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Private Equity 2021

Portugal: Trends & Developments
Duarte Schmidt Lino, Tomás Almeida Ribeiro
and João Serras de Sousa
PLMJ

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Trends and Developments

Contributed by:
Duarte Schmidt Lino, Tomás Almeida Ribeiro and João Serras de Sousa
PLMJ** **see p.6

Overview of the Portuguese Economy

The COVID-19 pandemic had a harsh impact on the Portuguese economy in 2020 and the country's GDP decreased by 7.6%. Trends in the country's economy in the first quarter of 2021 were also disappointing.

However, this deterioration in the economy did not cause a significant spike in the unemployment rate and this remained relatively stable with a minor fall of only 0.3% in 2020.

Once the national vaccination plan picked up pace and most of the world's economies started to bounce back from the crisis, the Portuguese economy started to recover and is expected to register significant growth in its GDP over the coming years, in line with its European counterparts.

Nevertheless, Portugal's significant public and private debt continues to be perceived as one of the key risk elements to be watched closely in the near future. In fact, although the Portuguese government further extended the public moratoriums on debt for both individual households and companies until 30 September 2021, the number of non-performing loans is expected to grow in the coming months.

Furthermore, looking ahead, a potential shift in the European Central Bank's policy towards interest rates poses a relevant risk factor for the Portuguese economy.

Overview of the Portuguese Private Equity Industry

The Portuguese private equity industry continues to register steady growth both in terms of the number of players set up locally and organised under Portuguese law and, more importantly, in terms of assets under management. The industry is thus playing an increasingly significant role in the much-needed capitalisation of Portuguese companies across a broad number of industries.

According to the Portuguese Securities Market Commission, there are currently 189 active private equity funds in Portugal and 60 private equity companies (three of which are above the EUR500 million legal threshold of assets under management). Moreover, the EUR5 billion mark of assets under management was reached in 2019. Although still a modest amount of assets under management, it confirms a continuous growth pattern registered over recent years.

Furthermore, some of the most important international players in this industry, particularly distress debt funds, continue to keep a close eye on the Portuguese economy and the opportunities it has to offer. Their focus is mainly on the hospitality and real estate markets.

In terms of deal flow, the Portuguese private equity ecosystem was active during 2020, even though there was a slight break. Despite the uncertainty associated with the measures taken to control the effects of the pandemic, the last quarter of 2020 and the first half of 2021 saw some large transactions. These included the acquisition by Saur SAS (a France-based company, controlled by the Swedish fund EQT) of

Aquapor Serviços, SA (a company that operates several water and waste systems from the north to the south of Portugal) and Prio's acquisition by the Spanish Energy group, Disa.

Although it is difficult to foresee market developments in the near future, with the successful implementation of international vaccination plans, uncertainty is now set to decrease and the confidence of private equity players to increase. Therefore, in the coming months, the market is expected to recover from the losses suffered during 2020 and private equity players are expected to target distressed companies with a view to restructuring them. In Portugal, this is most likely to occur in the most affected sectors (particularly, the tourism sector).

In addition, private equity players will be expected to play a significant role in the investment of the EUR13.9 billion in grants to be injected into the Portuguese economy further to the Recovery and Resilience Plan to be implemented over the period 2021–2026. These funds will provide a historic opportunity for Portugal not only to reboot its economy and increase its competitiveness after the COVID-19 pandemic, but also to tackle its structural challenges in terms of growth potential and competitiveness.

Trends in the Private Equity Ecosystem in Portugal

Divestment in restructuring funds

This year – 2021 – should see an opening-up in terms of the sale by some of the leading Portuguese banks of restructuring funds under competitive bidding processes to international bidders looking to increase their portfolios in the Portuguese real estate, retail and hospitality sectors.

Some of the most significant transactions of 2021, in terms of the assets involved and the deal value, are expected to be made in this context.

R&D/SIFIDE II funds

A comprehensive effort is being made to take action to support technological and business innovation in Portugal, and to help consolidate the National Innovation System and strengthen the competitiveness of the Portuguese economy in global markets. In this context, the System of Tax Incentives in Research and Business Development II (SIFIDE II) provides for a public research and development (R&D) incentive scheme whereby Portuguese companies can benefit by saving up to 82.5% in corporate income tax. They can do this by investing in private equity funds which invest predominantly in target Portuguese companies with R&D projects duly certified by the National Agency for Innovation (*Agência Nacional de Inovação, SA* or ANI).

Although the figures have not been publicly disclosed, it is believed that over EUR300 million had been raised for these funds by the end of 2020.

Private equity funds and the Portuguese Golden Visa Programme

A significant number of the new private equity funds currently being set up in Portugal by some of the leading players in the Portuguese market are intended to raise capital with individual investors across the world looking to apply for the Portuguese Residence Permit for Investment Activity under what is often referred to as the "Golden Visa Programme".

Private equity funds that meet certain legal requirements (eg, minimum investment amount, investment policy, minimum duration of the investment, etc) can qualify for this type of investment.

Trends in Deal Structuring and Terms

Material adverse change (MAC) or material adverse effect (MAE) clauses

As a result of the uncertainty brought about by the virus and the measures to contain its spread, market players are now more focused on providing for (or should we say, discussing) contractual mechanisms to control and allocate the risks of unpredictable and abnormal changes of circumstances that may impact their transactions.

MAC or MAE clauses are a type of contractual mechanism intended to enable parties to react to a change that may adversely impact the contractual terms in the period between the signing and closing. As a mechanism to allocate risks, these clauses can be designed in different ways. However, the most common type of MAC clause allows the buyer to terminate the agreement (or simply not to complete the transaction) if, between the signing and closing, a circumstance arises which has, or may (reasonably) have in the future, an MAE. These clauses also frequently provide for a price adjustment if an MAE occurs in this period.

MAC clauses are clearly acceptable under Portuguese law and are of great importance. Portuguese law provides that the parties are free to shape the legal framework of the “abnormal change of circumstances”, as provided for in the Portuguese Civil Code. However, it is frequently stated that clauses cannot be designed to eliminate completely the application of the legal framework, which is a “safety valve” to provide for the contractual balance of the contract in the face of unexpected and abnormal changes of circumstances.

MAC clauses can be (i) general or (ii) specific. The difference between the two impacts on their enforceability. General MAC clauses are designed with undetermined, general and abstract concepts. Therefore, they are easily negotiated by the parties and provide for lower transactional costs. However, they are less enforceable and easily disputed by the other party. In contrast, specific MAC clauses establish the precise meaning of the material adverse change or material adverse effect. They also frequently include a list of examples to be considered as a MAC event or fix a threshold relating to the economic or financial impacts on the target that could lead to the considerationof it as a MAC event. Even though specific MAC clauses are much more difficult to negotiate and, therefore, imply more transactional costs, they give the parties more legal certainty.

The COVID-19 pandemic has drawn more attention to the advantages of agreeing specific MAC clauses. However, it has proved difficult for these kinds of protective measure to be accepted in the market and sellers are (generally) keen on rejecting the allocation of risk that such clauses imply.

On the other hand, in an increasing number of transactions, we are seeing price provisions with earn-outs and other variable elements, intended to share the risks and benefits of the performance of the target companies and their underlying assets between the parties.

Warranty and indemnity (W&I) insurance

W&I insurance is a type of insurance purchased in connection with the representations and warranties (R&Ws) made by the seller. This insurance covers any compensation due for certain breaches of the R&Ws in the transaction agreements.

Following the international trend in the market, the use of W&I insurance is becoming increasingly popular in the Portuguese M&A market and, consequently, among private equity players. As R&Ws play a key role in M&A transactions – they are extensively negotiated by the parties – traditionally, the seller agrees to compensate the buyer (subject to caps, exclusions and other limitations) for breaches of the seller's R&Ws. Frequently, the compensation is backed by collateral agreements (eg, escrow). W&I insurance is changing this traditional structure.

The main advantages of W&I insurance are the benefits for the seller. This form of insurance:

- allows a reduction or elimination of the compensation for breaches of R&Ws;
- allows a reduction or elimination of the traditional escrow account, price retention and other similar mechanisms;
- reduces the contingencies for the seller; and
- gives the seller more comfort and safety to give more extensive R&Ws, probably without the knowledge or materiality qualifiers or any other restrictive caveats.

There are also advantages to the buyer as it can (i) rely on the effectiveness and protection of the insurance, which contributes to having more confidence during the transaction; and (ii) increase the buyer's protection (if combined with other collaterals and the seller's willingness to give more extensive R&Ws). It also allows the buyer more room to manoeuvre in terms of its ability to negotiate an extension to the original W&I insurance proposed by the seller to cover other areas identified in the due diligence in respect of the target(s) (eg, tax indemnities).

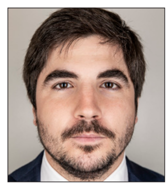
For both seller and buyer, W&I insurance can speed up negotiations regarding one of the most important topics and increase the chances of success, making the negotiations faster and smoother. However, the M&A transaction process can be slowed down, as the insurance company should be involved to review the transaction documents and the performed due diligence process, in order to negotiate the W&I policy with the buyer and/or the seller.

Contributed by: *Duarte Schmidt Lino, Tomás Almeida Ribeiro and João Serras de Sousa,* ***PLMJ***

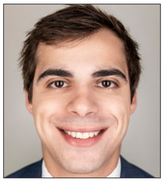
PLMJ is a law firm based in Portugal that combines full service with bespoke legal craftsmanship. For more than 50 years, the firm has taken an innovative and creative approach to produce tailor-made solutions to effectively defend the interests of its clients. The firm supports its clients in all areas of the law, often with multidisciplinary teams, and always acting as a business partner in the most strategic decision-making processes. With the aim of being close to its clients, the firm created PLMJ Colab (from the Portuguese "colaboração"), its collaborative network of law firms spread across Portugal and other countries with which it has cultural and strategic ties. PLMJ Colab makes the best use of resources and provides a concerted response to the international challenges of its clients, wherever they are. International collaboration is ensured through firms specialising in the legal systems and local cultures of Angola, China/Macao, Guinea-Bissau, Mozambique, São Tome and Príncipe, and Timor-Leste.

AUTHORS

Duarte Schmidt Lino is a partner and co-head of the corporate M&A and private equity practice at PLMJ. He has over 18 years' experience in private equity, mergers and acquisitions, corporate law, investment funds and privatisation. Duarte is known for handling major private equity, corporate governance, M&A and privatisation transactions, working both in Portugal and internationally, with a focus on the markets of Angola, Brazil and Mozambique. Since completing his law degree, Duarte has completed a postgraduate course in banking law at the Faculty of Law of the University of Lisbon.



Tomás Almeida Ribeiro is a managing associate in the corporate M&A and private equity practice at PLMJ. With around 12 years' experience, he has worked mainly on mergers and acquisitions, corporate restructuring, private equity regulatory issues, corporate disputes and privatisations. His clients come from various industries and sectors, including real estate, retail centres, tourism, ship building, repair and maintenance, sports companies and agribusiness. Before joining PLMJ, Tomás was a lawyer at the Lisbon office of a leading Iberian law firm. He was also an adviser to the Minister of State and Regional Development of the 19th constitutional government of Portugal.



João Serras de Sousa is an associate in the corporate M&A and private equity practice at PLMJ. He is also a guest lecturer at the Faculty of Law of the University of Lisbon and a researcher at the Centre for Private Law Research. João has completed the curricular part of his master's degree in commercial law at the Faculty of Law of the University of Lisbon and is currently preparing the dissertation for his doctorate, specialising in legal-business sciences, at the same faculty. He is the author of numerous legal publications.

PLMJ

Av. Fontes Pereira de Melo, 43
1050-119
Lisbon
Portugal

Tel: +351 213 197 300
Fax: +351 213 197 400
Email: plmjlaw@plmj.pt
Web: www.plmj.com/en/