

Nordic mid-market M&A

BY CLAIRE SPENCER

2006 was a busy year for both public and private M&A in the Nordic region, and activity is going from strength to strength in 2007. Deal values and volumes even exceeded the record year of 2000. Financial buyers have established a notable presence and made a meaningful contribution to these figures. But, as Petter Wirell, a partner at Cederquist, notes, financial buyers are only playing a part. "Private equity funds are no longer alone in the arena. Industrial companies are active as sellers in taking advantage of high liquidity, and as buyers in taking advantage of the opportunity to grow their businesses with existing and borrowed capital," he says. Increased buyer diversity has had a positive effect on the financial services sector, which was the most active in the Nordic mid-market. Other sectors of interest included biotechnology, pharmaceuticals and manufacturing.

Private equity firms have been drawn to the region by the steady supply of attractive opportunities. Adding to the appeal is the reduced regulation that governs Nordic companies, compared to certain other regions, and the pos-

sible privatisation of certain traditional businesses, such as TeliaSonera in Sweden, which may open the door to financial buyers. But the increase in leveraged buyouts and growth capital investments has made private equity a controversial topic among trade unions and politicians in the UK and US. So how does its reputation fare in the Nordic countries? According to Biörn Riese, chairman of the board and head of the M&A practice at Mannheimer Swartling, in Sweden private equity does not stir the same levels of apprehension seen elsewhere. "The global discussions regarding the PE business has been mirrored in Sweden, but with a less negative approach," he says. "Governmental representatives have expressed their positive attitude towards the industry, on the basis that it is important for the business climate and the economy, and have also invited the industry to further discuss how the investment climate can be improved." It is largely thanks to private equity activity that there is so much liquidity in the Nordic mid-market at present. This has helped to drive M&A activity as funds look to capture controlling stakes

in companies to improve their operational efficiency and management performance.

By its nature, the Nordic area is geared to welcome foreign investors. It is generally investor friendly and there are few exotic features when it comes to dealmaking. Generally, foreign investors are happy to lay down roots in the Nordic countries, as investment procedures are aligned with accepted international traits. Today, many deals are conducted in English, which has been a fairly recent development. "Historically, even rather large deals were conducted with fairly short and limited documentation, with the parties relying, to a considerable extent, on the provisions of statutory law, case law and general legal principles. But deals are increasingly being conducted in an Anglo-Saxon style, involving lengthier and more detailed documentation, thereby reducing the differences in how deals are conducted," Mr Wirrell explains. Of course, cultural differences will always arise, but professionals say these can be overcome by awareness, acceptance and compromise on both sides.

Yet the M&A market is not without risks for ▶▶

prospective buyers. For one, like many other places, valuations are currently soaring. "Some studies concerning investments indicate that the most successful investments do not usually take place when the valuation of target companies is at their peak. Therefore, it is evident that the risks of private equity companies in the Nordic market will be linked to the development of valuations and the market condition in the Nordic market in general, which is closely linked to developments in Europe and the US," says Petri Morelius, a partner at Luostarinen Mettälä Rääkkönen.

Moreover, the relentless competition for quality assets gives sellers a clear advantage in negotiations, and they are frequently able to shift transaction risks onto the buyer. There are fewer representations and warranties included in purchase agreements, and indemnities provided by sellers have declined. "The buyer must be able to handle, and assume, this risk allocation, in order to be a successful candidate. A buyer must make a more detailed analysis of what the real risks of the relevant business are, understand them, and if necessary, set a price tag on them," points out Mr Riese. This is made more difficult by controlled auction processes, which are almost unavoidable in the M&A market, and an expectation that successful bidders are expected to close the deal in a matter of days after acceptance. Such haste can impinge on the need for care and caution in analysing the target and identifying potential complications.

Nevertheless, deal advisers recommend that buyers should strive to maintain a considered evaluation process. They should investigate the target's products, its scope for growth, the existing management team and the company's position within its market. Due diligence is vital in answering the surrounding questions. With sellers keen to jettison all the transaction risks, due diligence findings are a buyer's best hope of clawing back certain provisions. Then it comes down to drafting the legal agreement.

"A well thought out and carefully drafted agreement ensures that disputes are minimised at the closing and post-closing stages. Obviously, the seller and the purchaser have opposing interests on matters such as the extent of seller's liability, warranties, and so on, but both parties share an interest in ensuring that the agreement contains a clear enough road map that avoids the need to seek interpretations of the parties' intent from the courtroom or arbitration," asserts Mr Morelius.

According to local professionals, the legal and regulatory environment in the Nordic region complements the M&A market. Investors are comforted by clear legislation, stable and transparent judicial systems and improved standards of corporate governance. Employee and pension laws seldom create obstacles to deal closure. Tax policies are also applauded, especially by private equity firms. Sweden, for example, has an advantageous tax regime with the potential to make dividends and capital gains tax-deductible. In Finland, new laws have been put in place since the beginning of 2006 to pique private equity interest in the region. These laws were designed to allow any profits gained from a Finnish limited partnership to be taxed in the same way as a direct investment into a Finnish company, which represents a considerable improvement on returns.

On the whole, the macroeconomic climate in the Nordic region is quite predictable. Politicians are keeping their promises to lower taxes, exchange rates remain sturdy, interest rates are at an all-time low and economic growth is ahead of the eurozone average. All of this suggests that M&A levels are set to remain high. Even in the event that interest rates do rise, the effects are likely to be felt on a sector-by-sector basis rather than across the board, at least in the initial stages. For the time being, the Nordic region is prominent on the global stage and will continue to take advantage of the wide availability of equity and cheap debt to

For the time being, the Nordic region is prominent on the global stage and will continue to take advantage of the wide availability of equity and cheap debt to finance mid-market acquisitions.

finance mid-market acquisitions. In addition, synergies between neighbouring countries lead to plenty of cross-border deal flow as foreign companies attempt to establish multiple footprints in the region. But persistent deal activity means valuations will remain high, and buyers must hone their skills to identify the right targets, beat out competitors and ensure they do not shackle themselves with unnecessary risks brought on by the speed of the process and the unrivalled negotiating strength of sellers. ■

Acquisition finance under the new Finnish Companies Act

BY KIMMO METTÄLÄ

Mid-market M&A transactions in Finland often involve private equity firms as buyers. Such buyers fund a portion of the purchase price by debt from external sources. This article looks at the limitations that apply in using the target business and its assets as security in such leveraged buyout transactions in light of the new Finnish Companies Act that entered into force in September 2006.

Importance of collateral in acquisition financing. Typically, lenders providing acquisition finance extend their loans on a non-recourse basis to the private equity sponsors. Therefore, it is crucial for the lenders to obtain a security package that consists of share security, guarantees and pledges of movable and immovable assets and, ideally, cash flows of the target business. When the acquisition tar-

get is a multinational group, involving one or more Finnish subsidiaries, from a Finnish law point of view the issue is whether the subsidiaries can provide 'upstream' guarantees and security to secure the borrowings by a foreign entity that is acquiring the foreign parent company. Similar issue arises in a purely Finnish acquisition, when the sponsors set up an acquisition vehicle that will be funded by equity ►

and bank debt and will then acquire the Finnish target.

What limitations are there to take collateral? The Companies Act contains limitations on the 'distribution of funds' by a Finnish company. Basically, a company is allowed to dividend the distributable equity to its shareholders. As to other distributions, transactions that reduce the company's assets or increase its debts without business grounds are considered illegal distribution of funds. One purpose of this limitation is to protect the company's unsecured creditors. Since the granting of a guarantee or security does not immediately reduce the company's assets, is it considered distribution of funds? No specific answer is given by the new Act, but legal literature indicates that it might be. Thus, the lenders' security package may be limited by the restrictions on distribution of funds. Illegal distribution occurs also if, at the time the distribution was approved, it was known that the company is insolvent or that the distribution will lead to insolvency.

The party that received the illegal distribution must return the funds to the company if it knew or should have known that the company was insolvent or that the distribution leads to insolvency. If granting a guarantee or security can indeed be viewed as distribution of funds, the possibility that the guarantee or security arrangement must be reversed can of course be disastrous for the lenders. To protect against

such consequence, the lenders usually require evidence to confirm that the governing bodies of the guarantor and provider of collateral have found that business grounds exist for the arrangement, and that the financial standing of the guarantor as well as those group companies against which it will have a right of recourse have been duly considered and approved.

Prohibition against financial assistance. The new Companies Act prohibits use of the assets of the acquisition target as security for debts obtained for the purpose of acquiring the shares of the target or its parent company. The prohibition, usually called the prohibition against financial assistance, also covers loans and guarantees by the target for such purpose. This limitation applies equally to private and public limited companies. The prohibition usually does not prevent the granting of share security in the Finnish target. However, it extends to the giving of a guarantee or asset security by the target to secure certain acquisition loans.

What if there is a separate Finnish acquisition vehicle (Newco) that acquires the Finnish target company, can the target be legally merged into Newco after the merger? This way, operational assets of the target can be transferred to the balance sheet of Newco and, if Newco has given floating charge security to the lenders, this security will after the merger cover also the movable assets of Newco. Such

a merger is a common procedure in Finnish acquisition finance practice, and as such is not illegal. However, there is some doubt as to whether the borrower as a condition of the loan agreement may be required to implement such merger. Since the protection of creditors is arranged by separate provisions in the law, an argument may be made that the financial assistance limitation is not violated even if such merger is contemplated already in the loan agreement, but no case law exists to confirm this view.

The prohibition against financial assistance does not apply to possible loans to finance the working capital needs of the target, loans to refinance existing debt, or loans to finance the acquisition of other subsidiaries of the parent company. Therefore, in practice the target in an LBO-transaction almost always gives security over its assets to the lenders to secure debt for these purposes.

Early experiences of the new Companies Act. From a legal practitioner's point of view, the new Finnish Companies Act has eliminated some problematic provisions in the previous Companies Act, and the Act now provides a reasonable legal framework for acquisition financing which is in line with similar principles in other EU countries. ■

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