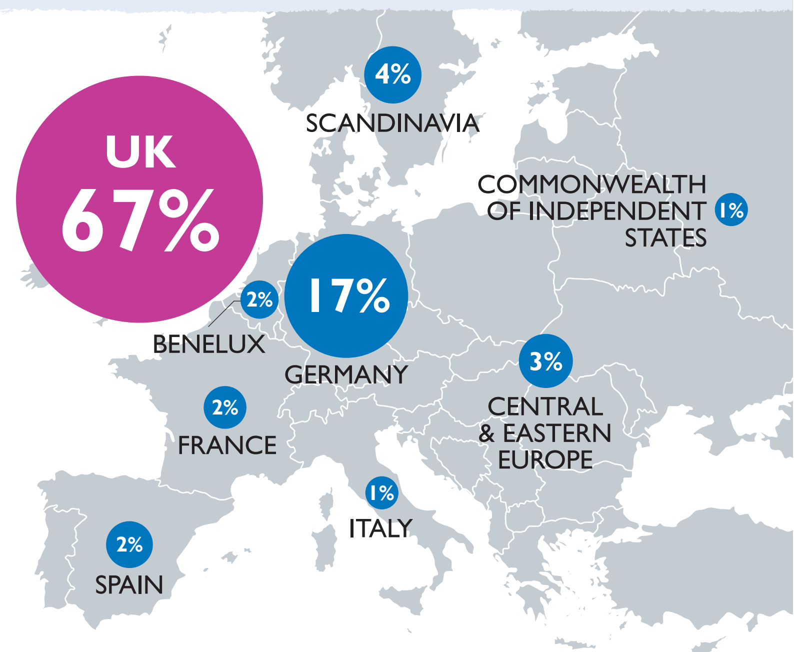
The UK is widely expected to be the most active market in Europe for acquisition finance debt deals in 2014 according to survey respondents – two thirds (67%) of respondents expect the UK to be the most active country, followed by Germany (17%), Scandinavia (4%) and Central and Eastern Europe (3%).

This was expected and is in line with predictions from last year's survey. The weight of private equity funds in the UK combined with the wealth of lenders and financial intermediaries continues to maintain the UK's position as the largest market in Europe for acquisition finance debt deals. Some 67 acquisition debt deals valued at €33.7 billion were executed in the UK in 2013 according to Dealogic, more than in any other country. Refinancings were the most prominent deal type, accounting for 38% of the total value of deals and 30% of the number of deals.

The general consensus is that in 2014 the UK market will be dominated by a large number of refinancings and recapitalisations alongside an increase in primary deal activity as the economy continues to strengthen.

"I think there will continue to be lots of refinancings in 2014 and maybe a slight uptick in primary deals," confirms Ian Crompton, Deputy Head of Leveraged Finance at HSBC Bank. "There is pressure on sponsors if they can't realise exits to refinance in order to return money to shareholders. We are in a period when

WHICH EUROPEAN JURISDICTION RANKED BY VOLUME (DEAL NUMBERS) IN THE EUROPEAN ACQUISITION DEBT MARKET WILL BE THE MOST ACTIVE IN 2014?



Liquidity and the increased range of products and providers have assisted in driving the market forward strongly – how that plays out with the traditional senior debt banks and mezzanine providers looking to respond to unitranche and the opening of the IPO markets makes for a very interesting 2014.

David Miles
Head of Debt Finance
DLA Piper, London

it is taking longer for private equity to achieve exits, so the natural consequence of this is more dividend recaps. As the economy recovers there will generally be more confidence so we might also see more actual deals."

Andrew Tully, Head of Structured Finance – Financial Sponsors, London, at Santander Corporate Banking, pinpoints two sectors where he expects significant deal activity in the UK. "Healthcare is pretty hot in the UK at the moment, especially at the acute end such as residential care homes for the elderly and for adults with acute learning difficulties," he said. "This is driven by a lack of capacity in the public sector. The restaurant sector has also suddenly heated up. This sector has proved particularly resilient over the cycle, particularly at the fast and casual end, so there is a flurry of restaurant deals around."

> "We have seen a healthy increase in deal activity over the course of 2013. New players, a wider range of products and added liquidity have bolstered a renewed optimism in the UK economy. This means that we are increasingly confident about the outlook for 2014. Certain sectors and transaction types will see more activity than others but overall we expect a further step-up in activity in the coming months.

Alexander Griffith
Partner
DLA Piper, London

GERMANY

DEAL ACTIVITY WILL INCREASE IF M&A MARKET CONTINUES TO PICK UP

Like the UK, Germany's economic outlook looks much more robust than most European countries. The German central bank's latest forecasts predict the country's GDP will grow 1.7% in 2014, significantly more than the 0.4% growth in 2013 and the 1.1% growth predicted for the entire Eurozone. This should lead to an uptick in new M&A deal activity.

An increase in deal activity will maintain Germany's position as one of Europe's strongest acquisition finance debt markets. Some 55 deals totalling €42.7 billion were completed in Germany in 2013, ranking the country third by the number of transactions across Europe, according to Dealogic. Survey data indicates that Germany will continue to play second fiddle to the UK this year – 17% of survey respondents expect Germany to be the most active country for acquisition finance debt deals in 2014, significantly less than the number forecasting the UK to be most active (67%).

A major development in the German market in 2013 was the significant growth in liquidity. A growing number of international banks are looking at Germany again and are keen to lend against German assets. Several large European lenders have even declared Germany their second home market. This is a direct result of the strong performance of German corporates during the Eurozone crisis, which has rendered them attractive clients for international lenders. At the same

time, German banks have an interest in keeping their clients and defending their market share. This trend will likely continue in 2014.

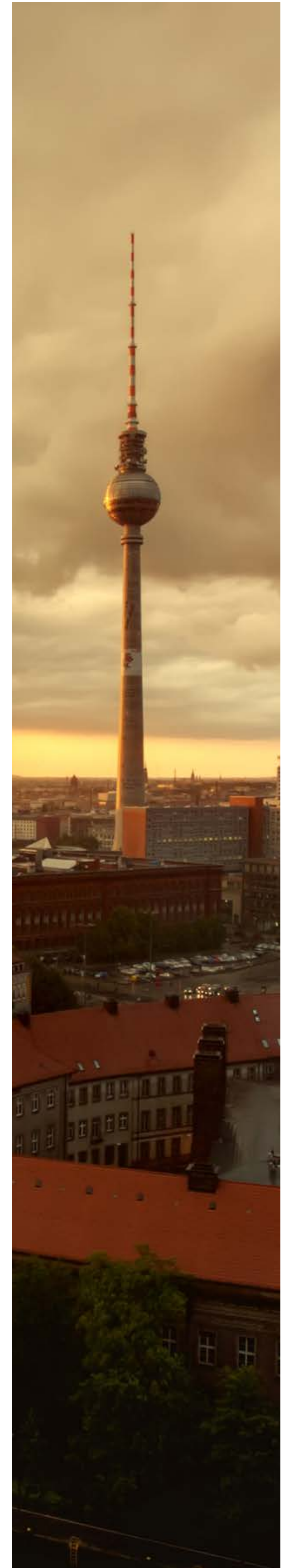
However, improved debt finance liquidity has not been matched by an increase in leveraged M&A activity. Many private equity sponsors are interested in the German market, but suitable opportunities are rare and prices for targets are high. Strategic German investors are traditionally reluctant to finance acquisitions by way of structured acquisition financings and prefer an all-equity approach. A major trend in recent years has even been a widespread deleveraging of German corporates, which again has led to less new money debt finance opportunities.

This imbalance between improved liquidity and a limited number of M&A deals led to pressure on margins and looser covenants in 2013, in particular in the second half of the year. This trend will continue unless leveraged M&A activity picks up.

Unlike in the UK, private debt funds made minimal impact on the lending landscape in Germany in 2013. This was mainly due to restored bank liquidity, meaning private debt funds are competing with banks offering all-senior loans which are in most cases significantly cheaper than the unitranche loans provided by debt funds. Consequently, debt fund lending is only relevant in "special situations", including borrowers with a sub-investment grade rating or a difficult track record, recapitalisations, or other situations in which banks find it difficult to lend.

In addition, the regulatory framework for private debt funds in Germany is a lot tighter than in the UK. Most importantly, all direct lenders in Germany, including private debt funds, require in principle a bank licence. There are possibilities to structure financings around this regulation, but legal advice should be sought.

Even tighter regulation can be expected in 2014. In December 2013 the parties of the grand coalition, CDU and SPD, set out that alternative lenders providing debt finance in Germany will be regulated in the same way as banks. It remains to be seen what this announcement will lead to in 2014.



The German debt finance market has plenty of bank liquidity again, but interesting M&A opportunities are still rare. If the M&A market continues its recovery, we can expect further growth of the acquisition finance market in Germany.

Wolfram Distler

Partner

DLA Piper, Frankfurt

SCANDINAVIA

POISED TO UPSET THE DEAL RANKINGS IN 2014

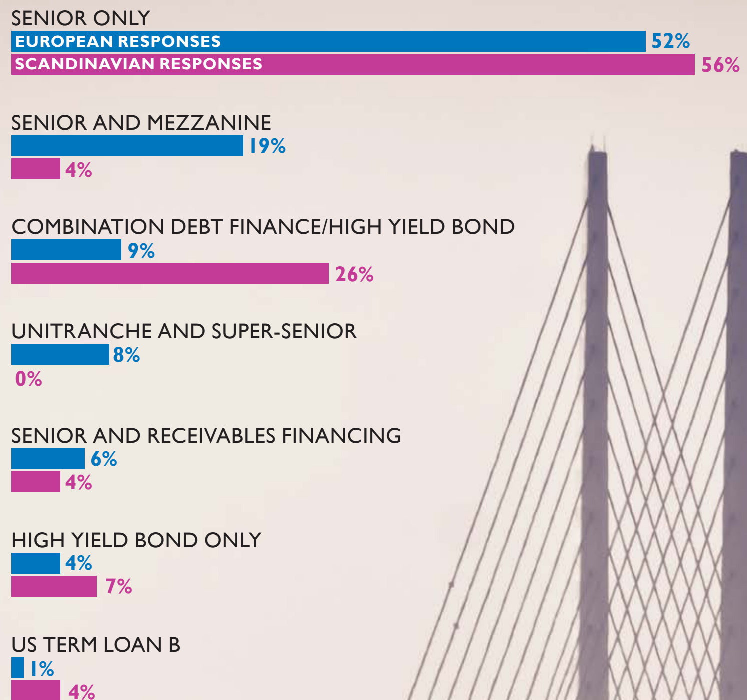
2013 was a relatively quiet year on the deal front in Scandinavia. Only 30 acquisition finance debt deals valued at €15.8 billion were executed in 2013, accounting for 8% of the total number of deals across Europe, according to Dealogic. This was a direct result of a hiatus of activity in Sweden, traditionally the largest market in Scandinavia.

However, Scandinavia was ranked third by survey respondents in terms of expected activity for 2014, behind only the UK and Germany. So the signs are that activity in Scandinavia should pick up during the next 12 months. This will in part be driven by an improved economic outlook for 2014 and 2015. In Sweden, economic growth is expected to rise from 0.7% in 2013 to 2.3% in 2014 and 3.0% in 2015, according to the OECD. Meanwhile economic growth in Norway is forecast to increase from 1.2% in 2013 to 2.8% in 2014 and 3.1% in 2015.

Despite a shortage of deals in 2013, liquidity increased significantly, meaning borrowers were able to enjoy very attractive terms and pricing. Indeed survey respondents report that leverage ratios in Scandinavia increased by up to two turns over the past 12 months alone, significantly more than in most other European countries.

Liquidity has improved for three reasons. Firstly, Swedish banks have become more active following a

WHICH OF THE FOLLOWING DO YOU THINK WILL BE THE MOST COMMON MIDDLE-MARKET ACQUISITION FINANCE DEBT STRUCTURE IN 2014?



period of cost cutting and fundraising to meet stringent capital adequacy requirements. Secondly, the Scandinavian high-yield bond markets, most notably the Norwegian bond market, are also rapidly becoming a major source of liquidity. Thirdly, as with the UK, private debt funds are also becoming increasingly active.

According to survey respondents, high-yield bonds are now the second most important debt structure in Scandinavia following senior debt. Some 33% of Scandinavian survey respondents expect pure high-yield bond or a combination of high-yield bond and debt structures to be the most common mid-market acquisition finance debt structure in 2014. This is a marked contrast to the rest of Europe, where only 13% of respondents believe bond structures will be the most common structure in the mid-market.

> "The end of 2013 was busier than we expected but for most of the year activity was subdued by historical standards. Norway was the most active market in 2013. The private equity houses in Stockholm, which is the main market in Scandinavia, weren't really doing anything. We closed the first major unitranche deal under Swedish law at the end of 2013, marking private debt's first major inroad in the senior space. This is something I expect to continue to take place in 2014.

Bjorn Sjoberg
Partner
DLA Nordic, Stockholm

FRANCE
AN UNCERTAIN OUTLOOK FOR 2014

In last year's report it was predicted that France would slip down the deal rankings behind Scandinavia. Despite this gloomy prediction, deal activity remained robust in 2013, with 56 deals totalling €22.9 billion executed, according to Dealogic. France was in fact the second most active country in Europe by the number of deals in 2013, behind only the UK.

The high level of activity was a direct result of the large volume of refinancings of LBOs structured in the pre-crisis years. €11.4 billion worth of refinancing transactions were completed in 2013, making France the third largest country for refinancing activity in Europe behind Germany and the UK. The pipeline of refinancing and restructuring deals is still strong due to the sheer quantum of LBOs structured six to seven years ago, meaning there will be plenty of transactions to keep dealmakers busy this year.

Banks have realised that they need to underwrite again and take syndication risk as senior debt funds won many financings in the French LBO debt market in 2013. They have won some deals like this as it is easier for sponsors to deal with one single party but it is tough because regulatory requirements like Basel III are making lending much more complicated.

Maud Manon
Partner
DLA Piper, Paris

However the prospects for new money deals in 2014 are less promising, with France ranked joint fifth in terms of expected deal activity by survey respondents (although notably this ranking rises to third when respondents select the countries expected to be amongst the top three regions for deal activity). This is primarily due to the stagnation of the country's economy. France's economy only grew 0.2% in 2013 and economic growth is expected to remain sluggish for the next two years. New money deal activity is already relatively muted in France – €3.4 billion worth of new money deals were executed in 2013, accounting for only 6% of all new money deals across Europe.

One trend that will certainly materialise in 2014 is the continuing decrease of the portion of deals done by traditional banks. This is a consequence of various factors, including recent changes to French banking monopoly rules that expand the type of entities able to lend to a French borrower, constraints imposed on banks by Basel III rules, and the huge sums of money raised by senior debt funds during the last 18 months.

SPAIN

GROWING CONFIDENCE DRIVES UPTICK IN DEAL ACTIVITY

Spain was one of the worst performing countries in the Eurozone during the financial crisis and as such experienced a significant decline in deal activity between 2008 and 2012. However, there is a growing sense that confidence has been restored in the leveraged finance market and that the worst of the financial crisis is over. Some 30 deals valued at €7.1 billion were executed in 2013, accounting for 8% of the total number of deals across Europe, according to Dealogic.

Notably, five new primary acquisition finance debt deals closed in 2013, a significant increase on the annual deal count during the past five years. However, Cesar Herrero, partner in DLA Piper's Madrid office, believes that limited liquidity amongst Spanish banks and a flat economic outlook means there is probably only scope for four to five new primary deals in the Spanish market per year. Spain's economy is only expected to grow 0.5% in 2014 and 1% in 2015. The economy actually shrank 1.3% in 2013 and 1.6% in 2012.

Deal activity in 2014 will instead likely be dominated by the refinancing of LBOs structured in the pre-crisis years, of which there are many relative to the size of Spain's economy.

Terms and structures have become tighter, with the majority of new primary deals in 2013 using a 50:50 debt equity structure. This represents a significant decrease on capital structures in the pre-crisis era, when 80:20 debt to equity ratios were typical. Given the high equity content in new-money deals it is likely that sponsors will seek to improve the capital structure in the next three years through introducing mezzanine finance into the capital mix.

In 2014 there will be a lot of room to improve the capital structure of deals through mezzanine financing and/or other alternative debt provided by private debt funds. It is very expensive for sponsors to stump up 50% of the transaction value. Banks are being quite conservative so I don't think there is much capacity for senior debt to be increased.

Cesar Herrero
Partner
DLA Piper, Madrid

ITALY

CORPORATE M&A UNDERPINS INCREASE IN DEAL ACTIVITY

There has also been a small increase in deal activity in Italy, underpinned by a continuation of large volumes of refinancing activity and an uptick in corporate acquisitions – 27 deals valued at €10.2 billion were completed in 2013, more than double the 11 deals valued at €3.3 billion executed in 2012, according to Dealogic. This is a direct result of a 53% annual increase in the value of refinancing activity.

In contrast, new private equity-backed acquisitions have decreased during the past three years, in part due to lacklustre GDP growth. Italy's economy shrank 1.9% in 2013 and 2.6% in 2012, according to the OECD. However, private equity funds are expected to look again at Italy in the next two years as the economy recovers. The economy is expected to grow by 0.6% in 2014 and 1.4% in 2015.

One notable development in 2013 was the use of bond take-outs by large Italian corporates to refinance corporate acquisition loans after the closing of the acquisition. The recent enactment of new tax laws and regulation that provides more flexibility in the bond market will also likely increase the use of bond take-outs by mid-sized and non-listed Italian corporates in 2014.

Use of bond take-out structures, which have been widely used in Europe for many years, saw a substantial increase in Italy last year. In 2014 I expect to see an increase of corporate acquisition loans and bond take-outs, both in terms of the number and value of deals. There may possibly also be some new levered finance transactions in terms of both high-yield bond issuances and leveraged loans.

Mario D'Ovidio
Partner
DLA Piper, Milan

TURKEY

GREAT POTENTIAL BUT POLITICAL UNREST WILL HINDER ACTIVITY IN 2014

With its large and diverse range of family run businesses, an active private equity community and well capitalised banks, Turkey is a market many believe possesses strong growth prospects. Successful companies range from established international brands to up and coming businesses located outside of its well-developed cities, known as the "Anatolian Tigers". In early 2013 the country appeared to be realising this potential, with a flurry of deals being executed.

However, a series of political events, including the Gezi Park Protests in May 2013, led to a sharp increase in interest rates, a depreciation of the Turkish Lira and volatility in the capital markets. Despite this, M&A dealflow for the remainder of 2013 remained high as the Turkish M&A market is not driven by capital markets volatility.

Recently, matters have not been helped by a major bribery and corruption scandal reported in December 2013 involving high level businessmen and politicians. At the time of going to press, this scandal is still being played out so its impact on deal activity in Turkey is uncertain.

These political events mean primary activity is likely to be muted in 2014, certainly in anticipation of local elections in March 2014. However, market participants are still optimistic about deal activity in 2014. Local and international buyers are sensing a more realistic adjustment in prices to aid what was becoming an overheated acquisition market.

Turkey's economic growth forecasts are conducive to an increase in M&A activity. The OECD expects Turkey's economy to grow 3.8% in 2014 and 4.1% in 2015, significantly more than the average growth forecasts across the Eurozone.

With domestic and foreign banks looking to grow their portfolios, and with new market entrants, such as mezzanine funds, eager to develop business in Turkey, there will certainly be deals to be done. As there are very few "standard" private equity or leveraged finance deal models, and as participants continue to grapple with the 2012 Turkish Commercial Code, including financial assistance restrictions, there may be more opportunities for alternative finance providers and foreign banks new to the Turkish market to be involved in acquisitions alongside the traditional domestic banks.

There is definitely long term potential in Turkey as the fundamentals are very attractive. There are a huge number of family run businesses that have become corporate in nature and are looking for private equity or alternative backing. Turkish banks are well capitalised and ambitious to encourage economic growth.

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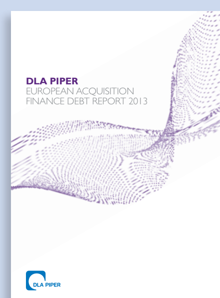
PREVIOUS EDITIONS



ABOUT THE RESEARCH

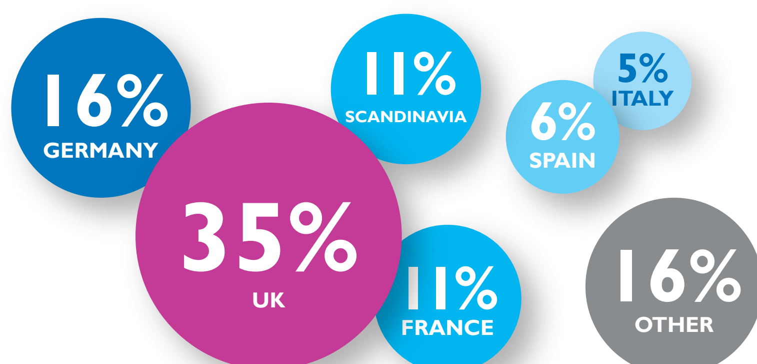
The survey and report were written in collaboration with The Lawyer Research Service, a joint initiative between The Lawyer and VB/Research. The survey was undertaken in November and December 2013, and was completed by over 250 debt providers, advisors, sponsors and corporates across Europe.

Survey respondents include: 3i Group plc, Akbank T.A.Ş, Alcentra, Ares Capital Europe, Armada Mezzanine Capital Oy, Axa Investment Managers, Babson Capital Europe Ltd, Barclays Bank PLC, Beechbrook Capital LLP, Danske Bank A/S, DC Advisory Ltd, Deloitte LLP, Ernst & Young LLP, GE Capital, HSBC Bank plc, ING Groep N.V., Investec PLC, KPMG LLP, Leonardo & Co, Lider Faktoring A.S., Livingstone Partners LLC, Lloyds Banking Group plc, NIBC Bank N.V., Nordea Bank AB, Park Square Capital LLP, PwC LLP, The Royal Bank of Scotland Group plc, Banco Santander S.A., SEB AB, Sun European Partners LLP, Swedbank AB and UniCredit Bank AG.

To supplement the survey, interviews were conducted with the following individuals:

- **Graeme Delaney-Smith**, Managing Director – Head of European Direct Lending and Mezzanine Investments, Alcentra
- **Mike Dennis**, Partner, Ares Capital Europe
- **Ciara O'Neill**, Managing Director, DC Advisory
- **Fenton Burgin**, Partner – Debt Advisory, Deloitte
- **Owen Verrier-Jones**, Managing Director, GE Capital
- **Max Mitchell**, Fund Manager, ICG
- **Ian Crompton**, Deputy Head of Leveraged Finance, HSBC Bank
- **James Ranger**, Co-Head of Acquisition Finance Mid Markets Team, Lloyds Bank
- **Richard Roach**, Managing Director, Financial Sponsors UK, RBS Structured Finance
- **Andrew Tully**, Head of Structured Finance – Financial Sponsors, London, Santander Corporate Banking

RESPONDENT BREAKDOWN BY COUNTRY



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