

Back from the brink

The Spanish economy – the fifth biggest in Europe – has shown signs of recovery over the past 15 months. Its businesses have a competitive streak and there is growth. What does it mean for M&A? By Brian Bollen

Like the rest of southern Europe, the crash in Spain was far harder than further north. Its banking crisis was exacerbated by a huge oversupply of real estate during the boom years, leading to crippling unemployment levels. It has been painful, but banks have been restructured and the economy is showing signs of recovery. There are signs that M&A involving Spanish companies is on the rise, too.

The statistics would seem to prove that sentiment is well informed. According to the *EY Eurozone Forecast December 2014*: “Spain continues to lead the eurozone out of recession, with a recovery that started with exports now broadening into domestic demand.” Spain’s GDP growth for 2014 is expected to be 1.3% in 2014 – there will have been six consecutive quarters of positive growth. EY

Plaza de Castilla, the financial district in Madrid, the Spanish capital



forecasts growth of 2% this year and 2.2% in 2016. The decline in the value of the euro will no doubt help Spanish exports, which had been gathering pace in any case.

POSITIVE TURNAROUND

When it comes to M&A – \$62bn (£40.9bn) for 2014, according to Dealogic – things are also looking up, as M&A in 2013 was \$43.9bn and in 2012 \$35.6bn. However, to contextualise that M&A figure, the market peaked in 2007 when there was \$183.7bn of M&A. Plus, from a mid-market perspective, some \$10bn of last year’s M&A was on one deal – Vodafone’s acquisition of Grupo Corporativo Ono.

The resurgence of private equity is rather more pronounced. Dealogic calculates the total value of Spain’s financial sponsor exits to be at almost \$14bn (\$12.8bn of which was by way of trade sale). This is more than double 2013 (\$6.1bn) and 10 times the value of such deals in 2012 (\$1.4bn). More pertinently, perhaps, it is double the previous peak in 2007, when just over \$7bn of deals were done. So what is driving Iberian activity?

Real estate, that very visible symbol of the boom before the bust, is a major component. Sergio Vélez, a senior managing director at FTI Consulting based in Madrid, says: “The private equity market in Spain over the recent past has been heavily centred on asset-based businesses such as real estate organisations. A number of large funds from overseas have acquired assets in the past year, after a period of relative quiet.

“There has been an increase in M&A around real estate businesses, for example those being disposed of by banks that need to restructure as a result of their exposure to consumers. Some of the largest names in the industry have been buyers of Spanish real estate assets in 2014, often taking

Above: Madrid, Spain, where property acquisitions by overseas investors have fuelled the private equity market



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Sergio Vélez, managing director, FTI Consulting



NEW APPROACH

The private equity marketplace in Spain has changed quite dramatically. KPMG's Jorge Rioperez says: "Traditional names in the first decade of the 2000s have disappeared, opening the door to new players, some of them investing directly from London. It is not unusual to meet with institutions that have no investments in Spain, but that are very keen to enter the market."

Remigio Barroso, an EY transaction advisory services partner, leads a specialist team set up in London to help clients capitalise on M&A opportunities in southern Europe, (Italy, Spain and Portugal). He says the international aspect of M&A in Spain is why they were set up: "As markets become more global and investors from all around the world look at Spanish assets, it is vitally important to have global reach and sector specialisation in order to be successful in the M&A market, making it more difficult for pure Spanish M&A houses to act in the local markets."

Barroso travels to Madrid regularly and has a specific mandate to present transaction and investment opportunities in southern Europe to UK-based clients across a range of sectors and funds, including infrastructure, distressed funds and real estate.

Against this backdrop, Rioperez says corporate finance is very competitive: "Large investment banks, local banks, boutiques and the Big Four firms fight for the market."

businesses from banks eager to free capital for other purposes."

Mark Thompson, a corporate finance and private equity lawyer at Sidley Austin, also highlights the attractions to buyers of real estate-related companies. While welcoming signs of recovery, however, he also draws attention to growing, perhaps obvious, concerns that property prices might already be too high.

According to Thomson Reuters, in the first nine months of 2014, 25.7% of mid-market deals (up to \$500m as defined by the firm) were real estate deals, 20.1% financials, 11.6% media and entertainment, 10.5% industrials and 9.2% energy and power.

EFFICIENT PRODUCER

Spain is, generally speaking, a productive and efficient country when it comes to manufacturing. It is the second largest car-producing nation in the EU. Labour costs have plummeted, almost certainly directly related to the unhealthy levels of unemployment across the country. There is roughly 25% unemployment, and that is not forecast to fall below 20% before the end of the decade.

Because of this reduction in

labour costs post-crisis, says Igor Gorostiaga, a partner at advisory firm Norgestion, the Mergers Alliance member firm in Bilbao, manufacturing has become more competitive. And because of the need for Spanish companies to look overseas for growth they couldn't achieve domestically, the country has become a net exporter. The Spanish treasury says exports had grown from 21.9% of GDP in Q1 2009 to 32.6% by Q2 2014.

"I see opportunity in many places," Gorostiaga says. "Not least among smaller companies founded in the 1960s where succession is now a major issue."

He suggests we might see a wave of mergers, and predicts a revival of buy-out activity as confidence and liquidity return.

In September 2014, German engineering firm the Hay Group acquired Forjanor, the Madrid-based supplier of gearbox, transmission and bearing parts to predominantly European automotive original equipment manufacturers, from its Brazilian parent company, steel-maker Gerdau, for an undisclosed sum. Forjanor had sales of €55m and 170 staff. Norgestion advised on the deal. Gorostiaga says it demonstrates how attractive Spanish mid-size companies are becoming to international investors, where the target businesses already have an international presence.



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Igor Gorostiaga,
partner, Norgestion

SPAIN AT A GLANCE

1.3%

GDP growth for 2014 as predicted in the EY Eurozone Forecast December 2014

\$62bn

Value of Spanish M&A for 2014, including \$10bn for Grupo Corporativo Ono



IBERIAN DEBT QUESTION

The need to restructure debt has clearly been a key driver of activity in the Spanish market. FTI's Sergio Vélez says KKR's acquisition of Grupo Gallardo's cement and paper division shows how the combination of overseas cash and expertise can help to rebuild Spanish industries. FTI advised Gallardo and its lenders on the transaction and the restructuring of the company's debts. KKR bought the business and injected around €225m in direct lending - it was the largest direct lending transaction in Spain in 2014.

There are two factors in such distressed situations - firstly, the restructuring of debt liabilities and capital, and secondly the operational and working capital support. Gallardo would not have been able to sell to KKR had it not addressed both previously.

There seems to be a recovery taking place in banking activity in the country. EY notes in its *Eurozone Report December 2014* that the ECB's stress test results confirmed that the restructuring of Spain's banking system over the past few years has paid off.

After business lending contracted by an estimated 5.7% in 2014, it is forecast to grow 1.8% in 2015 and a bounce back by 5.4% in 2016. The availability of debt, at relatively modest prices, is very often a harbinger of deals.

But, KPMG's Jorge Rioperez says the debt still has to find its way down the food chain: "There is plenty of money for large deals, but finding financing for the lower mid-market is not so easy. We think that we will see more capacity to finance small deals in the future and this will compensate the M&A industry soon."



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Jorge Rioperez, corporate finance head, KPMG

5.7%

Amount by which business lending contracted in 2014

1.8%

Amount by which business lending is forecast to grow in 2015

INTERNATIONAL CAPITAL

Jorge Rioperez, head of corporate finance at KPMG in Spain, says the country is now seen as a very attractive economy to invest in: "Confidence is back, expected GDP growth is above 2% this year and there is a need for capital to rebuild the economy. There are some goods assets to be sold coming from PE, large companies and multinationals, and projects or sectors with a lack of capital. On the other hand, there are good local companies that need to grow and the timing is perfect."

He says there will be a flow of Spanish divestments, but speculators looking for cheap assets might be disappointed. "Those companies that survived the past few years are very sound, profitable and ready to grow. The recovery of the market will come not only from sales but also capital injections in sectors to be consolidated, and further internationalisation of the Spanish economy."

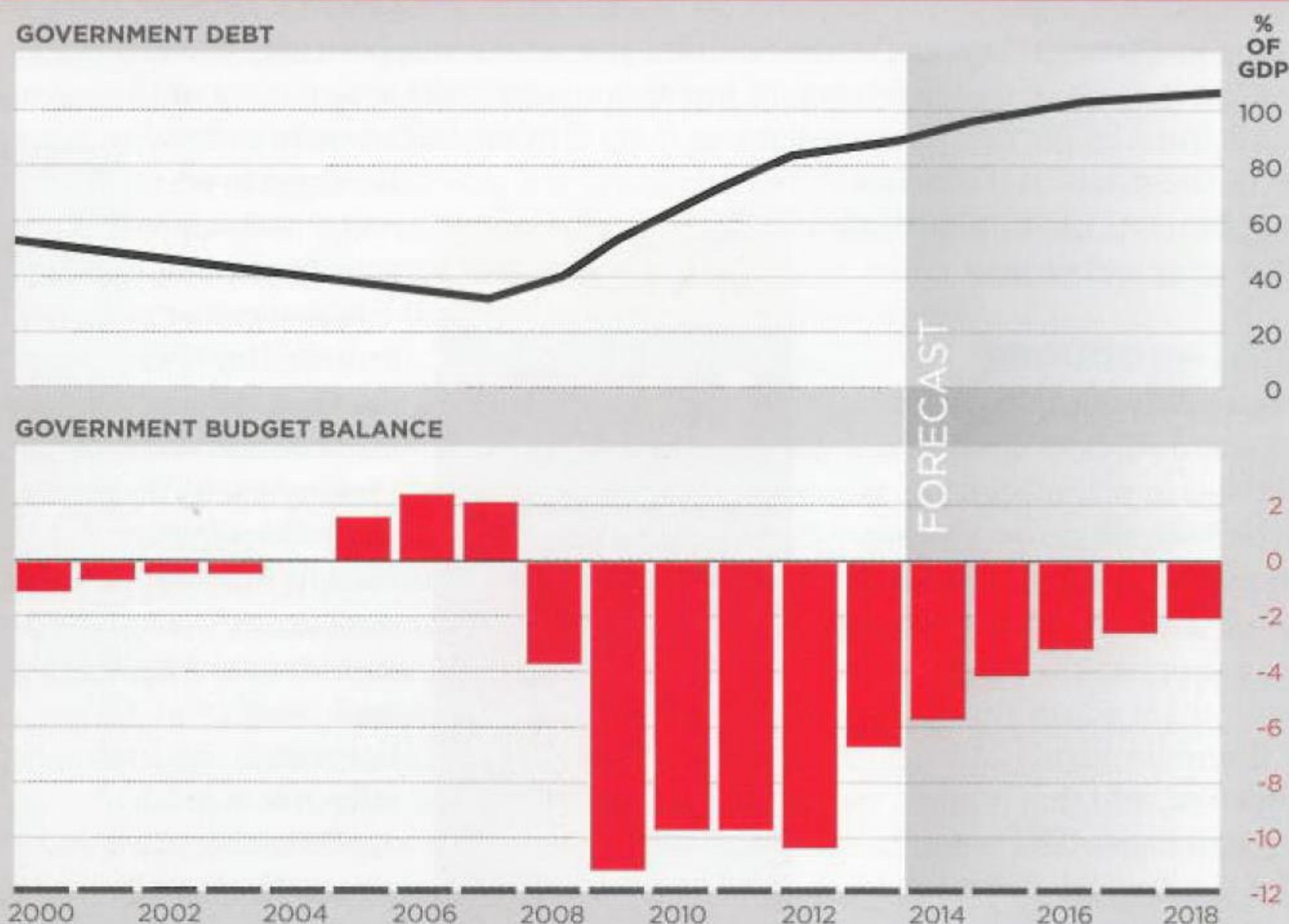
Europeans and Americans were the typical acquirers, but now there are buyers from the Far East, Russia and sovereign wealth funds.

Sergio Vélez says sophisticated investors from the US and the UK are partaking in both distressed deals and growth plays: "There has also been some interest in Spanish assets from others, such as Chinese investors attracted by currency and valuations of real estate and hospitality assets. These buyers have been particularly aggressive in competitive transactions."

But he adds: "The market today is stronger than four years ago, but far from its peak. Unemployment remains high. As a consequence, businesses heavily reliant on discretionary consumer spending such as retail are struggling. Businesses that are more insulated from the volatility of consumption patterns are more in demand." ■

SPANISH GOVERNMENT DEBT AND BALANCE

SOURCE: OXFORD ECONOMICS



GETTY IMAGES