SOUTHERN EUROPE: RISING FROM THE ASHES

IN BRIEF

- **Private infrastructure investment in southern Europe has collapsed since the crisis – but there are signs that revival could be on the way.**
- **High prices in northern Europe are forcing investors to look for assets further afield to unlock affordable assets.**
- **Governments are now considering privatisation programmes in an effort to pay down national debt.**
- **As prices rise, corporate disposals will lead the M&A market revival as companies sell infrastructure subsidiaries to reduce debt.**

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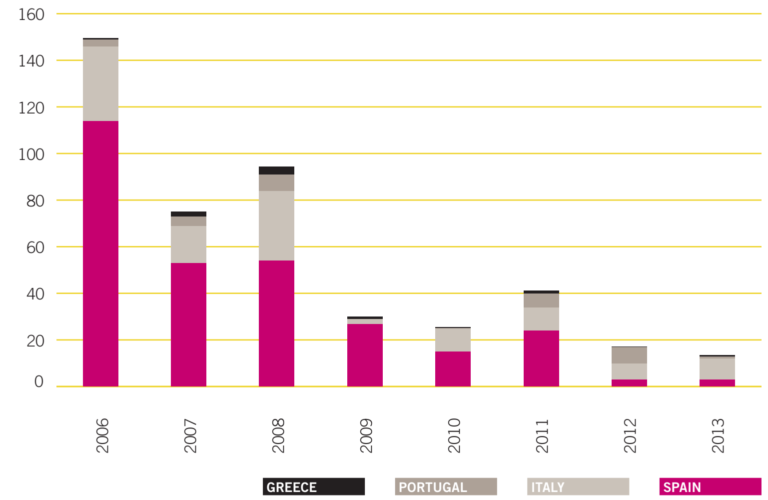
COLLAPSE

Fig. 4.1 Infrastructure M&A deals by value (US$bn)

SOURCE: LINKLATERS, THOMSON REUTERS



Private infrastructure investment in southern Europe has crumbled since the financial crisis. Italy, Spain and Portugal signed just one PPP deal apiece in 2012, while infrastructure M&A values plunged by more than 72% in Italy and by 97% in Spain between 2006 and 2013 (see figure 4.1: *Collapse*). That is to be expected, with all three countries flirting with a default on their sovereign debt and, in Portugal's case, being demoted to junk status by ratings agencies.

Though the figures tell a sorry story, there are signs that deal flow could improve. With northern Europe proving too expensive for many, investor appetite for the riskier markets of southern Europe is growing. They are happy to pay well for the right type of asset – those with predictable cashflows, which are not reliant on the local economy for growth – even in these crisis-stricken countries.

Even Portugal with its sub-investment grade rating, is not ruled out completely. A sub-investment grade rating is not a barrier in itself, says Michael Goldberg, Director at CPPIB, pointing out that his fund has made some big investments in emerging markets such as China.

The message that demand could be strong if governments start selling attractive assets again, is beginning to filter through to policy-makers, striving to reduce their sovereign debt mountains.

The Italian coalition government has embarked on what it calls "its largest privatisation programme since the late 1990s" with a plan to raise a further US$16.4bn. In fact, Italy has already announced that it will sell a minority stake in the oil and gas major Eni in 2014, along with, among other things, larger chunks in the state air navigation company ENAV and stakes in the holding companies managing railway stations, shipbuilders and pipelines. The government has also hinted that it will sell a 49% stake in Terna, the national electricity grid. Around 10 sales have been announced so far, worth well over US$15bn.

Spain, too, is restarting a privatisation programme, shelved two years ago due to a lack of investor interest. It plans to sell up to a 60% stake in the highly indebted Aena, the national airport management company valued at around US$20bn, as well as some regional airports and car parks in places such as Barcelona. Also frequently mentioned as possible assets for sale are Spanish toll road operators. "Spanish contractors are buying companies and winning huge contracts in North America, Latin America, Asia and so on," says Alejandro Ortiz, a Linklaters partner in Madrid. "They have sold subsidiaries as they reduce their Spanish presence and raise cash for international expansion. And there's big private equity interest, showing that international money will touch the right sort of asset in Spain."

Although there are buyers for assets in southern Europe, investors remain highly selective. Crudely put, assets in southern Europe must either be in a handful of attractive areas, such as airports and some utility companies, or "they must be affordable enough to warrant the risk", as one fund manager said. That's a marked shift for countries that would have wiped out the value of any investment had they defaulted on their debt – a real risk just one or two years ago, when even Spain and Italy were struggling to raise sovereign debt in the capital markets. And current interest levels are driving prices up to a level where both government and companies may be willing to sell.

THERE IS STILL SOME WAY TO GO BUT THERE WILL COME A TIME WHEN PRICES AND BUYERS' APPETITE COME TOGETHER AGAIN

ASSETS IN SOUTHERN EUROPE MUST EITHER BE IN A HANDFUL OF ATTRACTIVE AREAS OR THEY MUST BE AFFORDABLE ENOUGH TO WARRANT THE RISK

Portugal: still attractive

Portugal is one country which has proved that there is investor appetite for assets in southern Europe. It has privatised several big assets to help the state budget, pushed by the terms of its EU bailout and buoyant international investor demand. This has helped the country to raise much needed cash. "What is interesting is the appetite from markets outside of the EU. Chinese investors have been particularly interested in Portuguese assets," notes Pedro Siza Vieira, a Linklaters partner in Lisbon. For example, the acquisition by China's state-controlled Three Gorges utility of a 21% stake in EDP at the end of 2011 for US$3.7bn and State Grid International of China and Oman Oil's acquisition of a 40% stake in power and gas grid operator REN for US$810m. "We have also seen a string of secondary market and equity debt trades in the PPP sector," says Pedro.

It was the sale of the airports group ANA in December 2012 that really showed that Portugal could sell assets for a good price despite its debt crisis. France's VINCI paid over US$4.2bn for a 95% stake (see case study: *VINCI Concessions: a very different approach*), the price, equivalent to around 17 times EBITDA (earnings before interest, tax, depreciation and amortisation), was even higher than that for recent UK airport sales.

These sales should not lead to the conclusion that demand for Portuguese assets is limitless; certainly not all assets will fetch such high prices. For example, an attempt to sell the TAP airline failed in 2012, and investors remain wary of taking local GDP risk in southern European countries.

All of the companies mentioned were bought by corporate investors, sometimes taking on the management role at the head of a consortium of financial investors. As with the UK nuclear plants, Asian companies were attracted by the chance of gaining a foothold in Europe, as well as by the lure of local high technology and some of the Portuguese companies' healthy exposure to emerging markets, such as South America.

CASE STUDY

VINCI CONCESSIONS: A VERY DIFFERENT APPROACH

Companies such as French contractor VINCI Concessions take a very different approach to acquisitions than financial investors. VINCI decided to expand internationally when it realised that infrastructure activity was slowing in its home market, France. But it found that stable European countries such as Germany and the UK were too expensive to be of interest to a company that makes money by improving operational performance.

"Intense competition leads to crazy prices, which are not for us," says Chairman Louis-Roch Burgard. "We tend to be counter-cyclical, buying at the bottom of the market." That makes southern Europe interesting, despite the lack of new-build work, as well as emerging markets such as Russia, where VINCI is investing with Russian bank VTB in a new motorway.

Judging by its biggest acquisition to date, the Portuguese airport operator ANA, VINCI is far from being a simple-minded bargain hunter, however. The price tag was over 20% more than offered by the second-placed bidder, Fraport. Jean-Roch Burgard justifies the price by pointing out that ANA has grown strongly for the past decade, with potential to grow traffic further on some of its routes to Latin America. "It's a big success," he says, adding that he likes the fact that you can grow airport business "without relying on government regulation or economic growth."

WE SEE REAL OPPORTUNITIES IN GREECE.
Louis-Roch Burgard
VINCI Concessions

Greece: Any buyers?

Greece's story is not quite so positive. Following a string of delayed or cancelled sales, Greece's privatisation target has dropped to US$20bn, less than a third of the level promised at the time of its initial bailout three years ago. Many blame the Greek authorities for the muddle, but it has also been hard to find bidders for assets in a country that remains at risk of a sovereign default despite two rescues. For a country spurned by the big financial investors such as pension funds, local and emerging-market investors looking to snap up a bargain could be the answer.

Some attractive companies are likely to come up for sale over the next few years, including regional airports serving the big tourist market, the postal service and utilities such as Eyath, Thessaloniki's water and sewerage firm.

Regional airports, in particular, are stirring up strong interest from corporate buyers. They are mentioned as a possible acquisition target by Ulrich Heppe, Project Director of the German airports operator Fraport. And they are singled out by Louis-Roch Burgard, Chairman of the French contractor VINCI Concessions. "We see real opportunities in Greece," he says.

Privatisations vs. corporate disposals: where will assets come from?

Though there have been a small number of successful privatisations in southern Europe in the last year, there is still strong opposition towards private ownership of national infrastructure. There have been protests against austerity in both Spain and Italy, and it would be mistaken to believe that people there are any keener on private infrastructure ownership than their counterparts in Germany or the UK. However, these countries need cash and now private money is there for them to sell at a good price. Spain may consider privatising its toll roads, for example. "A significant number of toll roads built since 2000 are insolvent and face nationalisation," says José Giménez, a Linklaters partner in Madrid. "That raises the question of whether they will be reprivatised after their financial clean-up."

It is not just governments in southern Europe, however, that are bringing assets to market. Corporate disposals are also likely to generate investment opportunities, as companies seek to reduce debt and, in many cases, because they want to fund international expansion to escape stagnant home markets.

In October 2013, for example, Spain's Ferrovial sold a 9% stake in Heathrow Airport Holdings to one of the biggest UK pension funds, the Universities Superannuation Scheme, for US$530m. A year earlier, it had sold an 11% stake to Qatar Holdings and a 10% stake to China Investment Corporate (CIC), in a classic example of a company selling minority stakes in assets to raise capital, whilst retaining control over the asset. In the same month, Microsoft Chairman Bill Gates paid US$105m for a near 6% stake in Spanish construction group, Fomento de Construcciones y Contratas, in a deal widely heralded as confirming that Spain was back on the international investment map.

Although a more challenging environment than northern Europe, certain infrastructure assets in southern Europe have solid underlying credentials and, as we have seen, are attractive to investors. Governments and corporate contractors in southern Europe who require funds to pay down debt, need to harness the increasing interest for these assets.