Hogan Lovells

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Foreign Direct Investment in Italy – a Renaissance set to continue

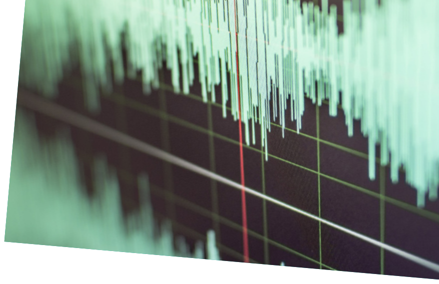
Read the international finance press over the last few years and you would get the impression the Italian economy is the "sick man of Europe". It's become fashionable, even commonplace, to write the Italian economy off. High government debts. Low growth. Political instability. Corruption. Obviously Italy does have challenges it needs to address but it would be a big mistake to ignore the many opportunities, especially for foreign investment.

The Italian economy is now recovering, and continues to enjoy its traditional strengths. It's a good place to invest, and we're not the only ones to notice that. Over the last 18 months, there has been increasing interest from abroad in potential acquisitions, particularly in Italian companies that make things. That trend is now at the highest we've seen since the Global Financial Crisis.

Italy Inbound: Look no further, a report we commissioned in conjunction with the Politecnico di Milano, has many of the answers to this question: why is there all this new found interest in Italian foreign direct investment?

Some of the report's findings:

- The volume of cross border M&A involving Italian targets increased by 67% between 2013 and 2017.
- The US topped the list with the most number of acquisitions, followed by the UK and France. However, bidders from 39 countries bought an Italian target in the 4 year period.



- The industrial sector accounted for 76% of deals, followed by Services 19% and Financial 5%.
- Consumer products achieved the highest EBITDA multiple, followed by Retail and then Transportation.

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There are many reasons behind the recent uptick. Let's start with the most fundamental. Italian companies are special in one particular way: there's a lot of technical and design ingenuity stored up inside them. Italian engineers produce extraordinary products, also in the small to medium sized companies that are the backbone of Italy's economy. This specialism is attractive to foreign investors, as not every country has this depth of talent. But despite their specialist prowess, those companies are often still owned by the founder, or at least the founding family.

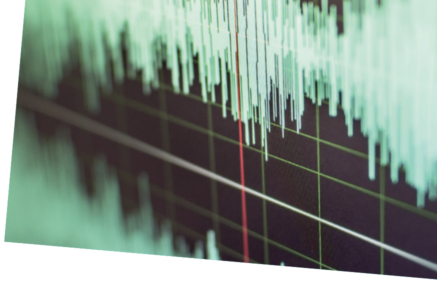
This structure brings benefits and drawbacks. The benefits: institutionalized knowledge and passion. The drawbacks: they can find it hard to come up with the money for expansion. Or to buy a competitor. Or find funds to cope with new environmental legislation. This is where foreign money can come in. It may often be the only way these family owned companies can progress or survive. Only just over 5% of leaders of Italian businesses are under 40 years old. A much greater percentage – 22.6% – are over 70, with a further 24.6% between the ages of 60 and 70. As leaders grow older the succession question becomes ever more vexed and the option of selling to a strong international investor with the ability to pump money and knowhow into the business becomes increasingly attractive.

But why is this all happening now? The answer: it's been driven by events both at home in Italy and abroad.

Economic recovery after the global financial crisis took root earlier in many of world's big economies than in Italy. Investors in countries like the U.S., France and the UK have the funds and the confidence to invest them. So Italy, with its high precision, hi tech companies, is attractive. In Italy itself, however, domestic demand is still weak, even almost a decade after the crisis. So Italian companies often need to forge links with others overseas to keep revenues flowing and growing. That can often end up with them being acquired.

Though domestic demand is still weak, however, Italy is seen as stable, a point that was brought up often at both panel events that surrounded the release of our report. And that stability is now tempting new investors back into the market. Demand, speakers said, now outstrips supply to the extent that originating deals is tough.

If appetite for deals is back, then why aren't Italian companies buying each other? Interestingly, it seems that they're much more inclined to sell to a foreign investor than to each other. The reasons are hard to fathom, but one



might be an unwillingness to cede control to a former rival. Another might be the difficulties in bringing two family controlled businesses together. Easier to sell to a foreign operator or PE fund than find painful synergies, perhaps. The fact that foreign investors seem to pay better than Italian acquirers may too play a role.

The recent elections, held following an electoral reform designed to create large coalitions, have produced no outright winner even though there were a few surprises, with the Five Star Movement gaining the largest percentage of votes and the League's share of the vote overtaking that of its coalition partner, Berlusconi's Forza Italia. The center-right coalition, which overall has the greatest share of the votes, has agreed with the Five Star Movement upon the Presidents of the House of Deputies and the Senate. This will test their ability to work together on a program for government. However, the need to rely on the votes of all three parties to attain a majority in Parliament is likely to temper the more radical proposals of each and may effectively lead to a stalemate, allowing continuing domestic stability. In this scenario, we think the upward trend is here to stay. If the global recovery continues, and companies seek to increase global sales and market penetration through acquisition, then foreign investors will continue to find willing sellers. The succession issue at many Italian companies will grow inexorably as time passes. And the easiest (and frequently most lucrative) solution to that problem will more often than not come from overseas.

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