Portugal : AN INTRODUCTION

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Economic recovery and improving market conditions

In 2013, the Portuguese economy found its way out of the recession, while continuing the path of reducing fiscal and structural imbalances. GDP has increased for two consecutive quarters, according to January 2014 data, above the EU average, with a stronger domestic demand that increased by 1.4% in Q3 2013. Investment increased in the same quarter by 1.5%.

Meanwhile, the exports-to-GDP ratio is now around 41% and is expected to reach 44% in 2015. The highest current account surplus over five decades is foreseen for 2014 (1.9%).

The benchmark Portuguese Treasury Bond (10y) yields now below 4%, and the Portuguese Stock Index (PSI-20) rose on a YTD basis by 12%.

Privatisation-led equity markets and important contribution from the private sector

In 2012, the market capitalisation of listed companies in relation to GDP was only 31%, as against 74% in Spain and 63% in the EU. Moreover, shares from companies operating in important sectors of the Portuguese economy, as in tourism and insurance industries, are unlisted.

This shows that there is plenty of room to increase the role of equity markets in financing Portuguese companies.

The privatisation programme agreed with the Troika under the framework for international assistance to Portugal was considered a flagship in the structural reform agenda and gave an important contribution to capital markets.

In 2013, the successful sale of 70% of the postal company (CTT) by the Portuguese state's holding Parpública was a landmark for equity markets and the first important IPO since 2007. The deal was priced at the top of the pricing range and the 70% free-float achieved via this IPO was an exceptional outcome, with around 26,000 retail investors becoming shareholders of CTT.

Following this path, Espírito Santo Saúde, a health sector company, launched a EUR30 million combined IPO and rights issue in early 2014, taking advantage of the improving market conditions and of CTT's successful IPO.

Market conditions will also be relevant for the Government's decision to sell other state-owned companies in 2014, in order to comply with the commitments of the Portuguese state towards the Troika. The Report of the Tenth Review of the Economic Adjustment Programme for Portugal mentions that the privatisation of the air carrier TAP will be considered in 2014, but does not specify actual deadlines. There is no specific information at this moment on the route that will be followed, once the privatisation is resumed. An M&A route was attempted in 2012, but the government stopped the process for public interest reasons.

The Portuguese state also affirmed its intention, in the context of CTT's privatisation, to sell its remaining stake at a later stage, but a timetable for this has not yet been announced. The sale and listing of the State's remaining stake of around 10% in the power grid operator (REN) is expected to take place before the end 2014.

However, considering that the targets set in the Economic Adjustment Program for proceeds of privatisations were already exceeded in 2013 (e.g. EUR2.7 billion for EDP, EUR593 million for REN, EUR3 billion for ANA and EUR579 million for CTT), the development of Portuguese equity capital markets will now have to shift to the private sector.

Ownership of Portuguese companies is traditionally concentrated in families. Capital markets are often seen as a risk for family control and for the secrecy of business.

Euronext Lisbon, which manages the Portuguese main regulated market, is making its efforts in order to counter this perception and attract new companies to the market. In light of this and current market conditions, we can expect new IPOs in 2014, but Euronext Lisbon did not announce any quantitative targets for this year.

The financial crisis and the number of financially distressed companies were seen as an opportunity for private equity firms, which acquired large equity and debt stakes in such companies. They are expected to search exit opportunities via equity capital markets, once they have managed to improve the companies' balance sheets and their investment is sufficiently mature to be disposed of.

We think that a rebalance and revocation of some legal requirements for delisting could definitely improve the prospects of new IPOs, as companies could positively evaluate trial periods in the regulated markets. Authorities should bear in mind that barriers imposed to the delisting of companies are often regarded by companies, shareholders and investors, for psychological, financial and other reasons, as barriers to listing in the first place.

Corporate debt markets still face legal and regulatory challenges

Even if the economic recovery continues and the credit crunch has been much contained, banking sector deleveraging will not allow banks to provide funding to companies at pre-2008 levels.

Accordingly, we would expect that corporate debt markets will tend to replace, at least to some extent, the traditional funding via the banking sector.

The door of prime bond markets was again open when EDP broke a 20-month deadlock in September 2012, by successfully placing a EUR750 million bond issue, with strong demand from investors, enabling the initially foreseen yield of 6.25% to decrease to 5.85%. Other blue chips then followed this track, in 2013 and Q1 2014. In May 2013, the first ever high yield bond transaction was launched by a Portuguese listed corporate (Portucel), potentially opening this avenue for other issuers. Besides high-yields, investors may also start looking for investment opportunities in mini-bonds, provided that they can benefit from risk diversification in their investment portfolios. For this to materialise, access to bond markets must be granted to a larger number of small and medium size enterprises (SME), which were those most strongly hit by the credit crunch.

One of the obstacles identified is the current legal rule requiring, at issuance, a given ratio between the company's equity and the outstanding principal of company bonds. This requirement is traditionally seen as a way to protect retail investors, but we see no need for it to apply when investors are more experienced, qualified and able to make adequate decisions relying on the available information.

Given that the financial crisis significantly whipped out equity in most companies, this ratio requirement strongly prevented smaller corporates accessing the bond markets, while limiting institutional investors' options to diversify their debt portfolios.

A decisive legal step forward was recently taken, regarding short-term debt instruments, when the commercial paper framework was revised last February, and whereby a similarly oriented equity-to-debt ratio was dropped, under certain conditions, but still retaining proper safeguards for retail investors.

The very active local issuers association (AEM) already put forward proposals to extend this orientation and drop these sorts of ratios for medium and long-term bonds, along with a package of other proposals to achieve a less burdensome legal and regulatory framework for companies that only have bonds listed in regulated markets. Thus, the pace and dynamics of the Portuguese corporate bond market for SMEs may to a large extent depend on these sorts of measures being implemented.