

Madrileña Red de Gas bolt-on acquisition

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Following an acquisition of 500,000 gas connection points in Madrid in 2010, Morgan Stanley Infrastructure Partners (MSIP) is due to complete a second bolt-on acquisition of 303,000 points this month (June 2011).

The €430 million deal is due to close on 30 June 2011 and will see MSIP's portfolio company Madrileña Red de Gas (MRG) become the second largest gas operator in Madrid and the third largest in Spain.

The deal is a first in many instances; a catalyst for the reopening of the syndicated debt market in Spain, as well as being a large synergistic bolt on deal to an existing infrastructure deal.

The context

In 2009 one of Spain's largest gas providers Gas Natural was looking to sell 500,000 gas connection points and related supply activities in Madrid following an M&A related ruling from the Spanish competition authorities which forced the company to divest some of its assets.

In December of the same year, MSIP, in conjunction with Portuguese energy group, Galp Energia, signed a *Sales and Purchase Agreement* (SPA) with Gas Natural, to acquire 500,000 gas connection points, along with the related supply business for €800 million.

MSIP was interested in acquiring the distribution side of the business, while Galp were interested in acquiring the related supply business. Following the close of the deal the infrastructure and supply assets were entirely separated. The gas connection points were grouped into a new company created by MSIP; Madrileña Red de Gas (MRG), the first standalone gas distribution company in Spain.

This deal was done on a competitive basis. It was a limited auction process of four parties. The deal had an equity debt ratio of 55:45. The debt package was financed by club of 11 banks.

The transaction

Following the initial deal, MSIP began talks with Gas Natural again later in 2010. Gas Natural was looking to sell another 303,000 connection points as it was looking for funds to satisfy anti-trust obligations with electricity company, Unión Fenosa, which it acquired in late 2009.

MSIP saw this as an opportunity to increase the scope and size of MRG. Once the deal has been completed MRG will have 814,000 connection points in its portfolio, making it the second largest operator in Madrid and the third largest in the whole of Spain.

The bolt on acquisition increased MRG's coverage to 48 municipalities and city districts in Spain from 38. The new gas connection points are adjacent to the existing gas connection points owned by MRG. MRG's network of medium and low pressure pipelines now stands at 5,100km and its coverage area includes 1.2 million households.

The bolt on acquisition allowed MSIP to benefit from significant fixed cost synergies. MRG will only incur incremental fixed costs of €7 per acquired connection point to its existing fixed costs of €35 per connection point. Therefore on an

aggregate basis, this should reduce the fixed costs to €25 per connection point, which represents a decrease of 30 per cent. Taking advantage of these fixed cost synergies will make the bolt-on acquisition accretive for MSIP.

The acquisition is a negotiated deal between MRG and Gas Natural.

Financing

The acquisition is being financed with a debt package of around 75 per cent. The remainder of the financing is equity from MSIP's US\$4 billion infrastructure fund.

The debt package was initially taken by three banks:

- Crédit Agricole
- Santander
- Société Générale

The original debt was syndicated to a further six banks and divided into two tranches. The tranches of debt are as follows:

- €360 million – 7 year tenor
- €20 million – 4 year tenor (credit revolver)

The six banks are:

- Caja Madrid
- La Caixa
- BNP Paribas
- Tokyo-Mitsubishi
- BBVA Bank
- Banco Popular Español

The deal is due to reach financial close on 30 June 2011.

Conclusion

The acquisition is unique in many ways. For one it is a fairly sizeable deal done on a negotiated basis. Secondly, it is not often that large synergistic bolt-on acquisitions take place in the infrastructure sector. More commonly an infrastructure asset is bought and that is it.

The speed of the deal was also unique. MSIP was able to utilise its existing relationship with Gas Natural to see an exceptionally quick deal process. From due diligence to the signing of the SPA the time period is estimated to be no more than six weeks.

The debt package for the acquisition saw a reopening of the syndicated infrastructure bank market. Prior to this deal, financing had been largely through club deals.

Meanwhile the original acquisition deal for 500,000 gas connection points resulted in the first case of unbundling in the utilities market in Spain and the use of a unique structure of partnering with a strategic.

Unbundling of the infrastructure and supply assets is something that the EU is keen to push and forms part of the EU energy package. Following the success of the original partnered acquisition between MSIP and Galp there is expected to be more unbundling in the utilities market in Europe.

As a result of the unbundling trend the expectation is for more investment from infrastructure funds in the utilities market.

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