

Still a long way to go: Hochtief's bid opens takeover battle with Atlantia for Abertis Infraestructuras

Hochtief AG (ETR: HOT) – market cap as of 03/11/17: €9.87bn

Atlantia SpA (BIT: ATL) – market cap as of 03/11/17: €22.68bn

Abertis Infraestructuras S.A. (BME: ABE) – market cap as of 03/11/17: €18.34bn

Introduction

On May 15, the German construction company Hochtief announced a counterbid of c. €19bn for the Spanish infrastructure company Abertis, after the Italian group Atlantia had offered €16.3bn for the company. Abertis expects Atlantia to make another offer and Atlantia's CEO Giovanni Castellucci has announced that the company is currently evaluating its options.

About Hochtief AG

Hochtief is a Germany-based holding company involved in the construction industry. It is divided into three business divisions: Hochtief Americas, Hochtief Asia Pacific, and Hochtief Europe. The firm conducts construction projects worldwide involving real estate and transport infrastructure such as tunnels, bridges, airports, marine ports and sports stadiums. Over 95% of the company's revenues are sourced from outside of Germany.

In 2016 Hochtief had year on year revenues fall by 5.63%, from €21.10bn to €19.91bn, but managed to grow net income by 53.87%, from €208.29m to €320.48m. Despite a relatively low net margin (2.37%), the company provided shareholders with a 21.22% ROE. Since 2011, the Spanish ACS Group holds the majority of the shares (71.2%) and the company has since then shifted its strategic focus towards its core business of construction and has sold off non-core business units. Most notably, Hochtief sold its subsidiary Hochtief Airport to Canadian infrastructure investor PSP Investments for €1.1bn in May 2013. At the same time, the company strengthened its presence in the Asia Pacific region by increasing its stake in Cimic Group, an Australian construction company, from c. 58% to more than 71%.

About Atlantia SpA

Atlantia SpA is an Italy-based operator of transport infrastructures and mobility networks. The company's activities focus on motorways and airports in Italy and abroad. Through its "Other activities" division Atlantia also offers integrated solutions in the field of engineering, construction and maintenance of highway and airports, such as free-flow tolling systems and transport management systems.

In 2016 Atlantia SpA grew year on year revenues by 3.34% from €5.23bn to €5.41bn while net income grew by 31.59% from €852.53m to €1.12bn. Atlantia also had relatively high net margins (24.75%), while providing shareholders with a 17.57% ROE. The firm is listed on the Milan Stock Exchange and is part of the FTSE MIB Index. Atlantia's largest single shareholder is Sintonia, an investment vehicle of the billionaire Benetton family, that controls 38% of the company.

About Abertis Infraestructuras SA

Abertis Infraestructuras is a Spanish company engaging in the management of highway infrastructure. The company's Toll roads division focuses on the construction, maintenance and operation of highways, while its Telecommunications division manages and operates satellite infrastructure and transmission towers for mobile telephony. Abertis runs over 8,000 km of motorways in Europe and the US.

In 2016 Abertis saw year on year net income fall by 57.68% from €1.88bn to €795.58m despite a 13.02% increase in revenues from €4.21bn to €4.76bn. The company maintained solid net margins of 18.00%, and returned 13.99% to shareholders. Abertis is traded on the Madrid Stock Exchange and is a constituent of the IBEX-35, Spain's blue-chip stock index. Dividend per share and earnings per share growth ranked the highest relative to its industry peers over the past five years.

Industry Overview

The toll road market in the European Union countries covers c. 22,000km privately managed toll roads. In countries like Germany and Austria, the pricing of the service is distance-based with a system of free flow with on-board units (OBUs) that allow for toll charging. On the other hand, in France, Spain, Italy, and others, the system is distance-based but there are toll plazas and vehicles may or may not be equipped with OBUs. Still, some other countries such as the Netherlands and Belgium implement a time-based system, with the toll charging being added to a compulsory road tax the owner of the vehicles already pays.

Usually the roads are either financed and run by the national governments and its taxpayers, or a public-private partnership (PPP) contract is established in order to allow a privately-run company to build the road section and collect toll for it. This usually happens in three phases during the execution of the project, the first being the infrastructure planning, in which the government itself creates a plan of what the project consists in. Later, a private sector company will come in the design and construction of the project, after which the company can operate and maintain the road, charging drivers for its use.

In 2016, traffic growth rates of c. 3.6% were reported, but in Spain the figure goes up to 7%. Moody's attributes some of the overperformance in Spain to shifts in touristic travelling toward countries with less perceived geopolitical risk and terrorism. This change would introduce a decoupling of economic performance and traffic volumes, and therefore the performance of toll road operators in such countries. Further, geopolitical considerations could hamper government investment in infrastructure and the capacity of privately-run companies to obtain funding.

Takeover Battle

After months of discussion behind the scenes, on May 15, 2017 the Italian infrastructure group Atlantia declared its willingness to acquire the Spanish rival Abertis in the biggest deal announced so far this year in Europe. On the same day, Atlantia unveiled its long-awaited €16.3bn takeover bid proposing two alternative forms of consideration: an all-cash offer (€16.50/share) and an optional share alternative pegged at an exchange ratio of 0.697 per Abertis share, for up to 23.2% of the total offer (equivalent to a higher per-share valuation). The latter was ultimately designed with the aim of attracting the Spanish company's main investor Criteria Caixa, which, if taking up the share-swap, would own around 15% of Atlantia shares and obtain the right to appoint up to three directors to Atlantia's board. The bid is already the second attempt to link the main Spanish and Italian toll road group, as more than a decade ago the two players were close to a €25bn merger, that was ultimately scrapped because of political resistance in Italy.

Nearly five months later, on October 10, 2017 the Spain's market watchdog CNVM approved the Atlantia's proposed takeover of the Spanish rival, clearing one of the hurdles to the creation of the world biggest toll-roads operator. Similarly, the bid won the unconditional EU antitrust clearance as the European Commission said that the Atlantia-Abertis deal would not hurt competition. However, few days later complications arose. The Spanish construction and engineering giant Actividades de Construcción y Servicios (ACS) came into play, as anticipated in July when, in a filing with Spain's stock market regulators, ACS first revealed that it was mulling its own takeover strategy to acquire Abertis, although not having submitted it yet to the board of directors for approval.

On October 19, 2017, the Spanish ACS challenged Atlantia with a €18.6bn counter bid – about €19 per share - carried out through its German unit Hochtief. ACS is using its subsidiary Hochtief to offer cash and shares: about 80% of the consideration will be in cash as the bidder managed to clinch financing of €15bn via JPMorgan and for the rest Hochtief is expected to launch a capital increase worth up to €3.6bn. ACS's move aims at protecting its credit rating and avoiding raising equity itself, though Hochtief's plan to issue up to 24.8 million shares could dilute ACS's 72% stake in the German firm to below 50%.

After ACS-Hochtief filed its rival bid, Atlantia's offer was put on ice while the Spanish market watchdog CNVM looks into the counterbid. Even though the market was already aware of the possibility for a counter offer by ACS before October, there will now be a period of several months while the Hochtief's bid wins Spanish and international regulatory approval, giving the Italian group some time to work on an improved offer. Following the German bid news release, Atlantia's CEO Giovanni Castellucci declared that the company was ready to raise its offer, given the large potential for synergies to be extracted from the deal. However, so far only few information is available. The readjusted proposal will likely remain a combination of cash and share, but would probably have an improved cash component. This is in line with what was concluded by Abertis's board at the end of the month, which declared that Atlantia's offer was "positive and attractive from the industrial point of view", but it believed the cash consideration value had room for improvement.

Finally, given the considerable size of the deal, the role of financing banks need to be assessed: rumors are currently spreading in the news about some of the banks that in May had signed the support of Atlantia (i.e. Bbva, Commerzbank, Société Générale, Hsbc and Natixis) which are now shifting sides towards ACS, given the higher fees paid by the latter. Hochtief is then trying to gain the support from Deutsche Bank, which has not expressed its preference among the two bidders yet, but is likely to assist the German peer in its capital increase. Abertis's final decision between ACS-Hochtief's offer and the Atlantia's readjusted bid will come only after the CNMV has reached a final conclusion on the German offer, provided any other external competitor will not challenge the deal with a third bid.

Deal Rationale

The deal will bring about diversification for Atlantia, which is seeking growth outside Italy, source of 85% of its income. With Abertis' business in France and Latin America, it could even benefit from scale outside of Europe.

The deal would create the world's largest toll road operator with a combined 14,095km under management in 19 countries. Economies of scale are vital in today's infrastructure industry, as margins are being pressured by technology and a volatile macroeconomic outlook.

As for financial benefits, Atlantia would be able to exploit the readily available cheap debt to capture returns which surpass the cost of its borrowing. According to Moody's, its debt-to-equity ratio would increase from 3x to 5.4x in order to pay for the deal. Meanwhile, Atlantia's operating earnings could cover the interest payments of its own sizeable net debt by 4x, which suggests possibility to accumulate cash flows in the deal and hence space to raise its bid facing the counterbid.

In terms of profitability, this merger would create a group with combined revenues of €14bn, 3x those of the French competitor Vinci.

A decade ago, it was the disagreement from the Italian government over the future of the contract to run the Italian motorways that scuppered the merger deal between Abertis and Autostrade, the former name of Atlantia. This time it's the Spanish government that could form the political outcry, as they may favour a deal that would prevent Abertis from falling under foreign ownership, raising questions about the merit of the offer at the

current price for Abertis as it is “already well geographically diversified”. However, in early October, Atlantia said to be “near approval” from Spanish authorities for the bid.

Meanwhile, ACS is also trying to diversify in order to cut its exposure to the volatility of the construction sector. Just like Atlantia, ACS could benefit from a larger size and more opportunities around the world against other infrastructure builders and operators such as Ferrovial and Vinci, according to the CEO Florentino Pérez (who is also the president of Real Madrid football club). However, ACS’s cash flows are relatively more volatile than Abertis’. As such, the deal makes less sense for Abertis creditors as well as Hochtief minorities.

Advisors

Atlantia is advised by Mediobanca, Credit Suisse and Santander, while JPMorgan, Key Capital Partners and Lazard are advising ACS. Citi and AZ Capital act as advisors for Abertis.