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Puerto Rico: Trends and Developments

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Trends and Developments

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Estrella, LLC is a full-service firm based in Old San Juan, Puerto Rico. As one of Puerto Rico's oldest and most prestigious law firms, Estrella's first-rate attorneys represent a diverse group of blue-chip clients, excelling in a breadth of business practice areas, anchored by its corporate, employment, and litigation practices. In addition to its expertise in litigation, the firm has trusted business advisers who provide corporate clients with practical, customised solutions that supplement its business objectives. Estrella val-

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Review of 2022

After a record-breaking 2021, 2022 started strongly with post-pandemic activity that surpassed historical norms. However, by the second half of the year, there was a significant decline in the number of transactions, leading to a decrease in the announced value of global deals. According to Capital IQ and Refinitiv as of 31 December 2022, the US reported a 36% decline in deal value compared to 2021, although it was still higher than 2020 figures, as per the

Bain and Company Report. Additionally, deals involving special purpose acquisition companies (SPACs) declined by 10% from 2021, according to Refinitiv.

Inflation figures across global markets were staggering, driven by rising demand, supply chain issues, and labour shortages. Consequently, central banks aggressively raised interest rates in 2022, with the US Federal Reserve announcing seven interest rate hikes during the

year. These factors, coupled with an uncertain macroeconomic climate, impacted various sectors, including technology.

The decrease in deal value also reduced potential sellers' interest in continuing ongoing offers, leading to a 33% decline in the strategic deal market from the all-time high in 2021, as reported by S&P Global Market. Strategic deal volumes dropped by 9%, with smaller to mid-size deals and divestments holding steady at 33% of deals, according to Refinitiv.

The Puerto Rico market reflected these global trends, particularly given the increase in inflation of over 4% in 2022. These factors affected 2022 deals and put pressure on businesses for the upcoming 2023. Additionally, a decrease in capital injections to local companies resulted in stalling scalability and new emerging market entrance, contributing to the decrease in transactions during the second half of 2022.

Market advisers expect a slow start to 2023, with an increase in deals anticipated for the second half of the year. These increases could result from increased capital, strategic acquisitions in core businesses, an increase in private investments, or cross-border transactions. Although 2023 may be a tough year, not every aspect of the changed economic circumstances is bad news.

Impact by Sector

In 2022, the trend of acquiring distressed companies and strategic purchasing continued from 2021. However, some sectors saw a decrease in market players, while other US companies entered the local market. There was an increase in foreign investment, particularly in the tech industry, with companies like Isbel (a member of Quantik Group) acquiring Envision Puerto Rico

and Maxar Technologies purchasing Wovenware.

CEMEX SA, a global producer and marketer of cement products, also acquired outstanding shares of Puerto Rican Cement Company Inc. through its subsidiary Tricem Acquisition, Corp. In the consumer industry, Walmart Puerto Rico sold its Amigo Supermarkets chain to Pueblo Inc., while Triple-S Management Corporation, one of the leading health insurance providers, was acquired by Guide Well Mutual Holding Corporation, holder of Florida Blue. This could indicate further changes in the industry and potential for medical tourism. In the energy market, MPC Energy Solutions acquired a Neol CHO Plant to provide energy solutions to the pharmaceutical industry. Sunoco expanded its midstream and fuel distribution businesses in Puerto Rico, with the purchase of Peerless Oil & Chemicals in the last quarter of 2022.

The financial industry saw key players expand through strategic asset purchases, such as Popular, Inc.'s acquisition of certain assets from Evertec Group, LLC to service its clients, and the sale of others to US-based entities, such as Citi International Financial Services, LLC to Insigneo Financial Group. In the hospitality industry, Braemar Hotels & Resorts Inc. completed the acquisition of the Dorado Beach (a Ritz-Carlton Reserve) Hotel. Meanwhile, Liberty Latin America decided to freeze M&A activity to focus on its integration in 2022 in the telecommunications industry. More strategic purchasing and expansions are expected to impact the number of market players in many industries in 2023.

Foreign Investment

Puerto Rico remains an attractive destination for new businesses and foreign investment due to its strategic location, competitive workforce,

lower cost of operations, and tax incentives. The government of Puerto Rico has actively promoted Act 60-2019, also known as the Puerto Rico Incentives Code (PR-IC), to position Puerto Rico as a competitive investment jurisdiction and attract new businesses and capital investment to the island.

These incentives are specifically designed to make Puerto Rico a more appealing destination for investment, particularly in industries such as technology, finance, tourism, international banking, international insurance, private equity funds, green energy, infrastructure, and other service-oriented industries. A number of companies in the biosciences, aerospace, and technology sectors are considering relocating to Puerto Rico. For instance, in 2022, Amazon Web Services, Inc. (AWS), an Amazon.com company, opened an office in the municipality of San Juan to support the rapid adoption of cloud computing in the country and the rest of the Caribbean.

The objective of Act 60-2019 is to promote manufacturing operations in Puerto Rico, positioning it as a desirable location for international companies seeking to relocate or expand their operations. Aurobindo Pharma Limited, an Indian pharmaceutical manufacturer, invested around USD100 million in 2022 to establish its operations in Puerto Rico. Aurobindo's subsidiary, Auro PR, Inc., acquired a 240,000 square foot pharmaceutical manufacturing facility in the municipality of Caguas and employed approximately 350 people. Additionally, Auro PR, Inc. purchased a 33-acre parcel of land in Caguas to expand its manufacturing operations and increase its workforce in Puerto Rico.

The PR-IC and the government's efforts recognise the importance of direct foreign investment, placing the island on par with the most com-

petitive global jurisdictions for technology and high-added-value industries. The entry of foreign companies and capital investment into Puerto Rico, along with the benefits provided by Act 60-2019, is expected to stimulate M&A activity as it introduces new industries and potential acquisition targets. Foreign companies continue to assess the financial health and growth potential of companies in Puerto Rico and identify attractive and feasible deals. Some of these deals are expected to be finalised by the end of 2023.

Upcoming Foreign Investment

While Puerto Rico's political and cultural links are closest to the US, the government of Puerto Rico is now turning its attention towards attracting European investment and companies. Currently, several Spanish-recognised multinational companies are investing in Puerto Rico, particularly in the energy and hospitality industry. In 2022, the King of Spain, Felipe VI, visited Puerto Rico with ministers to support investment in the country. As a result of these government-led efforts, an agreement was reached between Castilla de la Mancha and Puerto Rico, which predicts an increase in investments for 2023.

The agreement covers cooperation between both parties in economic development, trade, business investment, tourism promotion, and other areas. Plans for investment and talent production are expected to encourage the relocation of subsidiaries and production lines to Puerto Rico. These initiatives create a favourable business environment that provides companies with access to a skilled workforce and tax incentives, making Puerto Rico an attractive destination for investment. This is expected to reconfigure strategic priorities, such as relocation, and ultimately influence local M&A activity.

Small Businesses

Despite the perception that foreign companies dominate the Puerto Rican market, the government of Puerto Rico continues to work towards supporting local businesses. Recently, the US Treasury Department announced that Puerto Rico will receive up to USD109 million in funding from the American Rescue Plan Act (ARPA) to support small business growth and entrepreneurship. This funding is intended to help Puerto Rican businesses recover from the economic impact of the pandemic and promote long-term economic growth in the region. Capital injections to local companies can promote the growth of the local economy, while also spreading strategic expansions and increasing the scalability of existing small market players.

Looking Ahead to 2023 and Beyond

Although access to financial markets and investment remains uncertain, there are high expectations for an increase in both deals and values in 2023. Globally, the healthcare industry is expecting an increase in deals, as many expiring patents need to be replaced. This could directly impact Puerto Rico, as it has a significant presence of major pharmaceutical and biomedical players. Additionally, many companies are seeking to fortify global supply chains in light of the pandemic and the termination of limitations for international transactions. While technological companies faced difficulties in 2022, some are expected to return to private status through private equity investment and acquisitions. The influx of foreign investment and ongoing expansions may potentially impact many local sectors during the remainder of 2023.

Research and Technology

Technology has been one of the most active sectors in recent years and Puerto Rico is a preferred destination for key ICT companies such as

Cisco, Oracle, Honeywell, and Microsoft. These companies tap into the island's top-notch talent and attractive software export tax incentives. In addition, Amazon Web Services, Inc. opened a commercial office in Puerto Rico in 2022 to increase its customer base, support existing customers, and assist Caribbean markets in transitioning to cloud computing.

Furthermore, Scale AI, the data infrastructure for Artificial Intelligence (AI), has announced a partnership with the Ponce Port Authority to transform the Port of Ponce, Puerto Rico, into a Smart Port Lab. Scale will invest USD2 million to develop Smart Port infrastructure at the Port of Ponce, which will introduce advanced technologies such as AI-enabled document processing, object recognition, route optimisation, remote operations, and computer vision to the island. This cutting-edge solution, given the strategic geographic location with Latin America and the Caribbean, will not only benefit Puerto Rico but can also be exported to other emerging ports in the region and worldwide.

The PR-IC continues to be a powerful tool to develop Puerto Rico as the pre-eminent international export service, technology, and commerce hub by reducing income taxes and providing exemptions from real and personal property taxes, municipal licence and construction excise taxes and income tax exemption on distributions of earnings and profits generated by the exempt business. These sectors continue to be in high demand as businesses adapt to the new market realities while also seeking to enjoy the tax benefits provided by local incentives.

As these industries continue to strengthen in Puerto Rico, investment interest in technology will continue to grow, allowing for an increase

in M&A transactions that will directly impact the local market in Puerto Rico.

Anticipated Uncertainties

The implementation of the US Corporate Transparency Act of 2019 (CTA) and its new ownership reporting regulations' effects on M&A transactions are still to be determined, but they are expected to have a significant role in the 2023 corporate structuring. The CTA was passed by Congress as part of the Anti-Money Laundering Act of 2020, and its purpose is to provide information to the US Department of the Treasury's Financial Crimes Enforcement Network, commonly known as FinCEN. The CTA is set to take effect on 1 January 2024, and will immediately impose sweeping new disclosure duties when new entities are formed. These new reporting requirements could lead to additional due diligence, causing delays in the timing of the M&A transactions and compliance costs for the parties involved in the transaction.

Additionally, the transition of the local economy from austerity measures remains a point of contention for Puerto Rican businesses and investors. The unprecedented increase in the cost of living and government-controlled utilities create

unfavourable conditions for businesses and a lack of confidence in government measures. Furthermore, as of the writing of this article on 3 March 2023, Judge Laura Taylor Swain entered an Opinion and Order where the 2022 Labour Reform (Act 41-2022 amending the 2017 Labour Reform) was declared null and void ab initio, with no transitional dispositions. While current legislators file for new labour reform legislation, there is uncertainty about whether the government will appeal this Opinion and Order and the effect this may have. The ambiguity as to the applicable employment legislation and regulations for Puerto Rico employees creates a unique scenario of legal uncertainty, hindering future and/or ongoing transactions.

Conclusion

As M&A transactions globally begin to increase, local government efforts, tax incentives, adaptive industries, and global expansions create an ideal scenario to forecast an increase in Puerto Rico transactions for the second half of 2023. Although there is current apprehension from market players regarding government regulation and political challenges, it is not expected to hinder deal makers in the region from finalising transactions.

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