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Mármoles del Sur, S.A. (A). Novamármol

Jorge González
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We hope that the terms previously outlined are satisfactory so that we may move forward with our negotiations. If you would like clarification on any aspect, please do not hesitate to contact us.

Sincerely,

José Cuesta
MarSur S.A.
Managing Director
Macael, October 27, 2002

No way, the offer is not good enough! Forget it, Fernando... I manage a private equity fund. It's one thing to take risks but quite another to play Russian roulette.

Sure, Santi. It's risky. But you have to admit we've never seen such a groundbreaking product with such good prospects.

You're right. But let's talk about the reality. The company is technically in bankruptcy, the expected growth hasn't happened, and there's an extremely high risk of losing our shirts. Breaking into new markets is all well and good, but remember that those who go in first get eaten alive.

Santiago Palacios, managing partner of the capital management company Electrum, and Fernando de Zúñiga, representative of the group of industrial partners with a stake in the operation, expressed divergent opinions that morning on the business opportunity that would allow them to join the shareholder structure of MarSur. The analyses conducted to date raised several doubts about the potential of Novamármol, the marble tile backed with resin (see Exhibit 1), which, because of its advantages, could become a real revolution in the market for marble coverings for construction.

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For starters, we have to reposition the company financially, Palacios added. And additional resources will be needed for both the commercial launch and for expanding productive capacity. And, if all goes well, money to finance the growth... In short, we need to provide around €5.5 million. Meanwhile, the €15 million valuation that the family have in mind is way off the mark. We agreed that we would only buy into MarSur with a majority stake. If we make the investment, we must have the freedom to restructure everything, and it is already clear that the existing shareholders are not ready and willing to give in on that aspect.

They'll give in, said de Zúñiga. Their real concern is the discharge of sureties. In refinancing the debt, they have tied up all the family wealth as collateral for the loans, and they can't risk that. The other issue is the situation of the family members within the company–MarSur is their only source of income and obviously they want to take care of that issue before letting new investors come in. They'll give in, and they'll do it soon... Renegotiating the bank liabilities has given them a little relief for now, but they know that's not enough. The extreme financial stress they've undergone is still recent and very fresh in their minds. We obviously have to shift into high gear to revitalize the business - and they expect not only money from us but also managerial ability.

I don't know, Fernando. I have my doubts. I still think we should valuate the business restrictively and, if we go in, we need to have a clear majority. Like I told you before, 60% would be the ideal stake for us. Don't forget that in this type of high-risk operation we look for returns of 30% and that our plan is to get out after the fifth year with an EBITDA multiple[1] of six.

The Company

MarSur was a family business founded in 1942 by Santiago Ferro and Luis Cuesta in Macael (Almería). MarSur's business activity consisted of extracting marble from quarries, industrial processing and marketing the products. The company had €10 million in revenues in 2001, ranking fifth in a highly fragmented sector.

Throughout its history, MarSur was clearly focused on exports, eventually delivering around 75% of its production to foreign countries, mainly the United States. Historically, it had limited presence at the national level, with relatively little commercial activity.

MarSur's ownership structure consisted of a holding company that had control over MarSur Comercial, the industrial and commercial company, and Canteras MarSur, the firm with shareholdings in companies that had the administrative concessions for the quarries (see Exhibit 2). Ownership of the quarries was shared with other companies similar to MarSur. The quarries were run as cooperatives: the volume of marble extracted was distributed among owners based on their stake in the company. The companies operating the quarries had no debt. According to Santiago Ferro:

In this business, having control of the raw material sources is just as important as expertise and the industrial trade. Marble is a scarce commodity, and having quarries is not only a major asset–it is a guarantee the entire process.

In early 2001 the founding partners retired but remained as chairman and vice chairman of the Board of Directors. Taking the reins of the business were their sons, Pepe Cuesta, as managing director, and Manolo Ferro, as industrial director. Other family members held different positions in the company, and relations between the two groups were cordial and satisfactory.

[1] Earnings before interest, taxes, depreciation, and amortization.

The Marble Market in Spain

Production

In 2000, the marble used in the Spanish market was around 43 million square meters and 15% of national production was marketed for export. The marble market had experienced spectacular growth in the previous years (see Exhibit 3) thanks to the steadiness of the construction industry, the pronounced trend toward the use of marble materials in housing and an upswing in export activity.

Characteristics and Uses

Marble is a limestone used since ancient times as a decoration and construction material. As a natural product, it went by a variety of names based on its origin and characteristics (e.g., ivory white, Alicante red, travertine, Macael white). Marble was especially prized for its aesthetic qualities and because it had always been considered a "fine" material. It was a porous and relatively fragile stone with reduced elasticity, so it could easily crack if bumped even slightly.

Some 70% of the marble used in the domestic market was destined for construction and home renovation (floor and wall covering). The rest was used for decoration, bathrooms, gravestones and other funerary objects.

Marble was marketed in different formats according to its intended use. Large blocks of stone were extracted from quarries. In the initial industrial phase, the blocks were cut into slabs of varying widths and lengths. The best slabs (30% of the extracted surface) were marketed directly at high prices due to their pleasing aesthetic. These slabs could be used for bathroom countertops and other unique pieces.

The slabs that were not directly marketed got cut into smaller pieces, generally ending up as wall and floor tiles for construction and building renovation. The most common formats were 2 cm thick slabs (20%) and 1 cm tiles (50%) with different surface dimensions (40 × 60 cm and 40 × 40 cm being the most popular). The drawback of the tiles was their extreme fragility, so the shrinkage rate in production and installation was very high. Slabs were more resistant but also heavier, so handling was more complex.

Distribution and Installation

Marble was marketed through specialized marble wholesalers. These warehouses stocked marble from different suppliers and acted as wholesalers for direct customers—primarily builders—as well as retailers and other businesses (e.g., decoration, building materials, funeral homes). The marble wholesalers were typically located in industrial complexes on the outskirts of cities.

The marble used for construction had two distinct purposes: new buildings (65%) and renovation (35%). Normally, the buyers for new buildings and major renovations (hotels and public buildings) were the builders in charge of those projects. On some occasions, the architects played an important advisory role in identifying specific aspects of the materials to be used, but it was normally up to the builder to choose the supplier and negotiate pricing. For residential renovation projects, the purchase process generally involved a specifier (the architect, decorator and/or contractor doing the renovation).