EUROPEAN ACQUISITION FINANCE DEBT REPORT 2017

Executive Summary

Welcome to DLA Piper's European Acquisition Finance Debt report 2017. This report, now in its eighth year, presents detailed results of our survey of 300 participants active in the European acquisition finance debt market. It also includes extracts from interviews with senior dealmakers.

2016 was yet again a robust year for deal activity despite a slowdown immediately before and for a period after the Brexit vote. The majority (87%) of survey respondents across Europe reported that deal activity was at least in line with their expectations at the beginning of the year.

The first five months of 2017 have been notably quieter, particularly in the UK. This could be an indicator of deal flow for the rest of the year. Only a quarter of survey respondents forecast an increase in deal volumes in 2017, the lowest number in the last eight years.

What has caused the slowdown? A key factor is the diverse quality of assets that are coming to market. Good quality credits are frequently subject to highly competitive auction processes, often involving trade buyers, in which borrowers are able to drive terms from lenders competing for the mandate. But there are also a large number of lesser quality credits coming to market at valuations that buyers are not prepared to match (and their lenders not prepared to support), resulting in aborted processes.

Of course, many political factors are also at play. Elections in France and the UK have already taken place this year and German elections will take place in September. Deal activity is often quiet in the months preceding an election. Also, while deal activity picked up in Q4 2016 following the Brexit vote, deal volumes could be impacted by residual uncertainty around Brexit negotiations.

But the one key factor that may trigger an upturn in activity or at least help to maintain 2016 levels is liquidity. Debt fund liquidity is at record volumes and private equity funds targeting Europe had $173 billion of dry powder at the beginning of the year, according to Deloitte, a 21% annual increase.

As they strive to deploy their capital, the beginning of 2017 has been notable for direct lenders being more aggressive on pricing and terms. According to Debtwire, non-bank lenders executed more than 70% of mid-market deals in Q1 2017, their highest ever market share. Banks do however remain a key part of the market and there continues to be evolution of the products jointly being made available by banks and debt funds.

At the time of going to press with this year's report, the UK is still digesting the impact of the results of the UK's general election which failed to deliver a majority government. The result, in so far as it makes the UK's approach to the forthcoming Brexit negotiations currently unclear, also has an impact on Europe as a whole. Responses to our survey were gathered prior to the announcement of the surprise decision to call a snap general election and so were not factored into the predictions of deal volumes for the year. What is clear is that the election and its outcome are yet further political factors that add to the uncertainty for a market that has had to deal with macroeconomic headwinds over the past 18 months. Whilst temporary volatility may be welcomed by some lenders if it allows them to push back on aggressive borrower friendly terms currently seen in the market, the amount of liquidity available will inevitably mean that market participants will quickly find ways to deploy their capital.

If you have any questions about the findings, or would like to discuss how DLA Piper can assist your organisation, please contact any of the DLA Piper Debt Finance Partners, whose details are listed at the end of this report.

June 2017

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Market reflections on 2017

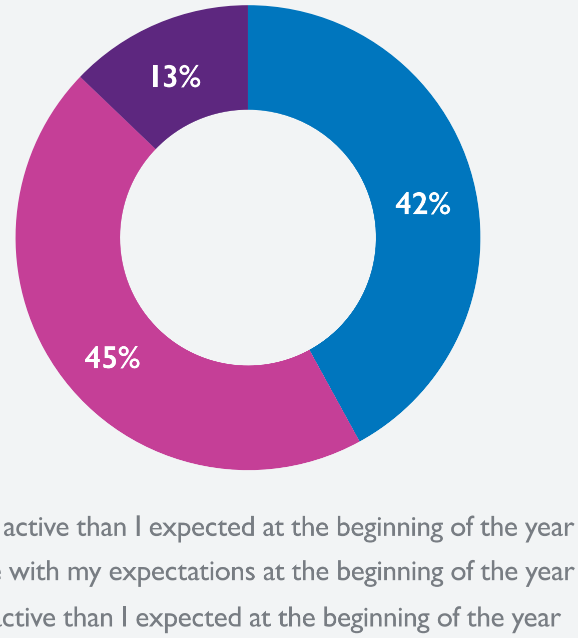
STRONG DEAL VOLUMES IN 2016 DESPITE BREXIT PAUSE

The European acquisition finance debt market had a robust year in 2016 despite a hiatus in deal activity in the third quarter following the Brexit vote.

The majority (87%) of banks, alternative lenders and advisory firms surveyed for this year's report stated that deal activity was either in line with their expectations at the beginning of the year (45% of respondents) or exceeded their expectations (42% of respondents). Only 13% said deal activity in 2016 was below their expectations at the outset of the year.

The Brexit vote did cause a deceleration in deal activity in the weeks before the vote and in the following months, but the consensus is that the year finished strongly with deal volumes for 2016 ending up at similar levels to 2015.

How active was the acquisition finance debt market in the country where you are located in 2016 compared with your expectations at the beginning of the year?



That said, the number of transactions has decreased significantly so far this year and the market has remained relatively quiet up to the time this report went to press in June. This is likely a result of a continuing lack of M&A transactions and political uncertainty caused by the triggering of Article 50 and this year's French and German elections. Of course, the UK election, announced after the survey was undertaken, added to the uncertainty.

"There are some headwinds kicking around – the European elections and the uncertainty caused by Brexit, particularly now we have triggered Article 50," said Richard Roach, Managing Director, Financial Sponsors UK at RBS. "I wouldn't have thought any of these things by themselves would warrant a slowdown in deal activity, but it might be a combination of those factors. Some people also think the market is overheating. These things taken together might mean people thinking about launching a process are sitting on their hands at the moment."

UNCERTAIN OUTLOOK FOR THE NEXT 18 MONTHS

Opinion is divided on how robust the volume of deals will be in 2017 and beyond – 24% of survey participants forecast an increase in deal activity while 35% forecast a decrease. The remainder (41%) expect deal volumes to be broadly similar to 2016.

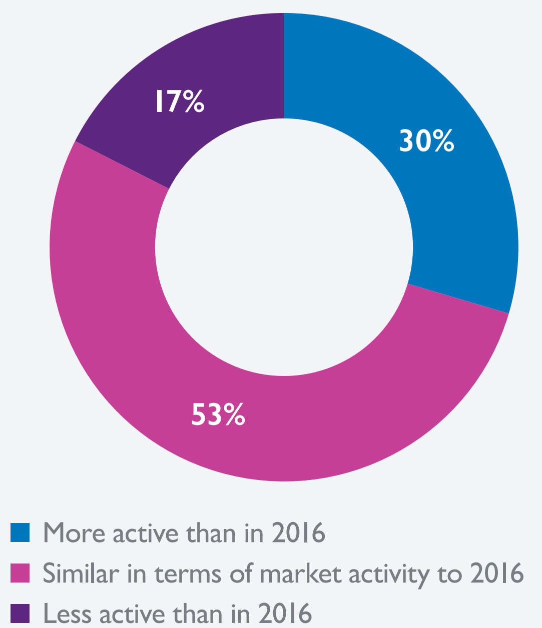
Whilst these predictions were made at the beginning of the year, respondents were asked to assume that Article 50 would be triggered in late March when making their forecasts.

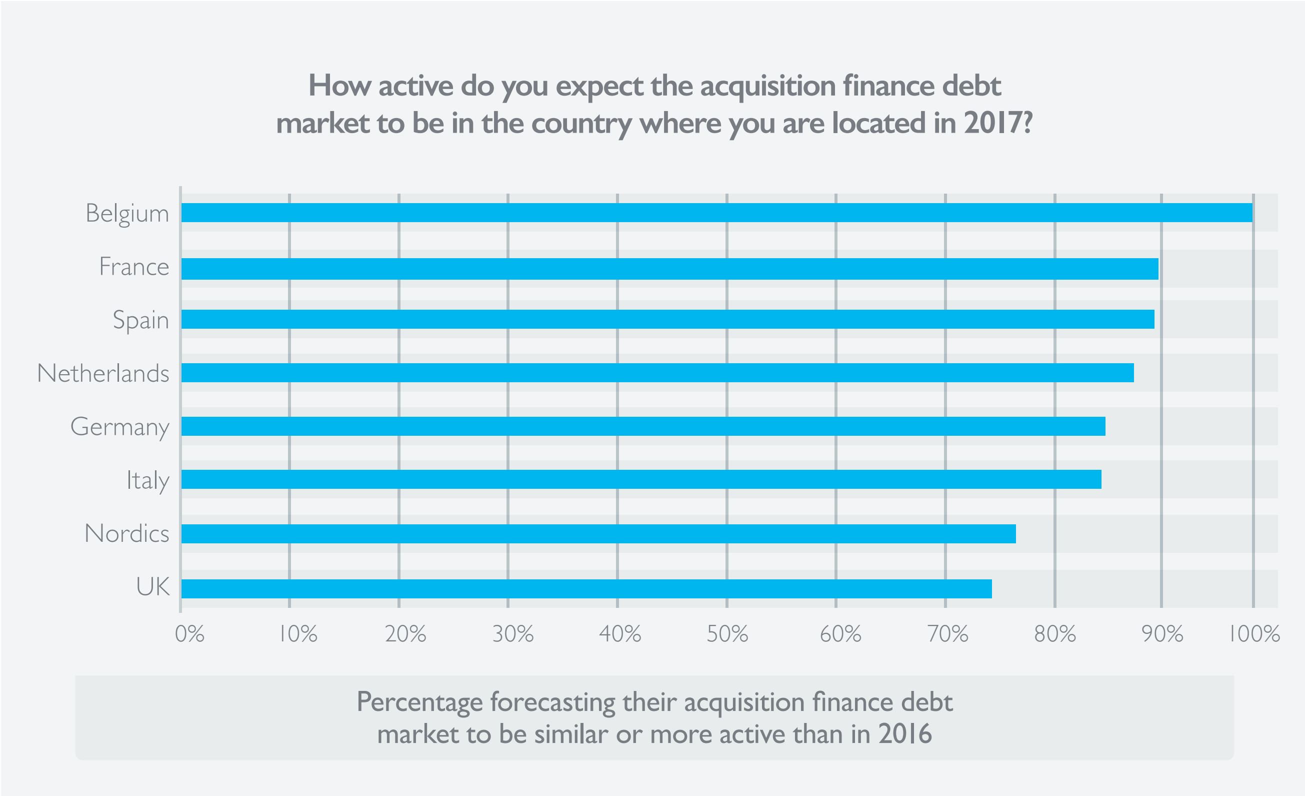
This is the first time in the last eight years that more survey participants have forecast a decrease than an increase in deal volumes. 47% of respondents forecast an increase in deal volumes in last year's survey while 54% forecast an increase in 2014 and 70% the year before that. The factors causing the current lull in deal activity – including political and macroeconomic uncertainty – also underpin the mixed outlook for deal activity.

But despite the uncertain political landscape, many dealmakers are positive on dealflow this year due to some strong market fundamentals. There are certainly large volumes of private equity dry powder. Europe-focused private equity funds had $173 billion of dry powder at the end of 2017, according to Deloitte; a 21% annual increase.

There is also abundant debt liquidity, with traditional bank lenders and direct lenders remaining extremely active. As of June 2016 (the most recent date at which this data is available) direct lenders targeting Europe had $29.7 billion of dry powder, an 18% increase on $25.2 billion a year earlier, according to Prequin. Some market participants are bullish on deal activity because they believe these positive market

How active do you expect the acquisition finance debt market to be in the country where you are located in 2017?




How active do you expect the acquisition finance debt market to be in the country where you are located in 2017?
Belgium
France
Spain
Netherlands
Germany
Italy
Nordics
UK
0%
10%
20%
30%
40%
50%
60%
70%
80%
90%
100%
Percentage forecasting their acquisition finance debt market to be similar or more active than in 2016

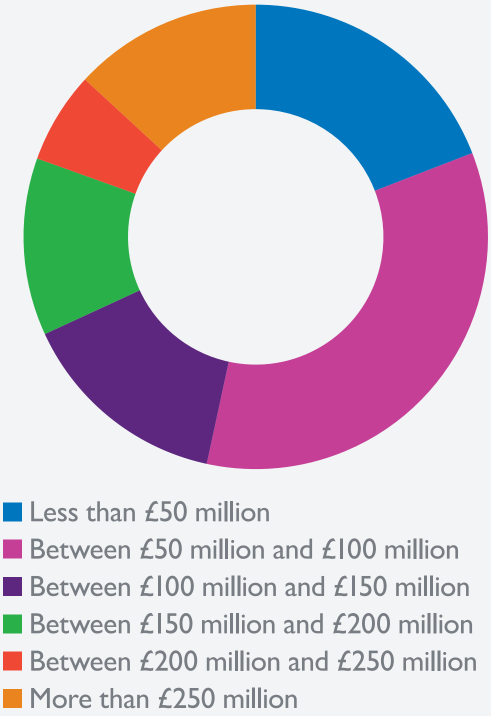
fundamentals outweigh the uncertain political and economic outlook.

"We feel confident in the medium-term deal outlook. We continue to see lots of private equity funds being raised at a time when PE dry powder is already at high levels," said Mike Dennis, Partner, Direct Lending Group at Ares Management. "This will continue to drive solid deal flow in this market despite the uncertainty over what will happen with Brexit from an investment point of view."

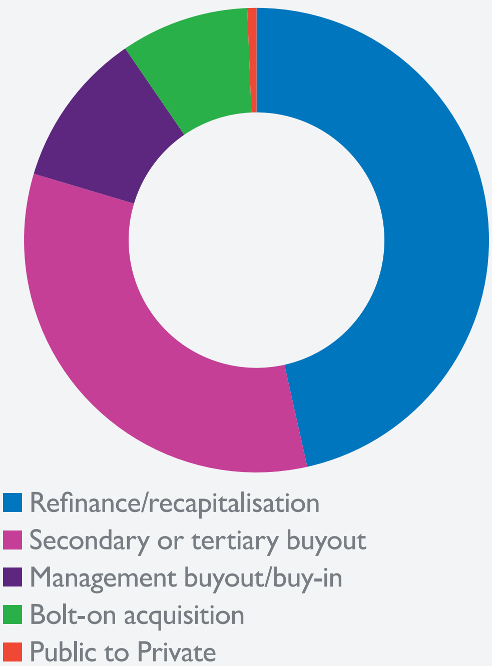
The outlook does however differ across Europe. More than 80% of respondents in Belgium and France expect deal volumes to at least be at a similar level this year compared with 2016. At the other end of the spectrum, only 54% and 45% of respondents expect deal volumes to be similar or greater to last year in the UK and Spain respectively. (See the "Countries in Focus" section at the end of this report for more detail on individual countries.)

In terms of deal size, the largest share (34%) of respondents expect deals where the total debt value is between £50 million and £100 million to be most common. An almost equal share of respondents expect refinancings and recapitalisations (46% of survey participants) to be as common as primary, secondary and tertiary buyouts (44%) in 2017.

Which deal category ranked by total debt value will be the most active by deal volume in 2017?



Which of the following deal types do you expect to be the largest by volume (deal numbers) in 2017?



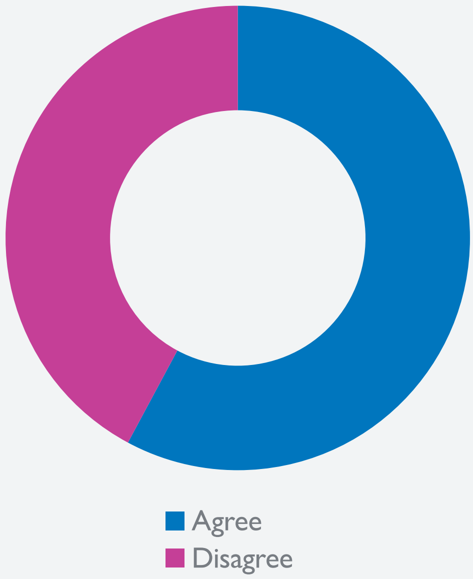
Understanding the impact of Brexit

There is no doubt that the UK's vote to leave the EU in June 2016 caused a short-term reduction in deal volumes last year. Everyone interviewed for this report stated that there was a hiatus in deal activity in the two months immediately following the referendum.

But what are the consequences now that Article 50 has been triggered? Of course, the long-term impact on the political landscape, the economy, M&A volumes and the acquisition finance debt market across Europe will in part depend on the outcome of negotiations between the UK and the EU, which will not be known for a number of years.

That said, the survey data collected for this report combined with the series of interviews offers some insight into the effects of the recent triggering of Article 50 over the next 18 months.

Do you agree that deal volumes will decrease if the UK takes formal steps (including an Article 50 notice) to leave the EU in 2017? (UK responses only)

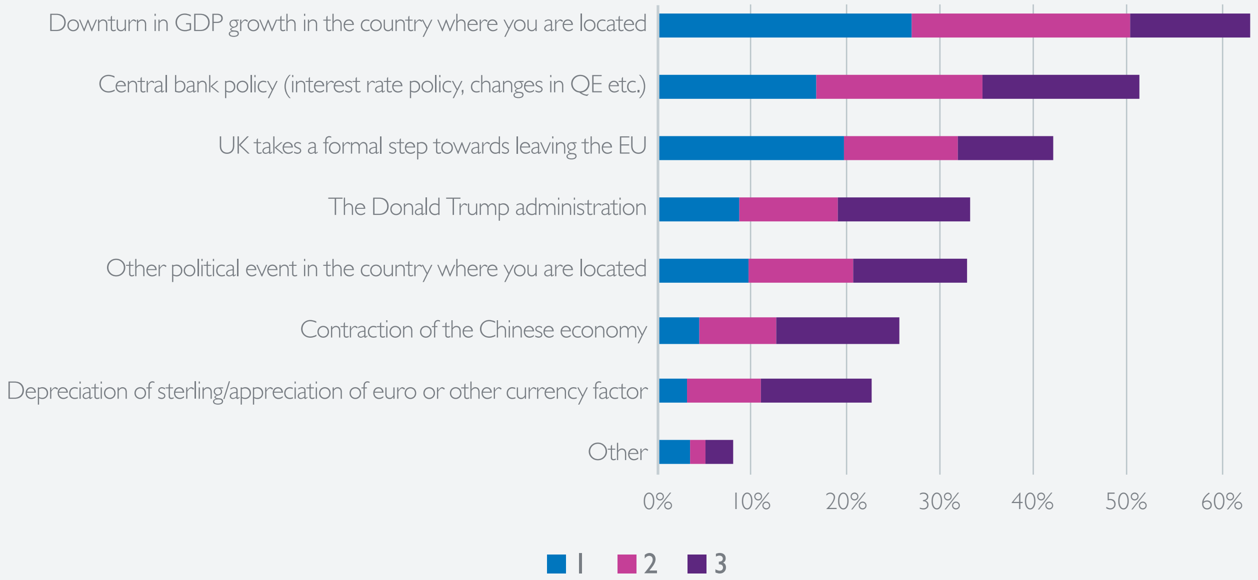


Interestingly, there are mixed views on whether Article 50 will result in a slowdown in transaction volumes. The majority (59%) of the entire sample of respondents across Europe disagreed with the statement that 'deal volumes will reduce if the UK takes formal steps (including an Article 50 notice) to leave the EU in 2017'. In the UK itself, the majority (58%) of respondents agreed with the above statement, but the margin is not particularly large.

Brexit is though just one of many political and economic factors that impact the acquisition finance debt market. Indeed more respondents stated a downturn in GDP growth would negatively impact deal volumes than the UK triggering Article 50. These factors are interlinked however and the UK leaving the EU might result in a long-term decline in economic growth. But the important point is that the triggering of Article 50 is just one of many factors that will influence deal volumes this year.

The Brexit vote will not just impact the volume of acquisition finance debt transactions. It might also impact the dynamics of the market, including liquidity, leverage, pricing and the types of participants that are most active in the market.

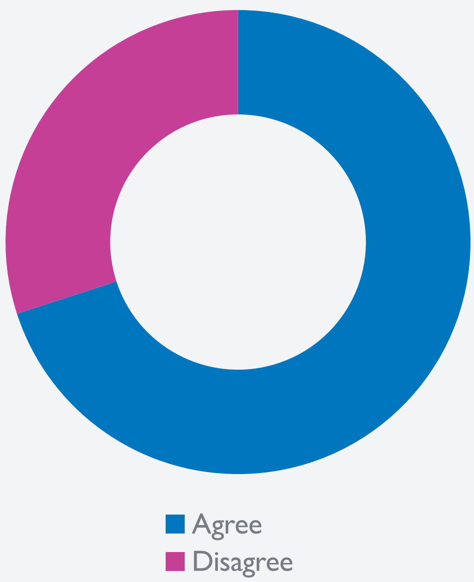
What macroeconomic factor do you expect will most significantly negatively impact deal volumes in the country where you are located in 2017?



For example, opinion is divided on the extent to which non-UK based alternative lenders might retreat from the UK following the separation from the EU. While 70% of survey participants believe that some debt funds will retreat from the UK market following the Article 50 notice, a number of interviewees believe that direct lenders will be more competitive than banks following the vote.

"Alternative lenders are well positioned in times of uncertainty as banks are inherently more risk averse and not able to price increased risk as effectively as funds can," explained Floris Hovingh, Partner and Head of Alternative Capital Solutions at Deloitte. "This opens up opportunities for alternative lenders."

Do you agree that some debt funds will retreat from the UK market if the UK takes formal steps (including an Article 50 notice) to leave the EU in 2017?



Alternative lenders continue to increase market share in early 2017

Alternative lenders continued to increase market share across Europe in 2016. They completed 267 deals in 2016, a 2% annual increase, according to Deloitte's Alternative Lender Deal Tracker. But the picture is very different in the UK versus the rest of Europe. Outside the UK, alternative lenders ramped up deal volumes, particularly in France and The Netherlands. But in the UK, deals done by alternative lenders declined 13% on an LTM basis, according to Deloitte.

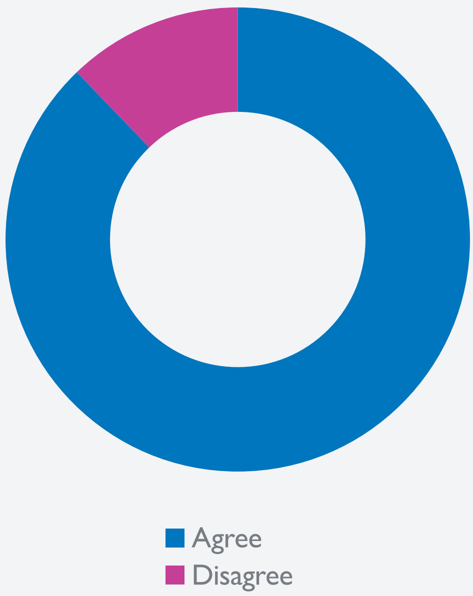
A clear majority (88%) of survey participants expect debt funds to continue to gain market share in 2017.

Statistics in early 2017 indicate this to be the case. Non-bank lenders executed more than 70% of EU mid-market deals in Q1 2017, their largest ever share, according to Debtwire.

The increase in activity is primarily caused by existing funds ramping up their activity levels. In contrast, there is a sense that the rate of entry of new alternative lenders into the acquisition finance debt market across Europe is decreasing. Indeed funds raised by European direct lenders halved to $10 billion in 2016, according to Deloitte.

"Our investors tell us they are seeing fewer pitches from new direct lending funds being formed as LPs continue to increase their relationships with established platforms," stated Dennis. "This is also the case because many new funds are still in their investment phase now and have not yet returned capital to their LPs."

To what extent do you agree that debt funds will continue to increase market share in 2017?



Direct lenders have taken share from banks in early 2017 by offering debt structures with an overall cost of capital priced comparably with senior structures offered by traditional banks. When direct lenders entered the market some five years ago the main product they offered was unitranche. Now, they offer a wide range of alternative debt products and can offer pricing similar to senior debt.

"We are now seeing alternative lenders coming down and competing on price for senior deals which is something we have not seen before," said Ian Crompton, Deputy Head of Leveraged Finance at HSBC. "That's the main change in the market. At the start of 2016 direct lenders were a unitranche threat, now they are a senior threat because some can match senior pricing while taking larger holds, which plays against banks providing an underwrite with flex language."

Callum Bell, Head of Investec's Corporate & Acquisition Finance team, agrees. "Last year the bank Term Loan B market was ferociously competitive and consequently a compelling choice for borrowers," he said. "So direct lenders rethought how to be competitive and this year are definitely being more aggressive and in my view are taking a lot more risk to deploy capital, sometimes on deals that banks have rejected. They have also done some large ticket single hold deals and some covenant lite transactions as they seek to find increased relevance."

But alternative lenders have certainly not had it all their own way in the last 18 months. The rising competitiveness of direct lenders followed a period in 2016 of banks being more aggressive for the mandates they wanted to win. At the upper end of the mid-market, most banks are now comfortable with Term Loan B structures with no amortisation. They have also reduced pricing and increased covenant headroom.

"Traditional bank lenders have increasingly in the last 12-18 months got used to all TLB structures, particularly for borrowers of size," confirmed Roach. "Pricing has held up okay although is around 25-50 bps lower than 12 months ago, both in terms of margins and fees. There is also greater flexibility on covenants and headroom. All of this has changed in the last 12-18 months in favour of the borrower."

DIRECT LENDERS DISTINGUISH THEIR OFFERING

Of course, alternative lenders are not just competing with banks, but among themselves. With this in mind,

many pursued strategies aimed at differentiating themselves from their peers in the last 18 months. Offering low-margin, senior-type debt structures as described above is just one strategy.

Another is to target the larger end of the mid-market. Many alternative lenders raised larger funds in 2016 that enable them to participate in larger transactions and compete with the syndicated leveraged loan and potentially the high yield bond market. These include Hayfin (€3.5bn), Ares Capital Europe III (€2.5bn), Barings Global Private Loan Fund ($2bn) and Pemberton European Mid-Market Debt Fund (€1.2bn).

The extent to which direct lenders have utilised their larger funds to invest larger tickets is mixed. The growing number of particularly large unitranche deals include the €625 million unitranche financing of the merger between Italian chemicals company Polynt and US-company Reichold in May 2016, the €475 million unitranche deal for UK pharmaceuticals company Mallinckrodt and the €350 million unitranche financing for German company HCS Group.

However there have not been the significant number of very large transactions that might have been expected given the large fund sizes. As Mike Dennis of Ares Management explains, this is primarily because alternatives to unitranche at the large end of the mid-market are currently priced very competitively.

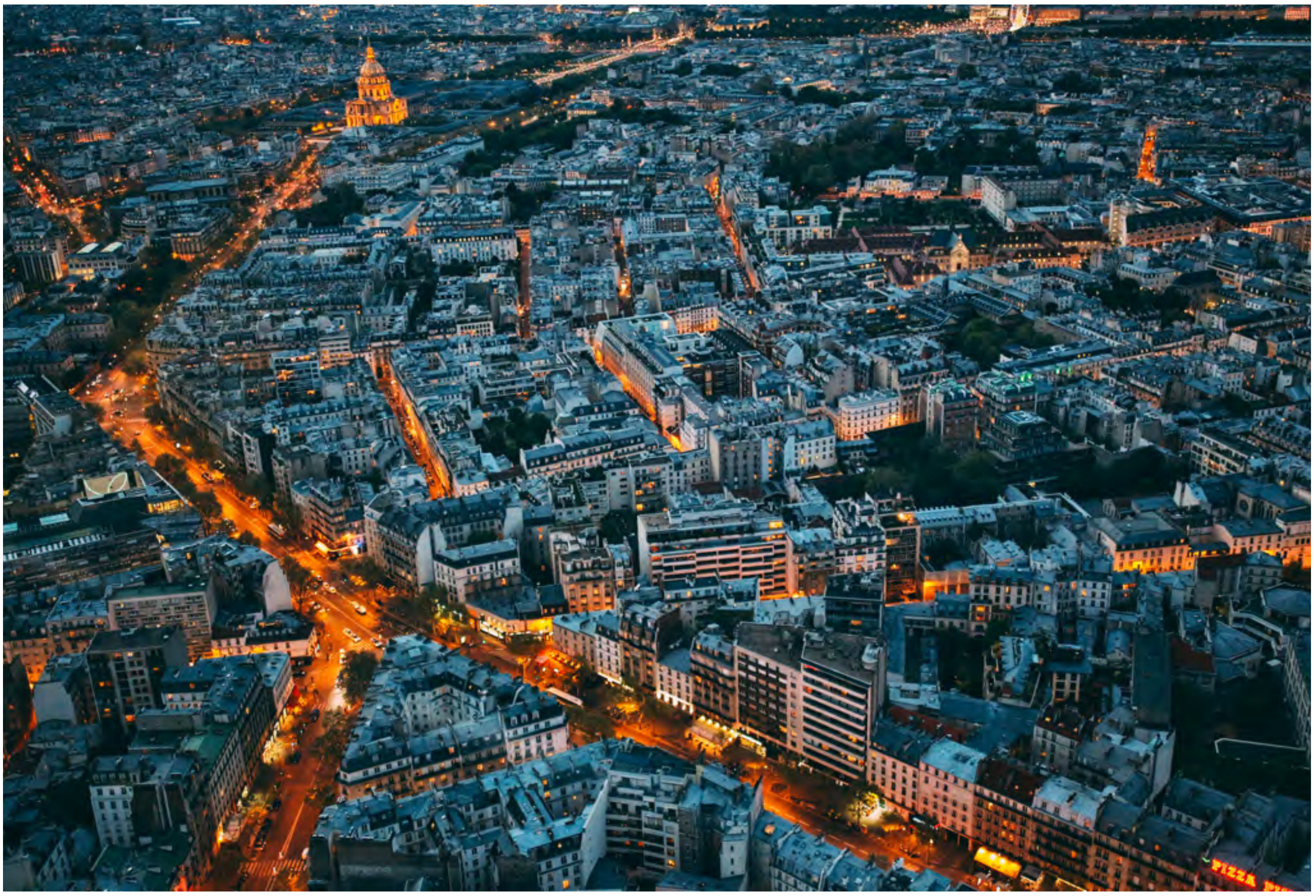
"Currently, the large cap markets in Europe are very liquid, creating more competition for direct lenders at the large end of the unitranche market," he said. "Spreads have tightened considerably in the liquid markets,

making a private debt or direct lending alternative appear less attractive. However, direct lending is a real alternative for transactions that require scale of capital, particularly as the capital markets ebb and flow through liquidity over time."

Meanwhile some alternative lenders are increasingly targeting sponsorless deals. One example is Beechbrook Capital, which closed a £150 million UK SME Credit 1 fund in February 2017. For corporates, alternative lenders are an attractive alternative to banks because they can execute deals quickly and can often also provide the combination of debt and equity needed to execute acquisitions.

The statistics underline the growing attractiveness of alternative lenders to corporates. They participated in 96 sponsorless deals in the UK in 2016. This was a 13% decrease on the 110 deals in 2015 but a 17% increase on the 82 deals in 2013.

"Alternative lenders are expanding into sponsorless transactions," confirmed Hovingh. "More companies are becoming aware of alternative structures and lenders. In the US, 40% of alternative lender deals are sponsorless. In Europe this figure is 25%, so there is an opportunity to do more deals with corporates. Anecdotally, we are getting a lot more requests from private companies across Europe looking for growth capital with the objective to minimise the need for equity funding. Family/founder owned businesses are waking up to the new world sitting in between bank debt and private equity money and start to see the advantages of using alternative capital as a tool for transformational growth, which was not within reach previously."



Other lenders are differentiating by focussing on specific sectors. For example, Silicon Valley Bank solely finances investments in innovation companies in the technology and healthcare sectors. "The intense competition means that offering commoditised debt and not adding value or differentiating simply won't work," explained Tim Cussins, Managing Director at Silicon Valley Bank. "We go out to market in this way and focus on technology. We might, for example, help businesses find acquisition targets or expand into the US. You still need to be competitive of course but the sector knowledge and value-add can be a differentiator in winning a sought after deal."

COLLABORATION BECOMES MORE IMPORTANT

Banks and funds are increasingly collaborating on deals, either through formal partnerships or through informal relationships forged on a deal-by-deal basis.

One of the most notable formal partnerships is Royal Bank of Scotland's exclusive joint venture with M&G, AIG and Hermes. The club provides up to £100 million of senior debt to private equity-owned mid-market companies. RBS originates and structures the deals. A number of banks also have informal relationships in which they have agreed intercreditor principles with funds so that borrowers receive a streamlined process when securing unitranche and super senior debt.

These partnerships are important strategic differentiation factors to both banks and direct lenders. For example, RBS's joint venture enables it to participate in transactions requiring more than the £30 million of debt it can provide itself. Of course, it could do this on a syndicated basis, but its club arrangement allows it to execute deals efficiently and swiftly. This arrangement is also beneficial to direct lenders because it enables them to tap into the bank's large deal origination platform.

"2016 was a year of consolidation of our direct lending partnerships," explained Roach. "Our partnerships with M&G, AIG and Hermes have some really good momentum and executed over twelve deals in 2016. It is a big differentiator for us relative to our peers. This is ideal where there is a £50m-£100m debt transaction, which historically would have been done with three or four banks. We are saying you can do it with one but we will front all the negotiations as if you were doing it with one. In 2016 a third of our deals were in some shape or form with partners, either direct lending partners or with unitranche partners."

The majority of the unitranche and super senior structures seen in the market continue to arise from informal relationships between banks and funds. Whilst such structures enable banks to participate in transactions that might not have otherwise taken place without the liquidity provided by direct lenders, banks are keen for such structures not to become the norm and for them to have a larger role on transactions, providing more of the core debt.

"We did quite a few super senior positions in 2016, which is not ideal, but this can happen when sponsors are uncertain about the ability of bank groups to step up and/or meet deadlines when an underwritten route is not progressed," explains Crompton. "As such in a number of instances direct lenders stepped in and used their fund size to make the deals happen. This led to an increase in the number of deals where the banks are in a super senior position with the direct lenders providing the main acquisition funding in the last twelve months. In these cases banks have been reduced to providing liquidity flexibility though the RCF."

That desire for the banks to deploy more capital on a transaction, and not be limited to the revolving credit facility, has led to much discussion around first out/last out and second lien structures (in which banks account for a larger percentage of the capital structure through providing a capex line or part of the term facility). There are differing views as to the number of transactions which have been executed using such structures, particularly in an environment where debt funds are prepared to write larger cheques, as often details of such arrangements are not actively publicised by the deal doers.

Jacco Brouwer, Head of Debt Advisory at AlixPartners in London, believes these structures are becoming more prevalent. "When unitranche lending initially started you saw the banks provide a super senior RCF and funds provide the unitranche," he said. "That's evolved to structures where the bank doesn't just provide the RCF but also part of the term loan. These include so-called synthetic unitranche and first-out last-out structures. One could argue that this is essentially the old senior plus mezzanine structure but there are differences in security and intercreditor terms. It can either be done in a transparent way or behind the scenes based on an agreement among lenders. This has been quite a big development in the last few years. We have now also started to see ABL plus unitranche deals enter the market but this adds a further layer of complexity into intercreditor terms and this market still needs to mature."

Pricing and terms continue to become more aggressive

The intensification of competition between lenders has resulted in pricing and terms becoming more aggressive. Dealmakers report that unitranche pricing has fallen from L+725-750 two years ago to around L+675 today for the best credits. Meanwhile senior pricing is reported to have fallen by 25-50 bps during the last twelve months.

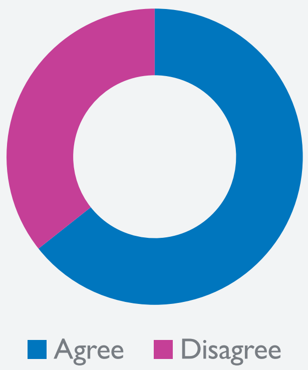
Pricing has dropped significantly at the larger end of the market in the first part of 2017, with some dealmakers reporting that large LBOs (with EBITDA above £50m) are pricing at 375-400 bps, a decrease on 450-475 bps at the end of 2016.

The majority (64%) of survey respondents believe that pricing has now bottomed out and will not decrease further.

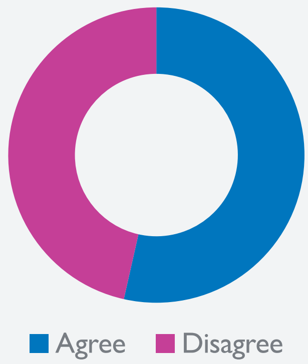
Dealmakers also report that good quality credits were able to extend leverage to the extent that it is in some circumstances comparable with 2007/08 levels. "We are comfortably back at 07/08 levels in terms of leverage and terms and in some cases these levels are now being exceeded," confirmed Cussins. "The only key difference is that there are very strong equity cheques, typically over 50%, going into the technology and innovation businesses we support. In the past equity would account for only 20-25% of the transaction."

Opinion is divided on the extent to which there is scope for leverage to increase further – 54% of survey participants believe leverage will not rise in the next 18 months while the remainder believe it might.

To what extent do you agree that pricing levels will not decrease further in 2017?



To what extent do you agree that total leverage levels will not increase further in 2017?

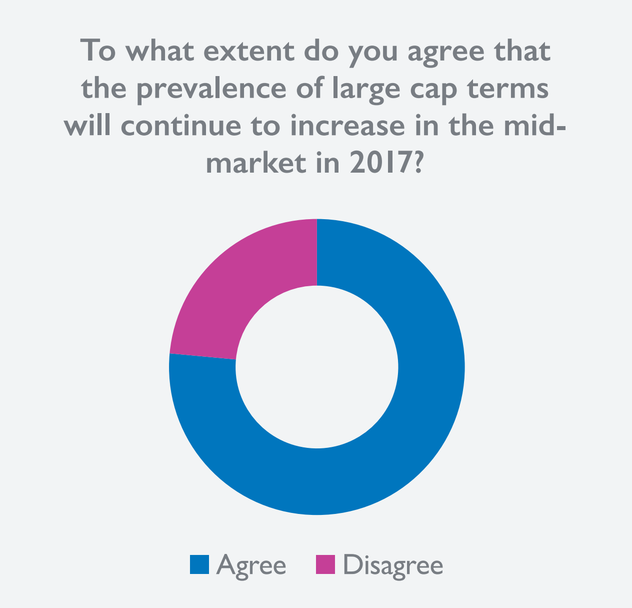


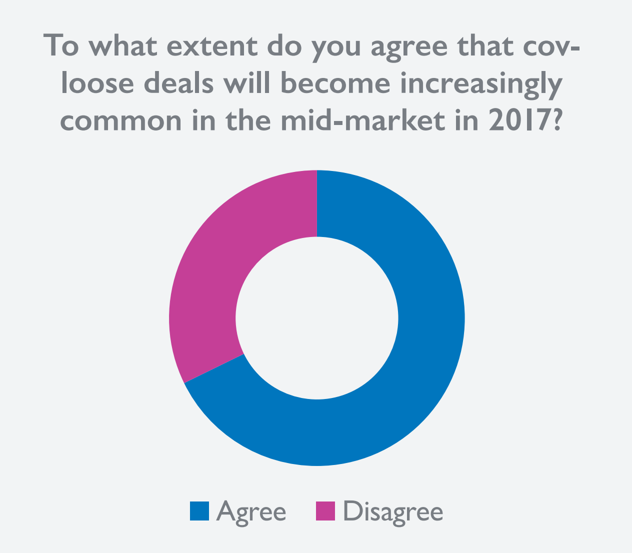
But the main impact of the increasingly competitive lending landscape has been on terms, particularly financial covenants. Covenant loose packages (comprised of just one or two financial covenants and frequently allowing for add backs and other adjustments to EBITDA) are now a permanent feature of the mid-market. 68% of survey respondents expect the number of mid-market cov-loose deals to grow this year. Covenant headroom has also increased from 20%-25% 18 months ago to 25%-30% today.

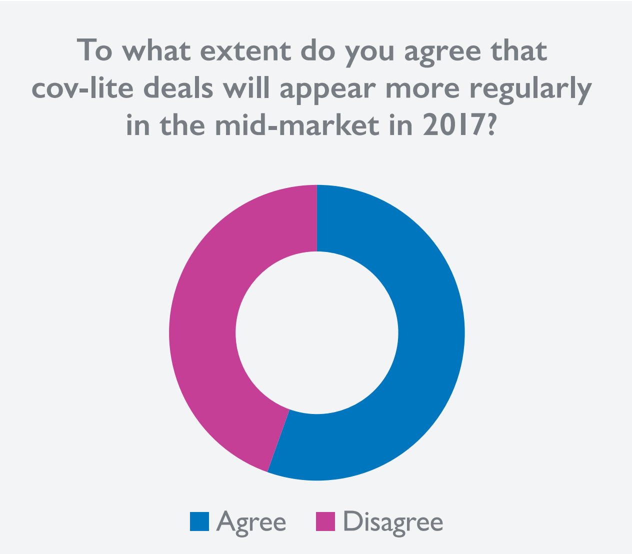
Covenant-lite packages, frequently seen in large cap deals, have also been seen to feature on mid-market deals, although only at the upper end of the mid-market. Opinion is however divided on the extent to which cov-lite deals will be done in the mid-market. Some 55% believe cov-lite deals will increasingly feature in the mid-market while 45% do not.

Covenant packages aside, language in loan documentation has also become more flexible and borrower friendly. The majority (76%) of survey respondents expect large cap terms (which themselves are becoming increasingly borrower friendly) to continue to permeate the mid-market in 2017. "There are a lot more portability clauses than a few years ago, when this certainly wouldn't have been possible," confirmed Hovingh. "There is also more flexibility in terms of undrawns and the ability to get dry powder for future acquisitions."

The extent to which pricing and terms will evolve during the next 18 months will largely depend on the volume of deal activity and the quality of the credits - both banks and alternative lenders have proved themselves willing to be aggressive on terms for the right deal.







United Kingdom

2017 STARTS SLOWLY AS ALTERNATIVE LENDERS REDOUBLE EFFORTS

Deal activity cooled in the first five months of 2017 following a robust 2016. Many dealmakers report that this was primarily a result of a mismatch between buyers' and sellers' valuation expectations. Indeed, despite a small number of good quality assets always being subject to highly competitive auction processes, there are also a relatively large number of lower quality assets on the market that private equity funds are not prepared to pay over the odds for.

In previous years, lenders could still participate in refinancing transactions if M&A activity was quiet. However the refinancing wave that kept lenders busy two to three years ago has now passed and is not expected to return for at least another two years.

Deal activity is also muted because corporates are increasingly deploying their large cash reserves to outbid private equity funds in auction processes. Many strategic acquirers are not using leveraged finance to fund their acquisitions.

The lull in deal activity could also be caused by the uncertain political landscape following the Brexit vote and the general election in early June. That said, the general consensus is that the Brexit vote only had a short-term impact on deal activity. In fact, most dealmakers report that transaction volumes picked up in the final quarter of 2016 after investors digested the implications of the vote. It waits to be seen what impact the uncertainty caused by the general election results will have on deal activity.

Deal activity aside, the beginning of 2017 has been notable for a resurgence in alternative lender activity. In 2016 traditional banks were more aggressive on structures, pricing and terms, meaning that many were competitive in certain deals against funds.

But many dealmakers report that alternative lenders responded in early 2017 by offering more aggressive pricing and terms and are now generally more competitive than banks. The banks that are still active are not helped by the fact that some traditional lenders have retrenched, making it harder to structure club deals. Alternative lenders are also increasingly seeking deal opportunities outside of London, targeting both sponsor and sponsorless transactions.

Market participants have not experienced any major change in structures, although there continue to be conversations in unitranche/super senior structures about banks providing a larger proportion of the debt in order to lower the overall cost of capital to the borrower.

One factor impacting the relative attractiveness of banks and alternative lenders that was commented on in previous reports is how the latter might respond when investee companies enter a distressed situation. The concern was that many debt funds would not have the bandwidth or experience to deal with a restructuring situation and would simply sell their debt at the earliest sign of an issue. There have now been a handful of unitranche deals which have been restructured. The funds involved have demonstrated an ability and desire to deal with such a scenario and some have shown they are comfortable with taking control of a business.

"Some private debt funds have shown a degree of comfort with taking ownership of assets but it tends to be the large funds that are prepared to engage heavily in restructuring discussions and consider taking the keys," confirmed Neil Riley, a Restructuring Partner at DLA Piper. "The small to medium sized ones don't necessarily have restructuring capability at present and may not be prepared to recruit such expertise to deal with this in house if their book doesn't justify this. Many of the larger players have already launched distressed debt/special situations funds and have the expertise to deal with restructurings in-house, in an expert and flexible manner."

Looking ahead, another frequently discussed issue in the UK market at present is the impact that ECB guidelines capping leverage at 6x for banks will have. This is unlikely to affect the majority of mid-market transactions, but it could limit bank lending, and therefore provide a competitive advantage to funds, if multiples further increase to the extent that higher leverage levels are required. It should be noted that the guidelines include undrawns when calculating leverage.

"We have seen more transactions attempting to bring more bank debt into fund led structures rather than the customary smaller sized super senior RCFs so that bank lenders get a larger slice of the financing. Funds are not necessarily adverse to this but they will seek the pricing to reflect the fact that their risk has increased. Sponsors might want to add more senior so that the overall cost of capital is reduced, and that's great apart from the unitranche who are under more risk. In general 2017 is much more of a fund driven market and some banks have retrenched."

Andy Kolacki, Partner, DLA Piper

"Deal activity has been quiet in the first five months of 2017 and there hasn't been a consistent run of deals for a while now. Political issues are certainly a factor but there is also a big disparity between vendors' and buyers' expectations. Even though buyers are paying over the odds for good quality assets, they will not meet expectations of sellers with poorer quality credits. Lots of assets are being put up for auction but private equity and banks backing them often aren't interested because the quality isn't as strong as it has been."

Julie Romer, Partner, DLA Piper

"What happens in London will, eventually, happen in the regions. Given that the North West market continues to deliver a strong deal-flow for financial sponsors, then it is no surprise that alternative credit providers based in London are increasingly used to fund regional acquisition finance deals, whether buy-outs or refinancings. However, what is a new development is the establishment of a number of private debt funds with operations in the North West, such as Tosca Debt Capital, Muzinich & Co and, most recently, Beechbrook. Targeting both sponsored and sponsorless deals at the smaller end of the mid-market, often partnering with a traditional bank lender in a senior/second lien structure, this "boots on the ground" approach further increases the opportunities for borrowers to take advantage of new funding structures."

Matt Christmas, Partner, DLA Piper

"It's worth noting that the first five months of 2017 in the European high yield bond market has seen approximately 80% more issuance volume than the same period of 2016. High yield bond investors have been demonstrating hunger for deals in a return to an issuer-favourable market. The market has reopened to first-time issuers, and remains open to ever-more-flexible terms and structures for refinancings."

Tony Lopez, Partner, DLA Piper

Germany

RISE OF PRIVATE EQUITY FUNDS TRIGGERS GROWTH IN ACQUISITION FINANCE DEBT

Acquisition finance debt deal activity surged in 2016 as an improvement in liquidity allowed private equity funds to be more competitive than corporate acquirers. Indeed the majority (53%) of German survey respondents stated that deal volumes in 2016 were greater than their expectations at the beginning of the year.

The continued expansion of alternative lenders to the German market, coupled with the ongoing attractiveness of the country to both local and domestic banks, means that liquidity is extremely strong. According to Frank Schwem, Partner at DLA Piper, Frankfurt, there is more liquidity in Germany than in any other European market.

Alternative lenders had participated in 101 financings in Germany by the end of 2016, behind only the UK (368 financings) and France (238 financings), according to Deloitte's Alternative Lender Deal Tracker. Most alternative lenders cannot provide more than €50 million of debt, so invest alongside banks or other funds in transactions that require more debt.

The increase in liquidity has caused covenant packages to become lighter. Pricing has broadly remained stable, but has decreased in deals involving particularly strong targets.

The robust 1.5% economic growth forecast for 2017 combined with the ongoing liquidity glut means 2017 is also expected to be a strong year for deal activity. That said, only 33% of German survey respondents expect the market to be more active than the blockbuster 2016.

The triggering of Article 50 in the UK is unlikely to impact deal volumes in Germany – 86% of German respondents predicted deal volumes in 2017 would be equal to or greater than in 2016 before Article 50 was triggered. At that time, the proportion of respondents forecasting deal activity to at least remain stable only fell marginally to 78% in the event that Article 50 was triggered. Anecdotal insight also suggests that the upcoming election in Germany this year will not materially impact deal volumes.

While 2017 is expected to be a strong year, private equity funds, which typically fund acquisitions through debt, continue to account for a smaller percentage of acquirers than in other countries. German corporates, which typically finance acquisitions on balance sheet, still remain very competitive.

"Last year was very strong in Germany. There were many M&A deals and private equity investors using leveraged debt were more active. 2017 started a bit slower but this is normal following a very good year. In the large cap market we have seen some Yankee financings, although not as many as in the London market. Even German law financings are more covenant-lite and use many elements of the NY style HY bond/ Term Loan B market."

Frank Schwem
Partner, DLA Piper, Frankfurt

France

AN INCREASINGLY COMPETITIVE LENDING ENVIRONMENT

France's acquisition finance debt market was again very busy in 2016. According to Maud Manon, Partner at DLA Piper, Paris, deal volumes were slightly higher than the already strong levels in 2015.

Survey respondents echo this view. Some 78% of respondents located in France stated that deal volumes in 2016 were similar to or greater than their expectations at the beginning of the year.

This came despite the relatively modest 1.1% economic growth in 2016, according to the statistics office Insee. The government forecasts 1.5% economic growth in 2017. Growth in deal activity is being driven by the abundance of liquidity, provided by both traditional banks and alternative lenders.

Deal volumes were particularly strong in the first quarter of 2017. There is the sense that dealmakers accelerated activity in early 2017 due to an anticipated slowdown in the immediate run-up to the French election.

Overall, survey respondents in France are bullish on the outlook for deal activity in 2017. Some 91% expect the market to be similar or more active than the previous year. Only respondents in Belgium – all of which forecast a maintenance or increase in deal activity – are more positive on activity levels in their market.

The general consensus is that the triggering of Article 50 won't impact deal volumes in France. At the time they were surveyed, some 87% still expected activity levels to at least be maintained in 2017 in the event of Article 50 being triggered. This is only slightly less than the 91% that forecast deal activity to at least remain stable at the beginning of the year if the status quo had been maintained.

Fewer new alternative lenders entered the French market in 2016 compared with the previous year. Those that are in the market are now well established and provide a compelling alternative to traditional lenders for certain deal types.

That said, banks fought their corner last year by being more aggressive on pricing and leverage and more flexible on terms. Whilst some borrowers will still feel that the structure of a bank financing will be simpler than the unitranche offering provided by funds, second lien and unitranche and super senior deals are gradually becoming more popular.

"We used to hear about a new debt fund entering the market every two weeks and this has definitely slowed down. Banks have made a real comeback in the mid and upper mid-market. Banks are being very aggressive now which creates challenges for alternative debt providers. Generally, despite the threats of political elections and the uncertainty, there are many attractive good sized primary market opportunities in France."

Maud Manon, Partner, DLA Piper, Paris

The Nordics

CAUTIOUS OPTIMISM ON THE DEAL PIPELINE

Deal activity continued to be sluggish in the Nordics in 2016. The majority (61%) of survey participants located in the Nordics stated that market activity was less than or in line with their expectations at the beginning of the year.

There was a slight uptick in transaction volumes in Norway, although the majority were refinancings or restructurings. In Sweden, the number of acquisition finance debt deals is subdued due to the buoyant IPO market. Corporates and sponsors view this as a better exit option than a sale to a private equity fund.

That said, survey respondents are cautiously optimistic on the deal pipeline – 44% of participants located in the Nordics forecast an increase in deal activity in 2017, a larger proportion than in any other country.

Dag Thomas Hansson and Fredrik Lindblom, both Partners at DLA Piper, Norway, said that the country is becoming increasingly attractive to international corporate and private equity investors. Also, while oil prices are still significantly lower than three years ago, the price has stabilised and there is less uncertainty, meaning the oil services sector has rebounded to an extent.

Hopes of an increase in deal volumes in Sweden are pinned on a potential cooldown in the IPO market, which may materialise if interest rates start to rise or in the event of a macroeconomic shock.

There are lots of options for Nordic borrowers. Nordic banks are very active and anecdotal evidence indicates that the bond market is now potentially an option for the first time in almost three years.

Direct lenders have raised large funds targeting the Nordics but struggle to compete with the competitive margins offered by banks. They therefore have to be more creative to deploy capital.

"Valuations when you take a company to the stock market are still very attractive so there are fewer opportunities than there used to be for private deals. Many direct lenders have raised new bigger funds but are concerned how to deploy all that money within their investment period. There are few private opportunities coming up and when there is an attractive asset there is lots of activity and the price will be very very high. There is lots of bank activity on those deals with competitive pricing and leverage being offered by the banks."

Björn Sjöberg, Partner, DLA Piper, Stockholm

"There is an influx of international private equity and strategic investors in Norway, partly driven by funds exiting businesses. Oil price depression created lots of uncertainty in Norway and people still don't want to rock the boat, but while prices have continued to be low there is more of a steady state now and people are generally a lot more positive. Oil services also seem to be picking up. The major portion of financing comes from Nordic banks. The bond market has been quiet for a while but we've recently seen it grow a bit again."

Dag Thomas Hansson and Fredrik Lindblom, Partners, DLA Piper, Norway

Spain

MID-MARKET DEALS CONTINUE RESURGENCE

Deal activity continued to improve in Spain in 2016 and the first quarter of 2017. Cesar Herrero, Partner at DLA Piper, Madrid, reports that this growth was mainly caused by an increase in primary mid-market transactions. That said, there continue to be a smattering of refinancings and recapitalisations as well as large cap deals.

This growth was caused by a combination of an improvement in liquidity and robust economic growth. The Spanish economy grew 3.2% in 2016, making it one of the fastest growing Eurozone countries according to the National Statistics Institute. The government forecasts growth of 2.5% in 2017.

Mid-market deals tend to be dominated by local Spanish banks, particularly Bankinter, BBVA, Caixabank, Banco Sabadell and Banco Santander, while larger international banks are active on larger deals. Alternative lenders are gradually increasing their financing levels but banks still dominate the market.

The strong presence of banks means that senior-only structures are most common in Spain. That said senior and mezzanine structures are starting to be used more widely, as are bonds in the upper mid-market. However second lien structures are not currently discussed in Spain.

Pricing and terms have remained fairly constant in the last 18 months. Herrero reports that tenors are between five and seven years, depending on the tranche, and that margins are in the 200-350 bps range. On some deals debt to equity ratios can creep up to 60:40 although it is rare that ratios exceed 50:50. This is significantly below the 80:20 leverage ratios seen in the pre-financial crisis years.

The outlook for deal activity in 2017 and beyond is uncertain. On the one hand, the current robust levels of forecast economic growth combined with the perception that Spain is a good place to do business should drive deal activity.

On the other hand the US election result and the Brexit vote have created an uncertain macroeconomic environment that might impact deal activity in Spain.

Underlining the extent to which deal activity in Spain will be determined by events outside Spain, a robust 91% of respondents based in Spain expected deal activity to increase or at least remain the same in 2017 when surveyed at the beginning of the year. However this percentage fell to 45% in the event that Article 50 is triggered.

"The outlook for the rest of 2017 is difficult to predict with absolute certainty because we've had the US, Dutch and French elections, Brexit and have elections in other important countries (i.e. Germany) to come. I'm very busy at the moment, which is an indicator that deal activity will at least be maintained in Spain this year. The country continues to be a good place to do business compared with the rest of Europe. Another important factor at play is the ECB's draft guidance on leveraged transactions. It's currently a working paper and we don't know whether it will be fully binding and compulsory or not. It could result in banks' leverage and lending limits going down, which could give some more room for alternative lenders to manoeuvre (either via lending or private placements)."

Cesar Herrero, Partner, DLA Piper, Madrid

Italy

DEAL ACTIVITY STEADY IN EUROZONE'S MOST SLUGGISH ECONOMY

Deal makers report a small increase in deal activity in 2016, particularly in the second half of the year. Most deals in the Italian market are of a modest size, requiring €120-€150 million of debt. There are very few large-cap deals.

Half of Italian survey respondents stated that deal activity in 2016 was in line with their expectations while 43% said it exceeded their expectations.

There is limited optimism that deal activity will increase in Italy this year – only 29% expect the market to be more active than last year. This is a marked decline on the 68% that forecast an increase in deal activity in last year's survey.

This is due to the anaemic forecast of 1% economic growth in 2017, according to the OECD. This is lower than the growth rate forecast for all other 19 Eurozone countries.

A handful of alternative lender-led deals completed in Italy last year but regulatory restrictions mean these deals are certainly not mainstream. The most notable unitranche deal last year was almost certainly the €625 million unitranche financing of the merger between Italian chemicals company Polynt and US-company Reichold.

Instead, mid-market deals are typically executed on a club basis. There is limited syndication.

Unlike in other European jurisdictions, Italian banks continue to be conservative in terms of covenant packages and deal structures, with most being very reluctant to invest in Term Loan B facilities.

"The pipeline is quite thin at the moment. The second half of 2016 was better than the first half, though it still wasn't a great year overall. Alternative lenders are not particularly active because although there have been some legislative improvements, the Italian market is not totally accessible and some regulatory restrictions remain. So, although alternative lending is not as active in Italy as in other northern European countries, the impression is that funds still consider Italy to be an interesting market and that the recent approach of the regulator that moves towards increasing flexibility in the lending market may free up growth potential in the future."

Mario D'Ovidio, Partner, DLA Piper, Milan

"There haven't been any major significant changes in the market in terms of structures. Italian bank lenders are quite conservative in their approach and tend to prefer financing with an amortising repayment structure and it is less frequent to see financings with a bullet repayment. Also, Italian lenders tend to require covenants and prefer not to have limited covenant packages in the structure."

Ugo De Vivo, Legal Director, DLA Piper, Milan

The Netherlands

DEAL VOLUMES FORECAST TO PICK UP

Survey participants report that 2016 was a robust year for acquisition finance debt transaction volumes – the majority (56%) stated that the number of transactions in 2016 exceeded their expectations at the beginning of the year.

There is also a sense that deal volumes could have been higher had the UK not voted to leave the EU midway through the year. This caused a decline in deal activity in the months immediately following the vote.

Dealmakers are optimistic that activity will increase in 2017. Some 44% of respondents anticipate that the market will be more active than in 2016, a greater number of respondents than in any other country.

This is partly due to the positive outlook for economic growth – the EC forecasts 2% growth in 2017 – but also because there is now some certainty following the triggering of Article 50 in March 2017.

Lex Oosterling and Gerard Kneppers, both Partners at DLA Piper, Amsterdam, stated that uncertainty in the period between the vote and the triggering of Article 50 stunted deal activity. This put greater downward pressure on deal volumes than the Dutch general election also in March 2017, which dealmakers report did not at all impact the acquisition finance debt market.

Transactions in The Netherlands continue to be bank-led senior-only deals. Direct lenders have struggled to make an impact as pricing offered by banks is very competitive.

That said, anecdotal evidence indicates there was a small increase in the number of senior and mezzanine deals and unitranche structures provided by direct lenders last year.

While banks are very competitive, they are not generally offering Term Loan B facilities as banks are in other European jurisdictions. Debt to equity ratios are currently at 50:50.

"There is a lot of interest from international private equity funds in Dutch targets. Dutch funds have also raised new funds and are sitting on a lot of cash. But they are very selective and were happy to wait until the triggering of Brexit. It was a psychological barrier. But now M&A activity should increase so I expect acquisition finance activity to be greater in the rest of this year. Sponsors usually go to the banks because the money is very cheap. We are still very much a bank market and 85% of deals are bank driven with senior only structures. Alternative lenders slightly increased their activity levels last year, though there is nothing to get excited about."

Lex Oosterling and Gerard Kneppers, Partners, DLA Piper, Amsterdam

Belgium

RESOLUTION OF POLITICAL UNCERTAINTY COULD LEAD TO SURGE IN DEAL VOLUMES

Deal activity was again strong in Belgium last year. All surveyed Belgian respondents stated that deal activity in 2016 was at least as robust as their expectations at the beginning of the year.

True, the market cooled in the immediate months before the Brexit vote, but Johan Mouraux, Partner at DLA Piper, Brussels, stated that deal activity has since picked up, even though the result of the vote was unexpected.

Market participants are optimistic about future deal activity – a third of surveyed Belgian respondents expect deal volumes to exceed 2016 levels this year while none forecast a decrease.

This is partly caused by the relatively positive economic growth outlook. The National Bank of Belgium forecasts 1.4% growth in 2017, an increase on the 1.2% growth in 2016.

That said, the prospects for the Belgian market will significantly be determined by the outcome of the general election in Germany later this year.

Economic and political factors aside, deal activity in Belgium is expected to continue to be boosted by the large number of family-owned and managed businesses that might seek an exit strategy through external investors if the current owners/managers come to the end of their tenure.

The lending market in Belgium is dominated by banks offering senior-only structures. A more modest number of senior and mezzanine structures are executed in specialist situations but there are barely any unitranche financings.

This is partly because deals in the Belgium market are typically too small for direct lenders, but also because local banks are very competitive.

While the lending environment is very competitive, there is a sense that pricing has bottomed out and cannot decrease further.

"There is a sentiment of prudent optimism. Everyone thinks deal activity will be the same if not slightly higher than last year, subject to macroeconomic or political factors such as the French or German elections as the Belgian economy is very dependent on Eurozone stability and on the economic state of its strongest neighbouring economies. With the recent result of the French elections considered by most market participants as a stabilising factor within the Eurozone, and if the result of the German elections is what most expect then there might be some strong growth because these are really the two main remaining uncertainties in Eurozone stability. Debt structures haven't changed much. You sometimes see appetite for mezzanine financing but we've not seen a lot of unitranche yet, primarily because the deal size in Belgium is too small."

Johan Mouraux, Partner, DLA Piper, Brussels

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About the research

The survey and report were written in collaboration with The Lawyer Research Service, a division of The Lawyer. The survey was undertaken in December 2016 and January 2017, and was completed by over 300 debt providers, advisors, sponsors and corporates across Europe. Survey respondents include: Alcentra, Ares Capital Europe, Armada Mezzanine Capital Oy, Babson Capital Europe Ltd, Barclays Bank PLC, Beechbrook Capital LLP, Canaccord Genuity Group Inc, CVC Credit Partners, Danske Bank A/S, DC Advisory Ltd, Deloitte LLP, Ernst & Young LLP, GE Capital, HSBC Bank plc, ICG plc, ING Groep N.V., Investec Bank PLC, KPMG LLP, Leonardo & Co, Livingstone Partners LLC, Lloyds Banking Group plc, Marlborough Partners, NAB Group, NIBC Bank N.V., Nordea Bank AB, PwC LLP, The Royal Bank of Scotland Group plc, Banco Santander S.A., SEB AB, Swedbank AB and UniCredit Bank AG.

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

- Jacco Brouwer, Head of Debt Advisory, AlixPartners

- Mike Dennis, Partner, Direct Lending Group, Ares Management

- Floris Hovingh, Partner and Head of Alternative Capital Solutions, Deloitte

- Ian Crompton, Deputy Head of Leveraged Finance, HSBC

- Callum Bell, Head of Investec's Corporate & Acquisition Finance team

- Richard Roach, Managing Director, Financial Sponsors UK, RBS

- Tim Cussins, Managing Director, Silicon Valley Bank

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