M&A: 7 market outlooks

The post-lockdown reopening

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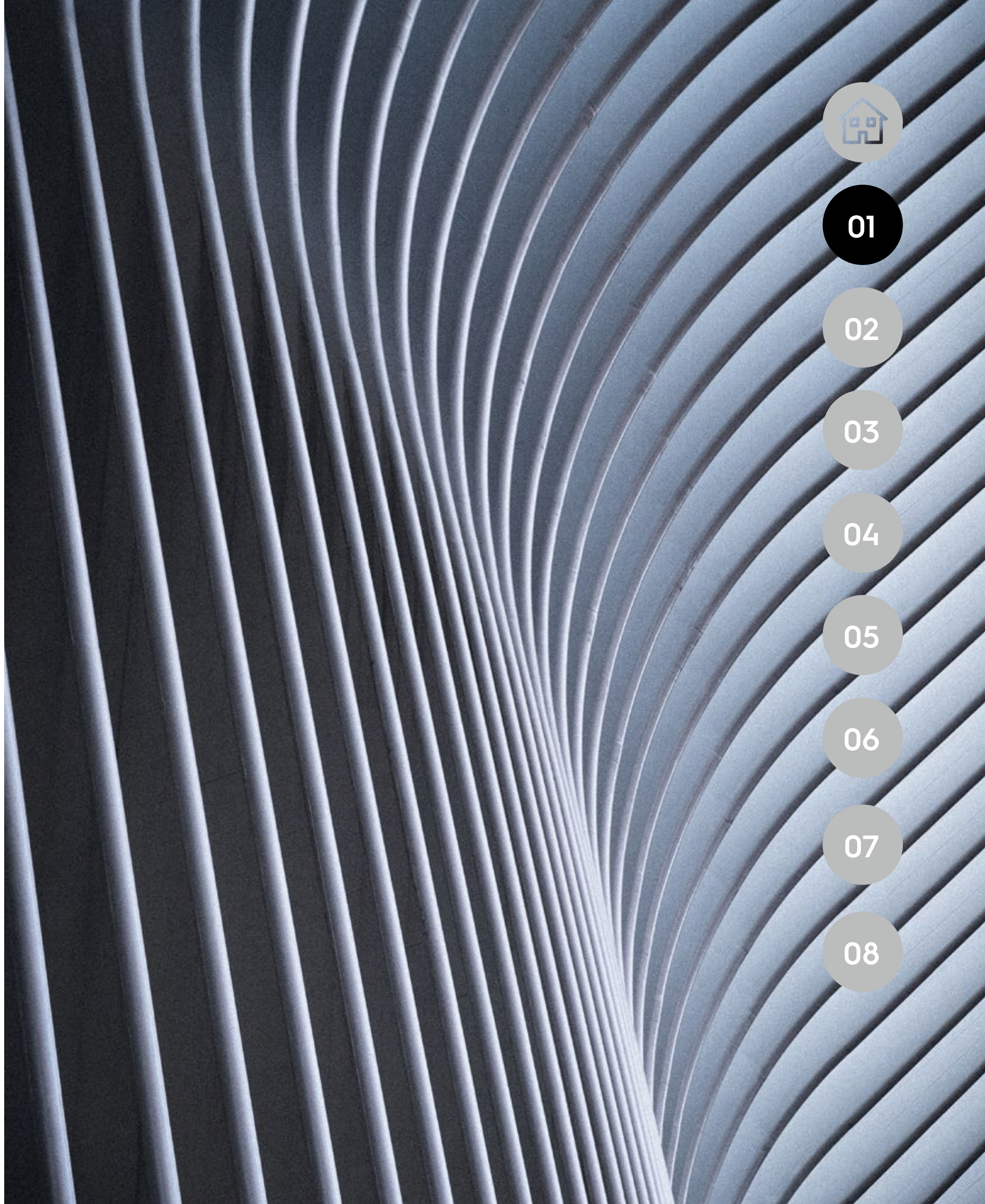
Coming trends in the M&A market: reopening post-lockdown

If we look at what happened in the Portuguese and European M&A markets in 2020 – in which we went through the pandemic between March and December – we see that there were fewer transactions, but a higher deal value was reached compared with previous years as a result of particular transactions that had a very significant value.



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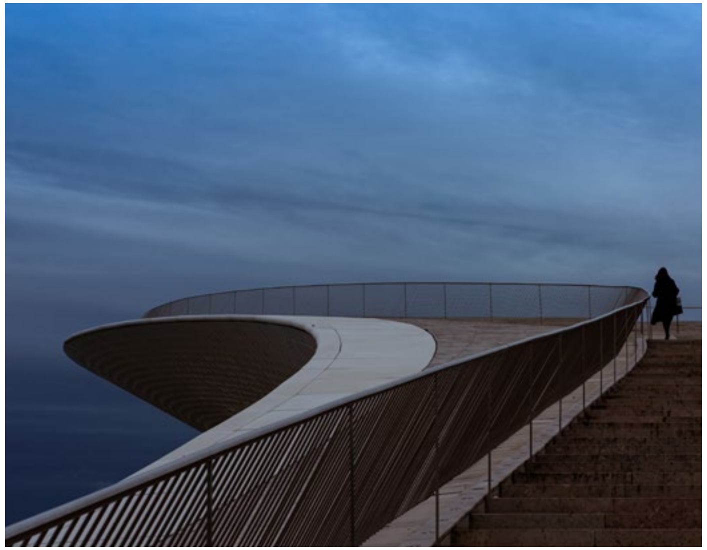

"The end of 2020 gave a signal of hope with a significant number of transactions."

Ana Sofia Batista

When the pandemic began in March 2020, there was a little bit of everything: cancelled transactions, suspended transactions that were resumed later and others that dragged on. Everything became a lot more difficult and slower. The lack of mobility and of physical contact hindered the creation of a climate of trust necessary for the fulfilment of agreements. Despite this, the end of 2020 ended with a strong and positive sign with a significant number of transactions in a period of lesser impact of the pandemic and in which companies, banks, consultants had already adapted to this new normality.

According to the publicly available information, the sectors where most M&A transactions were registered in Portugal in 2020 were: real estate, finance and insurance, health and technological businesses. Already in the first two months of 2021, the most dynamic sectors appeared to be these same ones, together with distribution and retail.

Despite having begun 2021 with the frustration of a new and prolonged lockdown, if everything goes well, the current lockdown will end over several weeks and phases, the rhythm of vaccination will accelerate and by summer, we will have the resumption of a certain normality in our economy, generating greater trust in businesses and investors and also in vendors. The experience of 2020 was that every time there was an opening, the rebound of the economy was almost immediate.

So there are reasons to be cautiously optimistic about 2021 as compared with 2020.

After a year we know that there have been sectors which have come through the crisis relatively unscathed and continue to operate with a certain level of normality and in some cases, activity even improved. This was the case, for example, of logistics businesses, the health sector and some retail segments.

But this isn't what happened in the majority of cases where activity was suspended or reduced significantly and where businesses, many of the SMEs or microenterprises, family-led and unsophisticated, are gravely affected or even have become insolvent or pre-insolvent, clinging to lifebuoys such as credit moratoriums and the scarce State financial support, for example worker lay off support.
That's why, when we do our review of 2021, we hope that the M&A market will have had a more dynamic performance than in 2020 as a result of the gradual reopening, resumption and normalisation of the economy, which will only be possible if businesses and the private economy are continually supported during this period and they position themselves in a suitable and balanced way.

If this doesn't happen then corporate restructurings and reorganizations will be a reality and the sale of distressed assets will once again by the order of the day as it was a few years ago.
We hope that the State and political decision-makers understand this. We are in a moment in which support to the economy and to businesses is needed, facilitating things and helping, not making them more complicated or inventing new obstacles.
Nevertheless, in the amended 2020 budget and in the 2021 State Budget, in the middle of the pandemic, the State decided to increase taxes, namely IMI, AIMI and IMT in a number of situations. It wasn't the time to do so and it continues not to be.
Public services and regulatory entities should take a proactive and helpful attitude, less punitive and, for example, not bombard businesses with fines, penalties, administrative penalties, complications and delays in payments and in the reimbursement of taxes, nor invent new indirect taxes.
Businesses are responsible for generating wealth, employment, economic growth, as well as paying taxes.
It's important that the State allows them to work, normalise their activities and grow.

Bazooka. The Recovery and Resilience plan and its impact on the M&A market

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We already know that the Portuguese economy will have access to EU funds at an extraordinary and not to be repeated level: the so-called Recovery and Resilience Plan, which everyone has already christened "bazooka".

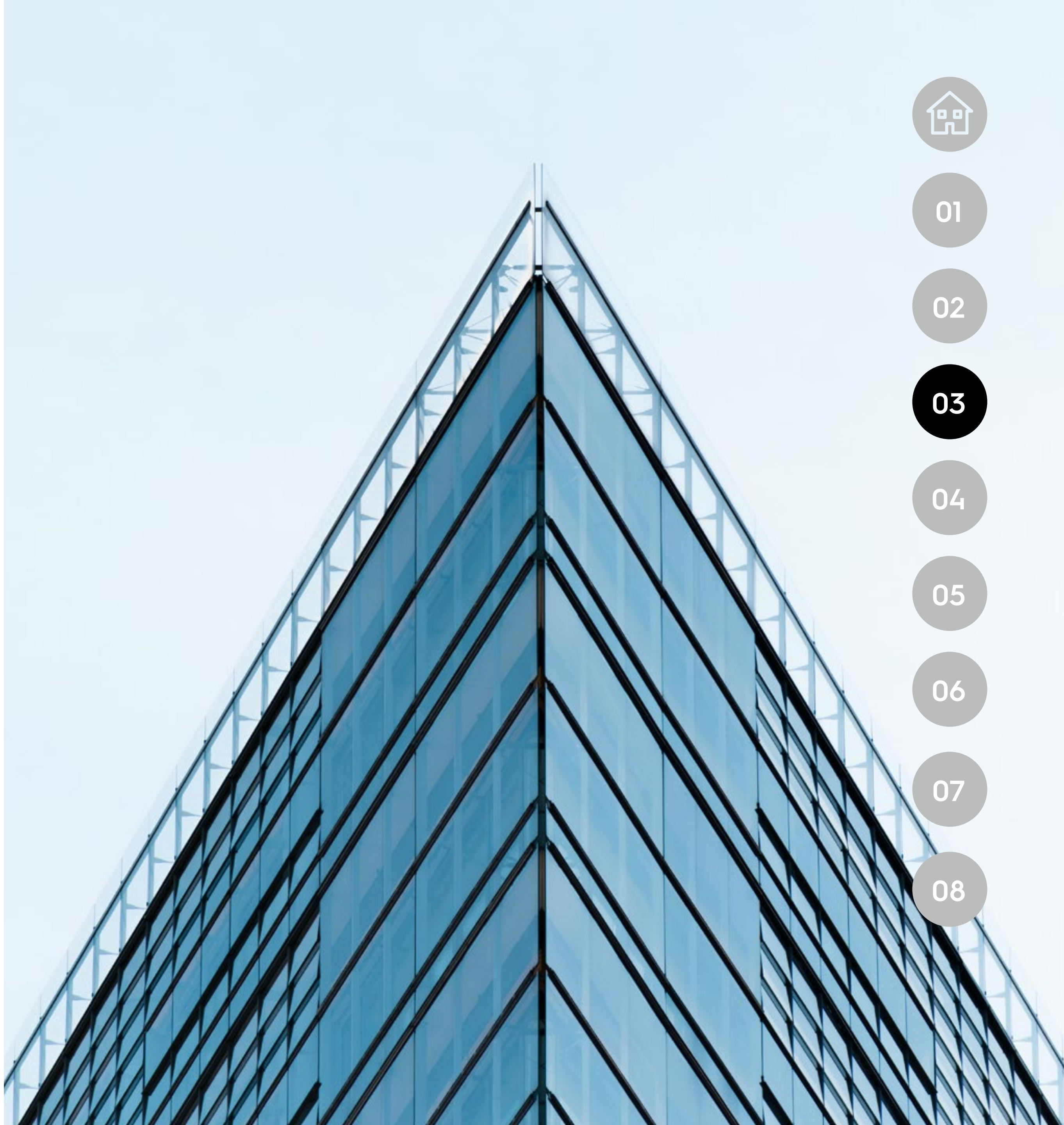
All EU member states will have their own bazooka. As we get to know more – and at present we don't know enough – it appears that the lion's share of these funds will be injected directly into the public sector economy as well as into our public administration. The funds were designed in this way. The massive injection of funds into the public economy should lead to a much greater level of investment by the State. The fulfilment of the objectives of increased digital capacity-building, of energy and climate transition, of decarbonisation of the economy, of the strengthening of the health system and others, should translate into new public investments in resources, services, equipment, innovative tools, etc. and therefore there will be growth opportunities for the private economy will provide these things.

That's why businesses that position themselves to:

I. have access to funds directed to the private economy and/or
II. come to participate in the flow of funds to the public economy (whether in Portugal or other European countries) supplying resources, services, equipment, etc. will be on the radar of the M&A market and may become targets of processes of acquisition, concentration, consolidation and growth, namely via investment by foreign players that already have this know-how and decide to establish themselves or strengthen their presence in Portugal, bringing together Portuguese businesses in order to more easily access the Portuguese bazooka.

The resumption of tourism and its consequences for the M&A market

With the tourism boom in recent years, sectors such as hotels, tourism and restaurants were decisive in the growth of our economy, employment, etc. Companies that supply these sectors also benefitted from this growth: agribusiness, logistics, transport, services, finance, construction, etc.



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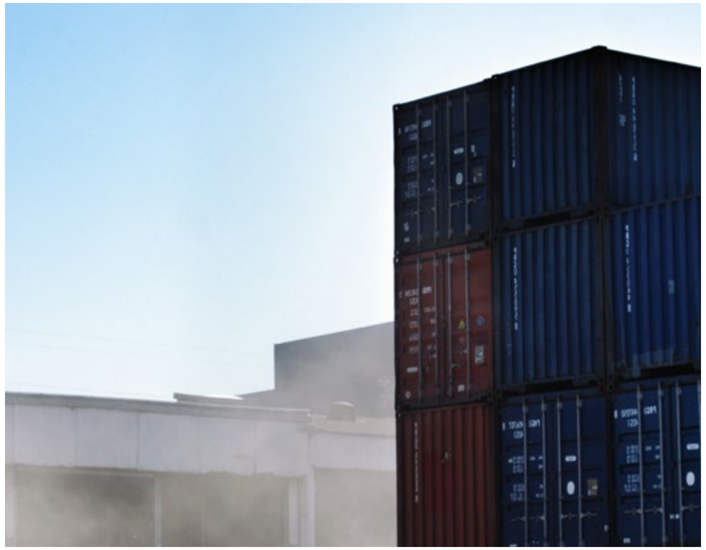
“The gradual resumption of tourism will have a positive impact on various sectors of activity.“

José Maria Corrêa de Sampaio

M&A activity was very significant in these sectors in recent years. These are some of the sectors that most suffered and which received least support during the pandemic by a State without the financial resources to do so. In fact, everything indicates that Portugal was one of the member states of the EU with least direct support to the economy and company cash-flow, which makes their survival harder and will make normalisation of activity more difficult. The gradual resumption of activity (result of the reduction of the impact of the pandemic, of the strengthening and acceleration of the vaccination effort, the issue of vaccination certificates among other things) should create the trust levels necessary for people to leave their homes and start traveling, going to hotels, restaurants, etc.

of assets and businesses, as well as consolidation that all energise the M&A sector will be seen also in this area - a major dynamic is already visible in the market, for now much more on a seller than buyer side. This imbalance may have as a consequence the devaluation of companies and assets and difficulties in the launch and development of new projects, above all if they aren’t differentiators in relation to what already exists.

M&A: the usual champions



Sectors such as energy, particularly renewable energy, technological businesses, TMT, export businesses, retail, agribusiness, real estate linked to commercial spaces, logistics, etc. were some of the most dynamic sectors in recent years.

These were some of the determinant sectors in the consecutive growth of the economy and of the M&A market between 2015 and 2019 and there is every reason to believe that they will continue to or return to being so with the resumption of economic activity, because they have been among the most resilient to the pandemic crisis.

Many stakeholders in these businesses are already international businesses that entered Portugal attracted by a politically and socially stable country, with a reasonable level of fiscal stability, despite it globally being an economy with low levels of competitivity, productivity deficits and high levels of red tape costs.

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The resumption of the Portuguese economy will be accompanied by the resumption of economic activity in other countries, many of which are strategic for Portuguese businesses either because they export and sell a lot to these markets, or because they are integrated into international and global groups present in these markets.
We are, and we will continue to be, a small open economy that is very sensitive to what happens overseas. There are some countries that are accustomed to investing in Portugal and which will continue to do so, above all member states of the EU.
The most obvious example is Spain. The interconnectedness of our two economies is huge and continues to grow, along with the presence of Spanish companies in Portugal. Many international companies treat their Iberian business in an integrated way, more and more with a main office in Madrid, starting their operations there and only afterwards in Portugal.
So the successful resumption of the Spanish economy will be important in order that new investments are carried out in Portugal by Spanish companies and by companies from other countries that wish to establish or strengthen their position in the Iberian peninsula.
That's why a significant level of investment coming from these countries is to be expected, above all in sectors where there already exists a significant level of foreign investment, mature sectors and those with assets which ensure long-term profitability.
It's important to permit the entry of new investors with experience in these sectors or with more of a financial profile (for example investment funds and private equity), offering alternative means of finance and a more sophisticated level of management.
We hope to also see more institutional investors which have been interested in the Portuguese economy with a degree of frequency, for example, pension funds from economies as different and far away as Canada and Australia and also, much closer, such as the UK.

What's new

As has already been mentioned, there are sectors that are more resistant to the pandemic and others whose robustness, resilience and importance have come to the fore during this period.
A good example is the health system and the strongly-felt need to strengthen the National Health Service (SNS), weakened by consecutive public strategies of reduction of investment and that has levels of performance weakened by the lack of resources, infrastructure, equipment and training.
If there is a political and social consensus then we will see a strengthening of the resources, equipment and infrastructure of the SNS, but also in complementary areas of private medicine (for example hospitals and clinics) and also in the pharmaceutical sector. Significant growth in the sector is already noticeable and appetite in the acquisition or taking of positions in companies in the sector is visible.

Growth in companies that provide supplies and services to the health sector should also be expected and these will also be natural targets of M&A transactions.

The transport system: decarbonisation and growth of rail travel

he public and private transport system is also one of the most sensitive sectors and one where it is plausible to expect a greater volume of business in the area of M&A in the near future.
Everyone is in favour of the growth of railways – we are waiting for the long-announced national railway plan – as an alternative to short-distance air travel or road travel and as a way of strengthening links within Portugal and also with other European countries, strengthening passenger transport and facilitating freight transport logistics (merchandise, equipment) and their export (and import, too, of course). This strengthening is essential for the decarbonisation of the transport sector and is critical so that the decarbonisation of the economy may be guaranteed.

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What everyone can do to energise the M&A market

The door to the economy, practically closed today, will not be open wide all of a sudden. We have to understand that nothing happens overnight and that the economy has to open gradually, has to convalesce and to be supported before going full steam ahead.

The levels of debt grew significantly, and many companies benefitted from formal and informal moratoriums, and from the patience of creditors that will have to start to be paid.
Even so, these moratoriums will probably have to be maintained during quite a prolonged period of time and will have to be gradually reduced. The two objectives are important: supporting those that benefitted from moratoriums and the creditors. The government announced publicly that it is analysing, and has proposed to the European Commission, the approval of mechanisms that will permit State economic stimuluses in the economy via the strengthening of business own capital (equity or quasi-equity). In the meantime, the Government finally moved ahead with the formalisation of the Development Bank that will bring together much of what has been done best in previous years in terms of financial support to the economy, namely by PME Investimentos, by IFD and by SPGM and related experiences.

The functioning of the legal system has been considered a major obstacle to the normal operations of businesses. Measures of adjustment and announced reforms have occurred without having significantly reduced the time that businesses lose in court and in lengthy (sometimes aggressive) pre-contentious processes which generate costs and cause excessive difficulties. This delay means that non-compliance with contracts and obligations is difficult to counter quickly by businesses that do in fact comply with their obligations and who want counterparties to do the same.
The same is also true of the State, which is quick to demand, but inflexible and not willing to compromise or explain, being slow and late to pay and meet its responsibilities, sometimes entering into paralysis.
It’s common to hear businesses complain that our public administration rarely changes opinion without being taken to court and drags matters out over years.

“Portugal should know to value itself in order to be seen as a safe investment destination.“

Manuel Santos Vítor

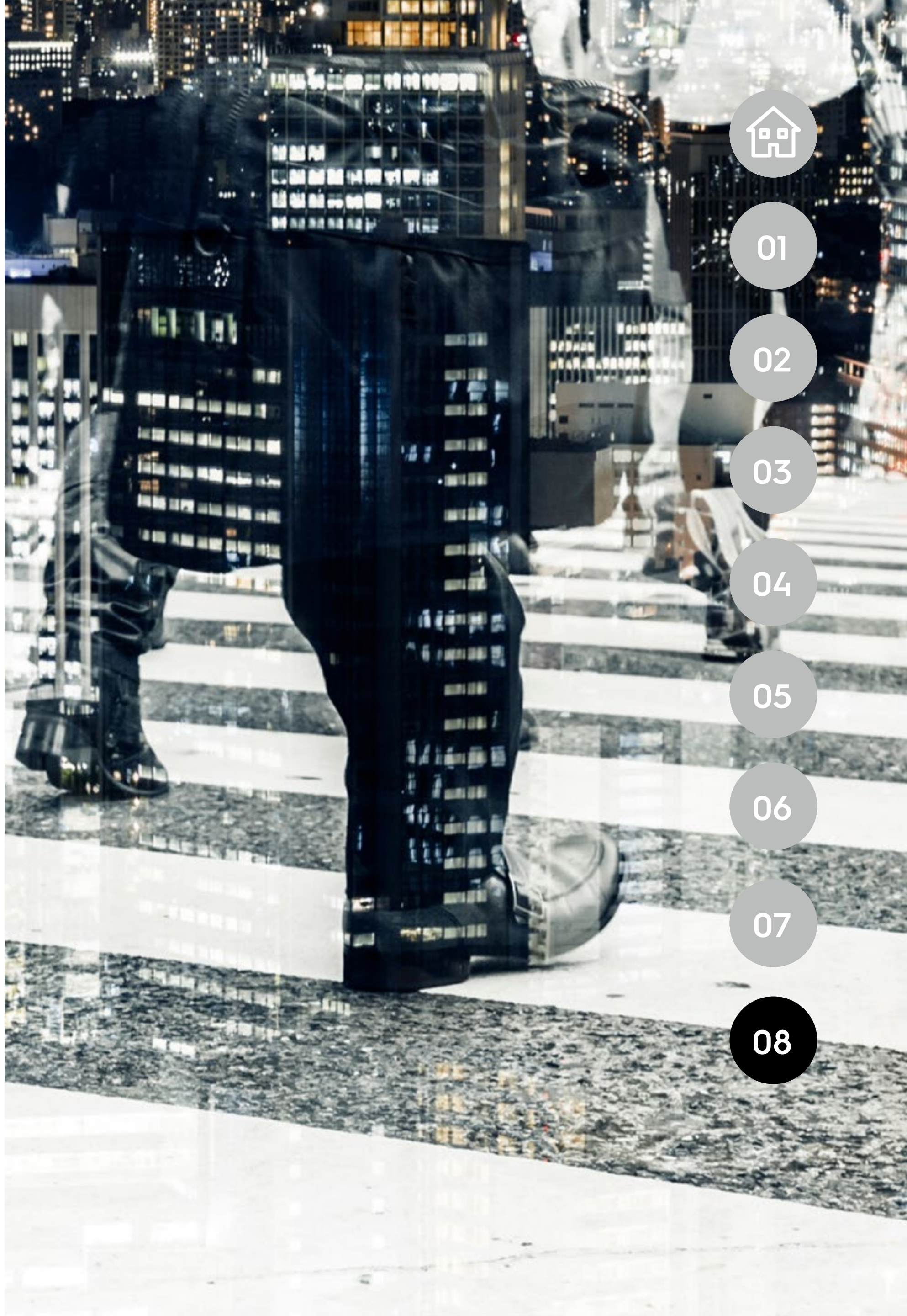
The performance of our public services is frequently a problem. It’s difficult to carry out projects in Portugal as a result of the lack of clarity, initiative and compliance with deadlines and also the lack of capacity of our central and local administration.

All of this presents difficulties and red tape costs that affect the operationality of our economy as well as its competitiveness. It’s necessary to understand that each global company that thinks about investing in Portugal is, with all probability also considering, at the same time, investment alternatives in other countries and the destination that is quicker and more competitive wins.

Above all, at the moment, it’s important that the State is punctual in paying what it owes, patient and that it doesn’t increase direct or indirect taxes to companies and individuals that intend to invest in the economy and which are trying to support the resumption of the economy and of growth and that will generate more wealth, permitting the payment of more taxes and reducing social support.

Conclusions

- Nobody knows how 2021 will pan out, but a positive change with regard to 2020 and growth in the number of transactions should be expected;
- This growth will be more visible in some sectors than in others and in the market more on the seller than the buyer side at the moment, but this will tend to balance itself out.
- In a small market the possible sale of many large assets and/or those with a very significant value, namely by banks and private equity, will make sales by other players more difficult and they will have to differentiate themselves;
- Significant restructurings, company reorganisations and sale of distressed assets should be expected;
- The sellers, above all, family businesses, PME and similar, will have to do their homework, organise themselves, surround themselves with technical, financial, legal consultants familiar with these types of processes and adjust their expectations to this new, less predictable normal, where they will have to deal with sophisticated buyers.



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Thinking about tomorrow? Let's talk today!

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