



A Work Project, presented as part of the requirements for the Award of a Masters Degree in Finance from the NOVA – School of Business and Economics.

Academic year: Fall Semester 2015-2016

Work Project-Directed Research

Case-Study:

**CTT, the mail going public**

André Campos Trocado Pinto Bessa; 896

A Project carried out under the supervision of:

Prof. Paulo Pinho<sup>1</sup>

08/01/2016

---

<sup>1</sup> I would like to express my sincere gratefulness to Prof. Paulo Pinho for his supervision.

## Abstract

The main purpose of this case-study is to analyse CTT's privatisation process, a previously Government-owned firm, which went public in 2013, under the terms of the adjustment program agreed between Portugal, the European institutions (ECB and European Commission) and the IMF. The emphasis will be placed on the IPO process, but also on the company itself (its history, current situation and prospects for its new phase, as a publicly listed company). This piece of work aims to evaluate the different alternatives for the privatisation of the company along with the respective implications, as well as the outcome of the actual decision taken by the Portuguese Government.

One key aspect of the case is also to understand the importance that the privatisation of the Royal Mail, which can be seen as a peer of the Portuguese company, in the unfolding of the process and in the choice of the privatisation model. The case intends to show how the British process influenced the subsequent option of the Portuguese entities to sell CTT through an IPO, instead of a trade sale.

All in all, the overall objective of this case-study is to analyse CTT's successful sale process, which created the first Portuguese company with 100% free-float.

On the last days of November 2013, Steven Bernstein was staring at the window of his office overlooking downtown Manhattan, not even noticing the intense rain that was pouring down. As senior manager at ABC Fund, a pension fund responsible for managing more than 800 million dollars, his thoughts were focused on a very important decision that ABC Fund would have to make in just a matter of days. The American pension fund was considering whether or not to invest in the upcoming Initial Public Offering of CTT- Correios de Portugal, the Government-owned Portuguese mail company. Is this investment opportunity in accordance with the risk profile of a pension fund? Is it a wise decision to acquire shares in a Portuguese company when the country is at the centre of the European Sovereign debt crisis, going through a very demanding economic adjustment program imposed by its bail-out creditors? Would the creation of Portugal's Postal Bank make CTT a sure bet today when its price does not fully reflect the future benefits from entering financial services? Those were some of the questions that were constantly in Mr. Bernstein's mind over the last couple of days and he was struggling to find the answers...

### **The company's history**

The foundation of CTT-Correios de Portugal traces back to the XVI century, when King D. Manuel I created what was then known as "Correio-Mor". At that time, Portugal was starting to build its empire and gaining reputation as a global power, after having discovered Brazil, in 1500, and the maritime route to India, two years before, in 1498. Throughout the XV century, the Portuguese Crown launched several expeditions with the purpose of exploring the unknown regions of the globe and spreading the Christian faith. By the early 1500's, Portugal had occupied several territories in Africa and had become a relevant global imperial power.

The history of CTT- Correios de Portugal is closely related to the history of the country itself. Due to its long existence, the company faced over the centuries challenges that arose from the ups and

downs of the Portuguese nation. After almost a century under the control of the Crown, the business was first given to the exploration of the private sector in 1606, at a time of a union of crowns between Spain and Portugal and the Spanish monarch ruled over the whole Iberian Peninsula, which were nevertheless still administered as separate countries<sup>2</sup>. The mail company was bought by Luís Gomes da Mata, a member of the Portuguese Nobility. It remained under private control until 1797, when Queen D. Maria I decided that the activity should return to the control of the Crown. Over the course of the XIX century, the mail delivery service improved significantly, becoming much more efficient and similar to what it is in our days.

In the XX century, the company finally adopted its current designation (CTT). In 1911, only one year after the abolition of the Monarchy and the creation of a Republican State, CTT- Correios, Telégrafos e Telefones was created as an autonomous entity, with the purpose of “fulfilling the Republican ideal of providing its services to all national citizens”<sup>3</sup>. In this period, the company incorporated the mail delivery and telecommunications (telephones and telegraph). CTT held under his control the monopoly of communications in all regions of the country, except for Lisbon and Oporto broader regions, where the operator was TLP<sup>4</sup> heir to an older concession granted to the British company Anglo Portuguese Telephones. In 1992, the fixed-line voice telecommunications activity was separated from CTT and merged with TLP to form a new company eventually designated Telecom Portugal, SA<sup>5</sup>. From then on, CTT was responsible only for the mail distribution and other related activities. Still, it kept the original designation.

---

<sup>2</sup> During this period, the Spanish monarch was also King of Portugal. It lasted from 1580 to 1640, when Portugal restored its independence

<sup>3</sup> “Vencer a distância; Cinco séculos dos Correios em Portugal”, Fundação Portuguesa das Comunicações

<sup>4</sup> TLP-Empresa Pública de Telefones de Lisboa e Porto, was a State-owned company that, at the time, managed the telephone network in the two biggest cities in Portugal

<sup>5</sup> Telecom Portugal, SA, was the telecommunications company that aggregated the business of the two existing ones and managed the entire telecommunications business nationwide. It was later redennominated Portugal Telecom (PT).

### **CTT Group: Activities and composition**

By 2013, the CTT Group incorporates several subsidiaries and associates, under the control of CTT, SA (the holding company, at the top of the pyramid). The group has four main business units (Mail, Express/Parcels, Financial Services and Business Solutions) and several subsidiaries that are focused on the different services provided by CTT (**Exhibit 1**).

The core segment is Mail and it includes all the services associated with physical correspondence. This business unit aggregates the various types of mail service offered to both individual and corporate clients. Apart from this, it also transports and delivers parcels (CTT Expresso), a segment that represented 10% of the EBITDA in 2012.

In addition to this, it offers a wide range of services specifically designed for corporations, such as IT management, storage of documentation or even the provision of geographic information in order to help companies in the decision-making process. Finally, there is also the Financial Services area, whereby the company offers its clients the possibility to make payments, transfer money (either nationally or internationally), invest in mutual funds and even to subscribe insurance products or short-term Government debt, with CTT working as an intermediary.

In terms of international presence, the group has operations in Spain and Mozambique through the ownership of companies. Group CTT owns 100% of Tourline Express Mensajería, SU which operates in the Spanish express/parcels market, as well as a majority stake (51%) in the capital of CORRE-Correio Expresso de Moçambique, SA, also specialized in transportation and delivery of parcels.

### **Competition**

After decades of total market power, CTT was finally starting to feel what it is like to operate in an open market. Still, it kept a very comfortable position as the market leader.

Due to the progressive liberalization of the postal market<sup>6</sup>, concluded in January 2012, CTT had been progressively experiencing higher competition and the entrance of new operators, therefore threatening its consolidated position in the sector. In a recessionary environment such as the one existing in Portugal since 2009, the new firms entering the market could implement an aggressive pricing strategy and try to acquire market share by offer a significantly lower price. This type of approach could be successful, especially among business clients, who have large amounts of correspondence to send. Those firms would certainly look for ways of reducing costs in a period of economic crisis and cutting in these outsourced services is usually the most common option. Despite these potential threats, the fact was that CTT had a quite strong reputation, being an iconic national company, in which people trusted, and it still kept a very high total market share (**Exhibit 2**).

As for the express/parcels segment, competition was significant and CTT's market share was only 27.3%<sup>7</sup>, at the end of 2012, representing a decrease of 4.7 percentage points from the previous year. Chronopost, which controlled 22.1% of the market, and Grupo Rangel, with a market share of 12.5%, also presented themselves as major players in this market. The expertise of the rival companies, along with their high degree of market penetration constituted a challenge for CTT.

### **Overview of the Postal Sector**

Since the beginning of the century, with all the technological improvements, there was a widespread idea that the profitability of the mail business would be severely harmed over the following decades, as the traditional business model would gradually become less attractive to

---

<sup>6</sup> Only in January 2012 did the market become fully liberalized. Several services within the postal sector were already open to competition, but a real free market was only established in 2012. *Liberalização do sector postal: principais questões concorrenciais*, Autoridade da Concorrência, Julho de 2010

<sup>7</sup> Source: Anacom

consumers, which were already offered a wide range of alternatives as far as communication is concerned. The main tendency observed, which was expected to continue in the future, was for people to move away from this old-fashioned way of communication. The volume of postal mail circulating was expected to drop significantly, eventually threatening irreversibly the sustainability of the companies operating in this sector.

The volume of letters in circulation dropped substantially over the first decade of the new century, as the electronic communication gradually replaced the letters. Both individuals and businesses communicate through digital channels and the exchange of letters is limited to very specific situations. What was the primary means of communication a couple of decades ago was becoming irrelevant. In Portugal, from 2008 until 2013, the volume of correspondence in circulation, quarterly, decreased by approximately 100 million objects (**Exhibit 3**), which represents a reduction of more than 30% in less than 5 years. However, it is interesting to note that the same technological development that led to the fall in the volume of letters in circulation, also had a positive effect in another segment of the companies operating in this sector. The outstanding growth in e-commerce led to an increase in demand for distribution and delivery of products bought online.

By late XX century, the European authorities had started the process of liberalization of the postal sector. In most economies, until 2000, it operated under a monopolistic regime, where a single company offered the service. However, that was not considered to be the most efficient in terms of market equilibrium and, as also happened in the Energy sector, the EU countries started to prepare the progressive transition to a free market.

## **Portuguese Regulatory Environment**

CTT was granted the concession for the Universal Postal Service until 2020, which implies that it is responsible for providing specific postal services, with good quality standards, in all regions of the country at accessible prices. Those prices are fixed by ANACOM (the regulator for the Communications sector), based mainly on the costs incurred by the service provider.

The concession expires in 5 years and, given that the market was fully competitive in 2012, it is possible that other competitors submit their bids to be the universal service provider, which could drastically affect the company's position in the market.

### **The Postal Bank: a third and (final?) attempt**

CTT had a longstanding history as far as banking activity is concerned. Ever since the beginning of the XX century, the company had offered relevant financial services to its clients. It started with the emission of postal cards, known as "*vales postais*"<sup>8</sup> that were used as a means of easily making payments and transferring money.

Moreover, distributing mutual funds or insurance products had been some of the services offered at the post offices over the years, reinforcing its role as financial intermediary and for which it was paid a commission. Its widespread capillary branch network made CTT a popular distribution channel for rural savers and also for the risk-averse and less sophisticated financial investors in major cities. Most people associate CTT as the main retailer of *Certificados de Aforro*, a popular savings product issued by the Government. Still, CTT aimed at creating an actual bank and, by the time of the privatisation, that process was on track (for the third time)...

---

<sup>8</sup> This product is still available today at CTT's post offices.

In the early 2000's, CTT was granted a banking permit by the Bank of Portugal, the regulator of the financial sector, and created the Postal Bank, in partnership with Caixa Geral de Depósitos<sup>9</sup>. The bank controlled 51%, while CTT had the remaining 49%. The Postal Bank, however, did not succeed and ended up closing in January 2003. The bank operated only with 4 branches in the entire country (Lisbon, Faro, Oporto and Coimbra), which probably contributed to its failure, as the clients did not have access to a branch easily and the essential tasks, like opening an account, took too much time, since the process could not be completed at the closest CTT branch and the documentation had to be sent to one of those four branches. The main obstacle seemed to rely on Bank of Portugal's denial of the use of CTT's branches for normal banking activities.

After this first unsuccessful attempt, the top management at CTT did not give up on its efforts to create a bank and, in 2005, opened a period for financial institutions interested in partnering with CTT in the Postal Bank to submit their offers. This contest was won by BANIF, a Portuguese bank with a strong presence in the islands of Madeira and Azores but a low market share in the mainland. Nevertheless, the Postal Bank did not even start operating. When the previous partnership between CTT and CGD was broken, the two entities agreed that CGD would have a preference right in case CTT intended to create a Postal Bank, for the following five years. In fact, the Government-owned bank exercised that right, thereby destroying the eventual partnership between CTT and BANIF. Finally, during the year of 2013, as the company was preparing for the privatisation, its management (**Exhibit 4**) asked once again Banco de Portugal for a banking permit, in order to make a third (final?) attempt for the creation of the postal financial institution. This authorization by the regulator of the financial sector was actually granted, in November 2013, giving the company the option to create the Postal Bank (**Exhibit 5**).

---

<sup>9</sup> CGD is a Portuguese Government-owned bank. It is the market leader in banking and the only bank with branches in all Portuguese municipalities.

### **CTT's recent performance**

In 2012, CTT generated an EBITDA of 92.4M€, representing an 11% decrease from the previous year. However, this operational performance has to be considered in the respective macroeconomic context. Portugal was under a bail-out program and going through an economic recession (GDP fell by 3.2% in 2012). Even though the EBITDA fell on a year-on-year basis, the EBITDA margin was 13%, which compares with 13.6%, in 2011. Hence, the operational profitability of the company was not drastically affected.

In more detail, the revenues come mostly from services, in accordance with the nature of the company. Most of its operations are related to services provided rather than the sale of actual products and that is reflected in the company's financial statements. The nature of the company is to be a service-provider, even though it also sells some actual products. Revenues had been diminishing, as a consequence of the consistent reduction in physical mail, a global trend and not a country-specific factor, combined with the economic recession that Portugal was experiencing. Between 2010 and 2012, revenues had decreased by more than 80M€, which represents a reduction of 10.4%, in percentage terms.

In terms of costs, the corporation had been implementing a cost-cutting program<sup>10</sup>, outlined in November 2010 and restructured in the following year, in order to improve its operational efficiency. It was in line with the Government's strategic orientation for the State-owned corporations. The context of falling revenues forced the company to readjust its cost structure to avoid operational losses. From 2010 to 2012, operational costs dropped by 11.96%, which represents a significant adjustment in the cost structure over a short period of time, considering the size of the company.

---

<sup>10</sup> PRC: *Programa de Redução de Custos*

The mail segment was the one that most contributed to the EBITDA (**Exhibit 6**), as the majority of the earnings come from this business area. It is the division that consumes most resources, as most of the costs come from this activity. Additionally, it is worth noting the extraordinarily high margin on the Financial Services business unit (41.1%). Being an activity that is remunerated based on commissions on the sales, it generates a consistent profit, even though it is not quite significant in terms of volume.

### **Portugal: a country on the verge of bankruptcy**

The first few months of 2011 were a turbulent period in Portugal. The Euro-Zone sovereign debt crisis that led to a continuous increase in the Portuguese Government yields, a consequence of the growing concern as to whether the Portuguese debt was sustainable, was at its peak. Due to the fact that Greece and Ireland had already been bailed out and the speculation that Portugal was the next to ask for external support, it became almost impossible for the Government to issue debt, given the outrageous interest rates charged by investors. The Portuguese Debt-to-GDP ratio was more than 100% (**Exhibit 7**) and investors were questioning the country's capacity to repay the debt.

Moreover, Portugal had had budget deficits for several years and it was under the excessive deficit procedure that sanctions the EU countries that are not able to keep their deficits below 3%. The successive Governments had not been able to implement a rigorous fiscal policy, which resulted in an increase in the level of indebtedness of the country.

Given this context, on April 2011, with the yields on 10-year Government bonds reaching values as high as 7% (**Exhibit 8**), the Portuguese Government, asked for a bail-out from the IMF, ECB and European Commission (the international creditors that became known as troika). As part of the conditions of the financial support, the three main political parties (PSD, CDS and PS) signed

a Memorandum of Understanding, where the main economic and financial goals to be achieved during the period of the program were established. The Government had, then, to implement the necessary measures in order to ensure that those targets, mainly associated with the reduction of the budget deficit as well as the public debt, were met.

One important aspect of the Portuguese Economic Adjustment Program was the privatization of several State-owned corporations. Participations in companies such as EDP<sup>11</sup>, REN<sup>12</sup>, ANA<sup>13</sup> or TAP<sup>14</sup>, among many others, where the State had a shareholding position, were supposed to be sold in order to generate revenue for the Government that would either serve the purpose of reducing the level of government debt and contributing to the fiscal consolidation.

Without surprise, CTT-Correios de Portugal, which was 100% controlled by the State, was included in the list of companies to be privatised. The external creditors demanded the sale of the company with the largest retail network nationwide (**Exhibit 9**), under the package of structural reforms that were meant to be implemented over the course of the adjustment program.

### **Preparing for the sale**

Throughout the year of 2013, the Portuguese Government had been assessing, the various possibilities for CTT's privatisation. On September 6<sup>15</sup>, it approved the sale of the shares owned by the State, representing 100% of the capital of CTT, SA and outlined the strategy to be pursued in the privatisation process. At this stage, the Government was still not certain about the privatisation model and two different approaches could have been taken in the process of selling the company: a direct sale to one or more institutional investors, who would become reference

---

<sup>11</sup> Energias de Portugal- utilities company, responsible for the production and distribution of electricity.

<sup>12</sup> Redes Energéticas Nacionais- energy company responsible for managing the grids for the transmission of electricity and gas, nationwide.

<sup>13</sup> Aeroportos de Portugal- company responsible for managing the main Portuguese airports.

<sup>14</sup> Transportes Aéreos de Portugal- portuguese airline company

<sup>15</sup> Decree-law 129/2013, 06/09/2013

shareholder(s); a public offer (IPO), combined with a direct sale to financial institutions, which then had the responsibility to place it with investors, whereby the company would be listed in the stock market.

In selling CTT the Government was not just focusing on maximizing the revenue generated by the sale. The choice of the buyer was also a key factor to take into consideration, as it was of the utmost importance to attract investors with a long-term perspective and a strategic plan for the company in order to ensure CTT's future stability.

As the process evolved, several entities publicly declared their interest in the privatisation and it attracted a wide variety of interested parties from the most diverse backgrounds. Among those who expressed their interest in the company were: Urbanos, a Portuguese logistics operator, with expertise in distribution, deliveries of parcels (the company even offered moving house services) as well as solutions for storage of documentation; a consortium formed by Montepio (a bank) and Grupo Rangel (a transportation company); Apax Partners, a private-equity fund, and Paulo Fernandes, a Portuguese investor, major shareholder at Cofina<sup>16</sup> and Altri<sup>17</sup>. These investors were interested in controlling the company and, subsequently, implementing their respective strategic plan for the development of the corporation. Therefore, they all favoured the trade sale as the primary selling mechanism.

According to the press<sup>18</sup>, Urbanos, which had a strong profile as a strategic buyer, was willing to offer as much as 600M€ for the postal company in a trade sale. The logistics operator competed with CTT in some areas and, therefore, it would probably benefit from significant synergies in this acquisition.

---

<sup>16</sup> Major media company, responsible for a portfolio of several newspapers and magazines

<sup>17</sup> Company operating in the paper industry, responsible for wood pulp production

<sup>18</sup> Jornal de Negócios, 07/10/2013

It is interesting to note not only the significant number of interested parties, which attests of the quality of the company and serves as an indicator of the likely success of the operation, but also the diversity of the interested parties.

### **The British success story**

Meanwhile, some 1,584 Km from Lisbon, in London, George Osborne, Chancellor of Exchequer<sup>19</sup>, and Vince Cable, Business Secretary, were actively engaged in exploring the various alternatives for the privatisation of the Royal Mail, the State-owned British mail company, and searching for the one that best served the interests of the Treasury. Following the liberalization of the market in 2006, that allowed the entrance of private sector companies, Royal Mail had been facing competition from private competitors and the general idea was that the company could only grow and further modernise itself if it had access to private capital. In a context of tight budgetary control, the Government was not in a position to inject capital in the business and the perception was that it could be hampering the future growth of the company, in a sector where there were structural changes taking place and there was the urge to reinvent the business model.

Nevertheless, the decision to privatise Royal Mail was not peaceful, as some people stood up in opposition to the sale of the emblematic company. Not only was the Communication Workers Union (CWU)<sup>20</sup>, which represented most of the company's employees, strongly against the process, for fearing that working conditions would deteriorate, but there was also opposition in other sectors within the society, as Royal Mail had generated an operational profit of £324m and some argued that it did not make sense to sell a profitable company that was actually generating revenue for the Treasury, through the payment of dividends.

---

<sup>19</sup> Denomination given to the member of the British Government in charge of Treasury and Finance. Similar to the Minister of Finance.

<sup>20</sup> CWU briefing: The future of Royal Mail

Lazard Brothers, the London-based investment bank, was hired as the Government's main financial advisor, whereas UBS and Goldman Sachs were appointed global coordinators, and those financial institutions along with the Government itself, after assessing the pros and cons of each privatisation path, decided for the flotation of a significant stake in the London Stock Exchange (LSE). The firm's workers would be entitled to a 10% stake, which would be allocated to the Royal Mail Share Incentive Plan, and the remaining shares would be sold to both retail investors (households) and institutional investors. The prospectus stated the intention to sell between 40.1% and 52.2% of the company, with an over-allotment clause that allowed the Government to sell an extra 7.8%, in case of an oversubscription of the offer.

The offer price, it was set at 330p (£3.30), which implied the proceeds would, approximately, range between £1.3bn and £1.7bn. This price per share, implicitly, valued Royal Mail's equity at £3.3bn.

The British Government's goal in terms of shareholder base was to attract long-term investors that could constitute a stable ownership structure. One major concern was to prevent speculative investors from taking an equity position in the company, in order to guarantee price stability and that the presence in the stock exchange did not pose an additional challenge to the management team.

The deadline for placing the orders was October 8. On the first day of trading, when the market opened only for "conditional dealing"<sup>21</sup>, the shares closed at 455p, rising 38% in just a single day. On October 15, the first day when the general public was allowed to trade their shares, Royal Mail closed at 490p, a 50% increase from the offer price.

---

<sup>21</sup> It is when only the big institutional investors are allowed to trade between themselves. Usually, it is a few days before the shares officially start to trade in the open market.

Overall, the transaction was extremely successful. Demand significantly exceeded supply, implying that several investors did not have their orders fulfilled. Besides, the outstanding market performance of the stock over the first few days raised the question of whether the Government had left too much money on the table...

### **The decision for an IPO**

In October, the Portuguese Government, dissatisfied with the offers received, decided to abandon the trade sale process and approved a resolution whereby it defined the terms of the privatisation. Parpública, SGPS, the holding that aggregated all the participations of the Government in the capital of companies, was authorised to sell up to 70% of the capital of the company, through an IPO in the Portuguese market combined with a direct sale to a syndicate of financial institutions (which had as Global Coordinators Caixa BI<sup>22</sup> and JP Morgan), which would then place the shares with national and international institutional investors, in order to build a diverse and stable shareholder base. All shares would be listed in Euronext Lisbon stock exchange. The Government's resolution also defined the creation of a Special Commission responsible for accompanying the process.

Regarding the IPO, the public offering was relative to a portion of 14% of the capital, which amounts to 21,000,000 shares. From these 21 million ordinary shares, 5,250,000 (3.5%) were specifically reserved for CTT employees, which would be able to acquire them at a discount. The remaining 15,750,000 were to be sold to the general public. As for the direct sale to the financial institutions that constituted the banking syndicate, this part represented the biggest stake (56% of the capital). The institutional investors with which the banks would then place the shares were going to be allocated 84,000,000 shares.

---

<sup>22</sup> Portuguese Investment Bank, integrated in CGD group, the largest banking institution in Portugal.

An interesting feature of this sale was the fact that the deal with the investments banks was made on a best-efforts basis, rather than a firm commitment underwriting (the most common model, as it transfers risk from the seller to the banks). The price range for the shares was from 4.10€ to 5.52€, to be determined after the bookbuilding process and the roadshow. As for the shares that remained with Parública, there was a lock-up clause of 270 days<sup>23</sup>, during which the State-owned holding company could not sell its shares.

It was time for Mr. Bernstein to make his call... Would he take this opportunity or consider it too risky and quit? If he decides to go ahead, which price limit shall he put on his order?

### **The Aftermath**

The stock finally started trading in October at 5.52€, the final price of the offer, corresponding to the maximum value of the interval defined, a proof of the appetite for this security. The demand significantly exceeded the number of shares offered (for the general public, demand was more than 9.91x supply<sup>24</sup>), which led to a *pro rata* distribution among interested investors. The number of shareholders amounted to 25,433, signalling the significant dispersion of the capital. Total proceeds from this operation amounted to 579,000,000€ and the Government still kept a 30% stake (**Exhibit 11**). Implicitly, this valued the equity of the company at, approximately, 827,000,000€. In the first weeks of trading the stock price rose steadily (**Exhibit 12**), increasing by more than 23% in just two months...

---

<sup>23</sup> IPO prospectus

<sup>24</sup> Source: Euronext

## TEACHING NOTE

- **Synopsis**

This case describes CTT's privatisation process and the choice of the sale model. CTT is a postal company that operated as a monopolist for many decades and, even after the liberalization of the market, still kept an extremely high global market share.

In 2011, the Portuguese Government was forced to sell the company, as part of the reforms agreed with the ECB, IMF and European Commission. At first, a trade sale seemed to be the best option. However, certainly influenced by the success of Royal Mail's IPO, the Government eventually decided to sell its 70% stake through the stock market, in a transaction that turned out to be a tremendous success.

- **Target audience**

The target audience of this case-study are Finance graduate students, namely in Corporate Finance courses. The case covers the alternative methods to sell a company as well as the issues to take into consideration during the process. It also describes some particularities of an IPO and the challenges of attracting shareholders with the right profile. As far as Corporate Governance is concerned, the case can be used to explore the implications of going public in the performance of the company.

- **Suggested Questions and Discussion**

### **Trade Sale or IPO?**

Regarding the various alternatives for the sale of the company, the Government had two options on the table. On the one hand, it could sell the company directly to a strategic buyer or even to a pure financial buyer. Selling the company through a block sale had one important upside, associated with the fact that, normally in a direct sale, the buyer is willing to pay a control

premium<sup>25</sup> that pushes the price higher. As the buyer will benefit from the synergies resulting from the incorporation of the acquired company, this approach usually leads to a maximization of the sale price. Particularly, in this case, Urbanos' offer should have been considered as being at the top of the valuation interval, especially considering that the company would benefit from significant synergies mainly associated with savings due to the overlapping of activities. However, the Government was not convinced by that offer.

#### Why reject such an offer and go for an Initial Public Offering, a much riskier alternative?

Normally in an IPO, there is what is known as an IPO discount<sup>26</sup>, which is simply the fact that when placing the shares in the market, the investment bankers define a price range below the intrinsic value of the company, in order to make it appealing for the institutional investors. However, this implies that the seller is "leaving money on the table". This raises the question of the Government's choice for an option that seemed to lead to lower revenue.

The fact was that there was a "momentum" effect with the privatisation of Royal Mail, which the Portuguese Government seized, probably influenced by the advice of the two investment banks (Caixa BI and JP Morgan). The British success led the Governmental entities to rethink the privatisation model and actually opt for an IPO instead of a trade sale, seizing the existing window of opportunity. All in all, the key aspect to have in mind is that, in the end, the proceeds obtained in this operation turned out to be substantially higher than what could have been collected under a trade sale, contrary to what was said by Alfredo Casimiro, Urbanos' CEO, in October 2013<sup>27</sup>.

---

<sup>25</sup> *The Value of Control: Implications for control premia; minority discounts and voting share differentials*, Aswath Damodaran, Stern School of Business, June 2005

<sup>26</sup> *Initial Public Offerings*, Ibbotson, Sindelar, Ritter (1988), *Journal of Applied Corporate Finance*, Volume1, Issue 2, 37-45

<sup>27</sup> "I do not believe that an IPO could value the company at more than 400M€" - *Jornal de Negócios*, 07/10/2013

## **Where does CTT's value come from?**

One of the key factors that determines CTT's value is the extensive network of post offices spread throughout the country. The company was present in (or nearby) all of the smallest villages in the country and this capillarity allowed access to distant points of the country, representing one of the strongest aspects of the company. Benefiting from the monopolist statute, over the centuries, the company built its strong retail network, which also brought reputation and power to the brand. At the time of the privatisation, CTT was an extremely strong brand and an iconic corporation. Its reputation and the value of the brand are an intangible asset that clearly adds value to the company. Besides, the company's activity was regulated and in the contract for the concession of the SPU<sup>28</sup> it is established that the regulator could compensate the service provider if it incurred in extra costs as the provider of the universal service. The inherent stability of a regulated business like this one is also one of the aspects that contributes positively for CTT's value and an appealing characteristic to investors.

Group CTT had a highly profitable financial services operation, a business unit which had seen a lot of developments over the years, with various ups and downs, but still it was a segment of tremendous relevance for the overall picture of the company. The proximity to the population due to the great number of branches along with the wide variety of financial services that are offered to clients makes this specific segment a relevant source of value.

Additionally, the option to open a bank might be valuable for some investors. However, the upside of the Postal Bank is not clear, as one does not know if there are going to be significant incremental revenues from this project on top of the ones already generated by the wide array of financial activities performed by CTT. Entering retail banking, with checking and savings accounts would

---

<sup>28</sup> Universal Postal Service

consume enormous resources and could be a risky investment. On top of that, it is already known by the general public that there were two other attempts - in 2002 and in 2005 - that ended up being unsuccessful. Thus, the feasibility of this project is dubious and although it was a strategy to boost the value of the company in the privatisation, the effective creation of the bank was not guaranteed.

**Who could be the main investors in this IPO and how does the stated dividend policy influence it?**

Considering CTT's profile and its activity, the main target of this IPO are mainly yield-seeking investors, who intend to hold the stock in their portfolio for the long-run, rather than make a short-term gain by selling quickly. Between 2010 and 2012, the State received in the form of dividends approximately 128.5 M€, which attests of the suitability of the company for those investors searching for dividend yield. The different management teams had always kept the tradition of distributing the profits to the shareholders, with a quite high payout ratio, and that must be seen as an appealing aspect for the type of investors mentioned above. But even more important than the historical payout are the prospects for the future dividend policy and, with respect to this, the prospectus clearly states the intention to distribute more than 90% of the profits to the shareholders (**Exhibit 11**). This statement serves the purpose of positioning the stock in the market and targeting the investors that are looking for a low risk, slow growth and high payout stock.

More specifically, pension funds and low-risk/medium-risk equity mutual funds are examples of the type of institutional investors that could be interested in this IPO. Income funds that actively look for companies with a proven business model with a stable and low-risk cash-flow are also a main target in this process.

### **What are the main risks of this IPO?**

As we know going public involves a lot of costs, risks and uncertainties. The failure of an IPO can significantly undermine a company's possibility to raise money from capital markets in the future, which means that the management team ought to be extremely careful in the process and ensure that nothing goes wrong.

The operation could, primarily, be affected by an international perception of excessive country risk, a fact that could shift away potential investors. Some pension funds or conservative mutual funds, which constituted the shareholder base that the Government looked for, could give up on signing for shares thanks to the negative outlook for the Portuguese economy. In some cases, even if they considered it a good opportunity, the investment guidelines of the fund could prevent them from doing so, as some of these financial institutions with a conservative profile do not allow, statutorily, the investment in countries whose sovereign debt is rated below a certain threshold.

Besides, a deterioration of the state of the Portuguese economy might cause investors to withdraw their orders for CTT shares, if there is a perception of higher country-risk.

As a consequence of the above mentioned risk, CTT's IPO could attract not the type of long-term and yield-seeking investors that were desired to construct a stable shareholder base, but rather speculative investors, which could imply higher volatility of the stock.

Moreover, CTT is not exactly the type of company that can go public on a hype such as Google or Facebook that can be easily "marketed" to institutional investors. However, in practice, what one observed in the Royal Mail privatisation was a tremendous appetite for this type of asset, indicating that, in fact, the market might have interest in CTT, specially the above mentioned type of investors.

Finally, the bearish sentiment in the market posed a threat in terms of valuation, as it could pressure downwards CTT's valuation. The turbulent period that Portugal was experiencing might very well push the value of the shares down, thus reducing the proceeds from the privatisation.

**What are the possible implications in terms of governance after the 1<sup>st</sup> phase of the privatisation?**

The fact that the Government decided to sell only 70% of the company, may raise some concerns about the Governance model. The State would still keep 30% of the company, which implied that it would have an effective control over the Board and the key strategic options of the company. This might once again detain a certain type of investors. Those looking at the sale as an opportunity to acquire a significant share in the capital and, consequently, not total control but a considerable power over CTT's future path could lose their interest in the process when they understand that the Government would keep a large portion of the company to itself and could, therefore, interfere in the management of the corporation.

Basically, the outcome would be an undefined situation, whereby the external investors, despite owning more than 50% of the company, would still be highly dependent on the Government's plans, as the State would still be the biggest shareholder. Besides, the management team that was in office had been selected entirely by the Government, as the sole shareholder, which raises issues about the actual diversity of the Board's composition and the existence of truly independent members.

**Did the Government leave money on the table? What is the fair value of the stock?**

Looking at the stock performance over the first few weeks, one would conclude that there was definitely an underpricing of the company. Moreover, through a more detailed valuation analysis, using multiples as well as a DCF analysis, the estimated equity value of the company is higher

than the implicit value of 827M€. Still, even if there was an underpricing, one must consider that the price that could have been obtained in a trade sale was even lower, meaning that this option seemed to be the wisest choice. Using the EBITDA multiple approach, the estimated value of equity is approximately 1 billion, yielding an implicit price per share of €6.86.

EBITDA 2012	€ 92,366,000
Median (EV/EBITDA)	5.965 x
Enterprise Value	€ 550,963,190
Net Debt	-€ 478,087,306
<b>Equity</b>	<b>€ 1,029,050,496</b>

Implicit price per share	€ 6.86
--------------------------	--------

Note: Total number of shares - 150.000.000

Alternatively, valuing CTT through an APV analysis, using the projections on **Exhibit 15**, the value of the company's equity is estimated to be even higher (approximately € 1.4 billion), resulting in an estimated value per share of €9.30<sup>29</sup>.

(thousands of €)	2013 F	2014 F	2015 F	2016 F	2017 F	2018 F
<b>Free Cash Flow</b>	85,960.1	48,305.2	45,810.4	44,590.7	40,204.9	876,977.0
Discount factor	0.9514	0.9052	0.8612	0.8193	0.7795	0.7795
Discounted FCF	81,783.09	43,724.77	39,451.53	36,535.17	31,340.95	683,630.70

Note: From 2018 onwards, the company is assumed to grow perpetually at a rate of 0.5%, which is a quite conservative. The value of the perpetuity is on the column relative to 2018, however it is discounted at the discount factor of 2017.

EV ( $\sum$ FCF)	€ 916,466,221.79
Net Debt	-€ 478,087,306.00
<b>Equity</b>	<b>€ 1,394,553,527.79</b>
<b>Value per share</b>	<b>€ 9.30</b>

Note: The value of financial debt (mostly related to leasing contracts) is irrelevant. Therefore, the impact of the tax shields is negligible (can be ignored).

### How do you justify the choice of Caixa BI and JP Morgan as bookrunners and global coordinators of this operation?

The choice of financial advisors is in line with the Government's strategy. The operation had two main targets: on the one hand, the Portuguese retail investors, which relied on a brand with a strong recognition in Portugal and saw this IPO as good investment to obtain a good return on their

<sup>29</sup> See Annex A for details on the APV valuation

savings, whereas, on the other hand, there were the international players, mainly European, which required the hiring of an international investment bank in order to establish contact with that potential pool of investors. Consequently, the choice of two bookrunners, one focused on the national market (Caixa BI) and another one (JP Morgan), experienced in large IPOs and with a vast network of contacts and a well-established reputation in the global markets, was in line with the overall strategy defined for the operation.

**In 2014, after the 2<sup>nd</sup> phase of the privatisation, CTT became the 1st Portuguese listed company to be 100% free float. What are the main opportunities and threats?**

This fact raises some important issues. Firstly, the dispersion of the stock determines a complete separation between the shareholders and the management team, meaning that control and ownership are totally detached. The lack of a reference shareholder might have implications in terms of the performance of the top management<sup>30</sup>, as they perceive that no single shareholder has significant control to fire them. It could lead to an attitude of non-accountability, where the senior executives could dismiss the interests of the shareholders and decide according only to their own interests. Basically, the main risk is the non-alignment of interests between the shareholders and the Board<sup>31</sup>.

Secondly, the company was in a fragile position as far as an eventual hostile takeover is concerned. The dispersion of the stock made it more prone to takeover bids, since it would not be easy to organize a joint defence plan as there are too many shareholders with different agendas and intentions.

---

<sup>30</sup> Corporate Governance: effects on firm performance and economic growth, Maria Maher and Thomas Andersson, OECD 1999

<sup>31</sup> Corporate ownership and control structures: an international comparison, Pieter W. Moerland, Tilburg University, Review of Industrial Organization 10: 443-464, 1995.

## References

Vencer a distância; Cinco séculos dos Correios em Portugal, Fundação Portuguesa das Comunicações

Liberalização do sector postal: principais questões concorrenciais, Autoridade da Concorrência, Julho de 2010

Comparações de preços dos prestadores do Serviço Postal Universal na União Europeia em 2011, ANACOM

Decree-law 129/2013, 06/01/2013

CWU briefing: The future of Royal Mail, Communication Workers Union, 2013

Apuramento dos resultados da Oferta Pública de Venda, Euronext, December 2013

CTT's IPO prospectus

Supplement to the IPO prospectus

*The Value of Control: Implications for control premia; minority discounts and voting share differentials*, Aswath Damodaran, Stern School of Business, June 2005

*Initial Public Offerings*, Ibbotson, Sindelar, Ritter (1988), Journal of Applied Corporate Finance, Volume1, Issue 2, 37-45

*The Long-Run performance of Initial Public Offerings*, Jay R. Ritter, Journal of Finance, Volume 46, Issue 1 (Mar 1991), 3-27

*Corporate Governance: effects on firm performance and economic growth*, Maria Maher and Thomas Andersson, OECD 1999

*Corporate ownership and control structures: an international comparison*, Pieter W. Moerland, Tilburg University, Review of Industrial Organization 10: 443-464, 1995

*Equity Market Risk Premium – Research Summary*, KPMG, January 2013.

*Equity Risk Premiums*, Aswath Damodaran, Stern School of Business.