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Private Equity in Italy: overview of the industry and analysis of remarkable cases

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Abstract

Over the past few years Private Equity ("PE") has become one of the most important investment activity in the corporate finance context. The purpose of this paper is to describe the PE industry and understand how this type of alternative financing affects target company performance. In addition, there will be a focus on the evolution and the current state of PE in Italy, with an analysis of empirical cases useful to demonstrate concretely the impact of funds on the companies dynamics.

The first chapter of the paper provides an introduction to private equity by first defining the key aspects of this alternative investment activity. An overview of the PE industry is provided by reviewing the main articles and studies published in recent years in this context. The focus will then be on a description of the main types of private equity investments, trying to identify common aspects and differences between them. After that, the organizational structure of a PE fund will be presented, defining the role of the limited partners (LPs) and the general partners (GPs). The chapter will also include the description of the fund's lifecycle and its phases: the fundraising, the investment period and the harvest period (with a focus on the most common exit options).
Finally, the attention will be shifted to the PE in Italy, showing its current state and main characteristics, and providing a brief description of the key players active in this context.

The main objective of the second chapter is to understand how PE funds affect the performance of target companies. Firstly, there will be a description of the main methods used by the funds to determine the value of a portfolio company and then it will be provided an overview of the main performance measures, focusing on IRR, return multiples and other indicators useful in assessing the operating efficiency of the company and its financial strength. The chapter will end with a description of how PE funds create value in target companies and what are the drivers of a deal success.

The third chapter is dedicated to the analysis of empirical case studies aimed at determining in practice the impact of PE funds on portfolio companies. The analysis will focus on buyouts (especially LBOs), as these are the transactions in which the PE fund acquires a majority stake, allowing it to directly influence the target company's decisions.

The selected case studies involve Italian companies managed by national or international funds. The analysis will try to identify the key factors and the strategies implemented by the PE funds that have characterised the deal, determining its success or failure.
The three main value drivers assessed in the analysis will be: revenues improvement, EBITDA change and Net Financial Position change. The data used for the financial analysis are taken from the "bilanci ottici" extracted from the AIDA database.

In the last chapter, some conclusions are presented on the results obtained and some indications are given on possible future developments of the private equity activity in Italy.

Chapter 1. - Literature review

What is Private Equity?

Academics do not share a unanimous agreement on the definition of private equity. The definition provided by the EVCA (European Private Equity and Venture Capital Association) refers to the equity capital provided to companies that are not listed on a stock market. However, this simple description needs to be refined to encompass the different investment activities within the private equity industry.
In Italy, the definition of private equity provided by the Italian Private Equity, Venture Capital, and Private Debt Association (AIFI) refers to an investment activity in risk capital of unlisted companies aimed at creating value in them, with the ultimate goal of selling them in the medium to long term.
Wilcox and Fabozzi (2013) define private equity as an alternative asset class; what distinguishes private equity from other alternative assets such as hedge or real estate funds is its transformative, value-added, and actively managed investment strategy, characterized by a clear exit objective (*Gilligan and Wright, 2010*).
Private equity investors provide equity capital to private companies characterised by high potential to grow. Their primary financial goal is to sell their ownership stake, realizing a significant return on the capital they invested (*Credit Suisse, 2020*). This characteristic strategy in private equity, commonly referred to as a "buy-to-sell orientation" (*CFA Institute, 2020*), underlines the intention to increase the value of the company and then sell it for a profitable outcome. The relationship between PE funds and target companies is defined as a win-win as both parties benefit: the PE firm gets shares of the equity of the company in return for the inflow of cash, while what the investee company receives depends on the objectives underlying the partnership. In general, there is a "certification" benefit, a network benefit (the PE investor has many contacts in the industry), a know-how benefit and a financial benefit (the PEI provide expertise and financial resources).
Private equity firms are in some ways, financial intermediaries: they raise private equity funds with capital provided by investors. The investment is directly made in companies privately held. The differences between a private equity investment and an investment in a public company regards three main aspects: pricing, liquidity and monitoring activity.

In a public investment, the price is determined by the market, while in a PE transaction it is the result of a negotiation process between the parties involved. In terms of liquidity, it’s very high in a public investment, the shares can be sold on the stock exchange market; in a PE transaction, it's more difficult to find a new shareholder. Regarding the monitoring activity, shareholders have a higher level of protection in the stock market, while they have to protect themselves in PE investments.

Types of PE investments

Private equity encompasses several investment strategies that vary according to the stage of development of the companies in the portfolio, as outlined by the *CFA Institute* (2020):

- **Venture Capital**: this strategy involves investing in early-stage companies or start-ups that may currently have negative cash flows but exhibit significant growth potential due to innovative business ideas or technology. In these investments, venture capitalist injects capital into the company, usually in exchange for minority ownership, to facilitate its growth. Venture capital investments commonly target high-tech companies in sectors like the internet, healthcare, media, and telecommunications. Given the high level of risk involved in these transactions, the expected rate of return is very high, typically between 25 % to 35%.
  Venture capital includes seed and start up financing transactions: seed financing aims to finance the research and development of a business idea before it has a well-defined product and a structured business plan; start-up financing aims to support newly born companies that are ready to go to the market.
  Accel, Andreessen Horowitz, Index Ventures and Sequoia Capital are major players in the global venture capital market..
- **Growth capital:** this strategy involves the provision of capital to well-established private companies, often through the acquisition of a minority stake; in this case, the fund supports the target company in developing new products or technologies, entering new sectors or expanding internationally. The main purpose is to work

alongside the management to support the growth of the business by providing financial resources, experience and know-how.

- **Buyout**: Buyout strategies involve the acquisition of a majority stake in a mature company in order to take control of its assets and/or operations. Buyouts are the most common type of private equity investment activity worldwide and, unlike venture capital deals, involve companies in the later stages of their lifecycle.
  It's possible to distinguish several types of buyout:
  _Leverage buyout (LBO): the holding company (HoldCo) acquires a majority shareholdings in the target company through a Special Purpose Vehicle (SPV); the acquisition is financed by both equity (money from the fund's investors) and debt. The debt portion (higher than equity) comes from banks and other financial institutions and becomes the target's equity as a result of the acquisition; after the merger with the HoldCo, it returns in the form of debt, partly secured by the target company's assets.
  The high leverage makes the operation very risky for both the fund and for the target company. LBOs are suitable for companies with secure and stable cash flows: through value creation, it's possible to pay off high interest and debt.
  _Management buyout (MBO): the company is acquired by its managers and/or employees. They are often backed by an institutional investor and benefit from their specific knowledge of the company.
  _Management buy in (MBI): similar to MBO but management comes from outside the company.
  If the target business is a public company, the result of the buyout is the delisting of the company from the stock market, constituting a public-to-private transaction. Key players in the buyout context globally, include major U.S. funds such as Blackstone, the Carlyle Group, and KKR (*Preqin, 2017*).
- **Turnaround or restructuring financing**: is a niche area of PE that focuses on companies in financial distress characterised by declining revenues and low profits and returns on equity. They need critical support from a PE operator to avoid bankruptcy and get back into business.

Organizational structure of PE funds

A private equity fund typically takes the form of a limited partnership involving two main parties: the investors, known as limited partners (LPs), and the managing entity, the private equity firm controlled by the general partners (GPs). Institutional investors such as pension funds, endowments, sovereign wealth funds, family offices or also high net worth individuals (HNWI) commonly serve as LPs. In the fund structure, LPs provide the majority of the committed capital (96-98%) but are passive investors with no influence on investment decisions. When they invest, they receive a certificate with the value they invested in the fund; in that way, they lose any right to have a tailor-made investment and their money is managed by the private equity fund.

GPs operate within an "investment period" during which they deploy the committed capital and are fully responsible for the management of the fund. GPs act in the interests of investors through an Asset Management Company (AMC) which is a financial institution approved and supervised by the local authority (in Italy, it is called “Società di gestione del risparmio – SGR”).

GPs are responsible for the monitoring of investments and the selection of the likely exit route that will provide the highest return for investors.

Once an investment is successfully exited, the generated cash is usually distributed to the LPs rather than reinvested. The timing and amount of capital calls and distributions are uncertain beforehand, with GPs having significant discretion over the timing of investments and exits. GPs’ actions are guided by the terms laid out in a limited partnership agreement, which specifies the investment period and the fund's expected termination (*Sahlman, 1990*).

Fund managers receive compensation that includes a management fee, a carried interest provision that allows them to share in the fund's profits, and other fees paid by portfolio companies.

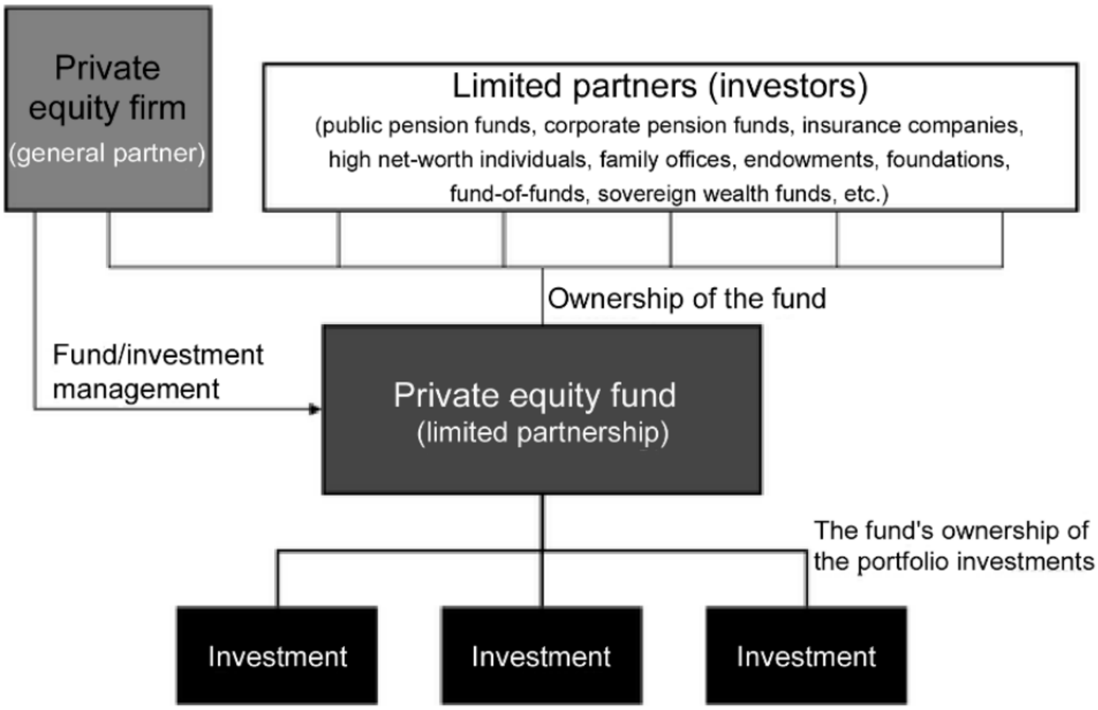
In general, GPs compensation depends on the performance of the target company: higher performance means higher profits for the fund managers. However, if the investee company underperforms, the only loss for the fund managers would be the lost income. This risk-shifting mechanism leads GPs to take on too many risky initiatives that could cause potential losses. For this reason, GPs also commit capital to the fund in order to be more involved and more prudent in avoiding fund losses. They typically invest 1-4% of committed capital.

The management fee serves as the fixed component and is typically 2%, calculated based on committed capital during the investment period and invested capital later in the fund's life. Carried interest, amounting to 20% of fund profits, is contingent on the fund's performance surpassing a predetermined hurdle rate, commonly set at 8%. Carried interest is a useful tool for the alignment of investors' and fund managers' interests.

Alternatively, the GPs may receive more than the initial 20 cents per euro after the preferred return has been met. This approach is called “catch-up” and allows GPs to receive more than their standard share until they reach the full 20% of the gross profits, which were originally distributed to Limited Partners. The hurdle rate in the partnership agreement ensures that the LPs receive a minimum return that could be higher than what they might gain from investments in the public market. It’s important to note the presence of a waterfall mechanism which is useful for determining the priority of distribution among the unitholders.

In addition to the fees above mentioned, GPs may also impose deal and monitoring fees, which are then covered by the portfolio companies. GPs are incentivised to achieve the highest returns through variable compensation rather than a fixed one.

Several studies have analysed the agency relationship between GPs (fund managers) and LPs (investors). *Robinson and Sensoy* (2013) find that GPs whose compensation is based on invested capital tend to exit investments more slowly, while GPs whose compensation is based on carried interest exit more quickly.



Source: Talmor and Vasvari (2011)

Funds' lifecycle

Private equity funds typically have finite lifespans, commonly lasting 10–12 years divided into three distinct phases, as outlined by *Blackstone* (2020):

1. **Fundraising Period:** In the initial phase , General Partners approach investors and ask them to commit capital to the fund. Private equity firms typically have the opportunity to raise a new fund approximately every three to six years, according to *Barber et al.* (2014). When this need arises, the General Partners of the existing fund initiate a fundraising campaign. At the beginning of this process, the GPs set a target capital commitment and later announce the closing amount at the end of the campaign. The fundraising campaign, as described by *Caceis* (2010), is the method by which private equity firms seek financial commitments from limited partners. This involves the pooling of funds into the private equity limited partnership vehicle. In simpler terms, the general partners of the current fund undertake a fundraising campaign to secure financial commitments from the limited partners and pool these funds into the new private equity limited

partnership. The fundraising process typically lasts from a few months to about a year and its duration is influenced by factors such as the reputation and capabilities of the firm, the size of the fund, and prevailing market conditions. During the initial offering period, which is the first phase of fundraising, investors have the opportunity to commit to the fund by subscribing for units or shares as determined by GPs.

2. **Investment Period:** if the fundraising is successful, the capital is deployed in selected opportunities during the investment period. Managers and General Partners actively choose and invest in various ventures or companies. The private equity investment process consists of five phases: evaluation, initial negotiation, due diligence, final negotiation, and monitoring (*EVCA, 2007*).

   In the evaluation phase, the private equity firm receives an initial overview of the potential investment, encompassing a review of the business plan and analyses of the company and market. General Partners, along with the management team, initiates a preliminary assessment of the company's future profitability, management expertise, and potential returns for the fund's investors.

   During the initial negotiation phase, the fund managers begin to evaluate the potential investment. The Offering Memorandum, a document received by the Fund, provides information on the business, industry, business plan and financial characteristics of the target company. The source of financing, including the mix of equity and/or debt, is also determined at this stage. After a careful assessment of the target's profitability objective, Non-Binding Offer (NBO) is made to the target company outlining the terms for the next stage. If the investors indicate a willingness to proceed with the deal, the advisors begin the due diligence process to assess the quality of the investment. This phase allows to reduce the information asymmetry between investors and the seller[*].

   There are several types of due diligence:

   - Business or commercial: it assesses the competitive positioning of the target company in its reference market; it is carried out by some strategic consulting firms such as BCG, Bain and McKinsey.

[*] Luciano E. (2023), elaborated from slide of the course Applied Corporate Finance and Private Capital

- Financial: it includes an accounting review to ensure that the target company's reported financials are accurate and truthful; it is performed by other consulting firms such as the Big Four.
- Tax and legal;
- Environmental (ESG);
- Technical;

The due diligence process is therefore useful in identifying deal breakers or deal issues that need to be resolved[*]. At this point, the investors make the investment decision and if it is positive, they realize an Investment Memo including a Binding Offer (BO).

All the collected information is used in the final negotiation phase and for the closing of the deal. If the parties reach an agreement, the transaction is completed, and final clauses are discussed to determine the final price.

The final stage is represented by the Managing and Monitoring activities, which have two main purposes: to create and measure value, and to protect the value created. In the first case, the PE investor could have two different profiles:

- ♦ Hands-on approach: it involves an active role and guidance of the private equity firm in the target company.
- ♦ Hands-off approach: the investor is only involved in financial decisions and has little interaction with the target company.

To protect the value created there are several rules or clauses such as:

- <u>Tag-Along rights</u>: used in the case of a minority stake of the PE investor; it allows to sell the stake at the same conditions and to the same buyer that is purchasing the majority shareholding.
- <u>Drag-Along rights</u>: used in the case of majority stake of the PE investor; it includes the possibility to sell 100% of the target company without owning it.
- <u>Right of First Refusal and Right of First Offer</u>;
- <u>Lock Up clause</u>: this is an agreement between investors and existing shareholders that prevents the sale of shares for a certain period of time,

[*] Luciano E. (2023), slide of the course Applied Corporate Finance and Private Capital

while between shareholders and management it defines the amount invested and the amount provided by the PE investor.

3. **Harvest Period:** The final phase involves realizing the investments made earlier. This is when the investments are sold or otherwise monetized, and the resulting proceeds are distributed among the investors. After the investment period, the primary focus of the private equity firm shifts towards growing portfolio companies to enhance the value of the fund's investments.

   The exit of investments typically occurs through four main strategies (*Fakhro et al., 2011*):

   _ Initial Public Offerings (IPOs): it's the most complex way for private equity funds to exit an investment, because of the regulatory restrictions and the significant fixed costs connected with the listing on a public market. General Partners may choose to list the portfolio company on the stock exchange. Shares of the company are sold to both institutional and non-institutional investors. The timing and amount of proceeds depend on the market's interest, providing access to more liquid capital (*Rosenbaum, 2009*). An IPO needs critical size to attract interest and is not a viable option if the fund wishes to leave the investment fully and soon, since it would signal a lack of confidence for investors. In addition, lock-up agreements typically limit the ability to disinvest at the IPO date, either partially or fully. In this case, returns are not realized at the time of the IPO but are contingent on the share price at the time of the exit. On the other hand, this exit solution could be a very attractive exit route if the target company has a solid equity story and an equity stock price that is expected to increase. In that case, the target company can be well appreciated by the market and obtain higher levels of visibility;

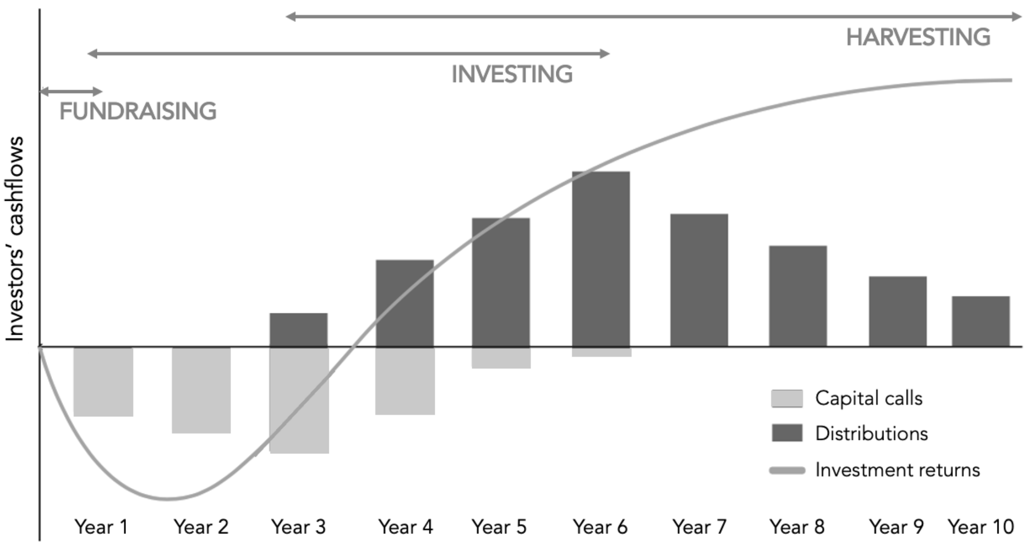
   _ Trade Sales: A trade sale, also known as a strategic buyer sale, involves selling a portfolio company to a corporate entity (as opposed to selling to a financial sponsor). The strategic buyer can be a direct or indirect competitor, or a supplier/customer seeking vertical integration. The purchase price in a strategic sale is typically higher compared to a financial sponsor sale: strategic buyers may be willing to pay a premium to gain access to synergies or strategic advantages. (*Fakhro et al., 2011*)**;**

_ **Secondary Buyout:** the target company is sold to another private equity fund. In this case, on one hand, General Partners are able to secure liquidity sooner when they act as sellers, on the other hand the operation gives to buyers the opportunity to acquire positions in private equity limited partnership beyond the initial investment period (*Perry and Chang, 2017*)**;**

_ **Buy back:** the original owner or the existing management acquire part or all of the target company by purchasing Limited Partners' stakes (in the latter case, there is a management buyout – MBO) (*Fakhro et al., 2011*). This process typically occurs when the portfolio company has reached a stage of maturity or profitability where it can afford to repurchase shares from the PE firm. This could be facilitated by using cash reserves, raising new funds, or issuing new equity.

_ **Write off:** the PE firm decides to fully depreciate the value of its investment in a portfolio company due to various factors such as poor performance, financial distress, or unfavourable market conditions. This means that the PE firm essentially recognizes that the investment has lost all or most of its value and removes it from its books. Write-offs allows to cut losses and reallocate resources to more promising businesses within the PE portfolio.

In essence, the private equity fund lifecycle progresses from gathering capital, to strategic investments, and ultimately culminates in the realization and distribution of returns to the investors.



Source: Caceis (2010)

Italian Private Equity market

After having delineated the organizational structure, core mechanisms, and internal dynamics of private equity funds, this paragraph will now address the size and significance that private equity currently holds within the Italian market.
Over the past two decades, the landscape of private equity in Italy has experienced a huge expansion. The first steps of the PE industry in Italy can be traced back to the mid-1980s, when nine private financial companies and banks formed a trade association called AIFI. The Italian Private Equity, Venture Capital, and Private Debt Association is an organism whose main role institutional, involving intensive lobbying to promote initiatives aimed at creating a favourable environment for private equity and venture capital in Italy and abroad. AIFI supports the development of the PE industry by continuously interacting with legislative bodies to improve the regulatory framework and discipline the activities of funds. The AIFI also organises seminars and conferences open to the public, focusing on specific topics, analysing the latest data from the previous year and presenting the results of the most recent and important researches. Seminars are tailored to topics suggested by AIFI members and are led by experienced professionals. In addition, another tool used by AIFI to monitor the activity on risk capital investments is the Private Equity Monitor - PEM. This is an observatory that publishes an annual research report on the Italian PE market, in order to provide operators and analysts with useful information on the state of health of the industry, the main trends and the main transactions completed during the year.

Since the 1990s, Italy has experienced rapid growth in the PE industry, marked by the emergence of the "new economy" phenomenon. As a result, there was a first peak between 2000 and 2001 with 86 active operators. Between 2005 and 2010, the market witnessed a steady increase in the number of active player, reaching 129, along with a rise in the average size of capital under management. Subsequently, following the market contraction prompted by the international financial crisis there was a gradual consolidation. This process involved the exit of certain operators and, more specifically, the combination of various initiatives promoted by different PE funds.

Italian funds are still small in the European private equity and venture capital context. France is first with 24.2 billion in total spending, followed by Germany with 15 billion.

Italy precedes Spain both in total amount invested, 13 and 9.2 billion respectively, and in relative development trends (*AIFI-PwC and Invest Europe data*).

Italian private equity firms often specialize in transactions within the mid-market segment, which mirrors the country's industrial landscape dominated by a multitude of small and medium-sized enterprises (SMEs). This focus reflects the fact that these companies constitute a significant portion of the market and present an attractive opportunity for private capital investment.

The Italian market holds great appeal for the private equity sector, primarily due to its prominent industries such as high-tech, fashion, design, and fast-moving consumer goods (FMCG). In this context, the luxury industry remains one of the key sectors in Italy, with family-run companies whose production is a symbol of excellence.

As reported by the PEM report, in 2022, there were 441 deals (+14% than previous year).

The fundraising for Italian private equity and venture capital amounted to 5,920 million euros (of which 5,084 million were raised on the market), showing a 3% increase compared to the 5,725 million of 2021.

In terms of type of transactions, buy out deals have the larger market share (80%) and are showing stable growth, thanks to the increasing presence of add-on operations. Specifically, private and family-owned businesses represent the majority of investment opportunities, followed by Secondary Buy out and divestments of domestic branches.

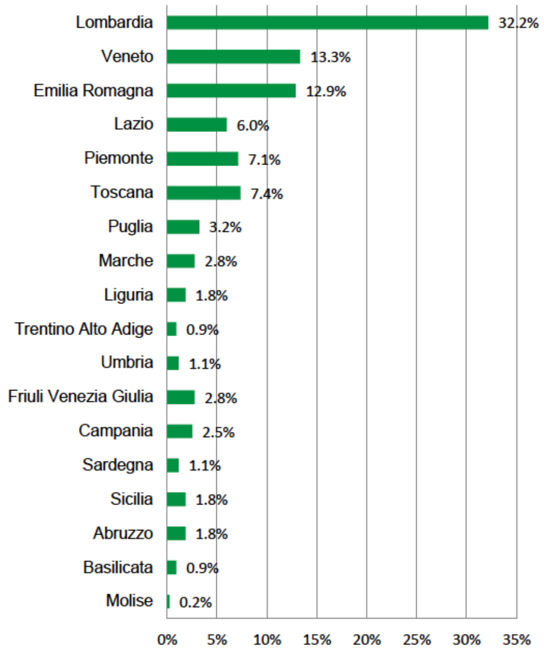
It’s important to note the increase in add-on operations, with a total of 210 transactions (+45% compared to the previous year), confirming the importance of industrial aggregation processes as a tool to face the challenging environment in which Italian companies operate.

The number of operators involved in risk capital investments was 241, of which 15 were entering the Italian market for the first time; 51% of the active investors, are international players, which are increasing their presence in the market by investing in Italian companies with high growth potential.

Regarding the geographical origin of funds raised on the market, the domestic component accounted for 55%, while the foreign component weighed in at 45%. In terms of funding sources, 18% of the fundraising came from pension funds and provident funds (890 million euros), followed by insurance companies (13%, 678 million), and banks (9%, 448 million) .

The regions with the majority of transactions were Lombardy, Veneto and Emilia-Romagna representing 58% of the total investments in Italy, followed by Toscana, Piemonte and Lazio.
The northern regions are historically more active than the southern regions and are driving the entire sector thanks to the presence of important investment opportunities for PE funds.

2022: Regional distribution of target companies



2000-2022: Total number of deals by region

Lombardia	1,105
Emilia Romagna	424
Veneto	376
Piemonte	242
Toscana	180
Lazio	169
Friuli Venezia Giulia	101
Liguria	75
Marche	75
Campania	65
Puglia	43
Trentino Alto Adige	38
Umbria	34
Abruzzo	31
Sicilia	29
Sardegna	16
Basilicata	8
Calabria	7
Molise	5
Valle d'Aosta	1

Source: *PEM report 2022*

In terms of sectors, industrial products, ICT and consumer goods were the most active. However, following the main industrial trends, sectors dedicated to the digital and ecological transition are gaining in importance, alongside more traditional sectors such as food and beverage and luxury goods.
Given the prevalence of SMEs in the Italian market, the majority of investments are made in companies that do not exceed a turnover of 60 million euros, but there is also a portion of transactions involving large companies (€ 101-300 M of turnover). In this sense, platform companies, which are responsible for add-on strategies, are generally firms with revenues above € 100 million.

In 2022, the disinvestment amount at the cost of acquiring stakes amounted to 4,398 million euros, marking a 63% increase compared to the 2,702 million of the previous year. The number of exits totaled 117, a 13% increase from the 104 exits in 2021.

The most utilized channel for disinvestments was the sale to other private equity operators, representing 60% in terms of amount (2,651 million euros) and 40% in terms of number (47).

Key players in the Italian PE market

Italy's private equity sector is marked by a few major firms that have a big impact nationally and across Europe. These firms are known for making smart investments in a variety of industries, from traditional ones like manufacturing to newer ones like technology and services. They don't just bring money; they also help create new ideas and drive growth in the Italian economy. Each firm has its own investment strategy to build leading companies in different markets.

One of the most important PE firms in the Italian context is **Investindustrial,** which focuses on investing in mid-market companies operating in Southern Europe, particularly Italy and Spain. It is owned by the Bonomi family and has raised more than € 13 billion of fund capital[*]. With its industrial expertise, operational focus and entrepreneurial approach, Investindustrial helps its target companies to become more competitive internationally, improve operational efficiency and build a sustainable business. Investindustrial invests in companies in four sectors with attractive global growth drivers and industrial opportunities. These sectors are: Industrial Manufacturing, Consumer, Healthcare & Services and Technology. One of the most remarkable successes in Investindustrial's portfolio has been its investment in the Italian company Ducati. In particular, the PE firm brought the company in when it was near to default and struggling in the market, and then it transformed Ducati into a healthy and profitable leader in the motorcycle industry.

Another major player in the Italian PE market, is **Permira,** whose long-term investment strategy is to identify market-leading companies with further growth potential and transform them into global market leaders. The firm prioritizes investments in specific

[*] https://www.investindustrial.com/who-we-are/our-company.html

sectors such as Technology, Consumer, Healthcare, and Services sectors. Previous investments in Permira's Italian portfolio include Arcaplanet, La Piadineria, Valentino and Golden Goose*.

Clessidra SGR is another top player in the Italian private equity scene. It is recognized for its prudent investment approach, hands-on management style and for investing in Italian upper-middle market companies with significant potential for expansion into international markets. Clessidra's investment strategy focuses on fostering the growth of its target companies through acquisitions, operational improvements and close collaboration. Consumer goods, Industrial products, Healthcare and Technology are the main sectors in which the firm specialises*. Clessidra's previous investments in the portfolio include Harmont&Blaine, Roberto Cavalli, Scrigno and Moby S.p.A..

In recent years, Italy has attracted increasing interest from foreign private equity firms. Many global players are implementing international expansion strategies, recognizing the potential offered by Italy's dynamic private equity environment. This surge in interest has led to increased involvement from top private equity firms such as **The Carlyle Group**, which has played a significant role in shaping the competitive landscape of the Italian market. Carlyle with $426 billion of AUM (Assets Under Management) is considered one of the largest and most diversified investment firm worldwide*. Carlyle portfolio include several Italian companies such as Dainese, Comdata and Twin Set – Milano.

Another major international player that was attracted to the Italian private equity market is CVC Capital Partners, whose main investments in Italy are represented by Sisal, BIP and Recordati S.p.A.

* https://www.permira.com/portfolio/our-portfolio?filters%5BcountryRegion%5D%5B0%5D=italy
* https://www.clessidraprivateequity.it/en/investment-strategy/
* https://www.carlyle.com/our-firm

Chapter 2. – PE Performance

Valuation of PE investments

As described in the previous chapter, during the investment period, after the fundraising has been completed, the PE fund makes a valuation of the target company. Before making a deal, it has to take into account different aspects:

- analysis of previous years' annual reports;
- interpretation of target company's balance sheet, profit and loss account and cash flow statement, understanding the relationship between current performance and capital structure;
- Evaluation of the internal organisation and management suitability, assessing the existence of an incentive system linked to value creation or capital gains;
- understanding target company's financial needs to define the most appropriate Business plan and capital structure.

Both Book value and Adjusted Book value are not good sources for valuing a company since they ignore the future and any potential earnings growth option.
There are three main methods that are used to value a target company:
_ *Pricing or relative valuation method*: the price of an asset/investment is determined by the demand and supply for it, looking at what people are willing to pay for similar assets or investments. In this context, it's important to remark the difference between value and price: the former is determined by future cash flows and is based on underlying hypotheses that make it objective; the latter is determined by the market and is set by looking at the price at which similar companies are trading on public markets or the price paid to acquire similar companies in the past. If in the short term, price and value can diverge, in the medium to long term they may be similar.
Return multiples such as Enterprise value / EBITDA or Price / Earnings are based on this method.
_ *Intrinsic valuation method*: the value of an asset/investment is determined by the cash flows it generates and the risk associated with those CFs. This method requires an estimate of the expected cash flows in order to discount them back at a specific risk-

adjusted rate. Discounted cash flow (DCF) is the main approach that uses intrinsic valuation. It links the value of a company solely to its ability to generate cash flows over a specified period of time. Future cash flows are estimated making hypotheses on the company’s B/S and P&L.
_ *Real options / Contingent claim*

The DCF method and return multiples are complementary methods used to determine the best estimate of the value of an investment. In theory, there is another method, the Adjusted Present Value (APV), which is most commonly used in leveraged buyout transactions. In general, the APV method is preferred when the capital structure varies over time, while the DCF method is preferred when the capital structure is expected to remain constant.

Performance measures of PE funds

Investing in a private equity fund involves committing capital to receive a series of cash flows generated by the underlying portfolio companies. However, predicting the timing and magnitude of these cash flows is highly uncertain. General Partners (GPs) have the flexibility to draw down funds over a period of up to 5 years from the fund's inception and may not utilize the entire committed amount. Similarly, GPs distribute returns from the fund's investments back to investors as they are realized. However, the timing and amounts of these realizations cannot be accurately predicted in advance, often being contingent on market conditions. Consequently, assessing the performance of an investment in a private equity fund is not straightforward.
The literature on private equity performance can be divided into two groups. The first set of studies focuses on performance at the PE firm level, evaluating returns from individual portfolio company investments and then calculating their aggregate performance.
The second category of performance studies focuses on documenting the cash flow streams to private equity (PE) fund investors, encompassing fee payments and carried interests.

Internal Rate of Return (IRR)

In the private equity context, multiple and internal rate of return (IRR) are the two key performance measures used to evaluate the performance of a private equity fund. These metrics are calculated throughout the fund's lifespan based on estimates of portfolio company valuations. The Internal Rate of Return (IRR) is computed as an annualized effective compounded rate of return, considering monthly cash flows. This calculation can be performed in net terms (inclusive of fees to the managing private equity firm) or in gross terms.

The Internal Rate of Return (IRR) is the discount rate that sets the net present value equal to zero. It represents the percentage rate of return, based upon time-weighted cash flows. The IRR takes into account the impact of the timing of cash flows across all future years. Consequently, private equity returns are calculated as compound returns from a defined starting year (the formation of the fund) to another specified year. The IRR is therefore wrongly based on the assumption that money can be reinvested in the long term at a fixed rate of return.

During a fund's lifetime, it is common to refer to the 'interim' IRR, which provides an estimate of the current status and future potential of an unrealised PE fund portfolio. This method estimates unrealised IRRs at market value using various assumptions.

Portfolio companies are valued only in specific cases such as:

(i) initial public offerings,

(ii) trade sales,

(iii) additional financing rounds with new investors,

(iv) if the company goes bankrupt.

For this reason, as reported by Ljungqvist and Richardson, the calculation of interim IRRs before these events is not useful and not very informative.

Alternatively, it's possible to consider a modified IRR (MIRR), which is based on the assumption that money can be reinvested at the company's opportunity cost of capital (*Appelbaum and Batt*, *2014*).

Return multiples

Return multiples are often used to evaluate the performance of a private equity fund's investment. These ratios are easy to compute and offer clear interpretations: to calculate them the value of the returns is divided by the invested capital.

The three main multiples reported by PE funds are: the distributed value to paid-in ratio, residual value to paid-in ratio, and total value to paid-in ratio. The paid-in capital is a quota of the committed capital that has been used for investments, fees, or fund expenses. (*A. Gervasoni, F. Sattin, 2020*)

Distributed value to paid-in ratio (DVPI):

$$DVPI = \frac{\Sigma \text{CF(past,received)}}{\Sigma \text{CF(past,paid in)}}$$

The first term, CF (past, received), represents the net cash flows distributed by the fund as a result of past investments, and CF (past, paid in) represents the cash flows paid into the fund.

This multiple is usually important in assessing the performance of the fund as it approaches the end of its lifespan. The DVPI reflects the net performance of the investment, taking into account all funds used either to pay the fund's management or to invest in portfolio companies. However, the DVPI may not be a reliable measure of fund performance if the fund is at a stage where the committed capital has not been fully deployed.

Residual value to paid-in ratio (RVPI):

$$\text{R}VPI = \frac{\text{NAV (T)}}{\Sigma \text{CF(past,paid in)}}$$

The net asset value (NAV) is the fair value of the assets of the PE fund at time T (which corresponds to the date of the TVPI calculation). This ratio is particularly valuable in the early stages of a fund's life, especially before many distributions have been made, as it indicates the degree of revaluation of portfolio companies. However, the accuracy of this measure is highly dependent on the quality of the valuation estimates provided by the fund. In cases where a fund takes a very conservative approach to accounting for its investments, the RVPI may show a misleadingly low return.

Total value to paid-in ratio (TVPI):

$$TVPI = \frac{\Sigma CF(\text{past,received}) + NAV\,(T)}{\Sigma CF(\text{past,paid in})}$$

TVPI can be considered the most efficient multiple to measure performance before the end of a fund's life. However, it is important to note that multiples, including TVPI, have a limitation—they do not consider the duration for which the capital has been invested in the fund. (*A. Gervasoni, F. Sattin, 2020*)

Assessing the performance of private equity involves comparing the returns of the private equity fund with other benchmarks. However, finding suitable benchmarks can be challenging for investors. Typically, they rely on two imperfect sets of benchmarks: peer groups (such as the average return of a group of private equity funds) and public market equivalents (like comparing private equity returns with an index of public equities).
Benchmarking the performance of private equity funds becomes crucial when investors are considering an investment in a new fund. Investors rely on an analysis of the historical performance of funds previously managed by General Partners raising the new fund. The assessment is based on whether or how often GPs' prior funds are in the first or second quartile of performance according to these benchmark statistics. This comparison is valuable because it allows an assessment of the performance of the GP's previous funds relative to the broader population of funds at the same stage and with the same geographic focus that were raised in the same vintage years. (*E. Talmor, F. Vasvari, 2011*).

Other key metrics of performance

In addition to IRR and return multiples, there are financial metrics that are useful in measuring other key aspects of a target company, such as operational performance and financial strength.
In terms of operational performance, some key value drivers are represented by improvements in revenues or in EBITDA margin. *Ayash e al.* (2017) find that in recent

years, private equity firms have become more focused on revenues growth. To achieve this, they implement "buy and build" strategies with the aim of expanding the activities of the target company and acquiring new businesses. As a result of the merger, the turnover of the portfolio company is higher.
EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortisation) is one of the most important financial metrics in the PE context. It is considered to be a good proxy for operating cash flows in a steady state, excluding taxes. For this reason, it is closely monitored by private equity funds. One of the first steps GPs take to improve the operating efficiency of the portfolio company is to try to increase EBITDA. This can be achieved in different ways: by increasing revenues, reducing operating costs or through strategic add-on transactions. In the case of PE investments that are financed with a large amount of debt, such as LBOs, an improvement in EBITDA and ultimately in cash flows is almost necessary to pay back the debt.
The EBITDA margin is calculated as EBITDA divided by revenues; this measure provides insight into how efficiently a company is generating profits from its core operations, excluding certain expenses that might vary due to non-operational factors. A higher EBITDA margin indicates that a larger portion of revenue is being converted into operating profits before considering non-operating expenses. It is useful therefore to assess a company's operating efficiency and profitability. However, it's important to note that it does not capture all aspects of a company's financial picture, such as capital expenditures or changes in working capital.

Regarding the financial strength, there are several indicators that private equity fund managers monitor when evaluating a potential target company or during the investment period. The Net Financial Position (or simply Net Debt) is one of these and represents the resources that are immediately available to repay debt.

$$\boldsymbol{NFP} = Bank\ debt\ (short\ and\ long\ term) + leasing\ debt + other\ fin.debt \\ - cash\ and\ cash\ equivalent.$$

NFP and EBITDA are used to determine the Debt to Operating Margin which shows how many periods a company needs to pay off its debt.

$$\boldsymbol{Debt\ to\ Operating\ Margin} = \frac{Net\ Debt}{EBITDA}$$

Every company should have a Debt to Operating Margin lower than 5x: a value above this threshold could indicate that the company is in financial distress and there may be some doubt about its ability to meet its financial obligations.

Another indicator useful to assess a company's financial strength is the Debt-to-Equity ratio whose target value is 2x; above this value the company is in financial distress.

$$\boldsymbol{Debt\ to\ Equity\ ratio} = \frac{Net\ Debt}{Equity}$$

In the PE context, where market multiples are used to calculate the value of a target company, the equity based on market values is determined by the following relationship:

$$\boldsymbol{Equity\ value} \ = (EBITDA\ x\ multiple) - NFP$$

where the result of the first operation is the Enterprise Value. Therefore, the Equity value is obtained by subtracting the net debt from the EV.
The previous relationship suggests that fund managers can achieve a higher return or capital gain through three main drivers: reducing NFP, increasing EBITDA or increasing the multiple (the latter depends on market fluctuations).

Private Equity and Value Creation

Private equity investors are not just “capital providers” but active owners who work with a company's board and management. They play a crucial role in executing growth and value creation strategies. The investor activism and hands-on approach are fundamental to achieve better performance than the market or the reference benchmark. The intervention of PE investors generally refers to extraordinary actions such as strategic ones and operations that differ from normal company management.

It's important to take into account the fact that the investor's primary interest is to increase the value of the investment in order to achieve a high return, and that his interventions are therefore consistently aimed at achieving growth and development objectives.

According to the market practice, there are several actions taken by PE investors to help target companies create value, including:

- The creation of a new professional network providing business and strategic contacts.
- Supporting the entrepreneur and the management in dealing with managerial processes and potential generational changes.
- Financial advices and services.
- Focus and investments in innovation, research and development for greater production competitiveness.
- Support for the international expansion of the target company's activities by reaching new countries and markets.

Every investor brings a unique wealth of experiences and contacts to the table in order to change the way the company sees the market and its own organization. This involves having an external perspective, allowing the company to scrutinize established procedures and practices through the eyes of an "outsider."

In this context, the PE investor acts both as a support and interlocutor for the entrepreneur or management and for the company in dealing with changes or extraordinary actions. The PE investor’s impact is greater in transactions such as buyouts, where it owns a majority stake in the company and can, directly influence the company’s managers and management methods. On the other hand, when the institutional investor holds a minority stake, it provides advisory services in order to influence the decisions of the majority shareholders; this is often the case in growth capital transactions. However, it's harder to build trust between investors and entrepreneurs or management in this type of transaction, so the impact of the PE fund is generally lower.

The presence of a PE investor backing a target company testifies to the validity of the business model and the growth expectations of the reference market.
Another crucial role that private equity firms often play is supporting target companies in developing an appropriate and well-defined business plan. This plan serves as a roadmap for the company's future direction and growth strategy within its market. In this context, private equity investors offer various forms of support. They may provide strategic guidance, industry expertise, and networking opportunities to help refine the company's growth strategy and ensure alignment with market dynamics. Additionally, they may facilitate access to additional capital, resources, or talent necessary to execute the business plan effectively. By working closely with management, private equity funds help to establish a clear and sustainable growth path that can lead the target company to the success. Initially, formulating an industrial plan involves a comprehensive analysis of the company's current state, including its organizational structure and the strengths and weaknesses inherent in both its current structure and business model. The investor also assists the target company in launching a series of exceptional nature projects, aimed at achieving specific strategic objectives. The investor shareholder helps to complete these projects and to manage and monitor them.

Private equity firms help companies grow by supporting their efforts to expand internationally. Many companies struggle with this because they don't have enough money or resources. Private equity firms step in to provide the funds needed for expansion and offer valuable expertise. They help companies overcome the challenges of entering new markets by giving them the resources and knowledge they need to succeed. In this context, the operator can be decisive in terms of greater availability of funds, thanks to the possibility of providing new capital to support the initiatives considered, human capital and strategic guidance to support the definition of the best strategies for entering new markets. For example, a study by *Locket et al.* (2008), based on data from 340

companies, shows that support for early-stage firms is mainly based on developing export activities, while for later-stage firms it is mainly based on monitoring activities.
A study by *George et al.* (2005) on a sample of Swedish firms, finds that companies with “external owners”, as in the case of private equity, are more likely to expand their physical network and internationalise their activities.
In this context, one of the main factors affecting the competitiveness of target companies is size, understood as both the ability to have the critical mass necessary to benefit from economies of scale, and the strength and solidity to compete in a new market or country. The specific competence of the investing partner can have a crucial role in pursuing of a growth path based on an add-on strategy. In this regard, PE funds help target companies first to identify further growth opportunities and then to acquire one or more companies operating in complementary sectors or in new business areas that they wish to integrate.

The entry of the investor, in general, implies an improvement of the corporate image towards the market and the financial community, acting as a guarantee for the soundness and validity of the business idea. Especially in a context such as the European one, historically more focused on access to the banking system as a primary source of financing, the reputational element is even more important, as it provides the company with a tool to be used in negotiating with the credit institution for the access to more efficient financial instruments and more competitive economic conditions. This series of benefits are then expressed in the possibility of designing and redefining, with the support and supervision of the investor, a more efficient financial structure for the target company, seeking the right balance between debt capital and equity.

Jensen (1989) tried to understand why private equity investors normally without specific industrial synergies, are able to make returns on their investments that are often significantly higher than those made by so-called industrial investors. His studies show that this depends on the aptitude of private equity operators to act as active investors and take a hands-on approach to the companies they acquire. In this context, the success of a PE fund depends on the contribution and on the ability of the management team to seize opportunities and to be able to accelerate the development of the target firms. Jensen focused on the study of the impact of LBOs on a company's governance structure and he demonstrated a positive relationship between LBOs and governance efficiency and effectiveness. *Acharya, Kehoe and Reyner* (2009) conclude that the effectiveness of PE boards depends on the ability of PE managers to know how to align the interests of stakeholders and management.

Kaplan and Stroemberg (2009) attribute the success of PE funds and their investments to the appropriate involvement of the various management figures in the deal. The incentives provided through stock options and the illiquidity of the shares due to the private nature of the investment would reduce management's interest in manipulating short-term performance to focus on long-term performance.

Numerous studies have examined the correlation between PE and a company's performance. *Meles et al.* (2014) investigated 118 Italian companies supported by private equity. They found that the impact of private equity investments on a company's performance, depends on the type of private equity, the length of the investment, the approach used by the investor, and the exit strategy. The poll also confirmed that businesses backed by private equity perform better than their competitors. This indicates that there is a positive correlation between private equity investments and a company's success.

The effects of buy-outs deals on the ex-post performance of target companies have been investigated by *Scellato and Ughetto* (2013) in a research realised in 2013. The analysis compares a sample of private-to-private buy-outs and a control sample of non-buy-outs. The study examines firm performance across three dimensions: size, profitability and productivity. The results suggest a positive impact of buy-outs on the expansion of total assets and employment within the target firms in both the short and medium term. Yet, a distinct and consistent pattern is not evident for productivity.

Focusing the analysis on a subset of buy-out firms, the study shows that generalist funds have a negative and significant effect on the average ex-post operating profitability of private equity-backed companies. In contrast, turnaround specialists show a positive correlation with operating profitability. In addition, the final results highlight that target companies with lead investors from the same country tend to have relatively higher post-deal profitability performance.

Amess, Stiebale, and Wright (2015) conducted an analysis of the effect of private equity on a company's innovative activities in order to evaluate the impact of leveraged buyouts on portfolio firms. Their studies confirm that private equity firms do not emphasize short-term cost reduction above long-term profitability but rather invest in new projects with long-term returns.

Cornelli and Karakaş' research (2012) states that after an LBO, management inserted by the PE fund is more careful about supervisory responsibilities; furthermore, they observe that a firm's operating performance increases after a leveraged buy-out in the long run, confirming what said by Scellato and Ughetto.

The success of a PE investment is determined both by the financial contribution of the PE fund and the leverage used for the deal. Debt plays a crucial role in the operational approach of a PE investor, and in certain scenarios, it offers different advantages both at the portfolio company level, and at the fund level. At the corporate level, debt plays a dual role. Firstly, it acts as a constraint on the managerial discretion of a company. The obligation to repay existing debts places restrictions on the company's capacity to indulge in excessive spending (*Jensen 1986, 1989*). With less cash available, managers must allocate resources more efficiently, reducing investments in less productive areas and a increasing focus on the core business. In addition, as liquidity decreases, management need to avoid wasting resources in order to increase the overall productivity. Second, interest payments are tax deductible, and this permits the company to enjoy of the tax shield.

At the fund level, leverage has the potential to increase the return on equity of a given investment. *Appelbaum and Batt* (2014) observe the importance of leverage in investment transactions to increase returns for the fund and its investors; nevertheless, they notice that an excessive use of it, increases the risk over the acquired company. However, on one side, leverage could be positive for the target company because cash flow is used immediately for interest and principal payments and financial efficiency is increased, especially when there is low interest on debt; on the other side, the risk of failure increases during economic downturns and, as reported by *Appelbaum*, more PE-backed companies typically approach to financial distress or go bankrupt. When debt surpasses a specific optimal threshold, it is probable that the overall value of the firm will decline. Notably, in leveraged buyouts, creditors bear a portion of the associated risk. For this reason, certain private equity firms might undertake excessive risks, recognizing that their potential losses are limited. By the way, *Jensen* (1989) asserts that there are negative impacts on the reputation of private equity (PE) firms if the companies under their management go bankrupt. Essentially, this means that in subsequent periods, these firms may encounter increased difficulty in attracting new funds and establishing fresh credit lines. Consequently, there exists a distinct motivation for PE firms to avoid allowing their portfolio companies to default on their loans.

Baker et al. (2015) relying on other studies, show that there is no evidence of bankruptcy risk due to leverage. Baker draws on Edmans' model (2011) that leverage would encourage the firm's stakeholders to pay more attention to cash flows, leading to better investment decisions.

A consistent branch of the literature in the PE context considers the timing of the investment a critical condition for the success of the PE transaction. This depends both on the time horizon and the macroeconomic environment in which the deal is realised. Broadly speaking, two important elements to take into account are GDP growth and interest rate changes.

Kaplan e Schoar (2005) assert that investment transactions are more likely to occur after periods when the sector concerned has performed particularly well. But their research suggests that investments made during boom times have lower returns than those made during downturns. This could be explained by an over-investment during good times due to the huge availability of capital to invest.

Other studies show that a period of boom and increased financial availability would create a high level of competition and constant bidding on prices offered for certain investments. This would result in a consequent decline in performance at the time of divestment. In this context, it's important to take into account, the speed with which deals are closed in a boom periods (in order to win an investment, management teams pay less attention to the data provided by companies).

Another possible source of value creation for a PE fund could be the multiple arbitrage. The estimate of the present value of the company's future cash flows, on which the valuation of the target company is based, is influenced by both internal metrics (EBIT, EBITDA, FCF, etc.) and external ones (interest rates, GDP growth, competitors performance, etc.). Consequently, the valuation of the target company varies over time, presenting a potential opportunity to benefit from arbitrage, especially in situations of

market inefficiency. In this context, PE firms will try to exploit this market imperfection to their own advantage.
Multiple arbitrage, as defined by Gompers et al. (2016), represents the possibility of selling at a higher multiple than buying, regardless of the underlying performance of the portfolio company. For instance, if the value of a company is expressed in terms of EBITDA multiple, if it has € 10 M of EBITDA and is valued at 6.0x EBITDA, then it's worth € 60 M. If for some reason the multiple increases to 9.0x, the value of the company increases to € 90 M. This € 30 M increase in value is not due to superior performance – the company's EBITDA is constant at € 10 M – yet, its value increased substantially. This could be explained by the changes in market valuation or the collection of higher quality information and superior deal making capabilities by PE investors.

First, it' s important to understand how changes in market valuation create opportunity to multiple arbitrage. Market conditions, strongly influenced by the business cycle, significantly impact the setting of valuation multiples. Given the fluctuating nature of these multiples over time, private equity firms must possess the capability to evaluate whether a target company is undervalued or overvalued and respond accordingly. This approach relies on external factors, so as demonstrated before, the timing of the deal is crucial.

Second, the gathering of higher quality information, compared to other investors, provides a great advantage for PE funds. According to *Berg and Gottschalg* (2005), PE firms that conduct extensive market research may be able to forecast future trends more accurately. The unique network comprising CEOs, advisors, employees, and consultants within these firms plays a crucial role in acquiring exclusive knowledge, which could be valuable in upcoming deals. Therefore, PE firms may benefit of superior information about a target company, not just about a specific industry; this situation is typical in management buy-outs, when managers want to acquire a company that they know better than outsiders.

Third, the deal making skills of the GPs are extremely important and can be useful in both the acquisition and the divestment process. The capacity to establish a network of contacts for instance, enhances the general partners' understanding of the prevailing multiples.

Periodically, they may receive information about companies being sold below their market value, presenting attractive acquisition opportunities. On the sell side, PE firms seek to identify buyers who are willing to acquire portfolio companies at prices above market value and who are able to create additional synergies with the acquired company. This market awareness contributes to a valuable proprietary deal flow (*Gottschalg, 2007*) and when it is coupled with negotiation skills, it empowers the GPs to identify arbitrage opportunities in the market.

In addition to the leverage and the multiple arbitrage, there's another way to create value for the target companies and it is represented by the operational improvements which involve target companies.

The operational improvements are considered crucial for the growth of the target company and the success of the PE deal, as reported by Jensen in a study realised in 1989. This research demonstrates that the operational value creation depends on three key features: cost-cutting and margin improvements, reducing capital requirements and operational/functional expertise.

According to *Kaplan* (1989), promoting a cost-cutting strategy to improve productivity and make the business more efficient is generally, the first step in a PE investment. For this reason, the first management decisions made after a PE fund comes in, are made to improve procurement and reduce workforce. However, laying off workers is not always necessary, because as *Davis et al.* (2011) argue, PE firms eliminate jobs only in unproductive areas and seek to create jobs in growing ones. The eventual employment drop depends on the type of firms targeted by PE; the selection of established companies with stable FCF, makes workforce reduction unnecessary.

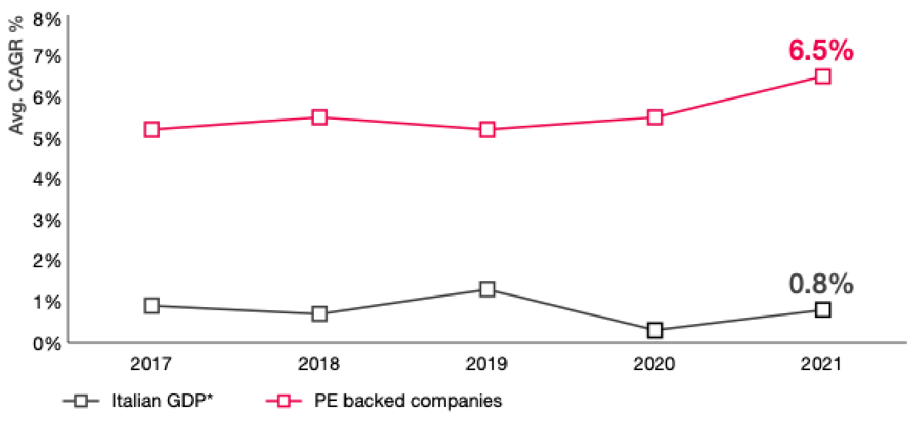
PE firms also consider reducing capital requirements through the divestiture of under-performing and/or non-core divisions. In that way, the portfolio company is able to reduce its debt and increase cash flow to invest in the company's core business. Therefore, it's possible to argue that selling assets is done to raise liquidity.

There are also outsourcing strategies that help the target company to improve its capital intensity; for instance, "sale and leaseback" agreements allow the company to lease an asset, typically equipment such as machinery and vehicles, rather than owning it.

Typically, between fund managers there are external and internal consultants, usually former CEOs, who advise portfolio companies on how to improve their operations. (*Kaplan and Strömberg, 2009*). Under some circumstances, PE firms may even use its own pool of talent to negotiate bank loans, credit facilities, etc., on behalf of the portfolio company, as it has a greater bargaining power. That happens frequently in the add-on investments.

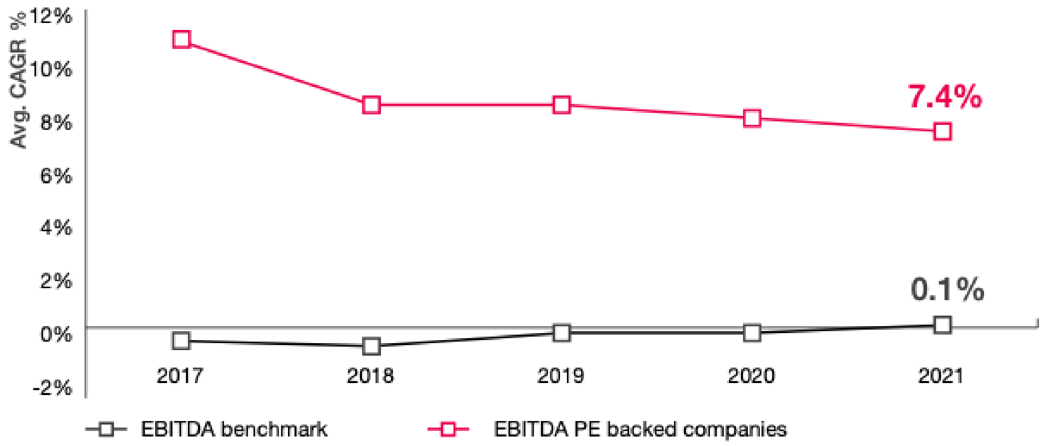
Besides the factors already mentioned, there are other relevant aspects which affect the success of a PE deal. For instance, *Kaplan e Schoar* (2005) prove the effect of the size of the PE fund: according to their research, larger funds (by amount of capital and assets) perform better than smaller ones, following a concave relationship.

Regarding the Italian context, several studies have been carried out in the last years to understand the impact of PE funds on the performance of Italian companies. A recent study by PwC (PricewaterhouseCoopers) and AIFI, examines the economic impact of PE and venture capital in Italy. Within the study, performances of Italian PE backed companies are compared with a specific benchmark composed of other medium and large sized Italian private companies; performances are expressed in terms of CAGR (compound annual growth rate) recorded by each company.
According to the analysis, companies backed by private equity (PE) have demonstrated robust revenue growth, with a compound annual growth rate (CAGR) of 6.5%. Consequently, with the Italian GDP at 0.8% in 2021, the gap between the average revenue CAGR percentage of PE portfolio companies and the national GDP has increased, reaching +5.7% compared to previous years.



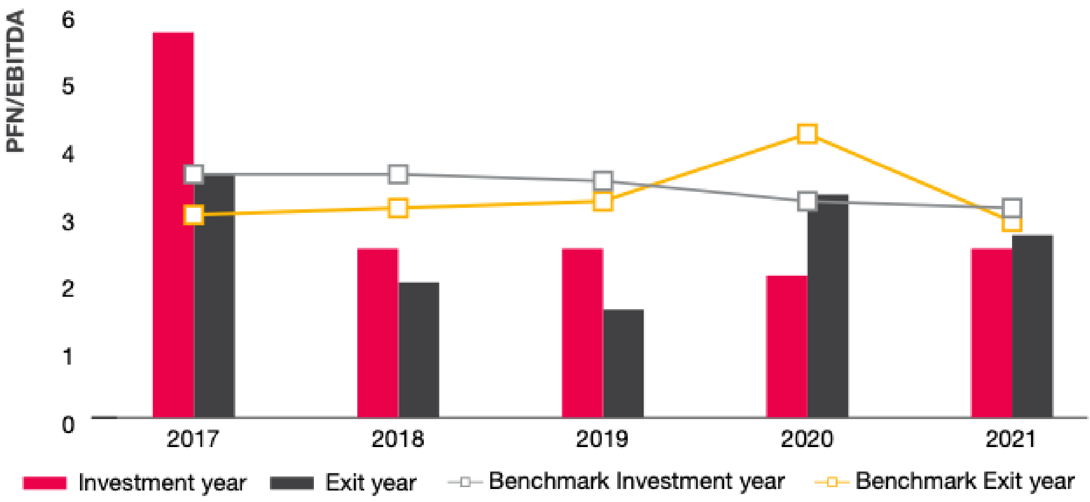
Source: ISTAT, AIFI and PwC analysis

In addition, the analysis shows that the profitability of PE-backed companies grows faster than than the revenues performance previously analysed (7.4% CAGR vs. 6.5% CAGR). This confirms the strong emphasis that private equity players place on improving the profitability of their target companies.



Source: AIFI and PwC analysis

The COVID-19 outbreak has revealed a significant increase in the use of leverage to finance private equity transactions. This is in contrast to the trend observed in recent years, which has been characterized by a lower leverage ratio in divestments. As described in the previous paragraph, private equity firms are increasingly pursuing "buy and build" strategies, in which they make new acquisitions in order to increase revenues and expand the activities of the target companies. In doing so, they increase the companies' debt exposure, which is reflected in higher financial leverage.



Source: AIFI and PwC analysis

Finally, the analysis shows that the main exit options over the last 5 years have been Secondary Buy (34%), followed by trade sales (30%) and buy-backs by the original owners (15%). IPOs accounted for only 8% of the total, indicating the difficulty for companies to go public during this historic period.
Another result of the analysis is that companies acquired through Secondary Buy-outs and subsequently sold to another Private Equity firm (Tertiary Buy-outs) over the past five years have demonstrated ongoing performance improvements. This is evident in the compound annual growth rates (CAGR) of revenues, EBITDA, and employees.

Chapter 3. – Case studies

This chapter will examine the impact of the entry of private equity funds into the companies analysed, in order to assess how this form of financing has influenced their development.

The analysis will focus on buyouts (in particular LBOs), as these are the transactions in which the PE fund acquires a majority stake, allowing it to directly influence the decisions of the target company. The main objective will be to identify the key factors and strategies implemented by the PE funds that characterised the deal and determined its success or failure.

The analysis included a preliminary step of mapping the active players in the PE context in Italy. During this step, it was collected all the information related to the current or past investments in their portfolio. Investment information was taken from the operators' websites, while investment details, such as the year of divestment, type of investment and amount invested were taken from online journalistic sources specialising in private equity. In order to identify notable case studies, attention has been paid to large and mega deals[*] that have taken place in the period from 2015 to 2022.

The data used for the financial analysis are taken from the “bilanci ottici” extracted from the AIDA database. Given the availability of data for the period analysed, the selected case studies concern Italian companies managed by national or international funds.

The three main value drivers assessed in the analysis will be: revenues improvement, EBITDA change and Net Financial Position change. In addition, as part of this detailed analysis, where possible, an estimate of the sector multiple at the exit of the PE fund is also made. This process will be based on information on average sector multiples available from online sources. Finally, the IRR and the MoM multiple achieved by the PE fund for the specific investment will be compared with the average IRR and MoM achieved by the fund over all its investments in order to assess its return.

[*] AIFI defines large deals as transactions with Equity between €150 M and € 300 M and mega deals as transactions with Equity above €300 million. – AIFI: “IL MERCATO ITALIANO DEL PRIVATE EQUITY E VENTURE CAPITAL 2022”.

Arcaplanet (Agrifarma S.p.A.)

Arcaplanet is a pet store chain based in Italy, specialised in pet food and care. The company operates a network of stores all over Italy, offering a wide range of products, including pet food, accessories and health care products. It offers both its own brand of pet food and products from various other brands, trying to offer their customers the widest selection of items.

Permira acquired the Arcaplanet group from Motion Equity Partners in April 2016. According to financial sources, the group, managed by Motion Equity through its holding company Agrifarma, was valued at approximately € 350 M (including debt) on the basis of an EBITDA forecast of € 34 M at the end of 2016. The investment was made through the Permira V Fund which was closed at the hard cap of € 5,3 billion in 2014[*]; with the Arcaplanet deal, the fund reached 72% of its committed capital. The Arcaplanet's founder Mr. Michele Foppiani with his family kept a minority stake and remained as CEO.
The exit was in June 2021, when Permira sold its majority stake in Arcaplanet to a financial and trading consortium led by Cinven, another European private equity player.

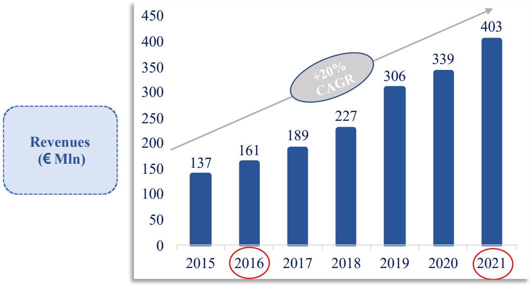
After having introduced the players involved in the deal, it's now possible to begin the analysis focusing on the actions taken by Permira to make the investment profitable.

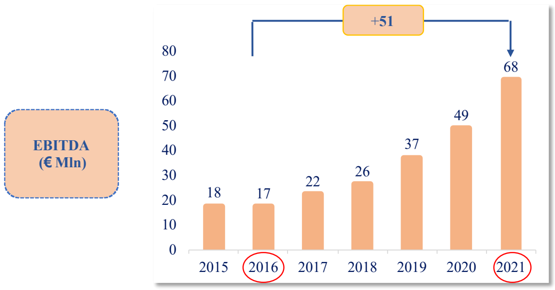
Firstly, it's important to note that the objective of Permira's intervention was not the rescue of a company in crisis and thus, the implementation of a restructuring plan, but the consolidation of Arcaplanet's leadership in Italy by reaching new regions and sectors where it was not yet present.
Considering the possible actions that a PE fund could take to help target companies create value, as outlined in the previous chapter, in this case they were aimed at supporting the

[*] https://www.permira.com/news-and-insights/news/permira-closes-permira-v-at-53-billion

expansion of Group's physical network into new countries and markets, and at targeting investments in innovation and R&D for greater production competitiveness.
In 2016, Arcaplanet was considered the leading company of the Italian pet care market. During Motion Equity's control, from 2010 to 2016, the company experienced a steady growth both in terms of revenues and EBITDA. In the year prior to the Permira's investment, Arcaplanet registered revenues of approximately €137 M (+22% compared to 2014) and an EBITDA of € 17 M. The company was present in eleven regions, and it had developed its portfolio of own brands, such as Start, Expecial, Next, Hifish and Virtus.
Therefore, it's possible to say that the company resulted well managed and healthy at the time of entry. Permira was attracted to the deal because it believed that there were further growth margins: by combining the fund's experience and expertise in consumer investing with the management team's awareness of the sector, Arcaplanet had the potential to strengthen its leading position in Italy and expand its activities internationally. As reported by Repubblica, the market of pet food in Europe alone was worth 2 billion euros in 2016 and it would have continued to grow in the following years.

Regarding the operational improvements, during the investment period, Arcaplanet has continued to grow its revenues and EBITDA, from € 160 M and € 17 M respectively at entry to € 402 € M and € 68 M at exit in 2021. There has been a positive revenues' CAGR between 2016 and 2021 (+20%), with a peak of 34% reached in 2019 thanks to the opening of new sales outlets in Italy and the effect of the merger with Mondial Pet Distribution S.p.A. Revenues and EBITDA have grown almost proportionally, that's why the EBITDA margin results roughly constant, reaching a maximum of 17% in 2021. Therefore, thanks to the huge growth in revenues and a controlled increase of operating costs, Arcaplanet has remained operationally efficient and has been able to improve its operational performance.





Source: own elaboration

Under Permira’s ownership, there have been several add-on transactions aimed at consolidating Arcaplanet’s pet store chain. As described in the chapter dedicated to the value creation in PE, it’s very common for PE funds to adopt an add-on strategy in order to continue the growth path of the target company. This confirms what a study by George et al. (2005) showed, namely that companies with "external owners" are more likely to expand their physical network and internationalise their activities. In this case, the acquisitions were aimed at consolidating Arcaplanet's leading position in Italy by expanding its activities in regions where it was not yet present. In particular, the acquisitions have been useful in purchasing some small Italian chains specialising in different segments of the pet store market, complementary to those in which Arcaplanet is a leader.

Thanks to this strategy, the company has remained the market leader in Italy in terms of turnover, square metres under management and number of stores.

Permira has played a key role in the individuation of the acquired companies: its experience and expertise has allowed to identify businesses with growth potential and with which Arcaplanet has been able to create important synergies. This remarks what established by the literature about the ability of PE investors to help target companies seize key business opportunities in order to continue their growth path.

Following a briefly description of the add-on operations in which Arcaplanet acted as the platform company:

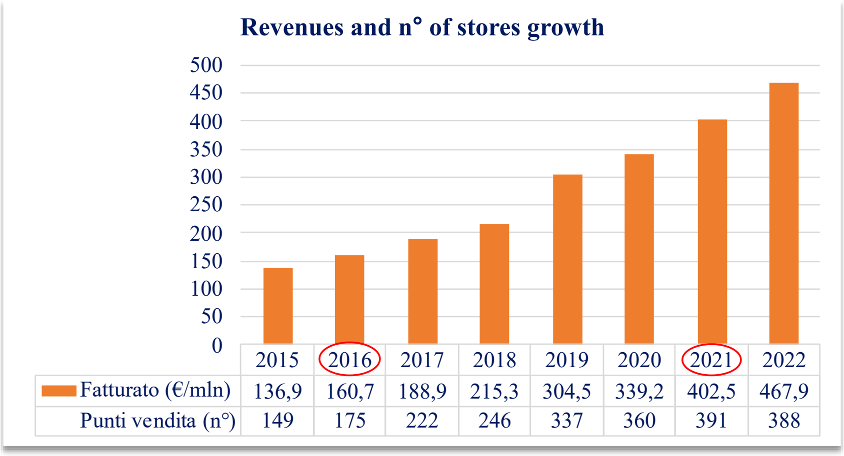
- **Zoomarket Group Sardegna Srl**: the acquisition was completed in 2016 when Agrifarma acquired the 100% of the company including 11 stores in Sardinia, where Arcaplanet did not yet have a presence.
- **Country Shop**: in 2017 Agrifarma acquired the Country Shop branded business unit with 11 sales outlets in the province of Turin; the operation has allowed

Arcaplanet to consolidate its presence in Piedmont where it has one of its most important customer bases.

- **Zoodom Italia Srl**: Agrifarma acquired the Zoodom branded business unit in 2019 with 15 sales outlets distributed across Abruzzo, Lombardy, Veneto and Marche.
- **Fauna Food**: also in 2019, Agrifarma completed the acquisition of NewCo Arcawip Srl owner of the Fauna Food brand, including 11 sales outlets distributed across Lombardy, Veneto and Piedmont. The operation has allowed Arcaplanet to consolidate its position in the north of Italy where it has the majority of its stores; the merger with Arcawip was expected to be completed in 2020, but due to the Covid outbreak it was finalised only in 2021.
- **Città degli animali**: at the end of 2020, Agrifarma acquired the "Città degli animali" branded business unit with 5 points of sale in Lombardy; in this case, the acquisition was aimed at strengthening the aquarium department, in which "Città degli animali" could offer its knowledge and expertise.

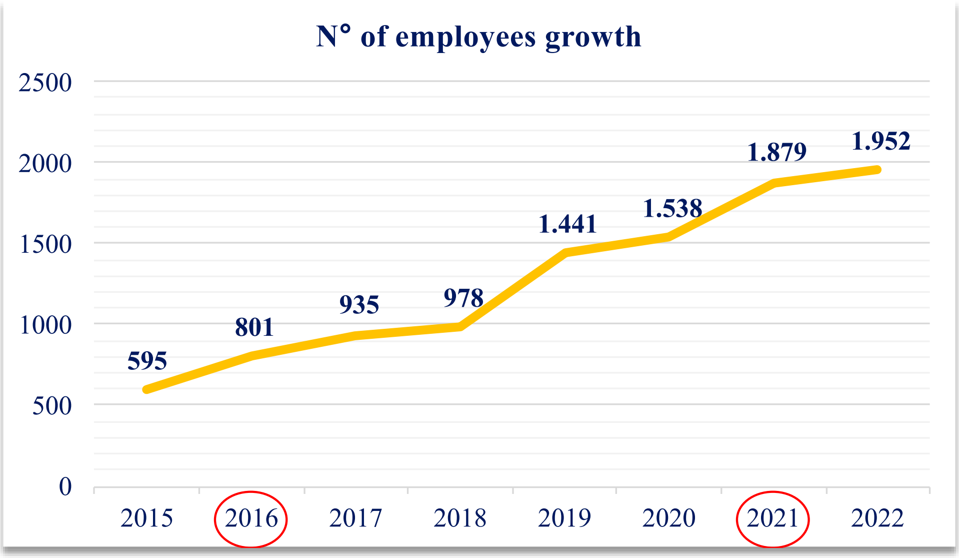
In addition to the add-on transactions, Arcaplanet made also a transformational acquisition represented by the purchase of **Mondial Pet Distribution** in 2017. At the time, the company was controlled by Fortesan, another important player active in the Italian pet retail market. Mondial Pet Distribution had 69 points of sale and a turnover of more than € 50 M in 2016. Permira invested € 50 M to acquire Fortesan, which was valued € 48,8 M (according to the Private Equity Monitor).
The merger has enabled Arcaplanet to develop synergies with a medium-sized player in the industry and to accelerate the group's growth. With this deal, Arcaplanet has become the third largest pet retailer in Europe and has been able to improve its international visibility.

As a result of the acquisitions made and thanks to the Permira's support, Arcaplanet has been able to expand its physical network in Italy from approximately 150 sales outlets in 2016 to 400 in 2021. Opening and acquiring new stores has helped the company increase its turnover and improve operating profitability.
Today, the company is present in 18 regions in Italy and serves more than 1.3 million loyal customers through its stores and online platform.



Source: own elaboration

Another effect of the add-on strategy has been the steady growth of the company's number of employees. The most significant increases have occurred in the year following a merger. The total workforce has passed from only 801 employees in 2016 to 1879 in 2021 (+234%). On the other hand, the workforce growth has determined an increase in the personnel cost which went from around € 26 M in 2016 to more than € 60 M in 2021. However, this has not had a significant impact on the operating profitability of the company which has remained positive during all the investment period. Moreover, the incidence of the personnel costs on the total revenues has been reduced over the investment period, passing from 15% in 2016 to approximately 7% in 2021.



Source: own elaboration

Add-on transactions have also had a significant impact on the company's balance sheet. From 2016, it's possible to observe a huge increase in intangible assets as effect of the buyout transaction; specifically, there was a reverse merger, in which three companies, Noah 3 S.p.A, Saluki S.p.A. and Angelica S.r.l. have been included in Agrifarma S.p.A. and thus in the Arcaplanet group. The operation took place concurrently with the closing of the transaction by Permira. It changed the Arcaplanet's corporate structure by appointing Noah 2 S.p.A (indirectly controlled by Permira) as the new single shareholder. The merger has generated a goodwill of 247.944.131 euros (net of amortisation) and also a variation in the net worth under "Riserva avanzo di fusione" for 226.776.765 euros. In addition to this operation, during the investment period, the goodwill has also increased due to the effect of the other bolt-on transactions, even if for smaller amounts.
From 2016, intangible assets also include the value of the Arcaplanet's brand, which initially amounted to 60.666.642 euros.
The increase in intangible assets has had an indirect impact on the company's overall profitability which has registered a final loss for three consecutive years (2017-2019). A possible explanation for this, could be the weight of the depreciation and amortisation (D&A) which rose from around € 7 M in 2016 to more than € 28 M the following year, determining a negative EBIT in 2017. The significant increase in D&A and other related expenses can be attributed to high intangible assets and the opening of new stores.

In addition, it's also necessary to take into account the impact on the Arcaplanet's profitability of financial expenses, which increased from around € 1 M in 2016 to more than € 7 M in 2021. The rise has started in 2017 as a result of the bank loan received by the company in the same year to finance the buyout.
Arcaplanet has returned profitable in 2020 with a net profit of € 7 M, which doubled in 2021. Despite the COVID outbreak, the company's profitability depended mostly by the huge increase in revenues which peaked at € 402 M in 2021 (+60 M than previous year). The growth in turnover has been supported by the increase in online sales and the opening of new stores, while paying attention to the increase in both operating and non-operating costs, avoiding excessive expenses. This confirms what a study by Ayash et al. (2017) found, namely that private equity firms have become more focused on revenue growth. Arcaplanet's case demonstrates that this can be achieved by implementing "buy and

build" strategies, which aim to expand company's activities in new markets and acquire new businesses.

However, Permira's intervention was not limited to expanding Arcaplanet's network of stores and customers, but also included targeted investment in innovation and R&D for greater production competitiveness. In this context, Permira has enabled Arcaplanet to increase its focus on innovation, research and development in order to become more competitive in both the domestic and European markets. With this in mind, it's important to note the increase in R&D costs which were close to zero in 2016 and reached approximately 420k euros in 2021. The launch of a new website and the improvement of the e-commerce activities are just two of the measures taken to promote and drive innovation in the company.

The development of online activities has been fundamental in offsetting the decline in sales in the physical stores due to the Covid outbreak.

A direct consequence has been an increased awareness of the importance of effective marketing activities and promotional campaigns (advertising costs in 2021 amounted to around € 10 M, while in 2016 they were just € 3 M). These actions have had a significant impact on the growth of Arcaplanet's branded products, which represented almost the 50% of the revenues of the company in 2021 (in 2016 they were just 10%).

As outlined by the literature, debt plays a crucial role in the operational approach of a PE investor. In the case of Arcaplanet, the use of leverage, even if not excessive, was almost necessary to finance primarily the merger, in which Noah 2 S.p.A was named as the single shareholders, as well as the other add-on transactions in which Arcaplanet has been involved.

The bank loan, linked to the entry of Permira V Fund into the company's capital, has been provided by a pool of financial institutions, led by Unicredit S.p.A.. Initially, the bank debt amounted to 110.269.396 euros, but in 2018 the Term Loan A has been extended to € 140 M bringing the total debt equal to 145.154.903 euros.

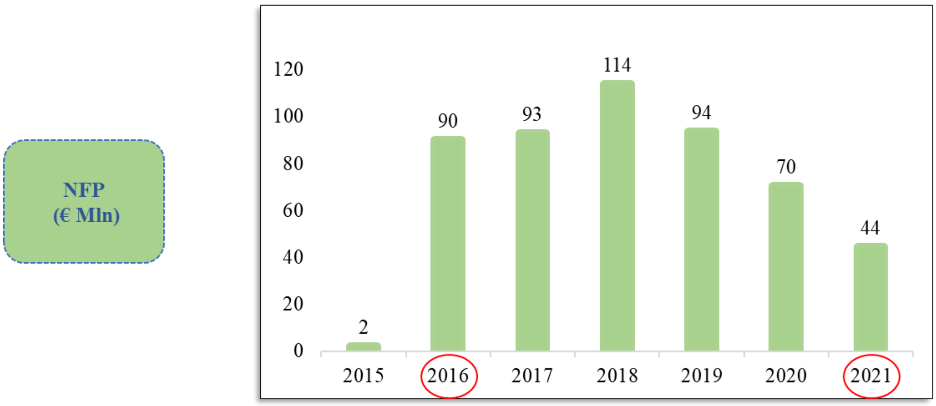
Structure of the bank loan:

	Amount (€ million)	Terms	Pricing (spread over EURIBOR)
Term Loan A	105	6-year bullet	400 bps + 6-months EURIBOR
Term Loan B	4.5	3 tranches (last one on 30/11/2022)	350 bps + 6-months EURIBOR
Term Loan C	4.428	3 tranches (last one on 30/11/2022)	350 bps + 6-months EURIBOR
Extension of term loan A	35	5-year bullet	400 bps + 6-months EURIBOR

Source: own elaboration from data of Notes to the Financial statements

Having said that, it's now necessary to include in this analysis an assessment of the company's financial strength. As explained in the previous chapter, there are several key indicators for this purpose, the first of which is the net financial position (NFP), which represents the amount of resources immediately available to repay debt (it can also be called only Net Debt).

Regarding Arcaplanet's NFP, the most significant variation is in 2016 and is related to the bank loan described above. It peaked at around € 114 M (negative) in 2018, before starting to rise as a result of the increase in available cash (it went from € 52 M in 2019 to approximately € 75 M the following year) and the reduction in the company's financial debt.



Source: own elaboration

Other two key indicators to measure the financial strength of the company are the Net Debt / EBITDA ratio and the Net Debt / Equity ratio. The target values for these ratios vary depending on different factors such as the industry characteristics and the market conditions. However, it is recommended to keep the Net Debt / EBITDA below 5x and the Net Debt / Equity close to 2. Specifically, for Arcaplanet, by considering at entry a

Net Debt of around € 90 M (including the bank debt related to the buyout) and an EBITDA of € 17 M, the first ratio is equal to 5,29x, therefore higher than the maximum value of 5x; management and investors had to pay close attention to this situation in order to avoid a financial distress. However, as shown above, within the investment period the company has been able to reduce its debt exposure and at exit, with a Net Debt of around € 44 M and an EBITDA of around € 68 M, the ratio has been reduced to 0,64x.
In this regard, Permira's supervisory and monitoring role has enabled Arcaplanet to avoid financial distress through low leverage and minimal waste of company resources.

To calculate the Net Debt / Equity ratio, it's necessary to estimate the Equity of the company based on market values. As described in the previous chapter, it's possible to analytically estimate the company's value after a fund's investment. To do that, there are two main approaches: one based on market multiples, where the value is determined by evaluating companies operating in the same sector or by taking into account the price of similar transactions; the other, the DCF (Discounted Cash Flow) method, where the value of the investment is calculated by discounting its projected future cash flows to their present value.
For its simplicity and reliance on market data, the market multiples method has been used in the analysis of these case studies. In particular, market multiples have been obtained by consulting a quarterly report in which they are reported by sector. The report is provided by Kroll[*], a consulting agency specialised in financial and risk advisory services; the EV/EBITDA has been considered the reference multiple for the analysis.

In the specific case of Arcaplanet, considering the Consumer Discretionary Distribution and Retail sector, it can be assumed a multiple EV/EBITDA equal to 7,7x (at 30 June 2023). From this, it's possible to obtain an estimate of the company's Enterprise value (EV) and therefore its Equity value. Taking into account Arcaplanet's EBITDA in 2021 (the year of the Permira's divestment) and the multiple, the EV is equal to approximately € 525 M; by reducing the EV for the corresponding Net Debt (€ 45 M), the Equity value is € 480 M.

[*] Kroll. (2023). Industry Multiples in Europe: Q2 2023. https://www.kroll.com/-/media/kroll-images/pdfs/industry-multiples-europe-q2-2023-executive-summary.pdf

Using the same approach and considering the same multiple, it's possible to obtain the EV and Equity value at entry, which are equal to € 132 M and € 42 M respectively.

Finally, knowing the NFP and the Equity value it's possible to calculate the Net Debt / Equity ratio:

_ at the time of entry it was equal to 2,14x, slightly above the maximum value of 2, confirming a moderate risk of financial distress.

_ at exit, the ratio falls to almost zero as a result of the reduction in Net Debt and the huge increase in the Equity value, confirming the company's financial strength.

Thus, using the multiples method, it has been possible to analytically calculate the EV and the Equity value of the company.

Nevertheless, at this point in the analysis, it's important to look at how the market valued Permira's investment at the time of entry and exit, and to consider the real numbers involved in the investment. To do this, let's look at the market valuations as reported by some press and financial sources such as the Private Equity Monitor (PEM):

- At entry with an Enterprise value (EV) of approximately € 350 M (the price paid by Permira to acquire Arcaplanet) and a Net debt of € 90 M, the Equity value was € 260 M;
- At exit, considering an Enterprise value (EV) of € 1,3 billion (the price paid by the consortium led by Cinven to take over the business) and a Net debt of € 70 M, the Equity based on market values was equal to € 1,23 billion.

Knowing both the Equity value at the time of entry and exit, it's possible to calculate the Money on Money multiple and then estimate the IRR of Permira's investment.

The MoM multiple is close to 4,7x, while the IRR is around 30%. With this in mind, it may be interesting to compare the return on this particular investment with the average return achieved by the Permira V Fund over all its investments.

According to CalPERS[*], the Permira V Fund has generated a net IRR of 21.5% and an average investment multiple of 2,8x. Comparing these values with those of the Arcaplanet investment, it's clear that the Fund has achieved a higher return on this investment in terms of both IRR and MoM multiple.

[*] https://www.calpers.ca.gov/page/investments/about-investment-office/investment-organization/pep-fund-performance

Here's a recap of the key pillars of value creation in Permira's investment in Arcaplanet and the key drivers of its success:

Investment goal → **Consolidation of Arcaplanet's leading position in Italy and international expansion**.

Investment strategy →
- **Add-on acquisitions** to reach new regions and new markets where Arcaplanet was not yet present.
- **Investments in innnovation and R&D** to achieve greater competitiveness on the market.

Source: own elaboration

Let's have a look on the impact of the investment strategy on the main value drivers assessed in the analysis:

Revenues →

During the investment period (2016-2021), there has been **a positive revenues' CAGR (+20%).** As a result of the bolt-on acquisitions and the opening of new sales outlets, revenues went from € 160 M to € 402 M. In 2015, Arcaplanet was present in only 11 regions in Italy with 150 stores, while in 2021 it was present in 18 regions with 400 stores, serving more than 1.3 million customers.

Arcaplanet has remained **the market leader in Italy** in terms of turnover and number of stores. The acquisitions made involved small chains specialising in different segments of the pet store market, complementary to those in which Arcaplanet is a leader. The merger with another major player, such as Mondial Pet Distribution made the Group the third largest pet retailer in Europe and increased its international visibility.

EBITDA →

Over the period 2016-2021, **EBITDA has grown steadily with an increase of around € 51 M**. Arcaplanet has always been able to achieve positive operating profitability, although acquisitions have also had an impact on its operating costs:
- The **growth of the total workforce** from 801 employees in 2016 to 1879 in 2021 has determined an increase in personnel costs, which rose to € 60 M in the last year of investment. However, thanks to high revenues, their incidence has been reduced, from 15% in 2016 to 7% in 2021.

Overall profitability →

Arcaplanet has recorded a final loss for three consecutive years (2017-2019), only returning profitable in 2020 with a net income of € 7 M, doubled in 2021. The losses were caused by several reasons, indirectly related to the acquisitions made:
- **Increase in D&A** due to high intangible assets (mainly by goodwill and the value of the Arcaplanet brand)
- **Increase in financial expenses**, which went from € 1 M to € 7 M, as a result of the loans taken out by the company to finance the buyout and the add-on acquisitions.

NFP →

The most significant variation is in 2016 (-88 M) and was related to the bank loan used to finance the buyout. The NFP reached a peak of € 114 M in 2018, before starting to rise as a result of the increase in available cash and the reduction in the company's financial debt.

Source: own elaboration

In conclusion, it's fair to say that Permira's growth forecasts for Arcaplanet were correct, as evidenced by both the fund's returns and company's financial results. A critical success factor for the investment has been the investors' ability to seize key and further growth opportunities and to recognise the importance of innovation in transforming an Italian high quality business, into a leader in the European pet retail market.

Comdata S.p.A.

Comdata is an Italian company specializing in the provision of outsourcing services, particularly in the areas of Customer Relationship Management (CRM), Contact Center Services, and Business Process Outsourcing (BPO). The company offers a range of services including customer care, technical support, telemarketing, credit management, back-office support, and digital communication solutions.

The Carlyle Group acquired Comdata from Altair Servizi Informatici and another private equity firm, Synergo SGR, in the end of 2015. According to the Private Equity Monitor and other financial sources, the group was valued 7-7,5x FY 2015 expected EBITDA, at approximately € 300 M. The equity for the transaction was provided by Carlyle Europe Partners IV (CEP IV), which acquired a 90% stake, while Altair retained a 7,5% stake and a 2,5% remained under the control of management led by CEO Massimo Canturi. Carlyle financed the buyout with a 4x EBITDA leverage (€170 M) and the senior debt was provided by a pool of financial institutions including Bpm, Intesa Sanpaolo, Bnp Paribas and Unicredit. As a result of the transaction, a new corporate group was formed with Comdata S.p.A. as the holding company.

At the time of entry, Comdata had revenues of around € 510 M and an EBITDA of € 57,9 M. The group, headquartered in Milan, controlled a total of 27 hubs in Italy, Romania, Czech Republic, Turkey and Argentina. The presence in different countries was the result of a series of acquisitions in which the company was involved since the beginning of the 2000s.
The main objective of the Carlyle deal was to help the company strengthen its international presence and become a relevant European player. On the one hand, Carlyle believed that Comdata's strong business model would have enabled the group to embark on a new growth path. Comdata's strong market position, diversified service offering and international presence made it an attractive investment opportunity for Carlyle. On the

other hand, the company would have benefit from Carlyle's vast international network and strategic guidance to support its expansion initiatives. Internationally, the business process outsourcing sector (BPO), was undergoing rapid consolidation and Comdata decided to be on the side of the aggregators.
Therefore, as seen in the case of Arcaplanet, a key aspect of the deal is the add-on strategy carried out by the company to reach out new countries or markets and expand its physical network and customer base.
The first acquisition within the investment period was made in 2016 and was related to the purchase of Digitex Informatica Holding SA, a Spanish company specialising in the same sector of Comdata with a wide presence in Latin America. The purpose of the transaction was therefore to gain access to new customers and to expand Comdata's activities in South America, where Digitex held a leading position in the contact centre market. The new group increased its revenues and global market share, the number of centres managed and the number of employees (almost 36k), becoming one of the major player in the sector worldwide.

In the following years the Group has been involved in further bolt-on acquisitions, the most relevant of which were:

- **Win Bilgi:** Comdata acquired the Turkish company in 2016 with the aim of expanding its activities in Turkey by opening new offices and entering in the BFSI (Banking, Financial Services and Insurance) sector.
- **Overtop Projects SL**: the transaction was completed in 2017 and allowed Comdata to increase its presence in Spain in the Business Process Outsourcing (BPO) sector, in geographical areas where Digitex was not yet active. This acquisition enabled the company to extend its client portfolio, including national banks, insurance companies and multinational clients, diversifying its revenues in Spain with these industries.
- **B2S group**: also in 2017, Comdata acquired the French group owner of Izium S.a.s. and three other subsidiaries, specialised in Customer Relationship Management (CRM) outsourcing, with contact centre onshore and offshore in Morocco and Madagascar. The B2S group had a turnover of almost € 200 M and employed around 6.000 people. The operation allowed the group controlled by

Carlyle to enter the French market, where it was not yet present and made Comdata one of the top five CRM and BPO companies in Europe, with revenues of more than €750 million.

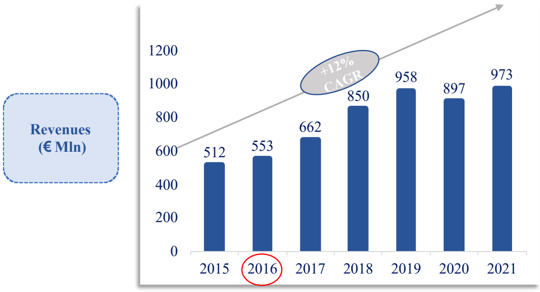
- **CCA International**: the acquisition was completed in 2018 to consolidate the presence of the Comdata group in the growing French market: CCA was the second market leader in France, with a turnover of € 164 M and a total workforce of more than 6,000 employees.

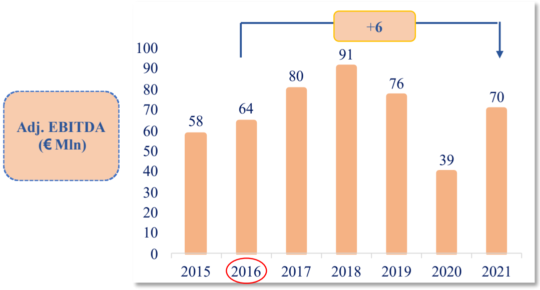
The most significant effect of the M&A campaign has been the huge increase in the Group's revenues, from around € 550 M in 2016 to almost €1 billion in 2021. Particularly, the most important increase has been registered in 2018 with approximately € 850 M (+28% than the previous year) as a result of the merger with the two French groups B2S and CCA International.

It's therefore important to note that the turnover's growth is mainly due to the extraordinary operations, defined as business combinations through which the Group has expanded the scope of its financial statements; from the date of acquisition, the revenues of the acquired companies have been included in the Group's turnover.

In 2020, the decline in revenue is mainly due to the COVID outbreak, which on one hand led to operational difficulties and the need to implement a new working model extended to all company functions, and on the other hand it triggered a global economic crisis. As a result, in this period there was a contraction of volumes on the existing customers and a slowdown in the acquisition of new ones. In addition, some customers decided to bring the activities previously assigned to Comdata back into their business (so-called re-insourcing process). The closure of some unprofitable subsidiaries and the cyber-attack suffered by some Group companies in South America, which caused serious difficulties in production, also had a significant impact.

In 2021, thanks to the recovery in customer demand and the implementation of a restructuring plan, revenues start to increase again, reaching a value of around € 973 million, the highest within the investment period. Overall, there has been a positive revenues' CAGR of +12% between 2016 and 2021.





Source: own elaboration

In terms of operating profitability, in this analysis has been considered the Adjusted EBITDA, which is calculated by excluding non-recurring costs and revenues related to extraordinary events or transactions. First of all, it's important to note that, despite the huge turnover, revenues resulted reduced mainly by personnel costs and service costs, whose incidence remained very high throughout the investment period: it was 85% at entry and almost 90% in 2021. The rise in personnel costs has been a direct consequence of the increase in the total number of employees resulting from the M&A campaign promoted by the Group.

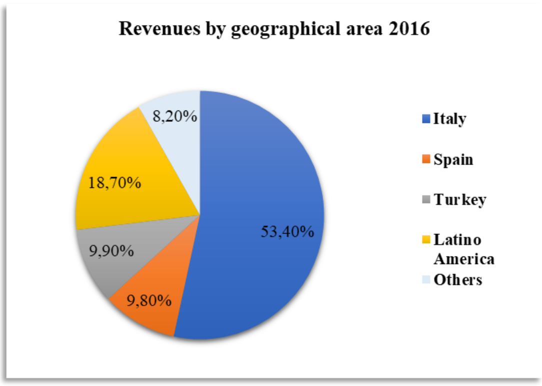
Despite this, Comdata has always been able to record a positive Adj. EBITDA with a peak of € 91 M in 2018 as a result of the huge increase in turnover following the merger with B2S and CCA International; in the same year, the EBITDA margin was 10,7%. The lowest value of Adj. EBITDA was in 2020 (-48,4% than in 2019) with an EBITDA margin of only 4,4%; this decline was caused by the reasons already mentioned in relation to the COVID outbreak.

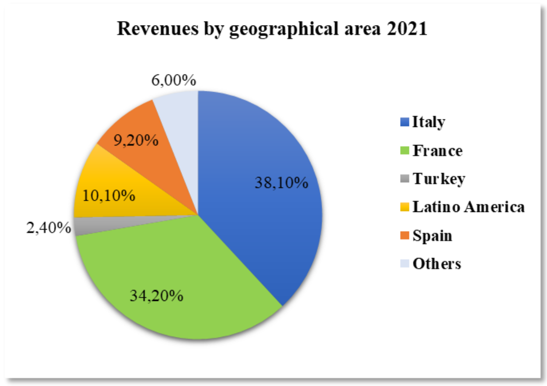
In general, it's fair to say that the group has remained operationally efficient under Carlyle's management, combining high revenues with a controlled increase in operating costs.

Another important aspect to consider when analysing Comdata's add-on strategy is the change in the distribution of revenues by geographical area.

As can be seen from the following graphs, the main market in which the group was active at the time of entry was Italy, which accounted for more than 50% of revenues. This was followed by the Spanish and Turkish markets, which accounted for almost 20% of sales; the Latin American region had a share of nearly 18,7%.

As a result of the further acquisitions made, in 2021 the revenues were distributed differently: the Italian market remained the most important, but its impact on the total revenues decreased to 38%. France became the second most important market as a direct result of the acquisitions of the B2S and CCA groups. Spain maintained its share, while Turkey and Latin America reduced their impact following the closure of some unprofitable branches.

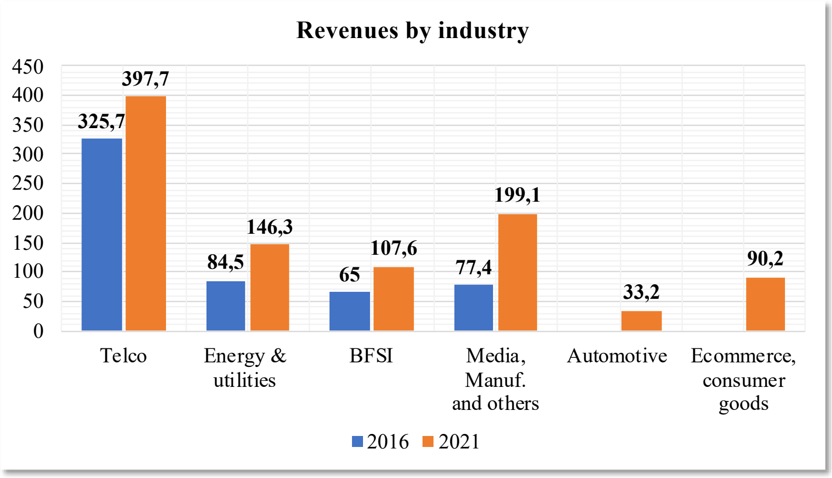




Source: own elaboration of data from Note to the Financial statement

The add-on strategy also had an impact on the composition of Comdata's customer portfolio. At the time of entry, the Group's customer base was mainly represented by customers belonging to four industries: telecommunications, energy and utilities, BFSI and media and manufacturing. In 2016, the majority of the revenues came from the telco sector, on which depended approximately the 60% of the Group's turnover. The other sectors contributed almost for the same share, not exceeding the 15%.

In 2021, the main contribution to revenues still came from the telco industry, but at a lower level (41%). In a market context with multiple growth opportunities, Comdata has been able to increase the weight of new customers not belonging to the telecommunications sector. The acquisitions, made by Comdata during the investment period, provided a more balanced and diversified customer portfolio with an higher exposure to sectors other than those mentioned above, such as automotive, e-commerce, consumer goods and the public sector.



Source: own elaboration of data from Note to the Financial statement

In terms of overall profitability, Comdata has been able to achieve a positive net income only in 2021, after the debt restructuring process started in 2019. The Group recorded a loss in 5 of the 6 years in which Carlyle held a majority stake. At entry, the loss accounted at around € 13 M, while in 2020 it rose to approximately € 190 M, making the situation very dangerous and almost unsustainable for the company. However, it’s important to note that the EBIT has only been negative in the last two years (2020-2021), confirming the fact that the Group has maintained its operating efficiency. Therefore, unlike Arcaplanet’s case, the company’s profitability was not too much affected by depreciation and amortizations, but it has largely been reduced by the high financial expenses associated with the debt taken on to finance the bolt-on acquisitions. These costs went from around € 20 M in 2016 to over € 55 M in 2019.
The increase in financial expenses is directly related to the leverage massively used to finance Comdata’s M&A campaign. Since 2016, the Group has been increasingly exposed to medium and long-term bank facilities.

Following are reported the main financial events in which the Group has been involved during the investment period:

- In 2016, in the context of the entry of Carlyle and the acquisition of the Digitex group, Comdata signed a financing contract with a pool of banks for a maximum total value of € 295 M. The financing consisted of both facility lines and revolving lines, all of which expired in 2023. During the year, € 250 M was effectively disbursed to finance the aforementioned operations, without recurring to the revolving lines. In detail, the two transactions determined a cash outflow of € 238,2 M and € 79,9 M respectively.

The contract signed with banks included a Credit Agreement related to the compliance of a financial covenant - the Leverage Ratio - defined as the ratio of Net Financial Position to EBITDA. In addition to the bank loan, there were also two capital increases for a total amount of around € 165 M (of which € 1 M as new Equity and the remaining part as "Riserva da sovrapprezzo azioni")

Structure and terms of the bank loan:

	Amount (€ million)	Terms	Pricing (spread over EURIBOR)
Facility B1 commitment	130	7-year bullet	450 bps + 6-months EURIBOR
Facility B2 commitment	20	repaid on 4 October 2016	450 bps + 6-months EURIBOR
Facility B3 commitment	40	7-year bullet	450 bps + 6-months EURIBOR
Facility B4 commitment	27	7-year bullet	450 bps + 6-months EURIBOR
Facility B5 commitment	3	7-year bullet	450 bps + 6-months EURIBOR
Acquisition/Capex facility	30	6-year bullet	400 bps + 6-months EURIBOR
Total senior debt at 31/12/2016	**230**		

Source: own elaboration of data from Notes to the financial statement

The facility B2 commitment was repaid in 2016, thanks to the company's ability to generate cash during the period.

- In 2017, the Group secured a new senior debt loan with a pool of banks for a maximum amount of € 435 M, due in 2024. The new debt was necessary to finance the acquisition of B2S group, which determined a cash outflow of € 222,2 M. Within the acquisition, the founder and chairman of French group, Maxime Didier, reinvested in Comdata taking an 11% stake. (Carlyle stake fall to 82% and management stake to 6,5%). In the same year, there was the full repayment of € 203 M plus interest of the long-term bank facility taken out in 2016.
- In 2018, Comdata increased its debt exposure by securing a new senior facility of € 75 million. The new loan was used to finance the acquisition of the French CCA International. At the end of the year, the total amount of non-recurring banks debt was of € 510 M.

	Amount (€ million)	Terms	Pricing (spread over EURIBOR)
Senior Facility 1	355	7-year bullet	450 bps + 6-months EURIBOR + Tax Gross Up
Senior Facility 2	80	7-year bullet	450 bps + 6-months EURIBOR + Tax Gross Up
Senior Facility 3	75	7-year bullet	450 bps + 6-months EURIBOR + Tax Gross Up
Total senior debt at 31/12/2018	**510**		

Source: own elaboration of data from Notes to the financial statement

In 2019, the Group also obtained a € 85 M revolving credit line, increasing its debt exposure to € 595 M and making its financial leverage even more aggressive.
From 2019 onwards, Comdata suffered from a decline in volumes and an overall decline in performance due to a challenging macroeconomic environment. In this context, it was almost necessary to renegotiate the terms of the signed contracts with the lenders in order to enable the company to meet its financial obligations. To achieve this, as reported in the previous chapter, the presence of a strong and reliable player such as The Carlyle Group, enabled Comdata to improve its corporate image and reputation with credit institutions.
Therefore, at the end of 2019, the new contractual conditions were first modified with the signing of an agreement between the parties which led to a redefinition of the financial covenants, following a modification of the so-called margin grid referred to in the Credit Agreement; the applicable interest rate margin increased from 4.5% to 5%.

In 2020, in addition to the negative performances described above, there was the COVID outbreak, which affected both the operational and financial profile of the Comdata Group. The net worth turned negative due to the huge loss of around € 190 M recorded in the period. Thus, there was a need for a further redefinition of the economic terms of the credit agreement in order to strengthen Comdata's capital structure.
In this context, the management decided to implement a new Industrial and Financial plan for the period 2021-2023, then updated to 2021-2025.
The main objectives of the new plan were:

- Strengthen the Group's capital structure by reducing its debt exposure;
- Consolidate the existing customer base;
- Improve operating margins;
- Implement of a turnaround strategy in Spain and Latin America.

To do this, the management initiated a restructuring process in 2019, which led to the signing of a stand-still agreement ("accordo di moratoria"). Specifically, the lenders granted some waivers allowing the Group to suspend its financial obligations for the second and third quarters of 2020.
In 2021, the parent company Comdata S.p.A. signed another agreement with all financial creditors aimed at implementing the established restructuring plan.

The plan can be resumed into four main points:

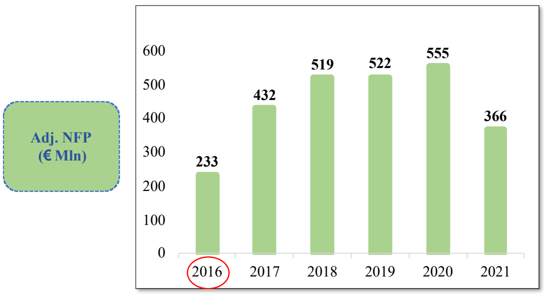
- **Swap of the company's debt into equity-like participatory financial instruments** (SFP): debt was reduced from € 595 M to € 375 M. In this context, there was the securitization completed by BNP Paribas, which sold € 356,8 M of loans owed by Comdata to Comway SPV S.r.l.. The special purpose vehicle issued € 356 millions of senior asset-backed securities notes for sale to qualified investors.
- **Change of the interest payment terms** on the € 375 M senior loan: from August 2021 to December 2022, 50% of the interest would have been paid, considering June 2024 as the maturity date of the debt.
- **Review of the financial covenants** in order to obtain more favourable conditions. In line with the waivers obtained, new financial terms were included in the agreement with the lenders, taking into account the new capital structure of the company: it was established a minimum value of liquidity, a new limit for the Leverage Ratio and some limitations related to the investment activity of the company and its indebtedness.
- **Issue of a € 25 M senior bond loan** with a maturity of three years and privately placed to some pre-identified investors.

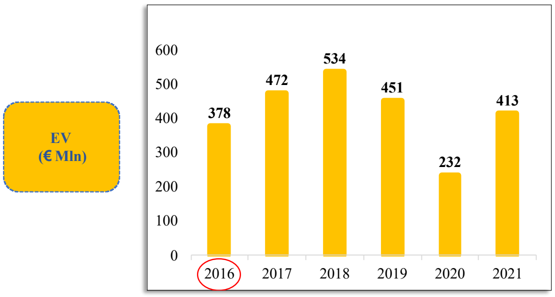
At the same time of the securitization operation made, there was also a capital increase through which management increased its minority stake to 40%, with 50 key managers participating in the equity structure alongside sponsor Carlyle.
All of these actions have provided Comdata with adequate capital and financial resources to continue to run its business. With a stronger capital structure and improved financial flexibility, Comdata has been able to overcome the market turbulence caused by the pandemic and continue the growth path started with Carlyle's entry.
The results of the restructuring plan were visible after only one year of implementation: in 2021, the Group's Adj. EBITDA was around € 70 M (+40% than the previous year) thanks to the increase in volumes and the recovery in demand. This allowed Comdata to achieve a greater operational efficiency and also higher levels of margins by keeping operating costs stable.
The securitization had a positive impact not only on the capital structure but also, on the overall profitability of the Group. It led to a huge increase in financial income which

amounted to more than € 150 M. It’s important to note that, in the same year, the EBIT was negative, while for the first time in the investment period, there was a positive net result for a total amount of € 102 millions.

At this point of the analysis, it’s possible to include some financial strength indicators to better understand the critical financial situation in which Comdata was struggling.
Firstly, the net financial position showed a negative increasing trend, peaking at € 555 M in 2020, including the two senior facilities and the revolving credit line which totally amounted to € 510 millions. This analysis takes into account the adjusted NFP, which is calculated by reducing the reported NFP by all transaction costs related to medium and long-term debt. The increasing trend is mainly due to the Group's high debt exposure, the excessive leverage used to finance the M&A campaign and the difficulty of the company of generating high cash flows.
The most significant variations in the Net Debt are in 2017, when it rose to € 432 M after obtaining the senior facility to support the Carlyle’s LBO, and in 2021, when it was reduced to € 366 M as a result of the deleveraging process started in the same year.

The implementation of the restructuring business and financial plan was crucial to avoid immediate default and carry out a turnaround strategy to get back into business.
Analysing the Net Debt / EBITDA ratio, it’s possible to say that the company’s financial distress started in 2017; from that year onwards, the ratio always exceeded the target value of 5x, peaking at 14,10x in 2020.





Source: own elaboration

Regarding the capital structure, the Equity has always been *in the money* except for 2019 and 2020 when the Group’s crisis was at its peak. The EV can be calculated by considering as valuation multiple the EV/EBITDA ratio.

In the specific case of Comdata, considering the Telecommunications sector (on which the majority of the Group's turnover depends), it can be assumed a valuation multiple of 5,9x (according to the Kroll's report[*] as of 30 June 2023). Taking into account Comdata's EBITDA over the investment period, it's possible to calculate the Enterprise Value. The EV has been higher than the Net Debt in four out of the six years in which Carlyle has had the majority stake in the Group. As a result, the Equity value has been greater than 0, peaking at € 145 M in 2016, when the Net Debt was just € 233 M. In 2019 and 2020, the EV has been lower than the NFP, thus it has not been enough to repay the debt. In this case, the Equity value has remained equal to zero and as said in these cases, the value broke into the debt.

Here's a recap of the key pillars of value creation in Carlyle's investment in Comdata and the key drivers of its success:

Investment goal → **International expansion of Comdata's activities to make it a leading European player.**

Investment strategy →
- **Add-on acquisitions** to reach new countries and new markets where Comdata was not yet present and to expand the physical network and customer base.

Source: own elaboration

Let's have a look on the impact of the investment strategy on the main value drivers assessed in the analysis:

Revenues →

During the investment period (2016-2021), there has been **a positive revenues' CAGR (+12%).** As a result of the M&A campaign carried out by the Group, revenues went from € 550 M to almost €1 billion.
The most significant increase is in 2018 (+28%) as a result of the merger with the two French groups B2S and CCA International.

In 2020, the decline in revenue is the result of several events:
- Firstly, the COVID outbreak, which led to a reduction in volumes with existing customers and a slowdown in the acquisition of new customers;
- The closure of some unprofitable subsidiaries;
- The cyber-attack suffered by some Group companies in South America.

In 2021, Comdata reached the highest value in revenue within the investment period (€ 973 M), thanks to the recovery in demand after the pandemic and to the implementation of the restructuring plan.
The add-on acquisitions had two major effects on the Group:
❖ The change in the distribution of sales by geographical area
❖ The change in the composition of Comdata's customer base

[*] Kroll. (2023). Industry Multiples in Europe: Q2 2023.
https://www.kroll.com/-/media/kroll-images/pdfs/industry-multiples-europe-q2-2023-executive-summary.pdf

EBITDA

Over the period 2016-2021, Comdata has always been able to record a positive EBITDA with a peak of € 91 M and an EBITDA margin of 10,7% in 2018. Despite the huge turnover, **the high incidence of personnel costs and service costs** resulted in low EBITDA values. However, the Group has always maintained its operating efficiency under Carlyle's management.

The most significant decrease is in 2020 (-47 million) due to the impact of the COVID outbreak.
In 2021, as a result of the restructuring plan implemented, EBITDA returned to the pre-pandemic level thanks to the increase in volumes and the recovery in demand.

Overall profitability

Comdata recorded a final loss in 5 out of the 6 years of Carlyle's management. In 2016, the loss accounted at € 13 million, while in 2020 it rose to € 190 M. The Group's overall profitability was mainly affected by the **increase in financial expenses**, which went from € 20 M to € 55 M, as a result of the massive use of leverage to finance Comdata's M&A campaign.
The Group only returned profitable in 2021 with **a net income of € 102 M**, following the implementation of the restructuring plan aimed at strengthening the capital structure by reducing the company's debt exposure. The plan included **the change of the interest payment terms** of the senior loans and **the review of the financial covenants** to achieve a greater financial flexibility.

NFP

The most significant decrease is in 2017 (-200 M) and was related to senior facility used to support the Carlyle's LBO. The NFP reached a peak of € 555 M in 2020 including the two senior facilities and the revolving credit line which totally amounted to € 510 million.

In 2021, there was a huge increase, as a result of **the deleveraging process** started in the same year. The increase of € 190 M was possible after **the swap of the company's debt into equity-like participatory financial instruments (SFP).**

Source: own elaboration

Having strengthened Comdata's capital structure and returned it to profitability, Carlyle decided to sell the company after 6 years of investment. The PE fund's preferred option was to sell the business to an industrial operator that could further support the Group's international expansion and with which develop significant synergies. The player identified was Konecta, a Spanish multinational specialising in customer experience solutions, controlled by the British fund Intermediate Capital Group (ICG). The Spanish company was the best fit for Comdata because of its similar size in terms of revenue and physical network.

In April 2022, Konecta signed an agreement to acquire the shares of Comdata S.p.A., the holding company of the Comdata Group, starting the merger process between the two groups. As part of this agreement, the Spanish group fully repaid the Senior bank loan for a total amount of € 434 M and at the same time signed an intercompany loan with Comdata S.p.A. for the same amount, due in 2032. The capital for the transaction was provided by ICG Europe Fund VIII. The new group had revenues of almost €2 billion, an EBITDA of € 300 million and more than 130.000 employees. According to a statement by the companies, the main objectives of the merger were:

- to consolidate their leading position in the Latin American and Spanish markets;
- to increase customer diversification;
- to increase their competitiveness in the market against global CXM providers;
- to develop operational synergies in order to offer improved end-to-end solutions and new services based on Big Data, IA and digital marketing.

The merger was completed in 2022, creating the sixth major player in the global customer experience BPO market.

Sisal S.p.A

Sisal S.p.A. is an Italian company specializing in the provision of a range of services, including gaming, insurance, and payment services. It was founded as a state-owned company and began its activities with the launch of 'Totocalcio', a popular football pool game in Italy. It was then privatised and controlled by various owners. Today, Sisal is the leader in the Italian gaming market, where it offers gambling, lottery and sports betting services. It also has a strong payment services arm, offering a range of financial services including bill payments, prepaid cards, mobile top-ups, and money transfers.

CVC Capital Partners acquired Sisal from funds managed by Permira, Clessidra SGR and Apax Partners in the May of 2016. The three PE funds, in turn, have controlled the Group since 2006, each with a different shareholding: Permira – 36,5%, Clessidra – 20%, Apax – 36,5%.

As reported by the Private Equity Monitor and other financial sources the value of the transaction was € 1,12 billion including debt. The equity for the operation was provided by CVC Fund VI which acquired a 100% stake. CVC financed the buyout with a 4x EBITDA leverage through the issuance of a new bond loan for a total amount of € 725 M. As a result of the buyout, a new corporate group was formed with Sisal Group S.p.A., as the holding company.

The exit was in December 2021, when CVC Capital Partners sold its stake to Flutter Entertainment plc, an Irish holding company that is a leader in the European gaming sector.

CVC was attracted to the deal because it believed that the Sisal Group had the potential to further innovate its proposition in areas such as online gaming, betting platforms and more generally, proximity retail. By combining Sisal's well diversified portfolio of businesses and strong market position with CVC's experience in the gaming sector (thanks to previous investments in Sky Bet and William Hill in the UK), Sisal could exploit its potential to become more competitive and reach new customers. CVC's growth strategy also included better positioning the company in the payment services sector, which accounted for just over a fifth of its total revenue in 2015. It's important to note, however, that the challenge for the PE fund was tough: it had to relaunch a group that was heavily indebted and operating mainly in a sector subject to a strict regulatory framework. Therefore, unlike in the previous cases, CVC did not focus on operational improvements at the time of entry. Instead, its priority was to reduce the Sisal Group's debt and net financial position.

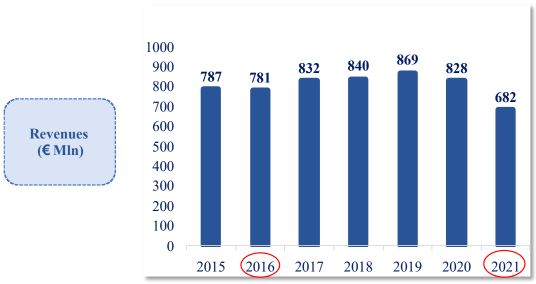
Before focusing on the financial side of the investment, let's describe how Sisal operates in the market and the main characteristics of its business units.
The activities of the Sisal Group are organised into four main business units:

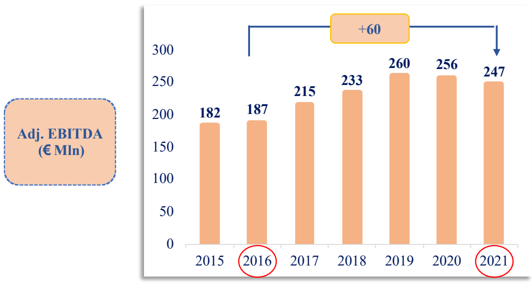
- **Retail Gaming**: it manages all the activities related to traditional sports betting competitions, gaming machines and bingo through a branded channel and an affiliate channel;
- **Lottery**: responsible for the management of the GNTN (Gioco Numerico a Totalizzatore Nazionale) collection activities, for which the Group is the exclusive concessionaire. GNTN includes popular products such as SuperEnalotto and WinForLife!;
- **Online Gaming**: it manages online gaming and betting activities through the Group's official website and the official mobile application.
- **Payments and Services**: it is the company division dedicated to payment services such as the payment of bills, taxes, fines or the recharging of prepaid debit cards, telephone cards and pay-per-view TV cards.

The Group operates through two physical channels: one branded (i.e. Sisal MatchPoint) and one affiliated with stores managed by third parties, as well as an online channel.
The business structure described above remained in place until 2019, when the management decided to merge Retail Gaming and Lottery into a single division ("Retail"). In the same year, a new "International" division was added to the organisation to manage the Group's activities abroad. In this sense, it's important to note the Group's

willingness to start an internationalisation process in order to seize new business opportunities and become a key player in the gaming sector in other countries as well. To achieve this, and to extend its leading position in new markets, Sisal has decided to expand its activities in countries where the retail and online gaming sectors are relatively small but have great potential for development. For these reasons, the Group has entered in Spain, Morocco and Turkey markets. To do this, it has acquired gaming licences in these countries and it has made some partnerships with local players such as the Turkish Sans Digital. In this context, it's important to remark the focus that PE funds such as CVC have on supporting target companies in their internationalisation path and also in identifying markets and business opportunities suitable for them.

Regarding the operational improvements, Sisal has shown moderate growth in revenue and EBITDA over the investment period: from € 787 M and € 182 M respectively at entry to a peak of € 869 M and € 259 M in 2019. The COVID outbreak has determined a reduction in the Group's revenues in 2020, due to the impact of lockdowns on retail activities related to the gaming machines, betting and lottery. However, this decline has been offset by an increase in revenues from online gaming channels. The decrease in 2021 is a consequence of the demerger, after which the revenues of the payment services branch are no longer included in the consolidated balance sheet.
Looking at the period 2016-2020 (excluding the year of the demerger) there has been a positive revenue CAGR of only 1%; excluding the negative effects of 2020, the revenue CAGR in the first four years of the investment is 4%.





Source: own elaboration

The Group has been able to maintain its operational efficiency by recording an EBITDA always positive. In this context, it's important to note that revenues were mainly reduced by service costs, whose incidence, however, has had a decreasing trend throughout the investment period: from 56% in 2016 to 40% in the last year of the investment. Thus, combining this with a significant increase in gaming revenues (+127 M compared to the previous year), even with the demerger, the company has recorded an EBITDA of € 246 M, almost stable compared to before the demerger.

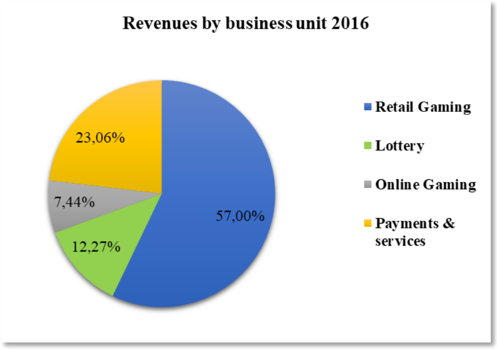
Another important aspect to look at is the EBITDA margin. Since CVC's inception, Sisal has recorded a high EBITDA margin indicating its ability to be profitable from its core activities. The highest value of this indicator was registered in 2021 and was around 36%.

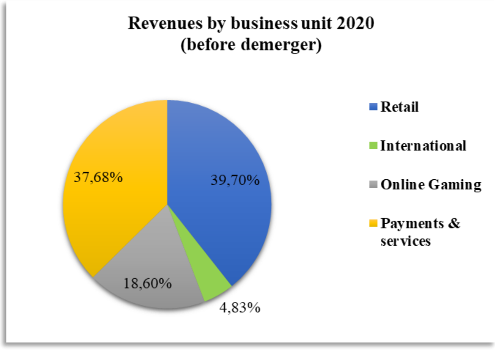
In terms of overall profitability, the Group recorded a positive net income in 2017 and 2018, following the debt restructuring process, which reduced the impact of financial expenses on the final result. On the other hand, in the following two years, the Group recorded losses of € 13 M and € 40 M respectively. In 2019, this was mainly due to the increase in the D&A of intangible assets and the resulting financial expenses, while in 2020, a reduction in revenues also contributed to the negative result. In the last year of the investment, Sisal returned profitable recording a positive net income of € 91 M.

Looking at the Group's business structure, it's possible to say that the distribution of revenues by business division has changed over the investment period.

As can be seen from the following graphs, at the time of entry, revenues were mainly dependent on the Retail Gaming division with approximately 57% of the total, followed by the Payments & Services division with 23%.

As a result of the development of the payment services activities, in 2020, the year before the demerger, revenues are distributed differently: the Retail and Payments and Services branches contribute almost equally with 39% and 37% of the total respectively. It's also important to note, on the one hand, the increase of the Online Gaming which went from 7% in 2016 to 18% in 2020, and, on the other hand, the presence of the International division in 2020, with a 4,8% share, amounting to around €40 million out of a total of €828 million.





Source: own elaboration

Having described Sisal's operational improvements and profitability, let's look at its capital structure and see how CVC has been able to reduce its debt.

At the end of 2015, Sisal had a Net Financial Position of approximately € 966 M. This high net debt was the result of the leveraged buyout made in 2006 by previous shareholders, when the company was valued 14,8x FY 2005 EBITDA ([*]). They financed the transaction with an 8x EBITDA leverage (€ 725 M), according to the Private Equity Monitor.

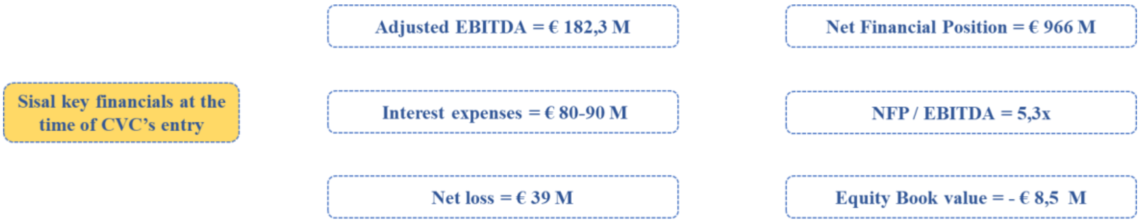
The Group's medium-to-long term debt was composed of various elements:

- The Senior Credit Agreement of € 725 M secured in 2006 and increased to € 745 M in 2008. It comprised four credit facilities and a revolving credit line, all with maturities up to 2017. The agreement included also the observance of some strict financial covenants such as an Interest coverage (EBITDA/Net financial expenses) higher than 1,90 and a Leverage ratio (NFP/EBITDA) lower than 5,75x.
- Shareholder Loan of € 452 M subordinated to the Secure Loan; it was an inter-company loan granted by the controlled company Gaming Invest.
- Senior Secured Notes issued in 2013 for a total amount of €275 million to partially repay the Senior Credit Agreement.

In 2015, Sisal recorded an Adjusted EBITDA of € 182,3 million and a net loss of around € 39 M. Thus, the company presented itself as operationally efficient but with negative overall profitability (interest expenses had an impact of € 80-90 M on the final result). In addition, the Group could be considered to be in financial distress due to an NFP/EBITDA ratio of 5,3x even if the financial covenant on the Senior Credit Agreement was always

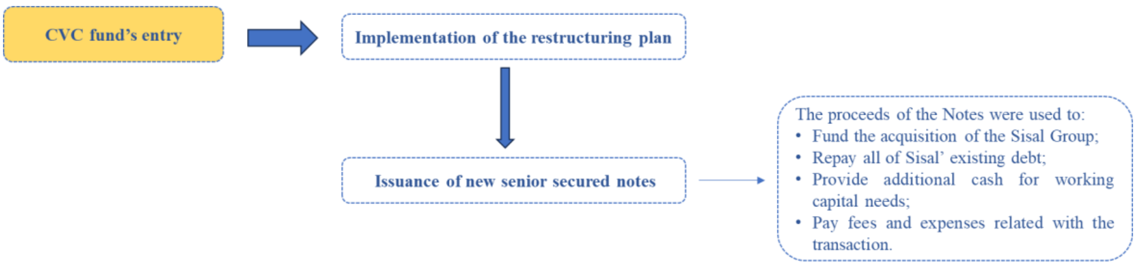
[*] https://bebeez.it/private-equity/cvc-conquista-sisal-un-miliardo-euro/

met; the Equity book value was negative by € 8,5 M as a result of the reported loss and some retained losses of € 290 million.



Source: own elaboration

After analysing all these aspects, it can be said that, at the same time as CVC's entry, it was necessary to implement a restructuring plan useful to strengthen Sisal's capital structure and reduce its debt exposure. To achieve this, the presence of a strong partner such as the CVC fund was fundamental. Firstly, Shumann S.p.A., the newco indirectly controlled by CVC, issued new senior secured notes for a total amount of € 725 M of which: 400 M as fixed rate notes and 325 as floated rated notes.



Source: own elaboration

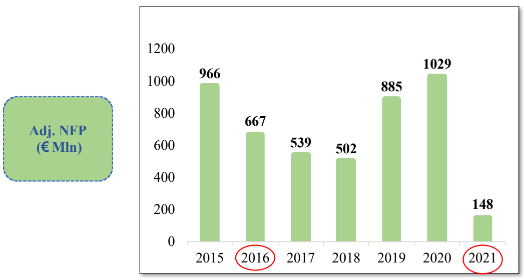
In this way the Group has been able to repay all its bank facilities and to extinguish the existing bond loan, thus eliminating all the financial covenants contained in these agreements. In addition, the Shareholder Loan of € 435 M granted by Gaming Invest was written off and a Super Senior Revolving Facility of € 125 million was made available for working capital management.

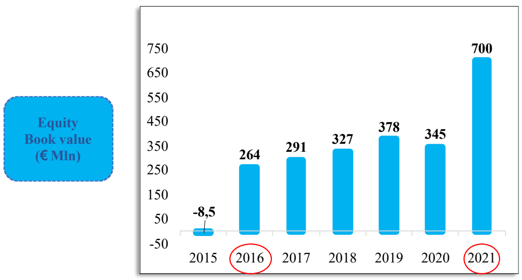
Structure of the long term debt:

	Amount (€ million)	Terms	Pricing (spread over EURIBOR)
Floating rate notes	325	6-year bullet	662,5 bps + 3-months EURIBOR
Fixed rate notes	400	7-year bullet	700 bps
Senior secured notes	725		
Super Senior Revolving Facility	92	maturity in September 2022	350 bps + periodic EURIBOR
Total long term debt at 31/12/2016	**817**		

Source: own elaboration of data from Notes to the financial statement

The new financial agreements did not include the same maintenance covenants as the previous ones, but the Group had to comply with a number of restrictions that limited its extraordinary activities, such as mergers and acquisitions, new investments or increasing its debt. The absence of strict financial covenants on the contracts enabled the Group to reduce the financial pressure on its activities. In this context, as outlined by the literature, the entry of a strong investor such as CVC helped Sisal to improve its corporate image and reputation with credit institutions, even when the Group was close to financial distress. This allowed the company to negotiate and then to obtain more flexible financial terms, useful for creating a more efficient and balanced financial structure. As a result of the restructuring process, the NFP decreased to approximately € 667 M in 2016, with an NFP/EBITDA ratio of 3,56x, while the book value of the Equity returned positive at € 264 M.





Source: own elaboration

As shown in the graph, the NFP had a decreasing trend until 2018 as a result of the repayment of part of the debt described above and of an increase in the cash generated by the company. The new increase in 2019 is due to the demerger, in which the Group separated the branch dedicated to payment services from the other branches dedicated to gaming and betting activities. This process also involved another player, Banca 5 S.p.A. (part of the Intesa Sanpaolo Group) and resulted in the creation of a new entity, SisalPayGroup S.p.A. with its subsidiaries SisalPay S.p.A. and SisalPay Servizi S.p.A..
The main objective was to create a new leader in retail payment services in Italy. The new company was therefore made up of the Sisal Group and the Banca 5 branches dedicated to this activity. The total value of the branches was of € 750 M and € 250 M respectively, and the new company was controlled 70% by the Sisal Group and 30% by Banca 5.

The demerger was financed by the issue of new Senior Secured Floating Rate Notes for a total amount of € 509 M. The proceeds were also used to repay the previous bond loan for the remaining amount of € 325 M. In addition, a new Super Senior Revolving Facility of € 92,5 million was required and a new Shareholder loan of € 186,6 M was secured. However, despite a high NFP, the situation was not financially critical thanks to a huge increase in the operating profitability: in 2020, the Adj. EBITDA was of € 259 M and the NFP/EBITDA less than 4x. At the same time, the book value of equity remained almost constant, reaching a value of € 378 M in 2019.

The reorganization process was completed in July 2021, with the definitive separation of the payment services branch from the Sisal Group, and the creation of a new entity, Mooney Group S.p.A., specialised in proximity banking and payments. As a result, from 2021, all the agreements and financial commitments relating to the demerged branch were no longer attributable to the Sisal Group: the Shareholder loan and the bond loan previously described were therefore no longer included in the Group's consolidated balance sheet, resulting in a significant reduction in NFP, which in 2021 amounted to only €148 million.

In terms of net worth, the most significant variation was in 2021 (+ 350 M) thanks to the positive net income of approximately € 91 M and an increase under “Altre riserve” as a result of the demerger described above.

Here's a recap of the key pillars of value creation in CVC's investment in Sisal and the key drivers of its success:

Investment goals →	**Relaunch of the Sisal Group** **Better positioning of the Group in the payment services sector** **Internationalisation of the Group**
Investment strategy →	• **Reduction of the Group’s debt** through the implementation of a defined restructuring plan. • **Expansion of Sisal’s activities in new countries** to seize business opportunities that have great development potential in the retail and online gaming sectors.

Source: own elaboration

Let's have a look on the impact of the investment strategy on the main value drivers assessed in the analysis:

Revenues

During the investment period (2016-2021), Sisal showed moderate revenue growth, peaking at € 869 M in 2019. Until 2019, there has **been a positive revenues' CAGR of 4%.**

In 2020, **the decline in revenue is the result of the COVID outbreak** and of the impact of lockdowns on retail activities related to the gaming machines, betting and lottery. The decrease of around € 40 M has been offset by the **increase in revenues from online gaming channel**.
The most significant variation in revenues is in 2021 (-140 million) as a result of the demerger, after which the revenues of the payment services branch are no longer included in the consolidated b/s.

The change in the distribution of revenues by business units has been determined by several factors:

- Firstly, **the development of the payment services activities**, which in 2020 contributed almost as much to total revenues as the retail sector;
- The pandemic determined an **increase in revenues from the online gaming channel**;
- The investments made abroad determined an **increase in revenues from the international division.**

EBITDA

Over the period 2016-2021, **EBITDA has grown steadily, with a total increase of around € 60 M**. Sisal has always been able to achieve positive operating profitability with a maximum EBITDA value of € 260 million (in 2019). During the investment period, **the incidence of service costs has been reduced,** leading to higher EBITDA values (even with the pandemic).

In 2021, despite the demerger, EBITDA remained stable at the pre-pandemic level, thanks to a significant increase in gaming revenues. In the same year, Sisal recorded its **highest EBITDA margin (36%)**, demonstrating its improved ability to generate profits from its core activities.

Overall profitability

- The Sisal Group has recorded a positive net income in 2017 and 2018, as a result of **the debt restructuring process**, which reduced the impact of financial expenses on the final result.
- The losses recorded in 2019 and 2020 are the result of several events:
  - Firstly, **the demerger process**, which led to an **increase in the D&A of intangible assets** and an **increase in financial expenses** related to the loans granted to finance the transaction.
  - The COVID outbreak, which led to **a reduction in volumes related to the retail activities**.
- The Group returned to profitability in 2021 (after completion of the demerger) with **a net profit of €91** million, following a significant reduction in financial expenses.

NFP

The NFP showed a decreasing trend until 2018, after the implementation of the restructuring plan, which included the repayment of part of the debt previously granted to the Group. The decline also followed the increase in the cash generated by the company.

In the 2019-2020 period, the NFP increased again, reaching its highest value of around € 1 billion. This rise was due to the massive use of leverage to finance the demerger process. Once this process was completed, with the creation of a new entity, Mooney Group S.p.A., net debt fell to just € 148 M.

Source: own elaboration

Regarding the capital structure, the Equity has always been *in the money* during the investment period with the Enterprise Value always higher than the Net Debt. The EV has been calculated on the basis of a valuation multiple for the Consumer Discretionary and Retail sector. According to the Kroll's report*, the multiple is 7.7x on 30 June 2023. Taking into account Sisal's EBITDA at the time of entry (2016) and at the time of exit (2021), the EV is equal to € 1,4 billion and € 1,87 billion respectively. Knowing the EV and the Net Debt, it's possible to calculate the Equity value which amounts to € 775 M in 2016 and to € 945 M in 2021.

Let's now have a look at how the market valued CVC's investment at the time of entry and exit, taking into account the real numbers involved in the investment. This type of information is provided by some press and financial sources such as the Private Equity Monitor (PEM):

- At entry with an Enterprise value (EV) of approximately € 1,1 billion (the price paid by CVC to acquire the Sisal Group) and a NFP of € 667 M, the Equity value amounted to € 433 M;
- At exit, considering an Enterprise value (EV) of € 1,913 billion (the price paid by Flutter Entertainment to take over the business) and a Net debt of € 1,029 billion, the Equity based on market values was equal to € 884 M.

Knowing both the Equity value at the time of entry and exit, it's possible to calculate the MoM multiple and then estimate the IRR realised by the CVC fund.
The MoM is close to 2,04x, while the IRR is around 13%. Let's now compare the return on this particular investment with the average return achieved by the CVC VI Fund over all its investments.
According to CalPERS*, the CVC VI Fund has generated a net IRR of 17,1% and an average investment multiple of 2,0x. Comparing these values with those related to the Sisal investment, it can be said that the Fund has achieved a lower return in terms of IRR while the MoM multiple is in line with the average multiple realised by the Fund.

* Kroll. (2023). Industry Multiples in Europe: Q2 2023. https://www.kroll.com/-/media/kroll-images/pdfs/industry-multiples-europe-q2-2023-executive-summary.pdf

*Private Equity Program Fund Performance Review: https://www.calpers.ca.gov/page/investments/about-investment-office/investment-organization/pep-fund-performance

Chapter 4. – Conclusions

The paper has provided an analysis of the private equity industry, focusing on the Italian situation and deepening the theoretical and empirical aspects of this alternative investment activity.

The first part of the thesis has established a solid theoretical basis for the topic, analysing the existing literature on private equity and describing the main characteristics of the various types of private equity investments. It has also outlined the organizational structure of PE funds by analysing the role of limited partners and general partners in them and their remuneration. In addition, this section has provided an understanding of which are the main stages in the life cycle of a private equity deal, from the fundraising stage, when the fund is established, to the disinvestment stage, when the fund exits the investment.

After having described the current state of the PE in Italy and introduced some key players, the attention has been shifted to the analysis of the impact of PE funds on the performance of portfolio companies. This activity has been divided into two parts: in the first one, there has been a further literature review on the methods used by funds to value a potential target company and on the main drivers that lead to the success of a PE transaction; in the second part, there has been a more practical approach through the selection of some notable case studies that can be used as examples to verify whether what is established in theory can happen in practice. The selected case studies involve Italian companies managed by national or international funds.

The main objective of the analysis was to identify the key factors and strategies implemented by the PE funds that characterised the deal and determined its success or failure.

The case studies have highlighted the importance of PE fund in supporting target companies to expand their activities and continue their growth path.

In the case of Arcaplanet and Comdata, both companies were growing at the time of entry and had a common goal of achieving an international dimension. The entry of a PE fund,

providing capital and know-how, enabled them to seize key and further growth opportunities, transforming them into leaders in their respective sectors.
In both cases, a key aspect of the deal was the series of add-on acquisitions made by the companies as part of the implementation of a "buy and build" strategy. In this sense, this confirms the growing trend of these operations in Italy, as outlined in the research conducted by PwC and AIFI on the economic impact of PE.
In the case of Sisal, the Group was in a difficult financial situation at the time of entry, so the priority for the PE fund was not the international expansion of the company, as in the previous cases or the operational improvements, but the relaunch of the Group. To achieve this, a restructuring plan has been implemented to reduce Sisal’s debt and strengthen its capital structure. In this context, it’s important to note that the presence of a strong partner such as CVC has been fundamental in improving the Group’s image and reputation with credit institutions, even when it was close to financial distress.

Arcaplanet and Comdata have followed two different approaches to expanding their activities and physical network:

- Arcaplanet’s acquisitions have mainly involved some small Italian chains specialising in different segments of the pet store market, with the exception of the merger with another major player such as Mondial Pet Distribution, which allowed it to create the third largest pet retailer in Europe and increase its international visibility.
- In contrast, Comdata’s acquisitions have involved medium and large-sized player such as Digitex, B2S and CCA International, with which it has developed significant synergies to become one of the major groups not only in the European context but also worldwide.

As a result of the acquisitions made, both Arcaplanet and Comdata have benefited from a steady increase in revenues; by avoiding excessive operating costs, they have also seen an increase in EBITDA, maintaining their operational efficiency. However, it’s important to note that this type of strategy produces different effects depending on how companies finance these acquisitions. The use of leverage is almost necessary to finance them but it has to be done carefully.

In the case of Arcaplanet, financial leverage has remained under management control throughout the investment period and the company has been able to maintain a stable capital structure. Steady revenue growth, even during the COVID outbreak, combined with the avoidance of excessive operating costs, has enabled the company to increase its overall profitability and value. As a result, Permira, the PE fund that controlled Arcaplanet, achieved a high return on the investment at exit (c. 30%).

In contrast, in the case of Comdata, the excessive use of financial leverage and the high debt exposure brought the company to financial distress. Revenues growth from add-on operations has been useful to maintain operational efficiency, but it has not been enough to avoid negative overall profitability and financial difficulties for the company. The COVID outbreak made the situation even worse, resulting in a decline in revenues. In this context, it's important to remark the crucial role of the PE fund's monitoring activity and its hands-on approach to helping target companies deal with difficult and unpredictable situations.
All of these factors determined the need for Comdata to implement a restructuring plan aimed at strengthening its capital structure and improving its performance. Having strengthened Comdata's capital structure and returned it to profitability, Carlyle decided to sell the company and entrust its growth to an industrial operator.

In the case of Sisal, the implementation of the restructuring plan has been the first step of the CVC's investment. Once the Group's capital structure had been strengthened and the risk of financial distress removed, the management started to focus on operational improvements and the expansion of Sisal's activities into new countries and markets. However, the expansion has not been achieved through add-on acquisitions but rather through the acquisition of gaming licences in new countries and partnerships with local operators.
The more efficient and balanced financial structure, together with greater financial flexibility, enabled Sisal to manage the demerger process without new financial distress (although this transaction resulted in a further increase in the Group's net financial position) and to return to profitability in 2021.

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In conclusion, it’s possible to say that companies that succeed in attracting a PE fund, in most cases, accelerate their growth path and expansion. The support of the fund is crucial to achieve better performance and to reach the desired international dimension. However, when the timing of the operation is not correct, bad management choices are taken or market conditions are not favourable, it’s harder to achieve certain results. Nevertheless, even in these situations, the presence of a PE fund is helpful in implementing a strategy that enables the target company to get back into business and improve its performance.

At this point, in order to provide a context for future research, it is important to critically assess the limitations of the analysis conducted.
The first limitation relates to the collection of information on private equity investments: it is based on data provided by the press and online sources or by the official websites of the players involved in the investments. However, some information, such as the exact amount invested or some of the financial terms agreed, may not be complete or accurate because they are reserved and known only by the investors and the companies.
In addition, access to the data taken from the “bilanci ottici” extracted from the AIDA database, was in most cases only available until 2021. This lack of more recent data did not allow a comprehensive understanding of the impact of the PE fund’s exit over the long term and how the entry of a new buyer has affected the performance of the target company. Future studies could include the collection of these missing data to gain a deeper insight into the performance of companies two or more years after the investment and to verify whether there are common trends between the companies analysed. For future research, for each private equity player considered in this paper, it may be interesting to analyse other investments in Italian companies to better understand similarities and differences in the approach taken within the investment period. This would allow to assess how much of the performance achieved can actually be attributed to the skills of the operators themselves, and how much is due to external factors influencing the results in a positive or negative way.
Overcoming these limitations and future developments in the analysis on a larger number of players may contribute to a better understanding of the strategies and performance of private equity operators in the Italian context.

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