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The Capital Markets for Italian Companies: A Resource to Relaunch the Country and Renew Growth*

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Preface

by EQUITA SIM

The institutions and leading opinion makers unanimously agree on a number of key points regarding the financial structure of Italian firms. Quite simply: (i) the average Italian firm is too small and undercapitalized, and (ii) bank loans have been used to an excess in this country, but they must make way for other forms of financing, as is the case in all evolved countries. In light of the current financial context, evolved and efficient capital markets are a must. Without them it is impossible to trigger a new upsurge in investments needed to boost Italian competitiveness and to improve growth prospects for the Italian economy. Moreover, capital markets must compensate for the credit crunch and the challenges of public financing. In sum, the capital markets represent a fundamental infrastructure that serves to support growth for the country and to provide funding for firms.

But as the evidence shows, this description contrasts with the current state of the financial markets in Italy, where we find involution, a phenomenon which major institutions routinely disregard. We need only be reminded that according to a recently published study, the Borsa Italiana accounts for less than 1% of capitalization on the global equity market, placing 23rd in the world ranking. Moreover, in the past decade the Borsa has recorded the worst performance of all the markets in the study, with 29 delistings from 1990 to today. As for investors, in 2012 the Italian investment management industry slid to 14th place in the world (from 3rd place in 2002).

A negligible number of companies access the capital markets through bond issues, which taken together account for less than 7% of the total debt of non-financial firms. In addition, due to the norms regulating the financial markets, issuers face high costs and extremely onerous admission procedures: the last company to be listed on the main market of the Borsa Italiana had to publish a 770-page prospectus, and despite this information overkill, went on to lose 20% post-listing. The latest fiscal initiatives too have penalized the Italian markets instead of relaunching them. Case in point, the detrimental and ineffective Tobin Tax which – as all market players predicted - is already failing to generate the projected revenues and dampening the interest of foreign institutional investors in the Italian markets.

In light of all this, the number one priority for this country, and specifically for the firms that constitute the backbone of the Italian economy, is to make the capital markets the central focus of strategy sessions and institutional initiatives once again. To guarantee that firms have access to an evolved domestic financial market, these four essential conditions must be met:

1) *A regulatory framework and tax regime that is advantageous, rational, and fair, protected by efficient and authoritative market managers and regulators*
2) *An investment banking sector that is solid, responsive to the needs of firms, well-structured and free of conflicts of interest*
3) *A vast pool of investors willing to invest in both the equity and debt capital of Italian firms, even SMEs*
4) *A cultural context and mass media that promote and enhance the key role that financial markets play for firms and for individual investors*

In Italy, all these considerations call for reflection and study. We need to put these issues on the table, and make them the focus of initiatives that can breathe new life into the sector, to turn around what has been happening for years. With a few recent exceptions, institutions have underestimated the negative dynamics that have impacted the capital markets sector, as well as the potential consequences. In fact, financial market activity has actually been 'demonized', with no distinction drawn between strategic activities to enhance overall equilibrium and actions that jeopardize this equilibrium (almost exclusively undertaken by global financial groups).

Here are some obvious and necessary initiatives that must be incorporated into a comprehensive project to redesign the capital markets to the benefit of firms:

- *Simplify the regulatory framework.*
- *Provide incentives, including tax breaks, to encourage individual investors to invest in the capital markets and to facilitate market access for firms.*
- *Increase the number investors in Italian equity as much as possible, by leveraging new initiatives and mobilizing existing instruments for investment management.*
- *Eliminate conflicts of interest that affect stock exchange regulations, lending policies of big banking groups, and the activity of investors controlled by these groups.*
- *Repeal the Tobin Tax, which is ineffective and drives away investors.*
- *Develop a financial culture that is also reflected in an appropriate journalistic language, avoiding terms that are misused today such as speculation, locust funds, and junk bonds, which reveal a prejudice toward the markets that is unparalleled in other developed countries.*

The list of concrete initiatives goes on, based on a meticulous analysis of various aspects of the markets and the players who guarantee that the markets function. Positive and encouraging are the 2012 Decreto Sviluppo (Decree for Development), the project Destinazione Italia, and the PiùBorsa initiative coordinated by Consob, clear signs of renewed focus on this strategic issue by the institutions.

EQUITA SIM, founded in 1973 under the name Euromobiliare, has always been a strong, innovative player in the financial markets, and a major contributor to their evolution. This is why for our institution it is a great pleasure and honor to initiate a three-year collaboration with Bocconi University. The aim of this project is to analyze the major characteristics of the capital markets for firms, to make a concrete contribution to the debate on this vital issue for the development of the country, and to search for incisive solutions and attentively and rigorously monitor their implementation and evolution.

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Stefano Gatti is Director of the Bachelor of Economics and Finance at Università Bocconi, where he has also been Director of the International Teachers' Program. His main area of research is corporate finance and investment banking. He has published in these areas, including recent appearances in the Journal of Money, Credit and Banking, Financial Management, the Journal of Applied Corporate Finance and the European Journal of Operational Research. Professor Gatti has also published a number of books on banking and finance areas and has acted as a consultant to several financial and non-financial institutions and to the Italian Ministry of the Economy, the Financial Stability Board and the OECD/Group of G20. He is financial advisor of the Pension Fund of Healthcare Professions and serves on the Boards of Directors and Boards of Auditors of Italian industrial and financial corporations.

Gimede Gigante, PhD, is contract Professor of Financial Markets and Institutions at Università Bocconi. He has held visiting positions at the Finance Department of Columbia Business School, and at the Salomon Brothers Center (Stern School of Business, NYU). Chartered Accountant and professional auditor, he earned a business degree from Università Bocconi and a PhD in Banking&Finance from University of Rome. He holds the ITP qualification (International Teachers' Program) from SDA Bocconi. His main area of research is corporate finance and investment banking.

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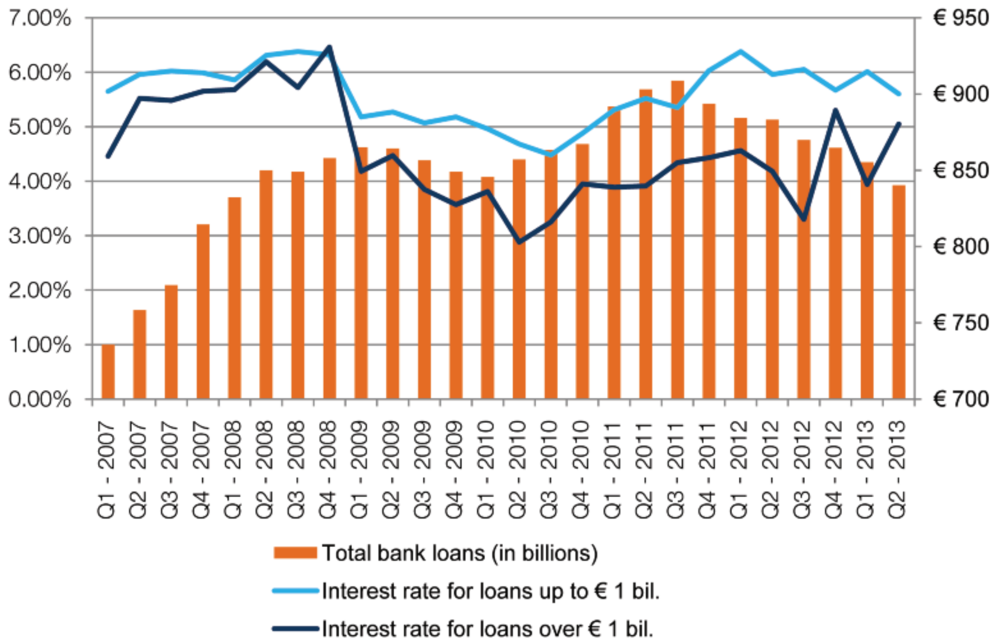
Introduction

Rebuilding the positive connection between finance and development through adequate financial support for businesses: this is an essential prerequisite for Italy's growth. Today's depressed economy combined with unsolved structural problems diminish the potential for investment and development. With current tensions in the bank credit market, the shortage of direct funding on capital markets is an obstacle to recovery. *Figure 1* shows variations from 2007 to today in total loans from Italian banks to non-financial firms and the average cost of this form of financing.

FIGURE 1
Bank loans to non-financial firms



Source: European Central Bank

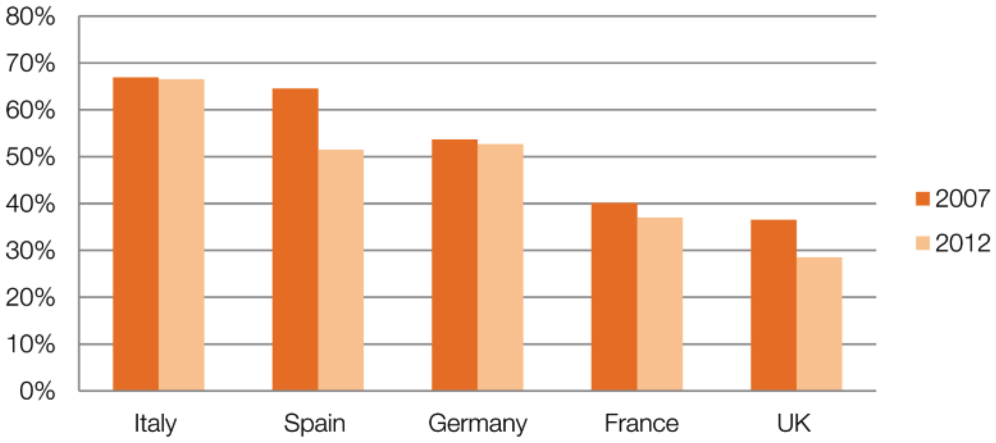
Total loans dipped by 4% in 2012, and a further 3% in the first six months of 2013 alone, bearing out the negative trend that began in the second half of 2011 with the initial fallout from the sovereign debt. At the same time, the gap widened between the average interest rate on new bank loans to non-financial firms in Italy with respect to the other major countries in the Euro Zone.

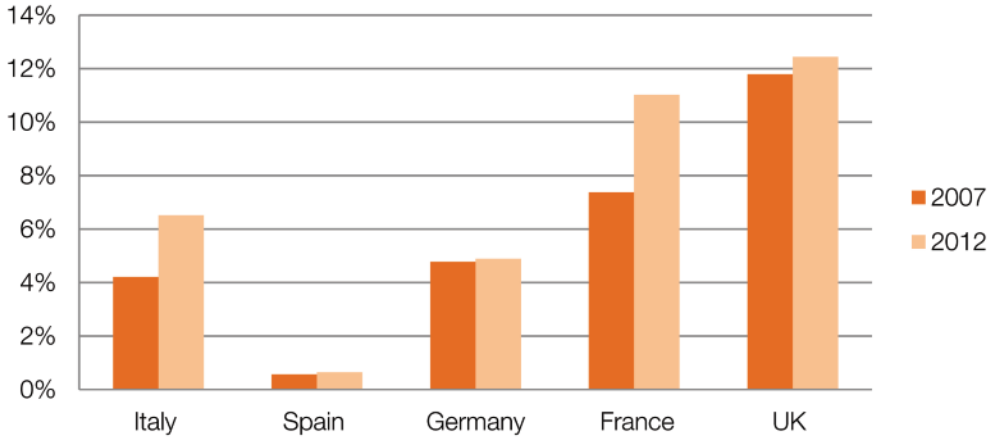
In fact, in 2010 a bank loan cost on average 35 basis points more for Italian firms than for their German counterparts, and 68 basis points more than companies paid in France. In 2012, instead, this spread increased to 114 and 130 basis points respectively. Demand-related factors impact this trend, but so does a progressively tighter supply. To some extent, fewer loans may reflect a contraction in investments. However, on the supply side, the main reason for the squeeze on bank loans can be traced to the widespread deterioration of credit worthiness among bank customers. In fact, non-performing loans to non-financial firms in Italy ballooned by 20% in 2012, and 13% more in the first half of 2013. Another cause of the shortage of bank loans are new regulations raising capital requirements for banks. Although these innovative norms provide stability to the financial system, they can also choke off the supply of short-term loans.[1]

[1] See Banca d'Italia's 2012 Annual Report, Table14.5; Consob's 2012 Statistical Bulletin, Tables 2.6 and 3.1

In Italy, the banking system plays a predominant role in financing businesses. In fact, bank loans represent over 60% of financial debts for firms in this country, while the same figure is only around 50% in Germany, 38% in France, and notably only 30% in the UK. Beyond this, the ratio of bank debt to financial debt has dropped since 2007 in France, Germany, and the UK, while in Italy it has remained constant. In sum, the Italian financial system is the most bank-centric, in contrast to other major European countries where institutional investors are taking on a more prominent role.

FIGURE 2
Bank loans (above) and bonds relative (below) to total financial debt





Source: Banca d'Italia, 2012 Annual Report

What emerges from Italy's bank-centric and fragmented production system is an underdeveloped financial market, with Italian firms rarely turning to the capital markets for funding. In fact, the weight of bond issues on total debt for non-financial firms is less than 7%; there are only a few issuers on the capital market, with an average of ten issues per year over the past decade. Despite a significant rise over 2007 levels, the ratio of bonds to financial debt for Italian firms is approximately half of what we see in France and the UK.

As we might expect, only a few big players in Italy resort to financing with risk capital on the Borsa Italiana. In Italy, 217 non-financial firms are publicly traded. This number translates into a market capitalization of less than 20% of the GDP, compared to 700 such firms in France and Germany which account for 50% and 35% of respective GDPs. According to Mediobanca's 2013 Indices and Data Report, the total capitalization of the Italian market is less than all the major European stock exchanges. Furthermore, the median Italian firm capitalizes approximately €90 million, double the figure for France and Germany, so the market apparently has little appeal for not-yet-listed firms.

Corroborating this assertion, since 1998 (the year the Borsa Italiana was privatized) the number of new listings have equaled the delistings, excluding the effect of the Expandi market.[2] What's more, from 1990 to today, the Borsa has lost 29 listings overall, and if it were not for the addition of the newly-created market (33 stocks: 45 listings and 12 delistings), the total loss would have been 62 .

Raising financial resources to invest in growth strategies and ongoing activities is especially critical for small and medium-sized enterprises (SMEs). The reason for this is the structural weakness commonly found in their financial profiles, which are bank-centric with limited capitalization. SMEs also show a reluctance to allow outside investments, rely heavily on bank loans and credit lines, and have an aversion to complex financial instruments. It follows, then, that hardest hit by the credit crunch are these businesses, which represent 98% of all firms in the Euro Zone, providing three-fourths of the jobs and generating 60% of value added.[3]

Confirming this appraisal, *Figure 1* shows that the positive repercussions of the expansive monetary policies of recent years have exclusively impacted big loans (which we can safely assume are contracted by big businesses). The purpose of these measures is to keep benchmark interest rates low to expedite financing for firms and shore up credit. But since the start of 2009, a conspicuous cost differential has emerged between smaller and bigger loans. Here we can refer to the most recent studies conducted by the European Central Bank (ECB) on financing conditions for companies. When small and medium-sized respondents were asked to describe the 'most pressing problems' they face, the most common answer (from around 18% of interviewees) was 'access to financial resources' compared to bigger firms. Also, their bank loan applications were rejected more often, and their profits, liquidity and capital have been more severely impacted by current market conditions, according to survey findings.[4]

[2] The Expandi market targeted small and medium enterprises, with rules that made it easy and economical to attain and retain listing status. Expandi was active until 22 June 2009, and after it closed, the firms listed there transferred to the MTA. To replace Expandi, AIM Italia was created (Alternative Investment Market Italia), a non-regulated market inspired by the UK's highly successful AIM.

[3] In line with indications from the European Commission, these data refer to firms with fewer than 250 employees and less than €50 million in turnover or financial assets valued at less than €43 million.

[4] Data were collected from October 2012 to March 2013 by the ECB and published in the Survey on the Access to Finance pf Small and Medium-Sized Enterprises in the Euro Area.

Therefore, SMEs would benefit from injecting more capital in their business, but they also need to rebalance their financial structure by progressively expanding the range of capital-raising methods they utilize. In light of this, a long-lasting recovery cannot happen unless capital markets take on a more central role in financing SMEs. Particularly critical in this regard is a solid and efficient financial intermediation sector, capable of assisting these firms in tapping financial resources on capital markets by offering investment banking services. However, from the onset of the crisis till today, the financial intermediation in Italy has experienced dramatic downsizing. Even before the crisis only a few national champions dominated the sector, but since then brokers working with commercial banks have gradually disappeared, and with them related investment banking services.[5] Teams dedicated to equity research have been cut, and foreign brokers continue to keep their distance. What's more, the few remaining players on the Italian market (foreign intermediaries and national champions) are concentrating their efforts on big listed concerns, leaving small firms, both listed and non, unserved. On the investor side, instead, Italy has seen a flight of foreign capital, set in motion for the most part by an unstable political context and fragile public finances; one of the repercussions of all this is the fiscal penalization of the sector (see the Tobin Tax).

The aim of this first position paper is to analyze investment banking activity in Italy, ascertaining the capacity of this sector to open up capital markets to small and medium-sized enterprises. To provide financing options other than bank debt, intermediaries must intervene effectively, matching the financial resources of the capital markets to the financial needs of businesses.

As far as supply and demand, bond issues by SMEs represent an interesting class of investment for investors looking to diversify their portfolios with high-risk, high-yield securities. Yet the demand for funding must reach a critical mass to attract the interest of institutional investors. But low unit volume, scant liquidity, and unbalanced risk-return profiles make smaller deals less attractive both for institutional investors and for issuers themselves.

There is, however, ample room for expansion as far as institutional investments. We need only note that for open-end mutual funds, bonds issued by non-financial firms represent a negligible share of the total portfolio, around 3%. Moreover, unlisted securities are far below the regulatory limit, which allows investments in illiquid instruments of up to 10%. The same is true for investments by insurance companies and pension funds; according to Banca d'Italia estimates, immediately accessible resources total between €6 and €10 billion.

But markets are not willing to support initiatives that are opaque or have a weak capital base. Therefore, to expand financing options, entrepreneurs must make a serious effort to render their financial statements transparent and to open up to outside investors. To achieve these aims, domestic players could play a vital role thanks to their deeper knowledge of the market and greater experience in assessing the financial profiles of small businesses. These professionals are also better equipped to respond quickly and effectively to the needs of their customers.

[5] Cases in point: Centrobanca, Efibanca, Interbanca and Meliorbanca have closed or modified the nature of their activities to some degree.

Structure and evolution of the investment banking sector in Italy

Matching the financial resources of capital markets to the financial needs of businesses: a variety of investment banking services aim to do just this. First are those pertaining to equity capital markets (ECM) and debt capital markets (DCM), specially designed to assist firms in relevant capital-raising endeavors. Second, through advisory services associated with mergers and acquisitions (M&As), intermediaries can support business growth by enabling companies to reach the critical mass needed to successfully tap capital markets and adequately diversify sources of financing. Lastly, sales and trading and equity research are services which help minimize information asymmetries between issuers and investors, enhancing the quality and dissemination of available information, making more effective market operations possible.

In this section we provide a description of investment banking services available in Italy, outlining the structure and evolution of each type of service, broken down by broker category and firm size. We based our study on two complementary aspects of this offering. By analyzing market data, we get a comprehensive understanding of the business volumes generated by various activities, and highlight the most noteworthy trends on the supply side, that is, financial instruments offered by firms. We also explore the structure of the offering of brokerage services, segmenting the market by domestic and foreign brokers, and SMEs and large firms.

ECM – Equity Capital Markets

According to estimates by the Borsa Italiana and Consob, there are around a thousand non-listed firms in Italy that meet the requirements for public trading with regard to size, capitalization, and earnings. Of this group, a hundred or so enjoy consolidated positions on the international markets.[6] Yet the Borsa is less developed than its major European counterparts, including those in other more bank-centric systems. Considering the size of issuers, in Italy the number of SMEs relative to total listed firms does not fully reflect the contribution of smaller organizations to the GNP, and is lower than the average percentage for Europe. These observations underscore a marked aversion to capital markets by Italian SMEs.

A technical working paper on SME admission to listing reports the perceptions of entrepreneurs with regard to sourcing capital from a broader pool of investors under competitive conditions. Findings appear to indicate that the benefits deriving from this opportunity are counteracted by an aversion to market risk, volatility of share prices, a reluctance to allow outside investors to access share capital, and the complexity and fixed costs of compliance and periodic reports, as per regulatory requirements for listed firms.

In this context, financial brokers and the ECM services they offer play a key role in achieving efficient resource allocation. On one hand they assist firms throughout the listing process to ensure a quality offering; on the other, they minimize information asymmetry to satisfy investor demand.

The stock offering on the ECM

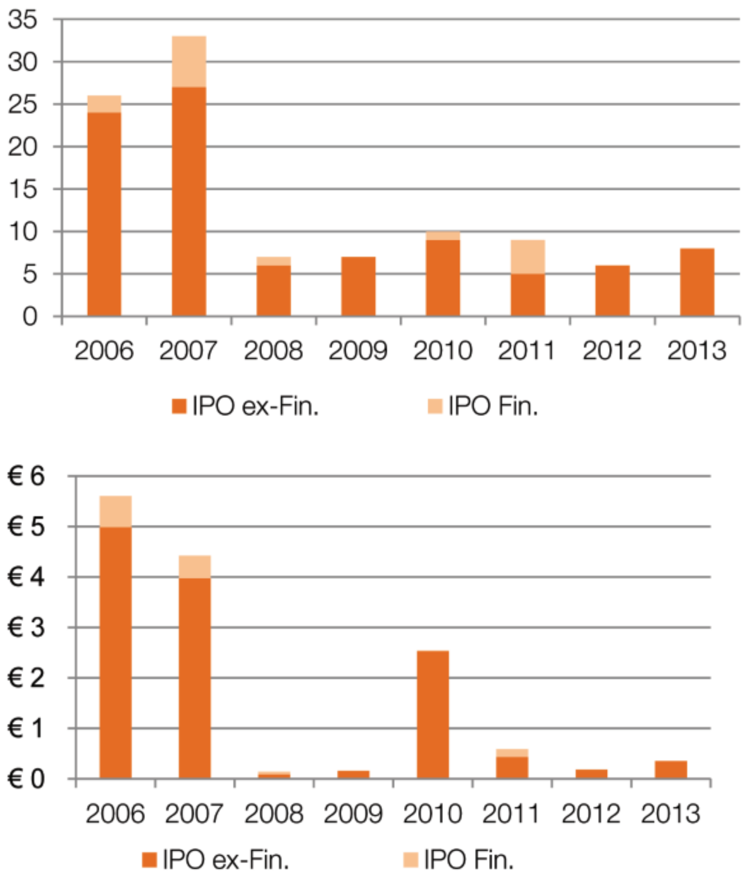
On the supply side of the equity market, the first nine months of 2013 saw a single IPO on Italy's major stock exchange segment, the Mercato Telematico Azionario (MTA), and seven on the segment dedicated to SMEs (AIM Italia – Alternative Investment Market). Overall, share values on the MTA, AIM and MIV are up from last year's level (€354 million, compared to €184 million in 2012), and in line with 2011 (€439 million). However, on closer scrutiny, with the advent of the financial crisis the number of firms which opted for listing on the MTA plummeted: only five new firms were listed in 2008 and eight total in the years to follow. These numbers are far below peaks in 2006 and 2007, when respectively 21 and 27 firms launched IPOs. The negligible number of recent new listings makes it difficult to draw any conclusions on trends in volumes.

In fact, the 13 deals that were closed after 2007 span a vast range of value. Topping the list is the ENEL Green Power IPO in 2010 totaling €2.5 billion. The smallest come in 2008 with Ross, Enervit and Terni Energia listings, all valued at less than €10 million; no IPOs exceeded €100 million that year.[7] The remainder of the deals posted between 2008 and 2013 fall in the range of €37 million (Tesmec, 2010) and €380 million (Ferragamo, 2011). These transactions would seem to signal growth in firm size for the most recent listings, while at the same time indicating the difficulties that medium-sized companies face in accessing equity markets, mainly because fewer investors are interested in this size class (see *Figure 3*).

[6] See Consob's technical working paper on SME admission to public trading: Incentive Initiatives, the Role of Markets and Operators. (Documento tecnico programmatico del gruppo di lavoro per l'ammissione alla quotazione delle Piccole e Medie Imprese: interventi di incentivazione, ruolo dei mercati e degli operatori.)

[7] Ross, Enervit and Terni Energia were listed on the Expandi market, and later transferred to the MTA in 2009.

FIGURE 3
Number (above) and volumes in billions (below) of IPOS on the Italian market



*Source: Borsa Italiana. (*As of this writing, year-end data for 2013 are not yet available.)*

Continuing on the topic of stock offerings, fund-raising via capital increase was far less frequent in the first nine months of 2013 than in the two years prior, which saw a flurry of activity, in particular among financial firms (less than €1 billion this year, compared to €11.9 billion in 2012 and €10.1 billion in 2011, see *Figure 4*). The reason for the upswing from 2009 to 2012 lies in the need to shore up capitalization, particularly among the major banking and insurance groups. Here are examples (in billions): in 2012, UniCredit (€7.5), Fondiaria SAI (€1.1) and Unipol (€1.1); in 2011, Intesa Sanpaolo (€5), Monte dei Paschi (€2) and Banco Popolare (€2); and in 2009, ENEL (€8) and SNAM Rete Gas (€3.5). However, on closer analysis, net of issues by financial firms, the value of capital increases based on flows channeled through the Borsa Italiana plunged from an annual average of €3.5 billion in 2006-2007, to approximately €800 million for 2011-2012, remaining constant in 2013.

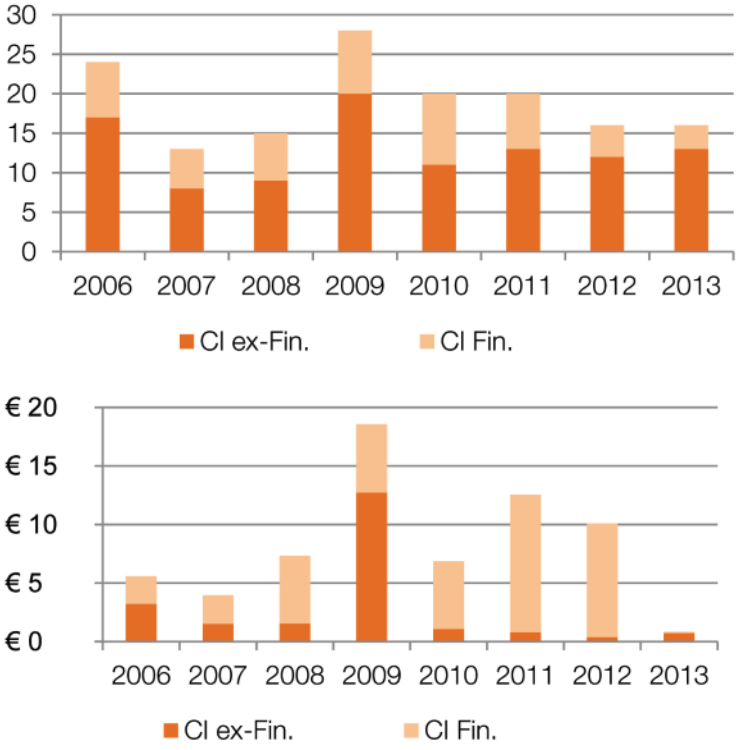
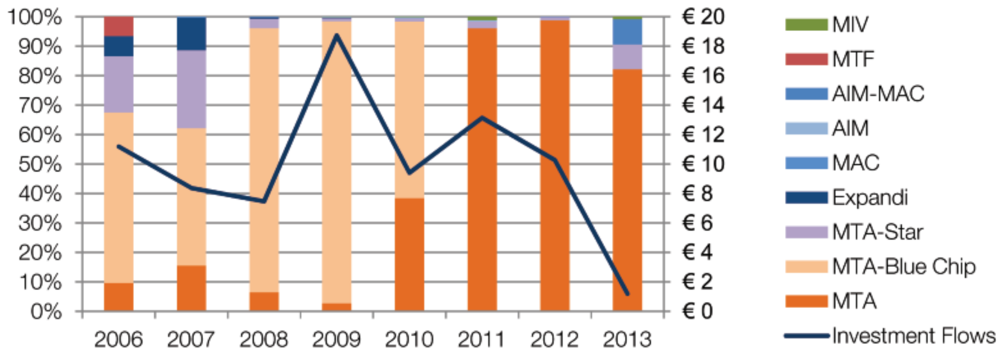


FIGURE 4
Number (above) and volumes in billions (below) of capital increases

*Source: Borsa Italiana. (*As of this writing, year-end data for 2013 are not yet available.)*

The trends highlighted above are reflected in the total capital flows channeled through the Borsa Italiana. From a system perspective, firms are sourcing capital on the markets far less often (see *Figure 5*), and most activity involves capital increases by already-listed firms. Net of flows generated by financial firms and major industrial concerns, the market has shrunk significantly, revealing an inadequate structure which makes it impossible for the equity market to provide financing for businesses. Last year alone (2012) we began once again to see a significant proportion of capital-raising on alternative markets, although in absolute terms this activity is still far below pre-crisis levels, when the average amount of capital raised on the Expandi market was approximately €800 million.

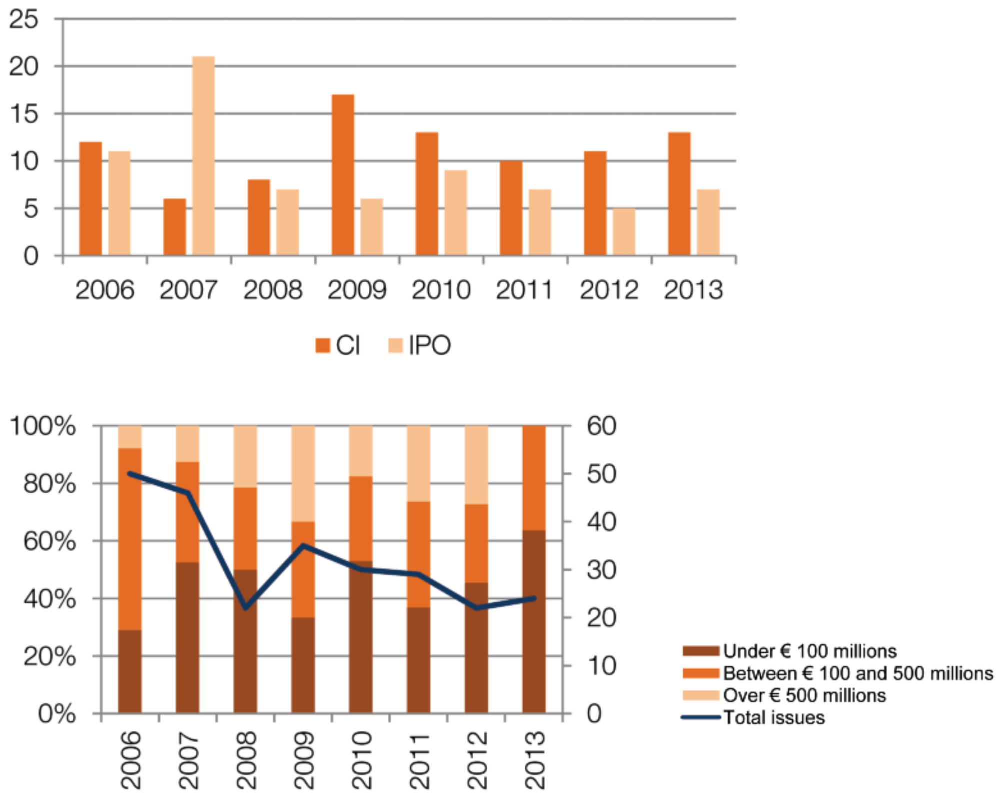
FIGURE 5
Total investment flows in billions channeled through the Borsa Italiana



*Source: Borsa Italiana (*As of this writing, year-end data for 2013 are not yet available.)*

As far as size class, the past three years have seen an increase in lower-value deals, yet it is clear that smaller firms have shied away from the post-crisis market. If we consider the 15 IPOs on the MTA valued at less than €100 million for the entire period in question, only three were posted after 2007, with Tesmec the sole listing in the last five years.[8] We find a similar situation on the AIM Italia where, until the Italian Independent Group IPO in June of 2013, listings were very few (often club deals). What's more, shares proved decidedly illiquid after listing, depleting the efficiency of today's market. In sum, it seems that smaller firms no longer have the possibility to access the equity market.

FIGURE 6
Total number of issues (above) and their size distribution (below)



*Source: Borsa Italiana. (*As of this writing, year-end data for 2013 are not yet available.)*

[8] Taking into account the new listings on the Expandi market as well, which subsequently transferred to the MTA, IPOs for less than €100 million for the entire period numbered 37, with only seven after 2007.

The role of intermediation and the structure of the ECM service offering

To complete our description of Italy's equity capital market, after analyzing equity supply, we now turn to the structure of the service offering from financial intermediaries to support firms that want to tap the markets to raise capital. Specifically, we examine IPO-related services offered by three different kinds of intermediary: foreign players, 'national champions' and other Italian banks, brokerage firms (SIMs) and advisory boutiques. *Figures 7* and *8* provide an annual breakdown of the number of IPOs involving the different kinds of intermediaries acting as global coordinators or book runners.

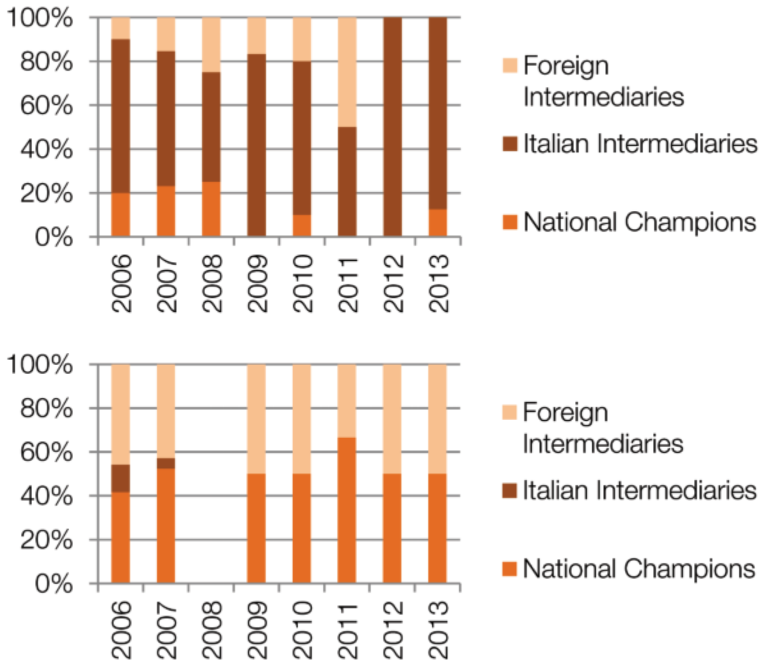
First, we call attention to Mediobanca, Banca IMI (Intesa Sanpaolo) and UniCredit – the only three domestic intermediaries, according to estimates by Thomson Reuters, to be ranked in the top ten of the league table for IPOs realized in Italy from 2006 to 2013, both for deal number and value. These national champions, along with foreign intermediaries operating on the Italian market, concentrate on higher-value initial public offerings, while the remaining domestic brokers generally take on smaller deals, although normally not as global coordinators. As far as roles, we note that commercial banks are also active, in particular as book runners, probably thanks to pre-existing bank relationships with client firms, or a special talent for placements with retail investors.

Moreover, until 2009 we saw numerous domestic intermediaries such as Capitalia, EQUITA SIM (until 2008, Euromobiliare SIM), Intermonte SIM working on listings valued above €100 million. But after that year, international banks and national champions have predominated, coordinating underwriting syndicates; such is the case with Mediobanca serving as global coordinator for Tesmec, the only SME that opted to go public.

In any case, in a market that is gradually being abandoned by major foreign investors, a consortium headed by foreign banks and major Italian banks is not always a guarantee of success. Any number of examples can be found of failed IPOs that may have benefited from Italian brokers serving as global coordinators or book runners. In fact, although some Italian brokerage firms may be small, they make up for their size with their deep knowledge of institutional investors, both domestic and international, interested in buying into Italian equity.[9]

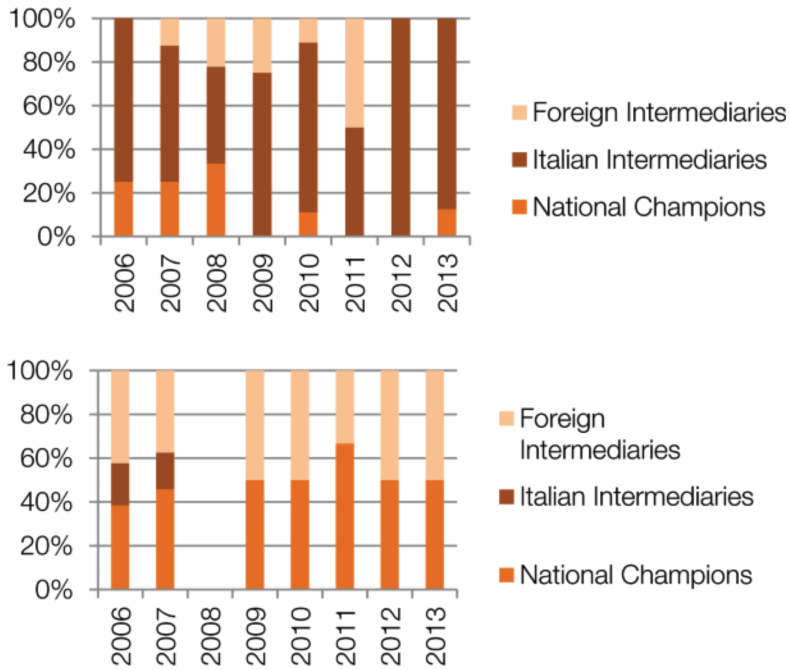
[9] Consider the Kedrion case in 2008, led by JP Morgan and Mediobanca; the Rhiag and Moncler listings in 2011, with the team of coordinators Banca IMI, Mediobanca, along with Goldman Sachs, Merrill Lynch, and Morgan Stanley, and lastly the SEA deal in 2012 coordinated by Banca Imi, UniCredit, Mediobanca and Morgan Stanley.

FIGURE 7
Global Coordinator -
Number of IPOs
up to €100 million (above)
and over €100 million (below)



*Source: Thomson Reuters, Borsa Italiana. (*As of this writing, year-end data for 2013 are not yet available.)*

FIGURE 8
Book Runners -
Number of IPOs
up to (above) and over
€100 millions (below)



*Source: Thomson Reuters, Borsa Italiana. (*As of this writing, year-end data for 2013 are not yet available.)*

The best teams for Equity Research and Sales & Trading in various markets around the world are ranked annually by Thomson Extel and Institutional Investors, based on voting by international and Italian institutional investors. The clear winners in Italy are independent domestic intermediaries EQUITA SIM and Intermonte SIM, who consistently hold two of the top three spots.

What also emerges from this ranking is a certain asymmetry: the closeness of independent brokers to investors, both domestic and international, does not correspond to the involvement these brokers have in coordinating underwriting syndicates. This once again goes to show that the bank-centric Italian system guarantees that national champions control the Italian industrial context.

TABLE 1
Best equity research and sales & trading rankings

	2007	2008	2009	2010	2011	2012	2013
# 1	EQUITA	EQUITA	EQUITA	EQUITA	EQUITA	EQUITA	EQUITA
# 2	Intermonte	Cheuvreux	Mediobanca	Mediobanca	Mediobanca	Mediobanca	Mediobanca
# 3	UBS	Mediobanca	Intermonte	Intermonte	Cheuvreux	Intermonte	Intermonte

Source: Thomson Extel

In addition, consider the quality of research and the sales desk with regard to the execution of these deals. The incongruity we find here is the consequence of a bank-centric system based on conflicts of interest and pre-existing relationships, mainly linked to the lending activities of banking intermediaries. These factors curtail growth and competitiveness, resulting in a markedly undersized sector in terms of number of deals and of brokers. This discourages firms from sourcing equity markets to raise funds, curbing the effectiveness of these markets and driving companies toward traditional banking channels. All this sets in motion a vicious circle, stunting growth for both businesses and for the brokerage sector.

DCM – Debt Capital Market

A new global trend has emerged in recent years: medium-sized firms are turning to the debt capital market. Spurring this phenomenon is no doubt the demand for financing with medium to long-term maturities, which is not always available with bank loans, along with the shrinking cost differential between bond issues and bank loans following the repricing of the latter in several countries. In Italy, for example, as of summer 2011 the average interest rate on new loans rose by 100 basis points, according to Banca d'Italia estimates.

Access to the publicly traded bond market is typically restricted to firms which are listed, and/or have public ratings, in other words, generally large organizations. But the number of smaller issuers looking for financing alternatives to bank loans is on the rise. This in turn has triggered a rapid expansion of the market for private placements of euro-denominated bonds, previously limited to a few domestic markets such as the UK and Germany. In fact, according to the latest Fitch Ratings, in the last three years the number of firms in Europe that have resorted to private placements of unrated bonds has doubled. These deals have raised €108 billion since 2010, which corresponds to approximately 10% of the total value of European bond issues.[10] Moreover, the US market has seen a sizeable increase in private placements by European issuers with consolidated international reputations for credit worthiness, for example the Italian companies Illy, Luxottica, Piaggio and Barilla.

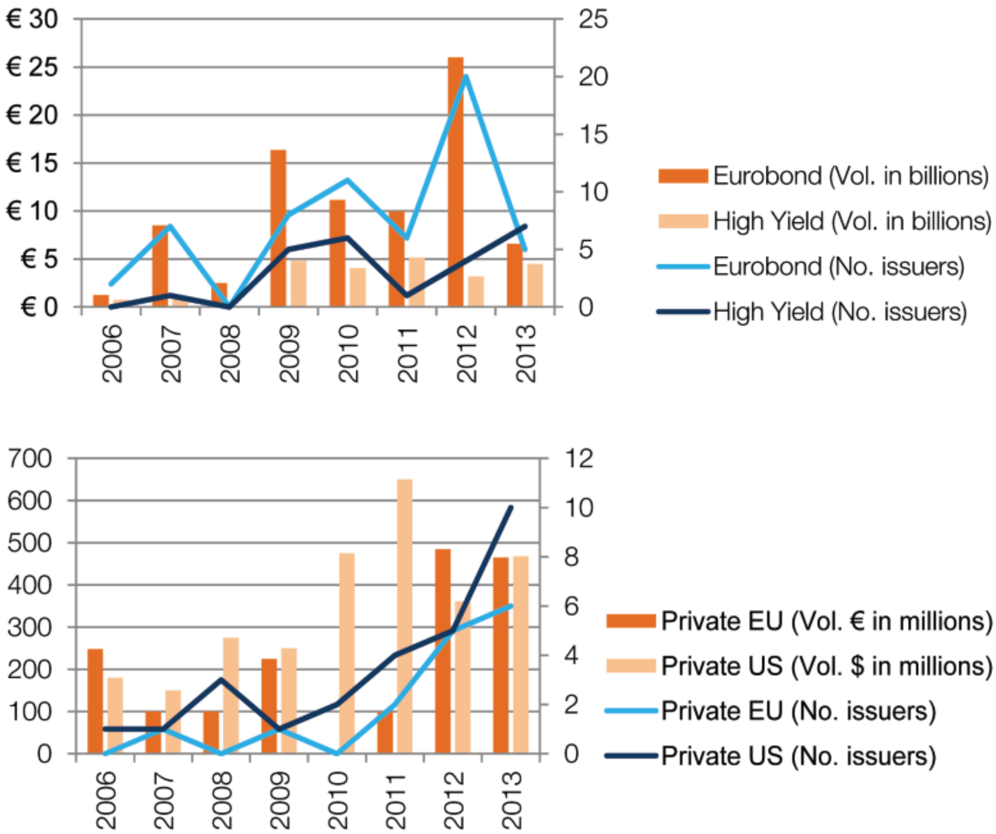
The benefits of unrated bonds are flexibility and simplicity. No public rating is needed for issuers, and regulatory requirements are not excessive. Issuers are typically medium-sized and in some cases listed firms, but without a public rating they would have a harder time accessing the market for publicly traded bonds. Major investors in unrated bonds are banks, insurance companies, pension funds, and to a lesser extent mutual funds seeking to diversify their bond portfolio with high risk/high yield securities. In any case, the average size of these issues, and the weight of the organizational costs they incur, seem to discourage smaller firms. The secondary market for these instruments is very restricted, mainly supported by the arranger of the issue in question.

The bond offering on the DCM

Now we will analyze the debt capital market for Italian firms based on the type of issue and the credit worthiness of the issuer. First, we distinguish between public and private placements on the bond market. The former we differentiate further on the basis of credit worthiness of the issue, either Eurobond Investment Grade or High Yield. We classify private placements by the destination market of the issue, either EU or US. *Figure 9* shows the major trends for the different types of issues by non-financial Italian firms from 2006 to 2013.

[10] See Fitch Research Reports: Europe's Unrated Bond Issuers: 2013 Update.

FIGURE 9
New bond issues, public and private placements



*Source: Thomson Reuters. (*As of this writing, year-end data for 2013 are not yet available.)*

In keeping with the global trend, Italy has also experienced major growth in the number of issuers and the value of bond issues, both for public and private placements. Specifically, since 2006 Italian firms have issued 207 bonds. Of that number, 143 are public placements which have raised a total of approximately €105 billion. The remaining private placements consist of 25 on the European market, and 39 on the US market, amounting to €1.7 billion and $2.8 billion respectively. 2009 saw the highest values, which would apparently signal a substitution effect, with the debt equity markets replacing bank loans as a reaction to the post-crisis credit crunch. Eurobonds are the most popular debt instrument.

The firms that access this channel of financing are either listed or have investment grade creditworthiness, be it implicit or explicit (i.e. a public rating). These requisites effectively close off the market to all but large organizations. In fact, fewer than fifty non-financial firms in Italy have a public rating from at least one of the major international agencies. Moreover, without this rating, firms that want to access the market must not only have implicit creditworthiness corresponding to one of the highest investment classes, but a high profile and consolidated reputation as well. As a result, since 2006 Italian firms have placed 99 Eurobond issues, but only six of these issuers are unrated: Campari, Pirelli, Mediaset, Prysmian, Indesit, Amplifon and Luxottica (this last company earned a rating in 2012).

With reference to Eurobonds, beyond the fact that these instruments are the most common way to access the market, they are also the highest value issues. In fact, in just 15% of cases, the total amount raised per single issue was less than €500 million, with the minimum value dipping to €150 million. As for the maximum, more than 40% of the issues were worth €1 billion or more, topping out at €2.5 billion. As far as costs, Eurobonds are cheaper for the issuer. Annual coupons tend to fluctuate between 3.5% and 5.1%, depending on the issuer, the amount, and the maturity. As for the latter, a medium-term maturity is most common; over 80% of these bonds mature in five to ten years, and in only a few cases is early redemption an option. The financial documentation required to issue a Eurobond includes an offer/listing document, but limited due diligence.

TABLE 2
Eurobond issues

	mean	st.dev.	med.	25°p	75°p.
Amount (millions)	€831	€435	€750	€500	€1000
Coupon	4.4%	1.5%	4.5%	3.5%	5.1%
Maturity (years)	8.4	6.6	7	6	10

High Yield issues, instead, involve firms with public ratings that do not reach the investment grade threshold. With respect to Eurobonds, loan conditions are more restrictive and disclosure requirements more stringent, due to the higher level of risk. In fact, issuers are generally subjected to heavier restrictions on new debt or dividend payments; in addition to a listing document, thorough due diligence is required. Since 2006, Italian firms have issued 41 High Yield bond. In recent years activity in this financing channel has intensified, in part because various issuers have been declassed in the aftermath of the crisis (the so-called fallen angels).

Continuing the comparison with Eurobonds, costs for issuers of High Yield bonds are significantly higher and the size of issues typically smaller. On average, the total amount raised per single issue is approximately €572 million, and in only six cases has that exceeded €1 billion (15%). Annual coupons cost an average of 290 basis points more than investment grade securities, and tend to fluctuate from 6.1% to 7.9% depending on the issuer, size, and maturity. Again compared to Eurobonds, High Yield bonds have shorter maturities: one-third mature in five years, and 90% in ten; more than half of this type of issue is redeemable before maturity.

TABLE 3
High Yield issues

	mean	st.dev.	med.	25°p	75°p.
Amount (millions)	€572	€443	€350	€200	€1000
Coupon	7.3%	1.8%	7%	6.1%	7.9%
Maturity (years)	7.5	8.5	6.0	5	7

During the time frame in question, listed firms are the most frequent High Yield bond issuers, in part thanks to advantageous fiscal treatment as compared to their non-listed counterparts. In fact, until implementation of the 2012 Decreto Sviluppo (Decree for Development), only listed firms were allowed to deduct all interest payable; they were also exempt from withholding tax on paid-up interest, and could immediately write off costs relating to the issue. If we consider listed Italian firms alone, although these organizations resort to bond issues as often as listed firmed in other countries, they are so few in number that the Italian market is undersized. For this reason, an attempt is being made to encourage access to debt capital markets by non-listed SMEs through a more advantageous regulatory framework, both with regard to taxes and compliance.

The 2012 Decreto Sviluppo, mentioned above, aligns the tax regime for listed and non-listed issuers, and removes statutory limits preventing the latter from issuing notes in excess of twice their share capital. As a result, substantial expansion of this financing channel is expected for all businesses, including smaller companies.

The Ministry of Economic Development estimated that upon approval of the decree, a potential pool of over 600 firms had the necessary requirements to take advantage of the new rules, with an issue potential of €10-12 billion over 18 months.[11] In 2012, after regulatory and fiscal impediments were removed, the number of firms that made placements on the debt capital markets more than doubled. However, a closer look at the relevant data reveals that the majority of these deals involved medium to large firms, or refinancing of existing debt.

Considering the approximately €30 billion worth of bonds issued in 2012 on international markets or through private placements by non-financial Italian firms, only around €700 million involved smaller issuers (with turnover of less than €1 billion); most of that amount can be attributed to the Guala Closures and Rottapharm issues. Only with the new year (2013) we have begun to see a more substantial number of deals and deal volumes undertaken by medium-sized issuers, all with turnover below the €1-billion mark, and none classed as investment grade.

TABLE 4
Recent medium sized issuers

Issuer (turnover< €1 billion)	Amount (millions)	Rating (S&P)	Coupon	Maturity (years)
Guala Closures	€275	B	5.6%	7
Rottapharm	€400	BB-	6.1%	7
Cerved Technologies	€250	B	5.6%	6
	€300	B	6.4%	7
	€230	CCC+	8%	8
IVS Group	€200	BB-	7.1%	7
Teamsystem Holding	€300	B	7.4%	7
Sisal Holding	€275	B	7.3%	4
Zobele Holding	€180	B	7.9%	5
Salini Costruttori	€400	BB-	6%	5
Manutencoop	€425	B+	9%	7
Gamenet	€200	B+	7%	5

For smaller firms, 2013 marked the debut of mini-bonds. The advantages of these instruments are, again, flexibility and simplicity, with few regulatory requirements and extremely simplified issuing procedures. Mini-bonds are normally very small issues and have short-term maturities. The first seven placements in 2013 raised €46 million, and according to Treasury estimates, once the mini-bond market is fully functional it could generate an annual value of €100 million.

[11] The 2012 Decreto Sviluppo abolishes the limit on tax deductions for interest payable on bonds, and the 20% withholding tax on non-resident subscribers, banks and institutional investors. Also, due to transparency requirements, to take advantage of fiscal benefits, bonds must either be listed or circulated among qualified investors. In the case of cambiali finanziarie (which are similar to commercial papers), an audit of the issuer is required. In addition, SMEs must have a sponsor (a bank, asset management company, investment firm, etc.) tasked with indicating the rating of the issue.

TABLE 5
Mini bond issues

Issuer (turnover< €1 billion)	Amount (millions)	Coupon	Maturity (years)
FIDE	€2.7	3%	3
Moviemax Media Group	€5	8%	6
Buscaini Angelo Srl	€10	7%	3
Sudcommerci	€22	6%	6
Primi sui Motori	€1.7	9%	2
FILCA	€9	6%	6
IFIR	€0.1	4.2%	1.5
	€1	5.5%	2.5
	€2.5	6.2%	4
CAAR	€2.8	6.5%	5

This highlights the fact that for small and medium-sized listed firms, like mini-bonds for small businesses, a new channel of financing is opening up as an alternative to traditional ones. Here we can cite the case of the listed retail bond, open to institutional investors, issued by Mittel S.p.A. which launched a Public Exchange Offer on shares for the newly-issued Mittel bonds, along with a public issue of Mittel bonds for an overall value of approximately €100 million.

Private placements for bond issues have grown considerably over time despite the underdevelopment of the EU market and the challenge of winning recognition among foreign investors for issuers in the US market. These usually involve private agreements among a small circle of professional investors. The restrictions and financial documentation required in this case are established directly through negotiations with investors, often with provisions for financial maintenance covenants, effective for the entire term in question and valuated periodically. The obvious gap in the development of the US and EU markets has prompted Italian firms to resort more frequently to the former over the latter.

In fact, the EU market is used by only six major issuers (e.g. ENEL). All these companies have a public rating (although this is not required) and investment-grade credit worthiness. Over the years they have undertaken a series of issues within the framework of Euro Medium Term Notes (EMTN) programs. In these cases, the capital raised per issue normally ranges from €50 to €100 million, with two issues topping €100 million, and none below €30 million. The cost of these instruments for issuers is similar to Eurobonds, but maturities are typically longer, the majority over ten years.

The American market instead has continued to attract a larger number of Italian firms over the years. In fact, we count 14 such businesses, some medium-sized and all with solid credit worthiness, either public or implicit, and consolidated international reputations. Typical issues are higher value than those destined for the European market. In fact, the capital raised with a single issue averages approximately $136 million; the maximum is $350 million. The cost is also normally higher than issues on the European market, and maturities are generally shorter: in around 70% of cases, between seven and ten years. The number of bond issues has risen over time, with six already launched in the first half of 2013 alone, generating a total value of nearly $500 million.

TABLE 6
Private placements in the European market (above) and in the US market (below)

	mean	st.dev.	med.	25°p	75°p.
Amount (millions)	€68	€31,6	€50	€50	€100
Coupon	4.6%	1.2%	4.8%	3.6%	5.6%
Maturity (years)	14	5,8	13	10	18

	mean	st.dev.	med.	25°p	75°p.
Amount (millions)	$ 136	$ 20	$ 75	$ 50	$ 127
Coupon	5.5%	1.2%	5.4%	4.6%	6.3%
Maturity (years)	10.4	9.3	10	7	10

If we segment the debt capital market and consider the different types of issuers active in various sectors, what clearly emerges is the vital role of information in the efficient allocation of market resources. Both for issues reserved for an exclusive circle of investors and for offerings open to the general public, professional competences are needed with regard to investment analysis, in particular for smaller issuers whose credit worthiness may be difficult to verify. In light of this, rating agencies play a prominent role in facilitating access for businesses to the debt capital market. In fact, the opinions of rating agencies provide indications as to the quality of issues and issuers, reducing information asymmetries between firms and investors. This said, however, the Big Three (Standard&Poors, Moody's and Fitch) only cover a small fraction of Italian firms. There are fewer than fifty non-financial firms in this country that have at least one public rating from one of these agencies, and all of these firms are large enterprises with consolidated international reputations. As far as smaller firms, instead, these are attracting the attention of Italian rating agencies such as CRIF and Cerved, which are growing rapidly but still lacking in the necessary international visibility.[12]

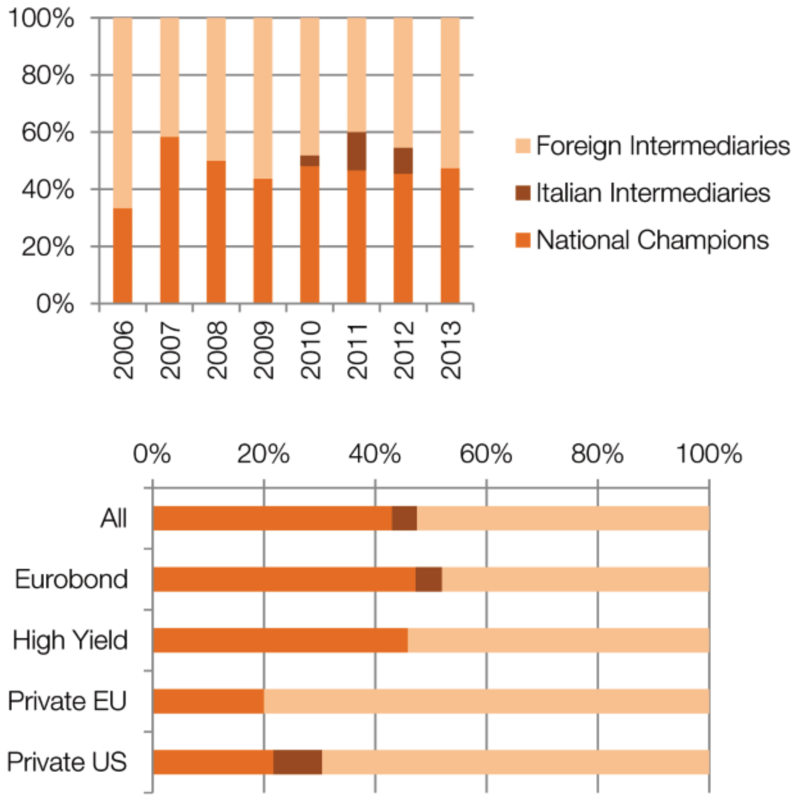
The role of intermediation and the structure of the DCM service offering

To complete our description of the DCM market in Italy, we now turn to an analysis of the structure of the service offerings proposed by financial intermediaries which support companies seeking to raise capital on the market. Specifically, we explore the services linked to bond issues provided by three different types of intermediaries: foreign players, national champions and other Italian banks, brokerage firms (SIMs) and advisory boutiques. *Figure 10* compares the number of issues involving each different type of intermediary, by year and by category.

The first noteworthy consideration is that the bond market is controlled almost exclusively by foreign intermediaries and national champions (Mediobanca, Banca IMI (Intesa Sanpaolo) and UniCredit). According to Thomson Reuters, these three companies are the only domestic brokers to be ranked in the top ten of the league table for bond issues from 2006 to 2013, both by deal number and value. The activity of other domestic brokers is limited due to a narrow range of operations and product offerings. In addition, the aggregate data on type of issue seem to indicate that even the involvement of national champions is marginal for private placements. This can be explained by the lower value of single issues, and the fact that foreign intermediaries have greater access to international investors. The ability to attract investor interest and fuel demand for bonds is the key to success for intermediaries on debt capital markets, and the primary shortcoming of Italian players.

[12] In light of this, and following changes in European legislation regulating rating agencies (n.462/2013), on 22 July 2013 a joint statement was issued by Banca d'Italia, Consob, Ivass and Covip inviting supervised institutions to adopt proper internal processes for valuating credit worthiness, to prevent an exclusive or perfunctory reliance on the opinions of rating agencies, and to curb rating dependency.

FIGURE 10
Lead Manager - Breakdown of the total number of bond issues by type of financial intermediary (above) and by category of issue (below)



*Source: Thomson Reuters. (*As of this writing, year-end data for 2013 are not yet available.)*

Our analysis of the debt capital market draws attention once again to the bank-centric nature of the Italian system. In this case, however, conflicts of interest seem to be even more prevalent, arising from pre-existing relationships formed through the lending activities of banking intermediaries. As for sector growth and competiveness, these are hindered more by the strong link between issuers and intermediary lenders, rather than the distance between independent domestic brokers and foreign investors. In fact, issues on the Italian debt capital market often serve to refinance existing debt. The result is a gap in the supply of investment banking services on this market by specialized professionals, which checks the capacity of Italian firms to issue debt instruments.

M&A – Advisory

The most vociferous criticism leveled against the Italian production system is undoubtedly that Italian firms are undersized compared to their European counterparts. Because of their small size, in fact, Italian enterprises are prevented from adequately diversifying their funding sources. However, through advisory services linked to mergers and acquisitions (M&A), intermediaries can play a vital role in helping grow businesses until they acquire the critical mass they need to successfully access capital markets.

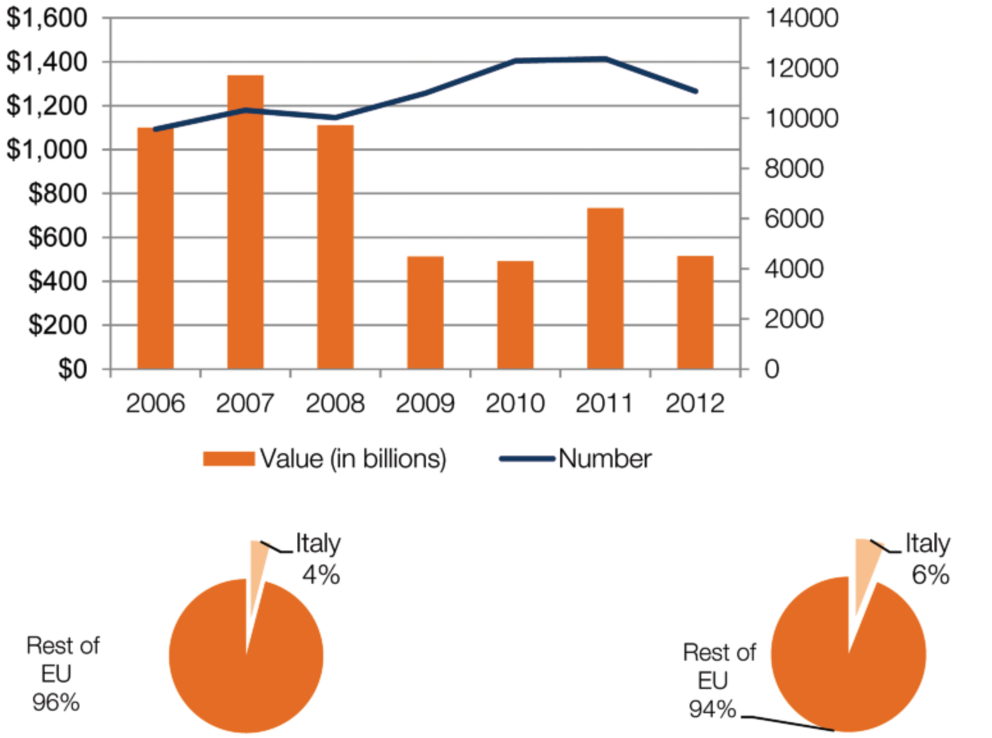
Below we explore the major dynamics that emerge in M&A activity in the Italian market. Before delving into this topic, we offer a brief overview of M&A activity at a European level, which will enable us to point out the most noteworthy similarities and gaps between the national and European markets.

M&A activity and volumes

From 2006 until today, the European M&A market has shown considerable fluctuations and discontinuities in terms of overall deal value. Specifically, *Figure 11* illustrates that after peaking in 2007 at $1,339 billion, the following year M&A activity in Europe contracted appreciably, reflecting similar trends on the financial markets at that time. These data would appear to indicate a slowdown in Europe, where the relative weight with respect to the volume of global M&A activity has seen a progressive downturn over the last five years. In fact, European deals in 2012 accounted for only 25% of the total value of all M&As.

The number of M&A initiatives has remained more stable, confirming the intense reorganization activity taking place in the European economy, which has principally impacted smaller companies. Taking a closer look at the European market in 2012, with an eye to the percentage weight of each country, we can see that Italy makes a fairly modest contribution in terms of both value and number of M&As. In fact, out of a total of 12,000 deals with European bidders or targets, only 4% of these involved Italian firms, corresponding to a value of just 6% of the total.

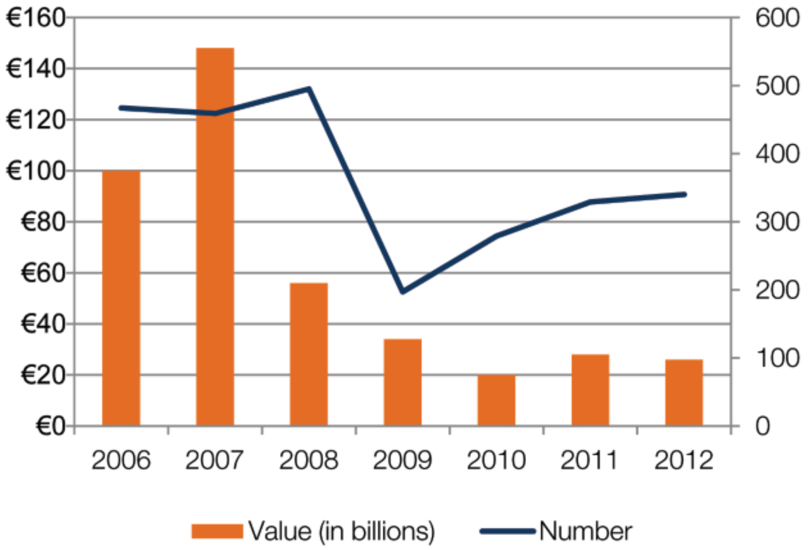
FIGURE 11
M&A volumes in Europe (above, total number of deals and aggregate value in billions) and Italy's contribution in terms of number of deals (bottom left) an value (bottom right)



Source: reformulation of Kpmg data

For further proof of the below-par Italian market performance in 2012, *Figure 12* compares data for previous years. As we can see, relative to 2007, the Italian situation reflects the broader European one, with a dramatic dive in the number of deals and, even more evident, the corresponding value. From this we can infer a significant drop in average deal value (€322 million in 2007, €173 million in 2009, €85 million in 2011, and €76 million in 2012).

FIGURE 12
M&A volumes in Italy (total number of deals and aggregate value in billions)



Source: reformulation of Kpmg data

However, on closer inspection of M&A activity over the past two years, we note that the decline in the average value of deals applies to transactions of all size classes with the exception of large ones.

TABLE 7
Size distribution of deals completed in 2011 and 2012

	2011		2012	
Value (in € millions))	**N° Deal**	**€ billions**	**N° Deal**	**€ billions**
> 1.000	4	10.80	4	12.8
from 100 to 1.000	45	14.60	34	10.8
from 50 to 100	19	1.30	14	1.0
< 50	261	1.30	288	1.1
Total	329	28.00	340	25.7

The table also underscores what is essentially a pulverization of the Italian market in terms of smaller operations, and simultaneously an intense concentration of high-value deals. In 2012 the top 20 deals on the Italian market represented approximately 80% of the total value of the 340 transactions in question. This is entirely in line with the typical entrepreneurial context of this country, where small and medium-sized enterprises clearly predominate.

TABLE 8
Middle market deals 2010

€ millions	**Italian/Italian**	**Italian/Foreign**	**Foreign/Italia**	**Total**
< 50	110	33	54	197
middle market	**25**	**7**	**12**	**44**
from 50 to 75	10	1	4	15
from 75 to 125	8	2	5	15
from 125 to 250	7	4	3	14
> 250	14	7	17	38
Total	**149**	**47**	**83**	**279**

TABLE 9
Middle market deals 2011

€ millions	**Italian/Italian**	**Italian/Foreign**	**Foreign/Italia**	**Total**
< 50	122	48	80	250
middle market	**21**	**5**	**10**	**36**
from 50 to 75	6	2	5	13
from 75 to 125	6	3	2	11
from 125 to 250	9	0	3	12
> 250	15	9	19	43
Total	**158**	**62**	**109**	**329**

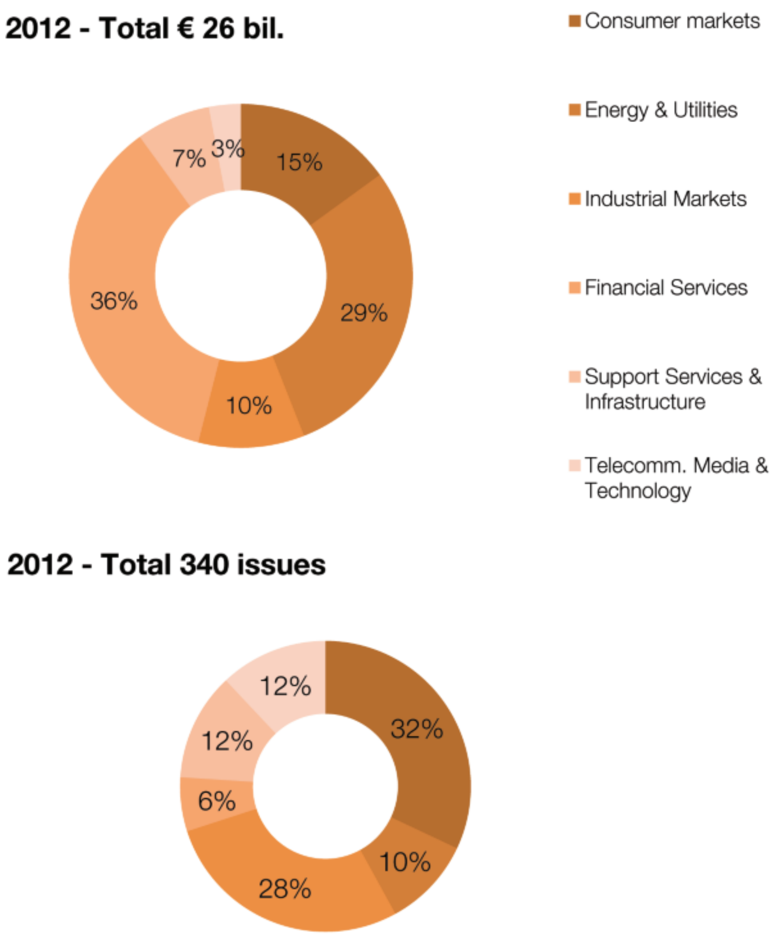
TABLE 10
Middle market deals 2012

€ mln	**Italian/Italian**	**Italian/Foreign**	**Foreign/Italia**	**Total**
< 50	158	51	72	281
middle market	**11**	**9**	**8**	**28**
from 50 to 75	1	4	1	6
from 75 to 125	4	1	4	9
from 125 to 250	6	4	3	13
> 250	17	3	11	31
Total	**186**	**63**	**91**	**340**

Calling attention to the so-called middle market (*tables 8, 9, 10* p. 27), deals where the target's equity value falls in the €50 to €250 million range, the table shows a gradual downturn in deal numbers. In 2010 the middle market represented 16% of the total number (44 deals); in 2011 this figure fell to 11% (36 deals); and in 2012, to 8% (28 deals). On the contrary, as far as the number of deals targeting small firms (equity value less than €50 million), we see appreciable upward movement. In 2010, these deals (197 in number) represented 71% of the total; in 2011, 76% (250 deals); in 2012, 83% (281 deals). Moreover, the weight of the entire Italian SME segment has grown to ultimately account for 90% of the total number of deals in 2012.

As regards the key macro-sectors of the target firms involved in M&As in Italy in 2012, we find that Financial Services saw the most activity, value-wise. As the graphs in *Figure 13* illustrate, deals in this macro-sector account for 36% of the total value of the M&A market in Italy, compared to 11% for the previous year; admittedly deal numbers here are quite contained: only 6% of the total (21 deals, 18 of which were domestic). The reason why Financial Services takes the top spot is primarily due to the contribution of the Cassa Depositi e Prestiti (CDP) which concluded major buyouts (Sace for €6 billion, Fintecna for €1.6 billion, Simest for €0.2 billion).

FIGURE 13
Breakdown of the total number (below) and the aggregate value (above) of deals by target macro-sector



Source: reformulation of Kpmg data

The second most active sector is Energy & Utilities. Here too the number of deals is quite low (35 total, with 22 domestic), with value totaling approximately €7.5 billion. Three major deals account for 80% of this amount, one of which was the €3.5 billion acquisition of a 30% stake in SNAM's share capital by the CDP.

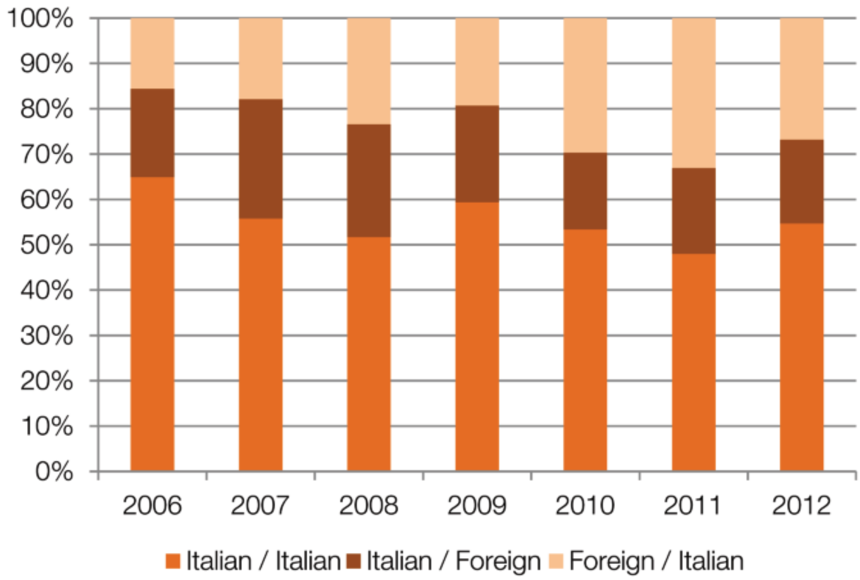
Consumer and Industrial Markets saw the greatest of number of deals (108 and 95 respectively), but taken together these macro-sectors represent only 25% of the total value. This, coupled with an appreciable contraction in value compared to the previous year, demonstrates the continued draw of so-called Made in Italy brands. Further corroboration can be found in the consistent number of deals done in these markets involving foreign buyers and Italian targets (53 out of 203) - renowned brands such as Valentino, Marcolin, Coccinelle, Sixty, Lamborghini, and Ferretti, among others.

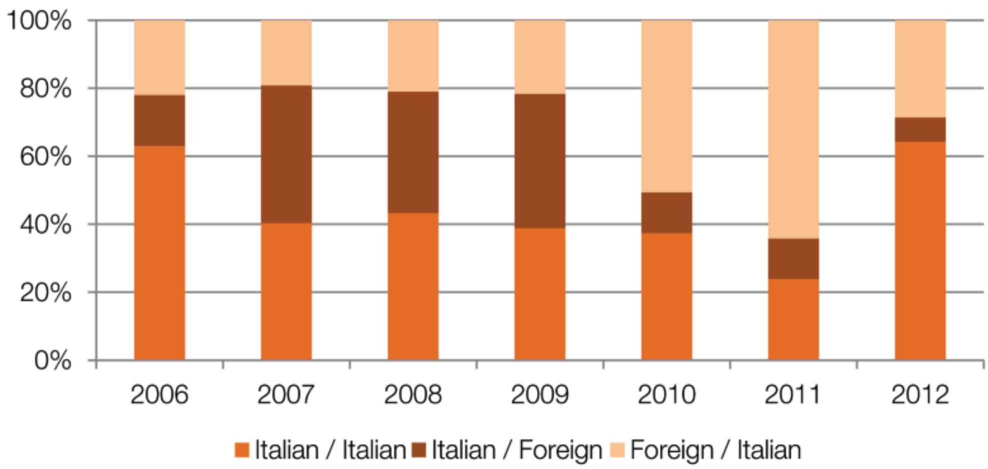
Before detailing 2012's top deals, we believe it is useful to analyze cross-border transactions, both inbound (with foreign buyers and Italian targets) and outbound (vice versa). Within an extended timeframe, we examine the evolution of the percentage weight on the number and overall value of the Italian market of these operations.

Figure 14 shows that in terms of number, the incidence of cross border deals has always been considerable. This is particularly evident from 2007 to today with a peak in 2011, when cross border deals outnumbered domestic ones (52% versus 48%). In 2012, instead, domestic transactions made a market comeback (with the percentage of the total rising from 48% in 2011 to 55%). As regards deal value, the figure below depicts a discontinuous trend, in particular in the last three years that are charted. While in 2010 and 2011, cross border deals carried a respective weight of 62% and 76% of the total value, in 2012 that figure plummeted to 36%, compared to 66% at a European level. However, the increase in Italy-on-Italy deals in 2012 can be attributed for the most part to initiatives undertaken by the CDP, which was responsible for three of the four biggest acquisitions, with a total value topping €11 billion. Excluding these deals, most of the year's activity is again cross border, for the most part with Italian firms targeted by foreign buyers.

Again in 2012, Italy experienced a sharp decline in cross border deals, due in part to the political instability, the recessive climate and the resulting lack of confidence in the country among foreign investors. The greatest impact was caused by a collapse in inbound deals, which contributed half as much as the previous year. In absolute terms, there were 154 cross border deals in 2012, compared to 171 in 2011, for a drop in value of approximately €21 billion.

FIGURE 14
Number (above) and value (below) of cross-border deals





Source: reformulation of Kpmg data

Here, in contrast to the preceding description, interesting to note is that among the top ten deals of 2012 in terms of value, six were cross border transactions (involving foreign firms buying Italian targets). A careful analysis of these deals brings to light a number of key considerations.

TABLE 11
Top 10 largest deals 2012

Target	Target Nationality	Bidder	Bidder Nationality	Stake	Value (€ bn)	Cross Border
Sace	Italy	Cassa Depositi & Prestiti	Italy	100%	6.0	
SNAM	Italy	Cassa Depositi & Prestiti	Italy	30%	3.5	
Transalpina di Energia (Edison shareholder)	Italy	EDF Electricité de France	France	50%	1.7	yes
Fintecna	Italy	Cassa Depositi & Prestiti	Italy	100%	1.6	
Edipower	Italy	Delmi	Italy	70%	0.9	
Gruppo Costanera (Gruppo Atlantia)	Chile/Italy	Canada Pension Plan Investment Board	Canada	50%	0.9	Yes
Ducati Motor Holding	Italy	Automobili Lamborghini (Audi - Gruppo Volkswagen)	Italy/ Germany	100%	0.7	yes
Valentino Fashion Group	Italy	Mayhoola for Investment	Quatar	100%	0.7	yes
UniCredit	Italy	Pamplona Capital Management	UK	3%	0.7	yes
ISAB	Italy	OAO Neftyanaya Kompaniya LUKOIL	Russia	20%	0.5	yes
Total value of top 10 deals					**17.2**	
Total value of all M&A deals					**25.7**	
Top 10 deals as a % of total value					**67%**	

First, relevant data confirm that the Italian M&A market is a highly concentrated one. The total value of the top ten deals accounts for 67% of the entire market (€17.2 billion), a noticeable increase with respect to 45% in 2010 (€9 billion) and 55% in 2011(€15.4 billion). However, it should be noted that 43% of the total value of 2012 deals were executed by the CDP.

As mentioned above, six of the top ten deals were cross border operations, but none of these was outbound (domestic buyers with foreign targets). This is evidence of the challenge Italian firms face in attempting large-scale deals, and a natural inclination toward small to medium sized acquisitions, which are more compatible with the entrepreneurial context that characterizes this county. What also becomes apparent from this analysis is the decisive role of International Private Equities and Sovereign Funds, responsible for two of the top ten deals, in addition to those undertaken by the CDP.

The role of intermediation and the structure of the M&A Advisory service offering

One or more advisors can take part in any M&A deal. What is interesting about the Italian M&A market is the prominent role of a small number of national champions and foreign intermediaries who handle most deals every year on the buy-side or the sell-side. In fact, the record shows that top ten advisors receive 60% of the M&A mandates. This trend holds true in 2012: out of a total of 262 M&A advisory mandates, 173 (66%) were taken on by the top ten players on the market. For the purposes of our analysis, M&A advisory activity can be broken down into three different types of intermediary: foreign players; national champions; and other Italian banks, brokerage firms and advisory boutiques. *Figure 15* compares the number of mandates from Italian firms per type of intermediary by year and deal size.

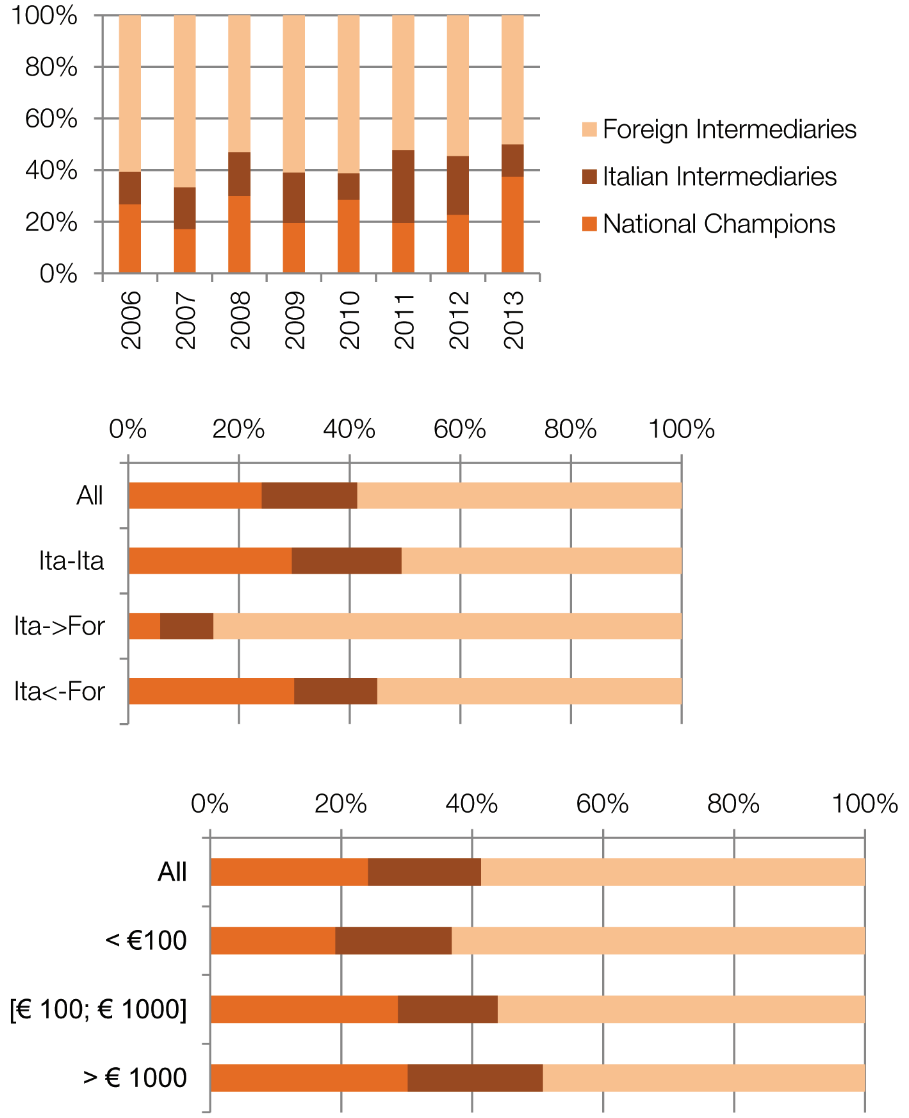


FIGURE 15
Breakdown of M&A Advisory by type of financial intermediary: Overall (top), by nationality of the firms involved (center) and deal value (bottom, in millions)

Source: Thomson Reuters

The title of 'national champions' in M&A advisory services goes to Mediobanca and Banca IMI (Intesa Sanpaolo), the only two Italian brokers to be ranked in the top ten on the Thomson Reuters league table for the period in question, both by mandate number and value. However, a closer look at the annual data reveals that following close behind these champions come Banca Leonardo&Co and UniCredit, especially in recent years.

The first observation of note here is that the market of advisory mandates has been dominated for some time by investment banks, particularly foreign ones. National champions and other domestic intermediaries win fewer mandates, and these mainly entail transactions with Italian companies on the sell-side and buy-side. Moreover, data seem to indicate the tendency for foreigners who buy in Italy to turn to national champions as advisors, while Italians who buy abroad prefer foreign intermediaries. The break down by deal size does not offer any particularly useful insights.

As for advisory boutiques and consultancy firms, their activity is less constant and concentrated on smaller deals. In this category, the most prolific Italians are EQUITA SIM, Vitale e Associati, Tamburi Investment Partners, Kletcha & Co. and EnVent; foreigners include KPMG, Deloitte and Ernst & Young. While in Europe the weight of independent advisors is on the rise, in Italy their share of total commissions is still a marginal one.

Although all data for the year are not yet in as of this writing, 2013 is showing an uptick in M&A activity. In fact, the first nine months of the year have brought a number of announcements for sizeable deals, some of which are already closed. Many of these involve a foreign buyer company, a sign of new-found confidence among foreign players, despite the uncertainties arising from Italy's political situation and prospects for recovery.

Some of the major cross border-in deals (foreign investments in Italian companies) concluded or being finalized in 2013 include the following acquisitions:

- the aeronautics division of Avio SpA by General Electric Group for approximately €3.3 billion;
- Gruppo Marazzi by the US company Mohawk for €1.1 billion;
- Cerved Group Spa by CVC Capital Partners, a British Private Equity, for €1.1 billion.

Other important deals, albeit with lower price tags, have been announced or already closed on the domestic market as well (of particular note, the acquisition of Telecom Italia Media by Cairo Communication, the Hera Spa - Acegas-Aps merger, and the Gruppi Unipol -Fondiaria–SAI merger), not to mention outbound cross border transactions (for instance, Erg SpA's buyout of IP Maestrale Investments Ltd, and the 70% share acquisition of Printemps by Gruppo Borletti along with a pool of Qatari investors).

From our analysis of M&A activity in Italy, what clearly emerges is a decline in the number of transactions involving Italian firms (CDP deals aside). Moreover, in terms of deal value, domestic enterprises are more frequently falling prey to foreign buyers. Once again, these trends can be explained by an undersized Italian system, with regard to both intermediaries and investors. The lack of a capital-raising system leaves Italian firms without efficient financing, thwarting growth in general, and growth via acquisitions in particular. When comparing Italy to other countries, the development gap in investment banking becomes apparent in cross border deals, the majority of which involve foreign buyers and Italian targets, and not vice versa.

Sales & Trading and Equity Research

Firms can tap capital markets to fund investments and growth only if these markets function properly and efficiently. Both equity supply and demand is increasingly dependent on how easily investments can be liquidated, how much information is available, and how accurate it is, especially with regard to investments in smaller enterprises. This is where financial intermediaries come in. By offering services in pertaining to sales and trading and equity research, they can pave the way to capital markets by breaking down information barriers and opening up information channels that are crucial for accurate investment valuations.

According to regulatory reporting statistics compiled by Consob, in 2012 Italian intermediaries, on their own behalf or for their clients, negotiated transactions of stocks and bonds issued by Italian firms for a total value of €342.9 and €142.4 billion respectively. During the same year, these intermediaries received and executed orders amounting to €141.4 billion for stocks and €294.5 billion for bonds.

FIGURE 16
Sales and Trading: volumes (in billions)

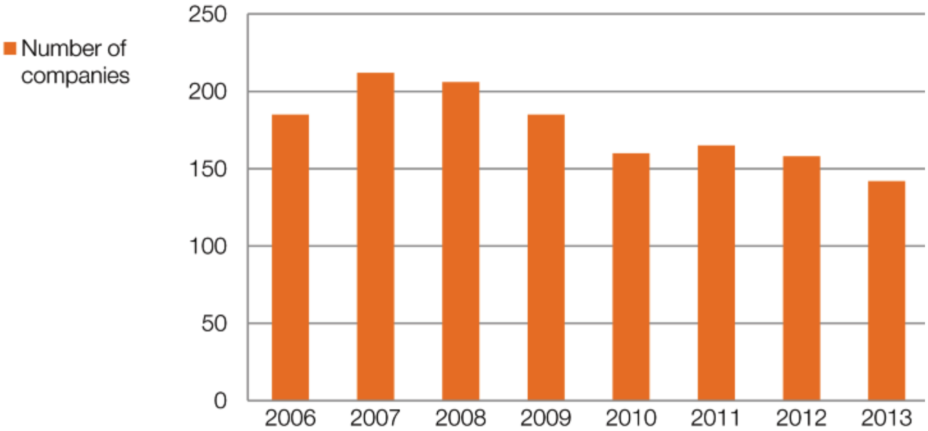
Source: Consob

Closely linked to sales and trading services is equity research. Here we analyze the structure and evolution of the offering based on company reports, published in accordance with regulatory requirements set down by Consob and Borsa Italiana (available on the Borsa website).[13]

[13] Article 69, Paragraph 9, Consob Issuer Regulation 11971/1999. A similar approach, although in a different context, is taken by Guagliano, Linciano and Magistro Contento (2013), who analyze company reports published in accordance with Consob and Borsa Italiana regulations in force pertaining to listed firms with lower capitalizations. Our analysis is potentially subject to two types of bias. For each observation of a firm-broker relationship, research activity must be finalized in a published report, which must then be submitted to the Borsa Italiana. Bias may arise in underestimating the coverage of firms for which one or both of these requisites is not fulfilled. However, in all likelihood this potential bias will not vary over time, therefore empirical evidence will not be invalidated on the evolution of equity research service provision, which is the topic of this study. It is only with the approval on 9 May 2012 of Consob act n.18241 that regulation pertaining the publication of equity research has become less stringent, by amendment of the requirements for its submission to the Borsa Italiana.

First, we note that the number of non-financial Italian firms in question has declined noticeably since 2008. In addition, proof of the downslide the sector is experiencing and the increasing concentration of the market for this service, we find a dramatic drop in the average number of studies per company. This trend is entirely consistent with our observation regarding trading on capital markets. According to Consob data, in 2012 alone the value of trading in shares of listed Italian firms dropped by approximately one-fourth compared to the previous year. For smaller listed firms, the lack of research coverage means a further reduction in the number of brokered deals and the gradual desertion of institutional investors among the ranks of shareholders.

FIGURE 17
Equity Research - Coverage

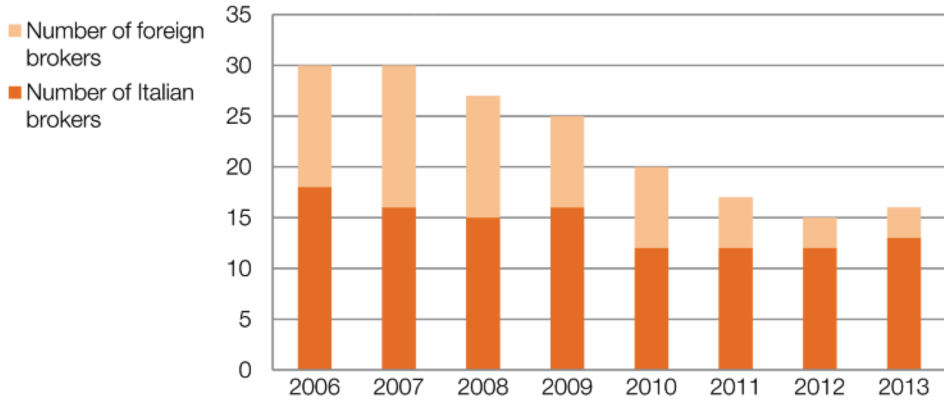


	2006	2007	2008	2009	2010	2011	2012	2013
Number of companies	185	212	206	185	160	165	158	142
Reports per company: average	8.90	7.47	5.21	3.44	3.07	3.31	2.77	2.03
Reports per company: st. dev.	5.53	4.98	3.52	2.11	1.84	1.88	1.34	0.84
Reports per company: avg.	8	7	4	3	3	3	3	2
Reports per company: 25°p	4	3	2	2	1	2	2	1
Reports per company: 75°p	14	11	8	5	5	5	4	3

Source: Borsa Italiana

The decline in equity research activity can be explained by noting that, beginning in 2008, the number of brokers who publish reports on Italian firms has plummeted. On closer inspection, it appears that for the most part, foreign intermediaries are the ones who have abandoned the market, probably due to the higher cost of information gathering. Also noteworthy is the average number of companies covered by each intermediary, which has fallen at the same rate. This corroborates the fact that although a sizeable pooling of players has occurred over the years, this alone cannot explain the overall downturn in the supply of equity research services.

FIGURE 18
Equity Research - Brokers



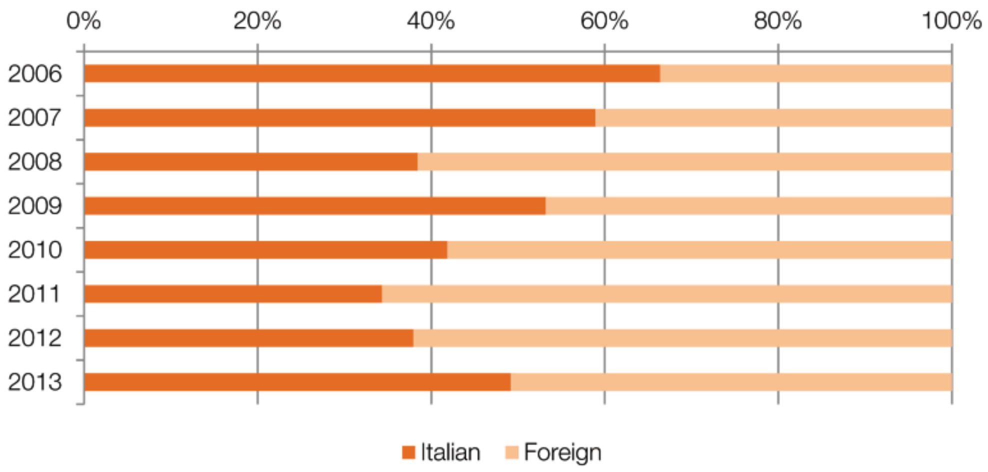
	2006	2007	2008	2009	2010	2011	2012	2013
Number of foreign brokers	12	14	12	9	8	5	3	3
Number of Italian brokers	18	16	15	16	12	12	12	13
Reports per broker: average	54.07	47.92	44.05	35.04	31.50	41.12	41.83	33.92
Reports per broker: st. dev.	22.46	24.62	26.67	19.63	14.95	20.38	26.74	22.50
Reports per broker: avg.	53	50	39	36	32	47	37	30
Reports per broker: 25°p	37	28	26	18	14	27	25	10
Reports per broker: 75°p	72	58	57	49	45	57	44	36

Source: Borsa Italiana

In any case, it would not be entirely accurate to conclude that foreign operators play a marginal role in equity research on Italian firms. A more in-depth analysis of the reports published every year shows that these few players provide the majority of the overall offering. The only foreign intermediaries that still operate on the market are the big investment banks, which offer ample coverage of Italian firms with their reports. However, the so-called 'global' players typically concentrate their research efforts on big companies, or firms that make up European sector indices (such as utilities, banks, insurance companies, and so forth) with stock liquidity levels that promise to generate satisfactory intermediation commissions.

The downward trend in liquidity in Italy, especially on the STAR and FTSE Mid-cap indices, has clearly driven away both global equity researchers and independent Italian brokers. In fact, without adequate returns on intermediation or commissions from advisory mandates, these professionals have reduced or even eliminated coverage of small to medium equities. Proof of this trend is the fact that various players have either quit the field (such as Centrobanca), joined forces (as with Kepler and Chevreux), or opted to outsource research activities (Unicredit). This fragmented context makes it difficult to identify national champions. In addition to banks like Banca IMI and Mediobanca, offering the most extensive research coverage are EQUITA SIM, Intermonte SIM and Banca Akros.

FIGURE 19
Equity Research – Company Reports



Source: Borsa Italiana

The inadequate size of the Italian financial system is closely linked to the fact that investment recommendations are not widely circulated; this is especially relevant with low-cap stocks or new issues. In fact, the dissemination of reliable and transparent information on issuing companies is both an effective tool for supporting the liquidity of shares, and a prerequisite for expanding the range of operations for institutional investors, particularly foreign ones.

Conclusion

The need to bring together companies and capital markets is not a problem facing Italy alone. The credit crunch is a challenge that all of Europe needs to overcome in order to give the real economy the necessary tools to deal with the crisis. However, compared to other countries, our analysis demonstrates that Italy's financial system is more bank-centric, dominated by a few national champions and potential conflicts of interest. The investment banking sector should facilitate firms' access to resources needed for growth, but this study highlights the fact that this already-undersized sector has shrunk even further in the aftermath of the financial crisis. Left out in the cold are small and medium-sized firms, which are considered less attractive because they offer limited penetration opportunities for investment banking products.

These SMEs, with no alternative sources of capital apart from bank loans, are hardest hit by the post-crisis credit crunch. Having no recourse to financing to support growth, these companies are at a disadvantage relative to their foreign competitors, and often fall prey to the sector consolidation processes currently underway. All this gives rise to the need to support the banking system with efficient capital markets to serve small and medium-sized enterprises, leveraging a series of measures that promote the role of financial intermediaries and the investment banking sector in general.

To this end, in 2013 several European governments have implemented a number of projects with a dual approach: utilizing the liquidity lever and giving smaller firms access to instruments, such as corporate bonds, traditionally reserved for larger concerns. In France and Britain, where companies have a more diversified financial structure (see *Figure 2*), most measures have centered on liquidity. Specifically, in France the Banque Publique d'Investissement (BPI) opened in 2013. Encompassing initiatives under the supervision of the Caisse des Depots, the BPI has a budget of €42 billion, and intervenes on three fronts: loans to innovative SMEs, investments in their share capital, and credit for exports. In Britain, instead, starting in 2014 the British Business Bank (BBB) will be fully operational. With £ 3.9 billion in available funds, this institution is tasked with supporting startups and small companies that are unable to provide adequate loan guarantees. This initiative will complement the £80 billion Funding for Lending program, created in 2012, which provides funding at below market rates to banks that lend to SMEs.

In countries where bank loans are the primary source of financing for firms, such as Italy, Germany, and Spain (see *Figure 2*), the most important initiatives have centered on regulating capital-raising instruments and markets, particularly bonds. Germany is the European forerunner in these efforts, having created the BONDM segment on the Stuttgart Stock Exchange in May 2012, where SMEs list bonds ranging in value from €25 to €150 million. Following Germany's lead, Spain is also working to establish a similar segment specially dedicated to SMEs.

Acting on these international experiences, in Italy two important measures took effect in 2012 aimed at paving the way for financing by firms on both the debt and equity capital markets. The 2012 Decreto Sviluppo simplifies bond issues, both from a regulatory and fiscal standpoint. On the equity front, 2011 saw the implementation of the ACE (Aiuto alla Crescita Economica - Aid for Economic Growth). This program offers 3% tax breaks on equity instruments when firms increase capital or allocate profits to reserves. In addition, this initiative is soon to be reinforced thanks to the 2014 Legge di Stabilità (Stability Law), currently undergoing approval. This new legislation will increase the above deduction to 4.2% for the current fiscal period until 31 December 2014, then to 4.75% from that date until December 2015, and to 5% after that.

To complement these measures, administrative procedures may be streamlined even further for access to credit and financial instruments, to shore up the economic system of Italian SMEs. These innovations could come on the intermediary front by means of institutional forms of investment and the creation of lending vehicles that could serve as alternatives to the banking system, fashioned on the American model for private placements. Specifically, access to the bond market should be made possible not only for medium sized firms, but small ones as well, by finding solutions that are appealing for all those firms in Italy with less than €10 million in turnover.

For example, one solution might be opening funds that are capable of analyzing small companies, and that are willing to buy small bonds, for as little as a million euro each. Finanziaria Internazionale SGR and the Montepaschi Group did just this, when in May 2012 they launched a closed credit fund specialized in mini-bonds priced from €2 to €5 million. Based on deal agreements, the SGR will handle firm selection, the Siena-based bank will act as advisor, and the CRIF agency will determine respective ratings.

Looking ahead, bringing together companies and capital markets represents an important opportunity for intermediaries, in particular independent domestic brokers. In fact, the sector is wide open, with the few remaining players tending to polarize on larger firms while neglecting smaller ones. *Figures 20* and *21* illustrate the evolution of the Italian financial system, demonstrating a gradual concentration of activity in groups of integrated intermediaries.

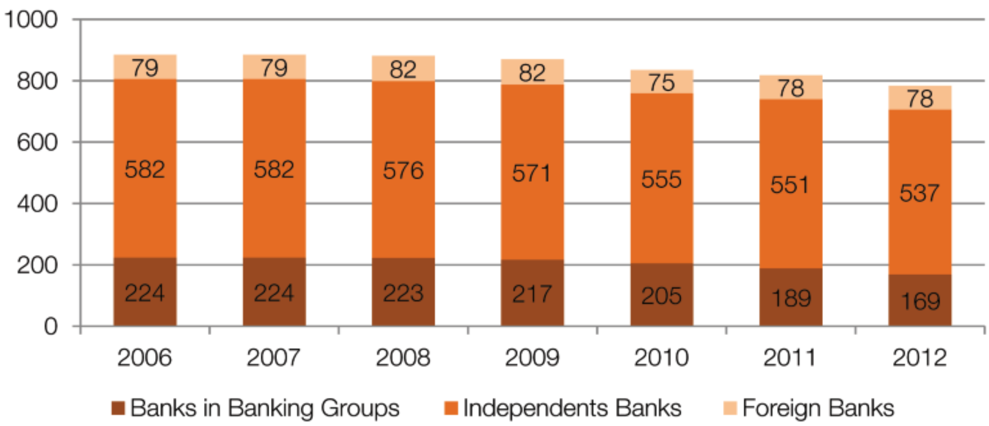
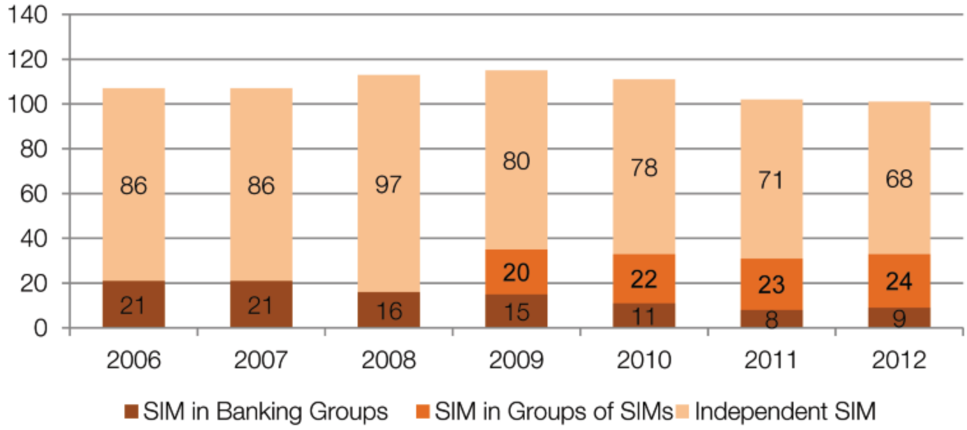


FIGURE 20
Evolution of the Italian financial system: banks

Source: Banca d'Italia

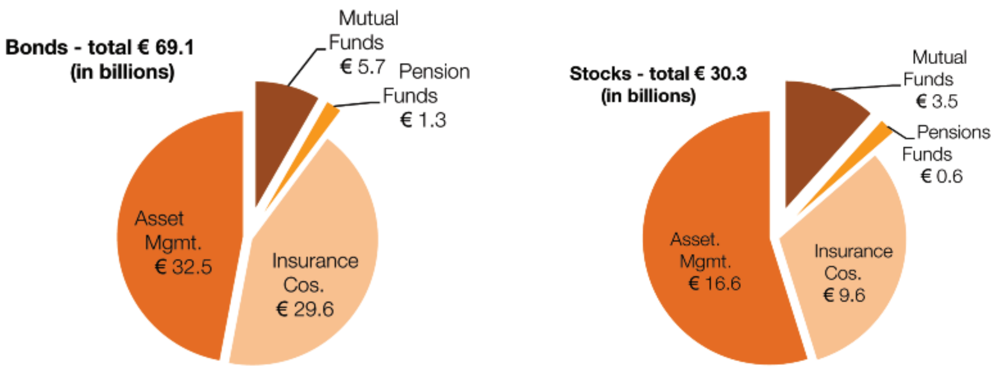
FIGURE 21
Evolution of the Italian financial system: brokerage firms



Source: Banca d'Italia

Moreover, instruments issued by SMEs can prove to be interesting investment opportunities for institutional investors. *Figures 22* and *23* show the total value of investments in stocks and bonds issued by Italian firms contained in the portfolios of the main categories of Italian institutional investors, and the weight of these investments on the total portfolio of each type of investor.

FIGURE 22
Institutional investments in the stocks (right) and bonds (left) of italian firms in 2012



Source: Banca d'Italia

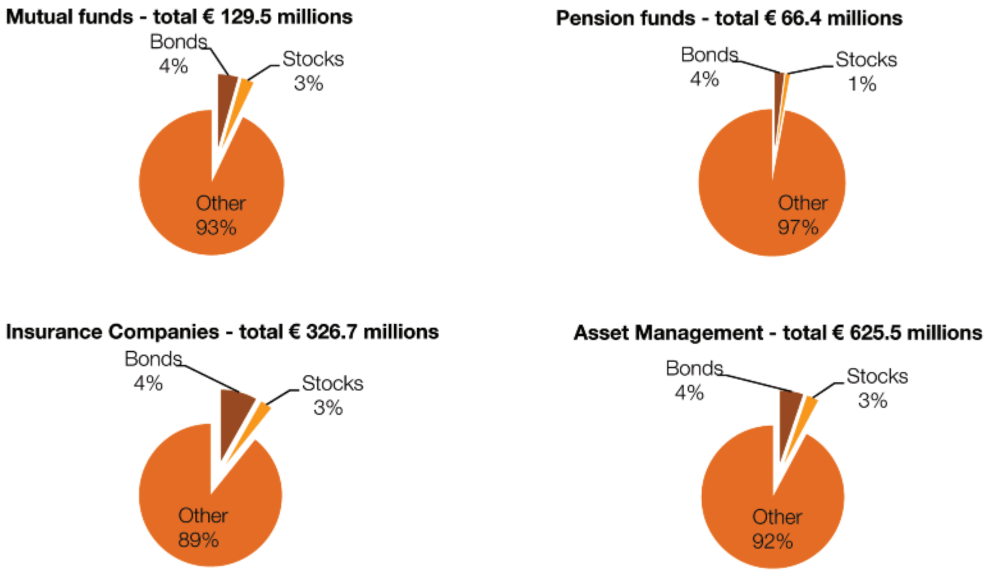


FIGURE 23
Portfolio allocation to stocks and bonds of Italian firms by type of investor: mutual funds (top left), pension funds (top right), insurance companies (bottom left), asset management (bottom right)

Source: Banca d'Italia

Compared to the rest of Europe, there are wide gaps between current and potential investments, which means resources earmarked for corporate investments have ample room to grow. Considering investment management companies alone, according to the latest Assogestioni estimates, of the €1,200 billion managed by the industry overall, somewhere between €5.5 and €11.5 billion could be allocated for financing SMEs. This would fall within regulatory limits applicable to different types of institutional investors in terms of the quotas on illiquid instruments. Specifically, in keeping with the regulations in force and in light of investment policies, mutual funds could channel resources totaling between €3.2 and €6.4 billion. Moreover, within the context of mandates from pension and insurance funds, these could generate resources ranging from €1 to €2.7 billion and €350 and €690 million respectively.

The aim of our next position paper will be to study the attitudes of various players toward investments in SME equity and debt, and their potential demand for this investment class. Specifically, in our analysis of the institutional capital markets and investment services, we will describe their development, structure, and size, in an effort to understand their role in financing firms.

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