WHITE & CASE

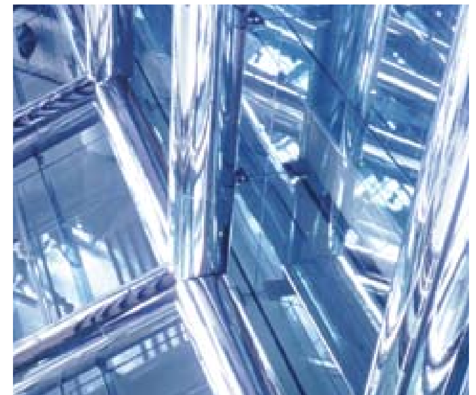
Insight: Bank Finance

January 2011

Reflection on 2010 and the outlook for 2011

Whilst market fortunes were mixed in 2010 the recurrent trends of bank/bond deals, complex multi jurisdictional restructurings and refinancings played to the strengths of the White & Case Bank Finance practice in London and we had an exceptionally strong year.

Set out in this alert are some of our highlights from, and reflections on, 2010 and our thoughts on what lies ahead in 2011.



Senior-bank market

The signs of recovery in the European LBO market in 2010 were slow and measured. Investors remained cautious and whilst competition for good quality credits continued, costs of funds, tightening margins and reduced or diluted fee arrangements made 2010 a challenging year for lenders. For borrowers valuation remained a chief concern. Innovation was key to successful deals such as the recently closed refinancing of **Wind Telecomunicazioni S.p.A**, where White & Case acted for the company and demonstrated its ability to deliver integrated bank/bond services to structure the refinancing (of a standard LBO package) with senior bank and bond debt and a lighter covenant package. Large bank deals continued to be the exception rather than the norm and were only possible for the most attractive of credits. More typically, bank debt was taken out with a senior secured high yield bond with any (small) working capital facility being provided on less onerous bond style covenant terms but on a super priority basis to give comfort to the senior lenders sitting alongside the secured bondholders.

The Nordic region remained active in 2010 and White & Case advised lenders and borrowers on a range of acquisition opportunities including our representation of Nordea Bank AB (publ) as arranger on the 2.5 billion Swedish Krona public-to-private purchase of **AcadeMedia AB (publ)**. In this case highly complex and tailored finance arrangements were required in order to complete the deal including enabling debt to be serviced whilst preventing cash leakage from the target group owing to the presence of a minority shareholder that was not subject to a squeeze-out procedure.

France too was active in 2010 with LBO transactions being implemented using the innovative "double Luxco" structure (including **Spotless, Sebia** and **Cerba**, all of which White & Case advised on). The main objective of the double Luxco structure is to provide the lenders with enhanced options following a filing by Bidco to obtain the benefit of a safeguard proceeding. Notably, the structure aims to permit senior lenders to enforce security over shares in the Luxembourg holding company of Bidco, notwithstanding the fact that Bidco is subject to a hostile safeguard. The acquisition of **Picard Surgelés** saw the first application of the double Luxco structure where a senior secured high yield bond was present in the capital structure.

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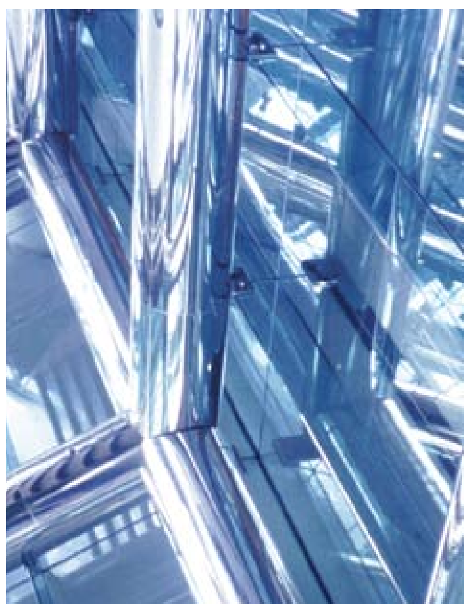

In 2011 we expect the LBO market to remain challenging in Western Europe but with measured improvement from 2010. Where a debt to equity swap has left senior lenders holding an equity stake it is unlikely that lenders will want to continue to actively manage these ailing companies (being expensive non-core activity), thereby resulting in an up-tick in distressed M&A transactions. Added to this is of course the mountain of 'dry powder' sitting with sponsors.

We believe that opportunities will continue to arise in CEE and we expect to see sustained activity in the Nordic region. We anticipate that the senior secured high yield bond will continue to play a key part in new financings and refinancings, in particular as the quantum of maturing debt grows with the progression of time, together with opportunities for cash rich companies to effect distressed M&A transactions. We are cautiously optimistic therefore for an active year ahead.

Jeremy Duffy, a partner in our Bank Finance practice advises that "We expect practices such as our own, with (i) strong combined high yield and secured bank finance teams; (ii) UK, US and international law capabilities; and (iii) an extensive international network, to maintain a distinct advantage through 2011 given that deals in the current environment will require specialised solutions which we are uniquely placed to provide."

For details of our forthcoming Breakfast Briefing on European Leveraged Finance, please click here.

Please click on our recent client alerts to download them: *The Double Luxco Structure* and its application in French leveraged acquisition financings and *Accelerated Financial Safeguard*.

Restructuring

Restructuring activity in the UK in 2010 was generally less intense than initially expected. The number of corporate insolvencies dropped by over 17% in 2010, showing a good level of recovery since record levels in 2009, although still 33% higher than the pre-crunch levels of 2007. This reduction was due in large part to low interest rates and the effect of government support programmes. Further, the increasing use of the high yield bond market enabled businesses to push out their maturity profiles.

Notwithstanding this, many economists now believe that 2011 could see a significant increase in formal restructurings and insolvencies. As is now widely known the LBO 'wall of debt' is due to mature shortly and this together with the public sector cuts and the likely interest rate rise, which will put pressure on already constrained cash flows, all add to the probability that the restructuring 'wave' is still to come in the not too distant future. Commentators point to the withdrawal of government support programmes and the deficit reduction measures by governments across Europe which will result in reduced consumer spending. With further macro-economic challenges such as high unemployment, excess capacity and the spectre of inflation looming overhead, companies will continue to be under severe pressure. The key determinant as to whether the threat of a significant increase in restructuring activity becomes a reality hinges, in all probability, on whether the risk of a sovereign default in the Eurozone can be contained. So long as the ongoing uncertainty over the fiscal health of countries such as Greece, Ireland, Portugal and Spain continues, the strength of the recent economic revival will remain very much in doubt.

Christian Pilkington, a partner in our Financial Restructuring and Insolvency practice, summarises our recent work flow: "White & Case's involvement in a series of pioneering restructuring transactions within the last 18 months has involved the restructuring of over **US$50 billion worth of debt facilities**, including the restructurings in 2010 of **Wind Hellas** (effected by way of scheme of arrangement and five separate administrations in the UK) and alumina producer, **Almatis**, which brought to an end one of the longest insolvency proceedings in Europe."

Please click here for our client alert on the Wind Hellas restructuring.

Sovereign Debt

Many commentators now speculate that sovereign debt in Europe threatens to tip the Eurozone into a 'double dip' recession. It is clear that the impact of the sovereign debt crisis over the next twelve months will be crucial for the global economy as it potentially has a critical impact on both the defaulting country whose debts are being restructured (for example, higher interest rates, negative impact on public spending and national tax policies) and also externally on any creditors to the sovereign (for example, German and UK banks are said to be exposed to Ireland in the region of €206 billion and €224 billion respectively).

The Eurozone remains at the centre of the sovereign debt crisis. Greece looks likely to miss its deficit targets and, as a result, it is unclear whether the remainder of the support package will be made available to it. In the latter part of 2010, Ireland was finally forced to request financial support from the European Financial Stability Mechanism and the European Financial Stability Fund, but the long term future over the country's debt remains under a cloud.

The key question for 2011 is whether other countries in the Eurozone are now at risk. Portugal is said to require US$38 billion in order to refinance its national debts, but there are currently major concerns about Spain which has seen CDS spreads widen considerably. Spain currently accounts for approximately 12% of GDP in the Eurozone – close to double that of Greece, Ireland and Portugal combined – and economists are watching the situation closely.

In 2009, White & Case assisted the **Kazakhstan Government** in drafting a new restructuring law, allowing the subsequent restructurings of in excess of US$20 billion of debt of **BTA Bank** and **JSC Alliance Bank** to be recognised by the UK and US courts. Mark Glengarry, a partner in our Financial Restructuring and Insolvency practice, summarises the success of these transactions, "The redrafting of Kazakhstan's restructuring laws, plus the successful restructuring of Alliance Bank and BTA Bank, was a real triumph for Kazakhstan, showing other countries how they can effect restructurings in their banking sectors in the wake of the financial crisis without relying on Sovereign support."

High Yield

2010 has been a transformational year for the high yield bond market with the continued emergence in Europe of the senior secured high yield bond. As banks deal with the revised lending markets and, for the most part, the absence of mezzanine players and CLOs, and get to grips with Basel III, we expect that the high yield bond market will remain very active in 2011 and beyond. We expect to see the senior secured high yield bond become increasingly prevalent in both refinancings and new acquisitions as an alternative to the traditional senior bank and/or mezzanine capital structures found outside the US, including with respect to shareholders, sponsors or issuers who recognise (based in many cases on first hand experiences during the market downturn) the benefits of the flexibility of the high yield product, in particular the incurrence-based covenants and the absence of amortisation payments. Further, we expect the high yield bond market will continue to be an increasingly important financing option as the LBO and CMBS 'walls of debt' mature over the next few years and considering that the inflation-adjusted cost of senior secured bonds makes them a relatively inexpensive financing alternative (particularly in comparison to mezzanine financing, amongst other options).

There are indications that the high yield bond market is continuing to gather strength in the emerging markets (both through the addition of high yield type covenants in Eurobond-type financings as well as in new financings based on the traditional US model) as demonstrated by the ground-breaking high yield bond issued in Turkey by **Yüksel İnşaat A.Ş.**, in November 2010 where White & Case acted for the issuer.

Colin Chang, a partner in our High Yield practice advises that "We are uniquely placed as we are one of few firms who have the ability to deliver integrated bank/bond services on very large and complex transactions, including our ability to move seamlessly among the various financial products and the related intercreditor issues as well as among US, UK or local law."

Please click here for our client alert, *Intercreditor Terms – How Super is your Senior* which analyses some of the key intercreditor terms in a transaction where senior secured bonds sit alongside a senior revolving credit facility in the capital structure.

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