Gatti Pavesi Bianchi

Strength in numbers

The Italian private equity market holds firm despite global headwinds

Unquote
An Acuris company

Contents

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How this year measures up against a record-breaking 2018

Volume trumps value

Value is down in 2019, but volume hits back

117 DEALS

volume rise year on year **2.6%**

€9.5 BILLION in deal value

Family businesses forge ahead

Deals for family businesses drive the market

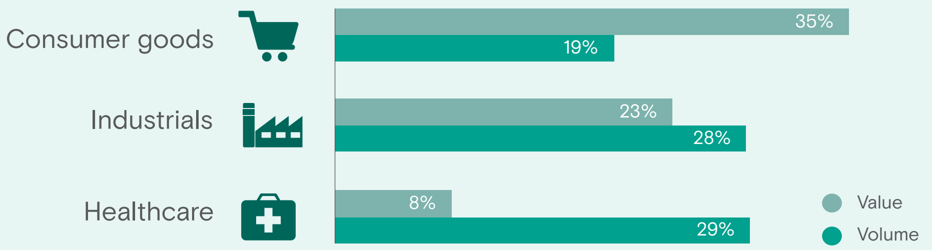
3 Of the top five deals were for family business

€1 BILLION

The largest deal for a family business – Carlyle's purchase of the Forgital Group

Sector Focus

Three sectors dominate market share



M&A in Italy

As in the rest of Europe, strategic dealmaking is down

444 The number of deals in 2019 (YTD)

compared to

480 in Q1–Q3 2018

€24.9 BILLION Value of deals

compared to

€44 BILLION in 2018

Private equity in focus

In the fourth edition of Gatti Pavesi Bianchi's series on the Italian private equity and M&A markets, we explore why buyouts have remained resilient in the face of difficult economic conditions

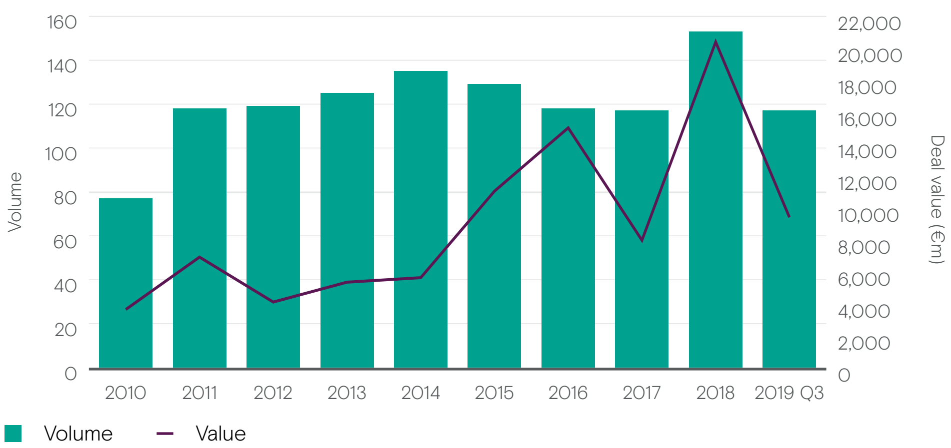
A record-breaking 2018 — the most prosperous year for the Italian private equity (PE) market on record — was always going to be a hard act to follow. However, 2019 has been up to the challenge. The first three quarters have shaped up very well in terms of volume, with total deal numbers marginally higher than those for the same period in 2018: 114 deals by Q3 in 2018 compared to 117 deals this year.

The picture in value terms is somewhat different. There have been €9.5 billion worth of deals in the nine-month period compared with €18.6 billion recorded by the end of Q3 2018. However, the 2019 figure should be put into perspective — of the record €20.5 billion registered last year, more than €5.9 billion, or 29%, was attributable to a single deal: the acquisition of medical firm Recordati by CVC Capital Partners. In addition, the value total is already above every year from 2010 to 2014 and 2017, and, by the end of 2019, it is likely to be the second highest total on record.

MEGADEALS ON THE DECLINE

The key factor behind the fall in value compared to 2018 is the absence of megadeals. The three largest transactions in 2018, all of which were €1 billion-plus trades,

ITALIAN PRIVATE EQUITY DEAL ACTIVITY 2010-Q3 2019



117

The total number of private equity deals in 2019

€9.5 Billion

The value total for private equity-backed deals in 2019

had a combined value of over €9 billion; so far this year the top three had an aggregate value of €2.9 billion.

This same downsizing has played out in Italy's broader M&A market and, indeed, in Europe as a whole. Moreover, several mammoth transactions in the US notwithstanding, such as United Technologies' bid for Raytheon (US$87 billion), the global M&A market has been more subdued in 2019 to date.

HEADWINDS SWEEP IN

Italy's private equity market has remained resolute at a time of increased global challenges. Trade frictions have frustrated PE and strategic activity not only by elevating uncertainty but by hindering economic growth. In October, the International Monetary Fund (IMF) forecast global growth for 2019 at 3%, its lowest level since 2008-09 and a 0.3 percentage point downgrade from its outlook six months prior. Much of this inertia has been attributed to trade protectionism and the broader breakdown in multilateral cooperation.

This is significant for Italy, the eighth largest exporter in the world and the second in Europe after Germany. The country has a world-renowned pedigree in industrials and the manufacturing of consumer products for sale abroad. At the same time, the nation contends with perennially weak household

consumption, leaving it heavily reliant on exports and therefore exposed to falling overseas demand.

Growth has been slow in the country. In the second half of 2018 Italy contracted, with GDP shrinking by a marginal 0.1% in both the third and fourth quarters. However, this has since reversed, with economic output rising by 0.2% between January and March 2019.

Debt is also a concern, both in the public and private spheres. State debt stands at a stubbornly high 135% of GDP, second only to Greece among EU member states. Italian banks too were performing poorly; however, significant progress is being made in this area. According to the Bank of Italy, non-performing loans totalled €190 billion at the beginning of 2019, or 9% of loan books, a significant improvement on the €350 billion (17% of total loan) three years ago.

FAMILIES DRIVE ACTIVITY

As we mentioned in our H1 report, the focus of Italy's banks to repair their balance sheets by offloading bad loans has been advantageous for the private equity industry. It has left an opening for buyout firms to provide equity capital as an alternative to debt. Italy has a large, developed economy with a rich post-war industrial heritage. Much like Germany's feted Mittelstand, the northern regions of the country are driven by family-owned SMEs that are ripe for PE investment.

This is an important source of deal opportunities. After decades of product development and establishing market positions, these businesses are well-suited to financial sponsors. Buyout firms are progressing digitalisation and globalisation efforts, improving not only cost margins and revenues but also the corporate governance and operational structures, and making them more attractive investment

€1.1 BILLION

Value of Merieux Equity Partners take-private of pharma group Doc Generici

29%

The percentage of total deal value for Italian healthcare buyouts between 2018 and 2019. The highest sector by value.

targets for corporates and larger buyout houses.

Private equity also provides a solution to succession in family-run businesses where owners wish to only partially liquidate their equity, or in cases where younger generations have chosen not to continue their family's legacy.

BIG DEALS AND SECTOR SPREADS

This long-term succession trend that defines the country's golden PE opportunity is borne out in a number of Italy's top ten largest buyouts, which are also spread across eight different sub-sectors, demonstrating the breadth of interest from private equity in Italy's businesses. The top deal to date has been a secondary buyout, generic pharma group Doc Generici changing hands from CVC Capital Partners to Merieux Equity Partner for an estimated €1.1 billion. However, in second place was Carlyle Group's wholesale purchase of forging company Forgital for €1 billion, with the founding Spezzapria family selling its entire shareholding. Similarly, the fourth-largest deal of 2019 to date saw Industria Chimica Emiliana, a chemicals firm that was wholly owned by the Bartoli family, divested to Advent International for €600 million.

SETTING UP SHOP

In spite of the dip in deal value witnessed so far in 2019 after a record-breaking 2018, these best-in-class, cash-hungry, family-owned businesses are a major attraction for private equity firms. Italy's strengths — such as its world-renowned design and manufacturing capabilities and a long-established track record in global exports — makes the country

TOP PE DEALS IN 2019 – Q3 2019

Deal date	Deal name	Industry	Country	Equity lead	Super sector	Deal value €(m)
Apr-2019	Doc Generici	Health care	Italy	Merieux Equity Partners, Intermediate Capital Group	Health care	1,100
May-2019	Forgital Group	Industrials	Italy	Carlyle Group	Industrial goods & services	1,000
Aug-2019	Multiversity	Consumer services	Italy	CVC Capital Partners	Retail	750-830 (estimated)
Sep-2019	Industria Chimica Emiliana	Basic materials	Italy	Advent International	Chemicals	600
Aug-2019	Rino Mastrotto	Consumer goods	Italy	NB Renaissance Partners	Personal & household goods	300
Jan-2019	Italcanditi	Consumer goods	Italy	Investindustrial	Food & beverage	280
Apr-2018	Laminam	Industrials	Italy	Alpha Group	Construction & materials	260
Feb-2019	Celli	Industrials	Italy	Ardian	Industrial goods & services	250
May-2019	Persidera	Technology	Italy	Unknown Institution(s), Fondi Italiani per le Infrastrutture (F2i)	Technology	240
Mar-2019	Phoenix International	Basic materials	Italy	Ambienta	Basic resources	200-260 (estimated)

an attractive destination for buyout operators, who can fund and steer the growth of high-quality international-facing assets.

International and continental firms are taking a keen interest in opportunities in Italy. In recent months, a number of private capital firms including EQT Partners, Three Hills Capital Partners, Astorg Partners and alternative debt provider Hayfin Capital Management have all established bases in Milan.

In May 2019, Unicredit, the Italian bank, launched a €2 billion patient capital equity fund, billed as the largest of its kind, to sponsor domestic SMEs by taking long-term minority positions.

This suggests that Italy's private equity market stands in good stead for the coming year and beyond.

Even if investors' worst fears of softening economic activity are realised, this will only heighten the pressure on Italy's export-reliant industrials and consumer products businesses and increase their demand for capital. And they will be able to call on the invaluable corporate stewardship and operational guidance that PE can provide in more challenging times.

Italy's strengths — such as its world-renowned design and manufacturing capabilities and a long-established track record in global exports — makes the country an attractive destination for buyout operators.

Sector watch

Industrials and consumer goods once again dominate in terms of volume, but, thanks to megadeals, healthcare is breaking through in the value stakes

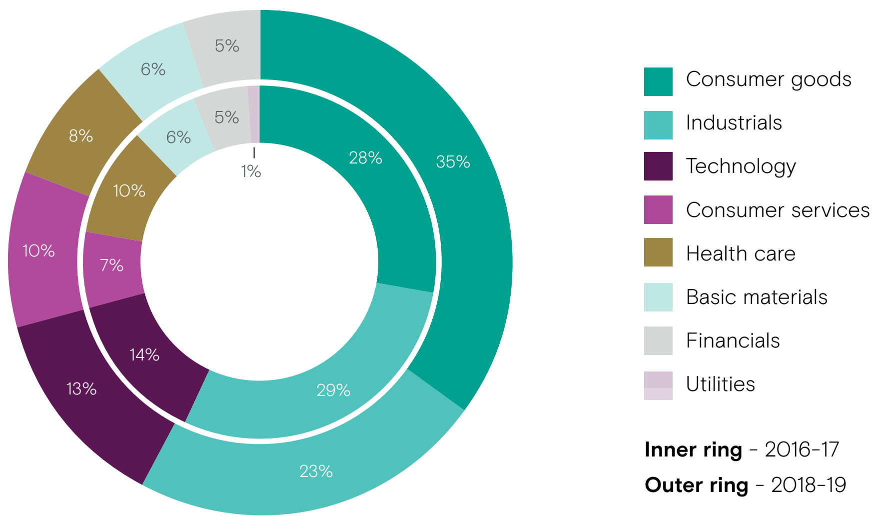
Sector splits of PE activity in Italy are broadly stable and underscore what the country does best. In terms of volume, the consumer goods and industrial sectors together accounted for more than half of all deals between 2018 and 2019, consistent with previous years. This is to be expected: these companies are the backbone of Italy's economy and represent an attractive opportunity for financial sponsors. PE funds can take high-quality, well-established industrial and consumer goods businesses to the next level by honing their operations, investing in digitalisation and extending their global reach.

Despite the spread of sub-sectors featuring in the top ten deals, the make-up of the largest deals of 2019 speaks to the dominance of these two sectors. In second and third place respectively are Carlyle Group's €1 billion acquisition of Forgital Group, which sits firmly in the industrials space, and CVC Capital Partners' €800 million (estimated) buyout of Multiversity, a consumer services company that owns Italy's largest online university Pegaso. All told, the industrials and consumer industries accounted for six of the top ten biggest buyouts of 2019.

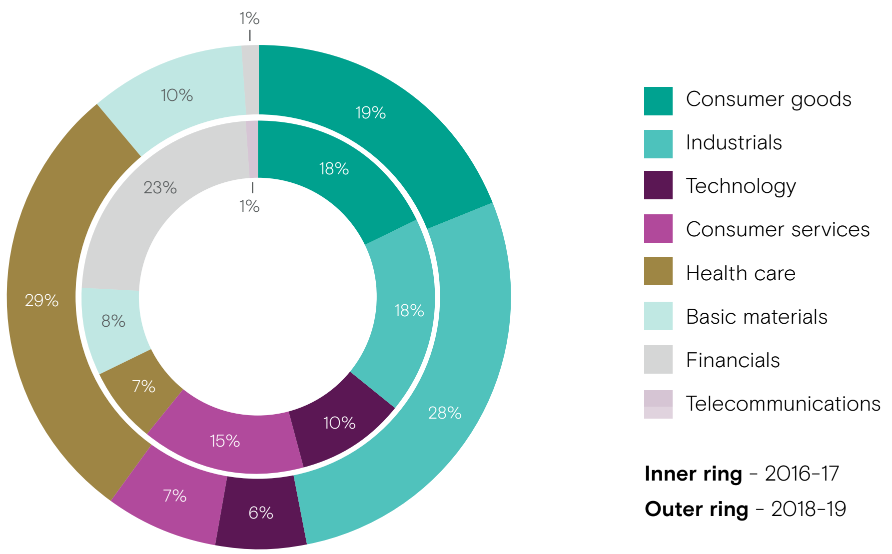
HEALTHCARE BONANZA

In value terms, healthcare is claiming the greatest share,

PRIVATE EQUITY DEAL VOLUME, SPLIT BY SECTOR



PRIVATE EQUITY DEAL VALUE, SPLIT BY SECTOR



usurping the previously dominant consumer and industrials segments. The sector constituted almost a third (29%) of euro invested between 2018 and 2019. This is a substantial gain — between 2016 and 2017, the sector represented just 7% of PE deal value.

Sectoral PE investment values are inherently prone to large swings as the result of blockbuster deals and this is evident here. As mentioned, last year's €5.86 billion deal for medical firm Recordati by CVC represented over one-fourth of 2018's record buyout value; similarly, the largest buyout of 2019 — Merieux Private Equity's €1.1 billion takeover of generic pharma player Doc Generici — was in the healthcare space.

However, there is reason to expect continued demand for healthcare assets, which could result in deal value weighing towards the sector in the short to medium term. This year has been marked by rising concerns of an economic deceleration. A number of signals — including the inversion of the yield curve on a number of countries' treasuries and weak manufacturing output — have heightened fears of a weakening economy in the coming months. Healthcare is a defensive sector in which PE has made returns even in difficult times. This is compounded by the long-term fundamentals that make it an attractive space even in times of growth: an ageing population, the rising prevalence of chronic illnesses and the need for increased efficiency while maintaining high standards of quality.

This global demographic trend is especially acute in Italy. The combination of rising life expectancy, a falling birth rate and declining immigration has left the country with one of the highest ageing indexes in the world — with 165 people aged over 65 for every 100 children under 15 — comparable only to Japan's top-heavy population.

At the same time, consumer-exposed segments tend to fare less well during times of economic decline, as people become more discerning about how they spend their disposable income amid rising unemployment. This suggests that healthcare deals are likely to be well-represented in buyout value terms in the next 12-24 months, not only in Italy but worldwide. Consumer and retail deals meanwhile are likely to be defensive or high-growth in nature.

HEALTHTECH ON THE HORIZON

One high-growth area could be the healthtech space. Private equity is taking an increasing interest in the intersection between healthcare and technology globally. Such deals account for a small fraction of healthcare deals currently and, according to McKinsey, between 2015 and 2018, 83% were in the US market.

However, there are an estimated 234 healthtech start-ups in Italy and while many of these will remain in the VC ecosystem for the time being, in due course some of these are likely to become attractive buyout targets. One of the appeals of such companies is the high multiples they can command on exit. The defensive qualities characteristic of healthcare assets coupled with technological capabilities make these highly sought after businesses.

Dealogic data shows that, on average, healthcare companies with a strong technology component are valued at 17.1x earnings, compared with 14.9x average across the industry, with lower multiples for companies without strong technology. This of course means that such assets come at a high price but, equally, that there are sizeable returns to be made on exit, especially when sponsors add operational value during their holding.

Italy's deal market

M&A activity matches this year's PE — volume is robust while value has slipped

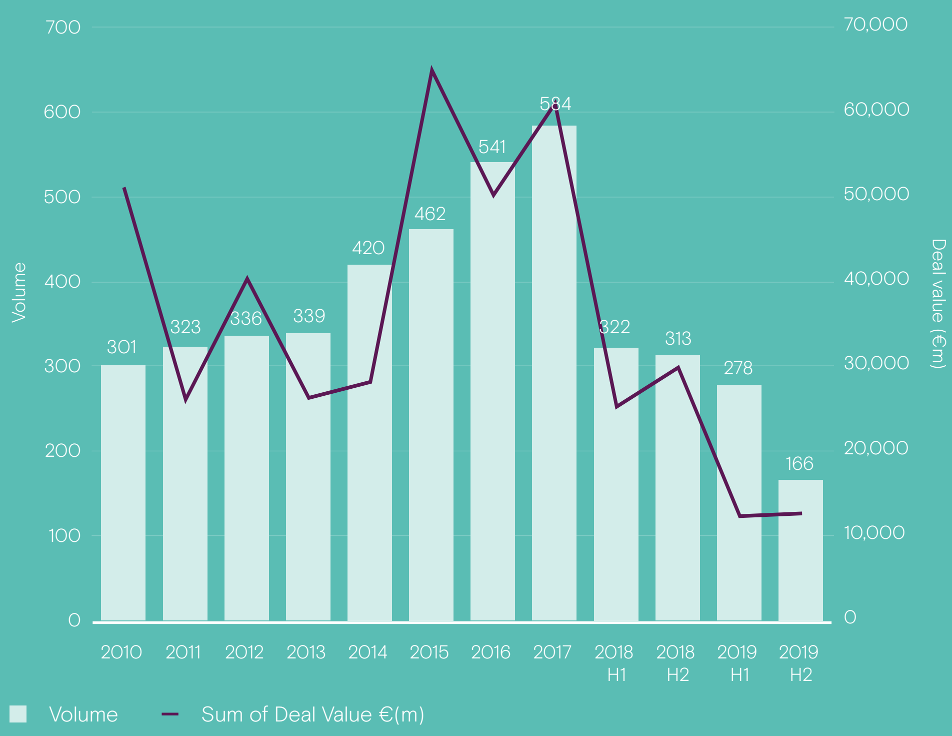
In tandem with the buyout market, 2018 was a record-breaking year for M&A — the total number of deals hitting 635, 9% more than the previous year. Meanwhile, total deal value in 2018 was the third-largest on record at €55 billion.

So far, deal volume has held up well in 2019, with 444 deals for the first three quarters of the year compared with 480 in the same period last year. However, as with its PE counterpart, value has dropped — from €44 billion in Q1-Q3 2018 to €24.9 billion in 2019.

Italy is not alone: Europe's most active and robust M&A markets have all witnessed a slowdown in the first half of 2019. Historically the strongest performer, the UK and Ireland has succumbed to concerns surrounding Brexit and its impact on trade and economic growth, M&A value plummeting 45% in 2019 so far year on year. The Nordic and German strongholds have also suffered.

Today's fractious and unpredictable trade and geopolitical environment is creating a drag across the continent and, indeed, globally. Mergermarket data shows that, in the first three quarters of 2019, European M&A deal volume dropped 13.5% to 4,756 deals, with value down by 32% to €472 billion when compared with the same period last year.

ITALY M&A 2010–Q3 2019



HEALTHY DEAL FLOW

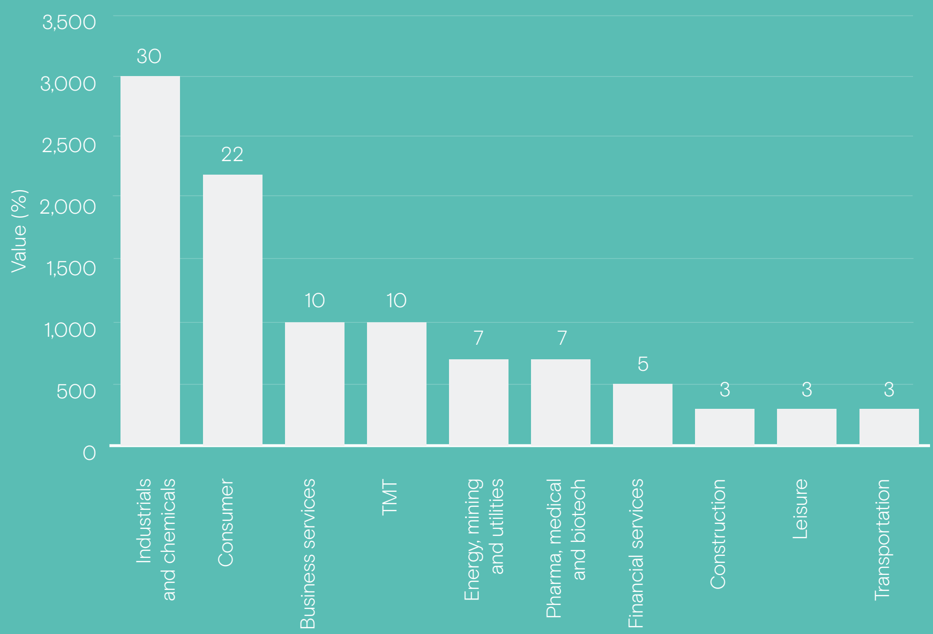
This endemic decrease in value, however, should not detract from the fact that deal flow in Europe, and in Italy specifically, remains healthy. Deals are being made although both corporates and financial sponsors appear to be taking a more conservative approach to their deal sizes in recent months. By the end of 2019, we anticipate activity being broadly in line with the historical average, even if aggregate value falls short of recent years.

Corporates, like PE, continue to show a strong interest in the jewels in Italy's economic crown: the industrial and consumer sectors. These two industries accounted for more than half of total deal volume: 30% and 22% respectively. While the largest industrial deals were both PE-backed, the biggest transaction in the consumer space saw Conad Consorzio Nazionale Dettaglianti, an Italy-based supermarket company, agree to acquire Auchan, an Italy-based supermarket chain for €1 billion.

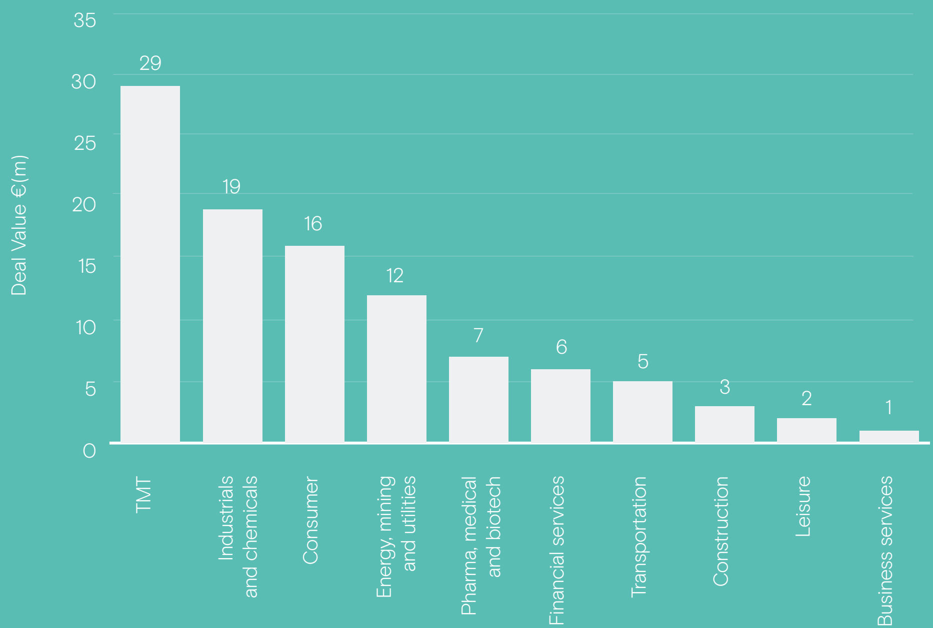
On a value basis, however, it is TMT that is attracting the most invested euro, the segment alone claiming 29% of all M&A value. This is, in large part, down to Italy's biggest deal of the year which saw Infrastrutture Wireless Italiane buy 11,000 Towers Italy from UK giant Vodaphone for €5.3 billion. The rationale for the deal is that it will allow the company to roll out its 5G network faster.

The TMT sector is likely to benefit from government initiatives to foster investment in technology and innovation. While the effectiveness of its implementation and impact remain to be seen, the Italian Budget Law for 2019 contains provisions concerning the promotion of "innovative SMEs", with the aim of boosting capex investment within these companies to, in turn, support economic growth. Among the measures, which include the establishment of a state-funded venture capital fund, are cuts to red tape and tax incentives for companies and private investors to back innovative start-ups and SMEs. The policy's focus on younger and smaller businesses means it is likely to support deal volume as opposed to value but should see increased investment into technology and TMT as a whole.

SHARE OF TOTAL DEAL VALUE BY SECTOR



SHARE OF TOTAL DEAL VOLUME BY SECTOR



Slow and steady wins the race

While megadeals have been in short supply this year, the Italian middle market has held firm. The opportunity to internationalise world-leading manufacturers and transition family businesses in succession will continue to attract PE firms to one of Europe's most attractive deal markets

In value terms, Italy's PE market has retreated somewhat in 2019, in line with a contraction in European dealmaking. There has been a notable absence of the very largest deals and this could persist until more positive economic signals emerge, as investors take a more tentative, risk-off approach.

But the fact remains that fund managers have a wall of dry powder to invest and Italian businesses possess many appealing fundamentals. The country remains compelling on a long-term basis. Unlike larger, more established buyout markets in Europe such as the UK, France, Germany and The Netherlands, private equity as a share of GDP in Italy remains low at 0.31%.

This means that there is a larger pool of primary versus secondary opportunities compared with these more saturated markets, where secondary buyouts often account for a majority of deal activity. Indeed, over the last decade secondary transactions' share of deal flow in Europe has doubled from 30% to 60%, according to EY. Prior to the global financial crisis, secondary buyout performance was between 0.1 and 0.3 times better than for primary transactions; however, deals sourced from PE funds have since underperformed by between 0.2 to 0.3 times.

This is one of the many appealing characteristics of the Italian private equity market and helps to explain why PE firms are capable of sourcing deals with attractive Ebitda multiples. There are many founder-owners who have yet to take on equity financing and whose businesses hold great potential for value-generating operational improvements in their first tenure under PE ownership.

THE BIGGER PICTURE

From a macro perspective, there is also cause for optimism. Undoubtedly, the economy remains challenging in Italy, however the country has returned to small but positive growth at the start of the year as the most recent data shows, while the political situation took a more positive turn towards the end of 2019.

The formation of a coalition government between the Five Star Movement and Democratic Party in early September was welcome news to investors. This replaced Five Star's previous coalition with LEGA and, in addition to representing a return to relative political calm and moderacy, has improved ties with the EU and increased market confidence.

Geopolitical developments are particularly relevant for Italy given its export credentials. What happens between the US and its major trading partners, including the EU, will have significant ramifications for Italy's economy and the confidence necessary to commit capital to Italian manufacturing businesses that depend on overseas trade. This should result in a flight to high-quality companies and assets that have defensive revenues in the face of potentially weaker demand. Nevertheless, private equity has a mandate to deploy investors' capital whatever the global geopolitical climate and source the most attractive assets it can originate.

International and pan-European multi-billion euro funds, targeting the lower end of their deal spectra in recent months, continue to take a keen interest in deals in the country. For this reason, even if the recent abstention from megadeal activity continues, it should be expected that Italy's middle market will remain a core opportunity for what is a well-resourced, highly capitalised private equity industry.

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