Advanced Corporate Finance

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Introduction
Course structure

Course structure
3 credits – 24 h – 6 lessons

1. Corporate finance
2. Corporate valuation
3. M&A deals
4. M&A private equity
5. IPOs
6. Case discussions

Lesson 4 M&A Private Equity

Lesson 4 Summary

1. **Why Private Equity?**
   - **Definition**
   - **Private Equity investors**
   - **Private Equity regulatory framework**
   - **Funds raising process**
   - **Investors strategies**
   - **Benefits and limits of Private Equity**
2. **Private Equity requirements**
3. **The structure of a PE operation**
4. **Private Equity process**

Why Private equity?

Definition

Private Equity represents the activity of equity investments in companies with growth potential, realized by institutional investors, aimed at obtaining a high return in the short-medium term.

Organizations for public savings collection (banks, Insurances, retirements funds, foundations, etc.)

Private Equity market:

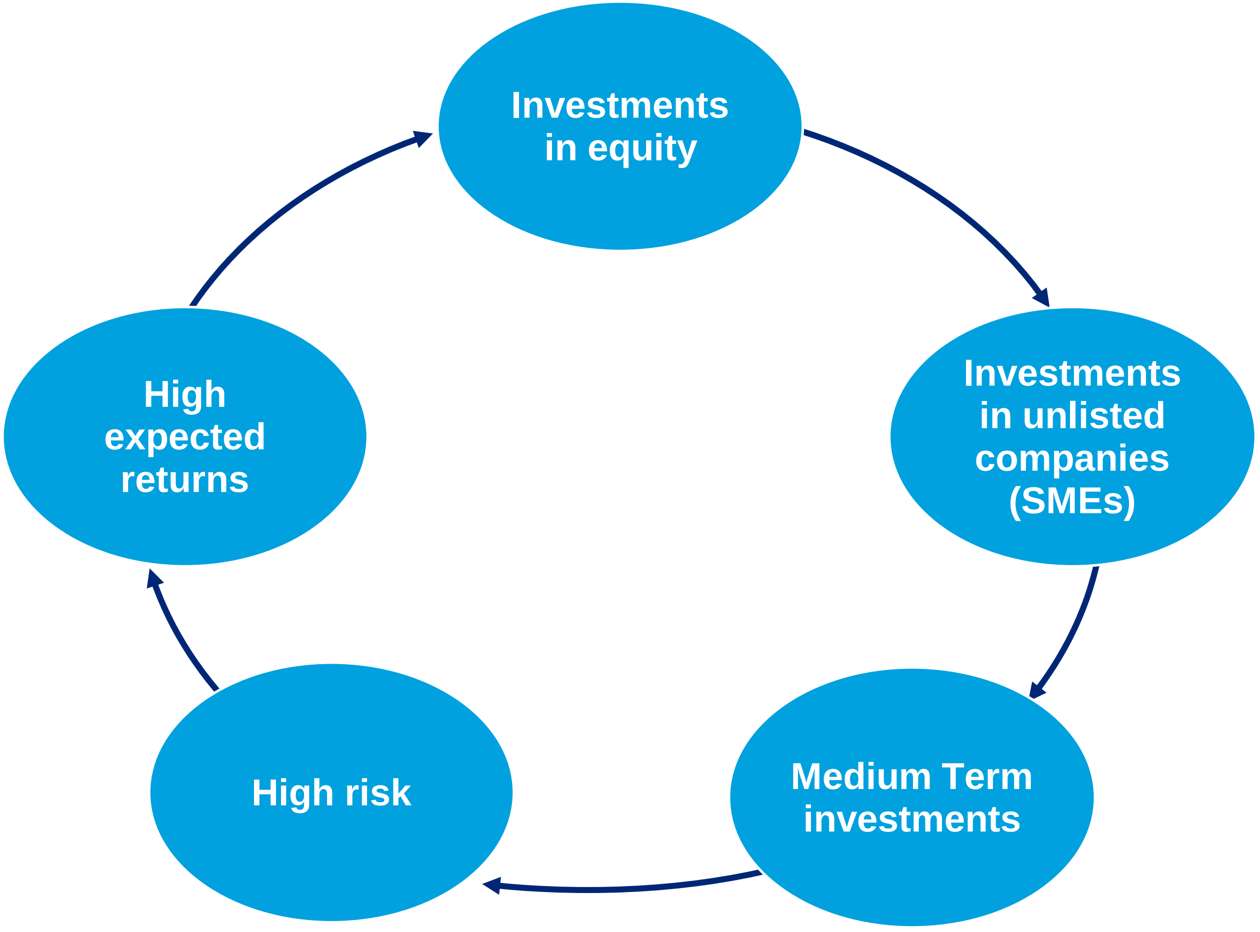
Institutional investors in equity

Target Company | **Target Company** | **Target Company**

…that need capital, management capabilities and experiences and investor relations to finance their activity and development projects

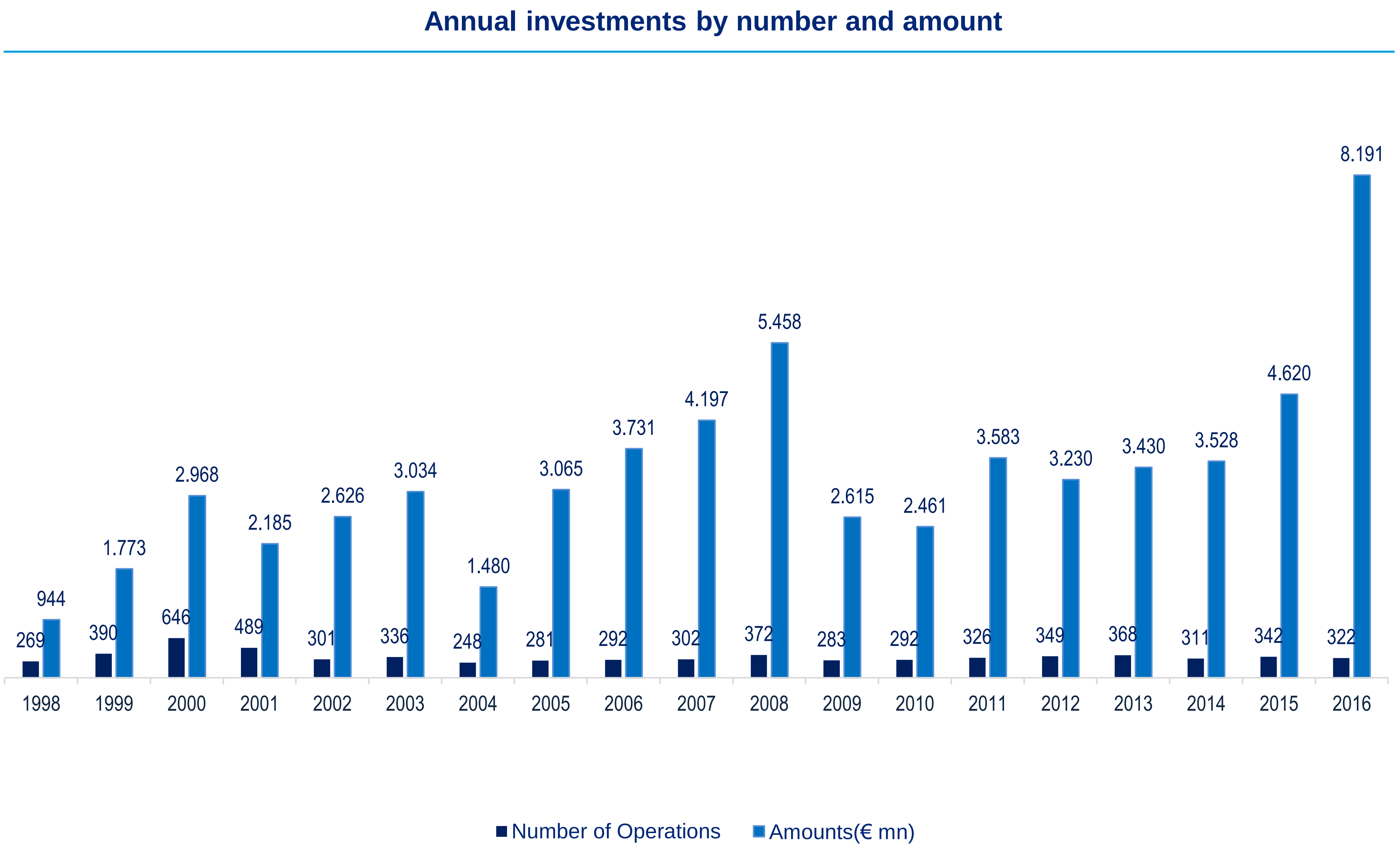
Why Private equity?
Definition

Elements that define and mark Private Equity activity are:



Why Private equity?

Definition



Source: AIFI

Why Private equity?

Definition

In the past	In the future
More financial and speculative perspective	More industrial perspective
Majority stake for buyout or replacement of historical shareholders	Toward minority stake investments supporting the growth (Expansion Capital)
Debt acquisition with a consequent overloading of the Company because of the high leverage	Different recourse to financial leverage
Short investment period with the target of high returns (IRR)	Increase of investment period and more restrained IRR

Private Equity investors

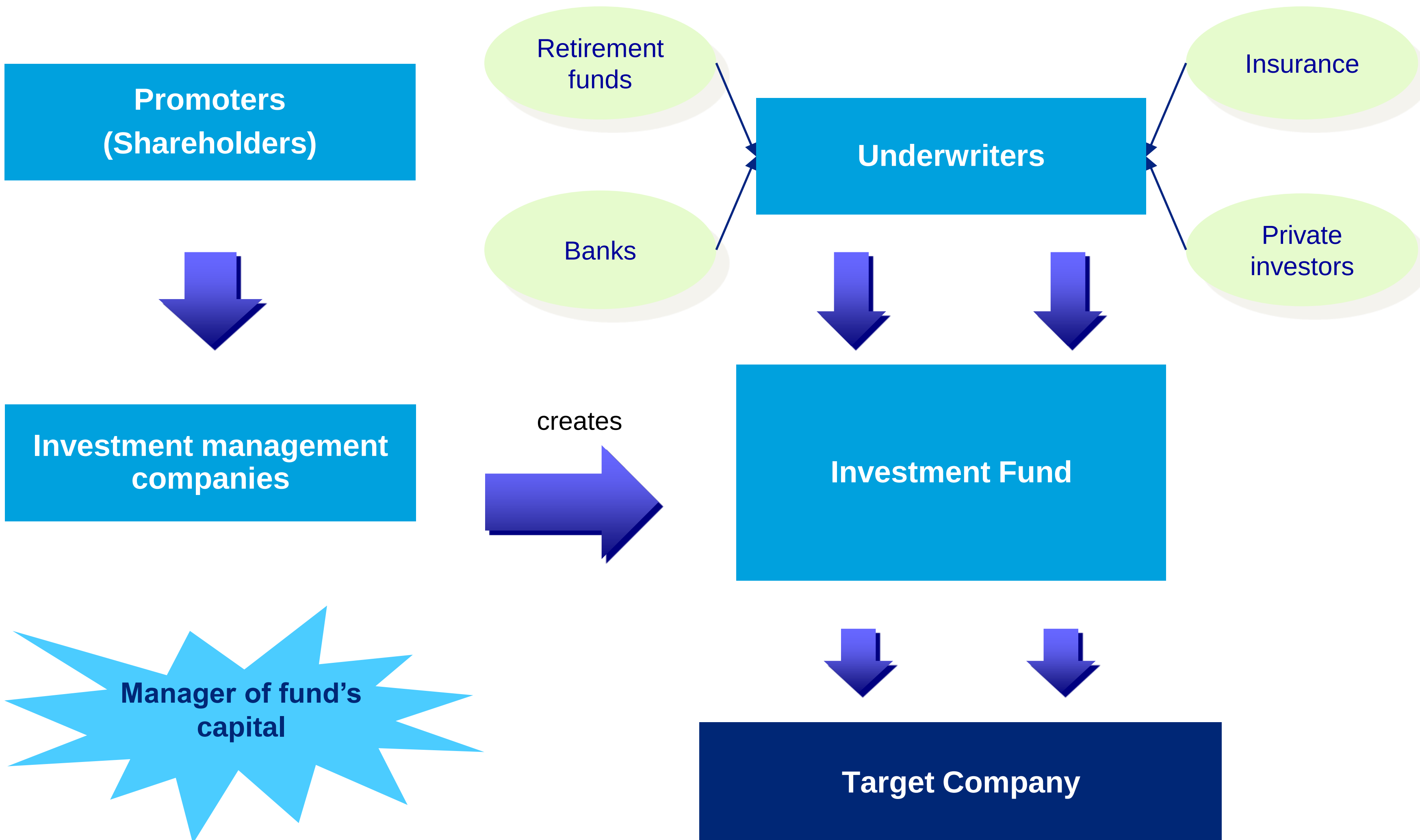
Private Equity investments are realized by different kind of specialized operators and institutional investors

Closed end funds	**Italian and foreign institutional investors, that directly, or through an advisor, raise funds issuing stocks. Raised capital is professionally managed on the basis of specific rules**
Investment Company	**Company which business purpose is exclusively the investment in companies' majority/minority stakes or in financial tools**
Banks	**Italian and foreign banks (brokers) that have special divisions in the corporate structure, exclusively dedicated to the activity of merchant banking**
Public operators	**Public financial players, often characterized by a regional focus and by a purpose of industrial support**
Private operators	**Large industrial groups that support the development of innovative companies**

Why Private equity?

Private Equity investors

Closed end funds funds



Why Private equity?

Private Equity investors

Closed end funds funds

The Investment Management Company is the key element of the fund activity. Its functions are: creating the fund itself, establishing its regulation and managing its portfolio.
Investment Management Company's fees are fund's operative costs (management costs)

Retainer fee

Management fees for recurring operations: they usually amount to 1,5% - 2,5% of the whole underwritten value during investment period (usually first 3-4 years), and of Net Asset Value (NAV) for the following period until deadline.

Performance fee

Carried interest: calculated as a percentage, usually 20%, of the net capital gain realized by fund's underwriters. It's usually paid out only for the sum exceeding a minimum prefix *return on* recognized to underwriters (*hurdle rate*), that usually varies between 5% and 8% annual compound rate.

Why Private equity?

Private Equity investors

Investment companies

Investors

Stake acquisition

Management team

Investment company

Majority/minority stakes acquisition

Target company

Thanks to their legal form, the investment companies supported the process of cash raising and introduced the concept of medium-long term investment in companies

Why Private equity?

Private Equity investors

Closed end funds vs Investment companies		
Key aspects	**Closed end funds**	**Investment Company**
Fund raising	Through an advisor or directly from the Investment Management Company. The stocks have to achieve a minimum amount by a certain term to permit the fund constitution.	Shares or financial tools (necessary to take part) are raised through the acquisition on the market or through Public Offers.
Management	IMC's Board of Directors, that first of all realizes the investment process and than manages the target companies.	the Investment Company through its own management team decides the investments/divestments in the target companies.
Remuneration	*"Return on"* determined through performance indicators as IRR (Internal Rate of Return) and the Cash Multiple (investment value/invested capital).	*"Return on"* determined through performance indicators as IRR (Internal Rate of Return).
Deadline	The fund has a fixed deadline, after whom the stakes are paid off.	There isn't usually a deadline. Investors can exit selling their stakes on capital market.
Fee	Fees due to fund's manager: -Retainer fee (management fee) -Performance fee (carried interest).	There are no fees, in relation to the fact that the manager is the Investment Company itself.
Listing	In the MTF segment (Mercato Telematico dei Fondi) dedicated to negotiation of closed listed funds (Class 2) and to Investment Companies (Class 3).	

Private Equity Regulatory Framework

There are no particular regulatory items related to companies' access to Private Equity

Private Equity, indeed, is only «upstream» regulated, in terms of **regulation of operator's activity**

Funds → Investment Management Companies

- ✓ **Italian regulation: Testo Unico della Finanza (D.Lgs. 24 febbraio 1998 n.58)**
- ✓ **Standards for implementation issued by:**
  - Ministry of Tresury, of Finance and Economic Development
  - Bank of Italy
  - Consob

Banks, financial companies and public operators

- ✓ **Specific rules related to player's sector**

Fund raising process

Phases
1. Individuation of target market
2. Formulation of investment strategies
3. Definition of the target amount for the fund raising
4. Marketing strategies
5. Placement and underwriting
6. Follow-up

Key elements

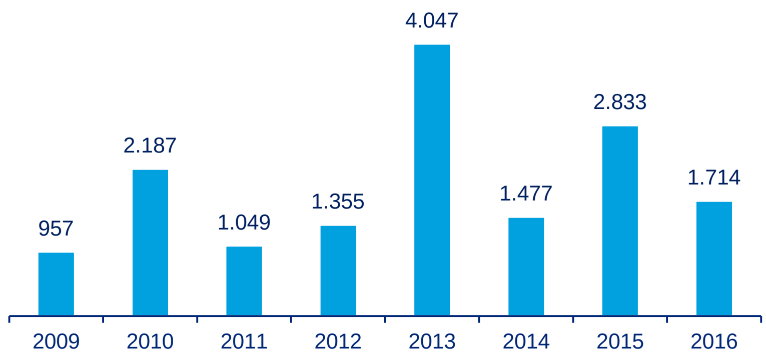
- **Times:**
  - *Pre-marketing* phase: fund conception, market tests, official announce of fund's start
  - Fund raising phase: presentation document, stakes underwriting
  - Fund raising medium term for a new fund: 6 -18 months
- **Costs:**
  - Direct costs: placing agents, marketing costs, legal costs, out of pocket expenses
  - Indirect costs: time employed by management team
- **Due diligence:**
  - Track record analysis investor that raises capital
  - Management team: experiences, organization and *fees*
  - Terms and conditions of fund operation

As a result: **Investor** → produces → **Annual and Infra-annual Report** → addressed to → **Financiers**

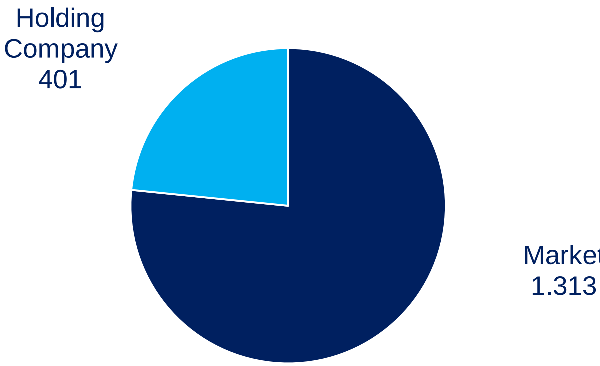
Why Private equity?

Fund raising process

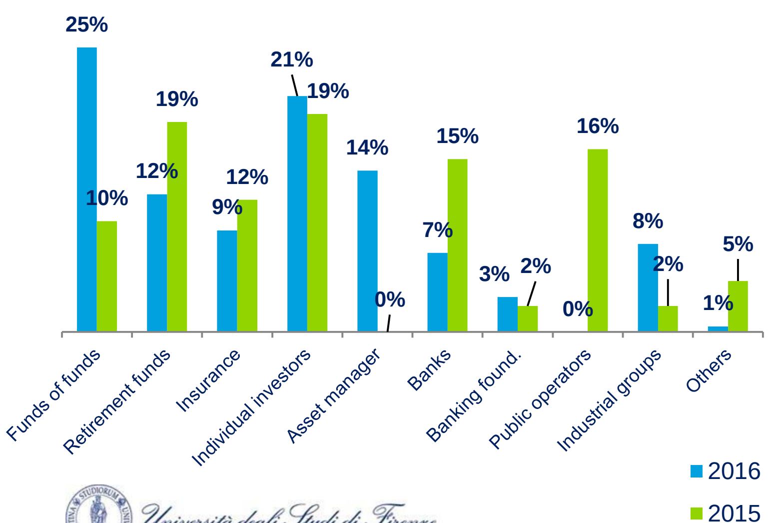
Evolution of fund raised by Italian PE (€mn)



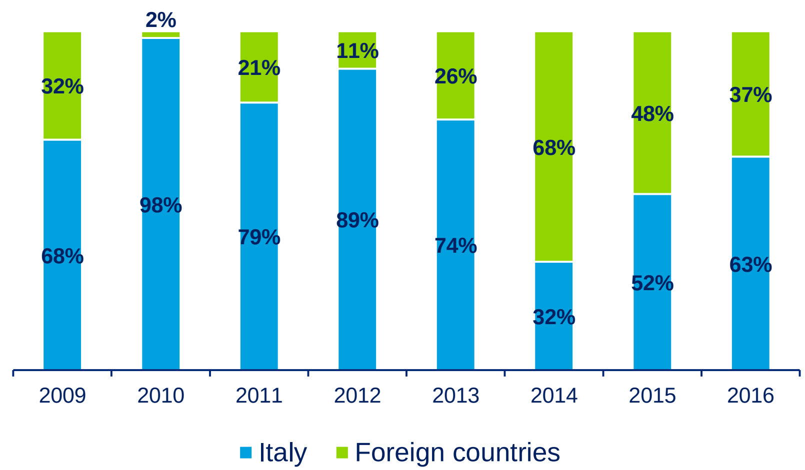
Source of raised capital in 2016 (tot. 1.714 €mn)



Raised capital breakdown by operator (€mn)



Capital raised operators geographical breakdown (€mn)



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Source: AIFI

Why Private equity?

Investors strategies

Funds' strategies related to the use of investments can be classified on two opposite approaches, in part conditioned by the nature of investors:

Diversification strategy

✓ Typical of large sized funds that have significant financial sources:
- to invest in a relevant number of initiatives
- to diversify the risk in different industries and markets

Specialized strategy

✓ Typical of small/medium sized funds
✓ Funds operating in markets where Private Equity is in a maturity phase
✓ Funds with team focused on specific capabilities

Institutional investors can specialize on the basis of the following factors:

- **Geographical area**
- **Target life cycle stage**
- **Specific industry**
- **Target dimension**

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Investors strategies

Geographical specialization

Specialization on a specific geographical area can be defined as follow

International

Internationalization strategy is typical of foreign large sized funds that operate on different geographical areas and markets establishing collaborations with foreign operators.

National

In Italy the Private Equity sector is not yet in a maturity phase, so funds strategy is usually focused on a national level.

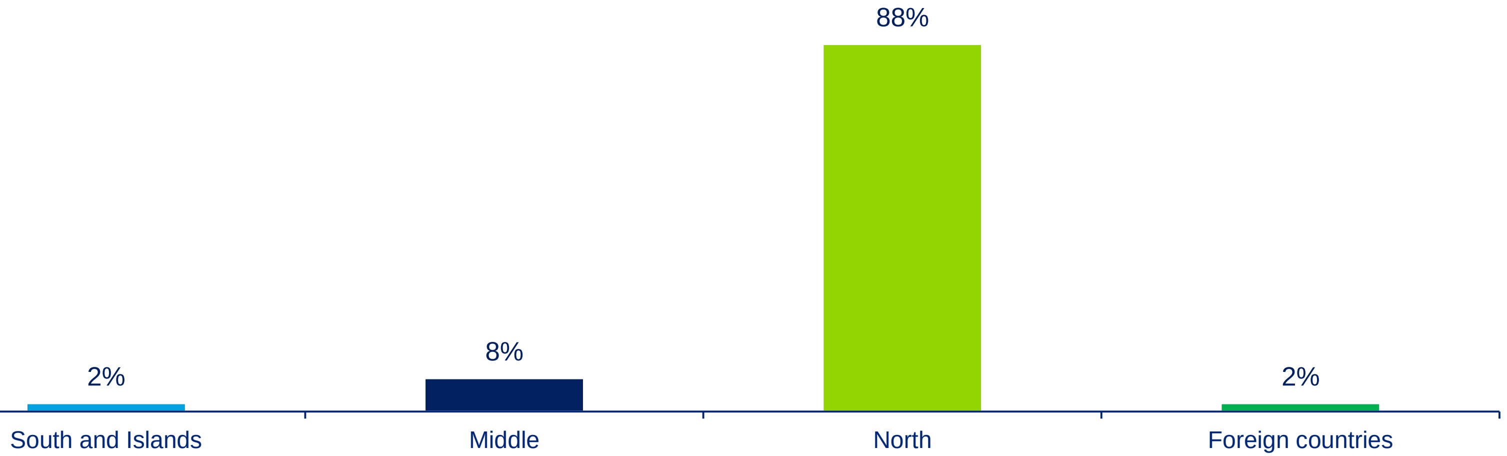
Regional

Many Italian investors focus on a specific local area and usually in specific industrial districts. It helps even in raising “local funds” thanks to local banks, regional financiers and local entrepreneurs.

Why Private equity?

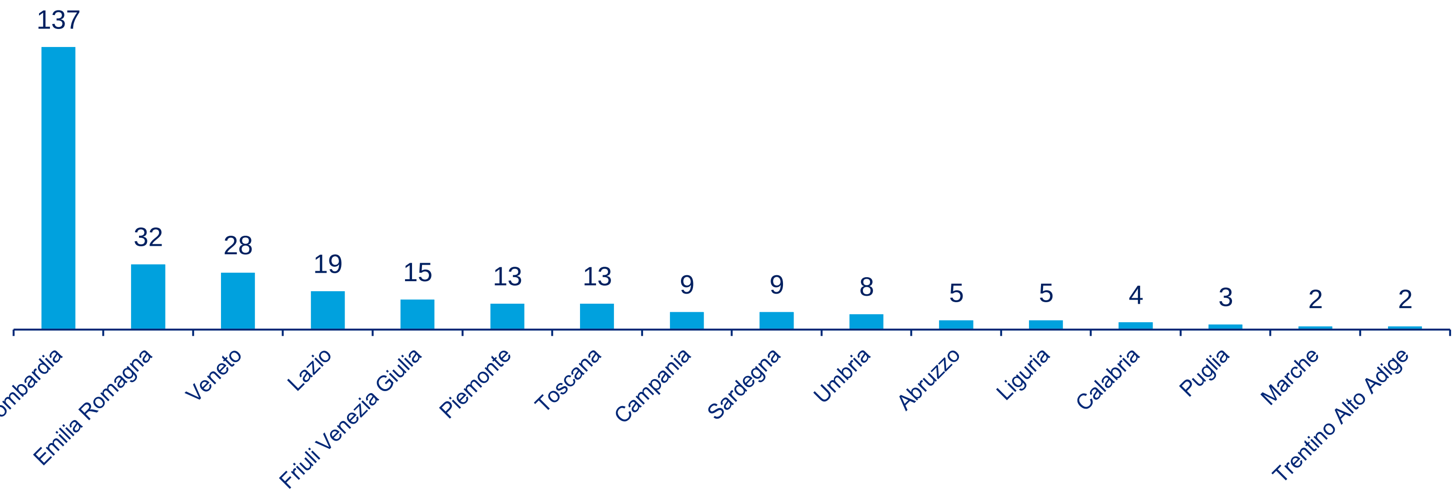
Investors strategies

Invested Amount, breakdown by geographical area (2016)



Number of investment, breakdown by region (2016)

304
#deals in Italy (*)



Nota: (*) 304 deals in Italy in 2016. (95% of number of total deals and 98% of total amount invested)

Source: AIFI

Why Private equity?
Investors strategies

Industry specialization

If the focus is on a specific industry where the PE fund has specific competencies a company can identify the following advantages

Competencies

An «industry focused» strategy supposes very high technical skills of the management team, that usually comes from experiences in the specific industry.

Value Added

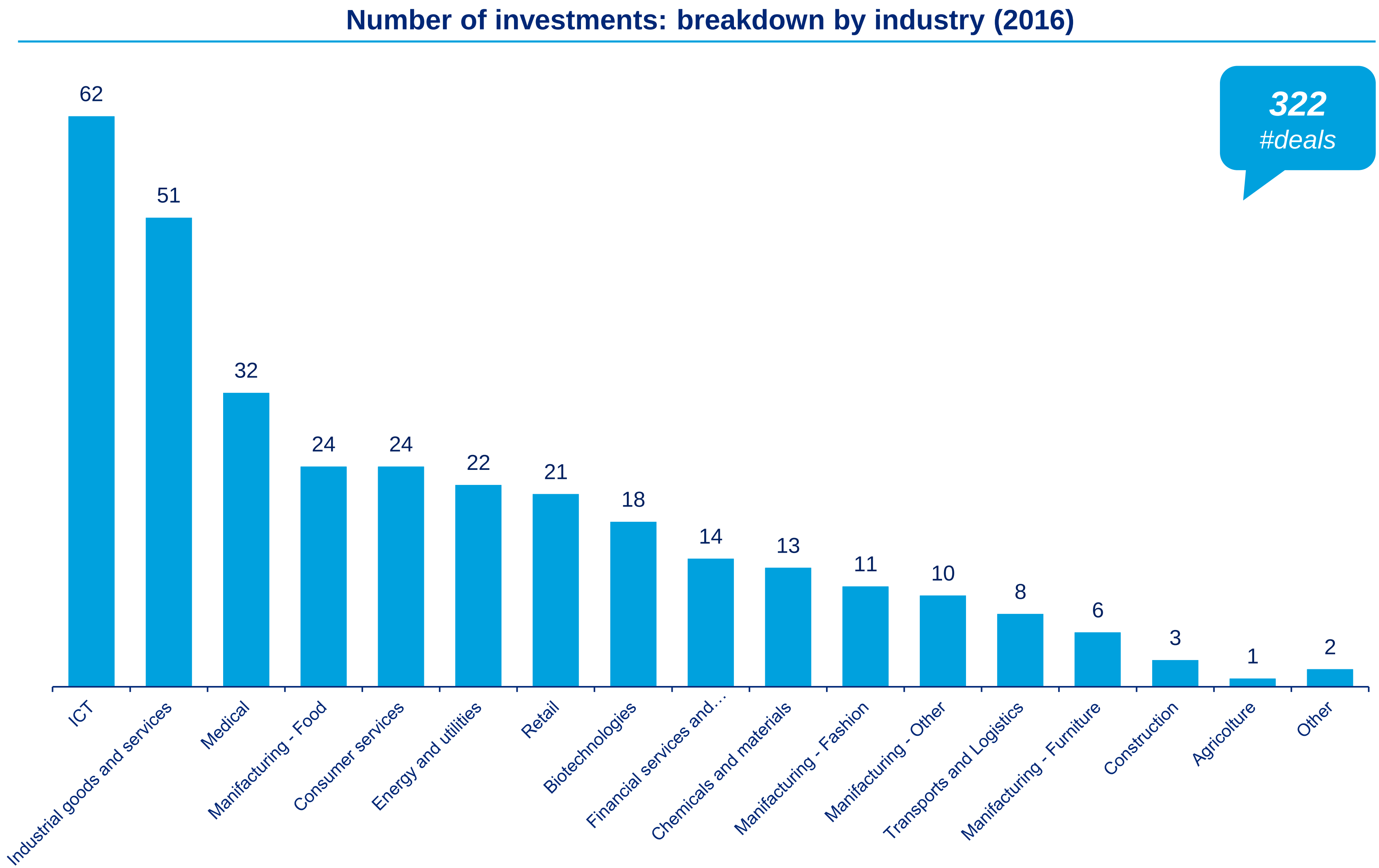
The competencies and high knowledge of the business (competitive system, product, etc..) represent a very important *value added* for subsidiary companies

Synergies

Operative synergies can take place between companies of the same fund, like so partnership agreements, strategic alliances ("industrial poles")

Why Private equity?

Investors strategies



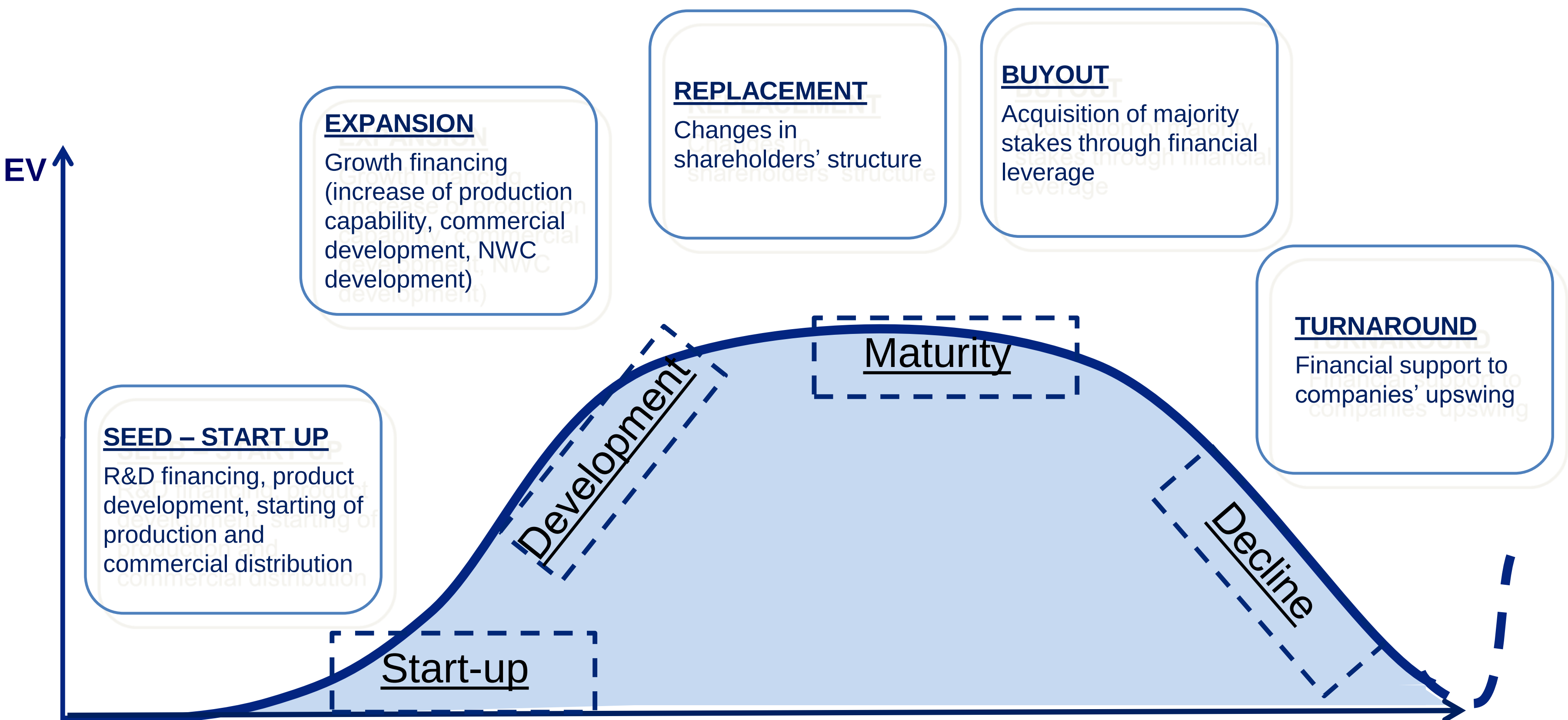
Source: AIFI

Why Private equity?

Investors strategies

Target life cycle stage

In relation to Company’s life cycle phase there are typical extraordinary transactions



Why Private equity?

Investors strategies

Target life cycle stage

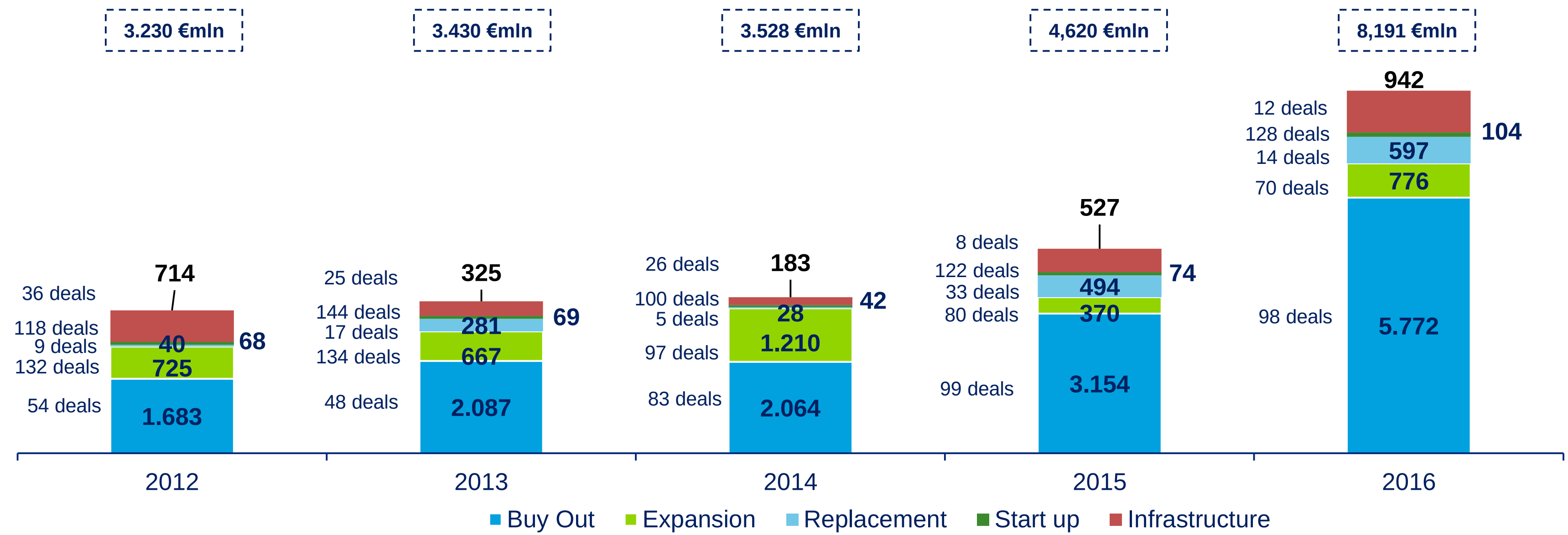
If the focus is on a specific life cycle stage the activities conducted by a PE fund can be different, such as:

Start-up	**Financing a new product/service** High risk; need of giving relevance at the project
Expansion	**Financing companies in a growth phase** Less risks; high complexity (many shareholders)
Replacement	**Restructuring company's ownership** Less risks; possible action for change in generation
Buy out	**Changes in company' structure** Less risks; possibility to use "leverage"
Turnaround	**Restructuring companies in a financial crisis** High risks; need of relationships with banking system

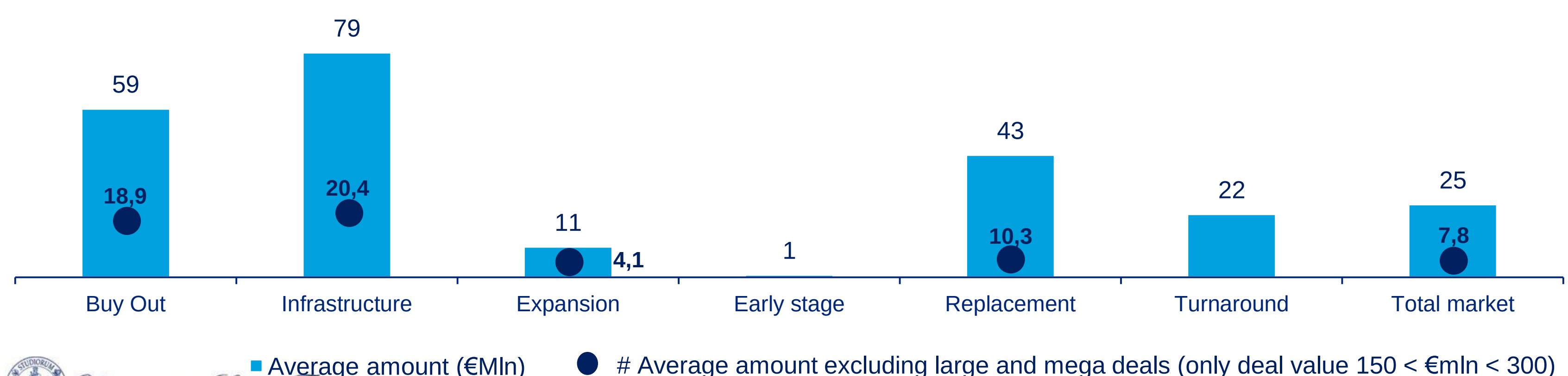
Why Private equity?

Investors strategies

Investment distribution trend (2012 – 2016) breakdown by life cycle stage



Average invested amount - breakdown by life cycle stage (2016)



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Source: AIFI

Why Private equity?

Investors strategies

Target dimension

Specializations related to dimension can be related to:

Investment dimensions

PE funds often establish minimum and maximum limits to investment in relation to fund's dimensions and structure (availability of human resources and financial resources)

Pool of funds

Funds often join together to co-invest in a specific project, to compensate funds' limited dimensions or anyway to share the risk and put experiences in common.

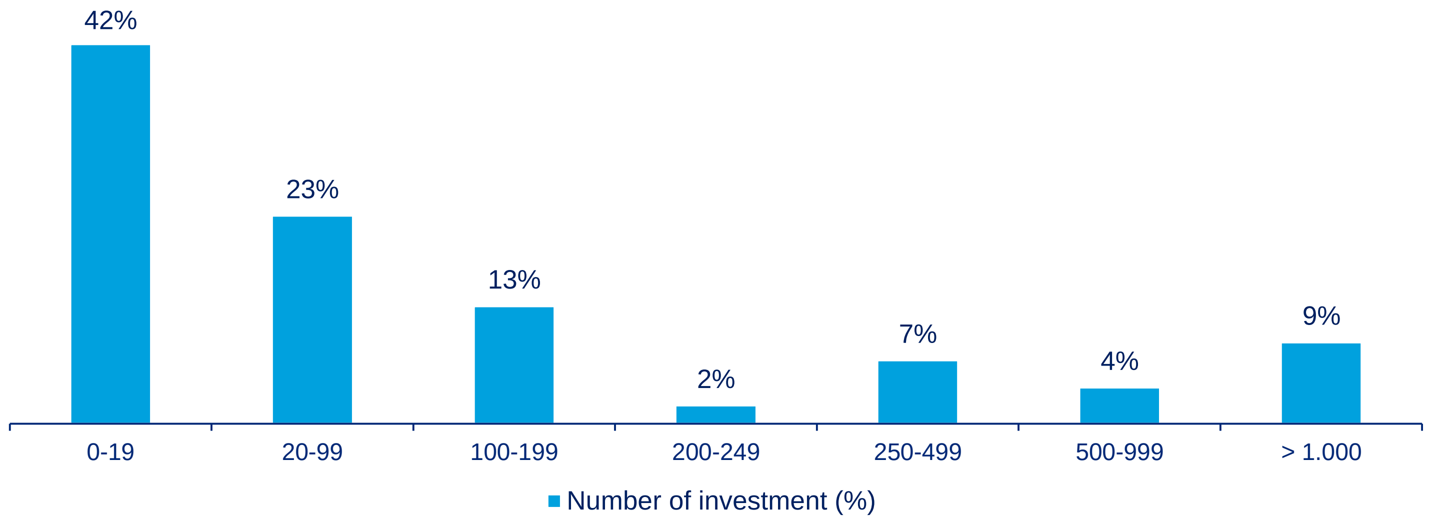
Target dimensions

It's frequent that dimension limits of target companies are defined in relation to fund's kind and aims

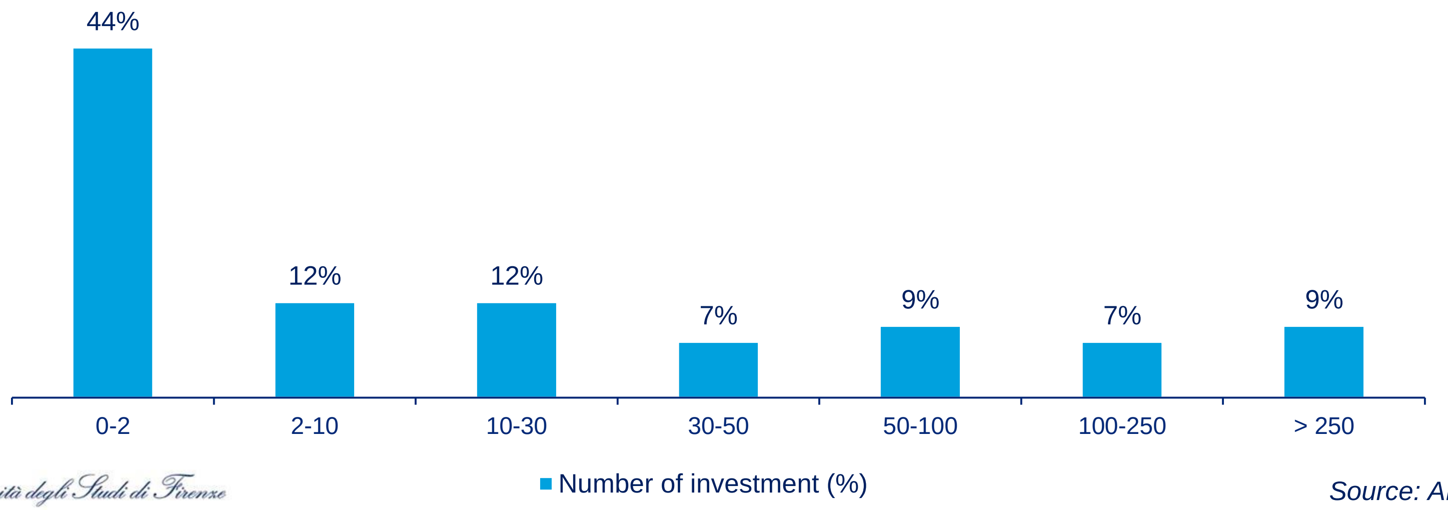
Why Private equity?

Investors strategies

Investment distribution by number of employees of target companies (2016)



Investment distribution by target companies turnover €mn (2016)



Source: AIFI

Benefits and limits of Private Equity

Benefits

- ☑ **Financial sources:**
  - Alternative to credit institution
- ☑ **Financial leverage**
- ☑ **Organization and management evolution:**
  - Reporting
  - Management
- ☑ **Imagine and reputation**
- ☑ **Network of PE contacts**

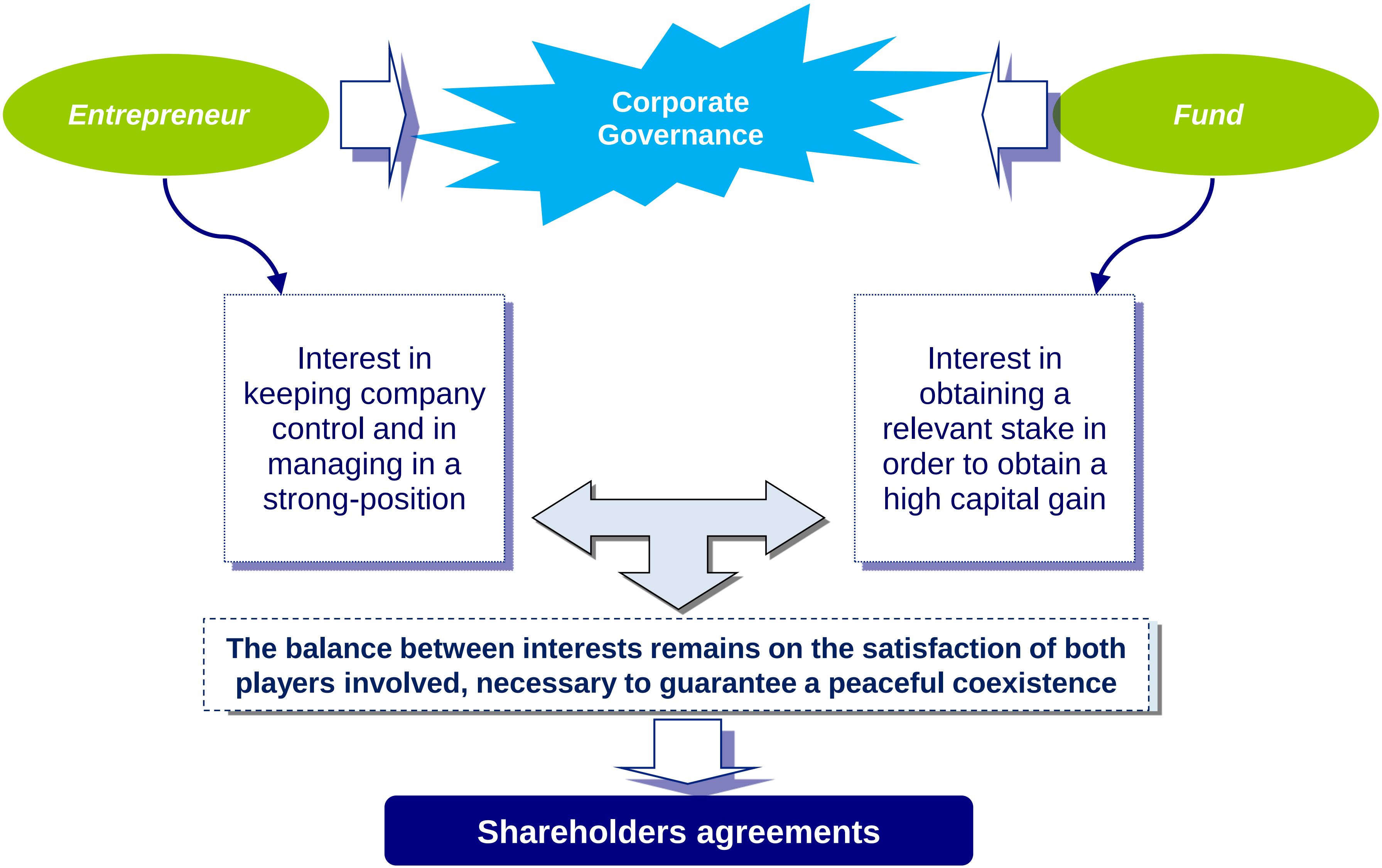
Private Equity

Limits

- ☑ **Exit:**
  - Lock-up
  - Drag and tag along
  - Options
- ☑ **Governance:**
  - "Veto power" on extraordinary activities
  - New governance rules
- ☑ **Monitoring:**
  - Reporting

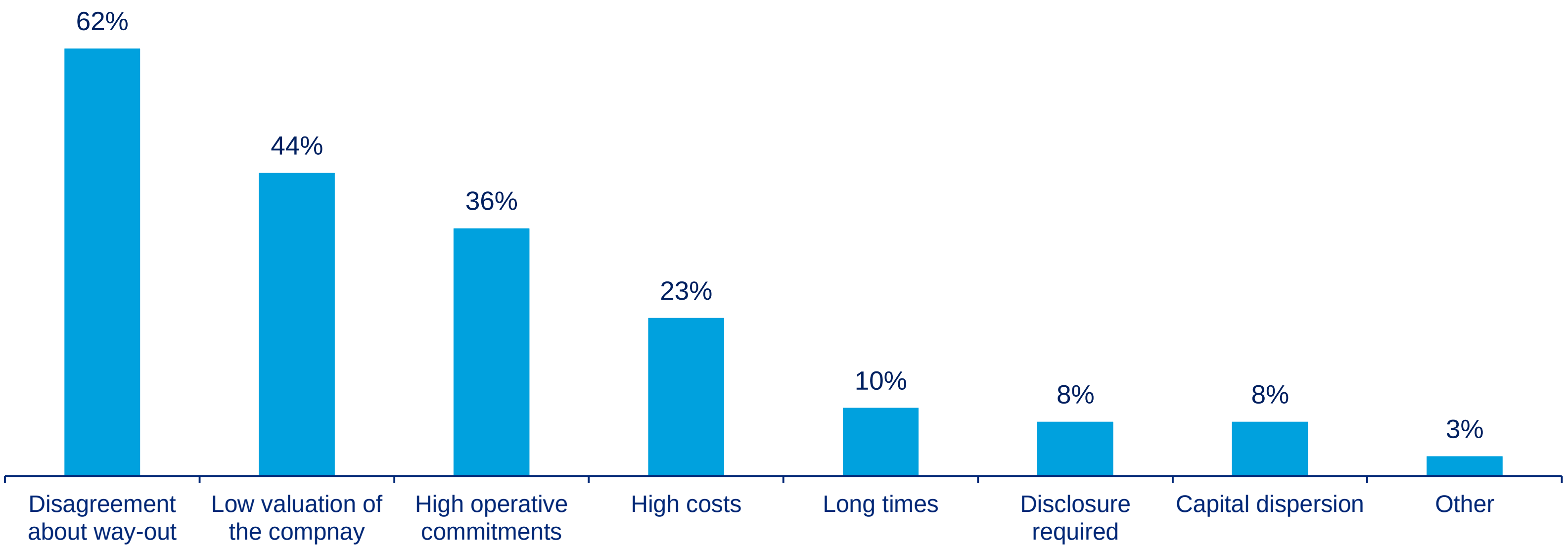
Why Private equity?

Benefits and limits of Private Equity



Benefits and limits of Private Equity

Results of a survey about companies' common fears and worries in relation to the entrance of new shareholders in the ownership structure



Source: AIFI

Lesson 4 Summary

1. Why Private Equity?
2. **Private Equity requirements**
   - **Strategic and organizational requirements**
   - **Requirements related to expected remuneration**
3. The structure of a PE operation
4. Private Equity process

Strategic and organizational requirements

Strategies of investment funds can change substantially from a fund to another in relation to investor's features and underwriters' features

However, there are some fundamental requirements that are ALWAYS required in target company's structure and strategic organization

- **Management**
- **Management**
- **Management**
- **Product**
- **Market**

Strategic and organizational requirements

Management

Management and entrepreneur's quality and capabilities are the key factor in the investment choice of a fund

The project is feasible, and the partnership possible, *if, and only if,* the management has significant qualitative capabilities such as: leadership, industrial vision, creativity, determination and good sense.

An article of ***European Venture Capital Journal*** has described the entrepreneur with the acronym

"A BIG HITTER"

- ✓ **A-Ambitious**
- ✓ **B-Believable**
- ✓ **I-Intelligent**
- ✓ **G-Greedy**
- ✓ **H-Honest**
- ✓ **I-Industry focused**
- ✓ **T-Time**
- ✓ **T-Team builder**
- ✓ **E-Experienced**
- ✓ **R-Risk taker**

Strategic and organizational requirements

Product

The product/service must present some distinctive features that can affect the success of the business

Brand identity

Low possibility to replace

Technological contents

Product analysis is particularly important for investors focused in **early stage financing,** especially if the fund it's focused on high-tech sectors

Sustainable competitive advantage

High margins

Strategic and organizational requirements

Market

The market where the target Company operates with its products/services should be characterized by a high possibility of develop and significant growth rates

Key Areas

- **Market dimension, to quantify the potential market share**
- **Marketing plan, to understand the necessary actions to achieve proposed sales' levels**
- **Market strategy, in particular high importance is given to company's positioning**

✓ **Growth perspectives**

✓ **High margins**

✓ **New sectors (ex Internet in 90's)**

✓ **New technologies**

✓ **Competitive system**

✓ **Entrance barrier**

Requirements related to expected remuneration

Target company has to hold peculiarities and plans consistent with the features of PE investments.
In particular:

Duration	**It's an investment of relevant amount, marketable in a term usually between 3 and 5 years**
Risk	**It's a risky investment because it's related to growth and development perspectives of unlisted companies usually small-medium sized**
Return on	**There are high performance expectations related to the investment (on the basis of EVCA estimates the performance differential compared to the Stock Exchange must be at least 5%)**

Requirements related to expected remuneration

IRR

Investors' remuneration in risk capital is measured by the annual compound interest of investment, since the moment it has been realized to the moment of stock divestiture (IRR)

$$IRR = [\ FV / PV\ ]^{(1/n)} - 1$$

If there is only one cash flow in entrance (*way out*)

$$\sum_{k=1}^{n} [F_k / (1+IRR)^k] = 0$$

If there are more than 2 cash flows (cash in or out)

where:

n = Investment duration (number of years)
PV = Realized investment
FV = Cash in at the moment of divestment
F = Generic cash flow (cash in or cash out)

To foresee the IRR it's necessary to evaluate *n* and *FV*: no financial investor will invest in a company, if there isn't the forecast of a minimum IRR.

Private Equity requirements

Requirements related to expected remuneration

IRR

Debt

- ✓ Maximizing debt recourse (leverage effect)
- ✓ Stability commitments

Operations

- ✓ Increase of operating margins
- ✓ Rationalization of costs structure
- ✓ Increase of turnover
- ✓ Optimization of NWC management

Timing

- ✓ Hastening exit times
- ✓ Reduction of investment timeline

Price

- ✓ “Discounted” acquisition during low phase of the economic cycle or in case of small corporate dimensions compared with the sector
- ✓ Aggregation effect and/or arbitrage on exit multiple

Requirements related to expected remuneration

IRR Example

Base Hp:

EBITDA growth 24%

Entry Multiple = Exit Multiple

D/E = 1,0

Investment duration 5 years

Debt annual reimbursement quota € 70

Final Hp:

EBITDA growth 50%

Exit Multiple = 8,5x

D/E = 1,7

Investment duration 4 years

Debt annual reimbursement quota € 70

Requirements related to expected remuneration

IRR Example

EBITDA +40%	Exit Multiple 8,5 x	D/E 1,7	Duration 4 years

	Base Hp		Operations Hp		Multiple Hp		Debt Hp		Time Hp		Finale Hp	
	Input	Exit	Input	Exit	Input	Exit	Input	Exit	Input	Exit	Input	Exit
EBITDA	100	124	100	150	100	124	100	124	100	124	100	150
Multiple	7,0x	7,0x	7,0x	7,0x	7,0x	8,5x	7,0x	7,0x	7,0x	7,0x	7,0x	8,5x
EV	700	869	700	1.050	700	1.055	700	869	700	869	700	1.275
Debt	350	-	350	-	350	-	440	90	350	70	440	160
Equity	350	869	350	1.050	350	1.055	260	779	350	779	260	1.115

IRR	**26% 5 years**	+6% 5 years	+6% 5 years	+6% 5 years	+6% 4 years	**62% 4 years**

Requirements related to expected remuneration

IRR Example

Operations Hp

	Base Hp			Operations Hp
	Input	Exit		Exit
EBITDA	100	124	EBITDA +40% →	150
Multiple	7,0x	7,0x		7,0x
EV	700	869		1.050
Debt	350	-		-
Equity	350	869		1.050

IRR	26% 5 years	→	+6% 5 years

Requirements related to expected remuneration

IRR Example

Multiple Hp

	Base Hp		Multiple Hp
	Input	**Exit**	**Exit**
EBITDA	100	124	124
Multiple	7,0x	7,0x	8,5x
EV	700	869	1.055
Debt	350	-	-
Equity	350	869	1.055

Exit Multiple
8,5 x

IRR	**26%** **5 years**	**+6%** **5 years**

Requirements related to expected remuneration

IRR Example

Debt Hp

	Base Hp		D/E 1,7 →	Debt Hp
	Input	Exit		Exit
EBITDA	100	124		124
Multiple	7,0x	7,0x		7,0x
EV	700	869		869
Debt	350	-		90
Equity	350	869		779

IRR	26% 5 years	→	+6% 5 years

Requirements related to expected remuneration

IRR Example

Time Hp

	Base Hp	
	Input	**Exit**
EBITDA	100	124
Multiple	7,0x	7,0x
EV	700	869
Debt	350	-
Equity	350	869

Time Hp
Exit
124
7,0x
869
70
779

IRR

26%
5 years

→

+6%
4 years

Requirements related to expected remuneration

IRR Example

Final Hp

	Base Hp		Finale Hp	
	Input	Exit	Input	Exit
EBITDA	100	124	100	150
Multiple	7,0x	7,0x	7,0x	8,5x
EV	700	869	700	1.275
Debt	350	-	440	160
Equity	350	869	260	1.115

EBITDA +40%

Exit Multiple 8,5 x

D/E 1,7

IRR	26% 5 years	+62% 4 years

Private Equity requirements

Requirements related to expected remuneration

Expected returns on investments depend on the risk that the investor is willing to hold

Higher is the hold risk higher is the expected return

Risk

Start-up	≥ 50%
Turnaround	≥ 30% - 40%
Expansion	≥ 25%
Replacement	≥ 25%
Buy out	≥ 25%

Return

Lesson 4 Summary

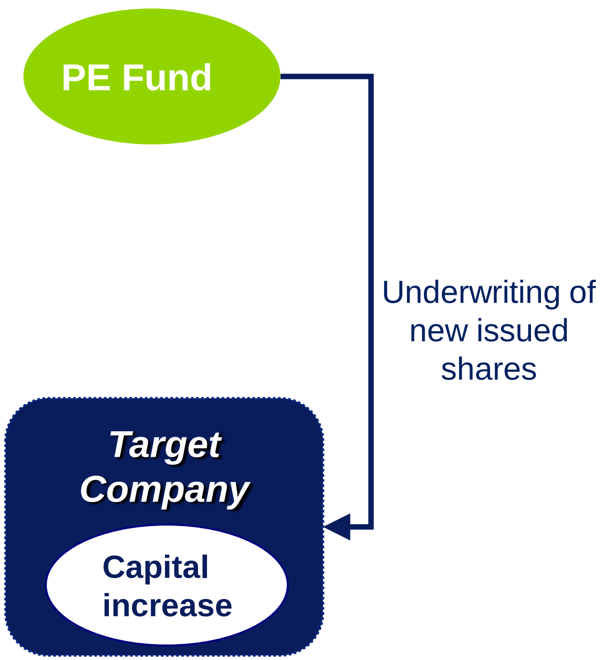
1. Why Private Equity?
2. Private Equity Requirements
3. **The structure of a PE operation**
   - **Corporate structure**
   - **Debt structure**
4. Private Equity process

The structure of a PE operation

Corporate structure

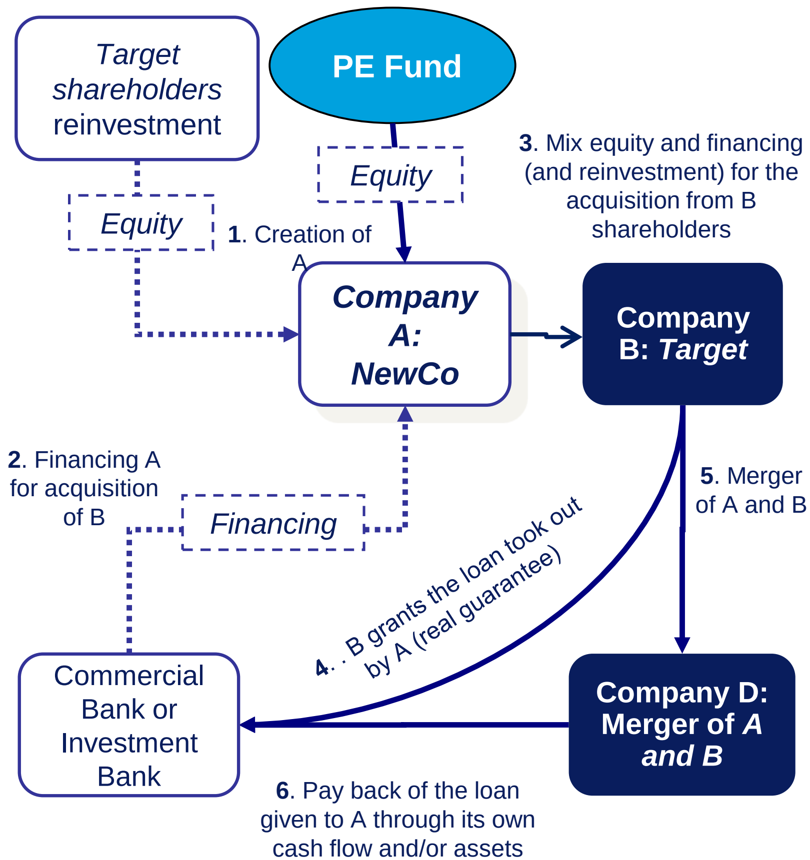
Expansion capital vs Buyout

EXPANSION CAPITAL



- ✓ Capital increases take place in particular in Venture Capital operations, when the Company is in the Start-up phase (early stage), and in the Development phase (expansion stage).

BUYOUT



Corporate structure

Expansion capital vs Buyout

EXPANSION CAPITAL	BUYOUT
Aim: financial sources to support company growth Resources for the company	Aim: changes in shareholders' structure (eg. change in generation). Marketability for shareholders
Growth as a driver of value creation	Financial leverage as a driver of value creation
Usually minority stake	Usually majority stake
Deal value on average lower (2016 average deal value = 10,6 €mn).	Deal value on average higher (2016 average deal value = 58,9 €mn).

The structure of a PE operation
Corporate structure

Expansion Capital

Requirements for capital expansion are:

S.p.A

- ✓ Approval of the extraordinary shareholders meeting with a qualified quorum (more than half capital)
- ✓ Company interest
- ✓ Price per share determined on the basis of equity value, considering (just for listed companies) share's trend in the last semester

S.r.l

- ✓ Specific indication in the certificate of incorporation of the possibility to expand capital through the offering of new issued shares to third parties
- ✓ Approval of the shareholders meeting with a qualified quorum (at least half capital) except for a different instruction in the certificate of incorporation
- ✓ Right of withdrawal for dissenting shareholders

Corporate structure

Buy out

Civil aspects of Leverage Buy Out after Reform in 2003 (D. Lgs 6-2003)

LBO

✓ Maintenance of articles **2357, 2357-quater and 2358** of Italian Civil Code

✓ Introduction of **new art. 2501 bis C.C → Merger in case of Leverage Buy Out**:

In case of merger if one of the companies involved took out a debt to acquire control over the other one, when after the merger the capital of this last one represents a generic guarantee or source of reimbursement for those debts, the following discipline is applied (comma 1):

Disclosure commitments:

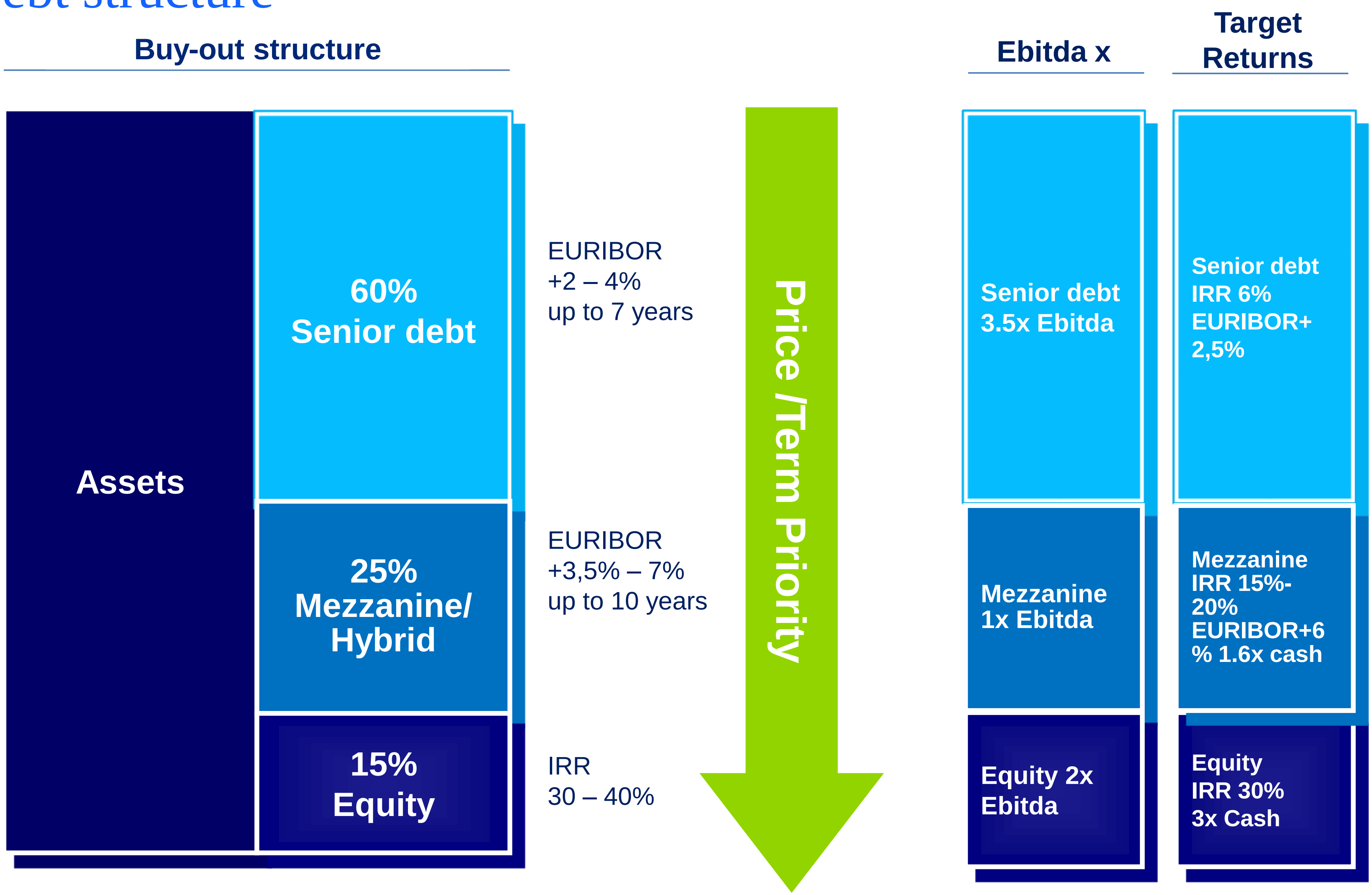
- Stating in the merger projects the financial sources necessary for fulfilling the debt of the post-merger company
- Explaining the financial and economic reasons of the operation in a specific report
- Disposing an economic and financial plan that underlines financial sources and objectives pursued with the operation

Certificate commitments:

- Adequacy relation
- Audit company (if one of the involved companies is subjected to mandatory audit)

The structure of a PE operation

Debt structure

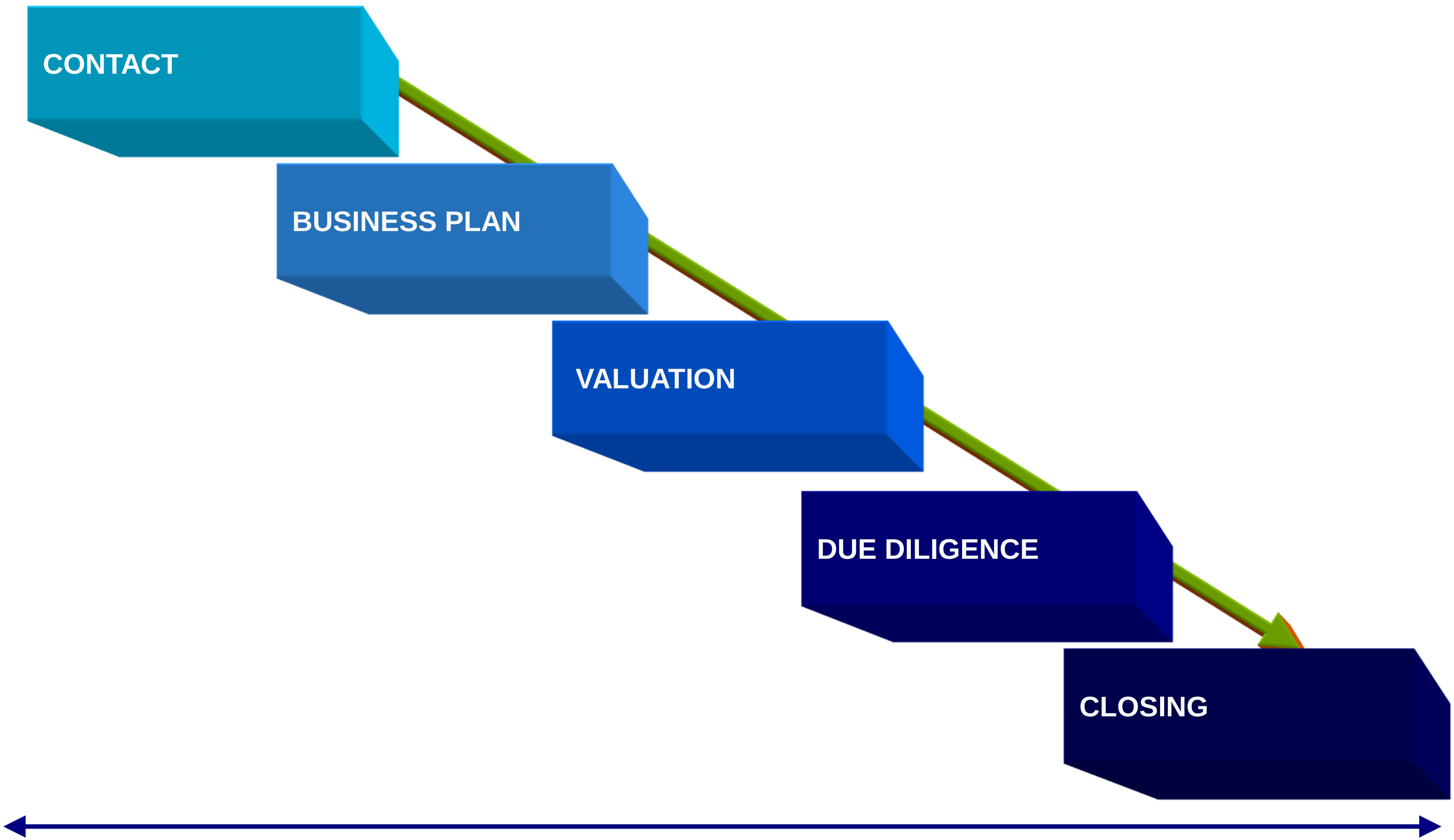


Lesson 4 Summary

1. Why Private Equity?
2. Private Equity requirements
3. The structure of a PE operation
4. **Private Equity process**
   - Steps
   - Contact
   - Business Plan
   - Valuation
   - Due Diligence
   - Closing

Private Equity process

Steps



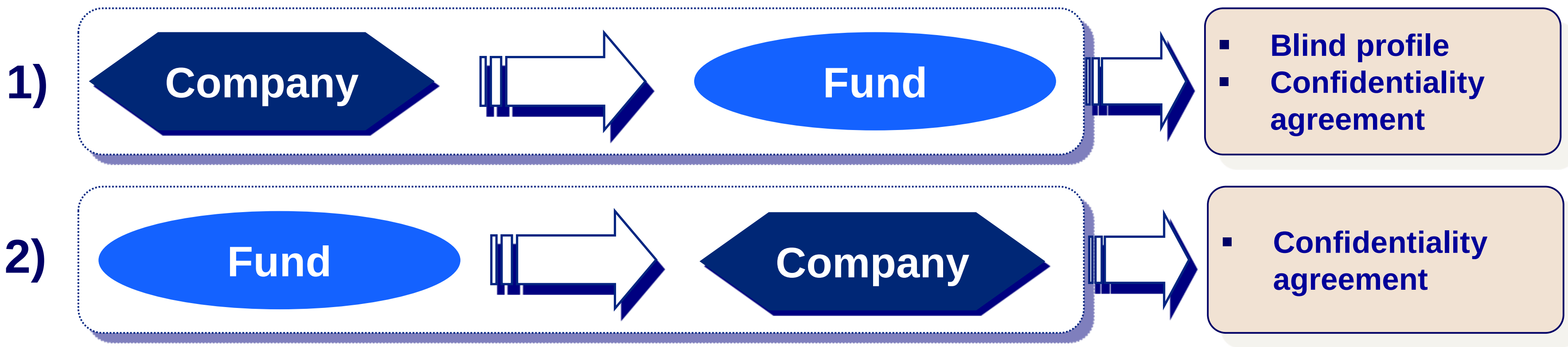
4-6 months *

*Possible changes in relation to specificities of the operation

Private Equity process

Contact

Two contact possibilities between a company and a fund



Blind profile

A blind profile is a short description (1-2 pages) of company and project and it is aimed at starting a first contact with potential investors to test the interest in the operation.

Confidentiality agreement

The confidentiality agreement is a legal contract through which the fund undertakes the commitment to keep confidentiality on the information that the company of course reveals during the transaction

Private Equity process

Business Plan

Components of Strategic Plan

"Yesterday – Today" → "Tomorrow" →

Strategy pursued → Strategic aims → Action plan → Assumptions → Forecast financial data

Strategy pursued

Description of:
- Operative strategic layout
- Performance realized in each SBA
- Need/opportunity for strategic renewal

Strategic aims

Management choices related to:
- Role in competitive area
- Value proposition
- Creation of competitive advantage

Market Analysis
Competitive Scenario
Business analysis

Action plan

Actions which reduce the gap between strategy pursued and strategic aims; in particular:
- Economic/financial impact and timetable
- Investments to be made
- Organizational impact of the individual action
- Intervention on products/services/ brand portfolio
- Actions which change the customer target
- Responsible managers
- Conditions and restrictions regarding realizable nature

Assumptions

Relative to key value drivers and forecast data, with reference to:
- Macroeconomic magnitudes
- Development of revenues
- Direct costs
- Indirect cost, financial charges and taxation
- Evolution of capital employed
- Evolution of financial structure

Forecast financial data

Consistent with the strategic aims and the Action Plan and referring to:
- SBUs
- Distribution channels
- Geographic areas
- Customer type
- Products/services/brands

Private Equity process

Valuation

Company valuation is one of the main issue during a negotiation between parties

Valuation methods

- Cash Flow methods
- Market Multiple
- Asset based methods
- Combined methods

In consideration of unavoidable discretion margins that attend every valuation method, estimated values can be different, even only for the different point of view of the counterparts

«financial» for the investor

even **«affective»** for entrepreneur

For all these reasons the valuation usually represents the starting point of a negotiating process between the counterparts

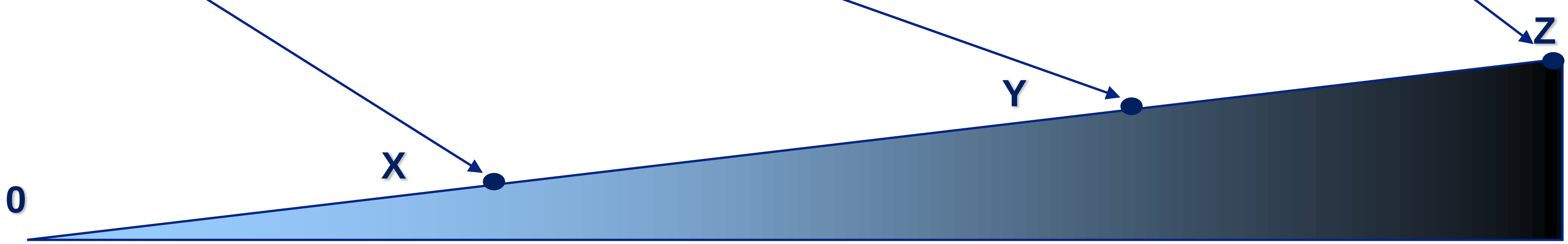
Valuation: implications in PE

Investors entrance price, result of different variables is quantified on the basis of pre-money value

Investors exit price, result of different variables (and objective in case of exit through an IPO) is determined on the basis of company's value at the exit period

Investor IRR (realized or not)

Pre-money value + Equity Increase by investor = Post-money value + Value generated by investor's capital = Company's value at the moment of investor's exit



Valuation: implications in PE

Cost Multiple (CM) → **Implicit multiple of investment paid by investor → immediate evidence of created (destroyed) value**

Company value pre-money (T_0)	**Value creation drivers**	**Company value at way-out (T_n)**
Price paid (T_0)		Price paid (T_0)
+ **NFP (T_0)**	Progressive refund of debt/improvement of NFP	+ **NFP (T_n)**
Enterprise Value (T_0)		Enterprise Value (T_n)
÷ **EBITDA (T_0)(*)**	Margins growth (in absolute/percent terms)	÷ **EBITDA (T_n)(*)**
Cost Multiple (CM) (T_0)		**Cost Multiple (CM) (T_n)**

If CM ↘ : value creation(**)

If CM ↗ : value destruction (**)

(*) Or another economic-financial indicator

(**) Hp of stable entrance-exit multiple

Valuation: implications in PE

In a PE deal margins for price determination are much higher than those applied in shares settlement on equity market through an IPO

A lot of negotiation possibilities

For example, the following tools can be used:

- ✓ **Convertible bonds;**
- ✓ ***Earn-out*: subsequent price integration related to the achievement of specific goals (revenues in a determined SBU, Ebit, incomes after tax, etc.);**
- ✓ **Price can be commensurated with achieved results;**
- ✓ **Other possibilities, individuated in every circumstance in relation to the specific needs of counterparts.**

Due Diligence

Due Diligence is a deep analysis of the target Company that the investor realizes directly or through the help of external advisors after the achievement of an agreement about the investment.

Aim

Verifying the presence of elements that don't allow to realize the investment or (more likely) that require reviews and revisions of one or more contractual conditions (price, guarantees, etc.)

"Light" Due diligence

It's the first phase of due diligence process. The investor directly collects information about the target company, through site visits, meetings with entrepreneur, management and experts

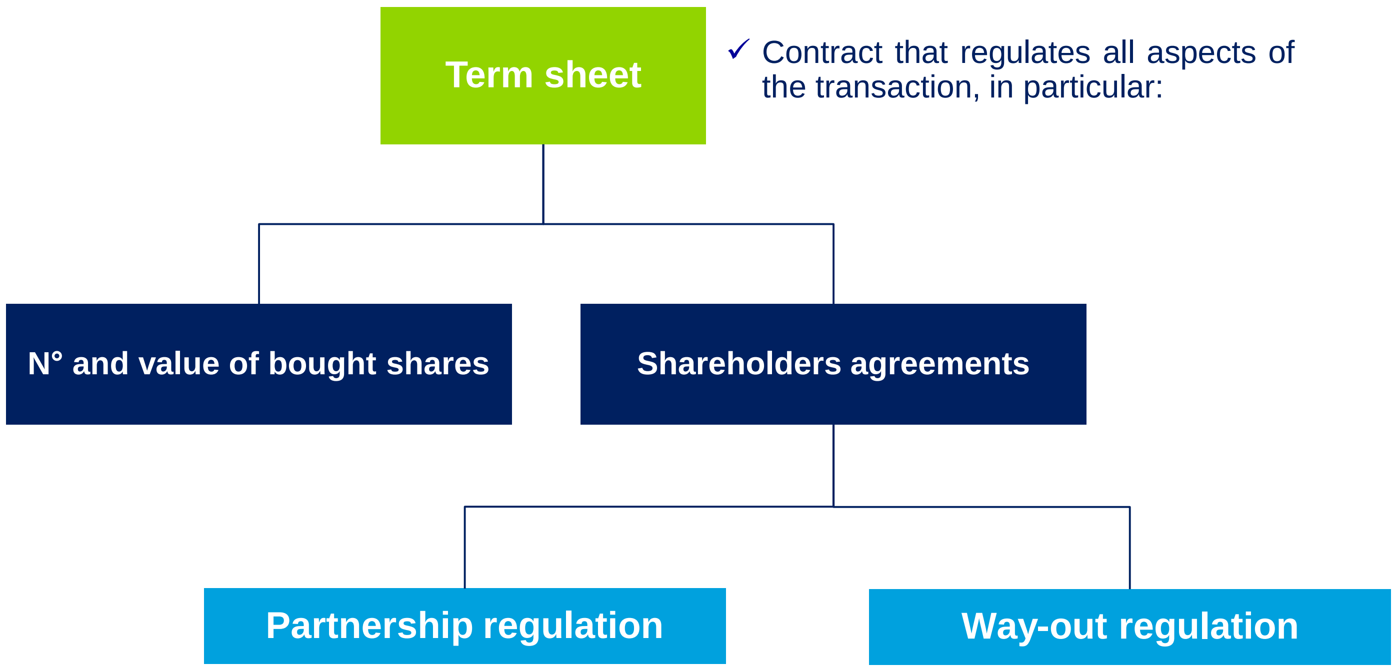
"Heavy" Due diligence

It's a subsequent phase, conducted by external advisors, which realize careful inspections on behalf of the investor, testing different aspects of the target Company

Private Equity process

Closing

Last phase of PE process, before closing the operation, is the draft of the Term Sheet



✓ Contract that regulates all aspects of the transaction, in particular:

Closing

Partnership regulation (1/2)

There are different aspects related to relationships between the Company and the investor that must be regulated

- Milestones to achieve
- Non competition agreements
- Information commitment (reporting, etc.)
- Incentives
- Veto rights on particular decisions
- Anti-dilution formulas (in case of second and third round of financing)

Closing

Partnership regulation (2/2)

Main tools of partnership regulation are

Safeguard covenants

Drag along Agreements

Provision aimed at protecting the investor in case of minority stakes: it concerns the right to obligate others (minorities) to sell their shares in order to optimize investor's way-out.

Tag along Agreements

Provision aimed at protecting minorities: it concerns minority shareholder's right to sell its shares under the same conditions achieved by the majority shareholder in case of sell of its stock at way-out moment.

Private Equity process

Closing

Way-out regulation

The last step of the process is the divestment phase, that usually occurs in a period of 5-7 years after the deal.

Divestment process is a really delicate and complex phase, indeed it must satisfy ***two conditions*** *for the investor:*

- *It must provide* ***cash for new investments***
- *It must realize such* ***capital gain*** *to generate high returns that satisfy the expectations*

Deal success

Planned in the closing phase

- ***IPO***
- ***Trade sale***
- ***Secondary buy out***
- ***Buy back***

Deal failure

- ***Write off***

Private Equity process
Closing

Way-out regulation

Deal Success

IPO	Listing of target Company in a regulated market (IPO) is the most desired way-out procedure for the possibility to easily divest at a high value minority stakes
Trade sale	The divestiture through a private sale to an industrial investor is the most common way-out. It supposes an active strategy of the fund that, directly or through an advisor, continually controls the market in which the Company operates to find interesting M&A opportunities
Secondary buyout	The divestiture through a private sale to another financial investor is less common than trade sale, because of the higher difficulty in finding interested investors and the lower valuation of owned stakes
Buy back	The entrepreneur's buy back (put or call) is the common way out procedure followed by passive funds, often related to not satisfying company's performances.

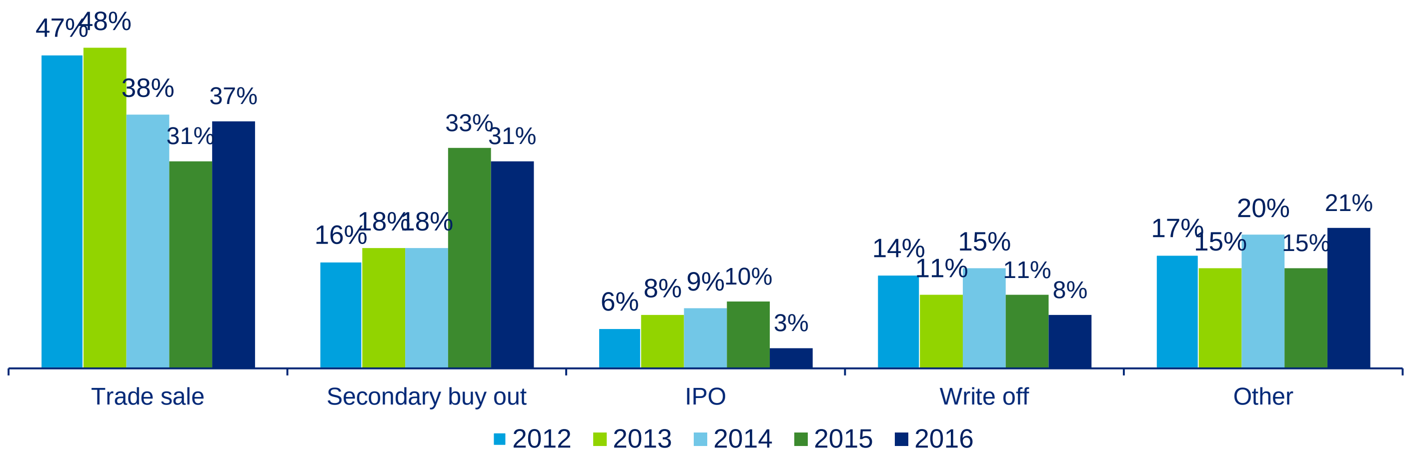
Deal Failure

Write-off	If the operation fails, the way-out is the accounting of the null value of the stake. It could be that the investment doesn't achieve expected performance levels without automatically being a failure. In this case it's important to promptly identify the crisis factors and try to sell the stake to someone able to revamp the investment

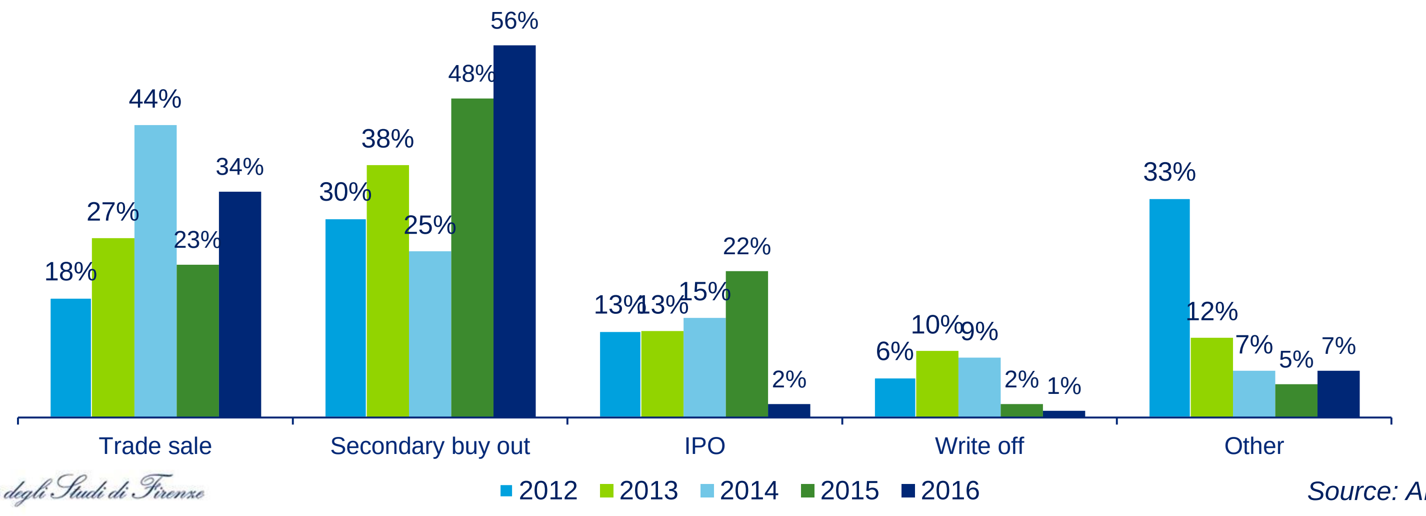
Private Equity process

Closing

Evolution of way-out procedures by number



Evolution of way-out procedures by amount divested (€mn)



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Source: AIFI