May 2008

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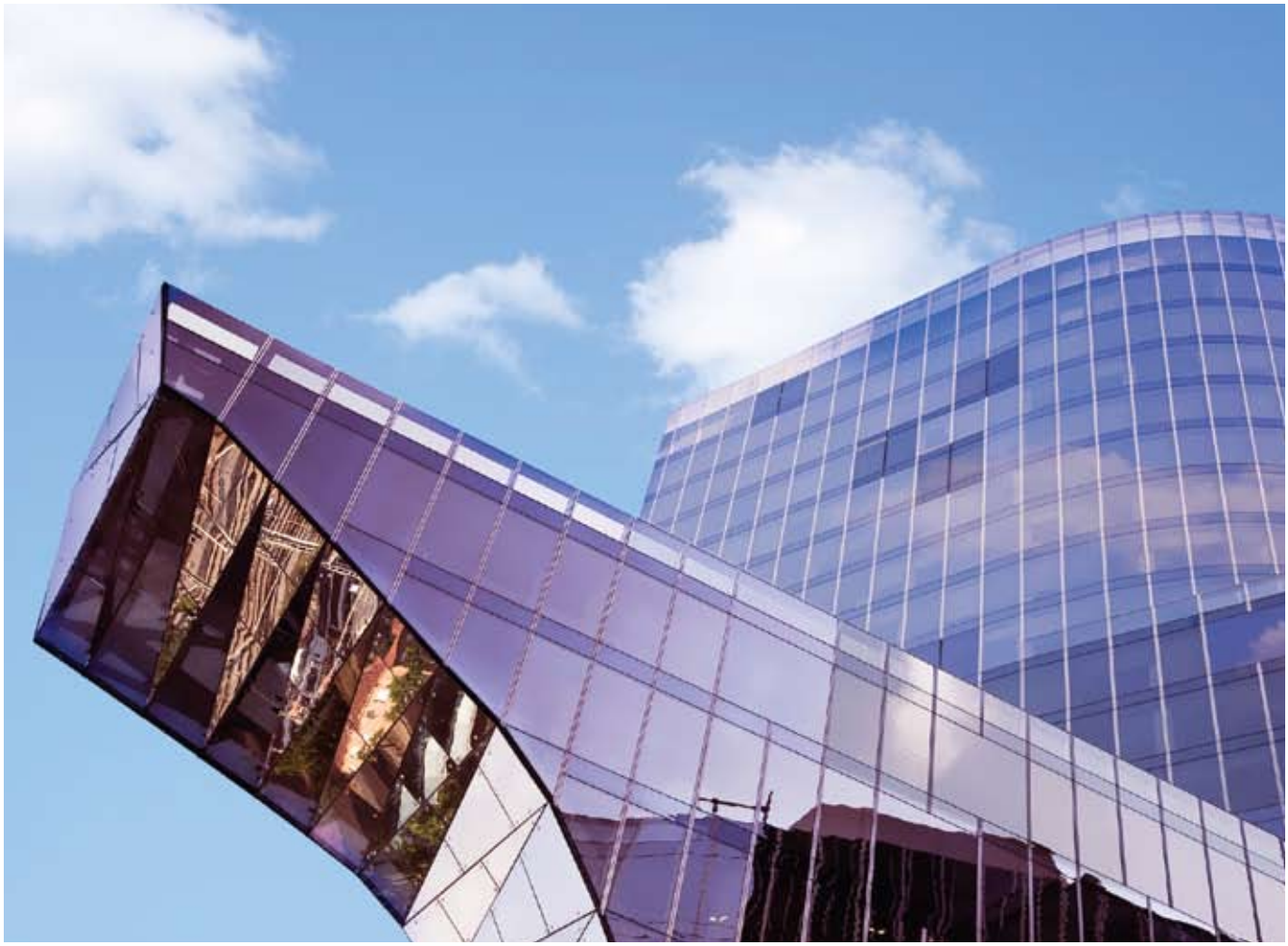
Spotlight Spain

A mergermarket report into the M&A market in Spain



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www.mergermarket.com

895 Broadway #4
New York, NY 10003
USA

t: +1 212 686-5606
f: +1 212 686-2664
sales.us@mergermarket.com

80 Strand
London, WC2R 0RL
United Kingdom

t: +44 (0)20 7059 6100
f: +44 (0)20 7059 6101
sales@mergermarket.com

Suite 2001
Grand Millennium Plaza
181 Queen's Road, Central
Hong Kong

t: +852 2158 9700
f: +852 2158 9701
sales.asia@mergermarket.com

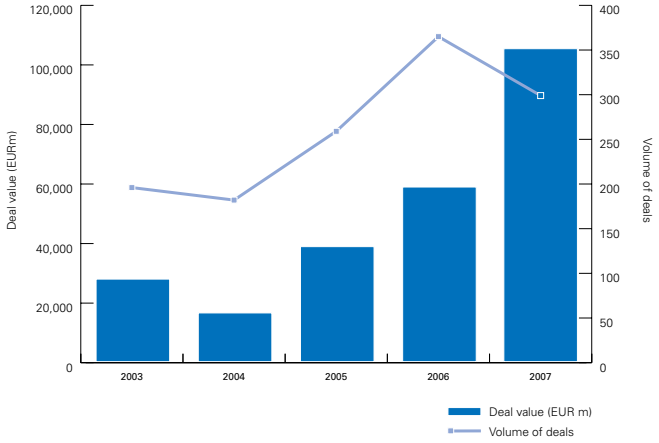
Foreword & methodology

Welcome to the inaugural Spotlight Spain report in association with IntraLinks, PricewaterhouseCoopers and Landwell – PwC.

At present Spain's M&A boom appears to have peaked. The strong domestic M&A market of the past few years has been matched by many large high-profile Spanish corporates undertaking cross-border transactions. The year 2007 in particular, saw M&A activity in Spain reach the highest level of the current boom in deal value terms. This is largely because of the resolution of the protracted Endesa situation – which saw the energy giant bought by Enel of Italy for €44.2bn. Spanish M&A volume, meanwhile, appears to have peaked in 2006, the slump in the Spanish Construction sector will clearly have an effect on M&A going forward.

Certainly, the indications from our proprietary research is that deal making is set to decline in 2008. Indeed, 63% of respondents expect the level of M&A deal making will decrease. Elsewhere, the outlook for cross-border M&A by Spanish companies is somewhat divided among respondents, with 36% expecting an increase, and 32% expecting a decline.

For the purpose of this report mergermarket interviewed 100 senior M&A practitioners in Spain, with the aim of getting beyond the headlines and assessing the real momentum and prospects for Spanish M&A in the next twelve months. mergermarket spoke to an even mix of prominent Spanish private equity partners, senior M&A bankers, M&A lawyers and CEOs of acquisitive Spanish corporates. The motivation was to garner their views on a range of issues spanning both strategic M&A and private equity activity.



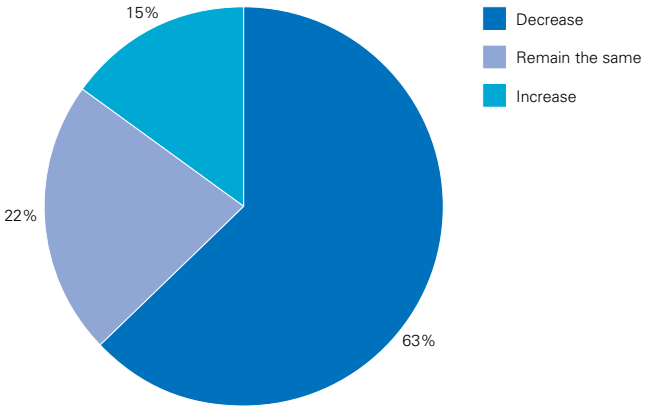
We hope you find the research and editorial presented in this report revealing, insightful and stimulating, and we welcome any feedback you might offer to benefit future editions.

Whatever lies ahead for M&A in Spain in the coming year, mergermarket and our sponsors are grateful to the respondents who took time out to contribute to what we hope will become the definitive market outlook on M&A in Spain. Your feedback is particularly welcome.

Survey Findings

63% of respondents expect Spanish M&A to decrease in the next half year

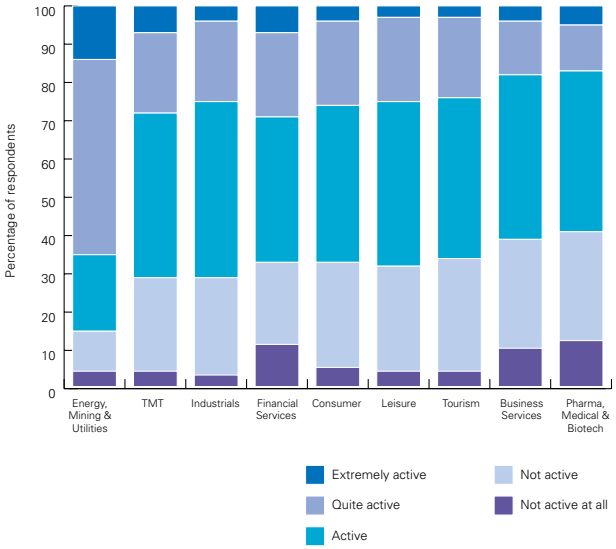
What do you expect to happen to the level of M&A activity in Spain over the next six months?



- In an indication that the top of the M&A boom might have been reached in the past year, 63% of respondents expect M&A activity in Spain to decrease in the next half year, while 36% believe that deal flow will either increase or remain the same.
- A number of respondents believe that M&A activity is heavily dependent on deal type, size and sector. One respondent thought that the "mid-market space will be stable whereas larger deals (€ 300m+) will decrease." Another said that "there should be a distinction between the expected levels of private equity acquisitions and strategic mergers," while yet another commented that a forecast "depends on the sector, for example, Construction and Financial Services deals have seen the most diminished levels of M&A activity."

Energy, Mining & Utilities transactions are considered the most active

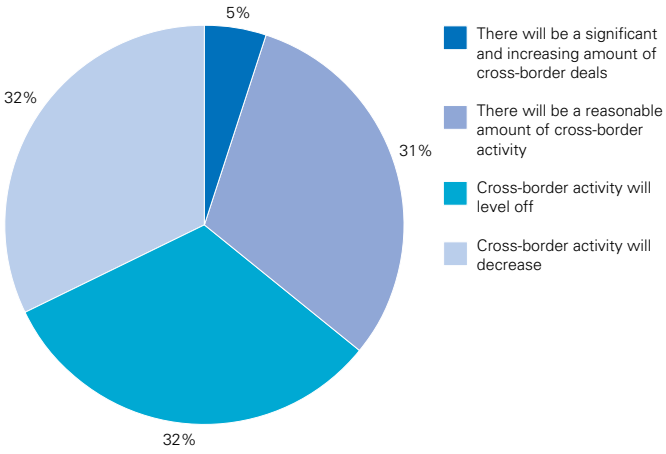
In your opinion, how active are the following industry sectors going to be in terms of M&A activity in Spain in the next 12 months?



- According to respondents, Energy, Mining & Utilities deals will most likely lead M&A activity by sector next year. 14% of respondents expect it to be an extremely active sector next year, 51% quite active and 20% active. Only 4% believe that it will be not active at all. The TMT and Industrials sectors were also relatively highly rated by respondents, with 71% and 72% respectively thinking that they would see at least an active amount of M&A activity in 2008.

Respondents are divided over the momentum of cross-border M&A

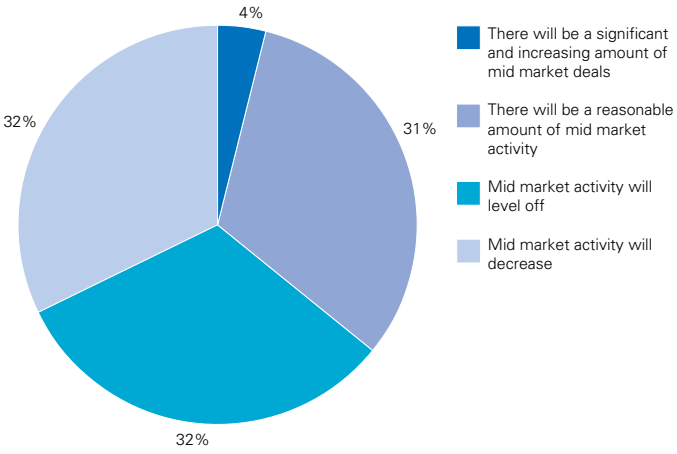
How would you best predict Spanish cross-border M&A activity for the next six months?



- 36% of respondents believe that cross-border M&A activity in the next six months will be at least reasonable with 5% believing that activity in the space will be significant and increasing. Equal tranches (32% apiece) of respondents believe that cross-border activity will either level off or decrease in the next half year.
- Some respondents who thought activity would decrease cited the credit crunch as a major factor. One said that "access to capital to finance deals is difficult because of the high rate of interest." Another said the level of activity "depends on how the financing crisis will develop – there is not enough liquidity to acquire." On the other hand, a respondent cited the weak dollar as a positive strong influence on his firm's ability to acquire cross-border targets in North America.

Respondents are evenly split about future mid market activity

How would you best predict Spanish mid market M&A activity for the next six months?

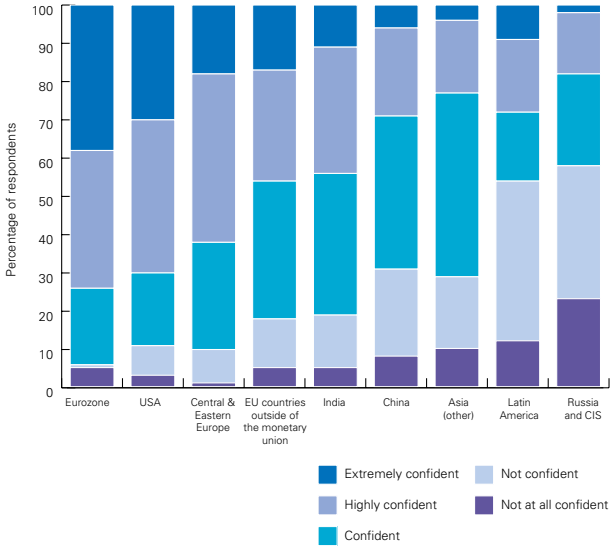


- Respondents were fairly evenly split about prospects for the Spanish mid market. 32% apiece thought that activity would be either reasonable, would level off or would decrease. Only 4% said that it would significantly increase. Unsurprisingly, the credit crunch influenced respondents' answers. One respondent bluntly stated: "private equity is not going to acquire anything at the moment."

Survey Findings

Respondents are most confident about conducting M&A in Eurozone and USA

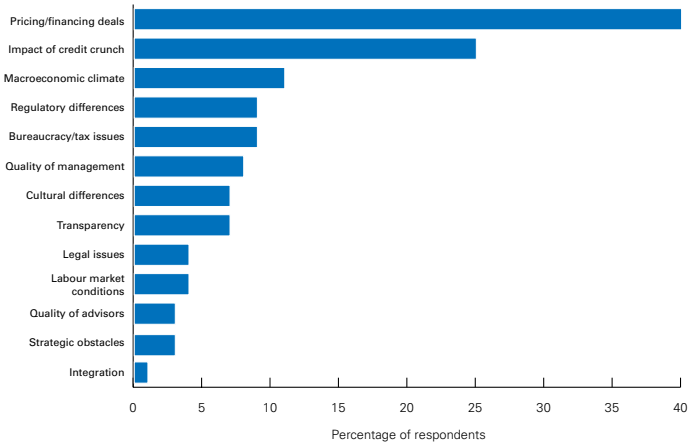
How confident would you feel about conducting M&A in the following countries and regions?



- The Eurozone and the USA were respondents' most favoured regions to conduct M&A, with 73% and 71% respectively being at least highly confident of undertaking acquisitions in these areas. On the other hand, Latin America and Russia and the CIS instilled the least confidence in respondents – only 27% and 19% in that order were highly confident of completing a transaction successfully there.
- It is important to note that regional differences exist. One respondent said that "in Latin America, it is necessary to distinguish between countries. Mexico and Brazil which will draw more M&A activity and generate more confidence than other Latin American countries."

Pricing/financing deals remains a key obstacle to outbound Spanish M&A flow

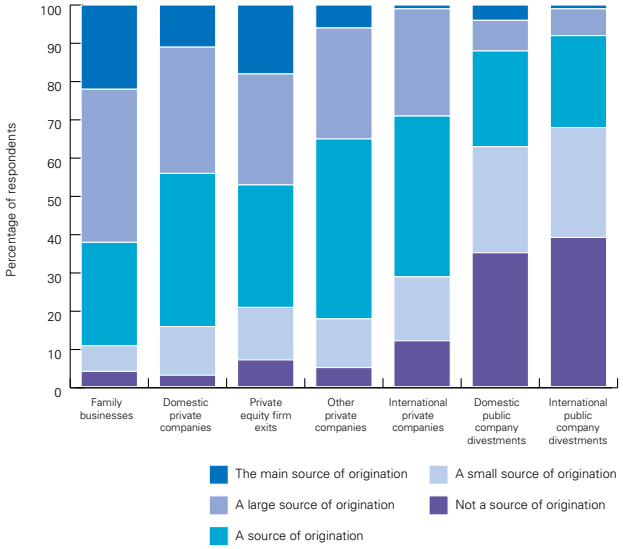
What are the key obstacles to conducting outbound Spanish M&A activity?



- 40% of respondents highlighted the pricing and financing of deals as a key obstacle to outbound Spanish M&A activity. In second place was the impact of the credit crunch, an obstacle inherently connected to financing, which was selected by 25% of respondents.
- According to respondents, pricing/financing obstacles are caused by a wide variety of factors. One respondent in particular talked about the challenge of matching the "gap between buyer and seller expectations."
- One respondent said that "The levels of leverage at the moment are very high meaning that sellers value their companies at a very high price." Another talked of the "lack of confidence in the banking sector. The international perception of the Spanish market and everything related to the Real Estate and Construction sector."

Family businesses are expected to be the leading source of M&A opportunities

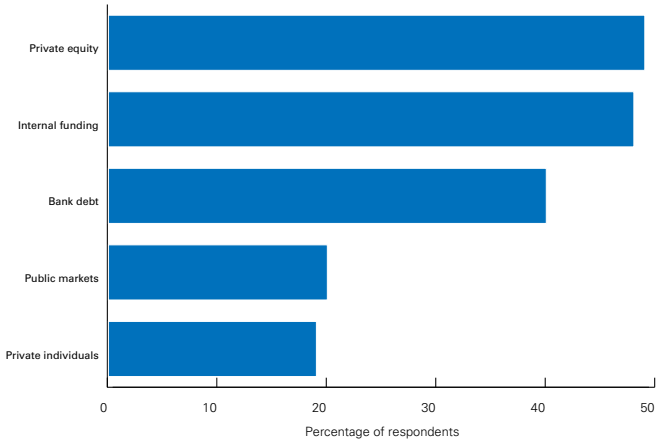
Where do you expect to source M&A opportunities in 2008?



- According to respondents, family businesses will prove to be a lucrative hunting ground for M&A practitioners, with 62% stating that this business type would be their main source of deal origination.
- On the other hand, both domestic and international public company divestments figure relatively low in respondents' expectations for deal origination – only 4% and 1% of respondents would use them a main source of deal flow.

Private equity and internal sources of funding are expected to be most prevalent in 2008

Where do you expect Spanish companies to source most of their funding for strategic growth in 2008?

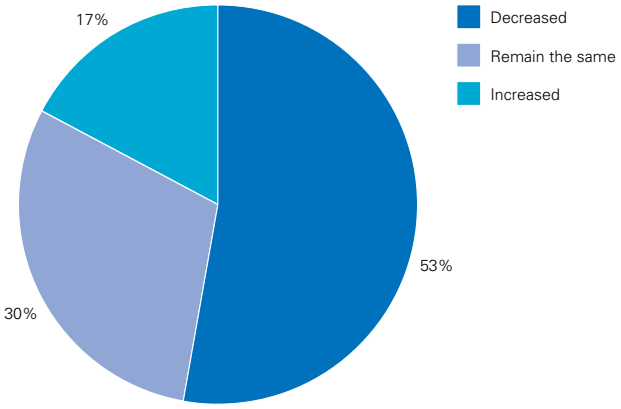


- Perhaps as a result of the credit crunch, 49% of respondents expect Spanish corporates to tap private equity financing for their strategic growth. Certainly, private equity funds are still sitting on significant raised cash that will now need to be deployed in more diverse deal structures now the bottom has fallen out of the LBO market.
- Otherwise, 48% of respondents expect corporates to tap internal funding and 40% believe bank debt will also be considered. Going to the public markets for funding is selected by only 20% of respondents, just ahead of going to private individuals (19%).

Survey Findings

53% of respondents believe that valuations have decreased in the past year

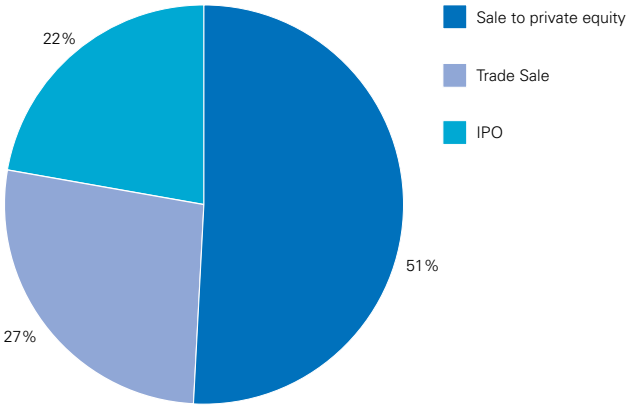
Compared to 12 months ago do you believe valuations have:



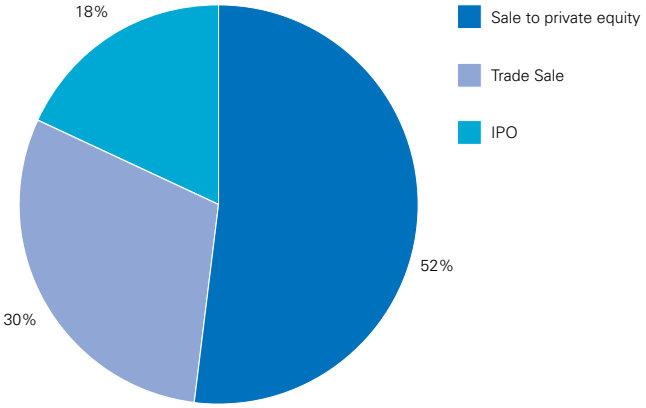
- Another clear sign of the turn in the M&A cycle is that 53% of respondents consider that M&A valuations have decreased over the past 12 months, while 30% think that valuations have remained the same. Only 17% believe that they had increased.
- In their commentary, respondents generally thought the top of the valuations curve had been reached. One respondent said that "valuations will stay the same for a while but will eventually decrease," while another said that "the most negatively reduced valuations are in the Banking, Real Estate and Construction sectors as a result of the credit crisis." A sizable number of comments also noted that valuations were very sector-dependent, as well as being influenced by company type – one respondent said that "quoted companies have increased their valuations while those that are not quoted have levelled off or decreased."

Over half of respondents back divestments to private equity as the most popular exit strategy, for both corporates and private equity funds

In your view, what is the most common exit strategy for corporate firms in Spain at present?



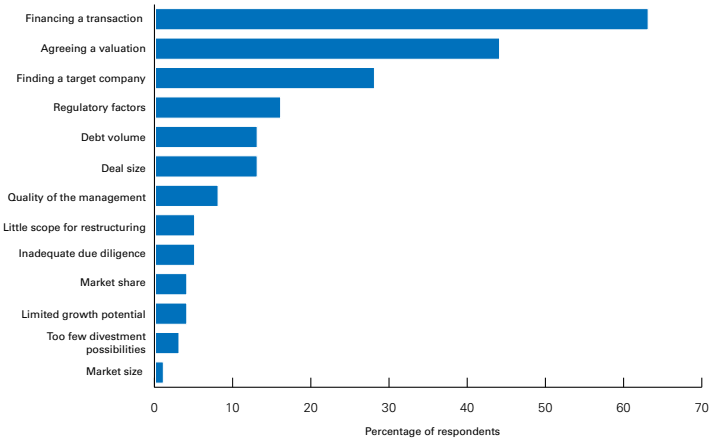
And for private equity?



- 51% of respondents believe that a sale to private equity is the most common exit strategy for corporates, while the remainder are fairly evenly split between trade sales (27%) and IPOs (22%).
- Findings for private equity exits were similar, with 52% citing secondary buyouts as the most popular method for private equity houses to exit their investments, followed by trade sales (30%) and IPOs (18%). Furthermore, the majority (72%) of respondents did not anticipate any change in the exit market in 2008.

Overall M&A activity is hindered by financing issues, according to 63% of respondents

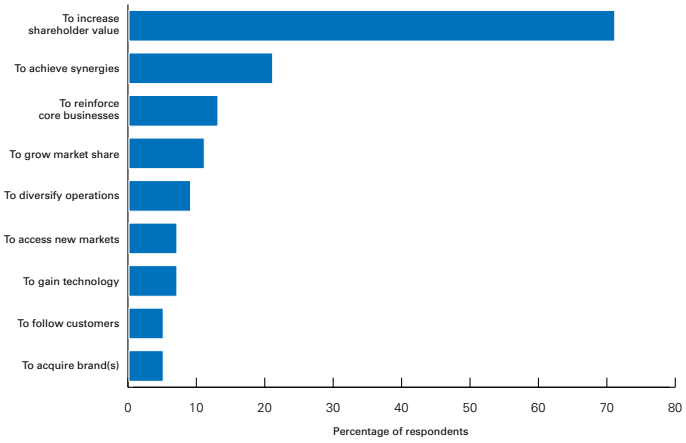
In your experience which of the following factors are the main obstacles to an M&A transaction?



- As earlier with outbound M&A, financing was cited by 63% of respondents as the main obstacle to completing a transaction, while agreeing a valuation was selected by 44%.

71% of respondents believe that M&A is largely conducted to increase shareholder value

What is the main strategic purpose of your M&A activity?

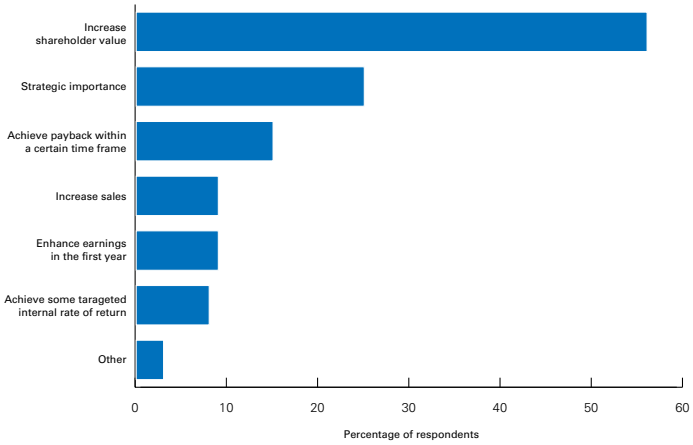


- 71% of respondents undertake M&A activity to increase shareholder value. This was by far the most popular reason to undertake M&A, with achieving synergies (21%) a distant second.

Survey Findings

56% of respondents rank shareholder value as most important mark of deal success

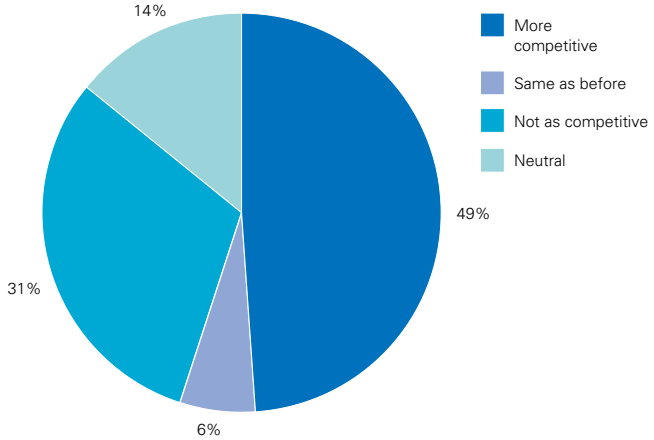
What financial attributes must an acquisition show for you/your investors within the first year post acquisition?



- Predictably, respondents also believe that shareholder value added is the measure of the success of an M&A transaction. 56% of respondents state this as an attribute which must be achieved within the first year of acquisition. The strategic importance of a transaction was also a primary consideration to take into account when assessing the success of a deal for a quarter of respondents. Achieving internal rates of return and other measurements of success were attributes required by just 8% and 3% of respondents correspondingly.

49% of respondents believe private equity will be more competitive with corporates in the next half year

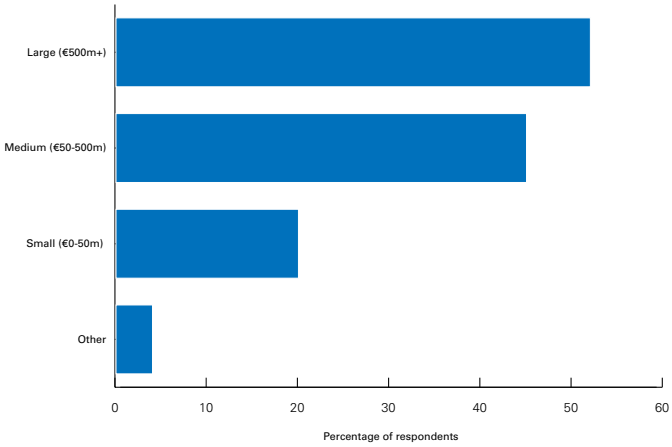
To what extent do you expect private equity firms to be increasingly competitive in auctions with Spanish corporates in the next six months?



- Respondents were relatively evenly divided regarding how competitive private equity firms would be in auctions with corporates in the next six months. The largest share (49%), however, believe that private equity funds will be more competitive, while 31% thought that they would not be as competitive. A small number (6%) thought they would remain as competitive as before, while 14% were neutral.
- One respondent who was neutral, felt the level of private equity competition depended on the size of the auction situation, with competition likely greater in the mid market than large-cap space. "Private equity funds are very competitive on medium size but on the large ones, they are becoming less and less competitive," he said. Meanwhile, another respondent added that "Private equity is more competitive in some sectors than others."

Private equity is thought to be most competitive in large (€500m+) transactions…

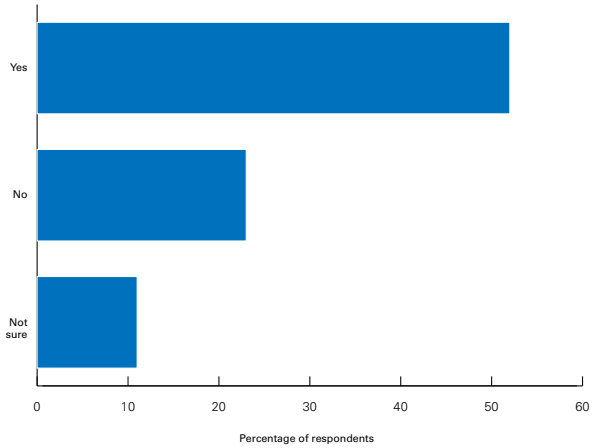
Which size of deal are private equity firms most competitive on?



- Somewhat in contradiction with views made in the previous question, 52% of respondents believe that private equity firms are most competitive in large situations (€500m +). A further 45% also believe they are competitive in the mid market deal space (€50m to €500m).
- Respondents also mention a range of deal-types in which they believe private equity firms will be most competitive participants, in particular family business deals, and buy & builds.

52% of respondents believe that Spanish private equity deals are over leveraged

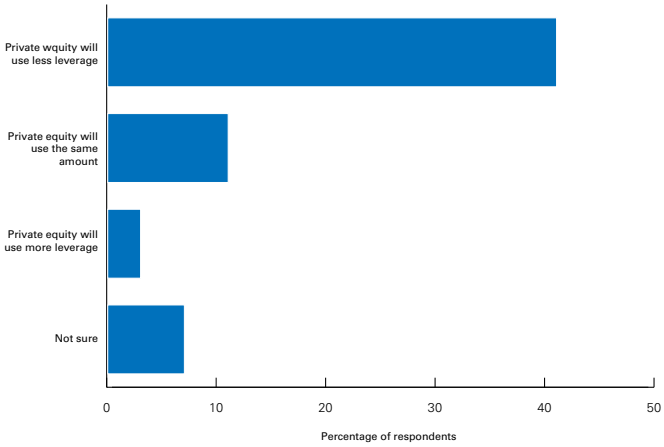
Do you believe that private equity deals are over leveraged in Spain at present?



- A small majority of respondents believe that the level of debt in many private equity deals is too high. This most obviously reflects caution post credit crunch, however it may also represent the adversarial relationship that corporates have frequently had with private equity funds.

41% of respondents expect debt levels to fall in the next six months

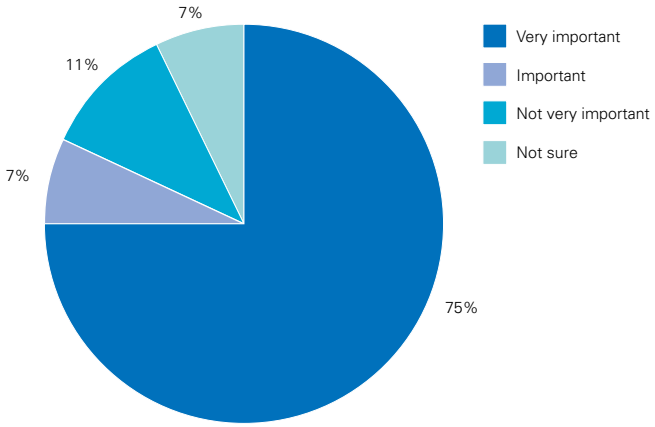
How do you see this developing over the next six months?



- 52% of respondents think that Spanish private equity deals utilise too much debt in proportion to equity while 11% were unsure. Meanwhile, even among the 23% who do not feel deals are currently over leveraged many admit that this was the case earlier in 2007. As one says: "Until June 2007, they were over leveraged, but not anymore."
- Looking forward, 41% thought that private equity will use less leverage in the coming half year, and only 11% believed that the industry will use the same amount. Many of those who thought that debt levels would decline proffered timeframes for the industry. One respondent said that "leverage will be lower in the next 10 months and after that it will increase again," while another said that "over leveraged transactions will continue but only until next summer."

75% of respondents say private equity plays a very important streamlining role in Spanish economy

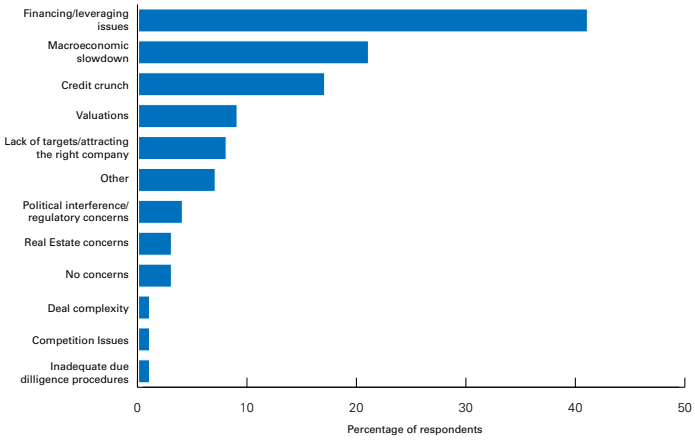
To what extent do private equity firms in Spain fulfil an important function by streamlining businesses and preparing companies for strategic buyers?



- Three-quarters of respondents thought that private equity firms play a very important role in the overall Spanish economy by streamlining businesses and preparing them for sale to corporates.
- Private equity firms also play an important role "because they organise the company and apply the rules of the Spanish government," one respondent said. Another said that "the companies sold by private equity are in a substantially better state than when they were acquired." However, not all respondents were so glowing. One comment noted that while private equity has a positive impact on the economy, "some Spanish companies view them with distrust."

Financing/leveraging issues are a chief concern for 41% of respondents

In terms of M&A activity in Spain, what is the issue that most concerns you in the next 12 months?



- Again, it is financing/leveraging issues that are foremost concern in the next 12 months, selected by 41% of respondents. A further 21% thought that the general economic climate would be an issue. The not unrelated credit crunch was cited as the main concern by 17% of respondents.
- Financing/leveraging concerns centred on the increasing inability of buyers to finance transactions with debt. One respondent said "obtaining bank credit" was his concern, typifying many other comments. Another respondent noted that "the stagnation of demand and consumption" in the economy was his worry.
- Interestingly, given the much publicised collapse of the country's real estate sector in the past year, only 3% thought that it was their most pressing concern. However, those who did mention it painted a bleak picture. One respondent said that "the failure of the real estate sector will affect every sector of the Spanish economy" while another said "the real estate crisis has very much affected international perceptions of the Spanish market."

Spain's M&A rollercoaster ride

mergermarket's inaugural Spotlight Spain report, produced in association with Landwell, PricewaterhouseCoopers and Intralinks, has found that the Spanish M&A market appears to be coming off the boil. The survey shows that for many deal makers, it is proving increasingly difficult to finance certain kinds of deals.

Nevertheless, in the aftermath of the credit crunch, the underlying picture remains broadly positive. Indeed, any pessimism about the Spanish market has to be placed in the context of the two previous years, both of which set new records. The long-term trend is likely to continue to be upward after a technical correction in 2008.

Spain's best-ever year in terms of deal value came in 2007, with one deal overshadowing all others. The country's largest-ever public takeover closed towards the end of the year, an incredible 25 months after Gas Natural made a hostile bid for Endesa, the country's largest electricity company. Endesa's chosen white knight, E.On of Germany, had deeper pockets than Gas Natural, but the German giant ran into political and regulatory difficulties. E.On eventually lost the deal after construction company Acciona built up a blocking stake in the company. At the end of the saga, Acciona and Enel of Italy successfully tabled their own €44.2bn joint bid for the company.

One of the important lessons of the takeover saga was that core shareholders are still a vitally important part of the Spanish market. Listed companies have for decades encouraged friendly investors to buy large stakes to deter predators. Over the last few years, there have been a few hostile takeover situations, including Gas Natural's bids for both Endesa and Iberdrola, but the success rate has tended to be fairly low. One common defensive tactic is the so-called white squire defence, where friendly shareholders buy shares in the market and decline to tender them into a hostile offer. Although the sheer scale of the investment was unprecedented, Acciona's stake-building in Endesa is part of an established trend.

The importance of core shareholders in Spain was once again reiterated at the end of 2007. The country's largest airline Iberia had put itself up for sale, in a situation that could be one of the larger deals of 2008. Towards the end of 2007, Caja Madrid bought out other core shareholders, putting any deal on ice until after the general election which took place on the 9 March this year. Although an eventual deal could come in at around €3.4bn, this is still a long way from the €44.2bn that Acciona and Enel paid for Endesa.

Another important lesson from the Endesa battle is the changing importance of the political establishment in Spanish M&A. In the past, it was common to ask for ministerial approval before launching bids for strategic companies. E.On decided not to go down this road. Although E.On's bid eventually failed, it won a number of regulatory battles with the government.

Since the end of the takeover battle, the government has also drawn up a new takeover code. The new rule-book should bring Spain closer to the Anglo-Saxon approach to M&A as the policitians are in effect legislating themselves out of the picture. The new takeover code has closed a number of loopholes that emerged in the old regime, such as the rule that allowed Acciona to buy Endesa shares in the market while E.On was restricted from trading in the market.

The new rule-book has changed some of the definitions of control. One consequence of the new code is that a number of companies are bidding for 100% of their listed affiliates. The new rules give a certain advantage to companies that hold more 50% of the shares of another. For example, in one deal due to reach completion in the first half of the year, Prisa has launched a mandatory bid for its pay-television affiliate Sogecable after going through the 50% level by buying shares in the market. The mandatory takeover values Sogecable at €3.8bn.

Although the sheer size of the Endesa deal meant that 2007 was a blockbuster year in terms of deal value, the market was already slowing down in terms of volume after a record-breaking year in 2006. The downturn in volume reflects a slump in construction, which was for decades the motor of the Spanish economy, along with its close relatives property, tourism and banking. The construction boom started in the 1960s with the advent of mass tourism and received another injection with European Union (EU) integration funds from the

1980s. With the recent entry of former Communist countries into the EU, the flow of money from Brussels for civil works has begun to dry up. The housing market is also slowing down after a long boom.

One consequence of the downturn is that many of the country's largest construction and property companies have been diversifying into new geographical areas and into new sectors such as energy and infrastructure. Acciona's decision to buy Endesa is part of a wider trend, which has seen rival Ferrovial become the owner of Heathrow and Gatwick after buying BAA. Of particular interest is ACS, which has bought stakes in both of Endesa's largest rivals, Iberdrola and Union Fenosa. The construction company is likely to be a key player if dealmakers are correct in predicting further consolidation of the energy market after the general election.

Ferrovial's investment in UK airlines also fits into another trend of Spanish companies buying aggressively overseas. The companies have been helped in part by a benign fiscal regime that grants tax deductions to those that buy foreign assets. The EU has launched a long investigation, which is likely to end in 2009, to see whether these incentives form state aid. The uncertainty of whether companies like Telefonica and Iberdrola will have to pay back the tax deductions they gained from buying O2 and Scottish Power respectively is likely to hang over outbound M&A in the months ahead.

Despite the EU investigation, one company that is unlikely to sit on its hands is Banco Santander. Over two decades, Chairman Emilio Botin has transformed the bank from a small provincial player into one of the largest banks in the world. An aggressive dealmaker, Botin bought ABN Amro's Brazilian and Italian assets last year as part of the bank's €19.9bn investment in an unprecedented consortium break-up bid. The total €71.1bn consortium bid was the year's largest successful European deal, with Endesa in third place.

Shortly after the ABN Amro deal closed, Botin then surprised everyone by selling most of ABN Amro's Italian assets almost immediately for €9bn. The sale puts Santander in a good position for more aggressive dealmaking in 2008. The bank has flagged the possibility of deals in the US, where it is a shareholder of Sovereign Bancorp, or the UK, where it already owns Abbey National.

Although the EU tax investigation could hurt overseas deals for investors that are less aggressive than Santander, one other negative factor is looming large this year. Some 63% of the dealmakers surveyed for this report said that finding financing is the biggest obstacle to completing a transaction. Following the recent credit crunch, trade buyers have been successful in some larger deals after years of finding it difficult to compete with private equity firms. For example, in a deal that is due to complete early in 2008, Imperial Tobacco is paying €12.8bn for Franco-Spanish tobacco firm Altadis after financial buyers decided not to proceed.

Despite the difficulty of financing deals, the overall picture remains promising for private equity firms, who have slowly and quietly been transforming Spanish business by buying up family-controlled companies and professionalising them. Around half of the dealmakers in the survey believe that a sale to a financial buyer will remain the most common exit strategy for corporate sellers and that private equity firms still have an edge over trade buyers in most competitive auctions. Financial buyers are seen as most competitive in deals valued €50m to €500m, and in the blockbuster category.

We hope you find the research and editorial presented in this report revealing and insightful, and we welcome any feedback you might offer for future editions. mergermarket and the report sponsors are grateful to the respondents who took time to contribute to what we hope will become the definitive outlook on Spanish M&A.

Rupert Cocke
Spanish Bureau Chief
Mergermarket

IntraLinks biography

INTRALINKS
The workspace is virtual. The trust is real.

As the leading provider of virtual datarooms to the global M&A community, IntraLinks is pleased to be a cosponsor this inaugural mergermarket "Spotlight Spain" M&A study. We hope you have found the results interesting.

There is little doubt that, over the past two years, Spanish M&A activity has been healthy. As M&A activity in the region has grown, so too have we seen the growth in the adoption of technology to facilitate the M&A process. This has been reflected in our increasing engagement in the Spanish market, and our decision to expand our local sales presence. With the study suggesting that Spanish companies will be looking toward international expansion in the coming year, IntraLinks provides the perfect tool to reach across geographical boundaries and time zones, without adding time or expense to the deal.

However, in what the majority of this survey's respondents have predicted as a more challenging market in 2008, the benefits of using a virtual dataroom in an M&A transaction, become increasingly valuable.

Using an IntraLinks virtual dataroom can dramatically increase the speed and efficiency of a transaction by eliminating the cost and hassle of creating physical datarooms; tracking all disclosure online; reaching more buyers and monitoring interest throughout the process.

In addition, multiple buyers can conduct due diligence simultaneously, eliminating scheduling conflicts and the need to travel. By accelerating the process companies can reduce the impact of market factors - on average using IntraLinks online workspace can shave up to 30 days off a deal.

As the market leader in secure online document exchange, we are committed to delivering a better way to manage and exchange the confidential information involved in M&A transactions and post-merger integration.

We look forward to working with all participants in the Spanish marketplace over the coming year.

For more information contact

Anne-Gaëlle Le Gallou
or
Patricia Gómez

IntraLinks
Salcedo, 2
28034, Madrid

Tel: +34 91 771 5117
email: alegallou@intralinks.com or pgomez@intralinks.com

www.intralinks.com

IntraLinks

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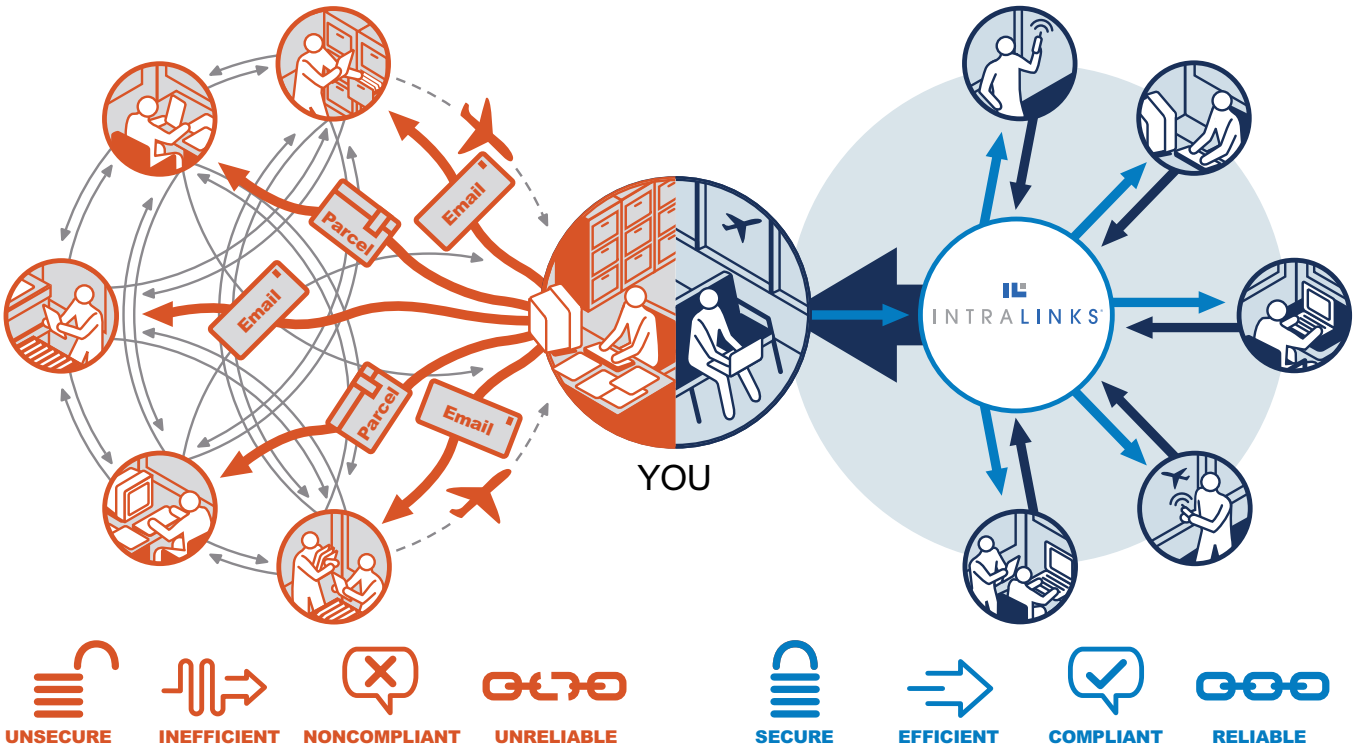
IntraLinks is the leading provider of secure online workspaces that speed and simplify document-intensive business processes and ensure the safe exchange of highly confidential information.

By bringing all the necessary information together in a single, secure online location, IntraLinks can streamline and improve the way you do business.



Secure

Keeping your confidential information secure is our highest priority. Comprehensive ID and password protection protocols keep you in control of who has access to your virtual dataroom, and allow permissioning down to the document level.

Efficient

Using IntraLinks virtual dataroom multiple buyers can conduct due diligence simultaneously. By eliminating scheduling conflicts and the need to travel, you can shave an average of 30 days off your deal. By accelerating the due diligence process, you also reduce the risk posed by market factors.

Compliant

Real time access reports reveal which information has been viewed when and by whom. IntraLinks enables you to maintain a full auditable record of information disclosure for legal or compliance purposes.

Reliable

World-class infrastructure and hosting facilities enable us to guarantee our clients 99.5% availability. Your information is stored in fully redundant servers housed in highly secure, geographically dispersed facilities. Real-time replication across data centers ensures data integrity and reliability.

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Landwell – PwC feature article

Recent reform of mercantile legislation and several rulings by the General Directorate of Taxation trigger uncertainties with respect to certain aspects of M&A transactions

Simplified mergers

Following the reform of Article 250 of the Spanish Companies Act, introduced by Law 19/2005 of 14 November 2005, legal cover has been provided to merger transactions under the simplified regime between related companies that, in practice, had only been accepted by certain Mercantile Registries.

For instance, downstream mergers and mergers between corporations wholly-owned by the same shareholders are treated as simplified mergers. Consequently, there is no need to include in the merger plan information about the share exchange ratio and procedure, nor to carry out a capital increase in the acquiring company and to obtain reports from experts and directors concerning the merger plan.

The approach held by the General Directorate of Taxation in a recent ruling of 31 January 2008 is that the application of the special tax regime (characterised by tax neutrality and deferral) to a merger between two companies wholly-owned by the same shareholders depends on the requirement that, after the transaction, the shareholders of the target are the shareholders of the acquiring company.

Conversely, in certain cases of mergers between "sister companies" where the companies involved are not wholly-owned directly by the same shareholder, it would not be possible to apply the special tax regime.

As a result, it is advisable that in merger transactions to which the simplified mercantile regime is applicable, a detailed analysis is carried out of whether the same may avail themselves of the special tax regime such that when the transactions are reviewed in the event of an inspection, undesired consequences are avoided.

Global assignment of assets and liabilities

The reform of mercantile legislation mentioned above did not address another controversial practice which is still subject to doctrinal debate: the option to apply the simplified merger regime or the regime for the global assignment of assets and liabilities in the event of the integration of public limited companies in which one is wholly-owned by the other. As we already know, the regime envisaged in the Spanish Private Limited Companies Act in this respect has no equivalence in the Spanish Companies Act.

It is important to note that the purpose of said transactions differs: A merger is a business restructuring process through the integration of assets and liabilities which results in the extinction of the owner of the assets and liabilities acquired; while global assignment of assets and liabilities is a measure, unique and simplified of the liquidation process, upon the company's dissolution. This is understood by the DGRN (General Directorate of Registers and Notaries) in its resolution of 22 May 2002, in which it is declared that the global assignment of assets and liabilities of a public limited company cannot be used for any purpose other than for its liquidation, without expressing a prior judgement on the requirements to which such global assignment should be subject to. It concludes that such a transaction may only be carried out in public limited companies in accordance with the simplified merger regime. This is the current registrar criteria.

The uncertainty existing in relation to mercantile legislation is reflected in taxation; through the ruling dated 14 January 2008, the General Directorate of Taxation reiterates the approach held with respect to such transactions in the past few years.

The DGT (General Directorate of Taxation), through a questionable interpretation of mercantile legislation, has confirmed that in its opinion, the fact that the global assignment of assets and liabilities is governed by the Private Limited Companies Act in the Section on Liquidation, leads to the conclusion that the global assignment of assets and liabilities of a company entails its real liquidation.

This is not a trivial issue due to the fact that those transactions involving dissolution with liquidation are not included as merger transactions to which the special tax regime is applicable and may give rise to situations where, in order to avoid uncertainty in the event of a tax inspection, the companies involved are forced to follow the vertical merger procedure in order to attain the same objective, namely, the transfer of corporate assets from a company to its single shareholder.

Tax deductibility of goodwill and new accounting legislation

Regarding the changes introduced by Law 16/2007 of 4 July 2007, with an impact on mercantile legislation, the removing of certain legal restrictions on the distribution of dividends in those companies that have recognised goodwill within their assets, is particularly noteworthy.

In particular, the prohibition of distributing dividends until incorporation expenses and goodwill are fully amortised, unless there are available reserves equal to the amount of unamortized expenses is eliminated. In its place, new regulations lay down that an unavailable reserve must be recorded for an amount equal to goodwill on the balance sheet. At least 5% of that amount must be allocated to such reserve from annual profits (or from freely available reserves if profits are insufficient or non-existent).

There are doubts surrounding the applicability of this regime to the periods ended in 2007 where the resolution for the distribution of profits must be agreed in 2008, following the entry into force of the new regime. The wording of the final provision concerning the entry into force is particularly unfortunate in this respect.

The possible deduction for tax purposes of the resulting goodwill entails a clear tax saving which should be considered in the light of recent legislative amendments.

The accounting reform that came into effect on 1 January 2008 attempts to uphold a neutral position with respect to corporate income tax and to this effect, does not in essence change the conditions laid down for the 5% deduction of goodwill: Its deductibility is permitted although new accounting legislation does not envisage its systematic amortisation.

Nonetheless, new tax legislation has added as a new condition, that in order to qualify for the right to the tax deduction, an unavailable reserve must be recorded for at least the tax deductible amount in the terms laid down in aforementioned mercantile legislation.

Although goodwill is not amortisable from an accounting viewpoint, an impairment test should be performed on an annual basis in order to determine if a provision should be made to adjust its value. This adjustment is not subject to any specific tax regulation and, at this stage it is not certain whether such provision will have the consideration of being tax deductible, even though it has been determined in accordance with the regulations provided in the Code of Commerce or other applicable legislation. We expect the General Directorate of Taxation to issue a decision in this respect shortly.

Javier Maceira
Lawyer, Partner and Head of Deals Group,
Landwell-PricewaterhouseCoopers

Rafael Rebate
Lawyer, Tax Partner of Deals Group,
Landwell-PricewaterhouseCoopers

Working Together

"Working Together" is the philosophy that guides the Landwell-PwC team engaged in legal and tax advisory services for M&A and Private Equity transactions in Spain. Unlike the majority of our competitors, our work is performed in association with experienced specialists from other divisions of PricewaterhouseCoopers, allowing us to offer an integrated, multidisciplinary and coordinated service in transactions related to the acquisition and sale of companies and businesses.

Landwell-PwC's team of M&A and Private Equity specialists, comprising more than 60 lawyers and tax advisors in Spain, is specifically selected for each transaction on the basis of our client's needs, the industry and the target and purpose of the deal.

Our philosophy of "Working Together" is beneficial for all concerned. The synergies obtained through our multidisciplinary services ensure that we are the firm of reference in transactions.

In order to discover how we can help you, please contact:
Javier Maceira- Landwell-PwC partner in charge of the Deals Group (M&A and Private Equity).
Phone: +34 915 684 528
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PricewaterhouseCoopers feature article

Overall, 2007 was a year of new records for Spanish M&A. Even so, as in other developed markets the summer's credit crisis formed a clear point of separation, a "before and after" moment. It is worth looking back over past events to try and gain a perspective on what the future has to offer us in M&A in Spain for 2008 and beyond.

Bank liquidity was at an all-time high just prior to the start of the crisis. We experienced a substantial fall in the cost of capital necessary to finance acquisitions, stemming from extremely high levels of leverage and tight margins that were exploited not only by venture capital funds but also by the occasional industrial buyer.

Behind this liquidity lay a fundamental change in deal financing, with the arrival of the so-called "institutional investors", consisting basically of hedge funds and CDO funds. Liquidity through these new vehicles had been growing at a healthy pace for several years and this boost in investment changed the decision-taking process of arranging banks, from credit analysis to an analysis of the syndication market. Banks underwrote those investments that they believed they could sell to the institutional investors, whose appetite appeared insatiable. Hence senior loans appeared with 8 and 10 year bullet payments, while second liens and PIKs became the order of the day. At the high point of this trend, traditional vocabulary became insufficient to describe what the banks were willing to commit to, until somebody invented the term "cov-lite" in an attempt to define (with some success, in my opinion) the excesses caused by market liquidity.

Then came the subprime crisis in the United States and institutional investors turned off the tap.

If we analyse the M&A year in Spain then the phrase "Spain is different" becomes less and less convincing.

The star deal of the year was clearly the acquisition of Endesa by Acciona and Enel, both due to its size and because it came after a genuine soap opera spanning over two years, with ups and downs, changing buyer groups and large doses of political intrigue. However, despite what a reader of the financial press could perceive at times, this was not the only major deal; another 10 transactions were completed above €1,000 million. Only one of these deals took place after the start of the credit crisis, and this was in reality a reorganisation of insurance industry operations between Caja Madrid and its invested company Mapfre.

The acquisition of Altadis by Imperial Tobacco and of a controlling interest in Metrovacesa by Sacresa were the next deals of note in terms of value (above €15,000 million and €14,000 million, respectively) and, in the case of Altadis, also in terms of the deal's gestation period.

Unlike certain other countries, none of these mega-deals involved a private equity fund, although this was not due to lack of interest from CVC in the case of Altadis. To find private equity involvement we have to move down to the €1,480 million paid by Carlyle to acquire Applus+, the certification company sold by Agbar. This transaction, closed on 24 July, would clearly not have taken place (or at least not at the same price) if a few more weeks had elapsed.

But the most representative fund activity in Spain during 2007 related to the seven buy-outs of Spanish targets with an enterprise value in excess of €250 million, and the 33 buy-outs of between €30 million and €250 million. Virtually all these deals were concentrated in the pre-crisis period.

Further signs of the maturity of the private equity market are the 31 divestments completed by Spanish funds in 2007 and the increase in secondary buy-outs as an exit route for investments, as evidenced in the "secondaries" of Parques Reunidos, Occidental Hoteles and USP Hospitales.

Clearly the market in 2008 will be a more cautious one, and we are not going to see a repeat of the level of deals reached in 2007. It is probable that major transactions such as the possible sale of Iberia, Logista (subsidiary of Altadis and now of Imperial Tobacco) and Día supermarkets are on hold until the market recovers. This trend is also reflected in other smaller deals, where if current shareholders are not under pressure to exit then they will not choose this as the moment to do so. While this is often the situation for family businesses, it is foreseeable that some other companies will come under pressure to restructure and reduce debt-levels. Clear examples of this are the non-core activities of certain property companies and, perhaps to a lesser extent, the industrial portfolios of regional savings banks.

As always, there will some sectors that defy the general market situation and maintain a healthy deal pace. Spain's energy sector is a good example at present. In addition to the reorganisation caused by the sale and subsequent partial segregation of Endesa, the highly controversial merger of Iberdrola and Gas Natural (ACS owns shares in both companies) is on the horizon, as are deals (with a larger volume but a lower value) in the renewable energy sector, driven by a tariff system that is highly attractive to investors.

In short, we expect a year with less activity than 2007 in terms of both value and the number of deals. Trade buyers will regain their competitive position in relation to private equity funds when it comes to pricing. Both funds and industrial players have easy access to equity, although bank financing for deals will remain problematic, particularly for deals above the €500 million mark.

The positive side, highlighted by a number of funds, is that those buyers who manage to complete deals this year are likely to do so at more affordable prices. Hence capital invested during 2008 will bear an attractive harvest of returns in years to come.

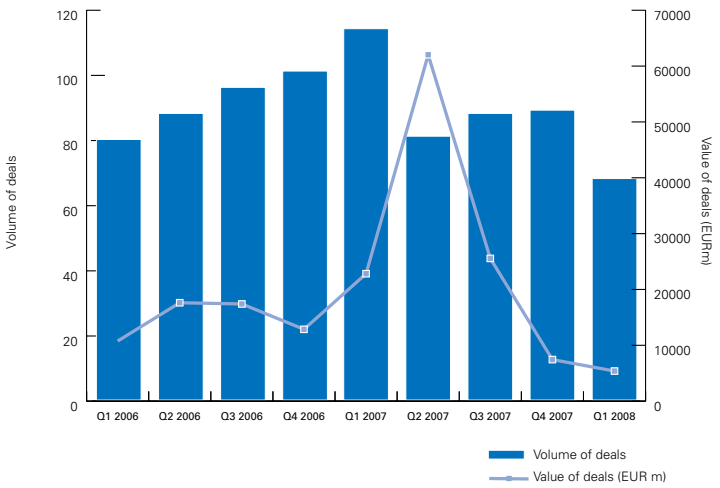
Julian Brown
Partner and Head of Corporate Finance
PricewaterhouseCoopers Spain

Historical data

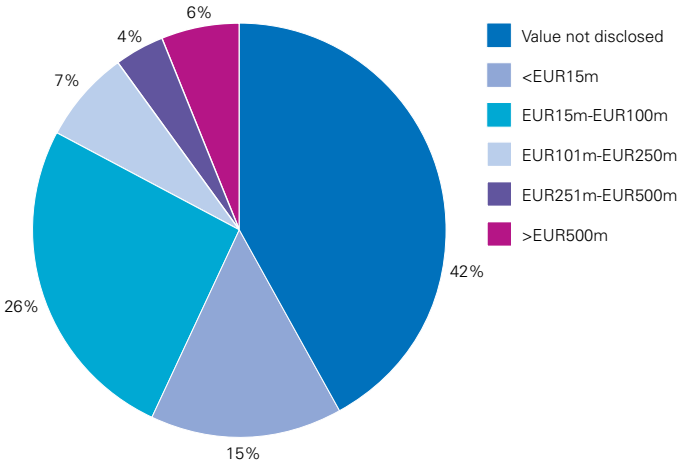
Top 10 Inbound Deals 2007-2008

Announced Date	Status	Target Company	Target Country	Bidder Company	Bidder Country	Seller Company	Seller Country	Deal Value EUR (m)
11/4/07	C	Endesa SA (46.05% stake)	Spain	Acciona SA; Enel Energy Europe Srl	Spain; Italy			40694
18/7/07	C	Altadis SA	Spain	Imperial Tobacco Group plc	United Kingdom			15093
2/3/07	C	Metrovacesa SA (60.39% stake)	Spain	Sacresa	Spain			14440
2/4/07	P	Endesa (energy assets)	Spain; France; Italy; Turkey	E.ON AG	Germany	Acciona SA; Enel SpA	Spain; Italy	11800
10/4/07	C	Grupo Agbar (52.13% stake)	Spain	Hisusa	Spain			3931
19/1/07	C	Riofisa SA	Spain	Inmobiliaria Colonial SA	Spain			2208
20/12/07	P	Sogecable SA (49.97% stake)	Spain	Promotora de Informaciones S.A.	Spain			1937
7/1/08	C	Metrovacesa SA (29.48% stake)	Spain	Undertake Options SLU	Spain			1709
24/7/07	C	Applus Servicios Tecnologicos SL	Spain	The Carlyle Group LLC	USA	Caja Madrid; Grupo Agbar; Union Fenosa SA	Spain	1480
2/8/07	C	Bancaja Inversiones SA (30% stake)	Spain	Deutsche Bank AG; Guggenheim Capital Markets LLC	Germany; USA	Bancaja	Spain	1355

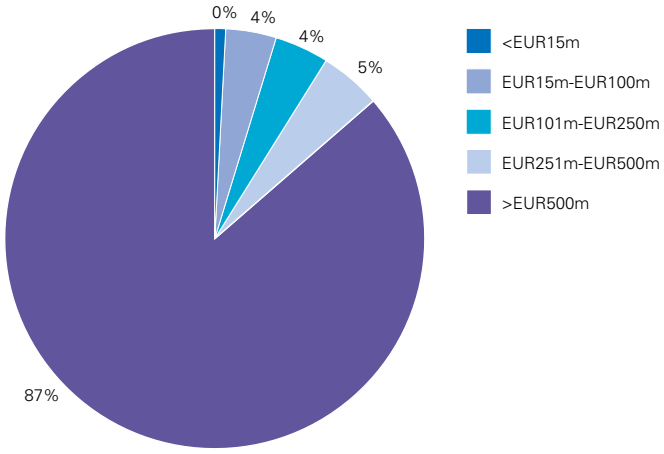
Overall Spanish M&A trends



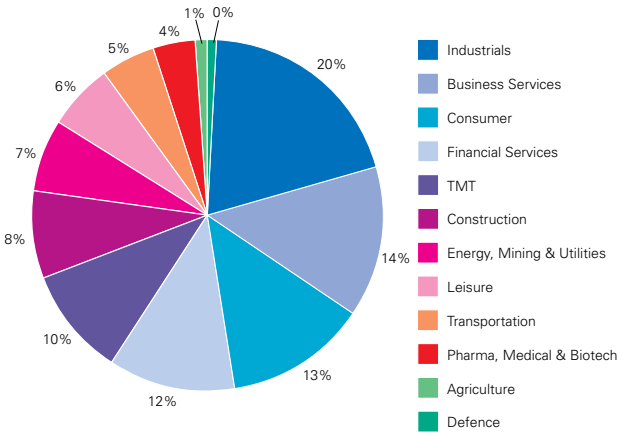
Sector split of Spanish M&A-volume 2007 - Q1 2008



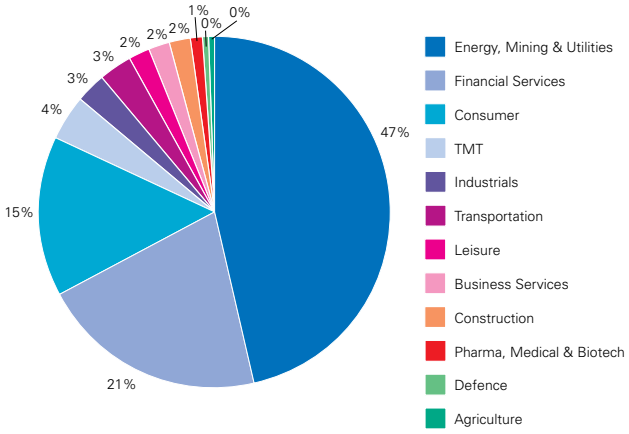
Deal size split of Spanish M&A - value 2007-Q1 2008



Sector split of Spanish M&A - volume 2007-Q1 2008



Sector split of Spanish M&A - value 2007-Q1 2008



Notes and contacts

IntraLinks

Anne-Gaëlle Le Gallou

or

Patricia Gómez

IntraLinks
Salcedo, 2
28034, Madrid
Tel: +34 91 771 5117
email: alegallou@intralinks.com
or pgomez@intralinks.com

PricewaterhouseCoopers

Patrick FitzGerald
Head of Transactions, Business and Financial Advisory
PricewaterhouseCoopers
Almagro, 40
28010 Madrid - Spain
Tel: +34 91 568 4405
email: patrick.fitzgerald @es.pwc.com

Julian Brown
Head of Corporate Finance
PricewaterhouseCoopers
Almagro, 40
28010 Madrid - Spain
Tel: +34 91 568 4405
email: julian.brown @es.pwc.com

Malcolm Lloyd
Head of Private Equity and Transaction Services
PricewaterhouseCoopers
Almagro, 40
28010 Madrid - Spain
Tel: +34 91 568 5075
email: malcolm.lloyd @es.pwc.com

Landwell – PricewaterhouseCoopers

Juan Ramón Ramos
Head of Tax and Legal Services
Landwell - PricewaterhouseCoopers
Pº de la Castellana, 53
28046 Madrid - Spain
Tel: +34 91 568 4529
email: juan.ramon.ramos@
es.landwellglobal.com

Javier Maceira
Head of Deals Group
Landwell - PricewaterhouseCoopers
Almagro, 40
28010 Madrid - Spain
Tel: +34 91 568 4380
email: javier.maceira@
es.landwellglobal.com

David Ramírez
Tax Partner – Deals Group
Landwell - PricewaterhouseCoopers
Avda. Diagonal, 640
08017 Barcelona - Spain
Tel: +34 93 253 2836
email: david.ramirez.garcia@
es.landwellglobal.com

Rafael Rebate
Tax Partner – Deals Group
Landwell - PricewaterhouseCoopers
Almagro, 40
28010 Madrid – Spain
Tel: +34 91 568 4380
email: rafael.rebate@
es.landwellglobal.com

mergermarket

Part of The Mergermarket Group

www.mergermarket.com

80 Strand
London, WC2R 0RL
United Kingdom

t: +44 (0)20 7059 6100
f: +44 (0)20 7059 6101
sales@mergermarket.com

895 Broadway #4
New York, NY 10003
USA

t: +1 212 686-5606
f: +1 212 686-2664
sales.us@mergermarket.com

Suite 2001
Grand Millennium Plaza
181 Queen's Road, Central
Hong Kong

t: +852 2158 9700
f: +852 2158 9701
sales.asia@mergermarket.com