Company & Corporate Report 2012: The changing face of M&A

WEDNESDAY, 02 JANUARY 2013 00:00

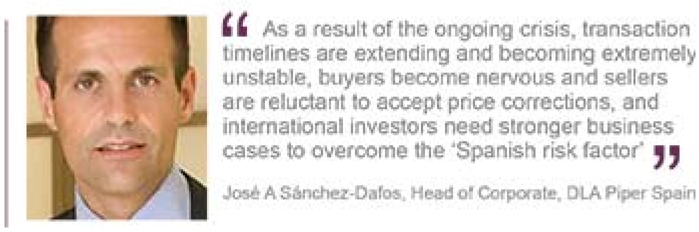
The big money transactions of the past years have disappeared, and the market has undergone a kind of metamorphosis that is ringing alarm bells through Iberia. But caution is advised before panicking – what may well emerge is a new form of M&A that is no less profitable, if you are prepared to adapt with it.

Across Iberia, the markets are weakening daily, and the steep decline in M&A over the past year has only served to fuel uncertainty in the markets and cause serious concerns for investors. There are less big transactions, those that are active are taking much longer to complete, debt financing continues to pose a huge problem for businesses and investors are looking elsewhere.

The question on everyone's lips, therefore, is: Exactly when will the activity come back?

But dig a little deeper and we see that while the 'wow factor' big money transactions of past years are gone, smaller deals are taking over the Iberian markets, and, while of much lower value, they are forming a new kind of M&A and showing that, while different, it is 'distressed',but that isn't necessarily a bad thing.

This change has meant that competition is fierce among law firms to gain market share of this new smaller-value deal sector, plus they are having to adapt their departments to deal with the new M&A world of insolvency, restructurings and distressed asset transactions.



Market trends

While we're not seeing the big transactions of previous years, says José Maria Corrêa de Sampaio, Head of Corporate & M&A at Abreu Advogados. “What we are seeing is a great deal of activity in smaller transactions, but with significant technical complexity.”

Also in Portugal, the ongoing privatisations have dominated the transactions market and will continue to do so until at least the end of 2013 in strategic sectors, such as aviation, infrastructure and shipping, say lawyers.

And the most usual transactions involve the acquisition of small to medium enterprises in economical difficulties at lower prices, and commonly by

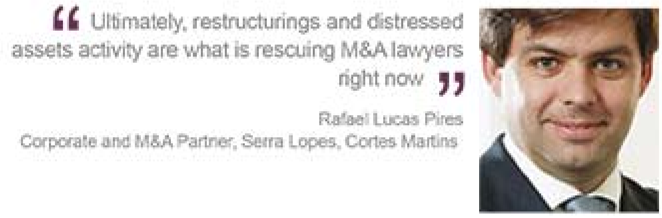
Tanto en España como en Portugal el mercado transaccional se debilita, y el declive en el último año, de fusiones y adquisiciones no ha hecho más que alimentar la incertidumbre en los mercados, frenando la toma de decisiones de los inversores. Hay menos operaciones de importancia, y aquellas transacciones en activo son procesos largos y lentos. La financiación de deuda continúa siendo uno de los retos principales para las empresas y los inversores parecen estar al acecho sin concretar acciones. Pero, profundizamos un poco, y vemos que las operaciones que están incentivando el mercado son las de menor cuantía, desarrollándose un nuevo mercado transaccional y demostrando que aunque las operaciones han bajado, no han desaparecido.

competitors. “Usually, these transactions are made without the resource to financing,” says Ricardo Rodrigues Lopes, Corporate Partner at Caiado Guerreiro, “and are made with the acquirer’s own equity”.

In Spain, there are three main groups of transactions that lawyers are seeing, explains Javier Ybañez , Head of Corporate and Commercial at Garrigues in Madrid. First, the sales of profitable businesses, in the wake of the insolvency of the business owner, as a means by which creditors seek to recoup part of their financing. Second, the sales of stakes in reasonably solid industrial businesses by owners seeking to deleverage. Finally, the sales of midmarket companies with wide and solid international presence, not dependent on the Spanish internal market.

The Spanish market is also being dominated by asset deals, namely transfer of business units, also at very low prices. Lawyers are seeing businesses looking to sell unproductive assets so as to reduce their losses instead of waiting to obtain the asset’s real value.

With insolvency now a big part of crisis-induced day-to-day business, proceedings are being used a lot more as one of the available strategies to take control of a company and its assets, says Rafael Lucas Pires, Corporate and M&A Partner at Serra Lopes, Cortes Martins . But many believe not enough is being done to prevent companies falling into insolvency. “Insolvency is seen as a tragedy,” says Octávio Castelo Paulo, Head of Corporate, M&A and TMT at SRS Advogado, “and when companies finally give in its too late to avoid litigation.



‘Distressed’ is top of the agenda as the year draws to a close – for assets and debt. “The trend in Spain is for restructuring transactions being carried out in almost all areas of economic activity, in particular affecting the financial system and especially relating to restructuring real estate assets,” says Federico Roig, Partner, Head of Corporate at Cuatrecasas Gonçalves Pereira in Madrid. The recent creation of the banco malo (SAREB) being a good example of this.

Since the beginning of the crisis, many profitable companies have turned into distressed assets due to lack of financing and the collapse of the retail market, adds Francisco Aldavero, M&A Partner at Araoz & Rueda. “Unsurprisingly, the total investment by private equity players as of Q3 2012 fell more than 40% with respect to 2011. “

Lawyers see a recent trend in so-called ‘boutique transactions’ – the acquisitions of distressed Spanish businesses, mainly through asset deals, which provide value to a foreign investor in terms of goodwill, technology and know-how, among others.

And private equity investors are no longer, therefore, the main players in the investment market. Lawyers are seeing more and more industrial investors taking an active role, demonstrating a trend for defensive transactions involving disinvestment in non-strategic areas and transactions to restructure portfolios, as opposed to those leaning towards growth and expansion.

“We are in a buyer’s market,” says Francisco Santos Costa, Corporate and M&A Partner at Cuatrecasas in Lisbon, “and there is no rush from investors to close deals since they could always expect that within six months the prices will go down further”. In this environment, he explains, investors are likely to put in place strategies to delay negotiations to see how low prices will go before they start taking advantage of market opportunities at cheaper levels.

In Spain, lawyers are seeing transaction timelines extending and becoming extremely unstable. “Buyers become nervous and sellers are reluctant to accept price corrections,” says José A Sánchez-Dafos, Head of Corporate at DLA Piper Spain. “International investors need stronger

business cases to overcome the ‘Spanish risk factor’.”
And there is overall high-pressure on divestments as a way to liquidity, adds Carlos Pazos, Managing Partner at SJ Berwin in Madrid. However, there is still a certain divergence in price terms with potential purchasers that are expecting hard discounts, which are not always justifiable other than for reasons of ‘country risk’.
Ultimately, says Pires at Serra Lopes, Cortes Martins, restructurings and distressed assets activity are what is rescuing M&A lawyers right now.

Lacking finance
Across Iberia, financing is scarce for all kinds of transactions, there is almost none for new investments and credit flow is limited. Financing is a kind of “never achievable dream” nowadays, says Ignacio Legido, Managing Partner at BDO Abogados. “It is almost like winning the lottery.”
The financial instability of both Spain and Portugal reinforces these difficulties, and the level of guarantees required, equity demanded and interest rates mean a scarcity of feasible options for investors. Leveraged loans are also practically non-existent. And a key concern, says Sergio Giménez, Commercial and M&A Partner, Jausas in Barcelona, is the chain effect that the lack of financing is having on payments from clients to their suppliers.
“The situation is extremely difficult,” says Fernando de las Cuevas, Head of M&A at Gómez-Acebo & Pombo in Madrid. “There is refinancing but little new financing, and alternatives are, for example, corporate finance through bond or share issues.”
Many current transactions, say lawyers, are being financed by existing, rather than new, debt, and more than ever it is necessary to seek out alternative financing formulas if a transaction is to stand a chance of going ahead.
“In Portugal, a trend continues to be the difficulty in getting financing approved,” says Corrêa de Sampaio at Abreu Advogados, “which means that transactions are facing delays, with many unable to move forward.”
And even the biggest companies are having to resort to other methods of financing, such as bonds, which are only available to a few companies, says Helena Vaz Pinto, Co-Head of M&A at Vieira de Almeida, and the rest are struggling to keep their heads above water.
Scarcity of credit has hit the respective LBO (leveraged buyout) markets hard, says António Soares, Head of Corporate Finance at Linklaters in Lisbon, and current M&A deals are now much less leveraged and dependent on the buyers having substantial amounts of their own equity. And they are being financed through other markets such as Brazil, Asia and the emerging markets.

Challenging times
The main challenges that clients are therefore facing, say lawyers, are linked to financing. But as they struggle with the financial crisis and their respective economies, many are having to undergo heavy restructurings and, at worst, close down. And lawyers are seeing foreign clients beginning to question and assess the benefits of having a physical presence in Iberia.
“One of the most risky challenge that clients, and law firms, are facing is the regulatory risk and lack of legal certainty,” says Roberto Pomares Corporate and M&A Partner at SJ Berwin Spain. Something that is having a dramatic effect on the perception that international investors have about the Spanish market.”
The key is adapting projects to the new reality and lack of financing, and lawyers are finding that this is creating a huge demand for advice on regulation, insolvency and restructuring, risk assessment,

employment, divestments and internationalisation.

“Regretfully, many require employment advice due to redundancy programmes,” Julio Veloso, Corporate Finance and Private Equity Partner at Broseta, “and also bankruptcy and finance advice because they are forced to refinance most of their loans and credits”.

In Portugal, a big challenge for lawyers is keeping their clients’ from having to file for bankruptcy, with lawyers seeing many of their clients having to subscribe to PER – the Special Revitalisation Procedure brought in by the new Insolvency & Restructuring Code introduced this year. This gives indebted companies creditor protection and is aimed at creating a means for viable companies to negotiate with creditors to avoid insolvency proceedings.

“And with the increase in insolvencies of customers, suppliers and partners of our clients,” says Pedro Guimarães, Corporate, Commercial and M&A Partner at F. Castelo Branco & Associados, “we have also seen an increase in clients’ needs for advice in how to safeguard their claims and rights in case of insolvency”.

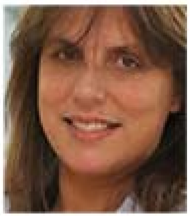
But while PER has been welcomed, it has not gone far enough as too much control is still left in the hands of the creditors, says Claudia Santos Cruz, Lisbon Managing Partner of AVM Advogados. “Portugal still has a chronic problem of inexperienced judges and administrators/insolvency practitioners in court controlled business recovery and turnaround procedures.”

Insolvency raises a number of key risks across both countries, for example with claw back issues, and directors’ liabilities and how to ring-fence them. This is prompting clients to ask for advice on contingency plans to be put in place before the transaction to stress test the model and prepare for possible defaults, explains António de Macedo Vitorino, Managing Partner at Macedo Vitorino.

And the internationalisation and expansion of businesses abroad continue to be a major challenge for clients and law firms alike. In general, foreign operations represent more and more a higher part of their turnover, says Juan Francisco Falcón, Corporate and M&A Partner at Uría Menéndez, which increases the demand for legal advice abroad. And law firms are having to adapt their roles to ensure they stay with their clients by supervising and coordinating the work of local lawyers and making sure to lead the negotiations and the legal direction of the transactions.

This is therefore generating work for law firms, as domestic clients are making significant efforts to globalise their businesses and there is increasing demand for help in doing so. Many clients are currently facing cultural changes, say lawyers, as some have been recently acquired by foreign companies from outside Europe. Lawyers are increasingly being asked to help clients in adapting their processes, internal mechanisms and legal compliance according to a new jurisdiction’s legal framework.

Ultimately, however, it is a challenge of survival. “As lawyers,” says Álvaro López-Chicheri, Corporate Partner at Lener, “we must take more care than ever in understanding the critical situation businesses face and identifying their actual needs.” Unlike in other economic cycles, law firms have to be prepared to accompany clients in their downsizing, restructurings, globalisation and in identifying new ways to help their businesses.



“Even the biggest companies are having to resort to other methods of financing, such as bonds, which are only available to a few companies, and the rest are struggling to keep their heads above water”

Helena Vaz Pinto, Co-Head of M&A, Vieira de Almeida

Opportunities

The key here, say lawyers, is to recognise that the M&A of past years is no longer today’s reality, and to accept the market as it is, and take advantage of the opportunities that exist. And they are out there.

Funds and investors will continue to be active in purchasing non-performance-loan portfolios and other distressed assets. And here there are opportunities for law firms to offer those funds and investors a true specialisation in distressed M&A, according to López-Chicheri at Lener, in particular by creating multidisciplinary teams of lawyers with a combined expertise in the fields of corporate, M&A, Insolvency and restructuring.

Because of the low valuation of listed companies in the stock market, lawyers predict that we will soon start to see some public-to-private M&A transactions. And the Spanish Government has finally started to put in place a series of privatisation plans in the healthcare and highways sectors that is already offering legal firms interesting M&A opportunities.

The restructuring of the Spanish financial system will also trigger interesting opportunities in the market, not only derived from corporate transactions among financial institutions, but also in relation to the need that the credit entities have to get rid of their industrial and real estate portfolio, explains Falcón at Uría Menéndez. “Locked box mechanisms (as opposed to completion accounts adjustments) are becoming more and more popular, and the constant decline of the stock exchange markets also provides a good window for public M&A.”

In Portugal, there are two areas that are in the spotlight as hopes for attracting both foreigner and domestic investors - privatisations and distressed M&A. “These sort of transactions have critical political implications and demand highly specialized as well as massive legal work,” says Luís de Gouveia Fernandes, Corporate and M&A Partner at Pares Advogados.

The much publicised privatisations have been attracting huge interest after the success of the first round of companies to go private in 2012, says Santos Costa at Cuatrecasas in Lisbon, which included EdP and REN. And this trend is likely to continue with a full list of companies to be privatised throughout 2013 in sectors such as defence industry, environment and water supply, transports and infrastructures.

M&A and corporate restructuring activity involving highly leveraged companies and distressed assets is also picking up, and lawyers expect that the bulk of the work of corporate teams will come from this area in the next couple of years.

Times are changing

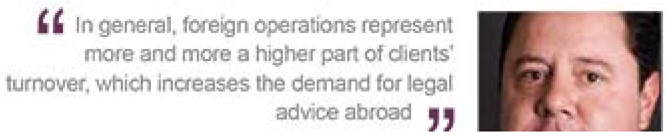
There is clearly a full deleveraging process going on across Iberia, and until stability returns to the financial system and the credit market returns to normal levels, lawyers do not expect a sustainable recovery of M&A activity.

The lack of financing continues to be a huge issues for the market, and the lack of investor confidence in both Spain and Portugal is impacting on investor decisions and putting at risk the closing of deals and market activity.

Internationalisation and worldwide presence are key for law firms, in particular for their corporate departments. “Businesses and transactions are now global and, therefore, law firms should be able to deliver the required legal advice globally,” says Alberto Racquet, Corporate and M&A Partner at Herbert Smith Freehills Spain LLP. Rather than new areas emerging, lawyers are seeing that new markets and investment opportunities are developing beyond Iberia (and even Europe), and this is where the new opportunities for law firms exist.

“We are currently serving a large international market, mostly from the UK and US, as they are looking at Portugal as a door to Africa,” says Rui de Oliveira Neves, Corporate, Commercial and Capital Markets Partner at Morais Leitão, Galvão Teles, Soares da Silva & Associados. “They see Portugal’s austerity measures and compliance with its duties under the MoU as positive signs to invest also in Portugal.”

And while it is distressing to see the problems their clients are facing, say



lawyers, and the market is no longer recognisable as that of the past few years, there is still a lot of work out there - if you look for it. A financial crisis may just be the right atmosphere for some private equity investments, says Antonio Mendonça Raimundo, Head of Corporate, Commercial and M&A at Albuquerque & Associados. “Historically, some of the best returns have been obtained with investments made in times of economic downturn.”

And lawyers have to be prepared to take some of the risk with their clients, and be involved in their decisions rather than just presenting them with options. “Clients will no longer be taking all the risk,” says Bernardo Abreu Mota, Corporate and M&A Partner at Campos Ferreira, Sá Carneiro & Associados. “They want advice and they want your opinion before taking a decision.”

They are also requiring much more security, and in-house legal teams are becoming more involved with their external law firms, says Castelo Paulo at SRS Advogados, which gives lawyers a real opportunity to get closer to them and build relationships.

So while M&A may be down, it is certainly not out. And ‘distressed market’ may not, in fact, be as distressing as it sounds, but rather than evolution of a market that is changing with the times.

Law firms would therefore be well advised to do the same and embrace the opportunities that are on offer.