UNCERTAIN TIMES FOR LEVERAGED FINANCE IN SPAIN - DLA PIPER

Posted on 30/12/2009

Category: Banking & Finance

The last two years have been an uncertain time for the private equity market in Spain (uncertainty which, unfortunately, is expected to continue during 2010). The country has, as a consequence of the socalled global credit crunch, been experiencing similar problems to other European economies including a significant slowdown in economic activity and consumer spending. An effect of which also, has been a very substantial decrease in the number of leveraged finance transactions closed during 2008 and 2009, albeit the midmarket has been slightly less affected.

The main features of the current deal market include there being much less liquidity, making it harder for entities to access financing. Lenders are increasingly concerned about insolvency related

issues and the conditions offered to borrowers are tougher when compared to those imposed during the M&A boom of 2005-2007. In addition, trading in the secondary syndication market remains, predominantly, at a significant discount to par and sponsors can no longer take advantage of the previously highly-liquid investor base.

The key consequences of this are that financing packages are structured with less layers of debt (second lien and mezzanine facilities have decreased dramatically), and there has been a return to more traditional and less aggressive lending practices – paying greater attention to the scope and nature of the covenants and representations that borrowers are required to provide in the loan documentation. There has been a substantial decrease in leverage (rarely more than two–three times EBITDA), a return to tighter covenants and reinforcement of security packages, and a significant increase in margins.

Los autores, Javier López Antón y César Herrero Mazario de DLA Piper en España, ofrecen su visión de la situación actual relacionada con las oportunidades para fondos de capital riesgo en su uso de crédito apalancado. Apuntan que la recién publicada Ley 3/2009, de 3 de abril, sobre modificaciones estructurales de las sociedades mercantiles, incorpora al ordenamiento jurídico español diversas directivas comunitarias sobre sociedades. En concreto subrayan la aprobación de la fusión entre el comprador y su objetivo como un mecanismo para evitar las restricciones relacionadas con la ayuda financiera y hacer bajar la deuda de adquisición hasta el nivel de la empresa escogida.
Lenders are likewise extremely reluctant to accept equity cures to financial covenant defaults (if finally accepted, a very limited number of cures are allowed) or Mulligan clauses (whereby certain financial ratios breaches can only result in an event of default if repeated). Material Adverse Effect (MAE) definitions are no longer limited to refer only to payment obligations but now tend to encompass any material adverse effect on the financial condition of the borrower, and its group companies, and the ability to comply with all obligations under the loan documentation.

There is scope for permitted acquisitions, subject to tighter conditions, with security being taken over practically all available assets despite the high execution costs – some lenders are insisting that borrowers create in rem securities on the transaction closing date instead of relying only on promissory securities.

Likewise reverse-flex provisions have practically disappeared as have covenant-lite provisions which, although hardly previously used, are definitively now ruled out, while market-flex provisions have been widened in order to successfully syndicate acquisition debt and market disruption provisions have become standard. Sponsors are now potentially forced to focus all their efforts on seeking structural solutions when faced with the difficulty of complying with financial ratios and honouring payments.

In terms of recent legal developments, it is worth noting that legislation (Law 3/2009 of 3 April 2009) now establishes new requirements applicable to all structural reorganisations of Spanish companies bringing about more flexibility with respect to the applicable legal requirements, including to both domestic and cross-border mergers.

This Law expressly authorises the merger of the acquiring entity with the target company (supporting a common Spanish practice but for which there was no legislation) as a means of getting around financial assistance restrictions and pushing-down the acquisition debt to the target company level.

Although it is not yet possible to give an opinion on the impact of the Law on leveraged transactions, we feel that it will be difficult in practice to comply with some of the requirements imposed in order to benefit from some of the provisions included. In particular, those relating to the obtaining of an expert's report, inter alia, confirming the reasonableness of the whole merger process and whether

there is financial assistance.

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