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Private equity in Spain by *Carlos J. Deupi, Esq.*

Last year broke worldwide records for private equity fund-raising and investment. It continued into 2006 with no end in sight. With accelerating leveraged buy-outs, 2006 will see a tidal wave of $300 bn in private equity funding, up almost 50% over 2005. The *Columbia/HCA* hospital chain LBO (approximately $33bn in transaction value) would top the *RJR Nabisco* deal, and would be the biggest prior LBO. Echoing the boom in the U.S., the value of LBOs in Europe topped €117 bn in 2005, according to *The Economist* (Aug. 10).

One of the most active European markets for private equity during the past 18 months has been Spain. *Kohlberg Kravis & Roberts*, flush with $5 bn from its listing in May on Euronext, is active there, along with *Blackstone Group*, *CVC Capital Partners*, *Providence Equity Partners*, and *Thomas H Lee Partners*, and others. Foreign firms opening shop in Spain and hiring fund managers include *Carlyle Group*, the French fund *L Capital*, and *Doughty Hanson* fund (U.K.)

Spanish buy-outs reached almost €10B bn in value in 2005, the largest being the acquisition of the *Amadeus Global Travel* reservation business for €4.34 bn by *Cinven Group* and *BC Partners*, plus airlines *Iberia*, *Air France*, and *Lufthansa*. For $2.7 bn, *Grupo Auna*'s mobile phone business was bought by telco *Grupo Ono* from *Banco Santander*, *Endesa*, and *Union Fenosa*. Financing was from an equity injection of $1.2 bn by *JP Morgan Partners*, *Providence Equity Partners*, TH Lee and *Putnam Partners*, and *Quadrangle*, plus $3.6 bn of senior debt arranged by *ABN Amro*.

High fashion clothier *Cortefiel* was sold in 2005 to private equity funds led by CVC for $1.4 bn. The Catalan industrial bakery *Grupo Panrico* was acquired by *Apax Partners* in a $1.1 bn LBO, partially financed with a syndicated loan from *Goldman Sachs*, *ING*, *Caja Madrid*, *Royal Bank of Scotland*, and *La Caixa*. Carlyle purchased *Occidental Hoteles* for €1 bn in 2005 after its sale of its stake in *Saprogal*, the Galician animal feed company (for a return of 5x what it had paid *Conagra* a year earlier).

Without mega-deal sizes, by number Spanish deals are on pace with 2005. The *TelePizza* chain has been the target of frenetic bidding, with the last a $1 bn offer from German VC fund *Permira* with TelePizza's president (over $150 mn over competing bids from CVC and another from Portuguese competitor Ibersol). In Jan., 3i sold its stake in the *AC Hoteles* group to other holders for $56 mn.

Fanning the Spanish boom are global factors like accessible credit markets and relatively low interest rates. Spain also offers favorable regulatory changes and a growing GDP. Helping the boost to private equity is the limited capital market access for small and midcap companies, as well as the protectionist streak of the Spanish govt.

Interest rates remain near 20-yr lows (despite 2 years of rate hikes by the Fed and European central banks). Leverage ratios (the amount of acquisition debt lenders are willing to finance, measured by target company EBITDA) has increased substantially in the last few years. Available credit led to increasing price multiples of over 10-14x EBITDA on large deals and 5–6x for middle market deals under €100 mn.

Burdensome securities registration requirements limit smaller company access to Spanish capital and stock markets. Listings are primarily family-owned companies. Also contributing to private equity demand are the recent weakness and volatility of stock markets, and uncertainty about rising interest rates, inflation, and oil prices. So some companies, like *Recoletos Media Group*, are delisting in public-to-private transactions financed by private equity group, in this case, a management buyout partially funded by Providence. Other public companies may follow.

Spain recently modernized its private investment laws to overcome certain legal and regulatory hurdles that posed obstacles to LBOs. These include recognizing funds of funds; and faster approvals for private equity funds managed by qualified investors (banks or financial institutions). The Spanish takeover law was modified to better protect minority shareholders.

> The Reign in Spain is Protectionist

Changes in the Spanish tax laws afford tax breaks on dividends paid to foreign LPs and have made it easier for PE funds to transact deals. Spanish pension fund laws changes raised the ceiling on pension fund private-equity investment to 30%. These legal modifications stimulate growth of the PE market.

Spain tries to protect local companies from foreign acquirers, even trade buyers willing to pay strategic premiums. This year, Madrid blocked the proposed €27 bn purchase of *Endesa*, Spain's largest electric co., by German utility *E.ON*. Prime Minister José Zapatero made no secret of his preference for a much lower in-country, bid of €21 bn from *Gas Natural*. PE funding could fill the financial void created by govt opposition to foreign takeovers.

Yet Spain has been more receptive to foreign private equity. While historically Spanish funds attracted govt money, recently they succeed in obtaining LP commitments from financial institutions at home and abroad. Banco Santander registered a PE fund of funds with a target of €200 mn; and *Altamar* converted a fund into a fund of funds raising €300 mn. Moreover, Spanish investors are now allowed to invest in foreign funds of funds.

Though still a fairly new asset class in Spain, private equity is accepted as a financing alternative for private companies with limited access to capital markets, or for public companies wanting to delist. The decentralized and loosely governed Spanish industrial base may prove a boon to PE funds seeking to achieve high IRRs. Fund-raising is up and institutional investors clamor for a piece of the Spanish action. Given the large amounts of capital to be deployed and readily available credit, 2006 could be another record breaker for private equity in Spain. ❖

Carlos is an attorney with Hogan & Hartson, LLP. *Spain's* NH Hoteles, *which we owned until June, launched a takeover bid for the 21% it does not own in the Sotogrande real estate developer.*