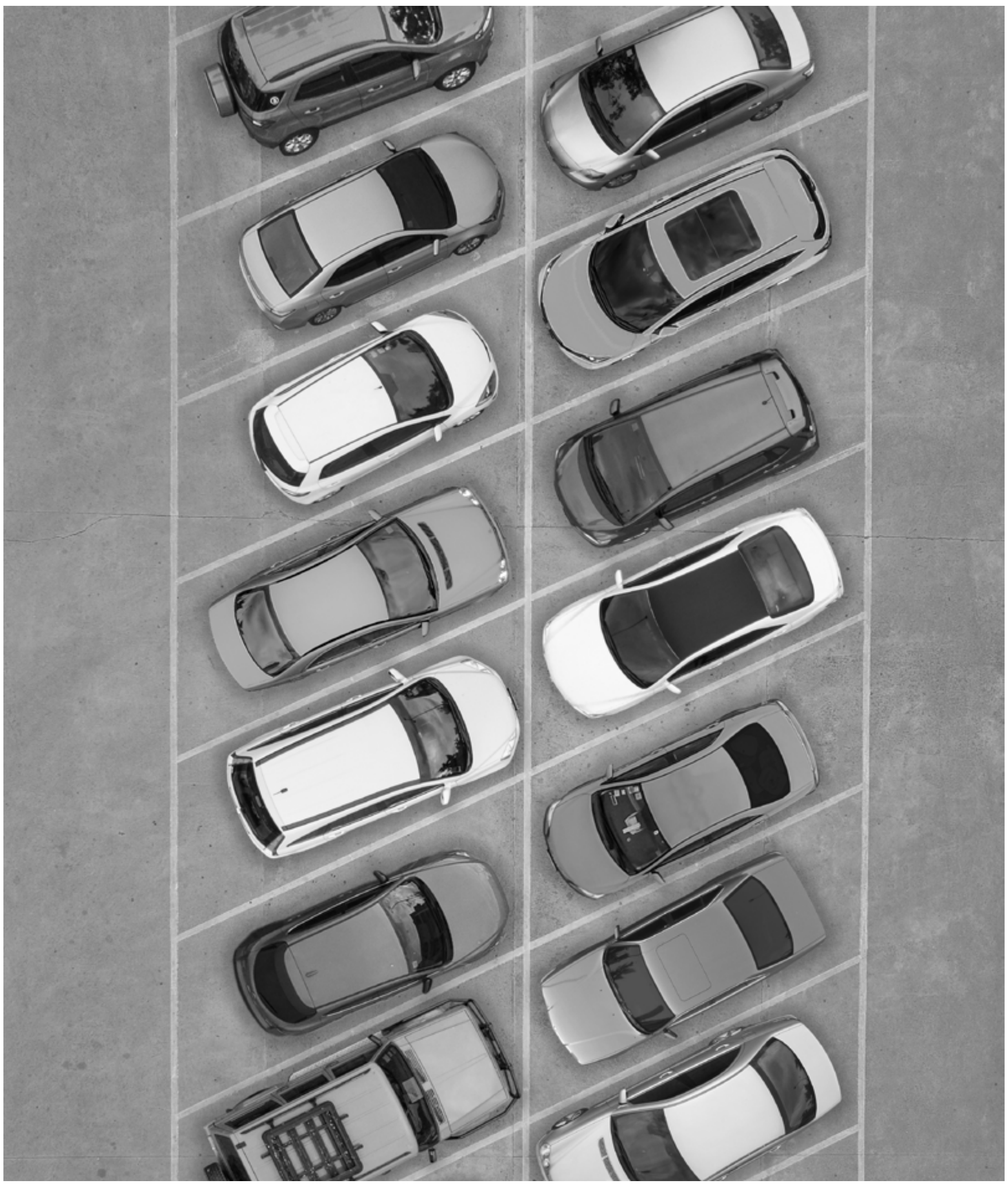
S&P Global
Ratings

The European Car Parking Sector Sees M&A Flurry, But Will It Be An Easy Ride For Investors?

December 6, 2017



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The European car parking sector has recently been the scene of increased interest from financial investors, including infrastructure and private equity funds, triggering a flurry of mergers and acquisitions (M&A) deals. Among other factors, abundant liquidity, the decline of green field opportunities in the infrastructure market, and the attractiveness of certain car park operators' credit characteristics have stimulated M&A deal flow. In particular, cash flow stability and sound margins generated by some of Europe's largest car park operators make this asset class appealing for investors, who have been lured by the opportunity to increase companies' leverage and extract returns. However, in S&P Global Ratings' opinion, higher debt driven by acquisition prices of about 13x-15x EBITDA multiples, exposes companies to future refinancing risk. Depending on the type of investors, this could lead to new shareholders adopting more aggressive financial policies, potentially resulting in negative rating actions.

Over the last year four of the largest car park operators have been put up for sale, but the future for the sector is somewhat uncertain. Local green public policies, changes in local mobility patterns--such as ride-hailing and car sharing services--as well as innovation in the automotive industry leading to the development of electric and autonomous cars are creating challenges(1). Leading car park operators have developed different business models, some of which resemble infrastructure activities, while others are closer to business services. Such differences affect operators' profitability and long-term cash flow predictability. Acquisitions are the major growth catalyst for operators, but we think it is too early to say who the winners and losers will be.

Despite lots of M&A activity in the European car parking sector, the future is somewhat uncertain. Acquisitions are the major growth catalyst for operators, but we think it is too early to say who the winners and losers will be.

Key Takeaways

- High prices paid for the acquisition of major European car park operators reflect abundant liquidity, but also a historically low cost of funding, which could pose refinancing risk and result in potentially negative rating actions on car park operators.
- Changes in ownership can also negatively affect companies' financial policies and their ability to maintain successful relationships with local municipalities and key stakeholders.
- Car park operators have different business models and growth strategies but they all face common challenges: Green public policies, changes in local mobility patterns, and the development of electric and autonomous cars could affect cash flow stability.
- In our view, it is too early to draw conclusions on how business models will need to adapt and who the winners and losers will be. However, the pace of technological innovation and regulation will play a key role in defining when and how this will happen.

M&A Activity Could Trigger Negative Rating Actions

Improved macroeconomic and financial market conditions in Europe, together with a lack of new projects, have created an ideal environment for M&A activity, fueling a surge of disposals in the car parking sector in 2017 (see "New Capital Rules For EU Infrastructure Investments Mask Pipeline Deficiency," published on Sept. 12, 2017). In these conditions, shareholders have found the right moment to sell in terms of the maturity of their investments, the car park operator's business performance, or the shared terms of the disposal among shareholders. Although a few major car park operators have bid for some transactions--for example, Spanish-based operator Saba Infraestructuras' bid to acquire Empark to create a unique Spanish market leader--sellers have usually selected infrastructure and private equity investors as preferred bidders. This was the case for KKR and Macquarie in their acquisitions of Q-Park and Empark, respectively. In our view, high prices as well as available capital to invest certainly give investors an advantage over operators when bidding for these major transactions.

However, these acquisitions typically lead to increasing financial leverage for the target company as a means to co-finance the high acquisition price. For example, as a result of Empark's acquisition by Macquarie European Infrastructure Fund (MEIF) 5 Arena Holding, we now anticipate the company to maintain its financial leverage at about 7.5x, while we were expecting this ratio to remain at about 6.5x-7.0x pre-disposal. Thanks to low interest rates, higher acquisition debt has a lower impact on interest coverage ratios than financial leverage, but could pose a future refinancing risk. In addition, changes in ownership can link the rating on the target company to the creditworthiness of the controlling group or can negatively affect a company's financial policies. For example, new shareholders or financial sponsors' use of aggressive debt or debt-like instruments to maximize their returns could potentially result in negative rating actions. This has not been the case for Empark as we don't consider Macquarie's infrastructure fund as a financial sponsor due to its nature of being an infrastructure fund with a relatively long investment horizon.

Negative rating actions could be triggered by refinancing risk and changes in ownership.

Recent M&A Deals In Europe's Car Parking Sector

- October 2017: MEIF 5 Arena Holding (Macquarie) issued €475 million of senior secured notes in connection with the acquisition of Spanish operator Empark Aparcamientos Y Servicios, which was put up for sale in May 2017.
- September 2017: Japanese car park operator Park24 secured $295 million in loans in connection with the acquisition of UK operator National Car Parks (NCP) which was put up for sale from MEIF II (Macquarie).
- End-March 2017: Ardian and Crédit Agricole Assurance put French operator Indigo-Infra Park up for sale, after acquiring the remaining stake (24.6%) of the company from French concessions and construction firm Vinci at the end of September 2016. However, the process stopped on Nov. 23, 2017.
- Q1 2017: German operator APCOA (owned by Centerbridge) completed a refinancing by raising a €350 million senior secured term loan.
- December 2016: Dutch pension funds put Dutch operator Q-Park up for sale, which KKR Global Infrastructure Investors II acquired.

That said, the opportunity for shareholders to extract dividends without negatively affecting the ratings on a company is strongly linked to their ability to maintain and possibly expand the company's asset portfolio, while delivering cost efficiencies. This explains why only the disposal of large car park operators attracts financial investors' interest, as they need portfolios of sufficient size to extract value, while smaller transactions can be targeted by car park operators to consolidate their local presence or expand geographically.

Finally, changes in ownership following the completion of M&A transactions may also affect car park operators' ability to maintain their market leadership if new shareholders are unable to establish and maintain successful relationships with local municipalities and key stakeholders, which would negatively affect companies' business risk profiles.

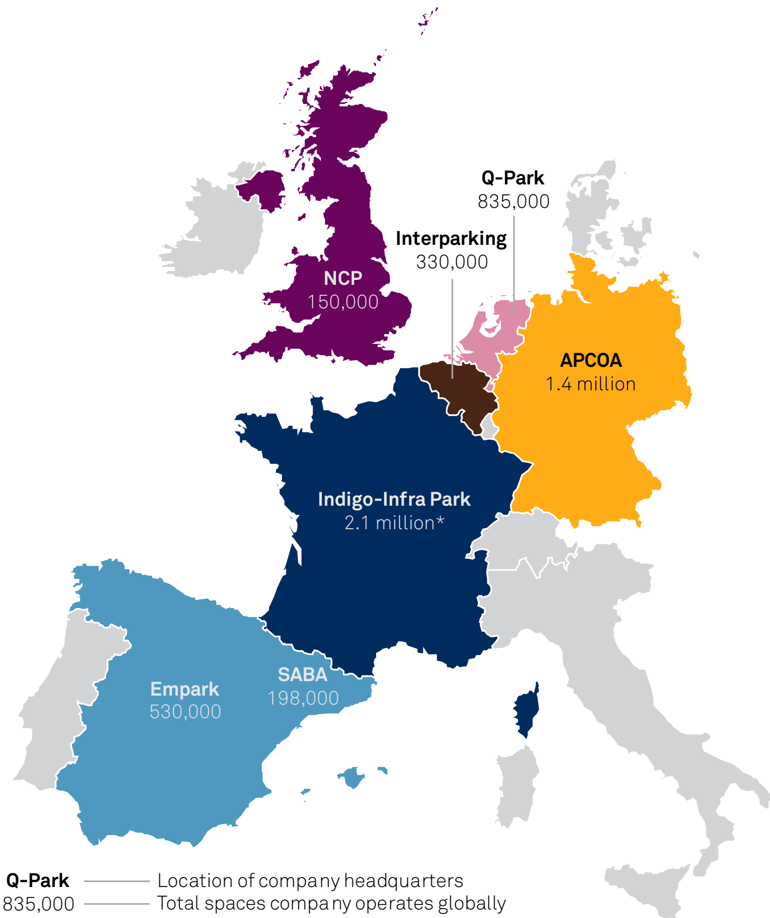
Only The Largest Operators Attract Institutional Investors, But Their Business Models Differ

In Europe we recognize seven large operators, but the market remains highly fragmented, with many public companies and small operators having a local focus and limited scale (see the Appendix for a summary of the car park operators that we rate).

These operators manage a large portfolio of contracts under different business models. We consider some of these models as resembling infrastructure activities, while some are more similar to business services (see table 1).

Chart 1

Where Are Europe's Leading Car Park Companies Headquartered?



*Within the EU only, Indigo-Infra Park operates 0.9 million spaces.

Table 1

The Characteristics Of Different Business Models

Business Model	Contract length	Capex amount	EBITDA margin	Volume risk	Revenues	Infrastructure or business services
Ownership	Long term	High	50-60%	Yes	Ticket fare (full control over pricing and service levels)	Infrastructure
Off-street concession (green-field)	Long term (>20/30 yrs)	Medium/high	40-60%	Yes	Ticket fare + subsidies (if any) - royalties	Infrastructure
Off-street concession (brown-field)	Medium term (10/20 yrs)	Medium/low	30-40%	Yes	Ticket fare + subsidies (if any) - royalties	Infrastructure
On-street concession	Short to medium term (5-20 yrs)	Low	20-30%	Yes/no	Ticket fare – fee (demand risk) Fixed (cost + fee) (no demand risk)	Business services
Leasing/rental	Short to medium term (5-20 yrs)	Low	10-20%	Yes/no	Ticket fare – annual lease/rent cost	Typically business services
Management contract	Short term (<5 yrs)	Very low	5-10%	No	Lump-sum or 'cost + fee' scheme	Business services

Source: S&P Global Ratings.

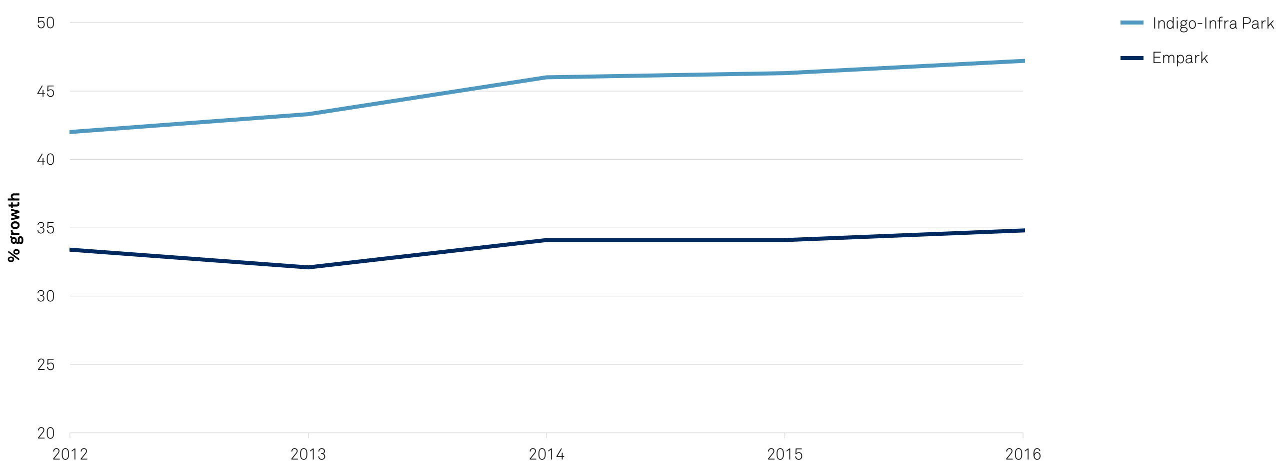
Car park operators usually combine different business models. For example, Indigo-Infra Park generates about 90% of its reported EBITDA from concessions and infrastructure contracts and Empark generates about 75%-80% of its EBITDA from off-street concessions and about 15%-20% from on-street concessions. We view these operators as infrastructure companies, able to generate stable cash flows and EBITDA margins. This is because the size and quality of their portfolios include assets in key locations which provide them with a quasi-monopolist position and they have a track record of high contract replacement rates. Also, concession agreements generally mirror tariff indexation mechanisms that are typical of core infrastructure assets like toll roads and usually protect the concessionaires against early termination by the grantor.

Some business models resemble infrastructure activities, while some are similar to business services.

Other companies like APCOA and NCP mainly operate under leases and management contracts and we consider them as business services providers. This is supported by their shorter maturity of contracts which exposes them to higher renewal risk, combined with limited capital expenditure (capex) and limited exposure to demand risk. These characteristics are mirrored in lower profitability levels than infrastructure operators. For example, APCOA's reported EBITDA margin is about 9%, depressed by significant lease rent payments, which we rectify in our metrics. This results in adjusted EBITDA margins for the company of above 25%, lower than its infrastructure peers (see chart 2).

Chart 2

S&P Global Ratings' Adjusted EBITDA Margins



Source: S&P Global Ratings.

Investors have shown interest in both types of car park operators (infrastructure or business services providers), as long as the company is a market leader and there is scope to extract value. For example, Macquarie acquired business services operator NCP in 2007 through MEIF 2 and disposed of it in 2017, almost at the same time of acquiring infrastructure operator Empark through MEIF 5. However, when it comes to price, investors seem to appreciate operators' different business models. For example, market commentators report that the NCP acquisition price was in the range of 9.0x-10x, therefore lower than the 13x-15x spent for infrastructure operators.

We expect further transactions to launch in 2018. For example, market commentators predict that some shareholders of Spanish infrastructure operator SABA (KKR, Torreal, and ProA Capital) would like to exit in 2018. At the same time, Indigo-Infra Park's shareholders could return to the market after its current disposal process was stopped.

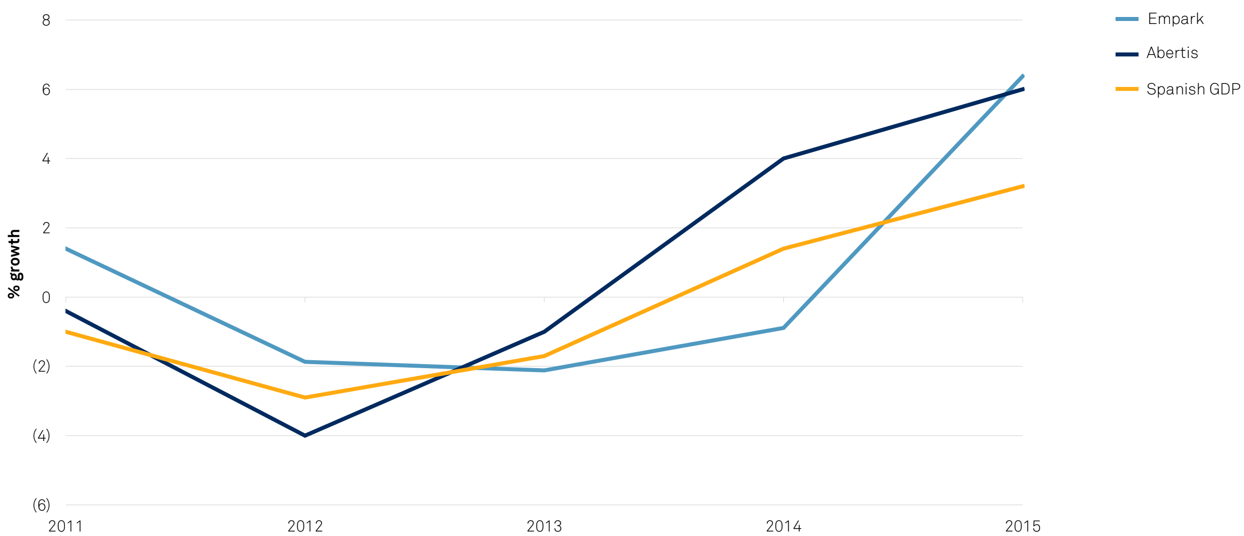
Macroeconomic Conditions And Acquisitions Boost Operators' Growth Potential

The past doesn't always predict the future, but we have seen a certain correlation between car park operators' performance and GDP growth in the countries where they operate. This is not dissimilar from what we observe for core infrastructure assets, like toll road operators. However, acquisitions and new contracts are the key volume growth drivers, given the maturity of the car park market and limited scope for further cost efficiencies. M&A activity helps car park operators to consolidate their positions, achieve geographical diversification, and also replenish expiring contracts. Although it's not easy to compare volumes on a like-for-like basis as car park operators' portfolios change frequently--compared, for example, to toll road operators that have a more stable asset base--we see a certain correlation when we compare revenue growth registered for example, by Empark and Abertis Infraestructuras in Spain (see chart 3).

Car park operators are more exposed than toll roads to competition and local shocks.

Chart 3

Empark And Abertis' Performance Versus Spanish GDP



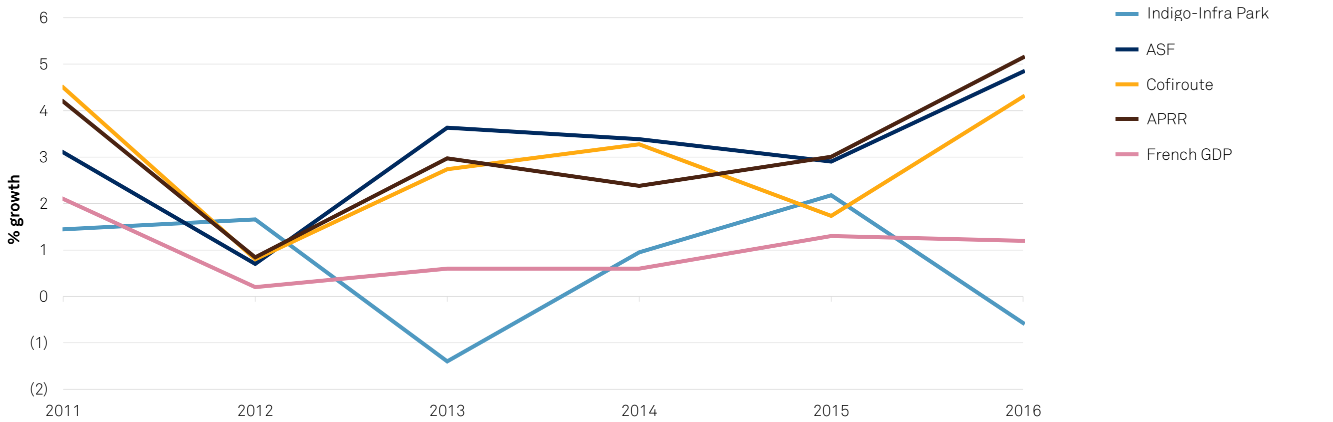
TRNOs: Toll road national operations. Source: S&P Global Ratings.

This suggests that macroeconomic conditions have a certain impact on demand, as is the case for other transportation infrastructure asset classes, but also that infrastructure car park operators' performance is not underperforming core infrastructure asset types. In our view, this is mainly because car park facilities usage is linked to short trips, is an essential service, and is less exposed to oil price fluctuations than core infrastructure asset investments.

However, car park operators are more exposed than toll roads to competition and local shocks. This is reflected, for example, in France-based Indigo-Infra Park's recent reduced revenues as a result of terrorist attacks, floods, and urban congestion and pollution public initiatives. The company's domestic growth has been lower than French toll road national operations (TRNOs) companies, such as ASF, Cofiroute, and APRR, also reflecting the exposure of car park operators to contract renewal risks, while toll road operators have a more stable asset base, which simplifies the management of the contract and operating efficiencies (see chart 4).

Chart 4

Indigo-Infra Park Versus TRNOs Revenue Growth



Source: S&P Global Ratings' and companies' annual accounts.

Nonetheless, car park operators can have higher asset diversification than toll road operators. This somewhat mitigates the above-mentioned risks. For example, large portfolios of car park assets in different geographical locations and segments (city centers, offices, hospitals, and airports) help to offset risks associated with single asset shocks.

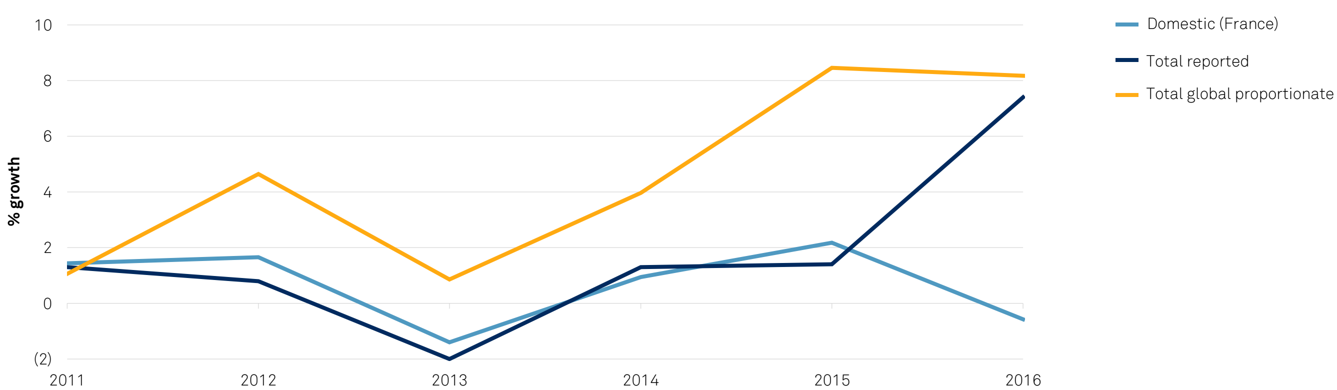
Different strategies have different risks in the short to medium term

We think that the major car park operators we rate in Europe, the Middle East, and Africa (EMEA) will continue expanding as they have a market share of less than 50% in their domestic markets. Therefore, there is still room for consolidation in a fragmented market. Operators also face opportunities from new green-field--and to a higher extent--brown-field contracts tendered. Here, each new contract incurs a low marginal cost in an already served city as remote control rooms optimize operating costs, with a limited impact on staff costs. Most operators are also investing in individual mobility services. These can increase users' loyalty and enhance operators' ability to use technology for the future generation of cars.

Some players like Indigo-Infra Park are combining this strategy with expansion overseas to growing markets, such as Latin America, as well as the U.S. and Canada, where higher urbanization and car penetration growth can offer more business opportunities (see chart 5).

Chart 5

Indigo-Infra Park Revenue Growth



Note: 2016 total revenues include consolidation of Brazilian subsidiary AGE. Global proportionate numbers reflect the contribution of joint ventures that are not included in reported numbers. Source: S&P Global Ratings.

We believe this strategy will help operators to diversify and accelerate their revenue growth, but can restrict the sustainability of future margins as long-term high margin cash generative concessions are widely used in Western Europe, but are not common overseas. At the same time, geographic diversification can expose operators to country and foreign exchange rate risk and could limit their competitive position if the contractual framework is less favorable than the current long-term concession agreements.

Car park operators that favor maintaining their existing geographic focus are not exempt from challenges either. For example, the decision by the municipality of Madrid not to retender Empark's concessions coming to maturity in 2017 has led us not to assume any renewal rate of concessions coming to maturity in Madrid over the next three years. This has not affected the company's rating, given the small portion of EBITDA generated by contracts expiring in Madrid over the next three years, but it does shed light on potential local domestic risks.

What Does The Future Hold For European Car Park Operators' Creditworthiness?

Our ratings on MEIF 5 Arena Holding, APCOA, and Infra Park strongly depend on their respective financial performances over the next 12 to 24 months. We believe favorable economic conditions will sustain these companies' EBITDA generation, particularly in the cases of MEIF 5 Arena Holding and Infra Park, which can benefit more from volume growth, given their business models' significant demand-risk exposure.

We also expect car park operators to continue improving their operating efficiency through digitalization, the use of remote controls, and diversified services. As a result, we forecast operators' profitability measures to remain at least stable unless they are affected by overseas investment and changes in the corporate perimeter triggered by M&A activities.

We forecast operators' profitability measures to remain stable.

Nevertheless, as previously highlighted, we think the three main trends that pose some uncertainties to the sector in the medium to long term are changes to local policies, urban mobility patterns, and automotive industry innovation. Local municipalities are reducing on-street parking spaces and promoting green policies, potentially limiting city center access for cars. This may particularly affect those operators that are more exposed to on-street business or are not protected or able to negotiate with the grantor to maintain the profitability of their investments.

Secondly, the increasing use of ride-hailing services, such as Uber and car sharing, could displace individual car ownership. Overall, such changes in mobility patterns may reduce the number of cars on the road looking for car parking services, with potentially credit negative implications for car park operators. That said, we think the impact is not yet clear and the increasing usage of hailing services will strongly depend on policy developments.

Finally, automotive industry innovation leading to the development of electric and autonomous cars will likely modify the services that car parks will need to provide in the long term and may restrict car parking demand. It is too early to draw conclusions on the timing for such changes and the overall impact on the sector. However, much of it will depend on the pace of technological innovation and actions taken by regulators. Electrification, in particular, would require significant investment and improved technology to reduce battery costs. Also, mandated targets in new policies could accelerate the penetration of hybrid and electric vehicles.

Overall, we forecast car sales to remain stable for the rest of 2017 and into 2018 in line with Europe's economic recovery. Although car sales volumes do not fully indicate demand for car parking services as they also include vehicles used for ride-hailing services and car sharing, the portion of diesel and hybrid/electric cars may rise sharply from the 40% and 5% market shares, respectively (see "Global Auto Industry 2018: At A Crossroad," published on Oct. 10, 2017). This implies that if the number of electric cars were to increase significantly, car park operators and electricity suppliers would need to agree utilities costs, but public subsidies and/or the extension of concessions to recover the investments may be needed to keep ticket prices affordable for users.

It remains to be seen whether the impact of autonomous cars will be disruptive for Europe's car parking sector. Although they could potentially be used as personal or shared taxis--with a limited need for parking spaces--parking services may still be required to avoid or manage traffic congestion.

We understand that some operators are already actively engaging with carmakers to test new car prototypes and assess what impact these industry changes could have on the car park business. It is too early to draw conclusions on how business models will need to adapt and who the winners and the losers will be. However, policymakers, regulators, insurers, and the pace of technological innovation will play key roles in determining when and how disruption will enter this sector.

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Note:

(1)Car-sharing is a car rental model where people rent cars for short periods of time, often by the hour. It attracts customers who only occasionally use a vehicle, as well as others who would like occasional access to a different type of vehicle than they typically use. Ride-sharing refers to a similar service to taxis where transportation network companies dispatch commercial operators using privately owned cars and drivers.

Related Research

- Are Airports Ready For Airline, Retail, And Mobility Disruption?, Dec. 6, 2017
- Global Auto Industry 2018: At A Crossroad, Oct. 10, 2017
- This Time Is different: The Eurozone Recovery Is Alive And Kicking, Oct. 2, 2017
- New Capital Rules For EU Infrastructure Investments Mask Pipeline Deficiency, Sept. 12, 2017

Appendix: Car Park Operators Rated By S&P Global Ratings

Corporate issuer	BRP	FRP	Modifier	Rating	Jurisdiction
Infra Park SAS (Indigo)	Strong	Significant	-	BBB/Positive/--	France
MEIF 5 Arena Holdings SLU (Empark)	Satisfactory	Aggressive	-	BB/Stable/--	Spain
APCOA Parking Holdings GmbH	Satisfactory	Highly Leveraged	-	B+/Negative/--	Germany
Chicago Parking Meters LLC	Excellent	Highly Leveraged	-	BBB-/Stable/--	U.S.

Project finance issuer	Preliminary SACP	Downside impact	Capital structure	Rating	Jurisdiction
Millennium Parking Garages LLC	bbb+	+1 notch	-1 notch	BBB+/Stable/--	U.S.

BRP--Business risk profile. FRP--Financial risk profile. SACP--Stand-alone credit profile.

Only a rating committee may determine a rating action and this report does not constitute a rating action.