POLAND M&A REVIEW

Since joining the EU the Polish economy has been developing at more than twice the pace of the Euro zone, driven to a significant extent by export growth, industrial production and increasing levels of foreign direct investment (FDI). Corporate UK caught up with some of the country's eminent advisers to discuss some of the keydevelopments taking place in Poland, now and in the future.

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Trade liberalisation, economic restructuring, privatisation, capital inflows, and the gradual adaptation of legal and administrative standards to market-oriented practices have improved economic structures dramatically and as a result, the Polish economy has been growing rapidly.

It is only recently, and because of the global credit crisis that Poland's economy has begun to show signs of waning. However, Tomasz Ujejski from Squire Sanders & Dempsey said that Poland will still boast one of the strongest performing economies in Europe over the next few years. "Although the EC's growth projection for Poland for 2009 was revised downward from 5% to 3.8%, Poland will still be the EU's fourth fastest growing economy after Slovakia, Romania and Bulgaria" he said. "Both the Commission and the OECD predict Polish GDP growth to stand at 3.8% in 2008, with the OECD predicting that Poland will be Europe's second fastest growing economy in 2009."

Key developments

Poland acceded to full membership of the European Union in May 2004. Prior to that date substantial amounts of legislation was passed to harmonise Polish law with EU norms, and Poland in common with all other Member States has much of its current legislation driven by European statements, resolutions and directives of various kinds.

Patryk Laskorzynski from DLA Piper said that more recently, the Polish legal system has embarked on the obligatory 'race to the bottom' in order to remove certain legal obstacles and liberalise the investment process. "The number of permits and approvals necessary for share or asset acquisition has been reduced dramatically. Nowadays, an investor in Poland should primarily be concerned with merger clearance and Internal Affairs Ministry clearance, especially when buying companies holding agricultural land," he said. "In addition to this, Poland has recently adopted the EU directive on cross border mergers, which provides a streamlined framework for multi jurisdictional M&A deals.

"Investments in Poland occasionally take the form of a greenfield project in the special economic zones. Those type of projects require additional permits and approvals but offer tax and employment incentives which are still available to investors."

Most of these principles do not necessarily apply to non-EU nationals and there are some areas where pre-existing legislative restrictions no longer apply to EU nationals, but continue to apply to investors from outside the EU.

Mr Ujejski said that one example is the requirement for foreigners to obtain a permit to purchase Polish real estate. "This law, which has existed since 1921, applies to nationals of non-EU jurisdictions in relation to all types of real estate and to nationals of EU member states in relation to agricultural land. The permit requirement applies not only to the purchase of land directly but also to the acquisition of shares in a company which owns land," he said. "The procedure for obtaining such a permit can be time consuming and delay an investment by several months."

Another key development that has transformed deal making in Poland is the growing awareness of non-physical, intangible assets, which has increased mainly due to the changes in the financial reporting systems as well as increasing volume of transferred assets, mainly tax purposes driven.

Henryk Ciesielski from American Appraisal said the explosion of M&A activity in recent years has brought many significant changes in accounting for business combinations. "The most important outcome of these changes was the recognition and amortisation of intangible assets. Furthermore, empirical studies show that customer lists, customer contracts and other contract based intangibles which provide rights to vital profit-making activities also represent substantial value drivers within the majority of transactions in all sectors.

"Aside from the financial reporting issues, the usage possibility of the tax deductible amortisation charges resulting from the identification of intangible assets and the differences of the tax burden in various jurisdictions led to an increasing significance of the transfer pricing issue, especially for intangible assets. As a result, we are seeing more and more institutions building their financing around intangible assets."

Investing in infrastructure

In recent years Poland has been faced with the lengthy task of modernising its infrastructure, which in places, is many years behind that of its EU counterparts. The country's accession to the EU opened up enormous opportunities for the modernisation of existing infrastructure projects and the construction of new ones.

Mr Laskorzynski outlined Poland's ambitious developments plans. "The country's main objective in terms of infrastructure is to provide nearly 2000 kilometres of new motorways and improvements to the current rail network over the next couple of years," he said. "Poland is also facing a unique opportunity to utilise approximately €50 billion of EU infrastructure and development funds over the coming years. Along with Ukraine, Poland is to co-host Euro 2012, the Europe wide football tournament, which speeds up the process of infrastructure investments."

Towards the end of this summer a new PPP bill was devised by deputy minister of the economy Adam Szejnfeld, with input from several other government ministries. Another important bill is the new Concession law drafted by the ministry of infrastructure, which should be in place by the beginning of 2009. The new law is expected to reduce the formalities of Poland's procurement process and set out clear concession frameworks for the building of roads, stadiums and other infrastructure.

Tadeusz Komosa from Furtek & Partners explained how this will open the market for new opportunities, both locally and abroad. "The new PPP law was approved by the Sejm (the Lower Chamber of Polish Parliament) and is likely to be endorsed by the Senate by the end of this year. Prior to this there was a PPP law in place but it was considered too rigid and not very investor friendly," he said. "When the time came to revise the existing law with something stronger for the private sector, it was agreed that the new PPP legislation should aim to open the market for new opportunities, which would enable international investors to take advantage."

"The new PPP law is a prime example of Poland's determination to create new legislation with a clear intention to remove any barriers the old one contained. This will result in an increase in international participation through PPP investment channels," Mr Komosa noted

An example of both the privatisation and infrastructure developments going on in Po-

land can be seen in the first airport privatisation in Poland, which took place in February this year when Meinl Airports International completed the privatisation of Sochaczew airport. Jacek Michalski from Allen Overy, the firm that advised Meinl Airports International throughout the transaction said. "The privatisation was made through the acquisition of a majority stake in Mi□dzynarodowy Port Lotniczy Sochaczew sp. z o.o. (MPLS), the company which will manage the airport. The investment will allow MPLS to modernise the airport, which is expected to start its civil operations by 2011. The total amount of investments made by MPLS is estimated at €210 million."

FDI in Poland

According to Ernst & Young's European Attractiveness Survey 2007, Poland is currently placed seventh in the world ranking in terms of attractiveness for foreign investors, and second in Europe. Furthermore, Poland is the world's second most popular country in respect of investment in industrial production, behind China.

According to the National Bank of Poland (NBP), the inflow of foreign direct investments in 2006 amounted to €15.1 billion and €12.8 billion in 2007. Christian Schnell from BSJP said that some 85.3% of all FDI in 2007 came from companies based in EU member states. "France had a 17.7% share, Germany had 17.2%, and Austria, Italy and Sweden all had from 7% to 8% of shares," he said. "The largest investors from outside the EU were from the US, which accounted for around 10% of all FDI, followed by South Korea and Japan," he said.

"The majority of industrial businesses, about one third of FDI, were in processing, and within this category the primary group were metal processing companies, while other large groups included the clothing industry, furniture, and wood processing sectors," he continued. "In recent years, the services sector has gained importance, mainly financial services with about 50% of all FDI in services. Trade investments mark about 14% and property investments about 7% of the total FDI."

He added that amongst other things, the determining factors for Poland's success in attracting FDI are the country's geographical location and low labour costs. "Poland's size as a consumer market and its central role within Central & Eastern Europe gives the country strategic significance. As the unemployment ratio will rise again in 2009 to a level of 11%, the pressure on wages in the last two years will reduce significantly, which makes investments in Poland yet more attractive," he continued. "Although inward investments may reduce by around 30% next year, this result is still excellent compared with other CEE countries. The involvement of private investors in the development of the infrastructure will be supported by the high allocation level of funds from the EU, which will have another positive impact on FDI."

Outbound FDI

Compared to the quantity of foreign capital invested in Poland, Poland's foreign investments are small, but steadily growing and since 1997 the value of Polish investment abroad has risen rapidly.

According to data from the National Bank of Poland, through the end of 2005 Polish firms invested $6.6 billion abroad. Mr Ujejski summarised the extent of Poland's outbound investments. "Poland's largest foreign investments are in Lithuania, the Netherlands, Germany, France, China, Malaysia, and Ukraine," he said. "Over 30% of these foreign investments are connected with the financial sector; other investments are in manufacturing, real-estate services, and trade and repairs. The value of Poland's foreign investment corresponds to 7% of FDI in Poland."

In 2007 the value of net outflow of capital from Poland for direct foreign investments amounted to €3.4 billion. This was comprised of purchase of shares of foreign companies, purchases of real estate property and capital contributions.

Mr Ujejski added. "It is estimated that in 2007 the greatest amount of direct outflow was to Switzerland (€685 million), Luxembourg (€398 million), Lithuania (€351 million), Holland (€281 million), Ukraine (€279 million), Russia (€234 million) and Germany (€217 million). The largest direct investments were in the service sector (69 %), IT, science, machine-leasing, construction and industrial processing."

While there clearly has been a growing trend for Polish companies to expand outside their own jurisdiction, the effects of the global credit crisis seem to be dampening the ability to do this effectively. Mr Michalski said. "There is certainly a growing appetite for outbound foreign investment in Poland," he said. "However, since the credit crisis took hold most transactions of this kind have not necessarily been shelved entirely but certainly put on hold for at least the next few months. I believe that if it wasn't for the credit crunch there would be much more Polish companies embarking on cross border acquisitions."

Biting back

As the credit crunch bites in economies all over the world Poland's economy is proving far more resilient from the crisis, bolstered by export growth, industrial investment and massive infrastructure projects in the transport and utilities sectors.

Mateusz Toczyski from Salans said the M&A and structured finance market in the last few months has been marked by unusual phenomena best described as 'fits and starts', he said. "On the one side numerous transactions have been abandoned or put on hold, on the other, some players are actually speeding up their investments so they can make hay while the sun still shines."

The resilience of the Polish economy can in part be attributed to the high levels of liquidity held by Polish banks, which meant they did not invest intensely in risky capital markets instruments in order to acquire funds for credit actions. Mr Toczyski said. "The behaviour of banking groups in Poland is largely influenced by the position and decisions of their foreign holding banks elsewhere in the EU or US. Although lending policies of all banks will be more restrictive and come under close regulatory scrutiny for reasons of caution, there appear to be few problems of a domestic nature."

The credit crunch has had its greatest impact thus far on the capital markets in Poland, which until now had been developing strongly. This included the dynamic expansion of the Warsaw Stock Exchange, especially in terms of IPOs, which have totalled more than 200 in the last three years, but also new segments such as New Connect, the platform for dynamic start-up companies. Mr Ciesielski said. "Much of the credit crunch's impact has been felt in the subsequent negative development of the capital markets, which directly affected the Warsaw Stock Exchange in Poland," he said. "Not only have the indexes fallen rapidly but many IPOs have been cancelled or postponed. However, due to the dynamic of the market, it is difficult to assess directly the extent of the financial crises."

Mr Komosa noted that a recent successful €550 million IPO of the energy company ENEA indicates that the WSE continues to be a viable channel for major privatisation transactions and that both private and institutional investors have confidence in big Polish companies operating in the infrastructure sector, where there is a huge demand for new investments.

Financial institutions and the commercial and residential real estate markets have also been affected. Mr Toczyski added that the real estate market is closely related to the financial sector and credit policies of the banks. "The real estate bubble will almost certainly burst but the effects should be less extreme than in many parts of the world, as the bubble did not have sufficient time to reach the levels seen elsewhere. This may sink some players but the infrastructure gap is still huge and most will survive in better or worse shape," he said.

The rest of the economy shows some signs of a slowdown but not a real crisis or even a recession. Mr Toczyski summed up his view of the future for Poland. "All reliable indicators show that the Polish economy will remain one of very few economies with economic growth, coming in at around 2-3% pa. This is due in part to the huge levels of EU funding for road, rail, sewerage and water projects that are ongoing and planned to continue over the next few years."