

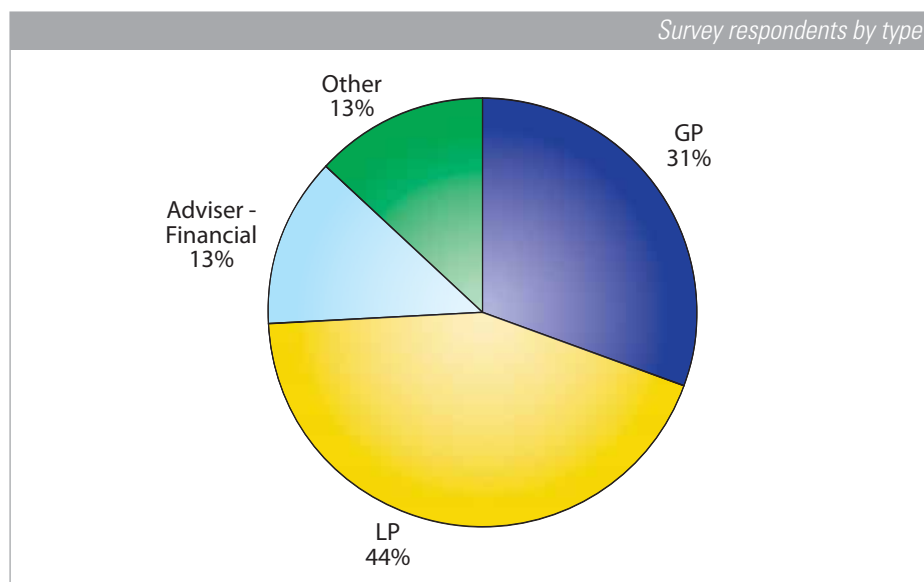
# ITALY SURVEY

FIRST EDITION

## Respondents

### unquote" Italia Private Equity Congress Survey

The following results are based on an on-site survey of Congress attendees, conducted by the law firm Delfino & Associati Willkie Farr & Gallagher LLP at the *unquote*" Italia Private Equity Congress held in Milan on 10 November 2011. The survey captures the views of approximately 100 attendees representing all areas of the private equity industry.



Source: *unquote*"

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# Scope for growth

Insofar as private equity activity is concerned, 2011 was a year of two halves, both in Italy and Europe.

In the first half of 2011, AIFI, the Italian Private Equity and Venture Capital Association, registered 159 new transactions, having an aggregate value of €1.5m and representing a 176% increase in value over the same period in 2010 and a 23% increase in volume (among these, buyout transactions were 76% of the total value – a 252% increase in value and 35% increase in volume). The same source also mentions that 75 divestments were made (a 21% increase compared to the previous year), for an aggregate value of €2.3m.

Once the data relating to the second half of 2011 is available, we will probably see that the impressive pace of recovery registered in the first half of 2011 has slowed down considerably, mostly due to macroeconomic reasons.

The current mood of the Italian private equity industry is an intriguing combination of caution, in the light of the complexity of the macroeconomic issues affecting the euro area, and discreet enthusiasm for the opportunities, which this very complexity may bring to life. Indeed, the sharp recovery of the first half of 2011 is a clear harbinger of things to come, once the global scenario finally becomes simpler and the collapse of the euro becomes, as one economist recently put it, “the biggest non-event of 2011”.

All in all, active private equity investments in Italy total around 1,300, reflecting an original investment value of approximately €20bn: considering the size of the Italian economy, the opportunities offered by the Italian network of excellent (and very international) small and medium sized enterprises, the scope for growth in the Italian market is large. Our wish for our clients and friends is to be able to take full advantage of these opportunities in the next year and beyond. ■

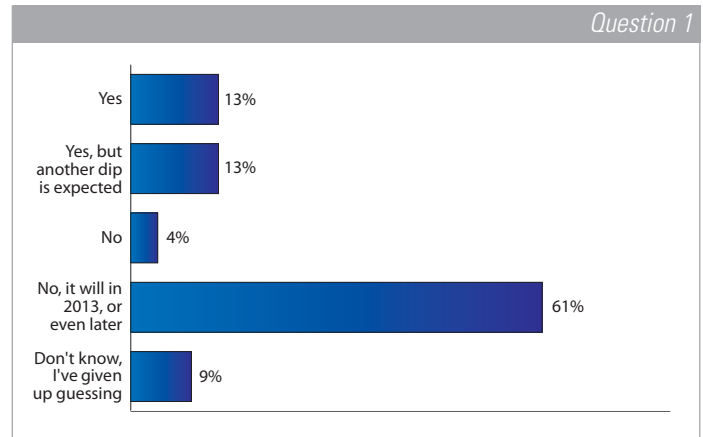


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## 1. Will Italy's economy recover in 2012?

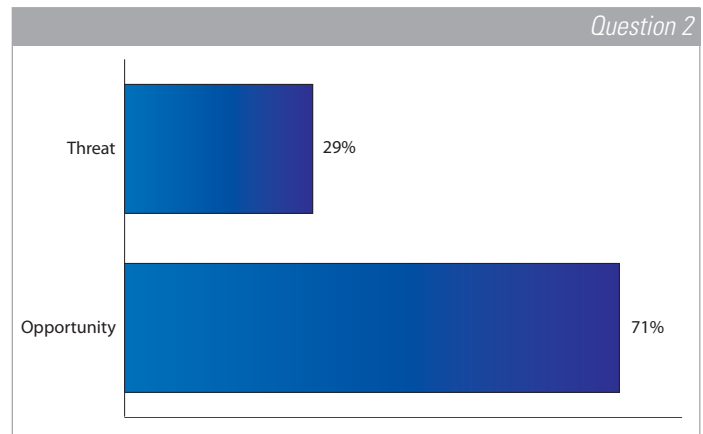
The escalation of the sovereign debt crisis in Europe has led to an inevitable knock on effect for the Italian market. With Italy already suffering from high levels of national debt and lower than average growth, the fears of contagion have only served to push up the cost of government borrowing even further. Against this backdrop it is unsurprising that almost two thirds of respondents did not expect economic recovery to begin until 2013 or later. That said, as we have discovered this year, market sentiment is fickle and any progress made in Europe in order to restore the liquidity of the banks and promote growth may well boost confidence rapidly and, in Italy, the new government of technocrats may still surprise the markets with new liberalisations and privatisation projects.



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## 2. Do you see the current economic situation in Italy as a threat or opportunity to investments in Italy?

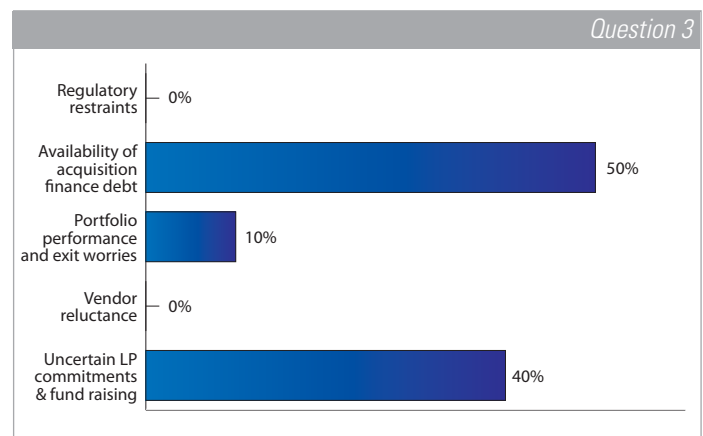
Interestingly, and perhaps surprisingly, rather than deepening the mood of gloom in the private equity community, the poor economic conditions seem largely to be seen as an opportunity. Perhaps, with three years of downturn under their belts, it is the case that PE firms have sharpened up their strategic and operational capabilities and are more tuned in to exploiting the opportunities that the current difficult conditions present. Although threats clearly remain, the clear perception is that big opportunities do exist for well-prepared PE firms to implement successful investment strategies.



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## 3. What is the most significant issue currently facing private equity funds?

Macroeconomic trends do not seem to be the primary concern for PE houses. Rather, the inability to leverage acquisitions is perceived as undermining the potential to maximise returns. The concern regarding uncertain LP commitments is also probably linked to performance in the sense of the potential damage to LP appetite for the asset class, resulting from the inability to provide the sort of returns seen in the past. The new environment could threaten the very existence of some investors: those able to successfully adapt their strategies to the low-leverage environment will most likely fare the best, particularly in the eyes of institutional investors.



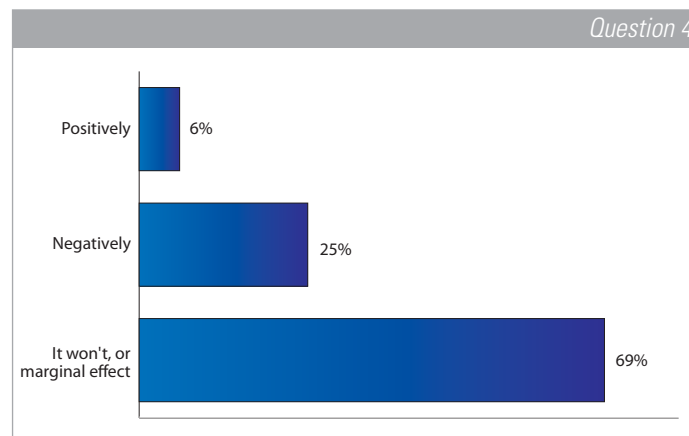
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#### 4. How do you think regulatory issues will affect the private equity industry over 1-3 years?

After initial fears that new regulation – especially the AIFMD – would cripple the industry, it appears that most participants think it will have little or no effect.

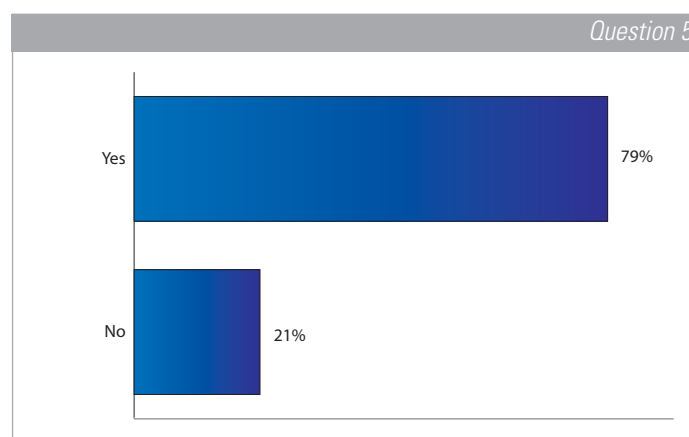
Still, it is likely that some in the industry are expecting to suffer, with 25% of respondents pointing towards the negative effect of recent legislation: the paradigm is now that private equity is subject to regulation and this is still a novel and pre-occupying concept for some.



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#### 5. For LPs and GPs: do you plan to invest in, or raise, funds focused on Italy over the next 1-2 years?

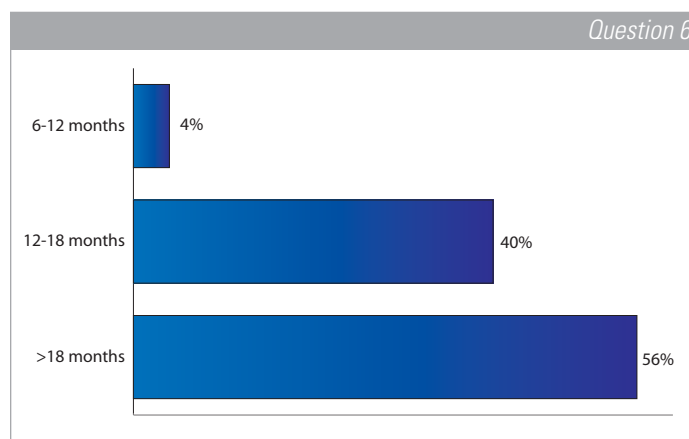
Despite the difficult conditions, a decent flow of fundraising activity looks assured, with almost 80% of attending GPs and LPs expecting to raise or invest in an Italian fund over the next year. However, as much of the following intelligence suggests, neither GPs nor LPs are expecting the process to be without problems and those that are expecting to engage in the market are putting the work in to understand market issues and drivers by attending specialist events.



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#### 6. Regardless of regional focus, how long do you anticipate it will take to conduct your next fundraising, from sending PPMs to final close?

While the specialist press frequently covers news of funds raised in short order, these remain the exception rather than the rule. The reality for most is a somewhat more bleak, or at best cautious, outlook for fundraising. More than 90% of those questioned expect fundraising processes to take over 12 months and more than half think it will stretch out even further – beyond 18 months. Privately, some LPs, and also some GPs, say that in the absence of a proven track record and appropriate organisation, some fundraising efforts may not succeed: the market will be more selective in the future than it was in the past.



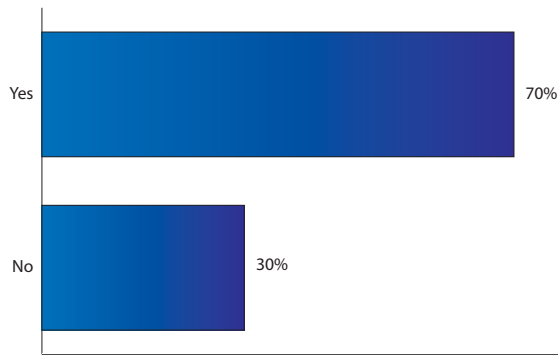
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### 7. Should the investment model for closed-end funds and compensation structures for PE professionals be reviewed in the light of changing conditions?

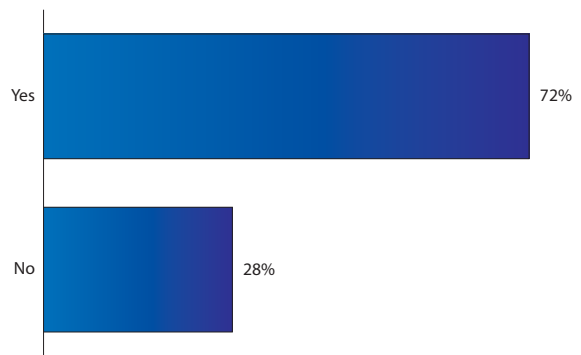
It is clear from the respondents that current economic conditions are pushing the industry towards a phase of accelerated evolution. Approximately 70% of respondents expect to see both a review of the classical closed-end fund model and a change in the compensation

structure for PE professionals in the coming years. And these changes are not likely to be in the favour of GPs, with lower management fees and late payment of carried interest being some of the possible outcomes.

Question 7a. Should the investment model for closed-end funds be reviewed in the light of longer holding periods?



Question 7b. Do you think there will be a change in the compensation structure for PE professionals in the next 1-5 years?



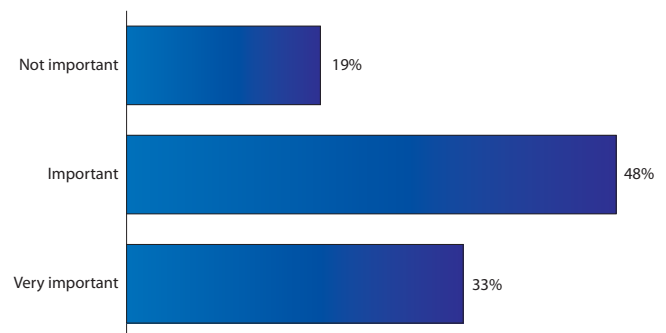
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### 8. For LPs, how important are the principles for responsible investment in the choice of GP?

Over 80% of responding LPs rate PRIs as an important or very important benchmark to be used in the selection of GPs. This underlines the extent to which the areas of responsible investment and corporate social responsibility are driven by the wider LP community. GPs really have to take these philosophies seriously in order to stay in the game.

Clearly, the ability to demonstrate success in this can become differentiators and sales tools for many GPs. Further down the line, the widespread acceptance of PRI may actually lead to a strengthening of existing PRI practices, so that differentiation among GPs may become easier to perceive.

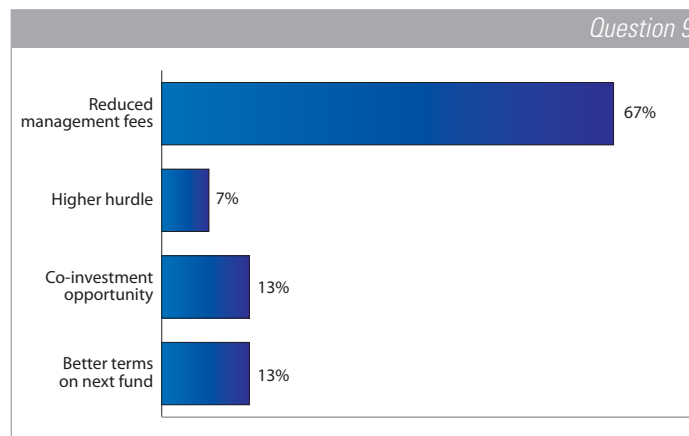
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## 9. What would be your conditions for granting your GPs extensions to their investment periods?

LPs seem to accept that the current investment conditions are exceptional and will present real challenges to GPs trying to deploy large pools of dry powder safely. However, if asked to extend investment periods, they would obviously seek a range of compensation measures to offset the effect on returns and liquidity. The main offset is expected to be a reduced management fee, though other mechanisms such as adjustments to the hurdle rate, co-investment rights and more concessions on future fund terms might also be considered. The management fee, however, is clearly going to be the main focus of LPs' attention.

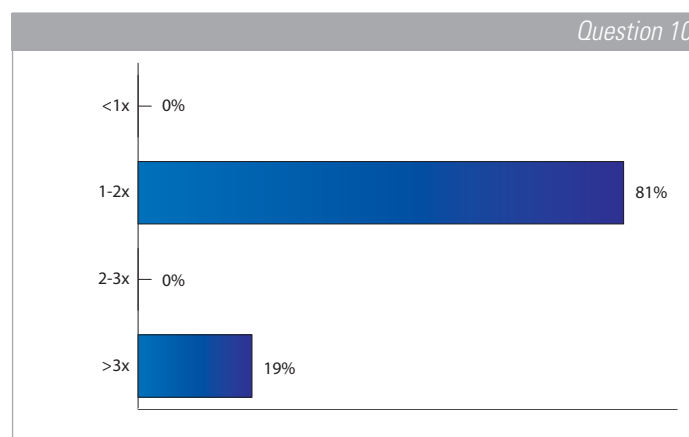


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## 10. What are your returns expectations in the next two years?

Funds generating returns over the next couple of years will largely have been invested during the peak years of 2005-2008. Consequently, institutional investors have relatively modest expectations as to the average yields they will see in the short term.

It may be some time before average returns from private equity equity products return to the net levels they should be seeing: GPs' current challenge is for the funds they manage to maintain a steady premium over other stocks and bonds.

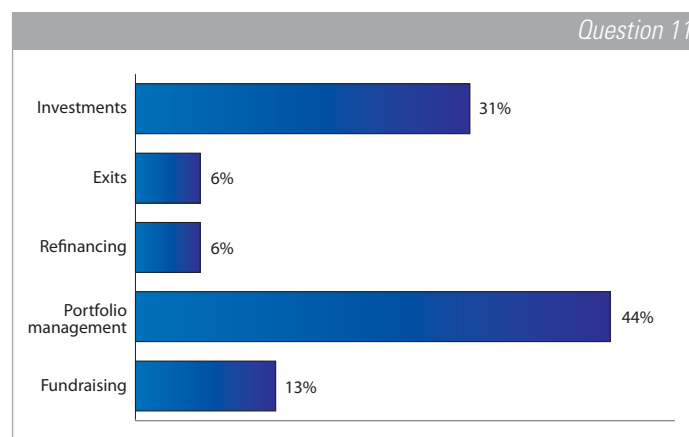


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## 11. What will GPs focus their efforts on in 2012?

The responses suggest a clear two-pronged focus on making new investments (ie aggressive) and on portfolio management (ie defensive). These responses are certainly in keeping with the trend of seeking to carve out opportunities in a challenging market.

However, it is perhaps more surprising, given responses elsewhere in the survey, that there is not an even greater focus on raising money and generating the sort of returns to investors that will be critical in that process.



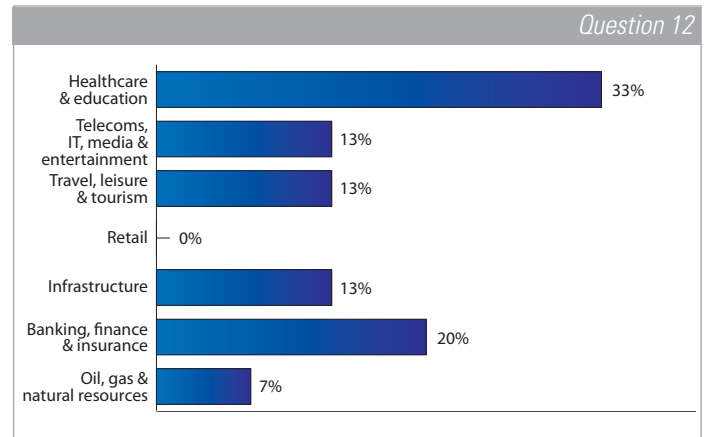
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## Results

### 12. Which sector do you think will be most appealing to invest in over the next 1-2 years?

As one would expect, there is a strong leaning towards the classic defensive sectors of health and education. These are likely to provide a significant deal flow for some time to come. Understandably, consumer-centric sectors are likely to suffer more for the foreseeable future.

Beyond that, the survey points to a spike in interest in the banking and financial sectors. These are relatively new fields in Italian PE and are driven by the multiple effects of rapid consolidation, increased financial regulation and comparatively under-priced assets. The reaction of Italian regulators to broader entry of the PE funds in such industries is difficult to forecast at this stage.



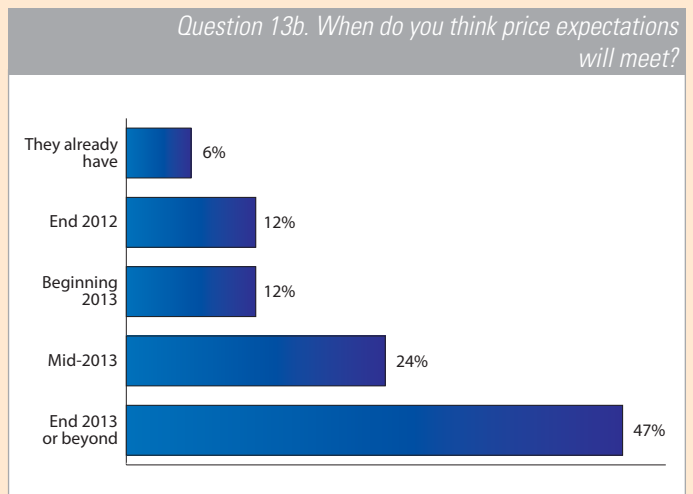
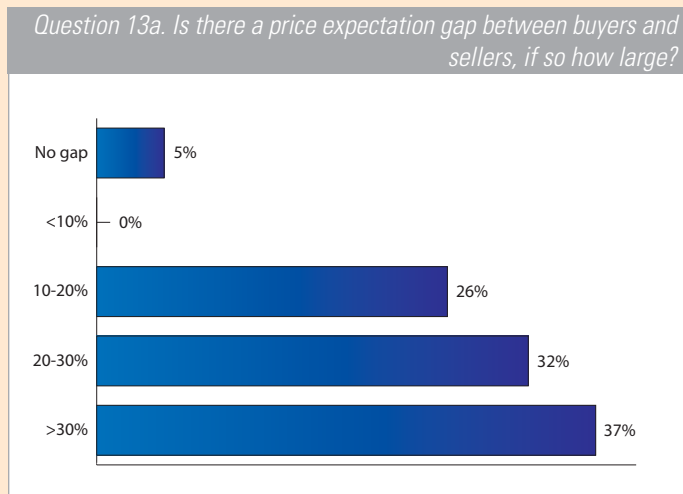
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### 13. How significant is the price expectation gap between buyers and sellers and when do you think price expectations will meet?

Despite the depressed conditions in the Italian market since 2009, a significant mismatch between price expectations persists between buyers and sellers. According to the survey responses, the vast majority believe this gap to be over 20%. Undoubtedly, the key driver here is the competition for the best solid assets: GPs' selectivity has certainly increased over the recent months. In general, there is a significant

amount of capital chasing few good assets and this is preventing prices from falling to levels that more accurately reflect the general outlook.

What's more, it looks likely that this feature of the market will not improve any time soon: almost half of the respondents expect the conditions to persist for at least another two years.



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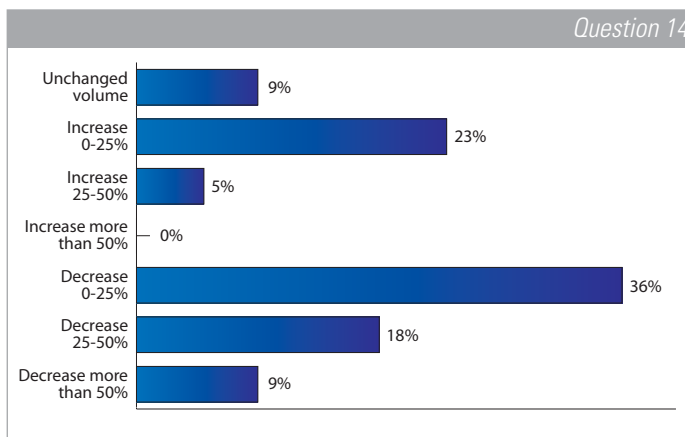


## 14. What changes do you expect in PE deal activity over the next 12 months?

Although there is certainly some optimism for deal flow over the next year – almost one in three expect to see increasing numbers – the majority of market practitioners expect the prevailing macroeconomic conditions and reduced financing to have a negative impact on deal numbers. Most of these (36%) expect the impact to be modest, though more than one in four think that the drop will be more severe.

Certainly, the pessimism is most acute where larger buyouts are concerned. The difficulties in leveraging such deals effectively means that nearly 75% of those questioned believe that these deals will not become a regular feature of the market again until the end of 2013 or beyond, echoing the decision by a number of large international buyers to scale back or even shut their Italian presence.

However, these decisions probably underestimate the opportunities that may arise from possible future privatisations of government-owned assets. Finally, it is to be noted that a significant minority, almost a quarter of respondents, actually expect deal volume to increase: one explanation is



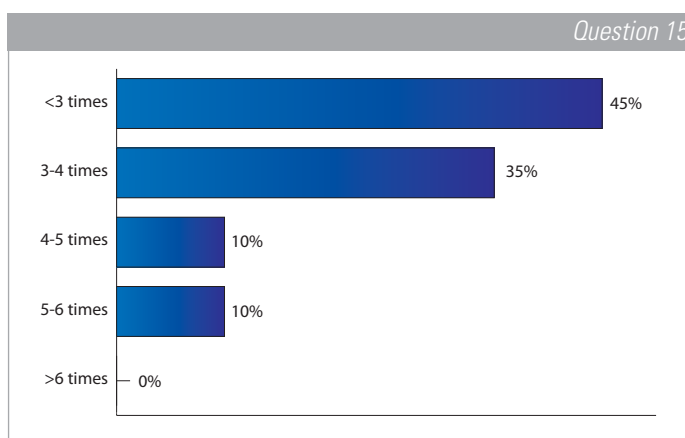
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that these respondents are focusing more on the growth capital market, an area which is predicted by some to become much stronger in the Italian PE space as Italian medium sized companies seek the backing to support their growth and internationalisation.

## 15. What will be the average Debt / EBITDA ratio for medium to large transactions in the next 12 months?

There is no doubting that leverage multiples are way down on the values they hit at the peak of the market in 2007/2008 – that is if you can secure the debt at all.

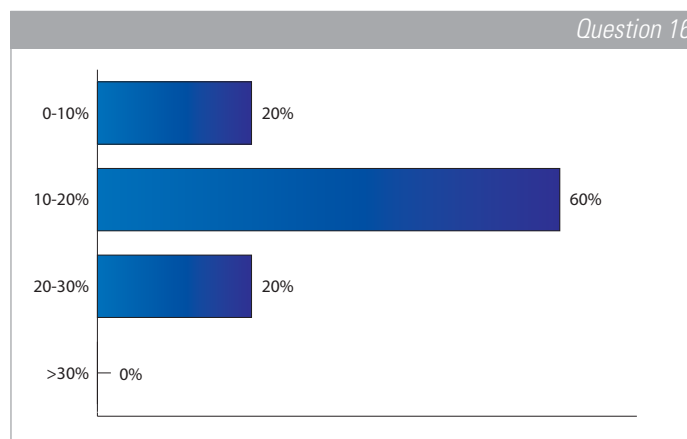
While 3x is the figure around which the consensus seemed largest, the fact that basically one in five respondents expect to see deals involving leverage multiples of 4-6x EBITDA over the next year does hint that for a small number of the most desirable assets, there are still pockets of lending appetite.



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### 16. What IRRs do you expect for acquisitions / investments made during 2010/2011?

Most market practitioners have realistic expectations of the sort of IRRs that are possible in the current market. The classic 20% target may still be the benchmark target but the overwhelming majority take the more cautious view that average returns on deals done in the current market will be in the 10-20% bracket. Some are more pessimistic, though, with one in five predicting returns of less than 10% per annum. Despite this, the challenge and key to success for the industry will be whether it is able to maintain a healthy premium over other lower risk asset classes.



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### 17. What type of investments will achieve higher returns in the next two years in Italy?

With its industrial structure dominated by vast numbers of small or medium, family- or privately-owned businesses, the Italian private equity market has always been strong in growth capital deals. However it is a measure of the rapid change in the market brought on by the global financial meltdown that predicted returns for such deals might compare to or exceed those from the leveraged buyout camp.

The same question asked four years ago would surely have elicited a radically different response. On the other hand, it is also true that Italian medium sized companies exist that already are, or are fast becoming, very international: the premium for investments in such companies is considerably lower than that for investing in equivalent companies established in higher growth jurisdictions, even if the sales of such Italian companies are mostly in such high



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growth jurisdictions: there is here an obvious arbitrage opportunity which an internationally aware PE fund may seize and, in the process, achieve a nice upside.

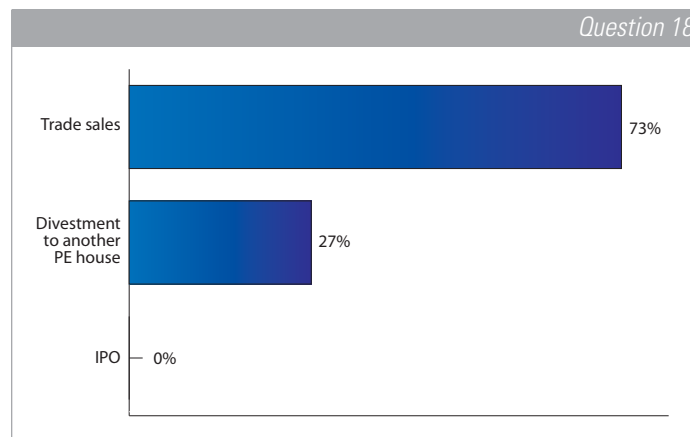


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## 18. What are/will be the best exit channels in 2012 and early 2013?

Although the symbiotic need for some investors to deploy capital and other investors to return it means that secondary transactions will surely remain an important feature of the market moving forward, the leverage-light environment will take its toll. So, with IPO markets also not receptive to new listings (at least in continental Europe), it unsurprisingly appears that where potential exits are concerned, most private equity practitioners are putting their eggs in the trade sale basket. With this in mind, a focus on portfolio strategy and careful exit planning will become more important than ever.



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