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FOCUS: As Cepsa Stake Sale Looms, Perfect Match Unlikely

By Christopher Bjork and David Roman

MADRID (Dow Jones)--Brazil's Petrobras (PBR) and Spain's Union Fenosa SA (UNF.MC) are just two of the prospective buyers eyeing the acquisition of at least a minority stake in Compania Espanola de Petroleos SA (CEP.MC), or Cepsa, a key asset in Spain's convoluted energy industry.

However, Cepsa's high valuation and the uncertainty over the final shape of the country's electricity market, ahead of the possible takeover of local energy giant Endesa SA (ELE) by Germany's E.On AG (EON), may confound the expectations of many who have been banking on a quick change within Cepsa's stable shareholding core.

Cepsa, Spain's second largest oil company, is on the M&A table after the controlling pact between the company's two top shareholders was finally unwound last week following a three-year legal battle. Santander Central Hispano SA (STD) - Cepsa's second-largest shareholder - has already said that it's looking to sell its 28% stake, worth around EUR4 billion at current market prices.

"There's no obvious buyer" for Cepsa, said Edinburgh-based ING analyst Jason Kenney. "So Santander may find itself a bit stuck."

Santander, the eurozone's largest bank by market value, faces crunch time with Cepsa just as Spain's energy sector appears ready for a new wave of consolidation with oil companies throughout the world seeing their market value jump on record oil prices.

Emilio Botin, Santander's chairman, is well-known for his savvy negotiating ploys. Botin is considered the main force behind last week's agreement between Santander and the company's main holder, Total SA (TOT), which closed a legal case dating back to 2003.

Total brought the case against Santander after the bank launched that year a bid to raise its stake in Cepsa by another 16%, seeking to become the refiner's leading shareholder, a move that Total said was illegal under the terms of their shareholders' pact.

Most market observers think that Botin never intended to replace Total as leading Cepsa shareholder, but simply tried to force the French major to acquire its stake at a premium. The arbitration ruling tipped the scale slightly in favor of Total, confirming the French oil major as Cepsa's largest shareholder, now with a 49% stake.

Nonetheless, it also annulled the pact, so Santander is now free to sell its own stake. And it heated up the share price, which has multiplied sixfold overall in the last four years.

"The price is definitely very high," said Sonia Ruiz, analyst with local brokerage Caja Madrid. "Valuations have gone through the roof and this makes it difficult to find a buyer." Caja Madrid rates Cepsa shares at sell.

A determining factor behind Cepsa's valuations is its very limited free float. According to Spanish stock market records, more than 90% of the company's 268 million shares are in the hands of the four main shareholders.

Santander has pocketed hefty premiums on its latest stake sales. Last week, the bank's unit Banesto (BTO.MC) sold a 50% stake in Spanish real estate company Inmobiliaria Urbis SA (URB.MC) for a 16% premium, and also booked large gains when it divested its 22% stake in Fenosa last year.

But this time around it could be very difficult for Santander to get a market price. "Certainly the share price doesn't reflect the company's cash flow," said Christopher Kummer, director of the Vienna-based Institute of Mergers, Acquisitions and Alliances.

Cepsa shares have significantly outperformed sector peers, even amid the recent bull run on oil stocks. It now trades at a price-to-estimated 2006 earnings ratio of 16.6, according to JCF Group's calculations. That compares with a 7.8 PER ratio for its larger peer Repsol-YPF SA (REP), and 8.9 PER ratio for Total.

The most obvious candidate to acquire Santander's stake is Union Fenosa, Spain's third largest electricity company, and one which already has an important exposure to the North African gas business, a clear complement to Cepsa's operations which rely on refining oil from the region and selling it via its ample network of Spanish gas stations.

Cepsa is also the main shareholder in the key Medgaz project, scheduled to pump Algerian gas into Spain from 2009 through a yet-to-be-constructed submarine gas pipeline.

Fenosa is already Cepsa's fourth-largest shareholder, with a 5% stake. The utility has said it's willing to raise its ownership to 10%. Analysts, though, say that the EUR4 billion cost of buying all of Santander's shares may be one that the company isn't prepared to make at this time, as the company has dedicated a fair amount of energy to lowering its debt burden.

Like other Spanish energy players, such as Gas Natural SDG SA (GAS.MC) and Iberdrola SA (IBE.MC), Fenosa may also be one of the top candidates to acquire assets from Endesa over the next few months if E.On completes the acquisition of Spain's largest electricity company. Last month, Spain's energy regulator imposed several conditions on E.On's proposed takeover, requiring the divestment of 30% of Endesa's generation capacity in Spain.

Caja Madrid's Ruiz said that she expects Fenosa to eventually increase its stake in Cepsa, but not to buy the entire Santander stake. She said that a deal in which two or more buyers acquire the shares from Santander is a possibility, if Santander can make such a deal.

Petrobras, Brazil's state-controlled oil giant, has been widely rumored to be a firm candidate to take part in the Cepsa sweepstakes. Company officials have expressed an interest in acquiring assets in Spain.

But, for a state-controlled company like Petrobras with a strategic interest in acquiring access to foreign reserves, the prospect of acquiring a minority stake in a company lacking significant reserves like Cepsa appears dubious, observers say.

"I can't imagine why they would be happy with a 28% stake," said MANDA's Kummer. "Even if they buy Santander's stake, what next?"

Total is likely to remain as controlling shareholder with almost half of Cepsa's outstanding shares and any company seeking to control the refiner would be ruled out of a bidding war.

"In this situation the market is very specific," Kummer said. "Total has a huge stake, it can take the decisions in everything. For them, it's enough to own almost half, so why buy the whole company? There's no need for them to do anything, he added.

"It would be different if they feared losing control, but they don't."

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