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Investec Europe
Research Weekly
9 April 2020

Economics | Treasury | Corporate Finance | Private Client Lending

Our Research Weekly note in this shortened week rounds up economic events, both at home and abroad. We also get the latest thoughts from our Treasury desk on FX and commodity markets and our Corporate Finance team summarises the findings from its Q1 M&A tracker. The note contains:

Economic Roundup: Ireland

Further evidence of the impact of COVID-19 on the domestic economy emerged during the week, although the NTMA's successful debt issuance highlighted the strong position of the public finances as the government tackles the economic consequences of the outbreak.

NTMA's €6bn bond sale receives record demand – Wednesday 8th April

The NTMA yesterday raised €6bn through the syndicated sale of a new benchmark 7-year bond. The funds were raised at a yield of 24.2bps.

The issue was met with exceptional demand on foot of the recent launch of the ECB's €750bn PEPP programme as well as the continued improvement in the country's public finances, notwithstanding present challenges. The order book totalled over €33bn, well in excess of the previous high for a syndicated debt sale.

Public debt levels will undoubtedly climb as governments look to contain the long-term damage from the coronavirus outbreak. However Ireland has made significant progress in reducing its debt load in recent years and now boasts a debt to GDP ratio well below the Eurozone average (even though this metric is flattered by a MNC-inflated GDP level). The country entered this crisis with plenty of borrowing headroom.

Unemployment now approximately 25% – Tuesday 7th April

The latest update from the Department of Employment Affairs and Social Protection showed that it had issued payments to 507,000 people in respect of the COVID-19 Pandemic Unemployment Payment as of last Friday, 3 April. This suggests that the unemployment rate has reached approximately 25%.

According to this update, the numbers receiving the new Pandemic Unemployment Payments increased by 224,000 from the previous week and presumably captures the majority of workers laid off following the tightening of government workplace restrictions over the weekend of 28/29 March. Although mindful that we are mixing datasets, adding this 507k to the latest (pre-outbreak) unemployment figure of 120k indicates that unemployment had reached approximately 627k at the end of last week. The most up to date figure for the total labour force is from Q4 last year and is 2.47mn. As such, the unemployment rate looks to now be in the region of 25%.

The CSO will publish the official unemployment rate for March on Thursday having delayed the release to allow it time to assess the new government support schemes. Such is the pace at which events are moving that it is not clear whether this release will capture the extent of the latest increase in Pandemic Unemployment Payments. Nevertheless, the hope is that unemployment does not have much further to rise from here and can quickly diminish once the economy begins to reopen.

Construction PMI collapse completes the trilogy – Monday 5th April
The Ulster Bank Construction PMI collapsed to 28.9 in March from 50.6 in February.

The decline was the fastest on record and the index hit its lowest level since the height of the previous economic crash eleven years ago. All three sub-sectors were hit to similar extents; commercial activity declined to 28.2, housebuilding dropped to 32.4 and civil engineering sunk to 25.2. Any reading below 50 indicates a contraction in activity levels. New orders, employment and expectation indices all fell significantly.

All three PMIs recorded unprecedented declines in March. The Services PMI plummeted to 32.5, while the Manufacturing PMI "only" dropped to 45.1. However the surveys reflect responses submitted in the middle of the month, and we would expect April's reports to reflect a further deterioration in conditions since then. This is particularly the case for the construction sector, with the majority of building sites only closing in the final days of the month.

Economic Roundup: International

Economic data was relatively thin on the ground this week and most of what was released just served to shape assessments of the economic backdrop that persisted over Q1.

Activity figures for the UK were published first thing this morning which showed that GDP contracted by 0.1% on the month in February, which was a disappointment versus expectations. Although today's figures represent the period before the coronavirus outbreak really took hold in the UK, and March's numbers will be much more significant, the data does show the UK heading into the virus period on a subdued path of growth. In addition, the RICS Housing Survey was released overnight which showed the UK housing market effectively going into hibernation amidst the coronavirus lockdown and this is expected to put downward pressure on prices in the months ahead.

In the Eurozone ECB President Christine Lagarde has pleaded for governments to come to terms with one another and manage the economic crisis. The Eurogroup meeting on Tuesday failed to result in an agreement and, as it stands, the meeting of Eurozone finance ministers is set to continue today. The European Commission has recommended that the closure of external borders surrounding the Schengen Area (plus the UK and Ireland) should be extended by a month to 15 May, despite the touted unwinding of measures on the continent.

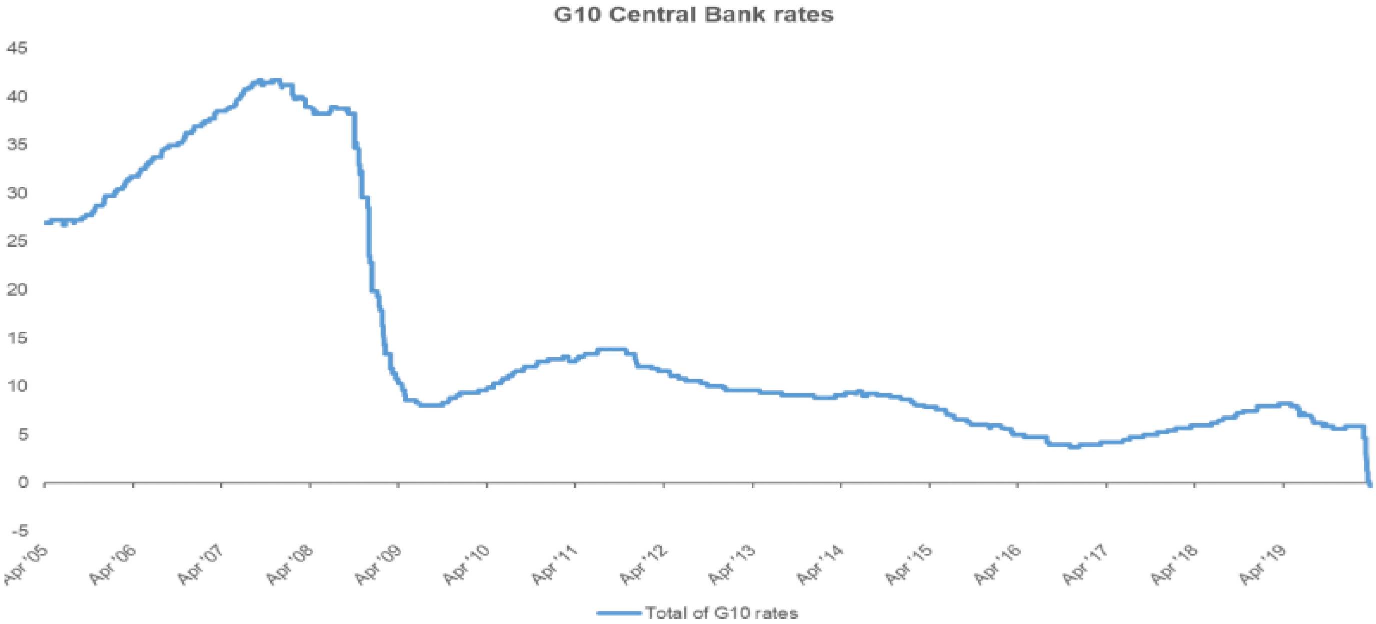
The Austrian Chancellor spoke this week of reopening some small shops on 14 April, but hotels and restaurants not before mid-May and in a step-by-step approach, while Belgium and Denmark are looking at a situation where school classes and the school week is cut in two when they resume. A report from the IFO Institute, Germany's premier economic research institution, over the weekend outlined a strategy that would see a gradual and controlled opening of parts of the German economy with priority given to "restrictions that incur high economic costs or lead to severe social and health burdens". It sees regions with low infection rates and low-risk sectors as being the first to resume activities.

Investec Treasury

Stimulus + Hope = Stability

From the first emergency rate cut by the US Federal Reserve just under five weeks ago (3 March), the extremely swift and seismic response from global central banks to the pandemic has without doubt helped to stabilise most if not all asset classes. The US Fed and the UK's BoE have both cut their rates twice and now consider their rates to be at the lower bound at zero (Fed) and 0.1% (BoE) respectively. The ECB hasn't cut rates but has suggested it could go further into negative territory if required. Interbank rates usually track central bank policy rates reasonably closely but the demand for dollars saw dollar Libor spike even while the Fed was cutting rates aggressively. This prompted the Fed to launch a range of other measures such as dollar swap lines with central banks and a Treasury repo facility to increase the supply of dollar in the market. US bond yields rose sharply in March even in some of the traditionally safest bonds such as ten year US treasuries and German bonds.

There was a number of different reasons given for this, including concerns over the added debt burden from fiscal stimulus and financial institutions and corporates liquidating safe haven assets to meet margin calls and other obligations.



Source: Bloomberg

This pressure was reduced as central banks announced a number of supportive measures including widespread quantitative easing or asset purchases. The ECB also eased the restriction (capital key) on how much of each Eurozone country's bonds it could buy under its asset purchase programme, meaning it could start purchasing Italian bonds again among others. Outside of the UK, Europe and the US, the policy response from central banks has been just as aggressive. Every G10 central bank who doesn't have a zero or negative policy rate has cut rates sharply to between zero and 0.25%, which they consider to be the effective lower bound for rates, reaching a total of 6.15% of cuts (12 cuts) from six different central banks. For the first time in history, the sum of G10 policy rates is now negative but to put the extent of the cuts into context, we saw cuts totalling 32% from the very same central banks in the aftermath of the global financial crisis.

The recorded number of coronavirus cases globally is fast approaching the 1.5 million mark. However amidst a myriad of concerning headlines some glimmers of hope have emerged. Of particular note has been the decline in daily deaths across the current 'hot spots' for the crisis. Total daily deaths in Spain are down for four days in a row whilst in Italy daily death totals over the past three days have been around 200 lower than levels a week ago. In the US, daily deaths continue to rise, with New York seeing a record 731 fatalities on 7 April but even there, NY Governor Andrew Cuomo has cautioned that rising daily fatalities are a "lagging indicator" and has highlighted slowing rates of coronavirus hospitalisations and intensive care admissions as signs that social distancing is working.

Taking the slightly more positive clinical developments in tandem with the deluge of global central bank stimulus and sovereign fiscal stimulus plans, it's no surprise that the FX and commodity markets have taken on board this news. Indeed, in the US the benchmark S&P 500 index has risen by almost 22% from the depths of just below the 2,200 level on 23 March. This week has seen the benchmark EUR/GBP (£0.8740 - £0.8970) and EUR/USD ($1.0770 - $1.1050) currency pairs trading in their tightest ranges for several weeks. Despite an expected economic rebound in H2 this year, the depth of the global recession this year looks set to impart an overall disinflationary shock to the world economy but right now this picture is most definitely far from clear.

Oil holds above $30/barrel with production cuts on the horizon

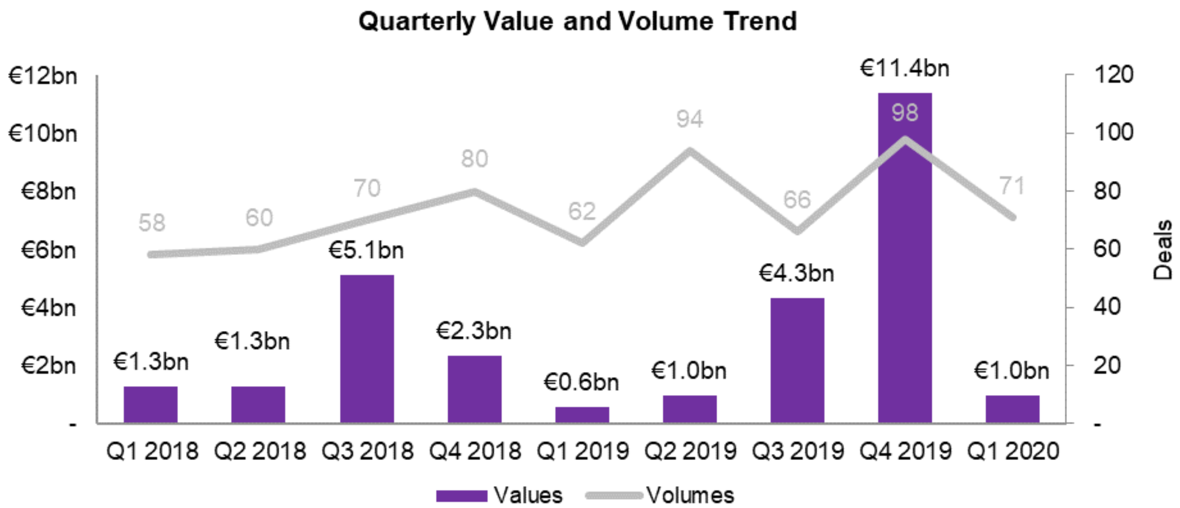
Though there is still no mention of it on OPEC's website, it is generally accepted that an OPEC+ meeting will take place today at 3pm and will be followed on Friday by a meeting of G20 energy minsters at 1pm. There has clearly been considerable dialogue going on in the background and so it is perhaps that Russia, Saudi Arabia and the US have already sketched out a deal. It would seem odd to call two emergency meetings unless there was a deal that had a chance of being ratified. As to what the deal might be, we have very little to go on. We know that the size of the cut could be 10 to 15 million barrels per day, but have little idea as to how that would be allocated. Consequently the market may be very turbulent today as it reacts to the outcome of the OPEC+ meeting in thin trading.

Investec Corporate Finance

Q1 Irish M&A Market Review – The Storm before the Calm

Since 2005 we have carried out a quarterly survey of deal activity. This records all transactions in which an Irish company was a buyer or seller or indeed both. We typically prefer deal volume as opposed to deal value as a barometer of the health of the market. There were 71 deals announced during Q1 with a disclosed deal value of €965.7mn. Whilst significantly down on Q4 2019, the figures recorded for Q1 are strong and in terms of deal volume compare favourably with the average quarterly volume of 64 deals across the period from 2015 to 2019 inclusive.

Q1's activity level can be further viewed as positive given that some transactions which were likely to have been signed or completed in the final weeks of March may not have done so given the impact of the current COVID-19 pandemic. The latter may possibly be one of the largest ever adverse impacts on economic and indeed social activity and is certainly likely to be the most abrupt given how it has so quickly halted entire areas of the economy globally – if there was ever a reason for deals not completing as planned then this is most likely to be it.



Source: Investec

Q1 2020 was unlikely to match or exceed the 98 deals recorded in Q4 2019, which is the highest quarter ever on record since this survey began in 2005. We had already anticipated that 2020 overall would not be as strong a year as 2019 due to the need for final Brexit withdrawal negotiations and a sense that 2019 may have been the high water mark of several years of activity underpinned by strong economic performance, readily and increasingly available amounts of capital and strong corporate balance sheets and valuations.

Significant Transactions

The three largest transactions during the quarter involved foreign acquirers of Irish businesses, with US based Qorvo Inc. acquiring computer chip maker Decawave for a reported €363mn, French listed Group Orpea SA acquiring TLC Group for a reported €150mn and Google acquiring another Irish business with the acquisition of Pointy for a reported €144mn. These three largest transactions were responsible for 68% of total disclosed deal value for the quarter, with the 10 largest transactions accounting for 96% of disclosed value.

Foreign Acquisitions

Irish businesses have historically been very active buyers of foreign companies given the size of their own domestic markets, and Q1 of this year was no different, with foreign acquisitions by Irish companies representing 41% of all deals. These overseas acquisitions included the aforementioned Portwest acquisition as well as acquisitions by ABP, Keelings, Version1 and environmental and utilities software provider AMCS.

In-Market Transactions

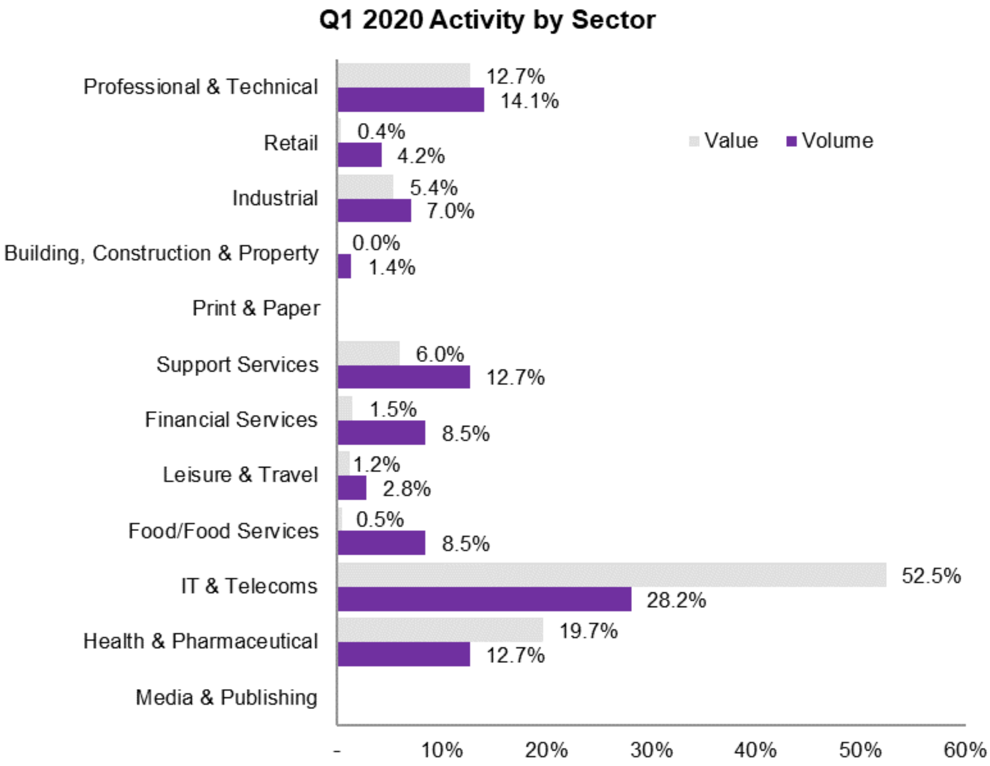
In-market transactions, where both the buyer and seller are Irish, accounted for 23% of all deals with 16 transactions recorded during the quarter. These were spread across a number of sectors including Retail, Health & Pharmaceutical and IT & Telecoms. Notable transactions involved the acquisition of interests in Blackrock Hospital and Hermitage Clinic, Version1's acquisition of Singlepoint Solutions, Eason's acquisition of Dubray Books and Irish Life continuing its acquisitive form with its purchase of Conexim Advisors.

Financial Buyers & Investors

Deals involving financial buyers, typically private equity, or financial investors usually account for a smaller percentage of overall quarterly deal activity, albeit showing an increasing trend in recent years. However, during Q1 there were a number of meaningful transactions and indeed some new funds concluding what we understand to be their first ever Irish transactions. These include FTV Capital which acquired interests in Irish companies Sysnet Global Solutions and Centaur Fund Services, Bregal Investments, which acquired IT services and solutions business Arkphire and Tikehau Capital's investment in Cool Planet Group. Furthermore, infrastructure fund ICON acquired Nua Healthcare during the quarter.

Active Sectors

The IT & Telecoms sector again drove activity levels in the market, with 20 deals during the quarter, representing 28.2% of total volume. The acquisitions of Decawave and Pointy were the only transactions that disclosed a deal value in the sector, which equated to a combined deal value of €507mn. Other active sectors in the quarter were Health & Pharmaceuticals (9 transactions) and Support Services (9 transactions).



Source: Investec

Current Outlook for 2020

Q1 2020 was a relatively strong quarter for M&A activity despite a drop off towards the middle to end of March. There will undoubtedly be a notable decline in activity in Q2 and into Q3 also as both the Irish and global economies struggle to deal with the consequences of the COVID-19 pandemic.

Crucial to underpinning any level of corporate deal activity, is confidence and capital and in respect of the former, the levels of uncertainty are so great at present (witness the movement in the VIX or Volatility Index) that in the very near term, confidence in strategic and investment decision making will be in much shorter supply than is normally the case. Once there is visibility on the timing of the transition period out of the current economic difficulties and recovery commences, so too will confidence in the typical decision making processes that are necessary to affect corporate activity. When this happens one often sees a spurt in activity as was the case in H1 of 2017 for example. Back then 138 transactions took place in contrast to H2 of 2016, when activity was muted following the result of the Brexit Referendum with 89 transactions taking place in what was the lowest half year total since 2009.

For now though, companies will seek to focus on ensuring the wellbeing of their various stakeholders and the challenges facing their businesses in the immediate near term. For many, this will include ensuring adequate liquidity, capital and a right-sized business for the duration of the crisis. During this immediate near term, corporate deal activity will continue but at reduced levels and in an environment of adjusted valuations, we may see opportunistic buying by cash-rich corporates and financial buyers in the weeks and months following the peak of the crisis.

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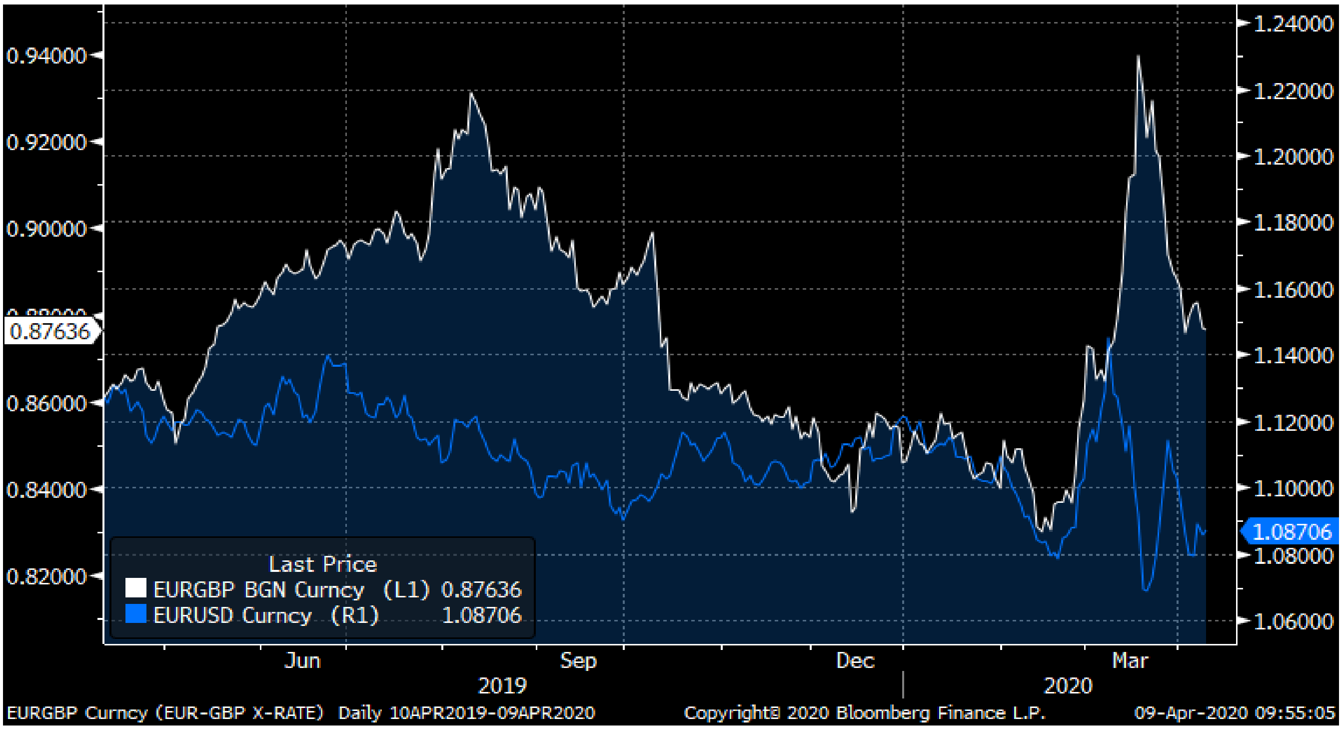
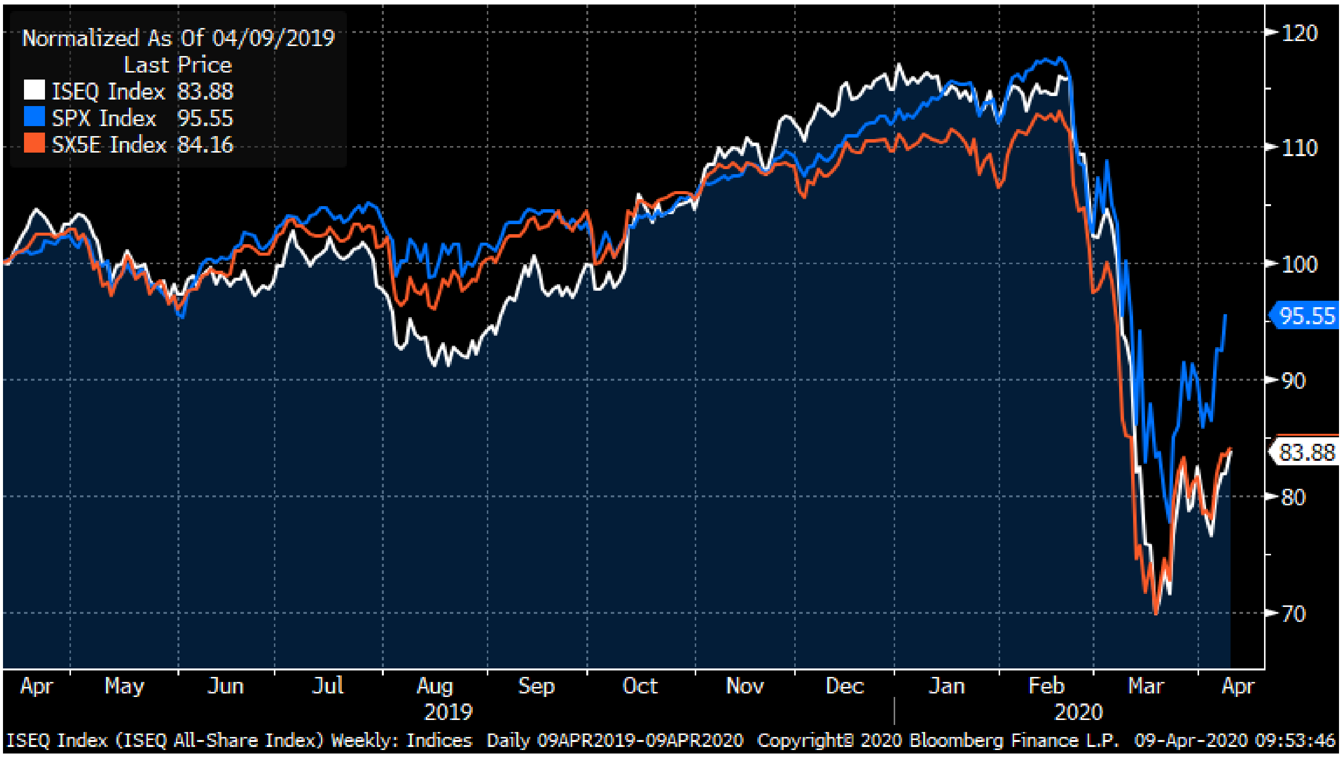
Currency Pairs: EUR/GBP (white, LHS); EUR/USD (blue, RHS)



Source: Bloomberg

Stock Market Indices (indexed to 100): ISEQ (white); S&P 500 (blue); Eurostoxx 50 (orange)



Source: Bloomberg

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