A promising pipeline

The last year has again been characterised by a tough economic environment. The difficulties to access bank financing persist and 'shadow banking' and alternative financing are on the rise. Mergers have been scarce, and companies continue to focus more on cost cutting and organic growth than on M&A. But the pain may be worth it, say lawyers, as there is a definite light at the end of the Iberian tunnel.

El pasado año, se ha vuelto a caracterizar por un entorno económico difícil. Persisten las dificultades para acceder a la financiación bancaria y "el sector bancario paralelo" y la financiación alternativa están aumentando. Las fusiones han sido escasas, y las empresas siguen centrándose más en reducir sus costes y en las estrategias de crecimiento orgánico que en las Fusiones y Adquisiciones. Sin embargo, según los abogados, este sufrimiento puede valer la pena, ya que siempre hay luz al final del túnel.

A year ago, the Iberian market was struggling with the survival of the euro, and a flat M&A market that some were worried would never bounce back. However, this year sees the panic turn to something approaching optimism.

Economic indicators are improving for both Portugal and Spain, say lawyers, and there is a confidence that market recovery is closer than before. Lawyers have seen growing investments in both private and quoted companies and transactional activity appears to be making a comeback.

Market on the mend

The macroeconomic situation in Spain improved during the second half of 2013, say lawyers. The banking sector is close to achieving stability, the housing market is gradually bottoming up its prices and the Spanish export sector is one of the strongest in Europe.

"Over the past six months we are seeing a much more positive view of the Spanish economy and market, and the general consensus is towards economic recovery," says José Armando Albarrán, Head of Corporate & M&A at Freshfields Bruckhaus Deringer, Spain. "However, 'recovery' is balanced with 'fragility', so we are being cautiously optimistic."

The deleveraging trend continues in a wave of divestment of non-core assets, say lawyers, and are becoming real opportunities for sophisticated investors and funds. "There is much more activity in the pipeline," says Álvaro López-Jorrín, Co-Head of Corporate at Garrigues, Spain. "Indeed we actually 'have' a pipeline, something difficult to say last year."

If you look at what companies are going through, even the big ones, this shows the realities of the market – they are still suffering, says Pedro Rueda, Corporate & M&A Partner at Araoz & Rueda. "We have huge unemployment and debt, and while we are definitely coping much better than a year ago, we need to be realistic as well. I would wait a little before being prematurely optimistic."

And as Iván Delgado, Corporate, M&A and Private Equity Partner Pérez-Llorca, points out, private equity investment fell a huge amount in recent years, so even a small rise in numbers can be seen as 'recovery'.

Lawyers in Spain are seeing a frantic amount of activity in distressed debt and assets deals, followed by real estate, M&A and the return of capital market transactions. "Earlier this year we started to see movements in the real estate market, which may set a new trend of deals," explains Fernando de las Cuevas, Head of M&A at Gómez-Acebo & Pombo, Spain. More recently lawyers are seeing the beginning of an M&A revival due to a pick-up in foreign buyers, and takeovers are back and look set to continue. "Also we are bound to see more privatisations given the financial needs of the public sector – AENA, for example," says Alexander Kolb, Corporate Partner at Linklaters, Madrid.

A key development, however, has also been a huge increase of bankruptcy and restructuring cases that have taken place in Spain and in other EU countries says Francisco G. Prol, Corporate Finance Partner at Prol y Asociados. And many feel that 2013 has been another very tough year. "Some signs of recovery do seem to be waiting for us at the end of the tunnel," says Julio Veloso, Corporate Partner at Broseta, "but the truth is that we have not left the tunnel yet, at least from a domestic point of view."

Cautiously confident

In Portugal, there is a certain overall sense that, even though it is a slow process, the crisis is coming to an end. "We have gone from providing full emergency assistance to some clients, particularly in debt recovery or debt restructuring debts, to a somewhat more flexible attitude that reflects a bit more confidence in the future," says Vasco de Ataíde Marques, Co-Head of Corporate and M&A at PLMJ. There have also been a number of important sectors undergoing structural consolidations, say lawyers, a trend that is expected to continue and even to accelerate in the coming quarter.

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The key driver of the M&A market is still the privatisations, according to Miguel De Avillez Pereira, Head of Corporate and M&A at Abreu Advogados, with Portuguese banks deleveraging and specific industry concentrations bringing an important boost, too.

And there is an increased interest by foreign investors in Portuguese companies. The majority are still transactions taking advantage of the low prices of assets due to the crisis, says João Caiado Guerreiro, Managing Partner at Caiado Guerreiro, but there are currently very good and profitable opportunities in terms of business acquisitions, both cross-border and domestic. But the crisis continues to undermine business confidence, says João Caldeira, Head of M&A at CMS Rui Pena & Arnaut, and as a result, corporate leaders continued to work on improving balance sheets rather than taking risks, while waiting for a turnaround.

It is now clear that ruthless austerity measures brought out a fragile economic situation. "The number of insolvencies is quite alarming," says Rodrigo Almeida Dias, Corporate, M&A and Private Equity Partner at F. Castelo Branco & Associados, "and the creation of an intermediate regime, aiming at the recovery of companies facing difficulties to fulfil their financial commitments didn't work as expected".

But while it's early days, companies appear to be growing, says Nuno Azevedo Neves, Commercial and Corporate Partner at ABBC & Associados, but are doing it within their sectors.

Alternative finances

Spanish banks do actually have a great deal of cash and are willing to lend, say lawyers. However, adds Raimon Grifols, Corporate Partner at Osborne Clarke, Barcelona it is really only financially strong companies that have access to the traditional financing options.

Most companies therefore continue having to be much more creative when it comes to financing, says Gonzalo Navarro Martínez-Avial, Corporate and M&A Partner at Roca Junyent, such as small-scale use of systems such as their own savings, short-term credit, mortgages, applying for grants or the use of concepts such as receivable factoring.

There has recently been increased activity by new debt funds in the market, including reinvented mezzanine houses, joint ventures between existing lenders, start-up funds formed by ex-bankers with access to European liquidity. Although, these alternatives are unlikely to replace traditional relationship banking in the short and medium-term, says César Herrero, Finance and Projects Partner at DLA Piper Spain, some companies who need to restructure and refinance their existing debt are currently relying on these because of their flexible approach to leverage, risk and structures and their ability to transact quickly.

Venture debts are growing rapidly and provide the extra runway needed to reach key milestones, says Ivo Portabales, Corporate and M&A at Dutilh Abogados. "Venture debt seems to be a strong option for venture-backed companies who want to add capital and minimise dilution." Project bonds are also starting to being considered as alternative financing in respect of large infrastructures and developments. "Spanish companies have been able to successfully access the capital markets with senior unsecured bonds over the last year," according to Íñigo Gómez-Jordana, Managing Partner at Allen & Overy, Spain, "which has enabled the restructuring of existing bank facilities".

Another very interesting and promising development is the creation of new lending platforms, commonly referred to as 'shadow banking', between Spanish banks and investment funds, says Juan Francisco Falcón, Corporate and M&A Partner at Uría Menéndez. "The combination of the relationships and know-how of the Spanish banks, and the liquidity of these funds, could prove to be an extremely potent one."

Credit funds and money market funds are also active, the former employing many of the structuring techniques and mechanics traditionally used by PE funds and hedge funds, combined with certain securitisation techniques, says José María Fernández-Daza, Head of the Corporate at Clifford Chance, Spain. "We are seeing an increased number of clients establishing funds or allocating resources to this area and there is evidence that alternative financing activity is providing much needed liquidity to the market."

Finding funding

While traditional financing by banks is still possible, many in Portugal are resorting to capital markets seeking financing alternatives, turning to new solutions and more effective management models to fund their activities. Another consequence is the rising of venture capital deals, says Rogério M. Fernandes Ferreira, Founding Partner at RFF & Associados, with some state-financed investments funds and risk capital funds appearing as a good solution for small and medium sized companies (SMEs) and start-ups.

Given the need for state, bank and corporate capitals,

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we have seen capital market become more dynamic, says António Soares, Head of Corporate Finance at Linklaters, Lisbon, by means of right issues to recapitalise banks, LME exercises and IPOs, such as the issuance of high yield bonds.

Such bonds have been one of these main alternatives for bigger companies as has the issue of non-voting preferred shares and redeemable preferred shares. These share capital increases are now a very important source of financing, say lawyers, probably more than they have ever been before.

The setting up of the Revitalisation Fund under the 2014 State Budget is important, say lawyers. This is made up of three venture capital funds with an aggregate amount of €220m to strengthen credit lines for direct financing of SMEs. The State also intends to strengthen the national mutual guarantee, operating as a guarantor for companies’ credit applications, under certain circumstances and provided some requirements are met. It is expected that these measures will help overcome the situation of under-capitalisation of many companies, particularly SMEs, and to support the revitalisation of companies, says Vítor Marques da Cruz, Founding Partner at Marques da Cruz e Associados, which, although in a difficult financial and economic situation, have recognised strategic potential.

All these are important signs that things could become quite positive in 2014 and that companies may be beginning to learn how to be less dependent on banking facilities and other more common instruments, says Jorge Bleck, Head of M&A and Corporate Finance at Vieira de Almeida. “So, as long as Europe and the emerging markets recover, I believe Portugal will follow with a different attitude and with a significant number of new and more sustainable players.”

Remodelling

In recent years, the main changes to company structures have been the concentration of decision centres and centralisation of departments, says Adelaide Moura, Managing Partner at A.M. Moura Advogados, especially the creation of Iberian business units in the cases of multinational companies, to take advantage of common facilities and thus reduce costs.

Iberian subsidiaries are increasingly being configured by international groups as pure manufacturing centres, operating under tolling agreements with the relevant affiliates in order to benefit from the competitive labour costs in Spain and at the same time optimising taxation on a consolidated basis, says Carlos Pemán, Corporate and M&A Partner at Eversheds Nicea. “This trend poses recurrent questions about the need to develop the regulation of ‘groups of companies’ both at international and domestic levels.”

Most companies are heavily focused on reducing

Supporting SMEs

Recovery seems to be coming from the top of the Spanish corporate and financial pyramid, say lawyers, and that real recovery can only be achieved if the small and medium-size companies (SMEs) regain some of their previous market strength. But small to medium-sized companies (SMEs) are still facing problems in getting financing, says Alberto Frasquet, Corporate and Private Equity Partner at Herbert Smith Freehills, Spain, especially as they do not have access to capital markets in the same way as listed and blue chip companies.

To deal with this, the new Alternative Bond Market (MARF) was recently launched for SMEs to limit their dependency on bank financing. The mechanism will allow solvent enterprises to access short-term liquidity, attracting capital from both domestic and foreign institutional investors, says Alvaro Marco, Director of Corporate at BDO Abogados y Asesores Tributarios. “The efficacy of this new model will be seen in the following months.”

In terms of costs and requirements, this alternative market could be very attractive say lawyers, in particular as one of its objectives is to facilitate new issues by eliminating certain burdens associated with traditional issues of securities. However, this method of financing is aimed at solvent companies that need access to working capital. Some recent reports point out that candidates must be companies with an annual revenue of at least €50m, a positive EBITDA exceeding €10m and a rating of BB or higher, explains Juan E Diaz, Corporate and M&A Partner at Eversheds Nicea. “Accordingly, most SMEs may not qualify under this criteria to benefit from this form of financing.”

The Law on support for entrepreneurs and their internationalisation also recently came into force, which contains the strategic lines for fostering and stimulating an entrepreneurial culture and drive, says Jaime Espejo, M&A and Corporate Partner at Roca Junyent, and facilitating the creation of business, establishing support from the tax and social security authorities and financing for entrepreneurs. This is hoped to encourage business growth and job creation, as well as supporting the internationalisation of Spanish companies.

costs, readapting themselves, becoming much more efficient, expanding internationally, looking for new opportunities and getting rid of old fashioned ways of doing business. "We are also seeing an important increase of e-commerce and of businesses oriented to consumers and end-users using more efficient and performant technologies," says Rafael Alonso, Head of the Corporate Finance at Squire Sanders, Spain.

And in Portugal, downsizing and consolidating are also the dominant trends, says Octávio Castelo Paulo, Head of Corporate and M&A at SRS Advogados. Large economic groups are reorganising and simplifying their structures by reducing entities and concentrating their businesses in multipurpose vehicles more in line with core activities. The market cleaned out many companies that were not viable leading then into insolvency, winding up and liquidation scenarios, says Paulo Olavo Cunha, Of Counsel at Vieira de Almeida. "Those that survive – and many of them thriving with well-prepared structures – are increasingly cost sensitive and therefore evolved to become more efficient and to rationalise the use of their resources."

Many are subscribing to PER (the Special Revitalisation Plan), using this with other solutions such as conversion of debt in non-voting preferred shares and redeemable preferred shares.

Others choose to innovate their products and strategy of approaching the market, says Joana Andrade Correia, a Partner at Raposo Bernardo.

Taking into account the framework of economic crisis, it is not possible to consider the existence of a business model that ensures its economic viability in a long term, according to Eliecer Pérez Simón, Head of Commerical at Rivero & Gustafson Abogados. "This fact has led entrepreneurs to focus their action in the search for the element that has more value in developing a business – the customers."

Shopping spree

Lawyers are seeing a marked increase in the appetite for Iberian companies and assets. Whereas last year it was all about 'window shopping', this year they are actually buying. There have been some recent and remarkable investments in Spain but there are not yet a number of significant transactions that allow us to describe a general or common pattern, says José Miguel Martín Zamorano Llamas, Commerical Partner at Marimón Abogados. However, it can be said that most of the investments are still led by an opportunistic approach.

"From my perspective as a commercial lawyer, it is interesting to see foreign funds that no one had even heard about, or services that one was previously not even aware of, are penetrating the Spanish business environment," says Alex Dolmans, Corporate & Commercial Partner at Hogan Lovells, Spain "and setting a new benchmark of added value in particular sectors".

Confidence in the country is returning, says Adolf Rousaud, Managing Partner at Rousaud Costas Duran, and, with a substantial excess debt to cover, Spain continues to be an attractive market for investors.

A number of private equity players have also shown interest in investing in Portuguese companies, says João Gonçalo Galvão, Senior Associate at Campos Ferreira, Sá Carneiro & Associados, particularly in distressed companies with long-term potential but that lack the required equity.

After a disastrous year where property investment was down to the lowest value of the past 12 years, 2013 saw a slight increase in the sale and purchase of real estate. The increase of investment in this business sector was reported in the rental market for habitation purposes, but also in the residential tourism market, says Nuno Almeida Ribeiro, a Partner Coelho Ribeiro e

Non-core divestments

Companies are clearly adopting a 'back to basics' approach and focusing on their core businesses, say lawyers. After having tapped the internal restructuring efficiency increases and cost reductions, says Diogo Leónidas Rocha, Head of M&A, Capital Markets and Banking & Finance at Garrigues Portugal, clients are now also looking at selling non-core assets.

There is a now consolidated tendency towards disposal or externalisation of these assets, and departments, services and business branches, and redirecting efforts to the core business and to foreign markets, in order to avoid or exit a distressed situation. One strategy being followed by some corporates/clients in Spain is divesting from all activities entered during economic expansion for diversification/vertical integration reasons that could be now considered 'non-core'," says Humberto Santillana, Finance & Project Finance Partner at Grant Thornton, Spain.

Companies, especially those with a high degree of debt that have sustained the acquisition of other companies and businesses are focused in going back to their traditional business and to complete their deleveraging process. In restructuring debt, says Alexandre Jardim, a Partner at pbbr, these companies use often distressed assets funds to whom they sell either their non-core businesses (assets deals) or their commercial credits/debits over other companies (clients/providers).

It is evident that do-it-yourself restructuring can accelerate bankruptcy, and simply refinancing is no longer an easy resource. This has brought awareness on the fact that a carefully designed and implemented restructuring, bankruptcy, asset disposal, refinancing or internationalisation strategy may be the right answer, explains Alvaro López-Chicheri, Corporate Partner at Lener, provided it is done through the right external legal and business experts.

However, companies that are trying to sell still have in mind the multiples they used to have few years ago. But these have dropped from 12 to around six, and it is very difficult for owners to accept that drop in value, still lawyers are starting to see deals at these lower prices.

Associados. The 'Golden Visa' programme promoted the development in this market, and according to official Government figures, it has already represented €150m of investment.

The buyers

Lawyers are seeing investments from international distressed funds, hedge funds and private equity funds as well as a number of high-net-worth individuals, mainly in real estate but also in specific sectors such as biotechnology, pharmacy and life sciences industry.

"A trend of the past two to three months is that funds from Asia, Canada, Germany, the UK and US, for example, are showing a huge interest in Spain – these include infrastructure, conservative and pension funds," says María Pilar García Guijarro, Managing Partner of Watson, Farley & Williams, Madrid. "They are doing due diligence, and while last year there was just talk, now we are seeing action."

According to Carlos Pazos, Managing Partner of King & Wood Mallesons SJ Berwin Spain, at their roadshows abroad international investors have consistently confirmed that Spain is seriously in their agendas. "They have praised the dynamism and capacity to react of the Spanish economy and its entrepreneurial fabric towards the current challenges." On the industrial side, there has been particular interest in Spain from the Asia-Pacific region.

Tourism in particular is a huge area of opportunity. Many major Spanish companies are headquartered here but all their business is abroad," says Fernando Martínez Comas, Head of Commercial at Deloitte Abogados. "So they present a much more secure investment."

At corporate and institutional level, Anglo-Saxon funds, and European corporations (notably Scandinavians and Benelux) are very active for industrial and, especially, services companies, according to Tomàs Fornesa, Corporate Partner at Fornesa Prada Fernandez Abogados. And funds that come from Russia, Asia (especially China), the US and Israel are striving to create important projects in the Spanish market and economy, says Enrique Marinel-lo Jordan, Partner at Monereo Meyer Marinel-lo Abogados.

Lawyers are seeing a great deal of inbound investment from wealthy families from Latin America, in particular many high-net-worth individuals. And well-known investors, such as Microsoft co-founder Bill Gates, have also turned their attention towards Spain, says Juan Manuel De Remedios, Executive Partner at White & Case Madrid. "Gates acquired a six percent stake in the FCC Group for €113.5m becoming the second-largest shareholder in the Spanish construction group."

Portuguese speaking countries, in particular Angola and Brazil, have also continued to invest in Portugal, as well as Chinese and Russians investors, all mostly in the banking, construction and telecom and media sectors. And high-net-worth-individuals are investing in real estate, enticed by the benefits of the 'Golden Visa' regime looking at the real estate sector, as well as tourism and sustainable activities markets.

Chinese companies are also showing interest in some sectors, having already bought important stakes in main utilities companies (namely electricity sector), according to Teresa Anselmo Vaz, Managing Partner of Anselmo Vaz, Afra & Associados. "Indian companies are also interested in buying Portuguese companies/factories in the pharmaceutical sector." With upcoming privatisations providing appealing opportunities in the public postal infra-structures and services or in waste management and disposal, among others, national and foreign investors are bound to remain engaged, say lawyers.

Back to basics

No one can deny things are very different from last year, say lawyers, and the trends in the markets show that the next 12 months will be better than the last. But to truly revive the M&A market, recovery is first needed in the real economy.

"We see the current situation more as a transition period with neither development nor recession, but there is still a lot to do as to make us feel different about the future of Spanish economy," says Santiago Gastón de Iriarte, Managing Partner of AC&G Asesores Legales. "It seems that we still need to wait some more time for the clear recovery that will give strength to the transactions in the Spanish market."

Lawyers, however, identify a huge range of opportunities for the coming year across the Iberian Peninsular, from privatisations and capital markets financing to shadow banking and non-core divestments. And investment is becoming a hot topic again. "It will be some time before we see real private equity activity happening," says Federico Roig, M&A and Corporate Director at Cuatrecasas Gonçalves Pereira, "but now is the time to invest as Spain has good assets and companies, at very good prices".

The current situation generates unique opportunities to anyone entering or reinforcing its position in the Portuguese market at this stage, say lawyers. There are many companies selling non-core assets or receptive to partner-up with new investors and many sectors are undergoing structural reorganisations, there is an important privatisation plan and the Government is actively trying to attract foreign investment to Portugal, says Francisco Brito e Abreu, Corporate and M&A Partner at Uría Menéndez-Proença de Carvalho. "In addition to all this, the economic perspectives for the country seem to be improving."

What lawyers hope is that all the pain that the markets have been through in recent years will result in a healthier M&A market with strong competitive players. And the signs are looking good across Portugal and Spain, and the transactions pipeline looks promising. But to do this, the market needs to adopt a 'back to basics' state where finance is just a smart business tool and not the fundamental fuel.