FORO MEDCAP 2022.
SMEs look for alternative funding sources

Foro Medcap 2022: Key Highlights

Attended by 110 companies and more than 150 institutional investors, of which 20% were based outside of the Spanish market, BME's Foro Medcap Conference took place in person in Madrid between May 24-26. In addition to being a source of cutting edge thought leadership, Foro Medcap is widely considered to be a premier networking event, with BME organising over 1,000 one on one meetings between companies and investors. The legacy of the pandemic – despite the worst of it being over in Europe – continues to reverberate as supply chain disruption derails the continent's fragile economic recovery and fuels inflation. Exacerbating matters has been Russia's invasion of Ukraine, which in addition to its tragic human cost – is weakening global growth further. Speaking at Foro Medcap 2022, industry leaders shared their unique insights into some of the dynamics shaping Spain's capital markets today.

Shock after Shock after Shock after Shock: An unenviable macro situation

The challenges facing corporates should not be underestimated. "We are operating in a very difficult environment. What seems to be the last throes of the global pandemic have been compounded by the negative effects of the war in Ukraine, the disruption of supply chains, the energy crisis, a hyperinflationary scenario, and an accelerated reversal of the expansive monetary policies pursued by the Central Banks of the developed world for many years," highlights Javier Hernani, CEO of BME.

The situation in the world today is unprecedented, says David Cano, Director General at AFI Inversiones Globales, a financial adviser in Spain. In contrast to past financial shocks - which have overwhelmingly been caused by drop-offs in consumer demand - Cano says this latest crisis was trigged by a supply chain crunch. Aside from the logistical challenges emanating from the reopening of the global economy post-COVID, ongoing lockdowns in Chinese manufacturing hubs are worsening supply chain shortages. The war in Ukraine is also unsettling supply chains, resulting in exorbitant price hikes in basic food, fertilisers and commodities. Cano argues this crisis – which has exposed structural vulnerabilities in supply chains - raises awkward questions about the future of globalisation.

All of these interlinked events are creating an environment ripe for inflation. Inflationary risk – which in turn could spark Central Bank interest rate rises – and with it a potential recession – is top of mind for many speakers at Foro Medcap. However, some markets are better shielded from rate rises than others. The Federal Reserve – owing to the US's flexible economy and full employment– has plenty of room to manoeuvre when it comes to raising rates, whereas Europe is in a more precarious position, says Michel Sánchez, CEO at Santander Asset Management. As such, the European Central Bank is taking a more cautious approach to rate rises than the Federal Reserve. "If rates are increased too quickly, the ECB risks causing a recession. This could be painful in countries such as Spain or Italy – which have huge debt burdens," notes Susana Criado, Presenter of the programme Capital, on Radio Intereconomía.

The current state of financing

Fuelled by a combination of pent-up demand, ample liquidity and investor bullishness about the prospects of a global economic recovery, Spain's IPO (initial public offering) activity was incredibly healthy last year. Hernani highlights 19 companies listed on BME in 2021, with three doing so on the main exchange and the rest on BME Growth, a platform for promising SME growth companies. However, 2022 has so far been marred by rising geopolitical tensions and macro uncertainty, which have negatively impacted IPO volumes in Spain, according to Verónica Guerrikabeitia, Executive Director at Santander. This sentiment is echoed by Hernani. "In the first third of this year, political and economic events have temporarily interrupted the process of recovery of IPOs that had begun and companies have also postponed corporate or expansion plans that required equity financing," continues Hernani.

Compounding the problem is that more companies are staying private for longer, as many believe that going public is a costly and time-consuming process. A lot of SMEs have also obtained cash injections from private equity and venture capital, asset classes sitting on large sums of unspent money. Although activity in the private markets has been buoyant , Thomas Zeeb, Global Head of Exchanges at SIX - BME's parent company - says public market financing in Spain is in excellent shape. "In 2021, financing in the form of equity capital on BME reached €24 billion, of which €3 billion was related to 19 new companies incorporated in the market and another €21 billion was raised in almost 100 capital increases of already admitted companies. Despite it being the second best year in its history, venture capital in Spain channeled only around €7.6 billion of new investment in 2021," explains Zeeb.

He adds: "In the first four months of 2022 - a year so affected by uncertainties and a good number of deferrals of financing operations - the Spanish stock market has already channeled €1.3 billion of financing to companies admitted to trading. This channeling of resources has taken the form of around 50 transactions which have benefited 34 companies, 14 on the stock exchange and 20 on BME Growth, four of which are new additions to the market. In the almost 14 years of BME Growth, €325 billion of new capital has been channeled through BME's financing platforms, of which €34 billion are related to 48 new incorporations / IPOS on the Stock Exchange and 165 to BME Growth. During this period, only 4,500 Venture Capital operations were carried out in Spain with investment totaling €50 billion."

SMEs look for alternative funding sources

In comparison to North America, European SMEs are less likely to tap into capital markets preferring instead to obtain their funding from traditional bank sources. For example, non-bank funding accounts for roughly 73% of corporate financing in the US but it comprises just 24% in Europe. However, SMEs are increasingly seeking out funding from capital markets, including at alternative venues, such as those offered by BME Growth. "BME Growth is one of the most successful platforms on the Spanish stock exchange for prompting SMEs. Since its creation in 2009, BME Growth has incorporated 165 companies and executed 461 corporate capital raising operations which have raised €5.9 billion in new investment. It has 127 listed companies with a market value of close to €20 billion," notes Zeeb. BME also enables SMEs to obtain debt financing through MARF - BME's alternative fixed income market. One of the primary advantages of MARF is that it is a cost-efficient venue for issuers to list on, which has helped boost its appeal among European SMEs in particular. MARF's flexibility is a vital ingredient behind its wider success. "MARF has surpassed 120 issuers in a decade," according to Hernani. Already in 2022, Hernani says the MARF has raised approximately €4.51 billion in new issues.

The benefits of these alternative venues were articulated by Santiago de Torres, Chairman of Atrys Health, a company specialising in cancer diagnosis and treatment. Atrys Health listed on BME Growth in 2016, before debuting on the main stock exchange earlier this year. During that time, Atrys Health carried out several capital increase transactions and also tapped into MARF for additional funding. De Torres highlights listing on BME Growth gave Atrys Health greater visibility and helped the company access more liquidity enabling it to expand its operations further and into new markets. Whereas many SMEs often eschew listing because it is too expensive, De Torres says this was not an issue at BME Growth.

Corporates factor ESG into their businesses

Corporates and consumers across Europe – including here in Spain - are increasingly embracing ESG (environmental, social, governance) principles. Many are doing so by pivoting away from pollutant fossil fuels in favour of cleaner renewable energy sources. While the drivers behind this shift to renewables has been largely altruistic, there is an element of pragmatism too. Marc Gómez, CEO of Magnon Green Energy, says the impetus to adopt renewables more widely has been driven by recent events, namely rising commodity prices, a direct consequence of the war in Ukraine and the pandemic.

Citing the volatile geopolitics in Europe today, Gómez acknowledges it is no longer feasible for consumers or corporates to be reliant on a single energy source, adding the future lies with renewables. This tilt away from fossil fuels is being facilitated by the EU through its RePowerEU Plan, an initiative designed to end the bloc's historic reliance on Russian oil and gas in favour of greener energy supplies. In terms of costings, renewables are significantly cheaper than fossil fuels – especially in today's over-heated commodity market. In the case of solar energy, Carlota Pi, CEO at energy company Holaluz, notes consumers can generate savings of up to 70% on their electricity bills.

A growing chorus of companies in Spain are funding their sustainability projects by issuing debt in the form of green bonds or sustainability-linked bonds (SLBs), according to Ixone Vicente, CFO at Arteche. Use of proceeds from green bonds will help finance projects with clearly defined environmental benefits. Of the $1 trillion in sustainable debt issued in 2021, green bonds accounted for $500 billion. [1]Less widespread than green bonds but growing in popularity are SLB, Sustainability-linked bonds. While SLBs do not have any limits on use of proceeds, they do contain a set of pre-agreed sustainability KPIs (key performance indicators) which

[1] Environmental Finance (February 16, 2022) The sustainable bond market in 2022 and beyond – transition is keys

issuers need to achieve, otherwise it impacts the coupons they pay to investors. Data shows SLBs grew by 941% in 2021 with $188.8 billion in issuances, up from $11.4 billion in 2020[2].

While many companies are gravitating towards ESG because they believe it will supplement their long-term performance, others are coming under mounting pressure from their own investors to become more sustainable. For example, Cristina Álvarez Méndez, Director of ISR at CaixaBank Asset Management, says a number of asset managers are integrating ESG into their investment processes. In many instances, asset managers are themselves facing demands from their underlying institutional and retail clients to start taking ESG seriously. In the EU, regulation – namely the Sustainable Finance Disclosure Regulation (SFDR) – which requires institutional investors to disclose information about how they integrate ESG into their investment processes – has prompted firms to think about ESG too.

But beware of the ESG challenges

While ESG investing is becoming more popular, there are issues which need to be overcome. Firstly, global regulation on ESG investing is not harmonised, while there are also a lot of different ESG standards. Ratings agencies – which themselves have started scoring companies on ESG – are also coming in for criticism, as there can be discrepancies between their methodologies – with identical companies being given contrasting ESG scores by different agencies. Fernando Luque, Senior Financial Editor at Morningstar, cites Tesla as an example of this, with MSCI, S&P and Morningstar all having different opinions on the EV (electric vehicle) manufacturer's ESG credentials. Luque concedes some investors find these divergences hard to understand, but stresses such diversity of opinion should be welcomed. "If all of the different ratings agencies had the same opinion,that would be odd," he argues.

Nonetheless, ESG investing is dependent on quality data, a point made by Carlos Martinez, Corporate Business Development & Sustainability Director at Cementos Molins. Without coherent ESG data at an issuer level, investors will struggle to demonstrate that they are satisfying their ESG responsibilities. Regulators – namely the EU – have recognised the scale of the challenge. Ana Puente Pérez, Deputy Director for Securities Market and Financial Instruments Legislation at Ministry of Economic Affairs and Digital Transformation, says the EU's Taxonomy Regulation will create a standardised set of science-based criteria determining which economic activities are sustainable. By creating a single benchmark, EU regulators will help investors navigate the myriad of different ESG standards, and avoid greenwashing. The Taxonomy Regulation will play a vital role in helping to strengthen ESG data quality.

The importance of digital

Speakers at Foro Medcap discussed the importance of technology extensively. With digitalisation likely to play a critical role in companies' success moving forward, it is vital businesses are able to access the right talent. In the Spanish market, this is not always straightforward. Antonio Garamendi, President of CEOE, says

[2] Climate Bonds Initiative (April 25, 2022) Sustainable debt tops $1 trillion in record breaking 2021, with green growth at 75% - new report

labour shortages – aggravated by the so-called "Great Resignation" - are impeding technology development at Spanish companies, which is hindering their ability to compete.

On a market infrastructure level, both SIX and BME are embracing digitalisation, in what will boost financing even further. Zeeb highlights that SIX created the SIX Digital Exchange (SDX) in 2018, a fully integrated trading, settlement and custody infrastructure for digital assets based on DLT (distributed ledger technology). A number of milestones were reached at SDX in 2021. In addition to SDX obtaining licenses to operate an exchange and central securities depository, it also issued the first tokenised bond, making it the first issuance of a digital bond on a regulated market infrastructure. BME is also taking digitalisation seriously, he adds. "BME is working on a project that will make it easier for SMEs to raise financing through the issuance of tokens representing participative loans. The marketplace would be mainly aimed at channelling the financing of Limited Liability Companies (SLs) – which in addition to their size and status as SLs - may lack financing alternatives other than banks," says Zeeb.

Until next year

The 2020s have been a period of profound disruption, fuelled firstly by the pandemic and now one of the worst conflicts in mainland Europe since the Second World War. These headwinds are creating huge problems for companies. With traditional financing sources likely to be constrained, the importance of exchanges in providing companies with access to equity and debt markets will be key.