INVEST IN ITALY

One Big Fund for private debt

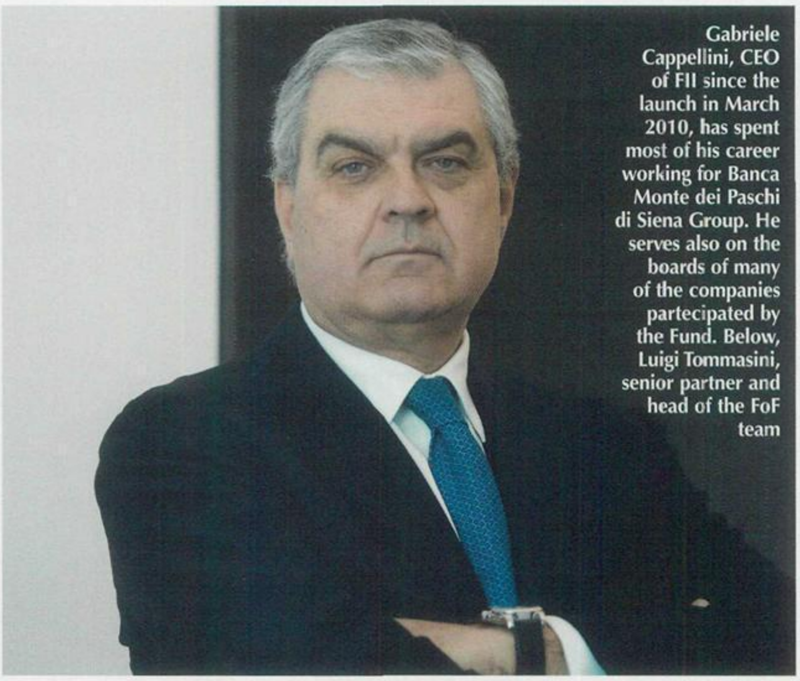
Aiming to **flow** some **€600** mn to corporations, the CEO of Fondo Italiano d'Investimenti, the largest private equity player, plays his **cards** in a **new** market. Where risks are **high** and returns not that **appealing**. But he has a **theory** behind the move

by Pier Paolo Albricci

The turning point came in mid-September, when CEO Gabriele Cappellini made a proposal to the board of directors of Fondo Italiano d'Investimento, which stands, alongside Clessidra, as the biggest joint Italian private equity fund with €1.2 bn in assets under management. Cappellini's proposition was to venture into the emerging private debt market with a huge fund of funds boasting assets of €600 mn. Although it is a big gamble, the fund won't have to start from scratch because an initial sum of €250 mn has already been contributed to the nascent initiative by Cassa Depositi e Prestiti, which is one of the main sponsors of the Fondo Italiano d'Investimento, along with the largest Italian banks. Cappellini is aiming to attract strong foreign investors who can at least match the Italian contribution with another €250 mn. The objective is to achieve significant growth in the market, where the 20 or so current operators all have small funds of approximately €50 mn and only sporadically manage to make investments: there have been around ten deals in total in the last 12 months.

Nevertheless, the potential demand is huge, since the traditional players, the commercial banks, are increasingly preoccupied with stress tests and they are still being parsimonious with business loans, despite encouragement from the European Central Bank. Will the arrival on the scene of a heavyweight be enough to inject some vitality into an area that is considered a strategic resource?

Cappellini's vision is for the new fund initiative to focus first and



Gabriele Cappellini, CEO of FII since the launch in March 2010, has spent most of his career working for Banca Monte dei Paschi di Siena Group. He serves also on the boards of many of the companies partecipated by the Fund. Below, Luigi Tommasini, senior partner and head of the FoF team

Fund of Funds participated by Fondo Italiano d'Investimento

	year	SGR/Advisor	Fund name	Investment location	Commitment FII (€mn)	Total AuM (€ mn)	Focus activity
1	2011	Futurimpresa SGR	Finanza e Sviluppo Impresa	Lombardy	20	70	private equity
2	2011	Gradiente SGR	Gradiente I	North East	20	76	private equity
3	2011	Progressio SGR	Progressio Investimenti II	Italy	25	204	private equity
4	2011	Wise SGR	Wisequity III	Italy	35	181	private equity for SMEs
5	2011	Vertis SGR	Vertis Capital Parallel	Centre South	15	45	expansion/buy-out
6	2011	Alto Partners SGR	Alto Capital III	Italy	25	94	Mbo,Mbi, Expansion for SMEs
7	2011	IGI SGR	IGI Investimenti V Parallel	Italy	20	93	private equity
8	2011	Finint & Partners	NEIP III	North East	20	75	expansion, minorities for MSC
9	2011	Mast Capital Partners	Winch Italia	Italy	25	62	develop./growth capital
10	2012	Star Capital SGR	Star III	Italy	15	88	expansion capital
11	2012	HAT Private Equity	HAT Holding All Together	Italy	15	39	holding company
12	2012	360 Capital Partners	360 Capital 2011	Italy	10	72	venture capital in IT
13	2012	Sofinnova Partners	Sofinnova Capital VII	Europe	15	240	venture capital
14	2013	United Ventures	United Ventures One	Italy	10	50	seed/early stage in ICT
15	2013	P101	Programma 101	Italy	15	32	seed/early stage
16	2013	Emisys Capital SGR	Emisys Development	Italy	30	131	debt/equity
17	2013	Ambienta SGR	Ambienta Fund II	Europe	30	162	green industry
18	2014	Consilium SGR	Consilium PE Fund III	Italy	25	92	expansion for SMEs
19	2014	Ardian	Ardian Expansion III Italia	Italy	20	133	expansion for SMEs
20	2014	Insec Equity Partners	SI2	Italy	20	55	mid cap buyout, expansion
	2014		Medical devices fund	Italy	15	na	venture capital
	Total				**425**	**1,994**	

Source: Lombard elaboration on FII data

foremost on replacing the medium- and long-term debt market, which was once the preserve of medium-term credit institutions. While they were gradually absorbed by parent companies as part of the universal banking model, their functions were never fully replaced. It should be noted that there are some structural issues with private debt funds, although they can clearly serve as an alternative source of financing to inject fresh life into the real economy, which has been neglected by the banks. The main issue is that investing in debt instruments (basically bonds) is very risky because the returns on the assets has a very low upside while the losses from any defaults will make the returns from the entire portfolio plummet. "The secret lies in a fund's ability to choose its investments wisely. This basically means carrying out the due diligence process effectively before making any investments," underlined Cappellini, who brings to the table vast experience in both business loans (from his decades at Monte dei Paschi) and private equity: a field where he is enjoying success at an unfavorable time in the market.

But, if due diligence is as fundamental in the choice of investments as Cappellini says, the restrictive criteria are bound to limit the number of deals completed, so the fund is already at a disadvantage as it seeks to reach its target of €600 mn in assets.

In any case, the new fund of funds will be run by an ad hoc group of at least three or four expert bankers. They will boost the ranks of the current team at the Fondo Italiano d'Investimento that manages indirect investments, i.e. the funds of funds. But the key factor in the management will be the possibility of investing not only in traditional bonds, but also in hybrid financial instruments with the potential for returns that are not tied to the bond market and actually closer to equity.

However, working in Cappellini's favor is the success of the funds of funds he has managed so far at the helm of the Fondo Italiano d'Investimento. The fund started in 2011, on the eve of the big sovereign debt crisis in Europe. During its joint management of business projects, it has poured €425 mn of its original assets into 21 direct funds, but most significantly it has acted as a catalyst for approximately €450 mn in foreign capital from public and private institutions, which thanks to the leverage effect has brought around €2.5 bn in fresh financing for Italian industry in the shape of equity and debt. "Our success in

bringing lots of capital to Italy in clearly unfavorable circumstances has been widely noted, including on a European level," revealed Cappellini, whose business model has been assessed by several EU countries and promptly imitated in their respective markets. There has been a far from typical response from abroad.
The EIB's European Investment Fund (EIF), which supports the growth of SMEs, has put €150 mn into organizations in Italy started by FII, which is three times as much as it had invested in the past. It has focused in particular on funds of venture capital funds, which is a brand new sphere for both Italy and the EIF. FII is also playing a leading role in venture capital. Cappellini and Luigi Tommasini, the manager in charge of initiatives in the area, decided to create business accelerators specializing in three strategic sectors for industrial development in Italy: information technology & media, biotech and mechatronics & robotics. "They are fields in which only specialists are capable of assessing whether a start-up has the potential to be successful," explained Cappellini, "but at the same time they have to be able to work on a number of projects, so they need substantial resources to bach them up." The fund has created a vehicle for each of the three sectors: a €50 mn fund for IT called P101, which raised €15 mn on the market; a €30 mn medical devices fund; and a third one which is currently in the fundraising process. The plan should reach greater heights than any previous efforts in the sphere not only because of the expertise of the individual specialists, but also thanks to the direct involvement in the fund of the proposer of the business, meaning that there is an economic incentive. Will all of this suffice to add a vital spark to a market that is still languishing, despite the fact that the fiscal regulations have been made more advantageous recently?

Cappellini takes a drastic view: there are no alternatives to creating new sources of equity for companies. It is inevitable. As the global situation becomes less and less comprehensible and stable, broad availability of capital is essential for companies that want to grow and get stronger, because the amount of loans on offer from banks is going to get smaller, especially for intangible assets, which play a crucial part in growth. In concrete terms, this means buying goodwill (i.e. other companies), sales networks, brands and patents. The risks associated with these assets have a big impact on the capital ratios of banks, so they avoid them. Consequently, there is a lack of growth among companies, which in turn holds back the economic growth of the whole country. L


CORPORATE ANALYSIS
Question: who will fund the next growth?