

Soaring inflation

Rising interest rates

Looming recession

Uncertain Geopolitical Environment

**“Pricing
will
increase.”**

**“Lenders and
investors will
pause to assess
the impact(?)”**

The Continued Rise of Direct Lenders

**“It will become
common for
ESG objectives
to feature in loan
agreements”**



Winds of change? - What a deal lawyer should know about acquisition finance today

DRAFT | 2 February 2023



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Christian Savvides



- › Christian is Global Co-Head of Debt Advisory at Rothschild in London
- › Christian jointly leads Rothschild & Co's market leading debt advisory group which comprises 200 professionals worldwide and has advised corporates, private equity and governments on over \$1 trillion of financing in the last 5 years.
- › He has nearly 30 years' experience in the market and has personally advised on over 300 transactions

Anita Schlöpfer

- › Anita is a partner in Schellenberg Wittmer's banking and finance group in Zurich
- › Her focus is on banking and finance law, finance transactions, asset/investment management, collective investment schemes, and financial services regulation
- › She is regularly advising Swiss and international financial institutions and corporate clients on the structuring, negotiation, and documentation of cross-border acquisition finance and syndicated lending transactions, securitizations and other finance transactions



Kirstie Hutchinson

- › Kirstie is a partner at Macfarlanes in London
- › Kirstie acts for private equity sponsors and portfolio companies, corporate borrowers and issuers, credit fund and bank lenders, special situations investors and speciality finance providers on a range of financing transactions
- › Her range of financing transactions includes investment grade, hybrid and leveraged financings as well as acquisition financings, dividend recapitalisations and capital restructurings

Eric Cartier-Millon

- Eric is a banking and finance partner with Gide here in Paris, with whom he has been since 1990.
- He is regularly representing senior lenders and/or mezzanine lenders in leveraged buy-outs and he also has wide experience in other structured finance as well as in project finance.





What a deal lawyer should know about acquisition financing today

Christian Savvides – 11th IBA European Corporate and Private M&A Conference

2nd February 2023





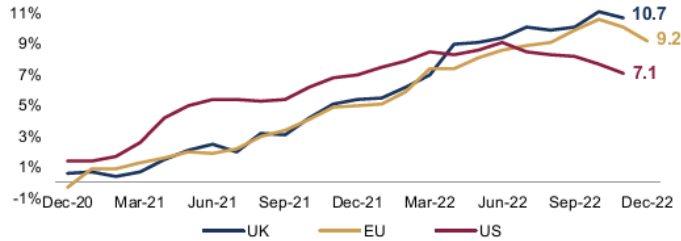
Setting the scene – Recap on 2022 (1/3)

2022 was the most challenging year for global debt capital markets since 2008

CPI¹

Central bank balance sheets, supply chain pressure and geopolitical tensions resulted in record inflation...

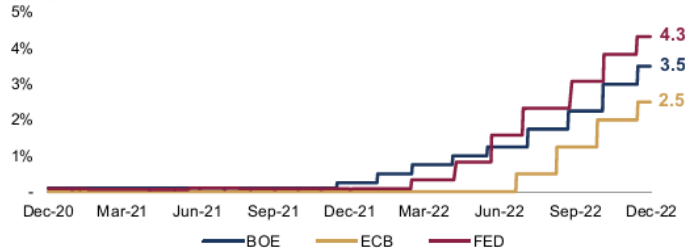
CPI (%)



Central bank rates¹

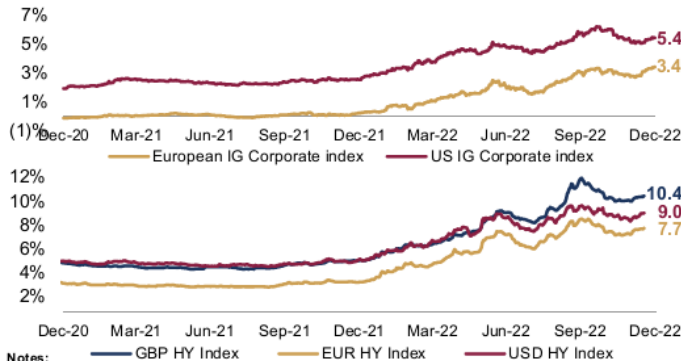
...with central banks raising rates in response...

Policy rates(%)



Investment grade and sub-investment grade indices¹

...cost of financing sky-rocketed...



Asset class returns²

...markets tumbled, in particular risk markets (equity and high-yield).

Equity	Dec-21	Dec-22	Δ
S&P	4,715	3,962	(16.0%)
Nasdaq	15,742	11,144	(29.2%)
DAX	15,885	14,307	(9.9%)
Eurostoxx 50	4,298	3,794	(11.7%)
Credit	2021	2022	Δ
European IG returns	(2.9%)	(13.7%)	(10.8%)
European HY returns	4.2%	(10.2%)	(14.4%)

Notes:
 1. Data as at 31-Dec-22
 2. Data as at 12-Dec-22
 Source: Bloomberg, Factset

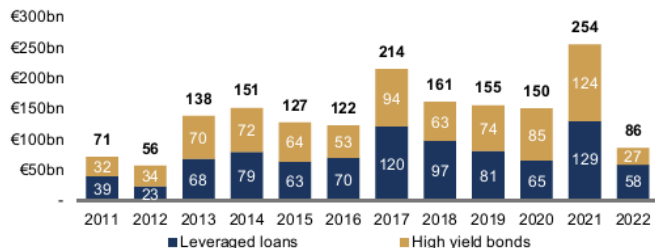


Setting the scene – Recap on 2022 (2/3)

Financing volumes to support deal-making were materially impacted

European high yield and leveraged loan volumes

Primary issuance volumes were severely impacted, with the lowest volume since 2012...



Hung syndications

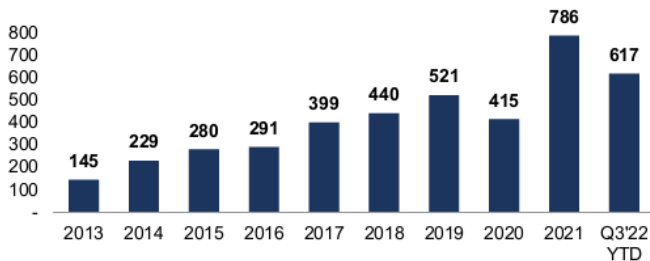
...tens of billions of underwritten transactions were therefore 'hung' on banks' balance sheets, resulting in substantial losses and consuming underwriting capacity for additional M&A...

Borrower	Sector	Sponsor / Corp	CCY	Est. size (€-equiv.)
Unilever Tea (Ekaterra)	Consumer	CVC	EUR / GBP	€2.1bn
Morrisons	Consumer	CD&R	EUR / GBP	€5.6bn
888 Holdings / William Hill	Entertainment	Corp.	EUR / GBP	€1.0bn
Citrix Systems	Technology	Vista / Evergreen	EUR / USD	€4.3bn
Refresco	Consumer	KKR	EUR / USD	€3.4bn

Private credit volumes

...private credit sought to capitalise on the opportunity, but unable to fully replace syndicated markets.

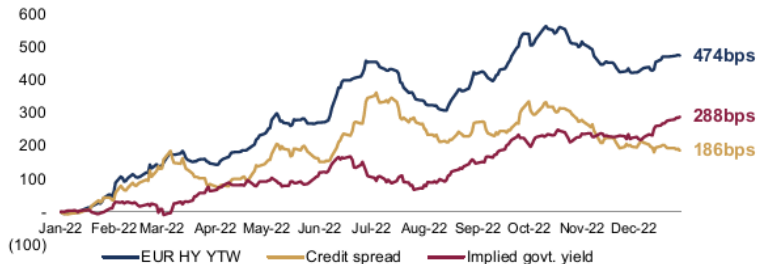
of reported deals



EUR HY index spread

Credit spreads widened throughout 2022, compounding central bank rate increases, although tightening again.

YTD change in yield (bps)



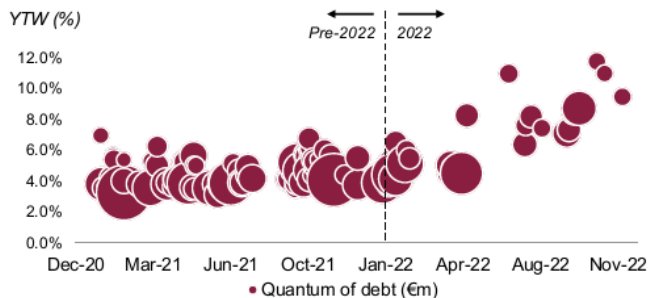


Setting the scene – Recap on 2022 (3/3)

M&A volume clearly impacted by scarcity and cost of financing

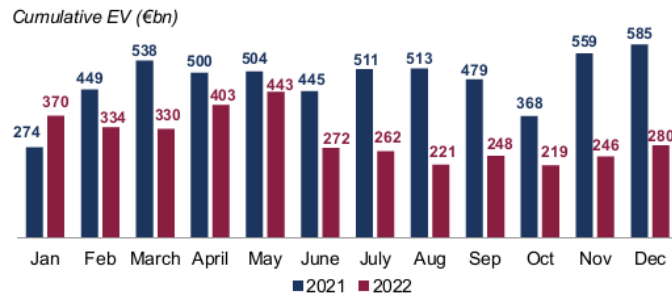
Evolution of size and cost of LBO financing¹

Size of deals declined, while the cost of such financing increased...



M&A volumes

...clearly impacting M&A deal volume



Notes:

1. EUR-denominated high yield bond and leveraged loan financings

Source: Bloomberg, LCD



2023 outlook (1/4)

Key themes / what does a deal maker need to know?

1

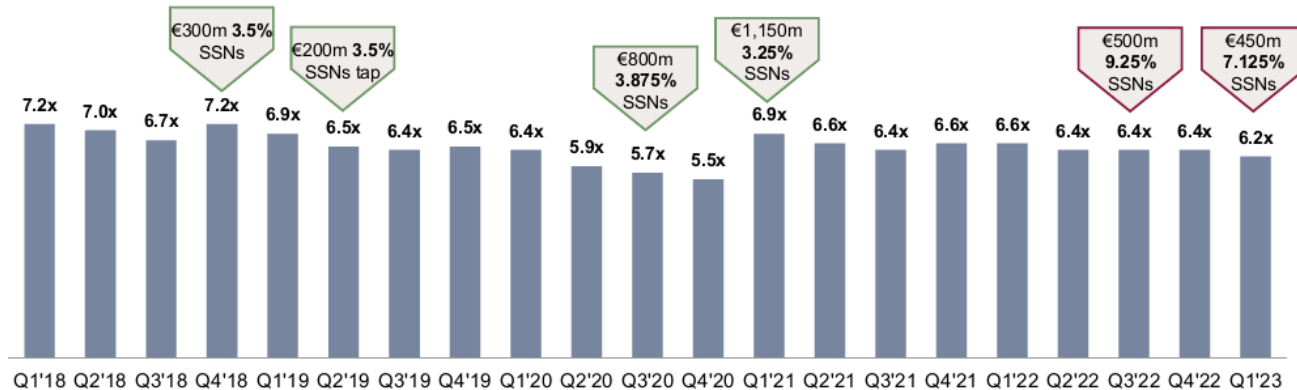
Market conditions expected to stabilise somewhat

- Will central bank base rates peak in 2023? If so, in Q2? Q3? Q4?
- If base rates peak, where will credit spreads settle? Likely dependent on defaults and 'price' of credit risk
 - Defaults remain relatively low, earnings have been resilient, however inflationary pressure and consumer sentiment may not be reflected in Q4-2022 trading
- Will fund outflows reverse enough or will debt markets be fundamentally smaller (total liquidity)?
- Even if capital is available, can all borrowers cope with higher interest costs, in addition to inflationary pressures on P&L and recessionary environment?

Illustrative example: Evolution of Verisure's net leverage

SSN issuances

- Verisure (owned by Hellman & Friedman) is one of the well-known and well-liked credits in the European leveraged finance markets
- A repeat issuer, including dividend recaps, it has seen cost of SSN issuance increase materially in 2022 despite relatively constant leverage





2023 outlook (2/4)

Key themes / what does a deal maker need to know?

2

Capital should be available,
but will be selective

- Bank balance sheets are recovering, but may be reserved for:
 - Favoured clients, best sectors, better rated borrowers
- Banks will factor in volatility in increased underwriting fees supporting M&A financing (fees, OID, cap rates)
- Private credit should take more market share but cannot replace bank and syndicated markets
- Private credit historically less willing to support cyclical sectors (for e.g. retail, consumer, commodities)

3

M&A processes need to go
wide, engaging many pools
of capital (and parties within
each)

- On a sale process specifically, pre-educating is key
 - Are the existing lenders inclined to roll? Can they upsize?
 - Is the existing debt portable? Can you re-lever at portability?
- Consider employing the 'noisy' refinancing
- Bank staples may be less executable than marketed
- Parallel tracking bank underwrite vs private credit for optionality



2023 outlook (3/4)

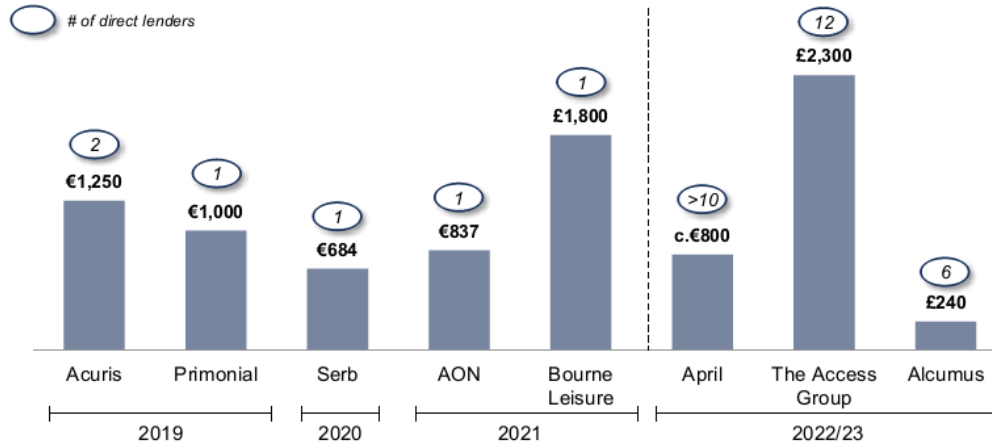
Key themes / what does a deal maker need to know?

4

Get used to club deals

- Some funds struggling to fundraise (with public markets down, investors are overweight private markets)
- General approach to reduce single credit from 2-3% of fund to 1%
- Average ticket sizes therefore down 75-50%
- Pricing divergent
- Leverage has come down (albeit modelling impacts of increased cost of debt and inflation, rather than arbitrary reduction of multiple)
- Subordinated capital (PIK / pref. equity / VLN) increasingly relevant to achieve target leverage in a more conservative, higher interest rate environment
- Historically, very few funds able to provide single ticket >1bn; now observing smaller transactions also via club

Club deals now more prevalent, with average credit fund ticket sizes down c.50%





2023 outlook (4/4)

Key themes / what does a deal maker need to know?

5

Time to market will educate terms and quantum achievable for capital markets

- Deals involving long-timetables to closing, and therefore longer-term capital charges for underwriting banks, more challenging
 - M&A involving competition clearance or P2P looks harder; relevant advisors and views on regulatory process / timetable to approval may be key

6

It's never too late to think about hedging?

- Despite recent rate hikes and relative stabilisation, the yield curve is still well below the levels of inflation in all major currencies, and rates volatility remains high
- Should inflation remain elevated, swap rates would likely rise despite any "hard landing" risks on the economy
- Hedging or pre-hedging against interest rate risk is still relevant to secure the economics of any debt-financed business or project

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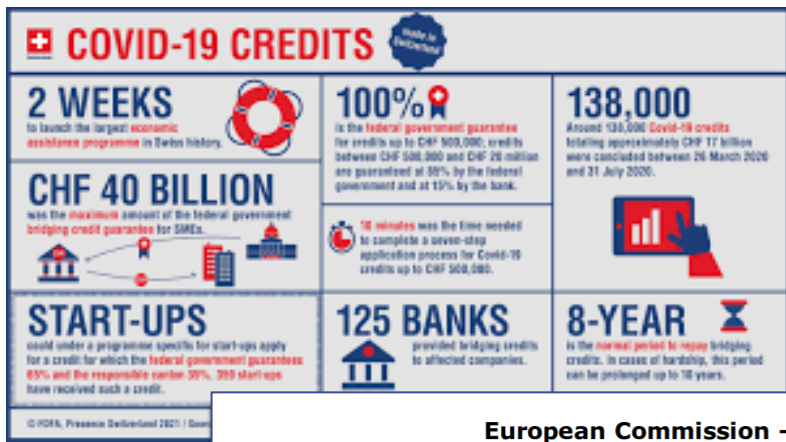
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Current Trend: State Aid Measures



Ad hoc announcement pursuant to Art. 53 LR



Media release

6 September 2022

Swiss government grants Axpo a subordinated credit line of up to CHF 4 billion

With unprecedented turmoil on European energy markets and future developments remaining unpredictable, the Swiss government at the request of Axpo, has granted the company a subordinated, unsecured credit line of up to CHF 4 billion. So far, Axpo has not used any of these funds. With this measure, Axpo is making further provisions to continue to deliver its contribution to the security of supply in Switzerland, even if the worldwide energy crisis escalates further.

European Commission - Press release

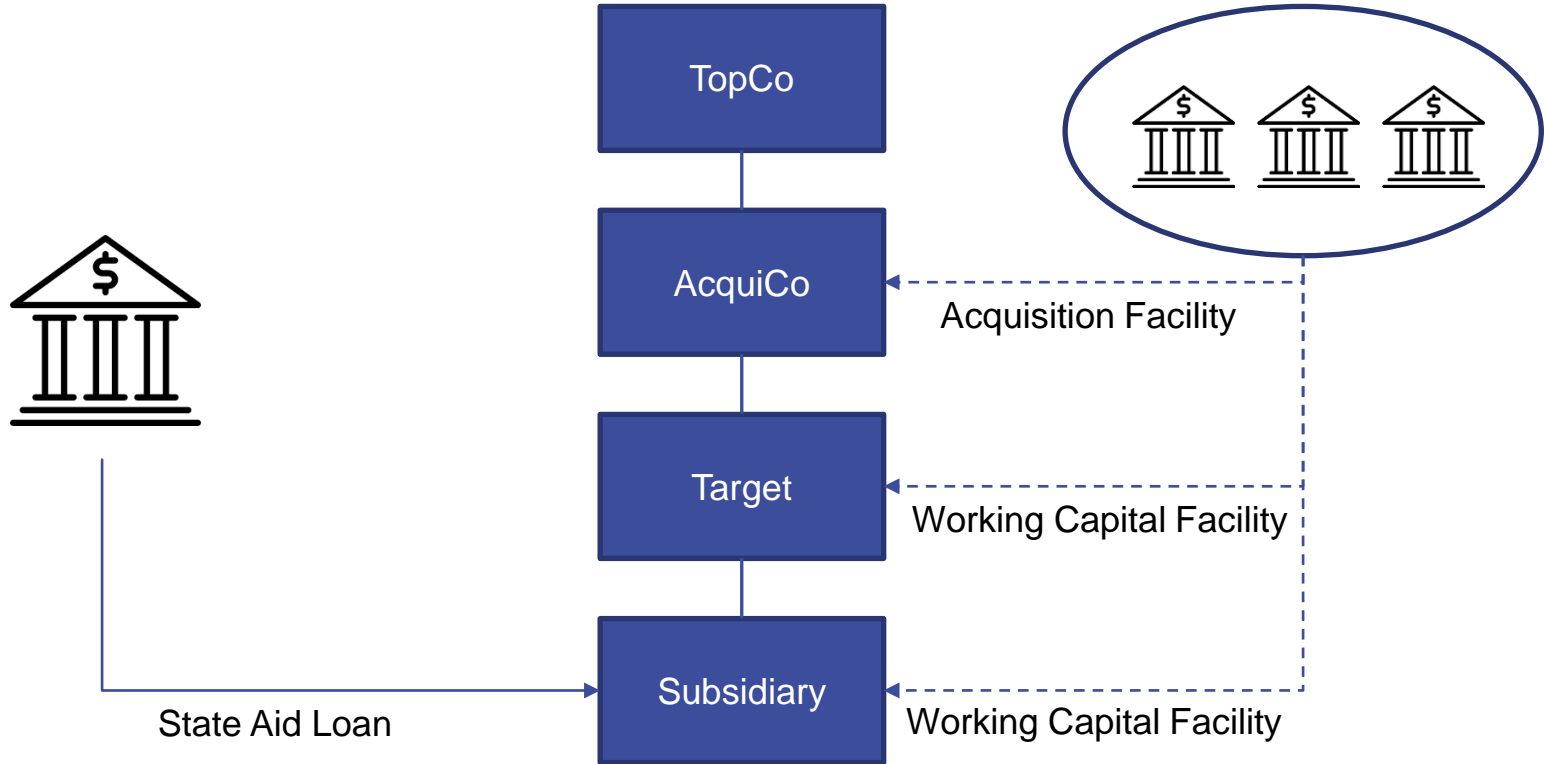


State aid: Commission approves €49 billion German scheme to support the economy in the context of Russia's war against Ukraine

Brussels, 21 December 2022

The European Commission has approved a €49 billion German scheme to support the economy in the context of Russia's war against Ukraine. The scheme was approved under the State aid [Temporary Crisis Framework](#), adopted by the Commission on [23 March 2022](#) and amended on [20 July 2022](#) and on [28 October 2022](#), based on Article 107(3)(b) of the Treaty on the Functioning of the European Union ('TFEU'), recognising that the EU economy is experiencing a serious disturbance.

Typical Acquisition Finance Structure



Potential Impact of Covid Loans and other State Aid Measures



Flow of funds to shareholders and other parties:

- Dividends and repayment of capital
- Granting of loans
- Repayment of loans/payment of interest



Transfers of rights



Disclosure of information



Change of control

Relevant Sectors

Energy

Sports
Entertainment
Recreation

Gastronomy

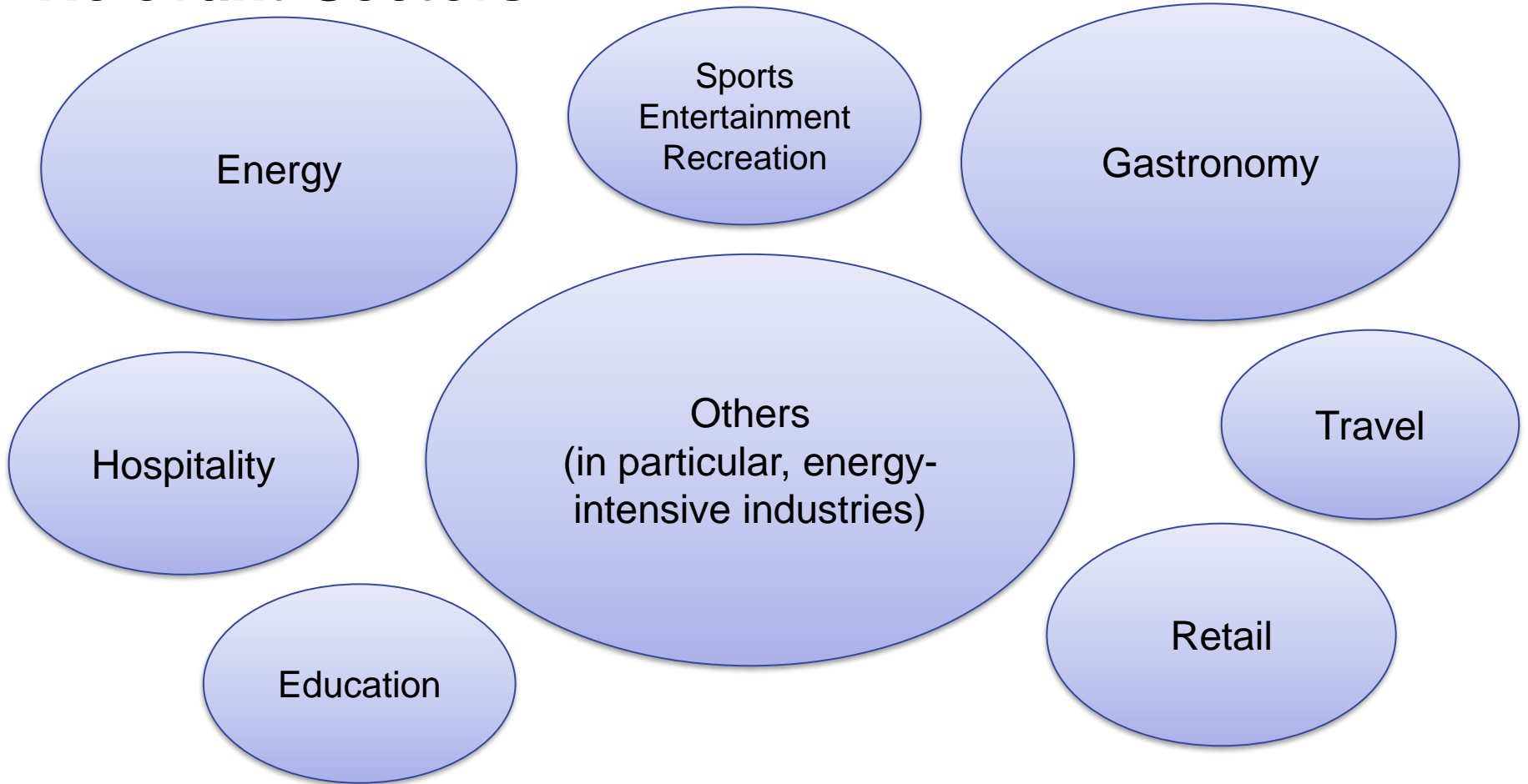
Hospitality

Travel

Education

Retail

Relevant Sectors



Winds of change? What a deal lawyer should know about acquisition finance today

> A UK perspective



Looking back – and forwards

- Liquidity, cost, quantum
- Diligence
- Timelines



Plugging the valuation gap

- Co-investment, warrants
- 'Preferred equity'
- VLN, deferred consideration



Plugging the funding gap

- Underwritten and hollow tranches
- Rollover
- Structuring EBITDA
- Equity commitment



A few words on ESG

- Sectors
- Pricing
- Approach

- ◆ State of the debt market (i.e. contraction of the commercial bank lending, larger share of the debt private funds, share grabbing of the private debt funds although becoming more and more conservatives, higher interest rates).
- ◆ Higher interest rates will most probably have an effect on valuation. Even for strong assets with resilient business EBITDA multiple might be negotiated on a lower basis. Investors will be more selective and regarding with longer due diligence processes. The lack of debt might also be compensated by greater equity cushion.
- ◆ Practical consequences on the terms of the financings: lenders are requiring tighter covenants (this materialises specifically in more conservative position on permitted payments, permitted debt, EBITDA adjustment), more financial covenants (no more cove-lite, additional financial covenants (i.e. ICR)), more TLA + TLB financings.
- ◆ 2023 expected to be a challenging year including persistent inflation, high interest rates and the prospect of slower economic growth. However there is dry powder as a lot of funds have been raised which will need to get deployed.

Thank you.

