

Challenge To Distressed Companies

The potential in this market is highlighted by a recent study sponsored by **Orlando Italy**, a leading operator. Meanwhile third quarter data shows a **reversal** of the negative **trend**, with banks more interested to **finance deals**

The industrial and financial crisis of the last two years is providing an enormous potential market for private equity players who specialize in turning around distressed companies and "special situations". According to the calculations of the Turnaround Monitor – an initiative put together by LIUC University in Castellanza and Orlando Italy, a private equity fund that specializes in turnarounds – approximately 2550 Italian companies with a turnover in 2009 of € 20 mn to € 200 mn, taken from a sample of 6700, are going through a "potentially distressed" phase and have a Debt/EBITDA ratio greater than 5. Furthermore, 4% of them – approximately 277 – are currently unable to pay the interest on their debt. 2008 data for the same sample group shows that only 1540 companies were in this potentially critical situation, so the conditions significantly worsened over the course of 2009. "Despite this enormous potential market and legislation that favors recovery from distressed

situations, with the temporary suspension of creditors' rights, Italian entrepreneurs are very reluctant to call on financial partners in order to recapitalize," states **Enrico Ceccato**, who launched Orlando Italy in 2007 with a number of prestigious partners, including **Gianni Mion** and **Pier Domenico Gallo**. They took the successful German fund by the same name as their model. Orlando has € 200 mn at its disposal and has invested approximately € 110 mn in 11 schemes, including 4 turnarounds. "We have another 4 in the pipeline" says Ceccato. In the last five years, 33 turnaround deals have been sealed on the market, only one of which ended up being written off. Disinvestment has already taken place for 8 of

them, mainly through trade sales to other companies. Atlantis is the other leader in this area, with 4 projects carried out. "The real issue at the moment is convincing the entrepreneurs to deal with their difficulties in



Two forefront players in the market: Paolo Gambarini, a founding partner of Wise, is on the buy side of the SMEs, while Gianni Mion (left), senior partner of Orlando Italy, is looking at special situations and turnarounds

good time. This obviously means diluting or wiping out their capital, but it also opens up very real possibilities of getting the companies back in shape," says Ceccato, who claims that the potential annual IRR of the Orlando fund (since there have not yet been any divestments) is around 30%.

On the more traditional private equity market, things seem to have started picking up in the third quarter of the year, unless the 2008 record data of deals

number are still very far. 16 deals were concluded, meaning that – together with the ones in the first half of the year – a total of 40 investments were made in 2010 (there were 50 last year). Real confirmation of this change of direction compared to the last 12 months comes from the quality rather than the size of the operations brought to a close in recent weeks, including the acquisition of 60% of Eidos Media – a leading publishing platform developer – by the funds managed by Wise and Aksia, and the Riverside fund's acquisition of Arena, a manufacturer of sports clothing and swimwear.

Wise and Aksia were the only Italian companies included on the shortlist of organizations invited to take part in the bidding for the acquisition of Eidos Media, a dynamic company that had turnover of € 27 mn in 2009 and was valued at roughly € 70 mn (approximately 7.5 times the EBIT in 2010). With a multiple of 2.5 times the turnover, it was an expensive acquisition, which means that the business has good prospects for growth and is heading in the right direction for funds that target SMEs. "The

best investments are in leaders of market niches," observes **Paolo Gambarini**, a founding partner of Wise, in which Banca Popolare di Milano has a 20% stake.

It is riding high following the success of Wisequity III, which closed its second fundraising phase after collecting € 140 mn at the end of November from institutional entities in Italy and

“Despite this enormous potential market and legislation that favors recovery from distressed situations, entrepreneurs are reluctant”

abroad, including the European Investment Fund (EIF). "The arrival of private equity funds boosts the confidence of employees and clients," claims **Gabriella Franzini**, CEO of Eidos and the second biggest shareholder, along with company president **Angelo Grampa**, who holds

Main investments in private equity

Date	Target	Industry	Investors	Type
Feb-10	Drogheria e Alimentari	Food	Alto Partners	Expansion
Mar-10	Octo Telematics	ICT	Charme, Amadeus Capital, Rothschild Capital	Buy out
Jun-10	Valvitalia	Industrial goods	Chequers Capital	Replacement
Jun-10	Microgame	Gaming	Tpg Growth	Replacement
Apr-10	Mar-ter	Transportations	Mid Industry Capital	Buy out
May-10	Ecoteck	Cleantech	Ambienta SGR	Buy out
Jun-10	Termoindustriale	Industrial goods	Argos Soditic	Buy out
Jun-10	Minotti Cucine	Consumer goods	Opera SGR	Turnaround
Jul-10	Findus	Food	Permira	Buy out
Jul-10	TeamSystem	ICT	Hg Capital	Buy out
Jul-10	Jal	Consumer goods	Progressio SGR	Turnaround
Jul-10	Bruni Glass	Consumer goods	Cape-Natixis SGR	Expansion

Source: PEM

40% of the company together with the rest of management. "Their resources will allow us to take advantage of the many opportunities for growth in both the media field and other vertical markets."

Riverside, which is based in Cleveland (USA) and has offices in Europe and Asia, bought 100% of Arena from the BS private equity fund. According to knowledgeable sources, it paid around € 100 mn for the multinational sportswear giant. Arena ended 2009

“
These figures show a structural trend reversal, after a negative cycle that has lasted around two years now
”

with a turnover of € 85 mn and an EBITDA of € 16 mn. The multiple on the 2009 EBITDA was 6x, which is less than the average of approximately 8x for the multiples in the fashion and garments sector over the last 6 years.

The operation was financed by Unicredit Bank AG and Banca IMI as joint mandated lead arrangers, underwriters and book runners, GE Capital as a mandated lead arranger and Banca Popolare dell'Emilia Romagna as a co-arranger. Riverside's advisors were

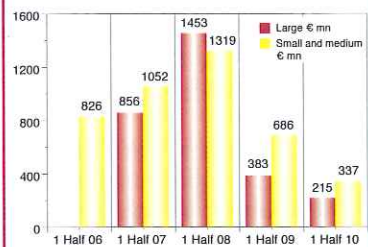


Bruno Bartocci,
partner in
the law firm
Legance

Turnaround highlights

- * The overall turnover of clearly distressed companies amounts to more than € 13 bn. They made a net loss of approximately € 1.5 bn in 2009.
- * The overall loss in terms of EBITDA is € 600 mn.
- * This means that their debt cost these companies roughly € 900 mn in 2009.
- * 42% of the companies work in the field of wholesale and retail * (116 companies).

Deals by Size: The SMEs' Upside



Source: Aifi - Large > € 150 mn, small and medium < € 150 mn

Roland Berger, PricewaterhouseCoopers, Deloitte, Studio Pirola Pennuto Zei & Associati and Finanziaria Internazionale, under the guidance of Legance, which also coordinated the acquisition of the foreign organizations owned by the Arena group.

"Arena is a multinational which also has significant operations abroad. We dealt with the lawyers of the other parties during the coordination of the due diligence process," explains **Bruno Bartocci**, a partner in the law firm.

Since it was founded in

1988, Riverside has made 237 acquisitions that add up to an overall enterprise value of € 4.1 bn. It now has a portfolio of 74 companies, with total net sales worth over € 2.7 bn and EBITDA of € 415 mn.

LIUC University's Private Equity Monitor (PEM) has also noted the return to the market of operations involving medium-large companies. When it comes to boosting the value of target companies, the average Enterprise Value is € 85 mn, but there were at least three vastly different cases in the third quarter of 2010: the acquisition of Findus and the Unilever group's other Italian businesses (€ 805 mn) by Permira through its subsidiary Birds Eye Iglo Group; the investment in Herambiente (total value of € 528 mn) by Eiser Infrastructure; and the acquisition of TeamSystem (€ 565 mn) by HG Capital. "These figures show a structural trend reversal, after a negative cycle that has lasted around two years now," says Roberto Del Giudice, the PEM manager and head of the Study and Research Office at AIFI, the Italian Private Equity and Venture Capital Association. **L**

Private Equity Partners: A Way To Success

Fabio Sattin and Giovanni Campolo, the founders of the financial company, tell the story of 20 years of investments made following an Italian recipe based on (at least) three key factors. And for the future...

Lombard: Pep has proven to be the longest-lived operator on the Italian market. It has one of the best track records and is able to attract some of the most prestigious limited partners in the world – such as the World Bank, sovereign funds in Abu Dhabi and Singapore. To what do you owe this success?

Sattin: The key factors can be easily pinpointed. The first is a strong focus on the local market, putting forward a professional and responsible business model with a long-term view, and adopting a business model that is compatible and coherent with consolidated international best practices. Additionally, a strong orientation towards innovation and towards adapting our investment ideas to the characteristics of the Italian market, proposing more easily managed investments in medium-sized funds to investors. Also, flexible and non-standardized entry methods that are tailored to respond to the exact requirements of the parties involved, and open both to minority and majority transactions. Last but not least, a moderate, careful and responsible use of leverage, always subordinated to requirements of an industrial and developmental nature. With these methods, we made 34 direct investments which – with the add-ons for the companies invested in – come to about 70 closed transactions in 20 years of business.

Lombard: What is your track record?

Campolo: For the first two now-liquidated funds in which about € 200 mn was invested, the compounded average annual IRR over 13 years was always higher than the one we had declared as our objective in the fund-raising phase, generating very interesting net returns for our investors. A third fund of € 200 mn – launched in 2002 and that we will liquidate in 2011 and 2012 – is currently fully invested, but it still has some more investments to



Giovanni Campolo (left), CEO, and Fabio Lorenzo Sattin, Chairman, co-founded PEP in 1989

make; while for the fourth € 300 mn fund – about half of which is invested – we expect to complete investments in the next 12 months. For both of these funds it is therefore still too early to draw conclusions, but the latest information we have regarding the performance of our investments looks good. What we are most proud of is that we have the trust of our limited partners, and the fact that in 20 years, not only have we never had any reason for conflict but we have always developed very open and constructive relationships.

Lombard: Often you talk about an 'Italian recipe' for private equity. What do you mean by that exactly?

Sattin: The classic, Anglo-Saxon model for private equity was and is largely based along two lines: heavily leveraged, major transactions. When we started to operate in Italy, after being schooled in an American bank of the caliber of Chase Manhattan, we adapted our modus operandi to Italy, combining majority and minority investments in small and medium companies, such as Med, Omim, or larger ones like Natuzzi or Datamat with large industrial growth potential, giving preference to industrial aspects, and – if opportune – using a small amount of leverage that involved a 40/60 equity-to-debt mix. But a lot of the transactions we carried out – even the very successful ones – did not involve any financial leverage at all. Having taken that road and achieved success, we decided that from then on, we would make decisions based on our experience, without uncritically copying what other countries, with social and economic contexts different from ours, do.

Lombard: What role did your team play?

Campolo: A fundamental one. We have always operated according to a methodology of partnership and

teamwork and we aim to encourage personal creativity, as long as it doesn't get in the way of the mutual objective. The team in which the two founders (ed: **Fabio Sattin** and **Giovanni Campolo**) are constantly interacting is compact and includes five professionals: **Roberto Tremi**, a director (an administrative director) and our chief analyst and head of training; **Leonardo Bruzzichesi**, a partner of ours for 13 years; and three investment managers who excel in their professional lives. The quality and professionalism of the team is the foundation of our strategy. We invest a lot in the professional and cultural growth of our investment managers and encourage them to attend training courses of the highest level.

Lombard: What role does your salary policy play in your strategy?

Campolo: At a team level, salaries are graduated according to responsibilities and contribution made to the results of the group as a whole, and never according to individual transactions. Often it is more difficult to say no to a transaction than do it paying more than everyone else. It would be very dangerous to push only those who make transactions, in that this could lead to less responsible behavior, putting the money of our investors at risk, but also putting our money at risk, considering the fact that Sattin and I always invest personally in all the transactions made by the fund together, and at the same conditions as limited partners.

Lombard: Not only in Italy, but in Italy in particular, private equity, in the past two years, has gone through a very difficult market and it is currently reinventing itself. However, one thing is for sure: the returns experienced pre-crisis will not easily be reached again. How will you defend yourselves?

Sattin: The slow-down in the market is an objective fact, but I do not believe that it is in itself damaging to very good operators. It will induce large investors to make more careful selections, investors who today choose to invest in Europe more cautiously. In the end, it could even be a very positive thing for the sector. The problem however is to show international investors why investing in Europe – and in Italy in particular – is still worth it and which of the Italian players deserve to be financed.

Lombard: What is your value proposition therefore?

Sattin: Pep distinguishes itself thanks to its careful selection of investment opportunities, an ability that we have honed in these years, sifting through the entire market of growing small and medium companies many times. We review about 200 companies a year, which means we've known at least 4,000 since we've been in operation. At this juncture, we also aim to make minority investments, which – contrary to what some people believe – are the most difficult to evaluate, and which infers recognition of the seniority of the fund and its individuals. In fact, with minorities, the alliance with the majority steering the company – frequently represented by the same founding entrepreneur – is achieved through the true seniority and authority of the people involved, and with a real and proven ability to bring value to the

company's management, through ideas, projects and managers.

Lombard: In the initial valuation, the key moment in making a good investment, what criterion do you give preference to?

Sattin: Discounted future cash flows. As a famous economist stated, 'the riskiest investment decision is to always invest in the past,' and today that is truer than ever. The method of multiples applied to certain income statement indicators such as EBITDA is very easy, convenient, meets standardization requirements and simplifies the market; but in times like these – characterized by low visibility and very high inconsistency – this can be extremely risky and I believe it is one of the main causes of the difficulties in which many operators found themselves. Certainly, if you seek to predict the future, you first have to understand the business and its prospects. And in order to do this you need time, experience and expertise. But that is precisely the essence of our business.

Lombard: Do you give preference to a particular industrial sector or business?

Campolo: Our focus in this phase is on the so-called 'export champions'. In approaching these companies, we don't just analyze financial statements, but rather we seek to understand in advance the possibility of development in some international markets that we especially believe in, and in which we have visibility. In fact, despite our boutique size, we have for many years been able to depend on an international network, with offices in Russia, China, Poland and India, and in the next few months also in San Paolo, Brazil and Istanbul, Turkey. These are offices that procure contacts for already-invested companies and flag opportunities in sectors or businesses in which we are not yet present and could enter. It is a proprietary network of PEP's that has already clearly proven to work very well. We can in fact state that many companies we have invested in would have suffered the consequences of the crisis much more had there not been concrete contribution from our international network.

Lombard: Doesn't betting on minority investments above all represent another element of risk in an already weak market?

Sattin: The successful experience that we have developed over years reassures us, and allows us to say that minority investments will continue to be a very big and profitable slice of Italian private equity. Pep has been the most active fund in the listing of invested companies, with six operations in six years. But another way out that has been satisfying to us was the share buy-back by a majority shareholder after going through a period of company consolidation and development together. In the future, even the secondary market might be an equally interesting and profitable road, because many funds will need to move their portfolios, after months of inactivity. Returning to the topic of listing, it isn't a given that a capable, internationalized and competitive Italian company has to list itself in Italy or in Europe: it should also evaluate worldwide stock markets.