

EU FUNDS 2007-13

Bye, Bye

Jesús Gómez

(34) 91-289-3315

jegomez@gruposantander.com

Juan José Fernández

(34) 91-289-3704

juanjosefernandezg@gruposantander.com

Antonio Espasa

(34) 91-289-3313

aespasa@gruposantander.com

Aránzazu Bueno

(34) 91 289 3308

aranzazubueno@gruposantander.com

- On Friday, December 16, the EU members reached an agreement on the EU Budget for 2007-13. The net funds Spain collects are to be reduced by two-thirds to €16,181mn for the 2007-2013 period from €48,715mn in 2000-06, with the amount of structural funds being cut by nearly 50% and Spain's contributions to the EU budget rising by due to the country's above EU-average economic growth and the fact that the GDP per capita gap with the rest of the EU has now been closed. The main novelty is the introduction of a newly created €2bn technology fund for Spain, aimed at reducing its below EU-average expenditure in R&D.

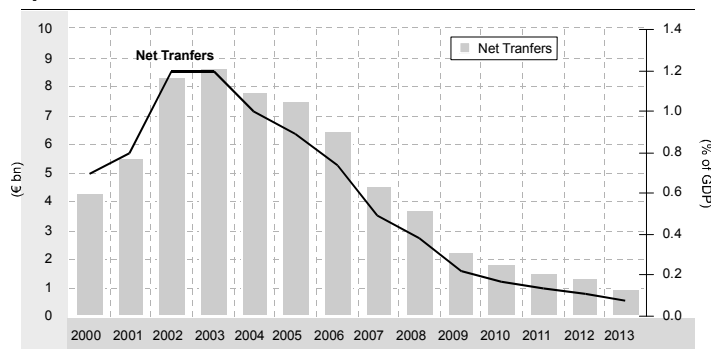
Spain – EU Funds in 2000-06 and 2007-13

	2000-06	2007-13	% Change
Structural funds	54,000	27,300	-49.4
Agricultural funds	43,967	44,129	0.4
Other	8,033	19,017	136.7
Total funds received from EU	106,000	90,446	-14.7
Total payments to EU	61,285	74,265	21.2
Net balance	48,715	16,181	-66.8

Source: EU and Spanish government.

- Spain will no longer be one of the main recipients of EU funds in the upcoming budget period. From receiving the equivalent of 0.93% of GDP in 2000-06, Spain is set to collect only 0.22% of GDP in EU funds in 2007-13. The reduction will be gradual, with EU funds declining from a peak of €8.7bn (1.2% of GDP) in 2003 to €1.0bn (0.1% of GDP) in 2013. Spain is likely to be a net contributor to the EU coffers in the subsequent budget period (2014-20).

Spain –Net EU Transfers, 2000-13



Source: EU and Spanish government.

- The impact on listed Spanish companies should be limited, as both the market and our own estimates had already discounted this scenario. We believe that the government and private initiatives will cover the drop in the EU's financing of infrastructures. On the other hand, some technology companies – Indra, Abengoa, Amper, etc – could well benefit from the new technology fund.



BYE, BYE EU FUNDS

PROGRESSIVE REDUCTION IN EU FUNDS

Two-thirds less EU transfers

On Friday, December 16, the EU members reached an agreement on the European Budget for the 2007-13 period. The net funds Spain collects are to be reduced by two-thirds to €16,181mn for the 2007-13 period from €48,715mn in 2000-06. This reduction basically stems from the sharp drop in structural funds, which are being cut by nearly 50% to €27,300mn in 2007-13 from €54,000mn in 2000-06, and the increase in the payments made to the EU (21%) due to Spain's above EU-average economic growth and the fact that the GDP per capita gap with the rest of the EU has now been closed (Spain's GDP only reached 75% of the average when it Spain joined the EU in 1986).

Spain – EU Funds in 2000-06 and 2007-13

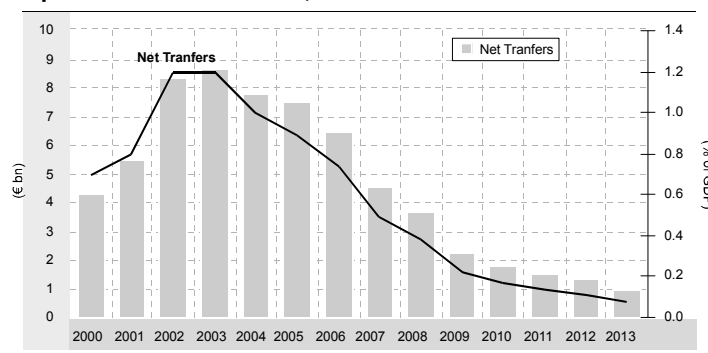
	2000-06	2007-13	% Change
Structural funds	54,000	27,300	-49.4
Agricultural funds	43,967	44,129	0.4
Other	8,033	19,017	136.7
Total funds received from EU	106,000	90,446	-14.7
Total payments to EU	61,285	74,265	21.2
Net balance	48,715	16,181	-66.8

Source: EU and Spanish government.

New €2bn technology fund

The structural funds receivable will comprise: (1) €3,250mn in cohesion funds; (2) €2,000mn in a newly created technology fund aimed at increasing Spain's R&D expenditure from the current 0.9% of GDP to the EU average of 1.8%; (3) €100mn for the Canary Islands and; (4) €50mn for Ceuta and Melilla. The agricultural funds should remain virtually flat (€44,129mn in 2007-13 versus €43,967mn in 2000-06).

Spain – Net EU Transfers, 2000-13



Source: EU and Spanish government.

Progressive reduction

Overall, these numbers are in line with our forecasts for 2007-13F. In the current period (2000-06), Spain collects an annual average of the equivalent of around 1.0% of GDP in EU funds, which is to be reduced to some 0.2% of GDP in 2007-13. The reduction is to be implemented gradually: 0.5% of GDP in 2007 down to 0.1% in 2013. In the next few days, we are likely to have the economy ministry's first official estimates on the impact of this situation on its GDP growth assumptions.



IMPACT ON EQUITY MARKET

In our view, this outcome is fully in line with expectations and should not pose a significant risk for Spain's listed companies. The two sectors most likely to be affected main are:

Construction Sector

New infrastructures has been one of the main drivers for Spanish companies in the past few years, as a result of the below EU-average penetration of infrastructures in Spain. In late 2004, the government announced a new infrastructures development plan (PEIT) for 2005-20 with an investment of €249bn, highlighting its intention of continuing to foster infrastructure development.

Spanish Construction Sector – Breakdown of Value by Activity, 2005E

(% of SOTP)	ANA	FER	FCC	ACS	SYV	Avg
Construction	11.6	14.9	11.6	15.2	7.6	12.2
Concessions	4.3	38.8	3.9	27.8	38.6	22.7
Power generation	41.8	–	–	12.6	–	10.9
Urban services	13.9	28.8	45.7	21.0	–	21.9
Industrial services	–	–	–	20.2	–	4.0
Cash & equivalents	14.2	–	–	–	–	2.8
Real estate- property	5.3	–	6.8	–	25.4	7.5
Real estate- housing	5.3	13.4	10.2	3.7	27.2	12.0
Cement	–	–	19.7	–	–	3.9
Other	3.7	4.1	2.2	-0.4	–	1.9

Source: Santander Investment Bolsa estimates.

However, the reduction in EU funding is likely to drive a change in the financing of public infrastructures. In recent years, EU funds accounted for a significant portion of the financing (typically 50%), with the remainder being covered by central/autonomous/local governments (30%) and private initiatives (20%). Once the EU funds are cut by more than 50%, they will cover roughly 20%-25% of the cost of newly built infrastructures. In view of the Spanish State's healthy financial situation (we are expecting a deficit of just 0.4% in 2007F), the government looks likely to play a bigger role in financing public infrastructures, particularly given the political calendar, with elections slated for March 2008. If the central government decided to make up the reduction in structural funds, this would have an impact of around 0.6% of GDP on the public deficit (from a deficit of 0.4% in 2007F to 1.0%). However, Spain's construction companies are still looking for ways to deploy their excess cash and would be more than willing to continue growing their concession businesses and increasing their role in financing new infrastructures. In fact, in mid 2005, the construction companies' association offered to finance infrastructures to the tune of €22bn to cover the shortfall in EU funds.

Spanish Construction Sector – Estimated Growth 2004-08F

(% Growth)	Sector	Large Contractors	Santander Investment Bolsa Estimates				
			2004	2005E	2006F	2007F	2008F
Civil works	24.0	65.0	6.4	6.2	6.0	3.0	3.0
Residential building	33.0	15.0	5.0	5.7	-1.0	-5.0	-3.0
Non residential	18.0	20.0	1.0	1.0	3.0	3.0	3.0
Refurbishing	25.0	0.0	2.5	3.0	3.0	3.0	3.0
Sector	100.0	100.0	4.0	4.3	2.4	0.6	1.2
Mkt for large contractors			5.1	5.1	4.7	2.1	3.0
GDP			3.1	3.4	2.8	2.4	2.0
Fiscal deficit			0.3	-0.1	0.2	0.4	0.5

Source: Santander Investment Bolsa estimates and forecasts.

On the other hand, the construction companies have concentrated on decreasing their sensitivity to economic cycles in the last few years, by diversifying away from the pure construction activity (which accounts for 12% of the sector's valuation) and increasing their exposure to concessions (with a weighting of 23%), services (representing 22%), etc.

Technology Sector

To minimise the negative impact of lower structural funds in 2007-13, Spain is to collect €2bn in technology funds to foster investment in R&D. We see this as a positive achievement and believe that those companies with relatively large R&D budgets are likely to be the main beneficiaries: Indra, Telefónica, Amper, Abengoa, Gamesa and some construction companies with large services arms (eg, Acciona, FCC and ACS).

ANALYST CERTIFICATION: We, Jesús Gómez, Juan José Fernández, Antonio Espasa and Aránzazu Bueno, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject companies and their securities. We also certify that we have not been promised compensation either directly or indirectly for expressing the recommendations in this report.

Local Offices

Madrid

Tel: 34-91-257-2309
Fax: 34-91-257-1811

Lisbon

Tel: 351-21-389-3400
Fax: 351-21-387-9133

London

Tel: 44-207-332-6900
Fax: 44-207-332-6909

New York

Tel: 212-692-2550
Fax: 212-407-4540

Bogotá

Tel: 571-644-8006
Fax: 571-592-0638

Buenos Aires

Tel: 54114-341-1052
Fax: 54114-341-1226

Caracas

Tel: 582-401-4306
Fax: 582-401-4219

Lima

Tel: 511-215-8100
Fax: 511-215-8185

Mexico City

Tel: 5255-5629-5040
Fax: 5255-5629-5846

Santiago

Tel: 562-336-3300
Fax: 562-697-3869

São Paulo

Tel: 5511-5538-8226
Fax: 5511-5538-8407

Tokyo

Tel: 813-3211-0356
Fax: 813-3211-0362

Key to Investment Codes

Buy	Upside of more than 15%.
Hold	Upside of 10%-15%.
Underweight	Upside of less than 10%.

Note: New investment code criteria were implemented on January 1, 2005. Target prices set from January to June are for December 31 of the current year. Target prices set from July to December are for December 31 of the following year.

This report has been prepared by Santander Investment Bolsa, Sociedad de Valores, S.A. ("Santander Investment Bolsa") and is provided for information purposes only. This document must not be considered as an offer to sell or a solicitation of an offer to buy. Any decision by the recipient to buy should be based on publicly available information on the related security and, where appropriate, should take into account the content of the related prospectus filed with the CNMV (Spanish National Securities Market Commission) and available from the CNMV, the company governing the related market (Sociedad Rectora de la Bolsa) and the company issuing the security. This report is issued in the United States by Santander Investment Securities, Inc. ("SIS"), in Spain by Santander Investment Bolsa and in the United Kingdom by Banco Santander Central Hispano S.A., London Branch ("SCH London"), which is regulated by the Financial Services Authority in the conduct of its investment business in the UK. SIS, Santander Investment Bolsa and SCH London are members of Grupo Santander. This report is not being issued to private customers.

The information contained herein has been compiled from sources believed to be reliable, but while all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation that it is accurate or complete and it should not be relied upon as such. All opinions and estimates included herein constitute our judgement as at the date of this report and are subject to change without notice. From time to time, Grupo Santander, its affiliates and/or any of its officers or directors may have a position, or otherwise be interested in, transactions in securities which are directly or indirectly the subject of this report.

Grupo Santander, or its affiliates, may from time to time perform services for or solicit business from any company mentioned in this report. Grupo Santander, its affiliates or any other person do not accept any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose.

Any US recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security discussed herein should contact and place orders in the United States with the company distributing the research, SIS at (212) 692-2550, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the US Securities Exchange Act of 1934) under this report and its dissemination in the United States. US recipients of this report should be advised that this research has been produced by a non-member affiliate of SIS and, therefore, by rule, not all disclosures required under NASD Rule 2711 apply.

© Santander Investment Bolsa, Sociedad de Valores, S.A., 2005. All Rights Reserved.

