



# Private Equity and Public Markets: the Viewpoint of Financial Providers and Industry in Italy and the U.K.



TWENTY-NINTH CONFERENCE DEBATE  
Friday 26th October 2007  
The Savoy., London



THE ITALIAN CHAMBER  
OF COMMERCE  
AND INDUSTRY  
FOR THE UK

*Proceedings of the Conference have been  
published with the support of*



**"PRIVATE EQUITY AND PUBLIC MARKETS:  
The Viewpoint of Financial Providers and Industry in Italy and the UK"**

Honorary Chairman of the Conference

The Italian Ambassador  
H.E. Giancarlo Aragona

President of the Italian Chamber of Commerce

Dott Leonardo Simonelli Santi

Co-Chairmen of the Conference

Professor Robert Leonardi  
London School of Economics and  
Political Science

Dott Gabriele Capolino  
Director  
Class Editore SpA, Milano Finanza

Panel:

Mattia Caprioli

Principal  
KKR

Terry Kramer

Group Strategy Director and  
Chief of Staff  
Vodafone Group Plc

Amadeo Nodari

Head of Institutional Participations  
Merchant Banking  
Intesa Sanpaolo SpA

Vince O'Brien

Director  
Montagu Private Equity LLP

Stefano Pessina

Executive Chairman  
Alliance Boots Limited

Claudio Sposito

Chairman and CEO  
Clessidra SGR SpA

Guest of Honour at Lunch:

The Rt Hon The Lord Newby, OBE  
Liberal Democrat Spokesman on  
Treasury Matters in the House of  
Lords



## No borders to your business.

*With 40 million customers, 170.000 employees and a widespread presence in 50 countries, UniCredit Group is a truly European bank. In Central and Eastern Europe, an area featuring a dramatic economic growth, we are the leading banking network, experienced like no other. Wherever your business brings you, rely on our complete range of international finance business products and deep understanding of any European local market.*

**UNICREDIT GROUP, MOOR HOUSE, 120 LONDON WALL, LONDON EC2Y 5ET, PHONE: +44 (0) 207 826 1600**

## Proceedings of the Conference

**Speaker: Leonardo Simonelli Santi**

Welcome ladies and gentleman. Some of you may know that last night the third Keynes-Sraffa Award ceremony was held at the Italian Embassy organised by the Chamber. The recipients this year were Arun Sarin, Chief Executive Officer of Vodafone and Vittorio Merloni, Chairman of the Indesit Company. The week before last the Chamber concluded the third successful edition of "Viva Italia" at the London Olympia and next year in March, together with Brand Events, we will present an even bigger show "La Dolce Vita with Viva Italia". Last week the Chamber arranged for the participation of five Italian companies at the British Wind Energy Conference and Exhibition in Glasgow. These are just some of the most recent examples of the different activities of the Chamber which continue to prove its versatility and competitive efficiency. Nonetheless we still consider the banking and industry conference the oldest and the most significant of our events. I am therefore today very pleased to open the 29<sup>th</sup> edition and I think that the longevity of this event is proof that this gathering is a relevant forum for topics important to the United Kingdom and Italy and indeed of general interest. The reason for its success is the choice of an interesting subject and a panel of great quality. This year's topic is a case in point and our panel is made of experts in their relevant fields. We are very grateful to everyone who has with their presence helped us to achieve this ongoing success. Private equity has recently received considerable media attention creating a debate about its "pros" and "cons". At the end of the conference everyone here will be in a better position to formulate his or her own opinion. At lunch our Guest of Honour, The Right Honourable The Lord Newby, will touch on the fiscal aspect of private equity. This year we have even a larger panel with two industrialists, Terry Kramer, of Vodafone and Stefano Pessina of Alliance Boots, two bankers, Amedeo Nodari of Intesa Sanpaolo and Vince O'Brien of Montagu and two main actors in private equity in Italy, Claudio Sposito of Clessidra and internationally, Mattia Caprioli, of KKR. After their excellent performance last year, we are delighted to have regained as co-chairmen Professor Robert Leonardi and Gabriele Capolino. The notes about our speakers and our guests of honour are in the conference brochure which you received when you arrived. As usual, my role is very limited so that we can take full advantage of our brilliant speakers. Therefore, before I hand over to Professor Leonardi it is my pleasure to introduce His Excellency the Italian Ambassador, Giancarlo Aragona, who would like to say a few words. Thank you.

*Clapping*

**His Excellency The Italian Ambassador**

Thank you, Leonardo, for your words and a very warm welcome to the Panellists and all the guests at this conference today. It is the fourth time I inaugurate the Banking and Industry Conference. It is, for an ambassador, a pretty high record, but it is a short time if we look at the long history of the conference which goes back to 1981 and celebrates today therefore its 29<sup>th</sup> Anniversary, so best wishes for entering adulthood. I congratulate the Italian Chamber of Commerce and its President, Leonard Simonelli Santi, for their efforts to ensure that this event remains an important forum, an important moment for gauging the state of good British Italian economic relations, as well as for an

exchange of experiences and best practices between the two countries. This year's topic is particularly challenging and important. Advantages and disadvantages of private equity are these days highly debated in the light of the role recently played by private equity groups in the buy out of some important listed companies. As a consequence, much has been written by economic and financial analysts, both in the UK and in Italy, against or in favour of this model with regard to its implications in terms of financial stability, market efficiency and consumer protection. The dimension of the phenomena in the two countries is, of course, very different. Problems and opportunities, however, are pretty similar, and this makes the discussion useful for both sides. You will understand if I do not venture into the debate about private equity. As I am aware of the technical complexity of this issue, I would rather leave the task of discussing this complex matter to the experts. I am confident, however, that the presence on the Panel of authoritative representatives of Italian and British industries, as well as British and Italian private equity groups, not to mention a high calibre entrepreneur such as Stefano Pessina with his direct experience in this sector, will help clarify the most difficult points. Before passing the floor to the Panellists, let me remind you, however, that the Banking and Industry Conference has always offered the opportunity to assess the state of the economic and financial relations between our two countries, and I am pleased to say that these relations are flourishing in all directions. The trade continues to grow and for us Italians it is good news that there is a very positive trend in Italian exports towards the UK. There is an increasing number of British companies which look at the Italian market as a favourable environment for their investments and the same happens for Italian companies towards the UK. I do not need again to mention groups but Finmeccanica, Indesit, Seda, Fiat and others have continued to develop their activities in Great Britain and vice-versa we have an ever-larger number of British companies exploring the Italian markets but let me just mention banks, such as Barclays and the Royal Bank of Scotland which are active in Italy and also the Italian banking sector is undergoing a very significant process of aggregation; although they decrease in numbers, they are more forceful and more active and present also in London. You probably are already aware that Mediobanca will very soon open a London branch. This is a very significant step. Mediobanca is the leading Italian investment bank and they will be active and present in London and, of course, just a few weeks ago the merger between the London Stock Exchange and the Borsa Italiana, the Italian Stock Exchange, creating a leading group in Europe and this, of course, will offer new opportunities for working together. So to conclude, this year's Banking and Industry Conference takes place in a very favourable moment for the co-operation of our two countries, and I am sure that your discussions today will give new impetus to this co-operation and will also allow for some useful networking. I therefore wish the conference full success and will see you again for the working lunch when we will be hearing from Lord Newby. Well done Leonardo and see you in a few hours.

*Clapping*

**Professor Robert Leonardi**

We shall now open the conference. I will be speaking from this table but I will ask the presenters to go to the lectern. We have the distinct pleasure today to discuss an issue which is the rage now in

terms of things that have changed so rapidly. Eight months ago when we thought of this conference, its title, content and speakers, it didn't seem to be so pressing. Now we see that we are in the midst of very rapid change which is the world changing around us. The players emerging are newcomers to the stage and the old protagonists are starting to fade so therefore we have entered, I believe, a new era where there is a shakeout of entrepreneurs, of businesses and particular activities. Today we have the distinct opportunity to listen to protagonists and have six excellent speakers with whom we can then engage in a dialogue in the question and answer period. So rather than take up time introducing them I think that it is much more worthwhile to listen to them directly and reflect on what they say and then engage them in a question and answer period at the end of the session. So I would like to ask, first of all, Terry Kramer of Vodafone to go to the lectern and make his presentation.

*Clapping*

### **Terry Kramer**

First of all thank you very much. I wanted first of all to say welcome and thank you very much for including Vodafone here. We appreciate the partnership with the Italian Chamber of Commerce and also appreciate the professor's introduction. Now what I would like to cover here is give you a little bit of background about Vodafone and our history to provide some context but then importantly talk about our view about private equity from our perspective, what we see about the value of private equity, where we see similar practices in our own company and mindset and then importantly where we see some of the differences, so I'll go through all of that and leave you with a couple of concluding comments at the end. Now, our next slide here in terms of our history as a company, what's interesting I think you'll find about Vodafone is our history is fairly young. The company is only about 23 years old, 1984 is when the first wireless networks were developed and they started in a variety of locations but the UK was the first one for us and at that time the business was very small as a network organisation and what happened was partially based on access to capital is we were able to grow the company quite significantly over the past few years so in the UK. Where we originally had a network organisation we were able to buy a series of distributors that then became our UK business today. We also acquired two large companies, Airtouch, which was a San Francisco based company, the company from which I'm from, that company had operations in the US but also minority stakes in a variety of European and Asian businesses and also Monosmon, which is a company that had a very large presence in Europe and through those two acquisitions, a global company was formed with a presence in five continents, with a lot of growth both organically and through acquisition activity. Today the market capitalisation of the company is approximately 93 billion, actually our share price moved up about 4% yesterday, positive news from France Telecom had a knock-on effect to the rest of the sector so there has been a fair amount of growth in the business.

On the next slide just to give you a sample here, again as I mentioned when the companies started out we had minority stakes in a variety of markets. In Italy we had a business called Omnitel Pronto Italia, in the US we had Airtouch, in Vodafone it was Vodafone. But what happened over a period of time began through sources of capital as we were able to buy up our ownership stakes to become a

majority owner in these businesses. In the process of that we were able to tap a certain amount of global scale by putting the Vodafone brand name on each of our businesses and picking out a few items that represent significant scale in areas like purchasing, as an example. So these are the businesses that we are in today, our largest businesses in Europe are in Italy, in Germany, in the UK and in Spain. We also have large operations in the US called Verizon Wireless where we are a 45% owner and then we have a variety of operations in Asia. Our largest acquisition most recently was in India where we purchased a 67% stake of Hutchinson Esser.

The next slide is on the rise of private equity, I mean one of the things that we watch as a company is what's happening in the private equity world and what I can see in summary is very impressive activity in this space, so going way back to the RJR Nabisco days when that company was acquired to a lot of growth through the dot.com era, a lot of private equity activity in the industry. In the UK specifically a fair amount of notable activities there. When you look at the number of people employed by companies that have a strong private equity background, it's about 3 million, about 51% of all activity that goes on in private equities here in the UK. It's a lot of activity. The key question for a company like ours is what does this mean to us. Is private equity an opportunity? Is it a threat to us? Does it represent something we should be looking at and changing how we operate and how can we learn and again that's what I'd like to cover.

The next slide here you'll see are the things that we would look at and say if we think of private equity at Vodafone, these are the things we think of when we do think of private equity. So number one in terms of an investment period or investment term we generally look at private equity organisations having a more defined investment term. We would call this short and intermediate term, not long term but short and intermediate term, and I'll cover in a minute how we would kind of counter these items and respond to these. Second one would be a very significant focus on free cash flow, the cash that's generated from a company and certainly in a company like ours it has significant capital expenditures as we invest in networks, thinking about how much cash comes out of the business every year is something that we see on the private equity side being very very notable.

The next one is a significant focus on the values and levers for success. Private equity firms having a very clear view about what drives the value in an industry and then the final one is cost management and a lot of this orients itself around knowing one of the most viable things that an organisation needs to do and investing in those but not investing in a lot of other items which may be more elective.

The other items I'll just share with you again from a private equity standpoint how we would look at it is, number one we'd see very strong performance related pay. So a lot of investment in an individual saying if the business performs well there'll be a significant return for the leaders and for the employees in the company. Another one would be fast decision-making, the speed at which decisions get made and a clarity of view. Active portfolio management, so in a business that has a variety of entities to it, what businesses are the ones that the company will stay with, what will be the ones they sell, what will be the ones that get purchased? Size and scope. In general the companies we see that have strong private equity focus tend to be focused in one sector and generally tend to be

of a certain size. not necessarily the size that you would see with Vodafone. And then finally optimising the capitalisation and the company, making effective use of debt and equity.

Now let me share on the next slide how we would look at those same measures in our own response and I think what you'll find is that a fair number of these items we find alignment with, that we would manage our own business to. Certainly the degree to which we focus on these is going to vary but the general focus is similar I think in several areas; there are one or two notable exceptions. So first item is on the investment term, in general what I would say with a company like ours is we're going to have a longer investment term. Our shareholders are going to be making an investment over a longer period of time and are going to expect that there's a balance between short, intermediate and long-term orientation. We certainly have quarterly results, we have half yearly results which we have to focus on, but we need to make sure that the portfolio of businesses that we are in is going to generate a long-term return.

The second piece is strong focus on free cash flow. In our business, what we've done is we've set what we call "Capital Intensity Targets" so as we think about the capital that gets invested, we think about the revenue that it's going to generate; so capital intensity to us is a measure of capital divided by the revenue that's generated in the company, so we get a focus on that on a regular basis. We also have a significant focus on operating expenditures. We've said publicly that we're going to have flat operating expenditures over a two-year period of time, again to create the discipline that says we are only going to invest in areas where we'll get a good return. Focus on value levers for success, having a clear sense of the small narrow number of items that matter most. Now what's interesting I find in a large organisation is its very very easy to get scattered with a lot of different things that you focus on, because there's a lot of activity going on in the company but knowing what are the two or three most important things which will generate value has been something we've focused on. Now in our company we updated our strategy about a year and a half ago, and we set out a small number of items which were big focus areas. Revenue stimulation. In our European markets we're facing a significant amount of competition, a significant reduction in pricing per minute. We're offsetting that with new services and more usage and that focus on revenue stimulation is a key one. Until we know how the competitive landscape comes out we're very focused on reducing costs. So we've reduced costs at our headquarters location, we've outsourced our IT development activities in the company and we've purchased globally as opposed to purchasing on a local country by country basis and that's on infrastructure as well as handsets. Terms of cost management, I think I've covered several of these here. Cost management in our global purchasing, in our operating expenditures are areas of focus for us.

On the next page you'll see performance related pay against several similarities. Our senior leaders are incentivised based on intermediate term results, so an annual bonus programme, as well as performance shares. We also expect our leaders to have an equity stake in the company. Now we don't expect them to take money out of their pockets and invest, but we do expect that they have a certain amount of their own net-worth that is in the company shares and we set a target over a period of time for that. On decision-making we fundamentally are a decentralised company, to keep

decision-making rapid we try and allow decisions to be made locally. Now the exception is where there is scale we do say that we are going to be making decisions in one location for the benefit of the company. We don't always have those decisions made at our headquarters. What's interesting more and more as time goes on is we find centres of expertise, so we have a new procurement centre we're opening in Luxembourg as a good example of that. We have a fair amount of our product development going on in Dusseldorf, so there is a variety of areas where we'll pick one area as a centre of expertise and make decisions globally for the company.

Portfolio management. Again as similarity we had a lot of investors that said you're in the wrong businesses if you aren't going to generate good returns. Over the past year we have sold several of our businesses. We've sold our stake in Belvercom in Belgium. We've sold our stake in Swiss COM in Switzerland. We've exited our position in Japan. On the converse side we've said our portfolio needs to have more growth to it so we bought a position in India, in Romania, in Czech Republic and in Turkey, all businesses we've acquired over the past two years. Size and scope, and this is again a difference with a lot of private equity-backed businesses, we are a global business. In general I think you don't find as many global companies like ours with a strong private equity ownership interest. We do believe that there is scale in the business and few areas to tap that scale. We've had access to capital, to the equity markets, which has allowed us to purchase the businesses we have; it has allowed us to build the business in 25 countries at present.

Optimising debt and equity. We've just recently announced we'll be going to a A-, BBB+ credit rating to free up more capital to go back to our investors. So again, similarities. Now let me just talk about a couple of differences that we see in the industry with our own company and with private equity. So the first one, in terms of management outlook, one of the key differences is the long-term horizon. We clearly have a longer-term investment horizon. That doesn't mean there isn't a short term and intermediate term focus. We have to report results on a regular basis, but we also have to make a compelling case that the investments we've made will create long-term value for shareholders over a long period of time. So as we look at making investments, for example in Tele2 which is a DSL business in Italy and in Spain, they offer significant long-term return because we believe our customers will want DSL service and mobile service. If we had a shorter and intermediate term investment we'd have a different posture on investments we've made. So longer-term investments would be one of my points. In terms of the investments themselves, we've made investments on the network-side in 3G technologies, these are the faster speed mobile technologies. What will happen in our industry is more and more people will not want to stay at home when they're in their office to communicate, they'll want to be able to do those things as they go, and we need to invest in networks and again with the longer-term orientation we have the ability to do that. Stakeholders, another difference. In the private equity world in general there is a smaller number of stakeholders. In a publicly traded company, candidly there is a much broader set of stakeholders. Those stakeholders, many of whom are investors, have got different points of view about what they want us to do in terms of growth, in terms of emerging market presence, in terms of cash orientation or profit orientation versus revenue. We have to balance those many interests and have a compelling investment thesis.

That creates more complexity but it also creates more long-term value, we believe, in the industry. On governance, corporate governance, a more complex environment I believe for a publicly traded company. Because of different interests we do have more public scrutiny and that's something we have to be very well aware of. Now the offset to that is we have access to the public capital markets. Very very important, it has helped build the company we are but we need to be dealing with the scrutiny that comes with that. The other piece is we are a global organisation, and we need to find scale or otherwise there's no reason for us to be at a company the size we are. So we have to take time to say what are the common interests across our businesses and what are the high leverage items and believe me, this is one of the items we discuss most at Vodafone, deciding what things should be done centrally and what things get done locally. The default is always things to be done locally, but we have to find a few things that do get done centrally that add value. Global procurement is an example of that. A common brand name is another example of that. Outsourcing our IT development and maintenance activities is another example. Regional data centres is another example. All of those are items that do take time and do have complexity and decision-making, but when that does happen, we do believe that it creates value in our industry and creates a competitive advantage.

The last item I would just say is capital. One of the benefits we have is access to broader capital markets and equity markets which creates the opportunity for us to invest in the business. We always have an obligation to make sure that the returns we get are attractive. One of the things we have recently shared as a company is that any of the investments we make will get a 200 basis point return over the local cost to capital in the markets we're investing in. So we have a discipline about the type of investments we make, but again we have the benefit of that access to capital.

So conclusion and comments. Several ones. First of all I think there's a significant amount of benefit from the private equity world. There is a focus on value drivers which is very very clear. There's a focus on cash generation in the business, a focus on speed, and that allows us to keep asking the question as a company, are we as disciplined as a private equity firm might be in running the company. And so I think that creates significant value, and I believe we are executing on those items. I believe there are some additional benefits of being a publicly traded company, first of all longer-term value creation opportunities because of a longer-term horizon, is a benefit for us. We also have the benefit of scale and scope. It takes a fair amount of capital to build the business we have and that generates some benefits in certain industries where there is scale of benefits to be had. The final comment I would just make would be a broader shareholder issues by having a broader shareholder base, then returns would go to a broader community. In our company, all of our employees are shareholders of the company. They benefit from the success of the company. Also we have a broader investment group of investors, small, medium and large organisations, and they benefit also as the company does well. So I believe private equity offers a significant value to us, I do think there are some notable differences but I think it has worked well to our benefit. Thank you very much for your time and your interest.

*Clapping*

## **Professor Robert Leonardi**

Thank you very much Mr Kramer, you synthesised very well the three aspects of private equity and the three aspects of the public traded company, and I think we should keep these elements clearly in mind during the course of this conference. Now I would like to turn to a banker to Amadeo Nodari of Intesa Sanpaolo.

*Clapping*

## **Amadeo Nodari**

Thank you, professor. Actually I am here on behalf of Mr Corrado Passera, who apologises for not having been able to come to this meeting, but he asked me personally to present our views, as a primary Italian bank, on the role of the bank in the private equity industry in Italy.

This presentation will therefore be based on the investments we made in the last five to six years. Just a very quick overview of the private equity industry. It is young and driven by its small size in respect of Italian GDP; you can see that the relationship between Italian investment and GDP last year is about half in respect to France and one fourth in respect to the UK. It is small and growing fast, 9% of the compounded average growth rate of total investments.

In this scenario the Italian banks play an important role. If you look at this chart you see that basically between 18 and 20% of the market is represented by domestic banks depending on whether you consider the number of deals closed or the amount invested. If you take into consideration the investments made by national investors, banks plus funds, the banks represent more than 50%, and represent a very important player. The high role of the banks is due to the fact that the private equity industry is young and immature so the banks have to play a long-term role in this industry. Now the view of Corrado Passera and the view of the bank is that the Italian banks, and Intesa Sanpaolo in particular, have to play a key role in this industry and for this reason in the last five years we have made several investments consistent with this view and you will see that our total investment portfolio this year is stable at around €2 billion – 2.5 billion in the last year. Actually, this chart has been prepared a few days ago and is out of date because yesterday we closed the Telecom deal so also for the year 2007 the amount of deals should be around €2,300m. Now to give you an idea of the activity we carry out in this industry we have made an effort to group our investment in three categories to give you an idea of the sort of transactions we do.

The first group we have called “Sustaining the Expansion of Italian Industry Champions”. This is the typical deal done by Italian banks which represents 70% of the deals done in the previous 2003 / 2005 and around 50% in the period from last year to June of this year. The targets of the investments are national leaders, in some cases international leaders based in Italy and the objective of these deals is to contribute to the domestic and the specialist international growth of Italian companies organically or via acquisition and are always minority investments generally via capital increase. Some examples of the investments we made in the last three years, Prada, which I think everybody

knows, Sigma Tao, which is one of the largest Italian pharmaceutical companies with a very strong research pipeline operation in the States, Fila which is the European leader in pencils for children, which after the entry of Intesa in the equity has made acquisitions in France, in the States and opened factories in China; Isotta is the European leader in medical equipment. Two more investments should have been included in this chart, Pirelli Tyres and Jolly Hotels, also belong to this category of deals.

The second group of deals we have called “Supporting Financial Restructuring”. We do not do turnaround situations but sometimes we are involved in turnaround situations as a lender. In these cases, when the distress is purely financial distress so the underlying business is healthy and there is a credible management either within the company or brought from outside we find a different solution to solve the situation of distress in respect to traditional debt recovery. Very often there is also an issue related to safeguarding employment since these companies are very relevant in the context of the regional economy and hundreds of families depend on the survival of these companies. The deals consist of turning the debt into equity as an alternative to the traditional debt recovery. We have provided you with three examples of this situation, one is the mandatory convertible bond of Fiat through which the lenders became temporary shareholders, a very success story because all the stakeholders obtained a good result from this financial solution. Piaggio was a very complicated deal because we had to convince some 20 – 25 banks to become shareholders of Piaggio Group and this was also very successful story because during the transaction Piaggio acquired Aprilia and then went public so the banks obtained a private equity asset starting from a position which was considered unrecoverable. And the last example is Yomo, which was acquired by Granarolo, the second Italian player in the dairy industry; in this case we not only converted the debts into equity but also made a cash injection in Granarolo

Third group of deals we have tried to put under the headline, “Transitioning Changes of Core Industry”. A group of deals, a group of investments related to the changes in a relevant industry in the Italian economy, generally infrastructure or utilities due to two main reasons. One, which we speak about, privately owned companies, a change of ownership. If we speak about industries which are still managed by state-owned companies, the process of privatisation or liberalisation. In this case, Intesa Sanpaolo wants to play a primary role in assisting this change of ownership and change of structure of the industry by having a presence, a temporary presence, in the equity of the companies. Two examples, one is Edison Investments which was made in 2002 and very successfully exited in 2005. The other example is Telecom as I mentioned before. There are also examples in the case of privatisation and liberalisation but these are in process now. One of these would be probably made public by mid-November but unfortunately it cannot be disclosed today.

Now why banks can play a different role in respect to other private equity investors and in some cases they do not overlap in this industry. First, they have the ability to support the company's growth without intervening in the management of the company. Secondly banks are in general more flexible than funds, with respect to the way out, especially the timing of the way out, at least in our case investments are made on our books so we can manage the market downturn or the fact that a company is not ready for an IPO etc. We are more flexible in terms of degree of leverage, and we are

more flexible with respect to the return because we do not have a limit under which the deal can be made in terms of expected return because we don't have a limit under which the deal cannot be made in terms of ROI; it depends on the risk of the business or the risk of the business plan or the phase in the lifecycle of the company. The third point is perhaps the most relevant and Corrado Passera always stresses this point heavily as it has to do with the responsibility of a large Italian bank. This means that every time we look at a new deal we have to look at it from two different points of view: one is our profit and loss account for the benefit of our shareholders, our return, and the other is the interest of the company and sometimes the interest of the local economic environment in which these companies operate, and in the case of any large deals, also the interest of the nation itself.

Now just a few points about the financial market issue and the relationship within the capital market and private equity. The first phase that ended at the beginning of this decade was characterised by a lack of trust of big Italian companies towards financial markets and the scarce degree of liquidity of such financial markets. This means that theoretically in this period there was an opportunity for private equity but there were constants in the way outs which limited the development of the private equity business. What we have seen in this period is that the private equity industry was essentially a LBO-majority deal industry. The only types of investor who could afford the rationale of this type of certainty in the way-out were the mid-term financial institutions which started at the beginning of the 90's with private equity businesses. Our rationale is totally different. We have assisted 41 IPO's in the period 2003 – 2006; 20 only in 2006. Now the capital market is an actual alternative to private equity markets, especially for expansion capital. On the other side, the capital market has higher requirements in terms of companies' strategic vision, companies' organisational structure in terms of financial transparency. The result is that there is a new opportunity for private equity investors who want to participate in the equity of a company, to help the company strengthen and, with a future IPO in mind, to satisfy all the requirements necessary to get to the market. In this scenario in the last three years Intesa Sanpaolo has taken five of its participations public: DMT, Guala, Bolzoni, Piaggio, RDB, while three more are expected on the stock exchange in 2008.

Thank you.

*Clapping*

**Professor Robert Leonardi**

Thank you very much Mr Nodari. A very interesting and enlightening presentation about the Italian situation. We now have more food for thought and discussion in the question and answer period.

Now I would like to turn to our last speaker of this morning before the coffee break, Vince O'Brien of Montagu Private Equity.

*Clapping*

**Vince O'Brien**

Good morning Your Excellency, ladies and gentlemen. I have had the computer brought up here so I could do my own slides because private equity people like control! I feel like I'm giving the case for the defence here because I am just going to speak very generally about European private equity and I thought I would cover how the industry's evolved, why it has been successful and what I think it does for companies and economies where it acts. It's a great honour to follow such good speakers, I won't be so eloquent but I'll be very very factual, and I'll take you through quite a few statistics.

So let me start by just showing you the developments of the industry in the UK and in Europe. First of all, we all know what private equity is, I think. Here are some standard definitions that we use at the British Venture Capital Association, my point is that private equity covers early stage ventures as well as acquiring bigger companies. The common theme in private equity is backing good managers and entrepreneurs, so whether our industry is backing a small start-up, a growth company in a certain stage of its development or a very large acquisition of a company, the constant theme is backing good managers and entrepreneurs, and I personally believe that's what makes our industry so exciting and its why it works. The growth of the industry, this is a very pretentious slide, I used to be Chairman of the British Venture Capital Association, and we used to put this slide up to show how the industry has grown. You know, on this slide we are claiming that the industry doesn't start in the 1940's with the post-war equity gap in the UK, it doesn't start with Charterhouse in 1934, the first venture capital company in the UK. It goes back to the 18<sup>th</sup> century, the 17<sup>th</sup> century, or even the 16<sup>th</sup> century when explorers ventured out with financial backing. I think for me it's presumptuous to claim as this slide does that the United States was a private equity investment, and a European one at that, so the BVCA itself wasn't founded until about the 1980's and when we talk about the growth of the industry I think we probably want to look at slides like this one. Now what this shows is that in the last ten years the industry across Europe has grown massively in value. The UK, as Terry pointed out, the UK is over half in value, although these figures are 2006 and I have to say Germany and France were unusually low last year. 50% is more like it for the UK. This is in terms of value. This is in terms of value invested by our industry. If you look at value in terms of type of transaction, buyouts look to be the big thing. Buyouts account for 69% of value and the other stuff we do looks small. If you look in volume terms, the vast majority of our members are actually investing in smaller growing businesses. In terms of number of transactions, number of commitments made, seed start-up, expansion, replacement capital in volume terms easily out guns the buyouts. So you see while the big transactions make the headlines, most people in our business are investing in small, medium-sized growth companies and if you wanted to look at the size of the industry it's one that tends to punch well above its weight. If you added up the value of the industry last year across Europe it would still account for less than half a percent of European GDP. So it's not actually a massive industry and one of the criticisms you see of private equity is that we're buying everything, we'll take over everything very soon. If you take the total values invested last year in Europe and then compared them to the values of the quoted stock exchange in each country, it would take something like 80 to 100 years for us to acquire that size value and this excludes the millions of private companies across Europe as well. So it's wrong to think private equity is taking over the world just yet.

Now why is private equity popular? Who invests in private equity and why? Here's an analysis that was produced a few years back, 2004, and what it shows is that private equity is still very much an institutional asset class. Over half of our money, and if you take out fund of funds which sort of reflect that here, over half of our money comes from pension funds, corporate, public, private pension funds, and that's reflected if you look at my own company; this is Montagu Private Equity's own investor base which is a fairly classic mix and it's a classic mix of institutions as well as a classic mix of geographies and what this slide shows is that private equity, people who invest in it, are global investors. People like investing in European private equity. When I am fundraising for Montagu, my fundraising pitch is actually very easy. I say to people if you invest with Montagu, and we are what's called a mid-market buyout house, if you invest with Montagu you are investing in medium-sized European companies. These are a good investment and it works, and people do like to invest in European mid-sized companies. It is still private equity in Europe and across the world really, it's still not a place for the private investor on the whole. Returns are still very slow for investing in private equity. The investments are illiquid, you can't sell them tomorrow. There are ways in, you can go in through investment trusts, you can go in through syndicates and so on, but the investors in private equity, particularly in the buyout funds do tend to be these large institutions. So to answer the question, though, of why European private equity is so popular, that's the answer really. It makes good returns. If you invest in private equity you've got a very good chance of making a very good return on your money. This is a summary produced by the European Venture Capital Association. Returns vary across the different types of investments but what this shows is if you were to invest in a top quartile buyout fund you'd expect to have made 31% per annum. 31% per annum. Or if you'd gone into a selection of buyout funds, you'd make about 14.4% per annum. So that's a good return. It compares very well with other asset classes, it compares well with indices. Because I was Chairman of the British Venture Capital Association I have to show you BVCA statistics whenever I can. What this shows you is the UK's figures. For returns from private equity across three years, five years and ten years and what it shows is that these returns beat all the other measures. We beat the FTSE, the FTSE All Share, the FTSE 100, the FTSE 250, and the FTSE Small Cap. We beat all pension funds. We beat an index called All Pension Fund Returns. So given the chance to make 18%, maybe 30% by investing in buyout funds versus over the last ten years I think it's between 7% and 8% per annum on the FTSE, you can see private equity is an asset class that is attractive. Now, of course, returns for early stage and venture are more variable, and we typically put this kind of risk return table up to say that, you know, it's a riskier business in investing in early stage businesses, but there's a top quartile in venture across Europe which is currently around 17% which is kind of suggesting that venture is actually an asset class still that can make good returns. I'd like if I may just to indulge you for a minute on venture across Europe. The reason I want to indulge you is that anyone who talks about venture in Europe tends to say nobody does it quite like the US or quite like the West Coast of the US, but I can tell you there is a change in venture. There is very much a movement which most people agree about and this movement is that whilst the US has been a great centre of venture investment, the US model is now being transplanted into growing markets elsewhere, and there is a strong belief that going forward venture will involve not investing just in

West Coast venture, but investing in four key markets, and these four key markets are commonly agreed to be the US, China and Asia, India and Europe and Israel. So, the outlook is actually very good for venture in Europe. Whilst successful venture funds have been hard to find, there is actually no shortage whatsoever of European success stories. And let me give you some statistics. Since 2004, venture companies in Europe, there have been over 100 exits where the companies has been worth or valued at over \$100 million. That's 100 exits at \$100 million. The average value of these exits has been \$250 million each. Those are big enterprises. Some of these exits have been worth \$1 billion plus, but in three years venture realisations have created value of something like \$25 billion and as the slide says, and that's without leverage, it's pure growth in venture companies. So, really with venture we mustn't write it off in Europe, there are some fantastic success stories and if you flick through these exits you would find some fantastic names. Now I stole this slide from my friends at D FJ Esprit, but the sheer volume of venture deals coming out in Europe is something to be very happy about. Here we have biotech and healthcare. Here we have new media and e-commerce. Next generation telecoms; clean and nanotech material; enterprise software; semi conductors. So if people say to you, venture is not very good in Europe, it's wrong. Look at the last three years. And D F J Esprit who lent me these slides said at this point I should ask you to toast European venture. I don't think we have drinks to do that with but I will do that nevertheless.

Now let me just take you back to the slightly, well it's not mundane, but compared to all those lovely slides my slides are very mundane, I just want to cover with you what we are looking for in private equity. So I am back now in the European mid-market, the private equity market. It was great hearing Terry's analysis of Vodafone. He did my work for me really. But here's my attempt to say something similar.

Here are the ingredients of a successful private equity transaction. This is the perfect company for Montagu. A perfect target. It's a company with strong management, defensible market position, proven track record and the potential for growth. Add to that the right financial structures, a full due diligence programme and hey presto, you have a very good transaction and a very attractive one for Montagu. Here's how we do it. Here's how we make our return. We buy into the company, we hope to increase sales, we hope to make operational efficiencies, we might do acquisitions, disposals, we might do what he did, de-gear the company. We might get multiple growth, although prices are very high at the moment so if you assume you're going to get multiple growth you're being very optimistic probably.

These are the blocks of value creation. We can do it by backing the incumbent management, we can do it by sweeping out the incumbent management and putting a new team of people in, you can do it by any combination of the two and anything between those two levels. The target though is all the same and the why it works is very very simple. It doesn't need clever slides for me to do this. Why I think private equity works is it achieves absolute alignment of investor and management goals and if you align the goals of management and shareholders you have an absolute focus on taking the company forward. Private equity works because equity incentivises management. It enriches management. Financially they should make lots of money if it all goes well. But you know Montagu's

experience, and we've been in the business since 1968, in Montagu's experience it is actually ownership that's the biggest driver of value creation. It's not about making loads of money for management teams. It's about giving management control of the business and whilst we may have majority control of the shares, our theory is the management team should be motivated to run the company and we talk a lot about liberating management from large groups when we do acquisitions. And let me say as well, these transactions, it's not about leverage, we make clever use of leverage but it's not a sustainable business plan to invest continually in companies and just rely on clever leverage to get your returns. It's about developing these businesses and creating value. I'm not saying management in quoted companies is not efficient as well, and Terry has done a great job there of showing you how it could be done in Vodafone. What I am saying is that in private equity this fantastic focus between management and shareholder is the thing that drives value creation. We now move on to almost a case for the defence here, what are the benefits of private equity? You know, we do have our critics in this industry but I am going to focus on the strengths and then maybe we can discuss the criticisms later. Firstly, if you break our industry down I don't think anybody questions the need for a strong venture enterprise culture. I think that case is well proven and every economy benefits from that. The case for private equity I think is also very strong. We can talk about stimulating entrepreneurialism, assisting economic growth. I said I would be factual, the vast majority of academic studies that have looked at the impact of private equity, have concluded that private equity benefits the target companies and benefits the economies in which it operates. It's like global warming, you can read ten books on it and you can find five that believe it and five that question it, but the academic research that's been done, and EVCO cites something like 20 separate pieces of work, all show this. At the British Venture Capital Association once a year we commission an external body to look at the impact of private equity on the economy and every year it shows that private equity grows jobs faster than other companies, it's companies grow sales faster than other companies, it's companies increase investment faster than other companies. So overall, I certainly believe and I would say this because I was Chairman of the BVCA, that private equity has a very very beneficial effect on an economy. As I said earlier, some of the bigger transactions make the headlines and some of the more controversial things make the headlines but the industry itself is grinding on doing good things. Of course, some of the companies we back have to make very difficult decisions from time to time, but don't all companies have to do that? Doesn't the automotive industry in the States have to make very difficult decisions from time to time? We are also criticised because some of our guys are very well paid. We know the hundreds of guys that are working in venture in early stage, they would love to be very well paid, well it's a market economy and they are only well paid if they are generating good value for their investors. I think that the benefits of private equity for me are very self-evident but possibly for our industry we have had a failure, and that's been a failure of communication. Perhaps we haven't communicated some of this well enough to the public, to the press in particular, and to the stakeholders in our companies. The stakeholders do include the employees and they do include the suppliers and the debtors and so on. So our industry is taking very positive steps to rectify this and many of you may have heard of a thing called the Walker Report,

looking at transparency, there has been a complete overhaul of the BVCA and the EBCA and we take the criticisms very seriously, and we are addressing them.

So my conclusion, and once again what would you expect me to say? My conclusion is that private equity works. It works because it achieves this absolute goal congruence between management and shareholders. It works because equity incentives and ownership of strategy drive management teams to develop a company and create value in tandem with institutional investors. I believe in private equity because of this goal alignment. I also believe this ability we have to change strategy quickly is a key benefit in some of our larger transactions. If you're an investor in a large quoted group and you believe strategy is wrong, it takes you about a year to get heard I would guess, particularly if you're an individual investor. In the companies we back, if we decide tonight that the strategy is wrong we can have the strategy changed tomorrow. Whether you think that is a good thing or a bad thing, we can debate, but that for me is the thing that makes it for private equity. So, I would say private equity is good for the companies it backs, it's good for the economies that it operates in and the investors in private equity do very well too, so I am an optimist, and I look forward to a great debate.

Thank you.

*Clapping*

#### **Professor Robert Leonardi**

Thank you very much Mr O'Brien. We won't be able to celebrate private equity with bubbly or with wine. We can just put that off until lunch, but now we need to move toward the coffee break, so therefore if you could please go on the coffee break and come back by 10.15am. Thank you.

Time is up. Would you please return to your chairs please.

Thank you.

#### **Gabrielle Capolino – Co-Chairman of the Conference**

Welcome to the second section of this conference. My name is Gabrielle Capolino, I am the Editor and Associate Publisher of Milano Finanza and as a journalist I am here to remind you of the difference between literature and journalism because as Oscar Wilde said, the difference is that literature is not read and journalism is just unreadable. What I am trying to do in this second section is to give the floor to some distinguished panellists who are on the ground in terms of involvement in private equity transactions or have benefited from private equity transactions.

I agree with what Mr O' Brien said about the Ernst & Young's survey of 100 of the investments by private equity funds as I have read that survey too. The 33% on average per year gain compared with 15% for the stock market in the US and 11% for the European stock markets for the same period is really astonishing, but apart from this what was astonishing for me was the enormous value creation in terms of enterprise values which is debt plus market cap was not due to cost cutting but was mainly due to business expansion, so apparently this survey goes against common sense with

the usual intervention of private equity which is aimed to short term-ism, cutting costs and slow investments for the sake of short term. I have heard with much interest what the previous panellist had to say and after all the secret of success of private equity in my opinion, but I'm a journalist so take it for what it is, is that basically they buy to sell, which is a completely different mood between them and a company, a public listed company, and this makes crystal clear some things which have been pinpointed before: the incentives to the management, the easily measured returns, the big control over management. So, in a sense, what we see here is huge value creation in the company they bought for the private equity company, and so there is a big return for the shareholders. What happens then when they are listed, what is going to be sold, whether on the public market if they are listed or to another prospective buyer? What happens to the next buyer and what will happen to the company itself after the intervention of private equity? These are some of the things that maybe will be underlined by the panellists who will speak in this second section.

I ask them also to comment on a sentence of Harry Kravis's. Last February Harry Kravis said the private equity world is in its golden era right now and the stars are aligned. I am wondering if it's still a golden era and if the stars are still aligned so far and ask our distinguished panellists to answer those questions. The first one is Claudio Sposito, Chairman and CEO of Clessidra SGR, one of the most prominent private equity operators with a long background in merchant banking, investment banking and Morgan Stanley. Claudio, the floor is yours.

*Clapping*

### **Claudio Sposito**

Thank you very much. It is a pleasure and an honour to be here. Thank you to the Chamber of Commerce. I will try quickly to give you my perspective of the evolution of the private equity industry over the last few years, of the segmentation of the private equity industry in Europe and the role the middle market and France which I can anticipate is essential for the future of private equity and how we see the market evolving after the recent turmoil and after the wave of criticism and debate that has gone on and the real positive and negatives of a strong private equity industry. I represent Clessidra. Clessidra is a typical country fund. We have 800 million under management, we focus typically only on, well, mainly on Italy, not exclusively but our core market is Italy. We are an independent firm, a typical private equity shop I would say, 7 partners, 20 people, I think the way private equity used to be before it became a global industry. We decided to launch this firm four years ago in 2004 because we thought there was a big space in the Italian economy. Private equity has gone through tremendous changes in the last four or five years; when we started we had a vision that private equity would become the most significant component of the Italian and European financial system. We were almost too right, I mean the level of attention and focus which private equity has received in the last couple of years has been tremendous, this has been very positive for the industry but also raises a reasonable number of question marks. I believe, obviously, that private equity has a very significant, positive role in an economy, particularly in an economy like Italy which is structurally made up of small and medium sized enterprises, with limited access to capital and significant challenges coming from

the evolution of a global market. Continental Europe, in particular, because the UK is obviously a different market with different dynamics and is really in fact an Island not Europe, is more similar to the United States in terms of the size of the market, the maturity of the market and the level of complexities. What I define a "perfect market" - this is the perfect market of continental Europe.

It is interesting to speak of a perfect market because it typically offers higher margins, it is a more complex environment, it is more difficult to work in, but it creates higher opportunities and this is the life I was used to when I was fundraising in the United States. It is extremely surprising to see how very sophisticated institutional investors in the United States have an extremely naïve view of Europe. Believe it or not, they believe that Europe exists, that Europe is a homogenous economy, yes there are differences but they look at Europe as an aggregated number, a big economy and so I spent some time explaining Europe doesn't really exist. I mean it's a nice concept, it could probably exist as a homogenous political, social, economic environment in some distant time in the future but today it is still made up of national countries with different languages, different business environments, different legal systems, different tax systems, different ways of doing business, business cultures, fiercely competing with each other with a strong level of government intervention, typically we don't like each other much, there is a lot of competition, and this creates a very fragmented business environment where it is extremely complex to work and operate with a pan-European approach. In fact, so far in private equity, very few firms have succeeded in building a pan-European franchise and the few we have, and to take one example, Permira, is historically the result of the consolidation of a lot of franchises, the Schroder private equity ventures were really totally independent and leveraged on very strong local roots and then they made the very smart move of merging into a single company and this, I think, works, and of course I believe but I'm sure my colleagues here will have something to say, it is even more complex for big US firms when it comes to this, obviously we are not talking about big deals, auctions, big privatisations, it's a level playing field as they typically build on very transparent and easy to understand standards. When it comes to middle market companies run by a family divided into three groups which fight each other and they want to buy something in China but no, it's not the right price, and the nephew is going out with ....., I mean there is also history involved, then it becomes much more complicated. I think the industry is recognising this and the large investors in the United States, Asia are becoming more and more familiar with the concept and they tend to concentrate their investments in alternative assets and in private equity in particular with global firms like KKR, Blackstone and the big guys, and then select one or two regional champions in different regions of the other parts of the world because I think the same is true for Asia, for Europe. It is not obvious but there is some evidence that middle market returns are higher than investments in large corporations, but certainly we are still talking about in both cases a very high rate of return and the evidence is proving at this stage very clear that private equity does offer better returns than public markets.

Now for a little bit about Italy we move to the next and last slide. Italy is very often underestimated. I think we are very good at talking badly about our country, and we have succeeded I think in this negative marketing. Italy is the 6<sup>th</sup> or 7 largest economy in the world. It has a GDP comparable in size

and in the same ball park as France and the UK, we are talking about a GDP of €1.5 trillion and the UK's GDP of 1.9 and France 1.7 so we are talking about very similar government, 60 million people, more or less, very large. The big difference is that we do not have large corporations, multi-nationals. If you look at the statistics, on the Fortune 500 there are probably two or three Italian companies, typically banks or financial or insurance companies: we have respect for the banks but not industrial companies, while the UK has probably 50 and France probably 20 or 30. The structure of the economy is really that of a middle market economy and as you know it is widely recognised that mid-size companies are the strength of the Italian economy so that means that there is a very rich territory for a company like ours, thousands of very attractive companies, we define middle-market as companies with sales from €100 million to a billion Euro, a billion and a half, something like that, it is a very populated environment and again with pretty significant barriers to entry, and I have lived many years in an investment banking environment and that I can tell you is a much more competitive market than what we are experiencing today in this segment of the market in Italy, even though everybody talks about too many funds, too much money shared in too few deals this is I think true in general but if you go into the specifics in certain situations we are actually competing in Italy with two other country funds. So occasionally we find in our space some international firms, which appear and disappear but we do not see the regular coverage of this space that is essential for success. We have also been helped by another factor which has been very visible in the market in the last two or three years which is the growth of the mega-funds. Ten billion, fifteen, twenty, sorry, twenty billion. A lot of money. This is good for us because some of these funds were raised by what used to be middle-market funds. Permira is a typical example. Permira is actually very good at middle-market in Italy as well as in other regions of Europe. Now they are less focused, they are still present but, you know, they have all this money to invest, they have to go after the big deals and after the big auctions and so for us it is good because it is a distraction for them. I am giving too many of our competitive secrets here. I should be more discreet. So, what is the future of private equity? Well first of all again I think we had the right vision that private equity would become much more important in our country; it would be interesting to run some statistics - how many times the word 'private equity' was mentioned in the press five years ago and how many times it has been mentioned recently. I didn't do the exercise but I can tell you there is an exponential curve. The level of attention, not only from the specialised press but also from the general public has been enormous. Indeed among the different effects, as a big positive, we have become a more recognised component of the economy. Entrepreneurs have become much more familiar with the concept and they have started to consider private equity as a real alternative to their financial needs and strategic question marks and we have a much easier dialogue with them. Now we are always one of the alternatives they consider when looking at the future, evaluating whether they should go public, they should sell to a competitor or consider the private equity alternative – this was not the case a few years ago. So there has been a dramatic change which has brought an acceleration of activity. The last statistic when you talk about the activity of private equity over GDP was 0.1%, it's now 0.2%, it has doubled in two years, and it is going up. Obviously we are still talking about 1/10<sup>th</sup> of the activity in the United Kingdom and probably less than half in France, but that in my mind is an opportunity for growth, I mean this is very fertile

territory which is still very young in its development because the history of private equity in Italy is really very very young.

Just to conclude, as maybe I have taken too much time, the future is challenging but this is natural; life is tough, what was unusual was the easy way we used to think life had become in the last two or three years or four years, the markets always went up and money was always available and rates only went down. It doesn't work like that. So a correction I think is healthy. We'll differentiate between the really good and the really bad and already a number of excesses in terms of leverage evaluations were overdue and have already been corrected. I think we will have a more normal market in front of us but a market in which I think the role of private equity can only continue to grow.

Thank you so much.

### **Claudio Capolino**

I have one question for you, Claudio. According to some estimates, public infrastructures in Italy require about €85 billion in financing and the amount of money available from the Government is only €37 billion. The public infrastructure sector therefore offers great scope for intervention by private equity while, at the same time, according to a survey by Standard & Poor last February, represents a major risk. What is your opinion on this?

### **Claudio Sposito**

We have had a boom in private equity over the last four or five years due to an excess of liquidity and the issue was where did this money go? In Italy we made sure that this money didn't go into Italy's infrastructure because infrastructure needs very basic things. One is transparency because the concept of infrastructure financing is that investors are ready, maybe not happy, but ready to accept lower yields, lower returns, in exchange for visibility of return over earnings. If you make the tariff structure, the legal structure, totally unclear the trade off doesn't work anymore and since capital markets are pretty rational you didn't see a lot of investment in infrastructures.

### **Mattias Caprioli's remarks have been withheld for reasons of confidentiality**

### **Claudio Capolino:**

Let's hear from a direct witness how private equity can help with doing high level business. Stefano Pessina is the Executive Chairman of Alliance Boots Limited. He is the Italian who has made the biggest acquisition outside of Italy to date. It is unusual for a country like Italy to venture into the broader financial market, and we are very excited to hear directly from him how this was done.

Thank you so much.

*Clapping*

**Stefano Pessina**

I am delighted to be here and to speak about this topic, the private equity and public markets. Of course this topic is very interesting for me in these times because, together with KKR, I decided to buy my company, Alliance Boots, back from the stock exchange. I can tell you that I am not here to promote private equity. My colleagues, the other speakers, have already done it quite extensively and I am not here to express a judgement on the stock market. Honestly, I don't believe that there is a perfect solution. I believe that what is important for the company is to have a clear vision and a clear strategy, and, of course, the solution depends on the opportunities and sometimes it depends on the different phases in the life of a company, if we exclude the very very large company where private ownership is not possible or the very very small company where public ownership is not possible as well, I would say that what is important is not the ownership of the company, it's not to have a public or private company, what is important is to have good management and a very clear strategy.

I had, as an entrepreneur, a number of different experiences. I started with a private company, my own company in the mid-70's in the late 80's, mid-90's I was part of a listed French company, a public French company, in 1998 we merged this company with a UK listed company and we became a part of a Plc, a UK listed company. In 1991 we joined the Footsie 100 and in 1996 we merged with Boots, becoming a Footsie 40 company and at the end of the process I decided to take the company private again together with KKR. So, why did I do this? Why did I take this decision? Because at the end of the day the merger with Boots was quite successful and the synergies were working, I had a deputy chairman, executive deputy chairman, a good relationship with the management and the board and the members of the company are aware and quite comfortable, but I saw in the environment in which we were operating, and we were mainly a healthcare and beauty company, the environment, particularly the environment in healthcare was changing rapidly, is still changing very rapidly. The times are changing and of course changes mean opportunities. But to save this opportunity you have to take very rapid decisions and you have to act quite rapidly and sometimes aggressively. This was the point in a public company we were not able or at least the management at the time, I was not the chief executive of the company, I was not really actively managing the company, the management and the board were not really able to take the decision with the speed needed to follow the external changing. So, in my opinion, we were missing opportunities and we had fantastic, according to my valuation, we had fantastic opportunities for growth, for external growth, for organic growth and also fantastic opportunity with the Boots brand which is a fantastic brand, with a fantastic number of people behind it, fantastic know-how which has just been partially exploited in the UK but which has never been exploited outside of the UK. So, I was thinking of doing something to make this growth possible and I had an opportunity to discuss this with KKR and I seized the opportunity, it's as simple as that. I was looking for a way to change the situation; KKR gave me this opportunity. They came to me, they gave me this opportunity and I seized the opportunity and I was not worried at all about the debt. In this acquisition we have booked roughly 1/3<sup>rd</sup> of equity and 2/3<sup>rd</sup>s of debt, a gearing of 200% but I have to tell you that when I merged Alliance Sante', my former French company, with UniChem our gearing

was 170% and when we left the stock exchange a few months ago our gearing was 17% so debt, provided you have a good company, was something which was not worrying for me at all. So, of course I understand and I could understand even before the advantages of being listed and the possibility of raising capital, the possibility of increasing the visibility of the company and I have to say that the stock exchange has served me well because if I had not been in a public company at the time of our Alliance UniChem I couldn't have done the deal with Boots. As I was saying before there are phases in the life of the company where you have to be or it is better to be public and phases where it is best to be private. The reality is that in most cases you are focused on the short term and you are being exposed to the external events. Very recently I have seen some of our peers in Europe and in the US suffering because the relevant governments have decided in one case to reduce the price of some generic medicines and in other cases in the US to increase, to push, on the generic thus reducing in that way that phase of the companies and honestly I have to say that the fact that the governments are trying to spend less to reduce their costs is part of life for companies like ours so this was a non-event, just a small issue that, over time, we have to pace and we have to recall but of course at the stock exchange there are institutional shareholders who are very sensitive and so it's clear that the decisions that you take in a public company very often are not the right decisions for the long-term interests of the company so you need a very very brave management to take long-term decisions, really facing the reaction of the analysts and of the shareholders and it is really difficult to find very brave management because most of the managers are of course thinking of their next jobs and so they are looking at the company in the short-run and not in the long-run. Of course a private company doesn't have this kind of problem and so in a private company you can really take a long-term view, particularly if the company has the opportunity to grow and particularly if you want to invest substantial amounts of money. And of course in a private company the ownership is not particularly important, a family or a private equity firm or a group of investors, it doesn't really make any difference, what is important is to have wise owners or owners who are not wise, or are less wise and this is really the point because in reality this is also true for the public company, if you don't have wise management of course you make the wrong decisions. I have heard and read about private equity that they benefit only themselves, strip assets, cut jobs; this is really nonsense because private equity firms are rational and try to create long-term value. Of course sometimes they are right and sometimes they are wrong. Everybody makes mistakes, but the logic of private equity firms is the logic of creating value. If I have to look back at my company I have to say that Boots in the past shut down a lot of businesses and destroyed a lot of value, fired a lot of people and now, as a private company, we are investing, we are really creating value, we are doing exactly the opposite and our results are well ahead of the budget we established as a public company last year in terms of growth, sales and cash. So, I have to say that the only problem that I have seen in private equity houses is that they are not really transparent, even though they feel now that they have understood this and they want to change. I strongly believe I have always believed that transparency is very very important and as a company, even though we are now private, we are really committed to publishing our numbers, to publishing an annual review setting out our strategies and also to consider CSR - Corporate Social Responsibility. This is one of our primary objectives, as it was when we were a

public company; this is particularly important for us because we operate in the fields of healthcare and wellbeing. Honestly, I believe that transparency and CSR are compatible with sustainable value creation because this is an important point for a company, be it public or private. What is important is to have a strategy which can assure its sustainable value creation. And, of course, we have to be careful when we analyse what this means. Market Cap is of course one of these indicators but it's not always the best indicator. All of you for sure remember what happened during the dot.com bubble so it's a value but it's not the only possible value. For example, in a company like ours, values like service, like trust, are really, really important because in the long-term this will create the value of the company, the importance of the brand.

Well, in the interests of time I can conclude here. May I just say to synthesise my thoughts that as an entrepreneur, my logic is to create long-term value for myself and for the people around me. When I was working in a public company I was always thinking of the value created for all the stakeholders and for the people working for the company, for all the stakeholders. I have really enjoyed doing this as part of a public company; I have enjoyed doing this as a private company as well and I have to tell you that I am still enjoying doing this, with KKR as a partner, because they share my long-term vision and they are here for growth and for the sustainable value and at the end I believe this should be the goal for every company and this is the all-important thing for a company.

Thank you.

**Claudio Capolino:**

Thank you so much. Thank you for this extraordinary focus on your own experience in the public market and the private market, Mr Pessina. I think that two important messages come out of these speeches. One is do not think that the short-term is the only habitat for private equity; this is not true, and this is also not true for the stock exchange. There are analysts who every three months visit public companies and urge them more and more to adopt new strategies and focus on short-term rather than on long-term. The second message is there is no single rule; there could be some stages in the life of a company when it would be better to be private rather than public and then again go back to being private. This is a really interesting point for us to consider. Prof Leonardi I don't know if you have any questions to ask as this is the question and answer time so please join us in asking questions of the panellists.

**Professor Robert Leonardi**

I'd like to use the prerogative of being Co-Chair to ask a question. This has been an extraordinarily fascinating panel, and I would just like to thank all of the participants. Let me just ask one question, in terms of this idea of building value, of making strategic decisions, on the velocity of the decision, in terms of these panel members, where do they think the fastest growing opportunities for private equity in the world are? I mean now we've just moved very much from an Italian / British view to a completely world view, I know that Mr Pessina is leaving tomorrow for India to look at opportunities of

expansion there. Taking all of these things into account, where do we have the largest potential, where we can make decisions to increase value in the short/medium-term?

### **Stefano Pessina**

Of course I can only speak for my own company and for the industry I know relatively well. There are other fantastic opportunities in other industries, but in my industry I believe that the emerging countries are now quite important because the logic is changing and in these countries we will have sustainable growth for the next years so I believe that a company like ours should look at these companies; we are already in Russia, we are China. We intend to go to other countries and we have stated publicly what we intend to do in the long-term, maybe in India, because it is quite a complex situation, a complicated situation and indeed in America, but of course we shouldn't forget that Europe is still a fantastic market and a market which has a lot of potential because the reality is that we don't have a European market. The reality is that we have tens and tens of different markets in Europe with different languages, different laws and different consumers. If we could exploit these differences, if we could understand and could meet the desire of the consumers in all these countries, we would have, and, of course, I am speaking about my company, a fantastic opportunity for expansion in Europe. We have, and again I am speaking for my company, we have another fantastic opportunity in Europe. This is probably linked to the fact that the governments are understanding now that they can use the pharmacy network better because of course in each single European village you find a pharmacy and the fact there is this network means that the government can use it not just to distribute medicines but more generally to distribute healthcare. This is possible when you have big pharmacy chains because of course a chain is more inclined to invest and to adopt a policy of investing in service, invest in people and take a long-term view. So we see that everywhere in Europe governments are thinking of allowing pharmacy chains. As you probably know pharmacy chains are not really possible in most of the European countries. It's easier to say where they are possible; there is really only a handful of countries where this is possible.

### **Unknown**

Is it possible in Italy?

### **Stefano Pessina**

No, in Italy it is not possible, except for some very limited cases in the former municipal pharmacies but it is not possible in England, not possible in Germany, not possible in France, not possible in Spain. It's not possible in the Scandinavian countries with the exception of Norway. So, in reality it is possible in very few countries. So when this will be possible, we as distributors and our peers in Europe, are the natural consolidators of these markets and for us these will be a fantastic opportunity because this will help us not only to make reasonable rational investments but will allow us to deliver synergies with our distribution network and will help us to find a way to distribute our Boots products in a very efficient way. So I would say that at the end of the day for a company like ours the future is still

mainly in Europe in the medium-term and in the emerging markets in the long-term, but of course we have to organise ourselves now in those markets to be ready for when the markets mature.

Thank you.

### **Claudio Sposito**

Hopefully for Italian companies the accelerated growth of emerging economies is a challenge as well as an opportunity, so from our point of view again if you want it more limited to one single region we do see an enormous impact on the way we analyse investments and there is an extreme variance of reaction and here I think the entrepreneurial skills of the manager make the difference. Globalisation and the merger of high quality producers in India and China in particular is really changing the world, that the older tier is more beautiful is obviously not true any longer so this is putting enormous pressure on the small companies, it's accelerating the need and the urge to rescale that will allow them even to consider relocation of their debt collection facility because they don't have enough funds. They cannot even pay a ticket for the marketing director to go to China and see what happens, so that I think this will force and accelerate the life and death process and a lot of companies will die. Few companies will survive, probably stronger than before, and this is obviously something that we are analysing very carefully and we are investing where we see the potential for following this trend as an accelerator of much needed conservation in certain sectors of the Italian economy.

### **Leonardo Simonelli**

We all congratulate the Panel and obviously Mr Pessina who, I must add, had a lot of involvement in organising this conference.

I must also congratulate the audience as well, because it is difficult to find an audience which is so attentive, so quiet in spite of the flu and everything. I see there is a question from the audience.

### **From the audience**

Thank you. I am Giuseppe Castagna. I am responsible for corporate and financial sponsor coverage for Intesa Sanpaolo. Thank you very much to all of you. Of course we were really interested in what the Panel had to say, but as a banker I have to be a little provocative. If we were talking about more traditional industries I would have been prepared to hear a lot about the role of the bank, because normally even though the banks are the real long-term partner of many corporates, we are quite used to receiving little feedback from the companies. Speaking of an industry which I think has grown so much just because of the role of the bank as investors, as advisors, especially in the middle-market where we hold the knowledge of the market and have worked together with the private equity industry providing high leverage and often also helped with exits through a capital market transaction, I think that really there is a third party in the partnership which has not been mentioned today, so I am really interested in understanding, also on behalf of the many bankers here today, what you think about this. Thank you.

### **Stefano Pessina.**

Of course the banks have played a fundamental role in all this and even though as always there have been ups and downs in the interest that the banks have had in this industry, it's clear that without the help of the banks and without the intermediation of the banks this industry wouldn't be here. I have to say that this is now very evident but if I go back 30 years ago, how did I build up my company? With you, my bank. I remember it was initially COMIT and afterwards CARIPLO so I built up my company with you. The banks gave me the money to buy other companies, to develop my companies and of course I remunerated them and they have never lost one cent with me and made a lot of money out of me, but they gave me the opportunity to grow. So, it's their traditional role, maybe sometimes you can see some excess, but this doesn't depend on them, this depends on the market or the liquidity which is around, but it's obvious that the banks have played a fundamental role in the development of the economy most generally and will continue to be of fundamental importance, even though very often now they want to use other people's money and just take commissions but this will also have its ups and downs. I believe that the fundamental role of the bank is still not to earn fees but to give money and to help and sustain the economy and why not entrepreneurs like me too.

### **Leonardo Simonelli**

Let's take a second question.

### **Alessandro Roselli**

Well, I think that there are three really hard issues in the private equity industry that are discussed right now. They appear to be a little bit neglected in this debate. One is the new macro-economic environment, particularly the macro financial environment, the present increase in interest rates and the financial turmoil. Another one is taxation and the third one that has been touched upon in a way is corporate governance. Starting from the third one, corporate governance, it has been said, and I think it's basically correct, that there is in private equity an almost perfect alignment between owners and managers of a firm. If that is the main problem of corporate governance, it seems to me that real corporate governance issues do not exist, almost do not exist, in private equity. So how would you explain the recent Walker report that deals with exactly those issues? Is that really a problem of corporate governance or a problem of better communication by the private equity industry? About the interest rates, well, it's in my opinion frankly surprising that we have debated the theme of private equity for a few hours without mentioning the present turmoil. My question is in the present environment, do you see any problem for the leverage of transactions which is so important in private equity? Problems both for private equity and capital money and for banks, because of the exposure they have and whether to hold rather than resell to the market. The third big issue, tax, is already an unpleasant problem, and I will not enter into the debate whether it is good or bad to tax private equity, but the question is whether a new way of taxation in this country will have a real impact on private equity.

Thank you.

### **Claudio Capolino**

Maybe there is a third question here? There is a problem of the 300 billion of un-refinanced leverage which is freezing the industry..

### **Claudio Sposito**

It's the market environment, as I did say before. I think this is healthy, the correction, if I remember did not originate from private equity, the problems came from sub-prime mortgages in the United States, it was nothing to do with private equity in Europe or in Italy. You really did not see any private equity transactions of any significant size run into any kind of trouble, so this was not an issue arising from the private equity industry due to over-leverage. It was a very significant event which caused a credit crunch, a significant credit crunch, which is now I think more under control than it looked to be in August or early September. From our perspective in Italy, we are not affected as has been said. Smaller transactions in the range of €1 - 2 billion are financed as before provided the companies are good, probably with more caution, more discrimination which again I think is a good sign for the industry. On the governance side, I do think the industry and in particular a few of the industry leaders have been slow to react. They initially reacted with some form of annoyance to the people wanting because of the tradition of being a private industry. This has now been widely recognised, again, maybe with some delay which has caused some damage, but now I think there is total consensus that transparency is very important and I think frankly the issue is going away. From my point of view, I see this much less of a hot issue than it was several months ago. Banks are our partners. I think in Italy particularly they are playing their role very well, because traditionally they were actually the originator of the industry in Italy, but with a different approach they were a more passive merchant banking investor with very small minority stakes, not really actively managing. In recent years they actually participated in the growth of the private equity industry, and it is very common that we do deals together with banks with the same view and obviously I think that we have financed all our deals particularly through the Italian banks because in the end we found they have evolved very quickly and have developed crucial skills comparable to the best international banks and obviously they are at an advantage again where we are talking about middle market because they have local knowledge and a much better understanding of the dynamics. I do not wish to talk about the tax issue.

### **Claudio Capolino**

Well, that's all folks for today. The time keeper, the official timekeeper, President Simonelli has final remarks and I thank you so much for the very high turnout here today and to Professor Leonardi and Mr Pessina and all the Panellists who gave us such excellent food for thought as Professor Leonardi says. I pass the floor to Mr Simonelli. Thank you so much.

### **Leonardo Simonelli Santi**

This concludes the morning section. Our Guest of Honour, Lord Newby, as I said earlier, will address the fiscal aspects of our subject so we can continue our discussions at lunch. This concludes the 29<sup>th</sup> Edition of our annual conference. My congratulations and thank you's go again to the Panel and the audience, and I hope to see you next year when we celebrate our 30<sup>th</sup> Anniversary in our ongoing series. Thank you very much.