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Corporate M&A 2022

Puerto Rico: Trends & Developments
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Trends and Developments

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Review of 2021

In 2021, global M&A volumes reached USD5.9 trillion in value, a 64% increase compared to 2020, according to [Refinitiv](#). Unfortunately, there is no publicly available data regarding M&A activity in Puerto Rico. COVID-19 has caused major disruptions in the M&A landscape and its effects are likely to persist over the coming months. Private equity played a major role, as the Puerto Rico market is focused mainly on private deals and has been impacted by recent capital influx to the local economy. According to Refinitiv, private equity firms accounted for 37% of 2021 US deal volumes. Similarly, Puerto Rico received more capital investment from private individuals and companies than in the past. The 2022 M&A market – when compared to the 2021 market – should continue to experience increased transactional activity, with private equity playing a significant role.

Impact by Sector

Puerto Rico experienced widespread COVID-19 restrictions, some of which are still ongoing. These restrictions significantly impacted various sectors, such as hospitality, entertainment and retail. In 2021 we saw an increase in leading competitors in these industries acquiring their distressed counterparts in efforts to gain increased market share and prepare for a post-restriction economy. As a result, many industries had a significant decrease in players, due to both M&A and restructuring activities brought by the pandemic and/or governmental restrictions. As restrictions eased, we also saw major players move to increase their operations and future expansions.

The impact on the hospitality industry led to various deals to focus on the expansion of this sector. Due to local tax incentives, many hospitality enterprises have received a significant capital influx in 2022 as a result of these deals, reportedly over USD186 million. Industry deals include Wyndham Palmas Beach & Golf, Dorado Beach, Ritz-Carlton Reserve and Sheraton Old San Juan. The telecommunication industry was also impacted with the acquisition of leading market player AT&T in Puerto Rico by Liberty Puerto Rico. Likewise, market leaders such as Restaurant Holding Company added to their portfolio additional chain brands such as Popeyes. Pressures from new market entries (such as Chick-fil-A) will foster deals by existing industry participants to maintain market position and be able to compete. These types of deals are expected to multiply in 2022, as COVID-19 restrictions decrease and economic activity increases.

Foreign Investment

Puerto Rico is an attractive option for foreign investment thanks to tax incentives and the advantages of being an unincorporated territory of the USA. Businesses that relocate to Puerto Rico, and export services to individuals or companies located outside Puerto Rico, can enjoy a unique set of benefits under Act 60-2019. In particular, a number of companies have gone all-virtual in response to the COVID-19 pandemic, and this kind of structure is the perfect set-up for Act 60's incentives.

Act 60's main objective is to promote Puerto Rico's economic development. It provides certainty related to the types of incentives that Puerto Rico offers to attract investment and create jobs in important traditional sectors such

as manufacturing, tourism and agriculture, as well as aerospace, biosciences, technology, renewable energy, entrepreneurship and export services. In addition, it defines new incentives to support emerging sectors, such as the creative, esports and entertainment industries. While many have invested, others have relocated some services to Puerto Rico to enjoy these benefits. This upward trend is expected to continue in 2022 and 2023.

Looking Ahead to 2022 and Beyond

As markets struggle with the effects of COVID-19 pandemic, a number of transactions were delayed or cancelled in 2021. Some of these deals may result in litigation, with parties alleging that transactions should be terminated due to the effects of COVID-19 as a result of the occurrence of a material adverse effect (MAE) or breach by the target of its covenants (including conduct of business covenants). Notwithstanding, litigation in the context of M&A transactions in Puerto Rico is very limited, particularly regarding disputes between the purchaser and the target company.

Because MAE provisions allocate risks that neither party knows at signing or controls between signing and closing, the definition of a MAE and the related provisions tend to be negotiated vigorously. MAE's are usually structured with a list of exclusions that do not qualify as material adverse effects. Perhaps the largest difference between a buyer-friendly and seller-friendly MAE is that the seller-friendly MAE will carve out a large number of detailed exceptions of events that do not qualify as a material adverse effect or change. Therefore, parties in M&A transactions are increasingly addressing COVID-19 risks through MAE provisions, with many explicitly carving out pandemics, epidemics and health emergencies from MAE definitions and some even expressly mentioning the COVID-19 virus in MAE carve-outs.

Research and Technology

Technology was one of the most active sectors, with a significant increase in transactions from 2020 and 2019. With more companies looking towards updating the way they conduct business, market adaptability, remote working and more digitalised experiences, the surge to conduct more deals in these areas significantly increased for 2021. Puerto Rico is a preferred destination for key ICT companies such as Cisco, Oracle, Microsoft and Hewlett-Packard, all of which tap into the island's top-notch talent and attractive software export incentives.

Act 60-2019 is a powerful tool to develop Puerto Rico as the preeminent international export service and commerce hub by reducing income taxes and providing exemptions from property taxes, municipal taxes and taxes on dividend distributions for income generated and property used in the exempt operations. These sectors continue to be in high demand, as business adapt to the new market realities, while also seeking to enjoy the tax benefits presented by local incentives.

Restructurings, Returning and Adapting Industries

Undoubtedly, the pandemic has had the most direct impact on the healthcare industry. The height of COVID-19 brought a temporary end to all but the most critical in-person medical visits. Instead, telehealth and virtual care suddenly became the primary methods to consult medical professionals, rapidly accelerating industry and consumer adoption of these new technologies. Consistent with general market trends, M&A activity in the healthcare services segment has been slow due to the pandemic and subsequent economic conditions.

The technology sector is a key area in which we expect to see increased M&A activity in 2022. Puerto Rico has become a global destination

for blockchain pioneers focused on cryptocurrency. Act 60-2019 supports the use and sale of utility tokens as software. It also allows 0% capital gains tax on crypto-assets, if properly structured.

SPACs

Special purpose acquisition companies (SPACs) have become a major phenomenon in the USA over the last several years. The last 12 months continued to see a significant number of private companies going public through de-SPAC transactions by merging with a SPAC. De-SPAC transactions are essentially part M&A deal and part initial public offering (IPO) and, therefore, raise unique issues. However, there is no record of private companies in Puerto Rico going public through a combination with a SPAC. Puerto Rico has but a handful of publicly traded companies.

Valuations

Given that the economy is still directly impacted by pandemic restrictions, valuations have been complex and uncertain. There is no publicly available data on valuations for Puerto Rico. However, the majority of the deals are conducted having valuations that not only look at past performance, but take into consideration adjustments based on current uncertainties and potential market barriers due to government interference. As such, most deals are structured to mitigate the risks for both parties by looking at the potential to have an open market, deferred consideration and the uncertainty of potential financial projections.

Anticipated Uncertainties

The last year was filled with significant uncertainties, beginning with restrictive COVID-19 measures and ending with a return to restrictive

measures due to the Omicron variant. As vaccination rates continue to increase, restrictions on local sectors are expected to ease and allow for local markets to recuperate. Though potential new variants create uncertainty as to governmental actions, we anticipate these restrictions would not be as stringent as before and should allow the economy to continue to slowly return to pre-pandemic levels.

Likewise, with the confirmation of Puerto Rico's restructuring plan under the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), we expect to see the local economy move beyond austerity to investment and growth. How much is still undetermined, given that the final restructuring plans are still contested in court by some sectors.

Local tax incentives have become a significant factor for local investments. Changes to the current incentives and/or oversight could cause a potentially adverse impact in future capital investments for private deals. Also, with the influx of funding from the Community Development Block Grant – Disaster Recovery (CDBG-DR) programme, we can expect more local investment and capital available for deals. Given the regulatory limitations of these funds, their impact on the economy remains undetermined.

Conclusion

We expect 2022 will be another strong year for local M&A, with robust activity through the first half and possibly well beyond. While the pandemic continues to have a negative economic impact, local commerce is expecting an increase in volume of deals in the next 12 months, as the markets continue to return to normal, with a significant capital influx into Puerto Rico.

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