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CAPITAL MARKETS AND M&A IN PORTUGAL POST-TROIKA

Portugal's successful return to the international capital markets continues, with CaixaBI a key player in the majority of recent issues

Portugal exited the Troika's economic and financial assistance programme in May 2014. The programme has put the Portuguese economy on a path towards sound public finances, financial stability and competitiveness. During the programme's three years, the external current account shifted from a deficit of over 10% to a surplus of 1.4% in 2013 (0.6% in 2014), the budget deficit was halved (4.5% in 2014 and projected by the European Commission at 3.1% in 2015), while public debt has remained sustainable, even at the current high level of 130% of GDP.

Ambitious reforms were implemented across all the main sectors of the economy and growth was reignited in 2013; in 2015, according to the Bank of Portugal, the country is projected to grow by 1.7%.

Successful implementation of the adjustment programme and consequent economic rebalancing led investors progressively to rebuild their Portuguese risk exposure, contributing to a dramatic tightening in Portuguese spreads throughout 2013 and 2014.

Portugal's return to international capital markets began in September 2012, 18 months into the Troika's assistance programme, but the clean exit from the Troika in 2014 sealed its comeback.

During the Troika, all the usual issuers, such as EDP, REN, BCR, Portugal Telecom and the country's main financial institutions, plus inaugural issuers Galp, Portucel and Empark, brought successful transactions to markets in the three- to seven-year tenors. The Republic brought two five-year tap issues and a 10-year new issue and tap. CaixaBI was bookrunner in 12 of the 19 corporate and SSA Eurobond issues in this period.

CaixaBI headquarters

Debt issuance continues with Troika's departure

Summer 2014 was marked by the fallout and subsequent resolution of Banco Espírito Santo (BES), a highly disruptive event that kept investor activity subdued and contributed to a temporary wobble in Portuguese spreads. The tightening trend in spreads quickly regained momentum after the summer break.

Taking advantage of this positive turnaround in market sentiment, the Portuguese sovereign came out with a ground-breaking 15-year benchmark issue after the summer lull (3 September); the first since 2008. The new €3.5 billion OT 3.875% due February 2030 at swaps spread of 235bps had CaixaBI as joint bookrunner.

Following on 11 September was prominent Portuguese issuer EDP, with a seven-year issue, a €1 billion 2.625% due January 2022 at swaps plus 190bps. Also, with the aim of maintaining its presence in the US dollar market, EDP opted for a new five-year issue on 13 November, a $750 million 4.125% due January 2020 at Treasuries plus 255bps.

The second half of 2014 brought the spectrum of deflation in the eurozone to the minds of investors, crystallising prospects of enduring low interest rates. In this environment, also plagued by a scarcity of investment opportunities due to the continuing deleveraging of European corporates, investors had to continue their search for yield by taking higher-risk and longer-duration assets into their portfolios.

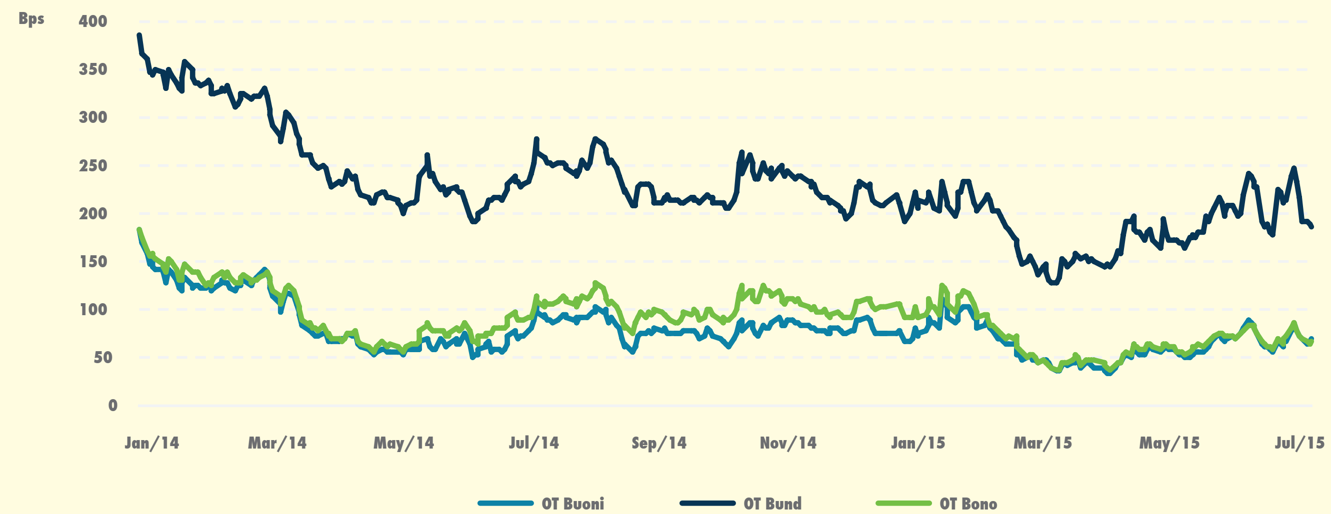
In October 2014, Greece was back in the spotlight due to concerns over domestic politics - the rise of Syriza and the risk of early elections - and uncertainty over the end of the bailout programme in December 2014. Greek spreads began a solo widening move, intensified in December by the aggravation of the same risks, resulting in an extension to the expiring bailout programme. The culmination came in January with the election of Syriza, effectively materializing investors' concerns and taking the country on a path of confrontation with European institutions and away from financial markets.

Despite being initially entangled by the re-ignition of Greek woes in Q4 2014, the new year confirmed the detachment of Portuguese spreads from the Greek situation as a reflection of investors' perception of separate country risks.

Proof of this pattern was the launch on 13 January of the 10-year and 30-year dual-tranche transaction by the Portuguese sovereign. The €3.5 billion 2.875% due October 2025 and the €2 billion 4.1% due February 2045 were jointly placed by CaixaBI at swap spreads of 212bps and 282bps respectively. This transaction carried the lowest-ever coupon for a 10-year public debt issue and, in its 30-year tranche, the first such maturity since 2006.

Galvanized by the ECB's launch of its covered bond purchase programme in October 2014, CGD decided to tap the markets on 20 January 2015 with a covered bond, which has become something of a tradition at this time of the year. This transaction of €750 million due January 2022 at swap spreads of 64bps, jointly run by CaixaBI, managed to print with a record-breaking coupon of 1%.

10-year OT spreads performance from January 2014 to July 2015



Source: Bloomberg

Investor confidence peaks, Portuguese spreads at lowest levels

Several months after the Troika's departure, Portuguese issuers continue to exude confidence in international debt markets. An additional sign of this return to normality in Portuguese debt markets was, in 2015, the 10-year tenor bonds successfully placed jointly by CaixaBI for the three main corporate issuers in the country, REN, EDP and BCR.

On 5 February, REN came out with a €300 million 2.5% due February 2025 at a swap spread of 182bps, the longest Portuguese corporate Eurobond to venture into the market since 2009 and bearing the lowest-ever coupon for a corporate. Also successful were EDP on 16 April, with a €750 million 2% due April 2025 at swaps plus 155bps, and BCR on 20 April, with a €300 million 1.875% due April 2025 at swaps plus 153bps.

Investors' search for yield and consequent risk-on mode propelled Portuguese asset prices and took the 10-year OT Bund spread to lows of 127bps (yield of 1.56%) on 16 March, coinciding with the launch of the ECB's public sector purchase programme (9 March) that gave this momentum an extra boost. Simultaneously, Portuguese sovereign spreads to comparable peripheral countries, Spain and Italy, also got to minima, with the 10-year OT Bono spread reaching 37bps on 17 March and the 10-year OT Buoni spread touching 33bps on 9 April, both coming from a level of 183bps at the beginning of 2014.

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Debt markets paradigm shifts, Greek woes intensify

By the second quarter of 2015, with the ECB's quantitative easing well under way, economic indicators showing better growth numbers and slight upticks in inflation, medium and long-term yields began to drift up, with volatility also on the rise.

This inversion of the market trend was confirmed during April, with the Bund flash crash of 29 April, which calmed investors searching for duration and set in a new rates and credit markets paradigm plagued by high price volatility.

In the midst of this shift in investor sentiment, the Republic managed a last-minute (29 April) tap issue of its dual-tranche transaction launched earlier in January. The €2 billion tap of the 10-year tranche priced at a swap spread of 155bps, while the €500 million 30-year tranche came out at swaps plus 215bps.

Adding extra volatility was the escalation of Greek woes in May, with daily headlines having a major impact on investor sentiment. This was reflected in credit market prices, which eventually all but closed the markets for new issuance until a decisive Greek agreement was to be found.

The Greek debacle during May and into the summer months kept investment banks' pipeline clogged with prospective new issues. This is also the case for Portugal, where CaixaBI continues its leadership in debt capital markets in the post Troika period, having placed seven of the 13 new corporate and SSA Eurobond issues.

Equity markets turn down

Despite the conclusion of the Portuguese adjustment programme in May 2014, there followed a

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PSI 20 index performance from January 2014 to June 2015

Source: Bloomberg

substantial downturn in the positive context of the Portuguese equity capital markets (ECM). The positive trend had been building since the summer of 2012, with the recovery of the PSI20 index, and had consolidated in the first half of 2014, with a significant increase in the number of new ECM transactions: initial public offerings (IPOs), accelerated bookbuilding offers (ABBs) and rights offerings.

From June until the end of 2014, the PSI20 presented a negative performance as a result of the instability in the Portuguese financial sector. This was due to the financial problems identified in the main shareholder of one of the largest Portuguese private banks, BES, culminating with the Bank of Portugal applying a resolution measure to BES by transferring its general activity and assets to a new bank (Novo Banco).

The sharp decline in oil prices that began in August 2014 and the political problems in Greece that surfaced in Q4 2014 and led to the holding of new legislative elections had a strong adverse impact on the Portuguese equity market. The PSI20 index fell by 29.4% in the second half of 2014 and 26.8% over the whole year.

As a consequence, Portuguese ECM activity suffered a sharp decline. However, even during this period, the Portuguese government was able to take advantage of a window of opportunity in early September 2014 and concluded the privatization of CTT, selling its remaining stake of 31.5% through an ABB, which amounted to €342.6 million. The offer achieved great success, reaching a significant level of demand, mostly from international investors, exceeding the total existing shares for sale. CaixaBI was joint global coordinator and joint bookrunner in this transaction, being instrumental in its success.

Additionally, Sonae Indústria was able to increase through a rights offering, a crucial part of its strategic plan, allowing a significant strengthening of its capital structure. CaixaBI acted as joint global coordinator and bookrunner in this offer, making an important contribute for its completion.

At the beginning of 2015, the PSI20 index returned to positive performance on the back of the announcement by the ECB of its expanded asset purchase programme, registering a growth of 31.2% until the middle of April. This new positive context allowed José de Mello Group to conclude the sale of its stake of 2% in EDP through an ABB which amounted to €249 million, on which CaixaBI acted as adviser and joint bookrunner. The offer achieved a level of demand that exceeded the total existing shares for sale and a discount that was below the average in similar European ABBs in the first half of 2015.

These examples show that, despite the instability of the Portuguese market, there is always place for good investment opportunities. Investors are always looking for companies with well-defined equity stories and valorization potential.

The political context in Greece and the uncertainty in relation to the negotiation of the third economic adjustment programme, culminating in the country's inability to repay a €1.6 billion tranche to the IMF on 30 June, again had a strong negative impact on the Portuguese equity capital markets. From the middle of April 2015 until the end of June, the PSI20 index decreased by 11.8% and market conditions did not permit the conclusion of new ECM transactions.

The recovery of Portuguese ECM activity by the end of 2015 is highly dependent on an improvement in overall market conditions, through a positive performance of Portuguese and international equity indexes and a decrease in volatility levels. If this is the case, and considering that Portuguese macroeconomic conditions have improved during the past two years, there might be opportunities for companies to finance themselves through IPOs, follow-ons or other types of ECM transactions.

M&A picks up on the back of economic recovery

In the past few years, Portugal has made significant reforms in a challenging macroeconomic context, paving the way for its successful exit from the economic and financial assistance programme in May 2014. According to the Bank of Portugal, the economy is projected to grow by 1.7% in 2015 (versus 0.6% in 2014). Exports are expected to continue to lead the economic recovery, as growth in Portugal's main export markets, especially Europe, is expected to pick up.

Not surprisingly, M&A activity has been strengthening. After almost four years of privatization-led M&A that brought significant overseas investment, especially from China, it is now time for some market-driven deals. 2014 marked a turnaround in M&A in Portugal, posting nearly €10 billion of announced deals, almost 40% more than in the previous year. In 2015, announced transactions already account for approximately €3 billion, with major deals still expected to be announced during the second half of the year.

The last sizeable privatization-driven deals have been announced, with TAP (2015), the Portuguese flagship airline, and EGF (2014), the waste management leader, being seized, respectively, by Portuguese-Brazilian private investors' consortium Gateway and Portuguese construction/ waste consortium Mota-Engil/ Suma. CaixaBI was actively involved in both transactions, alongside Brazilian-led consortia with competitive bids, contributing to market dynamics.

So far, 2015 has been marked by high-profile infrastructure deals, involving professional investors, some of whom fall into the category of top-notch private equity with a global reach, attesting to the overall improvement in the perceived risk allocated to Portuguese infrastructure assets. These are, for example, the announced acquisitions of several Portuguese-operating toll-roads belonging to the two major players, BCR (minority acquisition by Brazilian private investors) and Ascendi (50% acquisition by Ardian, the French private equity and infra group), with CaixaBI participating in both deals. The Ascendi deal represented close to a €3 billion enterprise value transaction, with CaixaBI being the sole financial adviser involved, acting on the buy side for Ardian. 2015 should see further infrastructure transactions towards the end of the year, notably in the renewable energy sector.

It is worth mentioning that the financial services sector has also been quite active, mainly following the break-up of the former BES Group. The sale of Tranquilidade to Apollo Global Management and the sale of BESI to Haitong Securities, both during the second half of 2014, will be followed by the sale of Novo Banco, which should occur in the second semester of the year.

All in all, 2015 should be a fairly good year for M&A, provided of course major global risks that could affect European and global economic performance do not materialize. The financial services sector should continue to stand out, not only due to the on-going sale of Novo Banco, but also to the overall

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market consolidation already in motion, led by recently announced or rumoured insurance and banking business sales (for example, Axa Portugal and Barclays Portugal) and potential retail banking tie-ups. Industrials should also play a bigger role, since private equity players are becoming extremely active in the market (sources of finance are again abundant), especially in the mid-market segment, as jumbo deals tend to rarefy and large privatizations have come to an end. Nonetheless, these financial investors are expected to become increasingly selective, seeking assets with scalable and/or export capabilities.

In addition, as already hinted, infra deals are clearly gaining momentum since portfolios need to be renewed and foreign investors see the opportunity to seize relevant yields at low levels of perceived risk.

Overall, from a fundamental perspective, Portugal's privileged geographic location and long-standing cultural affinities with several countries in the southern hemisphere make a compelling argument for investors to view Portuguese corporates as the preferred expansion platform not only to Portuguese-speaking emerging countries, including Brazil, Angola and Mozambique, but also to emerging markets in Latin America.

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