Italian private equity: Addio, Dolce Vita?

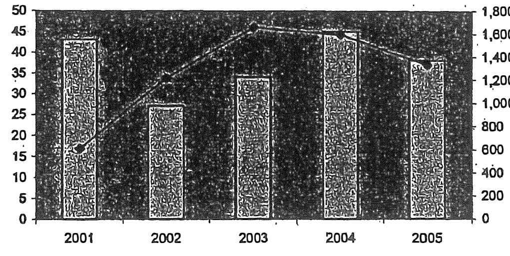
The Italian economy remained in regrettable shape over 2005 with 0% GDP growth following only 1% in 2004. Consumer confidence is low, whilst unemployment remains near 8%. Exports improved over the year (though Italy faces competition in key consumer goods markets from cheaper producers in Asia and Eastern Europe). The year also saw Italy retain a budget deficit beyond the 3% limit agreed under the terms of the Eurozone's Stability & Growth Pact. 2005 was, however, a year of significant activity in Italian banking. Last year Italy's Unicredito merged with Germany's second biggest bank, HVB, completing the largest European cross-border deal of its kind so far. The year also saw the Netherlands' ABN AMRO merge with Italy's Antonveneta bank, although the deal was mired in controversy following allegations that the Bank of Italy's governor had unfairly favoured Italy's Banca Popolare Italiana during the bidding. So what effect has this had on private equity? The following article examines Italian private equity activity over the past year and talks to local players about how the industry is shaping up for 2006.

2005 overview

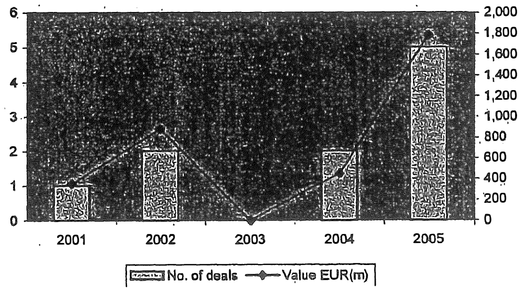
In the past, the volume and value of private equity-backed transactions in Italy has been extremely erratic. Italy's economic landscape is populated largely by family-owned firms, with only a handful of large Italian corporations. This has meant that while smaller deals fuel the market, the occasional large deal can send value figures soaring. The number of deals completed in Italy in recent years has, however, improved, with Berlusconi's low capital gains tax (at 12.5%) helping to bolster the volume of private equity activity in the country. According to Maximilian Fiani, head of KPMG Corporate Finance in Italy, private equity is also taking a larger share of the M&A market. 'In the past two years the Italian private equity industry has moved from the fringe to the capitalist action centre with strong growth in the size and number of private equity funds. In volume terms, private equity currently represents about 10% of the Italian M&A market.'

According to figures provided by Incisive Media's Alternative Assets division, the Italian private equity market reported 48 transactions reaching a total value of €7.63bn in 2005, a strong increase on the year before which saw 50 transactions valued at only €4.14bn. '2005 was a very good year because it was much more diverse, both in terms of investment opportunities and exits, and was less influenced by mega-deals,' says Antonio Corbani of ABN AMRO Capital. The statistics also suggest that the Italian private equity market has at last begun to stabilise in terms of dealflow, showing no sign of the volatile volume fluctuations of years ago. The five largest Italian private equity deals recorded in 2005 include the €1.3bn buyout of Pirelli Energy & Cables by Goldman Sachs Capital Partners, Investitori Associati's €888m acquisition of the retailer Rinascente, the €835m secondary buyout of FL Selenia by KKR, the €600m acquisition of N&W Global Vending by BA Capital Partners and Merrill Lynch Global Private Equity, and finally PAI's purchase of Gruppo Coin for €531m. A further five deals were reported in the upper mid-market range (between €200m and €500m), a cluster almost non-existent in the past. The largest deal in this range was 3i's acquisition of the toy company

Volume & Value (deals <=EUR 200m)



Volume & Value (deals >EUR 200m and <=500m)



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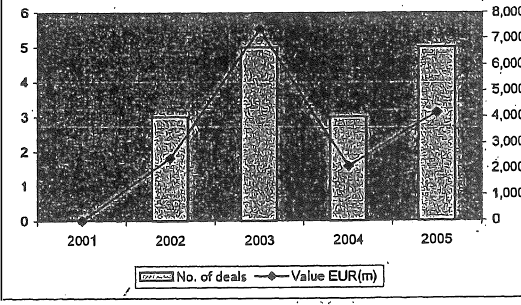

Top Italian Investors 2005	No. of deals	Value (€m)
Fondamenta	5	108
NATEXIS CAPE	5	83
MCC-Sofipa SGR	4	356
3i	3	480
Investitori Associati	2	963

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Giochi Preziosi (estimated to be worth around €500m). The top end of the market experienced dramatic growth in 2005 with a total of 10 deals above €200m, compared with five in 2004 and 2003. However, it is the lower mid-market (below €200m) that continues to fuel the industry. A total of 38 deals were completed in this range including MCC-Sofipa's €62m acquisition of the software company Gruppo Byte, BS Private Equity's purchase of the engineering firm Cast Futura and ABN AMRO's acquisition of Bianchi Vending, estimated to be worth around €140m. Gianluca Banfi of Arca Impresa Gestioni is positive about the continued development of the Italian mid-market: 'There has been a good level of mid-size transactions over the past 12 months and the economy is beginning to pick up, which will hopefully bolster M&A activity.' Emanuele Cairo of Barclays Private Equity agrees: 'Whereas multinationals will sell off businesses at any time, families tend to wait until the economic cycle improves and the M&A market is strong. In this respect, 2006 should be better.'

'There are fewer investment opportunities coming from corporate disposals which have traditionally provided many of the larger deals.'

Amedeo Carassai
Apax Partners

Acquisitions from private vendors remain the backbone of dealflow in Italy. Family businesses and private companies have consistently provided over 50% of buyout deals a year. The larger family/private deals last year included the sale of Sisal by the Molo family to Clessidra and the sale of branded foods producer, Cesare Fiorucci, by Ferruccio Fiorucci to Vestar Capital Partners. Sales by institutional investors have remained relatively consistent over the last few years with nine secondary buyouts in 2005, compared with six in 2004 and seven in 2003. FL Selenia and N&W Global Vending were the two largest secondary buyouts in Italy last year. Public-to-private transactions, on the other hand, remained weak; PAI Partners' acquisition of Gruppo Coin, operator of the Coin department stores, was the only such deal to occur in 2005. However, according to Amedeo Carassai of Apax Partners, public-to-privates could be one area to watch out for over the coming months. '2005 was a relatively good year, although there were a few big opportunities such as the sale of the food producer Star that never materialised,' says Carassai. 'In our size range there are currently some very attractive public-to-private opportunities, a few potential secondary buyouts and some interesting niche businesses in areas like consumer durables. However, there are fewer investment opportunities coming from corporate disposals which have traditionally provided many of the larger deals.'

Sectors to watch

In a market as small as Italy there has never been much call for sector specialists. However, there are a few sectors that are attracting the attention of private equity funds. 'The sectors that we are focusing on include consumer, food, retail, transport and financial services,' says Marco Fumagalli of 3i. Other sectors such as healthcare have seen huge growth in other European countries and with groups like Natexis Cape and BS Private Equity taking tentative steps in the area, some are questioning whether we are likely to see a healthcare boom in Italy. Corbani, who recently managed the sale of a stake in the private hospital chain Humanitas, thinks that this is highly unlikely given the nature of the Italian system. 'The fact that the regulations are different in each region means that it is very difficult to build a national platform like in the UK and France.' Fumagalli agrees adding: 'We have examined a few opportunities in the sector but we have not yet completed an investment because local government regulations make it hard to form a significant national player. Nevertheless, the sector is very attractive for 3i'

Looking at the mid-market, Barclays is very positive about opportunities in the more traditional sectors of manufacturing and engineering. Last year, Barclays acquired CEME, a manufacturer of fluid control components, and the group has just signed an add-on investment to acquire its main Italian competitor in a deal that will double the turnover of the company. Much of Italy's maligned industrial sector has been inwardly focused over the past few years as entrepreneurs concentrated on making their firms competitive with the Far East and Eastern Europe. The result is that there is now renewed interest among mid-market players for those industrial companies that have prepared themselves through opening new factories, outsourcing production or forming joint-ventures. CEME, for example, opened a factory in China last year to serve both subcontractors and European producers based in the Far East. 'CEME did not move to China for low-cost production,' says Emanuele Cairo of Barclays Private Equity. 'The pressure instead came from clients who wanted the production facilities there for quicker delivery.' Wisequity II, which recently held a second close on €152m, is also focusing on Italian SMEs and approximately 30% of its is dedicated to investments in the machinery sector. Michele Semenzato of Wise SGR is very positive about the opportunities in Italian SMEs, particularly in some of the niche sectors: 'Italy is a country of niche markets that can be very lucrative as long as the company has sustainable advantages in its brand or design and high-quality production techniques that are defendable on the world

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Marco Fumagalli
3i

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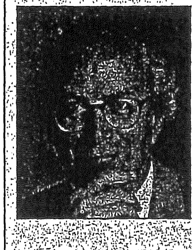
market.' Growing interest from non-European and US trade buyers in Italian industrial companies, particularly in areas like fine chemicals and pharmaceuticals, means that GPs now have an additional exit option – good news for those looking to sell a niche business. MPS Venture, for example, recently sold the Italian steel company Palini & Bertoli sale to the Russian Evraz Group – a firm that is now looking to merge with the Anglo-Dutch steel group Corus.

Auctions 'all'italiana'

Despite the weak economy, industry players are surprisingly optimistic about the future of Italian private equity and the opportunities available. Of course, it would be misleading to suggest that the Italian market was anything less than fiercely competitive, particularly since the advent of the auction. In fact, Italian auctions have received a lot of criticism lately. According to Antonio Corbani, this is caused by the growing number of auctions that are conducted 'all'italiana'. 'In a mature market the auction process is relatively quick and inexpensive, characterised by a high level of organisation and thorough vendor due diligence,' says Corbani. 'Unfortunately, in Italy this is not always the case and there are examples of formal auction processes being launched without the completion of vendor due diligence, with over ambitious time frames and with over inflated prices.' Matteo Enriques of Banca Intesa agrees and adds: 'It is important that management teams consider whether they have time to deal with the distraction of an auction process. All too often they dedicate too much time to the auction and not enough to managing the company or vice versa.' The failure of auctions is certainly more common in Italy than in other European countries. One such example is the much publicised sale of the food processing company Star, which was organised by the vendors without a financial advisor. The process began with 60 bidders and was brought to an abrupt end when the vendor decided not to sell, amidst rumours of a lack of organisation and poor vendor due diligence. 'Unless you organise the right process, you risk losing the sale altogether,' comments one industry player.

Innovative ideas

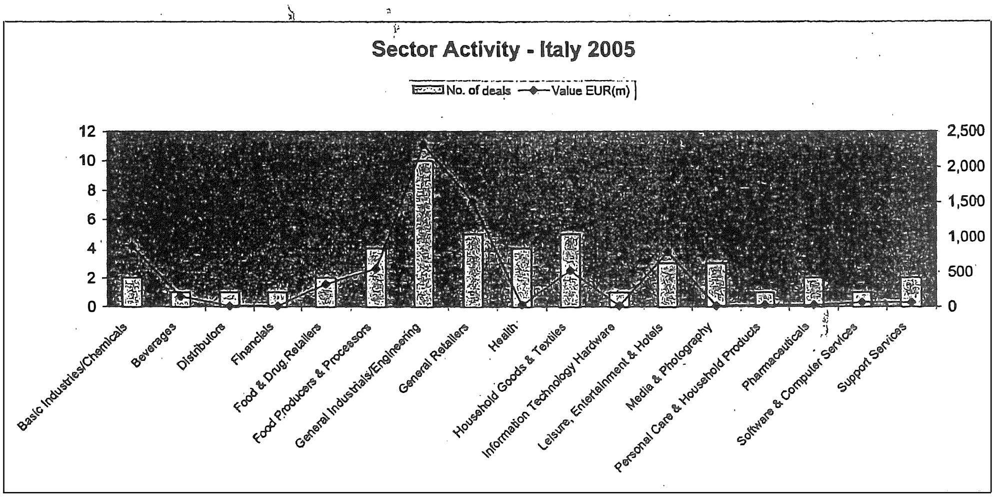
Private Equity groups looking to set up in Italy certainly have a challenge on their hands but slow market growth hasn't abated their appetite. International law firm SJ Berwin has just opened an Italian office, while Candover and Cinven are rumoured to be starting operations soon. Truly innovative ideas, however, are few and far between. One of the most interesting new funds to arrive on the scene in Italy is Synergia con Imprenditori managed by the former founder of Bain Italy, Gianfillipo Cuneo. The €278m fund will only invest in companies controlled by Italian entrepreneurs, an angle that it hopes will make it stand out from the crowd. 'The philosophy of the fund is to help entrepreneurs achieve their goals,' says Gianfilippo Cuneo, manager of Synergo SGR. 'We don't do classic buyouts and restructurings – instead we offer operational support, advice and financial backing.' The example he gives is of an



'Many good entrepreneurs remain under the radar beam in stale old industries that are difficult to consolidate.'

Gianfilippo Cuneo
Synergo SGR

entrepreneur who wants to buy his foreign competitor but is worried because he has never carried out a cross-border transaction and needs financial backing but doesn't want to lose control of his business. In this situation, Sinergia would invest alongside the entrepreneur and manage the acquisition process but would take a relatively hands-off approach in the day-to-day running of the company. Cuneo believes that there is a wealth of untapped potential in this area of the market – particularly from entrepreneurs who are hoping to sell in a few years but would like to expand their companies first. Cuneo adds that there are also proprietary opportunities in this area because 'many good entrepreneurs remain under the radar beam in stale old industries that are difficult to consolidate'. For those deals that do go to auction, Cuneo believes Sinergia has a distinct advantage because it will only participate alongside an entrepreneur who works in the sector and therefore has synergies that can be used to offer a higher price. 'In these cases we should be able to outbid intelligent private equity,' says Cuneo. 'The problem, of course, is that you can never beat an idiot.'



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