

PRIVATE EQUITY FOR DISTRESSED COMPANIES IN ITALY¹

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Summary: 1. Introduction. – 2. The Size of the Italian Market. – 3. An Empirical Analysis. – 3.1 The degree of participation. – 3.2 The impact of the new bankruptcy law. – 3.3 Turnaround: opinions about the market. – 3.4 Operative modalities – 4. Conclusions. – References

ABSTRACT

For several reasons, vulture funds have never been popular. While economic literature about venture capital is very articulated, this is not the case with vulture funds. Even in recent years, only a few academic papers have appeared (Hotchkiss & Mooradian, 1997; Rosenberg, 2000; Gilson 2001; Feder & Lagrange, 2002; Altman 2004; Altman & Hotchkiss, 2006; Kutcher & Meitner, 2006 about the German market; Krasoff & O' Neill, 2006).

In mature markets, especially Anglo-Saxon ones, high segmentation and specialization are normal. For every phase in the life cycle of companies there is a correspondent set of specific investors. Whether in decline or in crisis, it is easy to find investors willing to buy out shares, in order to check the chances for a turnaround or to acquire relevant portions of debts in order to carry out arbitrages of value.

The purpose of this paper is to provide a comprehensive overview of turnaround financing in Italy, meaning operations regarding distressed or troubled companies, carried out by professional private equity investors.

Sectorial data show that total investment in turnarounds is on the rise but still amounts to less than 5% of the Italian private equity market. Greater attention, however, seems to be paid by professionals and the media because of the great economic returns expected.

Rare, older works dedicated to the Italian market (Perrini, 1997; Danovi, 2001 and 2003) have shown not only the absence of dedicated operators, but also a general lack of interest for this private equity niche. More recent studies (AIAF 2009) trace the birth and first steps of specialized investment funds. In comparison to the situation surveyed in the past, this study tries to investigate whether there has been an improvement by means of analyzing the answers to a questionnaire submitted to a selected sample of professionals.

A significant change within the sector was expected due to both internal and external factors, a more developed private equity market and the reform of the Italian bankruptcy law in primis. The wider range of solutions offered by the new set of laws, indeed, aims at easing the successful restructuring of distressed companies.

However, empirical data highlight only a modest increase in total investment despite a growing interest towards the topic. Furthermore, there is evidence that a few private equity funds, originally set as specific to turnaround, have now diversified their activity to target also more traditional deals.

The new legislative framework will probably cause significant, long-term effects;

nonetheless, some delicate issues responsible for the slow development of the Italian market for distressed securities still remain unresolved.

KEY WORDS Vulture funds | turnaround investing.

JEL CLASSIFICATION: G24 - Venture Capital.

1. Introduction

For several reasons, vulture funds have never been popular either with the layman or academics². While economic literature about venture capital is very articulated³, this is not the case with vulture funds. Even in recent years, only a few academic papers have appeared (Hotchkiss & Mooradian, 1997; Rosenberg, 2000; Gilson 2001; Feder & Lagrange, 2002; Altman 2004; Altman & Hotchkiss, 2006; Kutcher & Meitner, 2006 about the German market; Krasoff & O' Neill, 2006).

Some works seem to reflect on the "social" role of operators, often seen in a negative light and called *vulture funds*⁴, notwithstanding the effectiveness and value creation entailed in their activity. Gilson (2001, 222) observes that the irrational hostility towards the category is not supported by real empirical evidence and underestimates the positive impact of these operators in a crisis situation⁵. In 1997 Hotchkiss and Mooradian (1997) published a study on the US market analyzing the role of *vulture investors* in reorganizations and relating the results with the degree of influence of the *vulture* on the company to be restructured. Evidence showed that company performance improved when the *vulture investor* took control of the target or became the CEO. The study also shed light on abnormal market returns in the two days following the announcement of the intervention of the fund, demonstrating that markets usually appreciate this kind of intervention.

Another interesting element is linked to the taxonomy of the operators, proposed by Gilson (2001) on the basis of investment strategies and the objects of the transactions. The classification, taken up in different variations by most of the authors, divides the *vulture funds* as either *passive* or *proactive* (Gilson 2001, 192.). The former buy shares or bonds of companies in crisis, or which have defaulted on their debts, in order to take advantage of mispricings in the markets⁶. The latter try to take control and guide the *turnaround* personally⁷ in order to gain from an effective restructuring. Perrini (1997, 27) adds a third category: *aggressive vulture funds*, meaning investors that acquire the majority of at least a class of debt with the aim of blocking any undesired restructuring plan⁸. In this

case other *stakeholders* often prefer to give something up rather than let the *turnaround* drag on.

Altman (2004 and 2006, 188) divides investment strategies in *distressed debt* into *passive* or *active*, where the latter are aimed at seizing control the company or not. In the second category the difference lies in the expected return (20-25% for the *active/control*, 15-20% for the *non-control*, versus the 12-20% for the *passive*), the average investment period (2-3 years as opposed to 1-2) and the degree of influence exercised on the *target* company (control even through a debt to equity swap, versus a moderate influence aimed at monitoring that the restructuring does not take unwanted directions).

The purpose of this paper is to provide a comprehensive overview of turnaround financing in Italy⁹, meaning operations regarding distressed or troubled companies, carried out by professional private equity investors. Sectorial data show that total investment in turnarounds is on the rise but still amounts to less than 5% of the Italian private equity market. Greater attention, however, seems to be paid by professionals and the media because of the great economic returns expected.

Rare, older works dedicated to the Italian market (Perrini, 1997; Danovi, 2001 and 2003) have shown not only the absence of dedicated operators, but also a general lack of interest for this private equity niche. Greater interest for the niche and the launch of specialized investment funds has been detected by a recent study by AIAF (2009).

This analysis springs from, and is compared to, a similar study carried out a few years ago (Danovi, 2001). In comparison to the situation surveyed in 2001, in the present study we try to investigate whether there has been an improvement by submitting a questionnaire¹⁰ to a selected sample of professionals.

A significant change within the sector was expected due to both internal and external factors, a more developed private equity market and the reform of the Italian bankruptcy law *in primis*¹¹. The wider range of solutions offered by the new set of laws, indeed, aims at easing the successful restructuring of distressed companies.

However in mature markets, especially Anglo-Saxon ones, high segmentation and specialization are normal. For every phase in the life cycle of companies there is a correspondent set of specific investors. Whether in decline or in crisis, it is easy to find investors willing to buy out shares in order to check the chances for a turnaround or to acquire relevant portions of corporate debts in order to carry out arbitrages of value.

Italian empirical data highlight only a modest increase of total investment

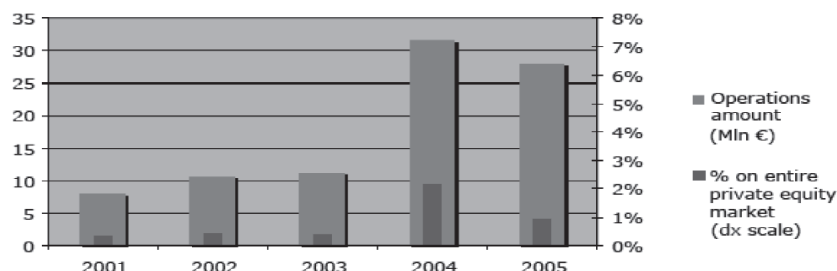
despite a growing interest toward the topic. Furthermore there is evidence that a few Italian private equity funds, originally set as specific to turnaround, have now diversified their activity to target also more traditional deals. The new legislative framework will probably cause significant, long-term effects; nonetheless, some delicate issues responsible for the slow development of the Italian market for distressed securities still remain unresolved.

2. The Size of the Italian Market

Compared to the international market, the size of the Italian private equity market is modest. Between 2001 and 2005 it never exceeded € 50 million and the number of operations remained between 7 and 14, from a minimum of 1.43% in 2001 to 4.17% in 2003 (AIFI, 2005 and 2006).

The value percentage fluctuated between 0.36% (in 2001) and 2.13% (in 2004).

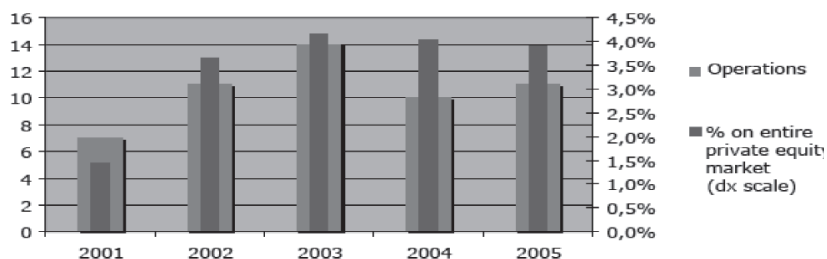
Exhibit 1 - Value of turnaround investment



Source: Own analysis on AIFI data

We can note that value percentages are consistently lower than deal count percentages; the latter are probably more indicative (3.61% versus 1.99%). It must be considered that the equity investment required to acquire companies in distress is usually very low, given the sheer size of the financial leverage already on the balance sheet of the target¹².

Exhibit 2 - Number of transactions



Source: Own analysis on AIFI data

The abovementioned data were supplied by the Associazione Italiana degli Investitori finanziari (AIFI) which gathers the Italian private equity operators¹³. During the past years the number of members grew and by the end of 2006, 105 companies were associated; 23 of which (22% of the total)¹⁴ also carried out turnaround operations.

Among these, only two were fully dedicated in 2006 to special situations: Atlantis Capital Special Situations and Management & Capitali. The former has been active for a number of years and mostly targets medium-sized companies. The latter was established in 2005 from a spin-off of DCB Web-Tech and listed since mid-2006, and targets medium-large distressed companies¹⁵. Others are companies, especially Investment Management Companies (SGR according to the Italian regulation), which invest throughout the entire life span of companies and can consider investments in distress, based on certain factors, for example knowledge of the sector, a strongly discounted price or specific interest for the deal.

Foreign funds (Oaktree, Cerberus, EOS Partners, Silverstar and KKR) occasionally carry out large sized operations in Italy; the same do private equity divisions of large investment banks as Goldman Sachs, Deutsche Bank or JPMorgan/One Equity partners..

COMPANY NAME	TURNAROUND DEDICATED OPERATOR	CLASSIFICATION	LOCATION
Argy Venture Capital SGR		IMCO	Milan – Northern Italy
Atlantis Capital Special Situations S.p.a.	X	Holding	Milan – Northern Italy
Banca Intesa		Bank dept.	Milan – Northern Italy
BNL Gestioni SGR		IMCO	Milan – Northern Italy
BPC Investimenti SGR		IMCO	Genoa – Northern Italy
Centrobanca Sviluppo Impresa SGR		IMCO	Milan – Northern Italy
Deutsche Bank		Merchant bank	London – Milan
Doughty Hanson & Co.		Dept. foreign found	Milan – Northern Italy
Effusia Investimenti SGR		IMCO	Milan – Northern Italy
Efibanca		Merchant bank	Rome – Central Italy
Finlombarda		Investment company	Milan – Northern Italy
Friulia		Investment company	Trieste – Northern Italy
Gepafin		Investment company	Perugia – Central Italy
Impresa & Finanza SGR		IMCO	Brescia – Northern Italy
Investimenti Piccole Imprese		Investment company	Milan – Northern Italy
Investitori Associati SGR		IMCO	Milan – Northern Italy
Management & Capitali S.p.a.	X	Listed company	Milan – Northern Italy
MCC Sofipa SGR		IMCO	Rome – Central Italy
Palladio Finanziaria		Investment company	Milan – Northern Italy
SFIRS		Investment company	Cagliari – Central Italy
State Street Global Investments SGR		IMCO	Milan – Northern Italy
Sviluppo Imprese Centro Italia SGR		IMCO	Florence – Central Italy
The Carlyle Group		Dept. foreign found	Milan – Northern Italy

Exhibit 3 – Funds actively investing in distressed companies

Source: Own analysis on AIFI data

The sample is not complete because members of AIFI do not represent all of the operators on the market, but it can be considered an useful estimate since the analysis is aimed at established and systematic investors and not at “informal” ones.

A brief comparison is possible with data from the European Private Equity and Venture Capital Association (EVCA), which represents the diverse players in the private equity and venture capital market in Europe and had 1,151 members in 2006.

In this case, the percentage of operators investing in the turnaround in Europe was 30%. 198 of the 661 full members declared that they were interested in troubled companies, a higher percentage than in the Italian market.

3. An Empirical Analysis

Empirical research was carried out through a questionnaire of 20 questions administered to 84 companies considered to be among the main private equity operators in Italy¹⁶. The sample was chosen from the AIFI member list and integrated with a few foreign turnaround funds active in Italy.

The survey was divided into 4 parts regarding the degree of participation, the impact of the new bankruptcy law, sector opinions and operating technicalities. 21-28 operators answered the questions in the first three sections while the results from the fourth section, which examined more specific characteristics, was completed only by 11-12 operators. These results, even if not statistically significant because of the size of the sample, represent an important part of the universe of Italian *vulture funds* and offer interesting qualitative points of view regarding the operating aspects.

3.1 The degree of participation

First we attempted to find out how many operators were interested in financing or acquiring companies in a situation of serious economic-financial imbalance¹⁷.

This question has a qualitative, rather than statistical, significance: it is in fact very likely that there is a sort of self-selection between those who participated in the survey.

Exhibit 4 - Interest
in conducting
turnaround
financing deals

	2001	2006
No	81%	64%
Regularly	3%	7%
Occasionally	16%	29%

It is nonetheless worth noticing that, in respect to the previous survey (Danovi, 2001), the number of those who claimed to engage in these deals occasionally or regularly has significantly increased.

Those who do not carry out turnaround deals explained that they were not part of their investment targets, because they were too risky or not among the kind of targets allowed by their own statute or bylaws. In a few cases, especially for banks, the difficulty has much to do with the unwillingness to contaminate regular activity with turnaround interventions carrying a different profile of risks and responsibilities. Many operators stressed that these deals require specific mentality, approach and know-how, which are different from their own. In a few cases it was highlighted that turnaround deals conflict with subjects who prevalently take minority equity positions and do not have the possibility to intervene directly in the restructuring. The same operators claimed that they do not have sufficient managerial skills to deal personally with these investments.

On the other hand, the dedicated operators declared that they managed 2 to 3 operations every year while others said that they occasionally completed from a minimum of one to a maximum of five. These numbers are in line with the data supplied by AIFI.

3.2 The impact of the new bankruptcy law

Empirical data highlighted that the majority of the interviewees did not intend to change investment targets nor plans to change its attitude towards turnarounds because of the reform of Italian bankruptcy law. Those who answered yes had the intention to increase the resources dedicated to these projects or to organize new *ad hoc* initiatives.

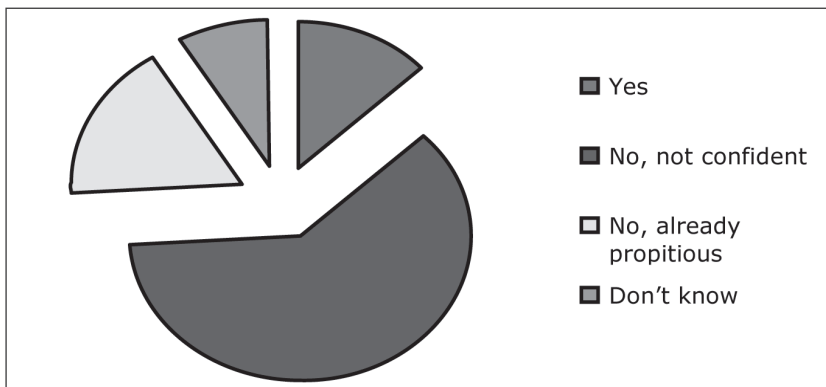


Exhibit 5 -
Sentiment of
investors towards
the reform

Source: Analysis of survey data

Those uncertain were waiting to assess the actual impact of the new regulations and the way in which Courts would interpret the new tools provided for by the reform; in other words they were waiting to see if the new rules could be of any use to ease the structuring of turnaround investments.

Participants were also asked to indicate the main advantages and disadvantages of the new discipline.

In general, the bankruptcy law reform¹⁸ is appreciated for the great flexibility of the Preventive Creditors' Settlement Procedure ("*concordato preventivo*")¹⁹. A broader range of legal proceedings can be used to solve the crisis and interested parties are granted greater negotiational opportunities without the rigidity of the pre-existing regulations (Stanghellini, 2005; Verna, 2005; Presti, 2006; Proto, 2006).

On the other hand, the weak point of the new discipline is the lack of clarity regarding some regulations which might lead, at least in the initial phase, to excessive freedom of interpretation. It has also been pointed out how the first applications by the Courts were characterized by a certain heterogeneity. There is the hope in any case that these problems will diminish as time passes, thanks to official interpretations supplied by legislators and sentences pronounced²⁰.

It has also been noted that the reform has not addressed the penalties associated with bankruptcy crimes, which remain one of the most severe in the entire Italian criminal law. This has historically weighted on investors' willingness to get involved in distressed situations, although it has also been an incentive for the entrepreneurs to address the crisis in a timely fashion not to be later charged with criminally relevant misconduct.

US Chapter 11 has been held up as the example to refer to, even if the sentiment among operators is that the new Italian law is still inadequate at preserving the operating continuity of the debtor firm²¹.

3.3 Turnaround: opinions about the market

The questions in this section are aimed at tracing a general picture of the market so as to define its actual and perceived risk-return profile.

First it was asked to state the expected returns deemed adequate for the deals, and the perceived risk.

The majority of the operators indicated returns between 30% to 50% or (17% of the answers) lower, even though a third expected an annual IRR of 100%. In this second case the answer is probably due to a lack of experience on turnaround projects or to an overestimation of the actual risk.

Those who habitually or occasionally carry out turnaround financing suggested, more reasonably, an average expected return of 40%.

High levels of returns are associated, as in economic theory, with high levels of risk, and in fact the interviewees confirm that turnarounds entail greater risk (81% of the answers) than traditional private equity investments. Only 14% of the interviewees found no appreciable differences in the level of risk²².

Analysis of the risk drivers and of the characteristic of restructuring operations appeared to be many-faceted given the variety of answers supplied. Most prominent was the difficulty in: i) evaluating the real amount of debt of the target company; ii) rapidly understanding the industrial and organizational problems; iii) finding managerial capability for the *turnaround*; iv) modelling the behaviour of suppliers and creditors; v) estimating the time required to fix the P&L. Also mentioned were human resources, operational discontinuity, lack of consistency on the part of the Courts, commercial and industrial risks. Many of these problems could be anticipated and diminished were it possible to conduct an accurate due diligence before consummating the transaction, but unfortunately in the context of distress investing this option is not always available to potential buyers.

A few elements are characteristic of turnaround operations or of companies in distress: uncertainty regarding the time needed to *break-even*, high indebtedness or financial imbalance, difficulties with other stakeholders.

It is worth considering the arbitrariness of Italian bankruptcy law and human elements. The former point is particularly relevant since it is merely external and cannot be influenced by the parties involved. Indeed the recent reform can be considered useful since it tries to limit the duration of the procedures. The latter is frequently underestimated but is fundamental, given that often the restructuring plans fail due to the conflicts which emerge between the parties involved²³.

In discussing the value drivers, the interviewees concentrated on three factors: a) the presence of competent managers, b) the characteristics of the target companies and c) the small amounts which, in the most fortunate transactions, one can happen to pay to acquire the business.

In the first place almost all of the operators cited under different aspects the importance of having managerial resources able to conclude operations of this type and often the possibility of finding capable management in the company was appreciated.

As far as the characteristics of the target companies are concerned, the starting point was unanimously deemed crucial. A sustainable competitive position, appealing structure and favorable development of the market,

ownership of a recognized brand and the quality of the products were among the most appreciated characteristics.

Finally, a few operators were keen to mention the ability to buy the company at deep discount.

The investment strategy of the turnaround operators seems thus broadly classifiable as “value”.

3.4 Operative modalities

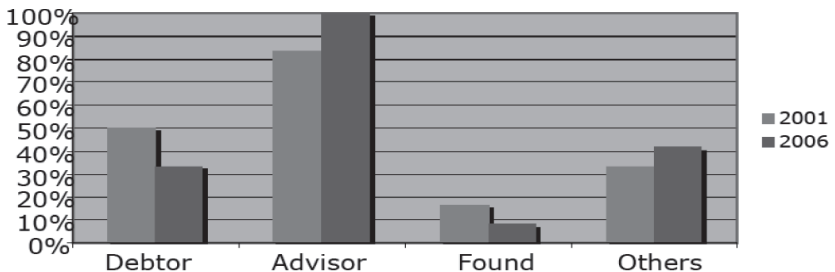
The last section of the questionnaire surveyed a few operational aspects regarding the origination, management and consummations of deals. Only answers from those who stated that they at least occasionally dealt with investments in distressed companies were considered.

First we tried to understand the origin of the deal flow. All of the operators said that the deal was proposed by a debtor’s consultant, who had greater experience rather than the debtor himself (indicated by a third of the sample)²⁴.

The percentage of those who think the proposal should originate (or does actually) from the fund itself is still quite low. This is a sign that the market is not yet mature and there is still room for growth.

Those who indicated “other” refer to banks, which are normally the largest holders of distressed companies’ debt and which, especially if concentrated, might be interested in a restructuring. In these cases independent advisors are given a specific mandate, or attempts are made to encourage the intervention of private equity funds to minimize the losses.

Exhibit 6 -
Origination of deals



Source: Analysis of survey data

Investors believe that they can manage 3-4 deals at the same time (55% of answers), 2-3 deals (18%), while 27% of the sample indicated 5-10.

Potential targets on scrutiny are less than 10 for 2/3 of the sample, even though many interviewees noted that the deal flow is up to 200 deals per year, 90% of which are discarded.

Given the weak competitive position and lack of strategic view of distressed companies, great attention is paid to strategic analysis.

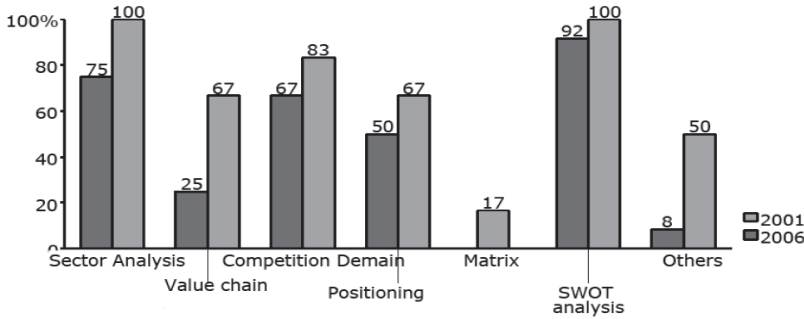


Exhibit 7 - Models used for strategic analysis

Source: Analysis of survey data

Preferred methods, as already shown by previous surveys, were SWOT and sectorial analysis, followed by analysis of the competitiveness and positioning within the sector. A few interviewees also reported use of value chain models, but nobody mentioned matrixes. It seems that the attention paid to strategic analysis is somewhat minor.

As already seen in 2001, the proportion of those who believe that strategic analysis should be different from that carried out for healthy companies and those who disagree is roughly 5 to 1. The interviewees stressed that the differences are often minimal and not particularly relevant.



Exhibit 8 - Contents of the business plan

Source: Analysis of survey data

It is surprising that the business plan hardly considers strategic issues given that they should be of utmost importance in singling out the errors that led to the crisis.

The great relevance attributed to financial contents can be related with the turnaround operations typically carried out in the Italian Market: in-

vestors tend to look for companies with good business and bad balance sheets suffering from imbalances in the financial structure. Among investors it is commonly thought that the best operations, if not the only feasible, are those that do not require an actual rethinking of the business but only a financial restructuring.

As far as the causes of the crisis are concerned, there is strong contradiction with abovementioned statements: for 58% of the interviewees, financial errors represent one of the causes of crisis on which external intervention can be more effective and are considered "easier" to resolve.

Exhibit 9 - *Optimal causes of the crisis for restructuring*

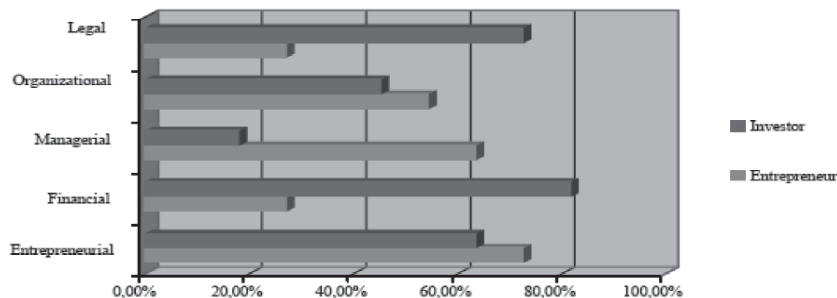
	2001	2006
Strategic near-sightedness	67	8%
Financial errors	83%	58%
Company handing down	100%	50%
Neglected company/not part of a core group	n.a.	75%

Only 8 % of the interviewees think a profitable investment is possible in case of strategic short-sightedness by a distressed company. There is, indeed, a strong feeling that to have success in this case, specific sectorial competencies are necessary, brought by companies operating in the same or in similar sectors.

The first choice for 75% of the operators are neglected or non-core companies within a diversified, often international, group. In fact, the mother company may decide not to try to recover losses incurred by a foreign, non-core subsidiary, and may therefore prefer to dispose of it, and benefit from its deconsolidation. This answer had not been given in the previous survey.

Given the peculiar structure of Italian capitalism and the problems still present in terms of governance, 50% of the interviewees are interested to troublesome succession.

Exhibit 10 - *Skills required for turnaround*



Source: Analysis of survey data

Interesting results are noticeable by comparing the skills an entrepreneur²⁵ needs to become an ideal counterpart and those necessary to invest in turnaround projects.

Besides entrepreneurial skill, the entrepreneur needs to have operating and managerial capacities, while investors need financial and legal know how. In an ideal situation, the entrepreneur is still useful for the recovery thanks to his knowledge of the business, while outside investors will manage financial and legal issues.

Finally, it is necessary to track how investors assess the value of the target. This problem is of primary importance given that the price paid for the acquisition or the possible increase in capital is the entry ticket for a vulture fund and it influences the restructuring strategy as well as disinvestment. This is the question showing the greatest differences in the results compared to the previous survey. Today, in fact, most common methods for analyzing and evaluating troubled companies in crisis are patrimonial methods and multiples of comparables, which were indicated by more than half of the interviewees. A third indicated the DCF and a little more than 20% mentioned revenue based methods²⁶.

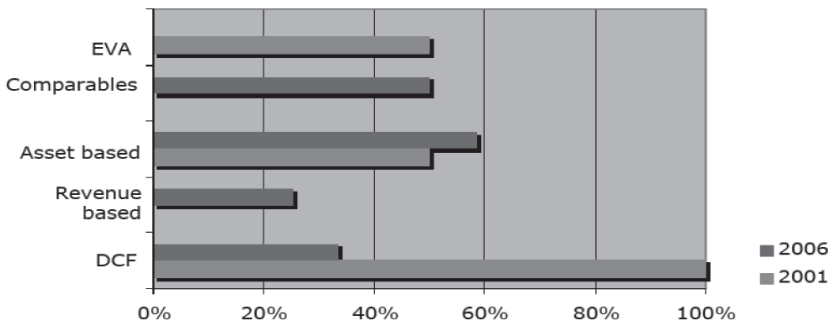


Exhibit 11 -
Valuation models.

Source: Analysis of survey data

Compared to the previous survey, a greater dispersion of results is noticeable, as is the loss of consensus of the two methods like DFC (which was indicated by all of the interviewees) and EVA, today hardly applied by anyone. The great success of multiples of comparables can be explained within its broader application as a control method to be used with others. It is important to mention, in any case, the difficulties in finding a trustworthy sample of homogeneous companies.

There are no significant variations regarding way out channels. The drop of IPOs (17% against 67%) can be imputed to the excessive trust for these

strategies back in 2001. Trade sales fell from 100% to 83%, as did secondary buyouts (from 67% to 50%).

4. Conclusions

Based on the data presented, it's possible to draw some initial conclusions. As mentioned, the aim of this study was to picture turnaround financing in Italy, through comparison with a previous survey from 2001. A significant evolution in the sector was expected due to the passing of time and a series of external events (first and foremost the reform of the Italian bankruptcy law).

The data in paragraph 2 show that this market is still a niche: In 2005, it accounted for 0.91% of the total amount invested in private equity, and for 3.91% of the transactions. These numbers are in line with those of the five preceding years, which were slightly above average (0.83% of the resources invested, 3.43% of the total number of transactions).

So it can be affirmed that in 2006 there was no boom; the market remained stable with a slight increase. The number of completed operations is gradually becoming more significant, and experience is one of the necessary components for successful restructuring operations given their complexity.

In the period from 2001 and 2006, there were at least two strong Italian players, exclusively dedicated to special situations: Atlantis Capital, which, with Euro 84 million of committed capital, targets small and medium-sized businesses, and Management & Capitali, listed on the Italian stock exchange, with funds in excess of Euro 500 million and focused on companies with a turnover of more than Euro 100 million. Together these two investors should cover all the segments of the market, guaranteeing constant presence and good operative continuity. There were about 10 other funds which claimed to consider restructuring projects in the context of investments in already known sectors, possibly at discounted prices, and also some foreign funds, both specialized or not, attracted to Italy by private equity mega-deals and assisted by Italian advisors with a track record in large turnarounds.

It is clear from these results that a good level of funding is now available in Italy for turnaround investments. It is still a moot point, however, whether investors will shift their focus from simple financial rebalancing to industrial restructuring over a longer period of time.

The bankruptcy law reform, whilst useful and necessary, does not seem to have been incisive enough to reshuffle the sector. Some actors stressed

that they expected more, especially as far as the judiciary and criminal issues are concerned, and that the legal framework is still inadequate to preserve the going concern. Other problems are still unaddressed because of the labor regulations in Italy which make it difficult to drastically re-trench a company. The case of Alitalia is a good example of these rigidities.

It is important to recall that the effects of the reform will be fully felt only in a few years' time when Court sentences and doctrinal orientations come to a shared and consistent view.

There are many obstacles to the expansion of the sector. The reforms have concentrated on the risks of these types of deals²⁷: There is, in fact, the widespread idea that *turnaround financing* carries high levels of risk and that it can be handled only by highly specialized investors with past experience and track record. Besides this, as an indirect consequence, many funds have statutes or bylaws which expressly exclude turnarounds or investments in projects deemed too risky²⁸. The landscape looks quite different from the US where even pension funds can invest (directly or indirectly through specialized funds) in distressed companies (Perrini, 1997).

Among other external factors, it is important to recall the market condition of corporate bonds, and that of distressed securities. In Italy, indeed, the market for corporate bonds is almost entirely represented by a few multinational companies (Eni, Enel, Telecom etc.). The situation got worse with the scandals linked to Cirio and Parmalat. Small and medium-sized companies find it is easier to finance themselves through banks rather than selling bonds on financial markets (also due to low ratings held down by the country disadvantage). This is even more pressing for companies with not-so-solid, or even just imbalanced, balance sheets. Current regulations and Central Bank reforms passed in December 2005 have made it more difficult for bonds to be traded. Therefore no active distressed securities market is available in Italy.

The growth of the turnaround sector is thus dampened by the illiquidity of the secondary market for distressed debt, which forces would be investors to carry out extensive negotiations with banks.

That said, we can try to picture the future evolution of the turnaround market in Italy. The next years are likely to see a growth both in the number of dedicated ventures and in the total amounts invested. The bankruptcy law reform might contribute to the attractiveness of the market for foreign investors. New opportunities are being created by the present recession and by the wave of corporate defaults. Interest by private equity

groups is on the rise. The Italian landscape, however, will not easily mirror that of the US and a degree of underdevelopment will persist in the market. But there is the hope that an Italian-style turnaround financing sector can be created, characterized by the strong presence of banks and bearing (not too heavily, hopefully) the bulky weight of the courts. With respect to 2001, 2006 shows renewed and decisive interest for this sector of private equity.

NOTES

- ¹ The paper, presented in 2009 Euromed Conference, is part of a research project lead by the Author. Data for the 2006 survey was collected by Matteo Tanteri who also took part in the preparatory work for the first Italian draft (Danovi, Tanteri, 2009). A short version has also been presented in the Ebes 2009 Conference, held in Istanbul June 1,2 /2009.
- ² There is even a novel by the well-known American mystery writer Stephen Frears, *The Vulture Fund*, which tells about an investment bank plotting to set up a speculative fund aimed at investing in depressed real estate stocks and bonds, while financing a terrorist attack on a nuclear plant near Manhattan.
- ³ For a bibliography focused on the Italian market see Gervasoni, Sattin, 2000. On the role of finance in times of crisis see Blatz, et Al. 2006.
- ⁴ The term plays on the similar sounds of the words vulture and venture. Critics of vulture funds sustain that while venture capitalists offer sustenance for the growth of companies, vulture funds feed on the few means left to companies on the verge of bankruptcy.
- ⁵ In fact, both banks and creditors can benefit from the chance to get rid of their distressed bonds or shares in a speedy way, despite the subpar price offered, depending on preferences and estimates about time value. Moreover, vulture funds' strategy consolidates large portions of debt which would otherwise be held by small bondholders, so easing and accelerating the restructuring and making the overall turnaround process more efficient. The same can also bring capital and business insight to the company and make good gains even if the nominal value is not reimbursed since the purchase was made at a great discount. As the original owners can recover their initial investment only in case of total reimbursement, they are less flexible.
- ⁶ Passive strategy also includes the possibility of co-buying where other vultures have taken an active role in order to benefit from any improvement brought about by these subjects. The hope of passive funds is for a rapid gain; otherwise the strategy can be changed from passive to proactive.
- ⁷ The American bankruptcy law allows, once a company has filed for Chapter 11, various alternatives: it can propose a reorganization plan which will need to be approved by the stakeholders assembly, the debt can be placed on a secondary market in the hope that it will be converted into stocks by the post-restructured company (loan to own investments), or it can finance new turnaround plans by underwriting capital increases and loaning capital under the form of debt. For an overview of failure in America see also Sandage, 2005; Skeel 2001.
- ⁸ Gilson (2001) defines this strategy as bondmail. He stresses the importance of the division in classes which allows for this kind of operation. Classes of creditors have to be homogeneous, both according to American law as well as in the Italian reforms.
- ⁹ Even though these operations are usually carried out by heterogeneous subjects (*private*

equity funds, single managers, industrial competitors), this study considers only the deals made by professional operators, due to lack of documentation of other deals as well as their episodic nature.

- ¹⁰ This analysis was carried out at the end of 2006 through a questionnaire administered to a sample of operators active on the Italian market and covering 4 areas of interest: the degree of participation, opinions on the bankruptcy law reform and its impact on investment choices; risk/return and value/risk drivers and operative modalities.
- ¹¹ The first part of the reform was enacted by the decree of March 14, 2005, confirmed by the Act of May 14, 2005. The second part was accomplished by the government decree of January 9, 2006, and took force July 16, 2006. The third part was enacted with the decree of September 12, 2007, and has been in force since January 1, 2008” (Panzani, 2009, 309).
- ¹² EVCA does not offer details regarding the Turnaround-Rescue operations for the European market for 2006. In 2007 the investments for these deals were worth 0,1% of the 74 billion Euro of total investment (but 0.9% of the number of deals). The difference with the Italian market is probably attributable to different reclassification criteria (EVCA, 2006, 2007).
- ¹³ Regarding the evolution of private equity activities in Italy, see Gervasoni, 2002, 338; Gervasoni, 2005.
- ¹⁴ See Exhibit 1.
- ¹⁵ In 2009 M&C announced a change of Mission and a relevant capital reduction.
- ¹⁶ The sample was made up of the following companies: 360 Capital Partners, 3i SGR, ABN AMRO Capital, Advanced Capital SGR, Advent International, Aksia Group, Aletti Private Equity SGR, Alice Ventures, Alto Partners SGR, AME Ventures, Apex Partners, Arca Impresa Gestioni SGR, Argos Sodic SGR, Argy Venture Capital SGR, Arner Advisory, Atlantis Capital Special Situations, BA Capital Advisors, Banca Intesa, BC Partners, Berrier Capital, BNL Gestioni SGR, BPC Investimenti SGR, Bridgepoint Capital, BS Investimenti SGR, Candover, Centrobanca Sviluppo Impresa SGR, CFI, CI Partners, Cinven, Clessidra SGR, CVC Capital Partners, Deutsche Bank, DGPA SGR, Doughty Hanson, Effusia Investimenti SGR, Efibanca, Euromobiliare PE, Fidi Toscana, Fidia SGR, Filas, Finanziaria senese di sviluppo, Finint & Partners, Finlombarda, Friulia, Gepafin, Impresa & Finanza SGR, Innogest SGR, Interbanca, Investimenti Piccole Imprese, Investitori Associati SGR, Kairos Partners SGR, Livolsi & Partners, Management & Capitali, MCC Sofipa SGR, Mittel, MPS Venture SGR, Natexis-Cape SGR, Nem SGR, PAI Partners, Palladio Finanziaria, Pentar, Permira Associati, Pino SGR, PM & Partners, Private Equity Partners SGR, Quadrivio SGR, Quantica SGR, R&D Advisory, Riello Investimenti, S+R Investimenti e Gestioni, SanPaolo IMI PE, SFIRS, Sigefi Italia PE, State Street Global Investments SGR, Strategia Italia SGR, Sviluppo Imprese Centro Italia SGR, Synergo SGR, Tamburi Investment Partners, The Carlyle Group, Unicredit Banca d'Impresa, Value Partners, VelaCapital, Vestar Capital Partners Italia, Virtus Capital Partners, Wise SGR.
- ¹⁷ In reality, comparing the answers with the AIFI data in the paragraph above, there is an overestimation of the number of those claiming to invest in turnaround projects regularly or occasionally. The aggregated percentage is 35.71% against 19% in 2001 and 22% of the data based on spontaneous declarations by AIFI members.
- ¹⁸ For a complete analysis of the Italian bankruptcy Law reform see Panzani, 2009.
- ¹⁹ This is a procedure for resolving crisis situations avoiding bankruptcy, through the execution of an agreement between the debtor and the creditors, under control of the Court. (Pajardi, 1986). The debtor submits to the Court a plan that can include:
- the restructuring of the liabilities in ways that can include, among the others, payments in kind or debt/equity swaps;
 - the division of creditors into classes that are homogenous as for legal position and economic interest and that accordingly receive differentiated satisfaction;

- The debtor usually remains in possession under an administrator and Court monitoring.
 - Non-guaranteed creditors have to vote on the motion proposed by the debtor, which is approved if accepted by the majority of creditors. In case class disagrees, the Court can impose a cram down and pass the motion.
- ²⁰ See, among others, Arato, 2006. For a brief synthesis of the reform see also Danovì & Quagli, 2008, chap. 11.
- ²¹ See Marano, 2006; Proto, 2006.
- ²² An investor indicated that the risk is to be considered of a different sort (apparently greater but actually smaller), so meaning that turnarounds can be distinguished from other private equity deals since they bring about the rediscovery of a value that the company had already proven to be able to generate.
- ²³ In previous articles much has been said on the relevance of the human factor. See Guatri, 1995.
- ²⁴ The decrease in the role of debtor as the originator is due to the greater role played by advisors.
- ²⁵ We have to remember that most of Italian companies (even public ones) are controlled by family or single entrepreneurs.
- ²⁶ See Danovì 2000 and Danovì 2003, chap. 1.
- ²⁷ This problem was also mentioned in Danovì (2001, 896).
- ²⁸ This also makes a quick reaction to the changes in the market difficult. Before actually consummating turnaround transactions, indeed, an investor would need to set up a new venture expressly dedicated to such projects. At the present day, existing funds are unlikely to change their statutes.

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