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Spain moves into the fast lane

INCREASING NUMBERS OF CROSS BORDER DEALS ARE MAKING SPAIN A HOT MARKET FOR M&A AND THE COUNTRY'S MAJOR PLAYERS ARE SHOWING THEIR AMBITION TO BECOME GLOBAL FORCES, WRITES CHERRY CANOVAN.

Spain's M&A scene is as vibrant as its paellas, with the meat being provided by some major cross-border deals involving the country's biggest companies. These giants, such as Telefónica, the banks BSCH and BBVA, Repsol and Endesa have been very active recently. They are at the head of the continuing charge into Latin America: Repsol acquired Argentine oil and gas company YPF in a deal worth $13 billion (€14.6 billion), BSCH is now doing due diligence for its acquisition of Grupo Financiero Serfin, one of Mexico's largest banks, while, also in Mexico, BBVA is tussling with Banamex for control of Bancomer — see our banking feature on page 19 for more details.

Bob McGuire, managing director and head of oil and gas for Europe, Africa and the Middle East at Chase, says the Repsol/YPF deal was significant for several reasons. "This was a bold move by the Repsol management to effectively redefine its company, from being primarily a Spanish oil and gas downstream company to being a large upstream player in Latin America," he comments. The fact that Repsol paid cash also marks the deal out.

Now, say commentators, the big Spanish players are turning their sights towards Europe. Jake Donavan, vice-president at JP Morgan's Madrid office, explains: "These companies have all done very well in Latin America, however they are now facing a moment of truth and are looking back towards Europe. There will probably be a major cross-border European deal involving a Spanish company in the near future." Although the proposed KPN/Telefónica deal collapsed, it looks likely that similar-sized tie-ups will start coming through.

Spain has, in fact, become a major acquiror as a nation. "The mood has changed dramatically," says Carlos Pazos, senior partner at law firm SJ Berwin's Madrid office. "A few years ago, we had foreign acquirors coming into Spain and buying companies. Now we see more and more Spanish companies looking abroad."

It's not just the size of the deals that has been hitting the headlines. The Spanish government, which has reportedly scuppered certain cross-border mergers, has found itself at odds with the EU. Madrid is fingered in the collapse of talks between KPN and Telefónica, and also for stopping a bid by Energie Baden-Württemberg (ENBW) of Germany for Hidroeléctrica del Cantábrico, the electricity group. The objection in both cases was that the foreign company was partly state-owned, KPN by the Dutch government and ENBW by Electricité de France, which is state-controlled. The European Commission (EC) is known to be unhappy with Spain over the issue; Europe is known to be keen to speed up the liberalisation of the energy market, with energy commissioner Loyola de Palacio stressing the need for an effective cross-border market. The Spanish government, however, insists that when it has privatised a company, it does not want another government to end up running it.

Closed to the public

Some commentators feel that Spain has a point. "This is an unfortunate response to the concern of the Spanish government not to renationalise a company previously privatised," says one investment banker, noting that Spain has pursued an aggressive policy of privatisation in the last few years. And, he comments: "The energy sector is in a very asymmetrical situation in Europe — EDF is still 100 per cent state-owned, as opposed to what has happened in the UK and Spain, and there are obviously some questions relating to the pattern of liberalisation. There is an interest in elevating that debate towards the regulator to impose a common pattern." Other sources, however, are not so sure the government's action is reasonable, saying that although it sees itself as defender of the faith of free market liberalisation, its actions can be interpreted as nationalism.

Striking gold in Latin America

One of the major drivers for European companies targeting Spanish firms continues to be Spain's potential as a gateway to Latin America, and the resurgence of South America's economies can only help this process. Chris Scales, a director based at Closa Corporate Finance Advisers' Barcelona office, says: "We've got a German ISP looking to buy a Spanish ISP in order to exploit the Spanish-speaking market and as a platform to Latin America, and a US broking house buying a Madrid-based broking house because it has an office in Colombia." Josep M. Romances, also of Closa, concurs: "Spanish companies are selling to a big market in Latin America, which means we can compete to merge or buy companies." At Merrill Lynch, MD of investment banking Francisco Sánchez-Asiaín confirms that Latin America is still uppermost in the minds of many Spanish companies, citing Repsol/YPF and Endesa's purchase

Francisco Sánchez-Asiain, Merrill Lynch

Josep M. Romances, Closa

of Chilean Enersis as examples.

Some now believe the next step for Spanish companies is to break into the US. In the past there has not been too much activity between the countries, but the possibilities are growing, says Ignacio Muñoz-Alonso, a Madrid-based executive director at Lehman Brothers. "The triangle between Spain, Latin America, and the US — or the Hispanic sector of the US — represents an enormous potential," he says. "Some Spanish media companies have been making serious attempts for the last three or four years, but it is a competitive market and it has been difficult for them to make a strong impact. Now some other companies close to the media sector are starting to believe that the opportunities in the US market are more real than they were a few years ago."

And, he adds, the Internet and new media sector is playing a big part in helping companies to break in. "You can start with simpler structures and smaller companies," he explains, mentioning the examples of Telefónica's agreement with Ariba to develop e-commerce, and Endesa's venture into the internet with Commerce One. "The connections made by Telefónica and Endesa will lead to more serious things."

Small banks stand their ground

So what sectors are hot on the M&A scene? Chris Scales pinpoints IT and the Internet, as well as construction and areas such as maintenance and office services. But the big story may well still be in banking; following the big deals which created BSCH and BBVA, there is still a lot of change to come at the smaller end, he says. "There are so many banks; there's going to have to be a shakedown, particularly because the Spanish are so IT literate, and are moving to Internet banking. The high street banks are going to be trounced."

However not everybody is of this opinion. Gonzalo Gortázar, executive director of Fig at Morgan Stanley Dean Witter in Spain, spells out the situation: "The gap between the large banks and the medium banks is now so big that the medium banks must now be viewed as small. There are two giants with market shares of 20 per cent each, and then another 50 per cent of the market is dominated by the savings banks, so that leaves ten per cent shared between other institutions."

Consolidation in this area of the market has seemed inevitable to many commentators; however Gortázar has a different view, pointing to the fact that some of these smaller banks are in a strong position and determined to remain independent.

Banco Popular, which has a three to four per cent market share, is highly profitable and emphatically not looking for partners, he says. It's a similar story at Bankinter. "The bank is strong in human capital and very flexible. It is small, but sells more products per client than any other bank in Spain. The management is forward thinking, and using the Internet is an integral part of its strategy. It has been aggressive, and is launching products every other week. It is expected to gain market share, and will not have consolidation as part of its strategy. The smaller banks are not under too much pressure. They are looking at the impact of the Internet, and whether they can cope with that and stay independent, but that issue is a long way in the future. They have been receiving the traditional message that consolidation must happen for years, but they haven't seen any problems and they are sceptical."

One bank which has formed a cross-border alliance is Banco Sabadell, which recently announced an 'Iberian partnership' with Banco Comercial Portugues; the two have agreed to establish cross-shareholdings. Banco Sabadell says it sees this partnership as its first strategic

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