MIXED SIGNALS FOR LEVERAGE FINANCE

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The M&A market in Denmark showed high activity levels during 2017 and 2018. Will it continue in 2019?

Strong investor appetite

Nordic PE funds have been raising new capital and there is still a lot of dry powder among investors. Combined with a keen interest from banks and other financial institutions to lend to M&A transactions, there is a strong potential for continued activity in the leverage finance market in 2019.

In 2018 we saw an increased focus from the Danish FSA (Finanstilsynet) on the risk of leveraged financing – both on alternative investments by pension funds and on the risk profiles of bank lending.

The Danish market also saw covenant breaches and even some full-blown restructurings and bankruptcies towards the end of 2018.

The event which received the most media attention in the Danish market was the in-court restructuring and subsequent bankruptcy of TOP-TOY, which traded under the brands Toys'R'Us and BR in the Nordic countries and Germany. Kromann Reumert has been heavily involved in that transaction.

Like other companies in the retail industry TOP-TOY came under pressure and a failed Christmas sale led to the unfortunate bankruptcy.

Market challenges

It has been predicted that retail companies with a large network of physical stores will be facing challenges adjusting to shifting consumer behavior and from the competition of the omnipresent internet giants. Toy companies all over the world have been faced by these challenges and the bankruptcy of TOP-TOY was the latest casualty in a chain of such insolvencies around the world.

It remains to be seen how other retail companies will be affected by the challenges in this sector and how their banks and other financiers will react in the longer term.

Certain other industries have also seen challenges. Swings in fuel prices and fierce competition have been a challenge in certain sectors and the Icelandic/Danish based airline company Primera went into bankruptcy in October 2018.

Certain manufacturing and industrial companies in the Danish market are also experiencing a lack of orders, perhaps due to uncertainties in the global market.

Some of these struggles may have been predictable, but others have come as a surprise to the owners and their financiers.

It remains to be seen whether these challenges will be limited to certain sectors and certain businesses or whether it is a symptom of more serious problems to come.
Developments in the financial markets

Since 2010 the number of leveraged finance transactions has increased each year and have continuously been subject to lighter and lighter covenant provisions in the larger syndicated deals in the European market.

But it seems that this development is slowly taking another turn.

The records from 2018 for the syndicated European market show that the number of deals completed over the year of 2018 has decreased for the first time in ten years\(^1\). At the same time, financial institutions are becoming increasingly risk adverse and covenants are being tightened somewhat (though the situation is still far from what was seen previously)\(^2\).

The terms of the smaller and more local leverage finance transactions in the Danish market have generally been more conservative and the covenant lite and covenant loose structures seen in the European market have not been adopted into the local Danish market although a softening of terms has been identified.

It will be interesting to see whether the softening of terms continues or whether we are at a turning point. Will the cautious approach addressed by the Danish FSA together with the challenges in certain sectors turn the tides or will the banks’ and other financial institutions’ appetite for returns overshadow such concerns?

Planning ahead

Investors and financiers are still competing for new deals in the market and the latest structured processes in the Danish market show great interest both from local and international players.

However, PE funds and other sponsors will probably be wise to have an increased focus on any challenges under their existing loans. Planning ahead to deal with emerging problems is generally recommendable as the banks could be hardening their stands and waivers may not be as easily obtainable as in previous years.

Similarly, banks may also want to initiate negotiations at an earlier stage bearing in mind that it often become increasingly difficult for PE funds to inject further equity as problems grow – at least not without substantial concessions (including potentially write-offs) from the banks.

Kromann Reumert has Denmark’s largest team of financing lawyers with both local and international experience. The financing team works closely together with our restructuring team and we have been involved in most major workouts in the Danish market as well as a number of international restructurings.

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\(^1\) Mergermarket, 2018 Global M&A report
\(^2\) Debtwire, Debtwire Par: Year-End 2018 European Leveraged Insights Report

Read Investor Update 2018 Q4.