Degree Program in Corporate Finance

Course of Cases in Business Law

Leveraged Buyout Structuring and Regulation: The Blackstone and Benetton Family Deal for Atlantia

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To my colleagues in Rome and New York, and to my forever friends back in Tuscany.
You are to me, family.

Ultimately, my deepest thoughts are with my grandmother, who is now supporting me from above.
This is all for you.

Abstract

The financial and macroeconomic outlook is in perpetual evolution. Following the global financial crisis of 2007 and 2008, global economies have been impacted by booms and bursts, and dramatic turns occurred. The more recent turmoil due to the COVID-19 pandemic in 2020 and 2021 has seen the market fall and rise to the top in 2022. The past years' volatility and rapid credit expansion that has led to inflationary peaks have been addressed by central banks as the FED and ECB through a tightening monetary policy. In the Eurozone, inflation averaged 2.40%, reaching its lowest in 2015 at -0.60%. However, in October 2022, it reached its historical highest at 11.50%. Consequently, the tightening monetary policy has driven surging interest rates, leading to increases in the cost of debt and capital overall. The markets have required participants to adapt rapidly and introduce alternative approaches and solutions to day-to-day operations and extraordinary ones. It is in this vortex that the financial players have developed alternative sources of financing to fill the new gaps created by the market shortcomings and demands.

The past decade has been distinguished by the increasing activity of non-banks and institutions, which, if previously preferred to be off the radar by tackling chances in private markets, are now targeting public markets to seize profitable opportunities within niches not harnessed by banks and other financial institutions. In this regard, alternative investment funds, such as private equities, are creating value. The investment strategy of prominent players in this industry relates to undervalued public companies; by identifying potential underperforming businesses, they invest in them to gain control and foster their growth in a private context, far away from the glare of the public and their short-term expectations. While private equity and venture capital offer alternative financing to companies at any life stage, the connection between the public and private markets occurs only at the epicenter of both worlds. Leading private equity funds, often called buyout funds, target mature and undervalued companies in consolidated industries to restructure them and create a sector leader.

The first chapter is an introduction to the private equity landscape and the operativity of the funds. This introductory chapter will serve the purpose to shed light on industry overall. It starts with a brief foreword followed by the sector's history and how it has evolved up until now. More attention is then paid to the fund structure, which involves limited and general partners, the financial sponsor, the fund itself, and the portfolio companies. Lastly, the chapter describes the investment process, including the necessary marketing material and how a target is screened and identified.

The second chapter introduces the concept of leveraged buyout, focusing on structuring the model and the debt financing. LBOs rotate around debt markets and solutions; therefore, it is imperative to provide highly detailed notions in this regard. Bank Debt, High Yield Bonds, and Mezzanine Debt are the three primary

sources of debt financing used in this acquisition method. The financing terms will be then mentioned in the credit agreement, and depending on these, several different covenants may be applied. The chapter concludes with the LBO model, which reflects the inputs and assumptions of the financial analyst performing the analysis.

The third chapter maintains the focus on LBOs. However, we now debate about the applicable regulatory spectrum in Italy. Knowledge about the peculiarities of PE in Italy is shared prior to diving into the regulations, as the PE industry in Italy is singular and has just recently commenced its growth. The Italian regulative framework is conditional to a certain extent to directives originated by the European Union. Funds targeting an Italian company may create multiple investment vehicles in the EU to benefit from taxation and legal treatment; however, they will have to comply with the EU takeover directives and the Italian provisions concerning LBOs.

The fourth and conclusive chapter exemplifies the Blackstone and Benetton family deal for the Italian multinational Atlantia, a major player in the motorway and airport infrastructure and mobility-related services industry. This transaction copiously reflects the considerations raised throughout the thesis and introduces related regulative concerns and measures. This deal saw the likes of Blackstone, the most relevant PE and buyout fund to date, and the Benetton family, one of the most influential at a national and international level. Eventually, this deal will be a turning point for the Italian infrastructure and PE industry as a whole as it signed 2022's greatest deal at a global level and Europe's largest private equity deal and take-private transaction in history.

This thesis seeks to provide a comprehensive understanding of the private equity spectrum and leveraged buyouts. By deeply detailing each aspect through a financial and business law perspective, practitioners will gain a complete understanding of these matters. The Italian context is chosen as the country and market of reference, being among the most structured and regulated. By commencing with a broad analysis and narrowing it down to a leveraged buyout case study that sees the involvement of major players, such as Blackstone and the Benetton family, we produce the most updated sector considerations.

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Chapter 1 – Private Markets and Private Equity Funds Activity

Private equity as a source of financing has gained increasing prominence in recent years. Due to the difference in required investment and capital available, the companies often look at other ways to finance their business instead of acquiring loans from traditional lenders like banks. Private equity existed as early as the 20th century and gained recognition after the Second World War. The increasing push for economic growth has led to the creation of PE firms that allowed investors to invest in high-risk areas at different stages of the company's life to help the company restructure and grow. Here, the PE funds have two stakeholders. The first is the general partner, responsible for managing the fund and making the investment decision. The second is the limited partner, who would provide the funding or capital required for the investment. The funding is based on the trust in the PE firm and its capabilities and past success. The paper explores how fundraising is carried out and the guidelines for the investment process. This information is critical to understand the PE market better as the trends show an increasing demand for PE funding, and growth is set to accelerate after the recovery from COVID-19.

Due to the rise of equity financing, which has been viewed as an alternative capital source and a supplement to bank finances during the previous fifteen years, the transition area has experienced significant gains in investments over time.[1] Reports show that public stock markets have expanded dramatically in size and liquidity, enabling businesses to draw cash from local and overseas investments. Thus, equity financing is a financial tool enabling investors to share a company’s gains and losses. For some investors and businesses, equity financing is more appealing due to the risk-sharing feature that distinguishes it from debt financing offered by the banking industry. From an investor’s standpoint, equity investments are seen as belonging to a business that, should it succeed, has the potential to generate significant financial gains. On the other hand, businesses are given long-term investments or capital to support their expansion.[2] This chapter primarily focuses on private equity in an effort to better understand how it operates.

[1] Teresa Hogan and Elaine Hutson, “Capital Structure in New Technology-Based Firms: Evidence from the Irish Software Sector,” 2005; Robert M. Hull, “Debt-Equity Decision-Making with and without Growth,” 2011; Claudio A Romano, George A Tanewski, and Kosmas X Smyrnios, “Capital Structure Decision Making,” 2001.

[2] Jun Chen, Ningzhong Li, and Xiaolu Zhou, “Equity Financing Incentive and Corporate Disclosure: New Causal Evidence from SEO Deregulation,” 2022; Michael Dowling et al., “Trust and SME Attitudes towards Equity Financing across Europe,” 2019; Zhengwei Wang and Wuxiang Zhu, “Equity Financing Constraints and Corporate Capital Structure: A Model,” 2013.

1.1 Private Equity

Private equity is said to be between outright ownership and public equity when considered in terms of investment horizon as well as the corporate control provided. This form of financing is a medium-term one that does not provide the same short-term horizon and the liquidity observed with publicly traded equities.[3] When contrasting private equity with public equity, it is necessary to keep in mind that the investor's links to the firm are closer as a result of the purchase of a significant ownership position in the business, which gives them some control rights and entitles them to board participation. This results in private equity investors taking a more active role in managing their investments and implementing operational improvements inside the business. In this respect, it is comparable to foreign direct investment (FDI), except the investment is allegedly for a shorter time. Based on this, we can say:[4]

Private equity is said to provide capital to be invested in unquoted companies, including public companies that have been de-listed as a result of the transaction. These investments could be in the form of the purchase of shares from the existing shareholders or through the investment in new shares that would provide fresh capital to the company.

The above is a broad definition of what private equity is. A more straightforward definition would be:[5]

Private equity is the investments made by investors in private companies through negotiated transactions carried out privately.

The basis for this kind of funding is their emphasis on bridging the gap between internally produced finance and traditional market avenues like stock and borrowing. These are addressed as the private capital being provided outside the public market for companies with high growth potential, young companies at the early development stage, start-ups, and in some cases, companies that need a financial turn-around.[6] However, compared with different types of investors, such as those in the stock market, private equity investors would need a much higher ownership interest to guarantee they possess control rights and the authority to appoint directors. Many professionals, organizations, and fund managers pledge funds to this cooperative investment program. Private equity firms, specifically general partners, are known to control or established under limited partnerships. Limited partners are member fund investors and frequently pledge capital throughout several closings or rounds. A limited partnership is often available for a fixed term of ten years. The general partner

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[3] EBRD, "TRENDS AND VALUE CREATION IN PRIVATE EQUITY," 2016, p.52.

[4] John Gilligan and Mike Wright, "Private Equity Demystified: An Explanatory Guide," 2020, pp. 10.

[5] Cyril Demaria, Introduction to Private Equity: Venture, Growth, LBO & Turn-Around Capital, 2012, p.11.

[6] EBRD, "TRENDS AND VALUE CREATION IN PRIVATE EQUITY." 2016, p.52

often makes investments within non-listed companies. In this way, the general partner provides the investee company with management and strategic support to help grow the company.[7]

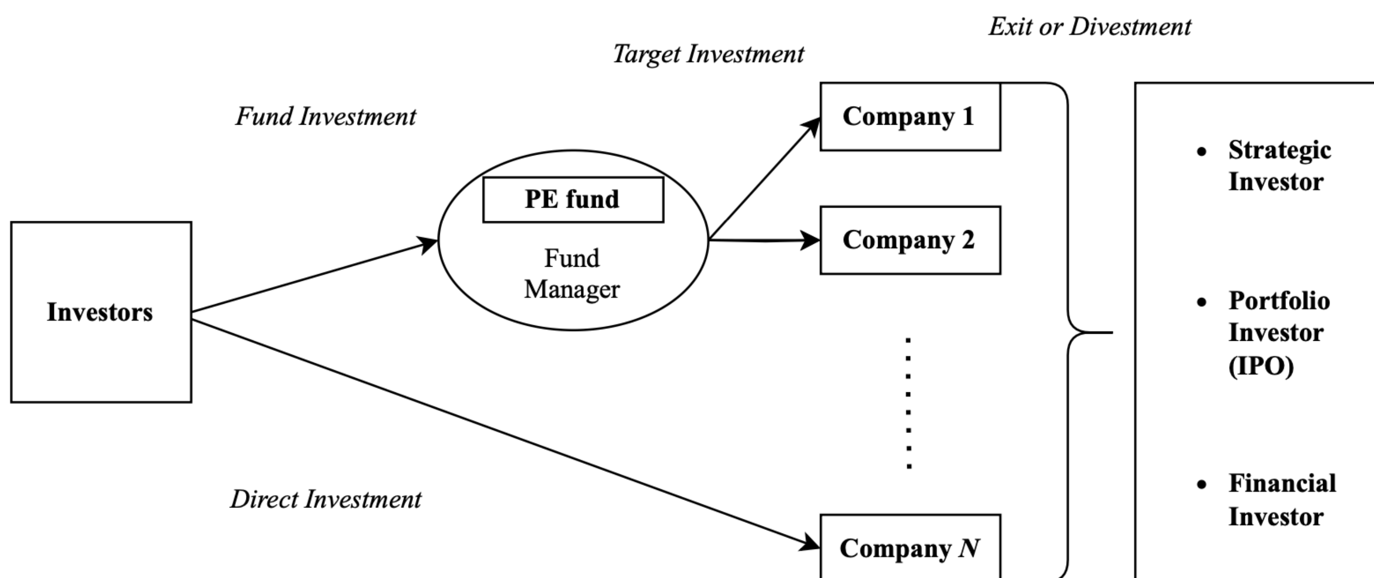

Figure 1 Private Equity Investment Cycle

Several characteristics are said to make private equity investments unique. These include:[8]

- The deal is done through direct negotiations, which allows for more flexible arrangements compared to public equity, which would satisfy both sides.
- Private equity investment managers often possess a more comprehensive range of information about a targeted company and their performance compared to stock market players. This larger share of data disclosure would allow for making better investment decisions and analyzing the risks.
- The nature of the equity pledged is generally illiquid or less liquid than that available in public markets.
- There is a need for a long-term commitment.
- There are difficulties in determining the current and fair market value of the target shares.
- Increased investor involvement can benefit the company as they get help from individuals with years of sector-related experience.

Private equity funds can also use bank-provided debt to purchase equity. When more debt than equity is used to finance the investment, we refer to a leveraged buyout.[9] The private equity model of investment is

[7] EBRD, p. 52.

[8] Herasym and Segura, "The Role and Benefits of Private Equity in Emerging Market Economies," 2006.

[9] Douglas Cumming, Donald S. Siegel, and Mike Wright, "Private Equity, Leveraged Buyouts, and Governance," 2007; Steven N. Kaplan and Per Johan Strömberg, "Leveraged Buyouts and Private Equity," 2011.

explained through two arguments. The first is that private equity is focused on seeking out and taking advantage of failures or inefficiencies in the market that would lead to mispricing opportunities. The second is that when viewed conceptually, the principal-agent[10] issue had been utilized to tackle a severe market failure identified within several organizations. Managers of publicly traded companies and stockholders sometimes have different motivations. It is said that, instead, the management would act in their best interests and that the shareholders would only hold them partially accountable. Additionally, it is said that the division of ownership makes it far more difficult for the shareholders to coordinate their efforts and oversee management. In these scenarios, shareholders in a publicly listed firm would have the option to sell their shares if they believed the management was not focusing on increasing the company's worth. Though in the case of private equity, the problems are thought to be addressed by ensuring that the goals would align with the interest of the managers and shareholders, thus achieving economic efficiencies.[11]

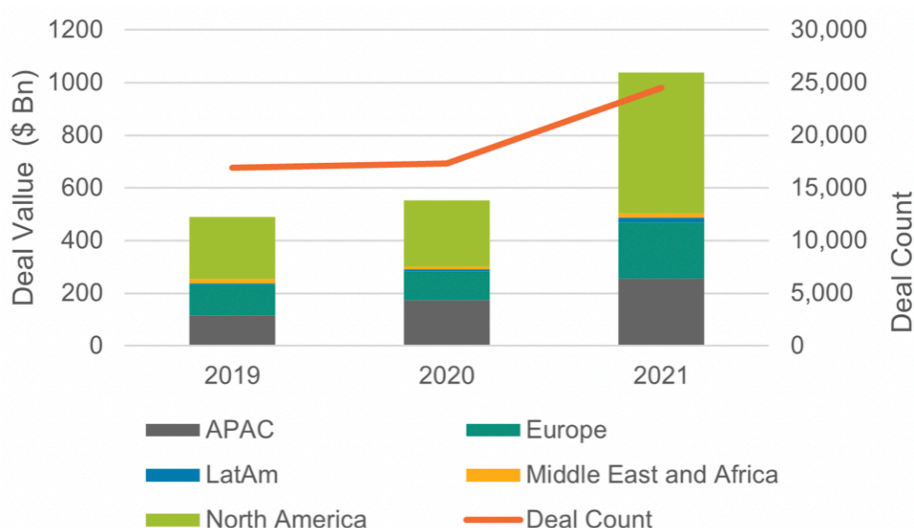

Figure 2 Private Equity/Venture Capital Deal Activity (2019 – 2021)[12]

The 2022 report by Standards and Poor briefs that 2021 was a record year for the private equity industry, which saw investments surpass the trillion-dollar mark for the first time. It was mentioned that a total of 24,520 deals were closed in the year, with the deal volume growing by 41.6% compared to 2020. All

[10] For the principal–agent relationship to be problematic, two ingredients are needed: conflicting incentives and private information. It is not surprising that the financial services industry finds itself rife with potential principal–agent problems. The interconnectedness of the industry has created a myriad of agency relationships in which monitoring is difficult, and many of these relationships involve risk transfer or risk sharing within groups. Consequently, ethical standards within the field must be high, lest the power of participants' own incentives drive them to act counter to their fiduciary duty to their clients – Sunit N. Shah, The Principal-Agent Problem in Finance, 01 April 2014

[11] Gilligan and Wright, *Priv. Equity Demystified An Explan. Guid.*, 2020

[12] Ewa Skornas and Suarez Bautista, "2022 Global Private Equity Outlook," 2022.

countries or regions have seen an increased investment spree that has allowed PE growth. In 2022 PE investors were expected to remain bullish, and the majority believe that the growth would continue in the coming years[13] once more, highlighting the growing importance of PE in investment and creating capital.

Every investor wants to see a return on their initial investment. This might come from a salary, interest, dividends, or capital gain from the sale of an investment when its value has grown. However, the primary goal of private equity is to realize capital profits. The intent is to invest in stock holdings in companies, run such companies, and then reap the wealth by flipping or selling the companies. The motives and desires of most private equity investors would be cantered on obtaining capital gains. They are considered to be focused on producing enhanced shareholder value since they are supposed to be geared at attaining capital and profit growth. Private equity would incorporate venture, growth, and buyout capital in general. Still, in recent years the term has focused on investing in later-stage development capital like buyouts or buy-ins of established companies or businesses.[14]

[13] Ewa Skornas and Suarez Bautista, "2022 Global Private Equity Outlook," 2022.

[14] Gilligan and Wright, *Priv. Equity Demystified An Explan. Guid.*, 2020

1.2 Private Equity History

Private equity can be traced back to 1901 when J.P. Morgan (the individual) purchased Carnegie Steel Co. from Andrew Carnegie and Henry Phipps for a total of $480 million. Phipps is said to have taken the share and created the Bessemer Trust, considered the first private equity fund. Today the same trust is considered a private bank transforming itself from a private equity firm, though it is still known to buy exclusive rights for new companies.[15] Even after this, there was no private merchant banking in the US due to the structural restrictions imposed on the investment banks. Though a well-known private equity firm that was established in 1946 was the American Research and Development Corporation, founded by Georges Doriot, who is considered to be the father of venture capitalism. The focus of this company was to provide the required funding to the soldiers returning from World War 2 and help boost the private sector and economic growth – the first push for private equity firms, which remained unimportant for decades. That said, in the 1950s, private equity was seen to grow in the form of venture capital. One of the first successful venture capital transactions occurred in 1957 by ARDC when it invested around $70,000 in a new start-up referred to as Digital Equipment Corporation, which would later be valued at over $355m once it released the IPO.[16]

Private equity focused on acquiring controlling interest, a rarity for venture capital firms leading then to the evolution and development of PE firms. First were the leveraged buyout firms established in the 1970s and 1980s by investment bankers. The focus was to leverage the target company with debt and equity capital to purchase it. One of the most well-known buyouts deals during this time was RJR Nabisco for $25 billion in 1988.[17] This was the first proper form of a contemporary private equity transaction. When we consider it an asset, the private equity industry is always known to have been illiquid and relatively long-term, with an average lifespan of 15 years. PE's primary market was prevalent at the start of the 1980s when they became relevant investment possibilities, but after 2008 financial crisis, secondary PE has seen significant growth. There is a difference between the primary and secondary markets. For example, the investments made in the primary market would be directly made in newly formed PE funds. In contrast, limited partner commitments in the secondary market are often in pre-existing portfolio companies.[18] The secondary market is more mature than the primary as it often has shorter holding periods. There was significant growth in the secondary market

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[15] David Gilchrist, "Book Review: Private Equity: History, Governance, and Operations," 2013; Harry Cendrowski, *Private Equity: History, Governance, and Operations*, 2008.

[16] Gilchrist, "Book Review: Private Equity: History, Governance, and Operations." 2013

[17] Nicolaus Loos, "Value Creation in Leveraged Buyouts: Analysis of Factors Driving Private Equity Investment Performance, Value Creatio*n,"* 2006; Gheorghe Hurduzeu and Maria-Floriana Popescu, "The History of Junk Bonds and Leveraged Buyouts," 2015.

[18] Silvio Vismara, "Expanding Corporate Finance Perspectives to Equity Crowdfunding," 2022; Alberto De Biasio and Alex Murray, "The Social Network of the UK PPP Secondary Equity Market–Returns and Competition in an Emerging Market," 2017.

due to the crisis, as people distrusted banks and large financial institutions. The latter led to a strategic sell-off of PE assets and PE funds' commitments on the secondary market. The below graph in Figure 3 shows the growth in the secondary market over the years. The PE sector is said to have had a strong performance in the last four decades, and the expectation is that it will continue to grow. However, considering the current economic macroeconomic outlook, the establishments and investments are to be more attentive.

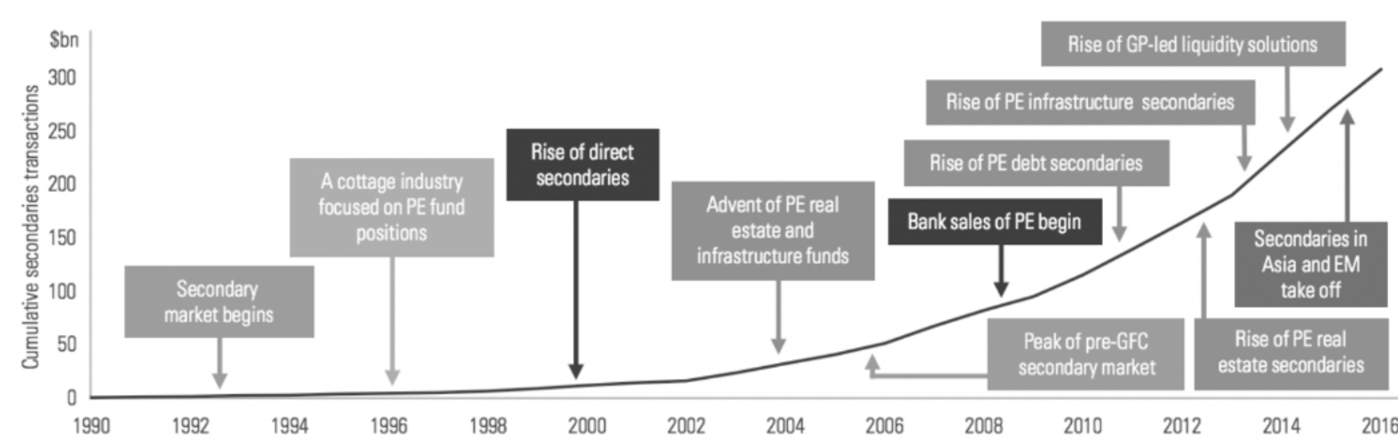

***Figure 3 Secondary PE Market Evolution*[19]**

The framework underlying the current private equity contract was laid in the 1970s and 1980s. The infamous trio Jerome Kohlberg, Henry Kravis, and George Roberts established Kohlberg, Kravis & Roberts Co. (KKR), the first genuine private equity firm, in 1976. In 1978, the three at KKR created the first equity fund in the sector with a committed supply of equity money.[20] However, beginning at this period, the primary source of acquisition funding was still sporadic secured credit borrowing from bank lenders. In order to take on more debt for acquisitions, if PEs were to grow, a reliable source of debt financing would be required. PEs were one of the major issuers of high-yield products by the middle of the 1980s, and Milken found this as an essential source of finance. In this period, PE companies employed high-yield and other debt-type instruments with conventional senior secured loans to enhance the debt level on certain acquisitions.[21] This levered funding enabled PE firms to conduct more eye-watering acquisition deals. The structure of PE purchases would be determined by the type of debt financing and the requirements of the investment banks underwriting or originating it.

[19] BSPE, "The Evolution of Private Equity and Venture Capital," 2022

[20] Victor F. Morris, "The New Financial Capitalists: Kohlberg Kravis Roberts & Co. and the Creation of Corporate Value (a Review)," 1999.

[21] Douglas Cumming, "The Oxford Handbook of Private Equity, The Oxford Handbook of Private Equity," 2012, p. 19-20.

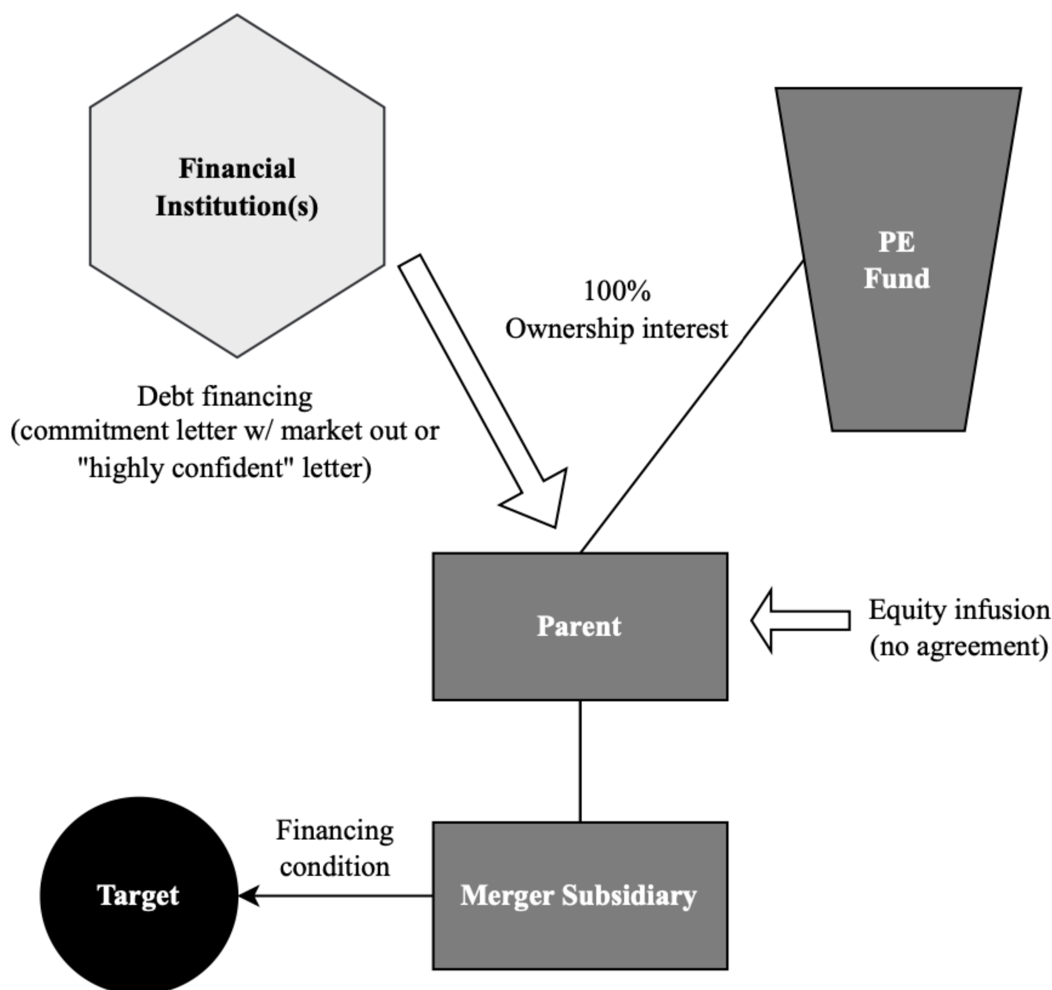

Figure 4 Early PE Structure[22]

The structure was limited, especially as the buyout was reliant on the thinly capitalized shell subsidiaries set up with just this purpose. It was vital for the terms of the deal to assess best efforts to assist in completing the financial transactions specified by the agreement because the shells lacked any significant assets of their own. This resulted in a demand assurance need to ensure the finances would be accessible because the shell had no genuine assets. Contracts would then require a letter from a commercial bank or other financial institution. The banks, in turn, added the market out clause, which would allow them to terminate their financing obligation in situations where the markets deteriorated or impeded the incurrence of the debt. The structure continued to evolve over the years. A new structure based on the SunGard buyout was introduced in the new millennium. SunGard is said to have removed the financial condition from the contract and also was able to negotiate the need for a debt commitment letter that is said to have also listed the commitments from both sides. The funding for the deal was judged to be more certain due to the provisions of the loan commitment letter and the private equity purchase arrangement being in harmony. It also introduced the

[22] Douglas Cumming, "The Oxford Handbook of Private Equity, The Oxford Handbook of Private Equity," 2012, p. 20

condition for market out or lender out. The deal set the building blocks for PE acquisitions, at least on a contractual basis.[23] The financial crisis has then influenced the structure again, instituting a reverse termination fee structure as an option. A private equity firm is focused on preserving its reputation, and it focuses on limiting the optionality. PE funds' reputation was severely damaged during the crisis, leading to a fracture in the existing balance. This meant that the targets needed to be more willing to bear the financial risks in the contract. This reputational hypothesis is supported by various studies, which found that in 2009 the equity transaction reverse termination fee was 4.6% of the enterprise value (EV)[24] and 30% of the transaction allowed for the target-specific performance.[25]

[23] Douglas Cumming, "The Oxford Handbook of Private Equity, The Oxford Handbook of Private Equity," 2012, p. 23.

[24] Enterprise value (EV), total enterprise value (TEV), or firm value (FV) is an economic measure reflecting the market value of a business (i.e. as distinct from market price). It is a sum of claims by all claimants: creditors (secured and unsecured) and shareholders (preferred and common). Enterprise value is one of the fundamental metrics used in business valuation, financial analysis, accounting, portfolio analysis, and risk analysis. Essentially it can be obtained through the common equity at market value ("market cap"), the debt at market value, any minority interest, and net of cash and cash equivalents. A simple interpretation of the enterprise value is viewing this metric as the price an investor would have to pay to own a company entirely, satisfying all claims on the business.

[25] Matthew Cain, Steven M. Davidoff, and Antonio Macias, "Broken Promises: Private Equity Bid Failures and the Limits of Contract.," 2010.

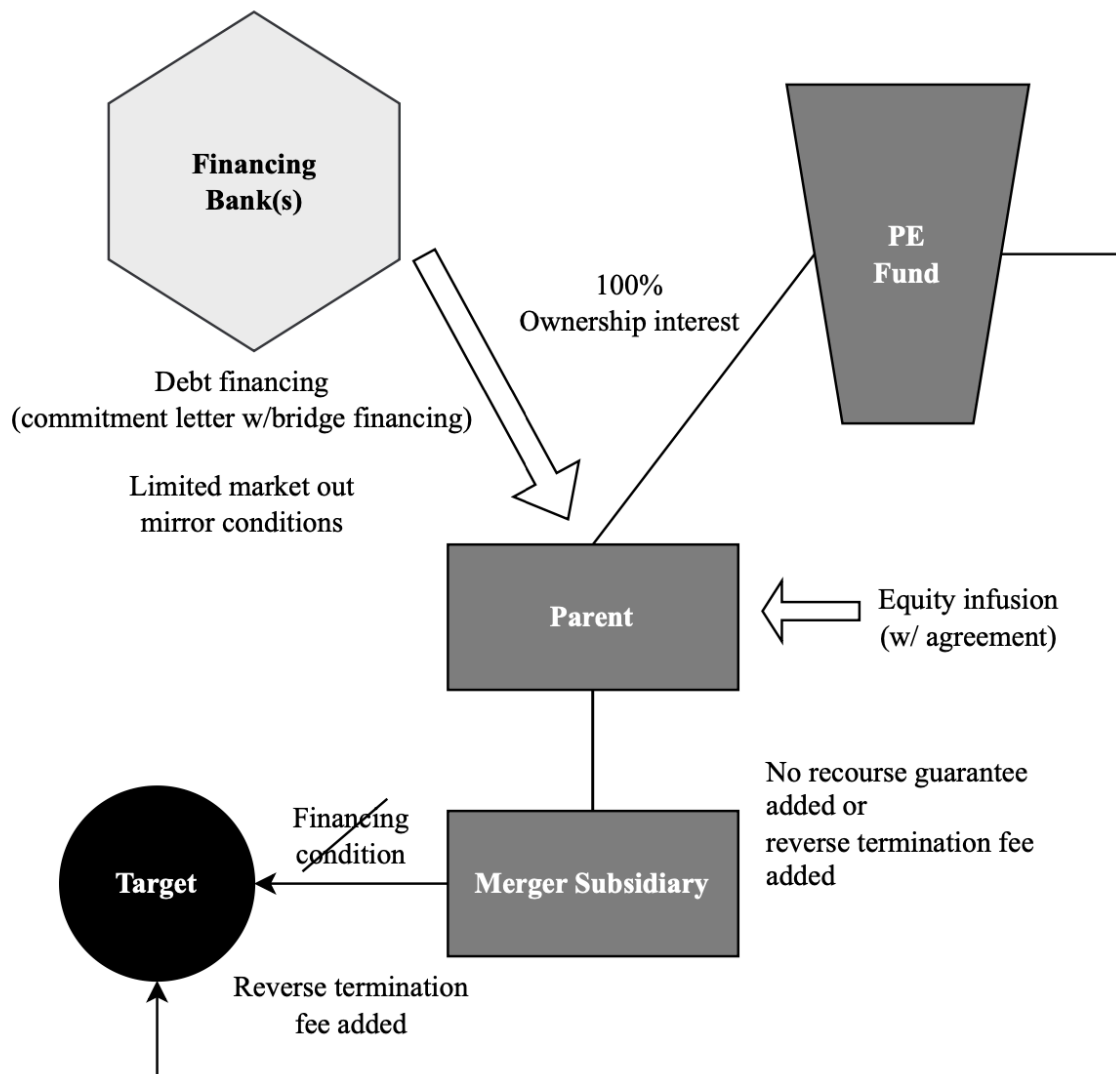

Figure 5 SunGard Structure[26]

Private equity has struggled to get finance to execute purchases in the post-financial crisis era. As a result, self-funded acquisitions and more expensive mezzanine borrowing have become increasingly common. Additionally, the struggle induced PEs to start and complete fewer, smaller investments. According to FactSet Merger metrics, private equity firms announced ten acquisitions of publicly traded US companies worth more than $100 million in 2009, an astonishing drop. While the private equity contracts have been evolving, new requirements and changes have pushed for new structures and terms to be considered to adopt and define new practices that could gain trust.[27]

[26] Douglas Cumming, "The Oxford Handbook of Private Equity, The Oxford Handbook of Private Equity," 2012, p. 23

[27] Douglas Cumming, "The Oxford Handbook of Private Equity, The Oxford Handbook of Private Equity," 2012, p. 35.

1.3 Private Equity Funds

Private equity investment funds are pools of professionally managed capital that invest primarily in privately held businesses with the objective of enhancing business operations, reducing expenses, disposing of assets that are not essential, and optimizing cash flow. Investors pool or combine their funds through a private equity fund, allowing the fund manager to invest in a variety of businesses.[28]

Private equity funds are generally set as limited partnerships or limited liability corporations. These are managed by experienced general partners responsible for finding and evaluating the different possible investments and would be responsible while having the required authority to make all the decisions regarding the investment on behalf of the whole PE fund.[29] The funds sometimes have a goal or strategy for their investments that may focus on companies in specific market niches, industries, regions, size ranges, stages of development, or investment kinds and sizes. Private equity funds may focus on complex business turnarounds, atypical situations, leveraged buyouts and change of control agreements, growth equity for more established organizations, and venture capital for early-stage businesses. Funds may also offer debt financing, including senior, mezzanine, subordinated, or convertible debt, even though "private equity" usually conjures up images of equity investment, which has a considerable upside potential for investors. Many PE firms help their portfolio companies run efficiently and in other ways. The existence of private equity in the US was based on the private placement offering exemptions that were available under the Securities Act of 1933.[30] Often the structure, as well as terms of funds, are said to be dictated in some part by the desire of the individuals to avoid registration which was often done in part due to the tax considerations that would be applicable. Terms are also dictated through multiple asset management constraints, such as pending disposition, valuation difficulties, and the challenging and time-consuming liquidation process. The terms are also dictated by the marketplace conventions that have been developed and vary based on negotiations between the manifold companies, thus implying no uniformity in terms.

Private equity funds have multiple investment vehicles, all in parallel, which structure is tailored to manage the taxes, regulations, legalities, and other concerns of different investors who are part of the fund more efficiently. In the early stages, funds were mostly subsidiaries wholly owned by large financial institutions, referred to as captives. Over the years, a shift occurred, and many of these organizations became

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[28] Douglas Cumming, "Private Equity: Fund Types, Risks and Returns, and Regulation, Private Equity: Fund Types, Risks and Returns, and Regulation," 2011.

[29] Michael Alles, "Private Equity Funds: Champions of Governance and Disclosure?," 2007; Andrew Metrick and Ayako Yasuda, "The Economics of Private Equity Funds," 2010.

[30] Joan MacLeod Heminway and Shelden Ryan Hoffman, "Proceed at Your Peril: Crowdfunding and the Securities Act of 1933," 2012.

independent and focused on raising funds for investment through external sources. The primary motivation behind the spin-out was based on the fact that the PE teams became entitled to the entire upside of funds based on their performance instead of just grabbing a certain percentage. Multiple forms of management teams have risen as a result. Some of these management teams would include:[31]

- Generalist funds, which can be focused on both buyouts and venture capital;
- Buyout funds;
- Funds of Funds (FoF) that would invest in other private equity funds;
- Specialist funds focused on a given sector, with the most common being technology, real estate, healthcare;
- Debt funds;
- Secondary funds to help acquire limited partnership interest in other funds. It typically occurs when the underlying fund operates for a certain period.

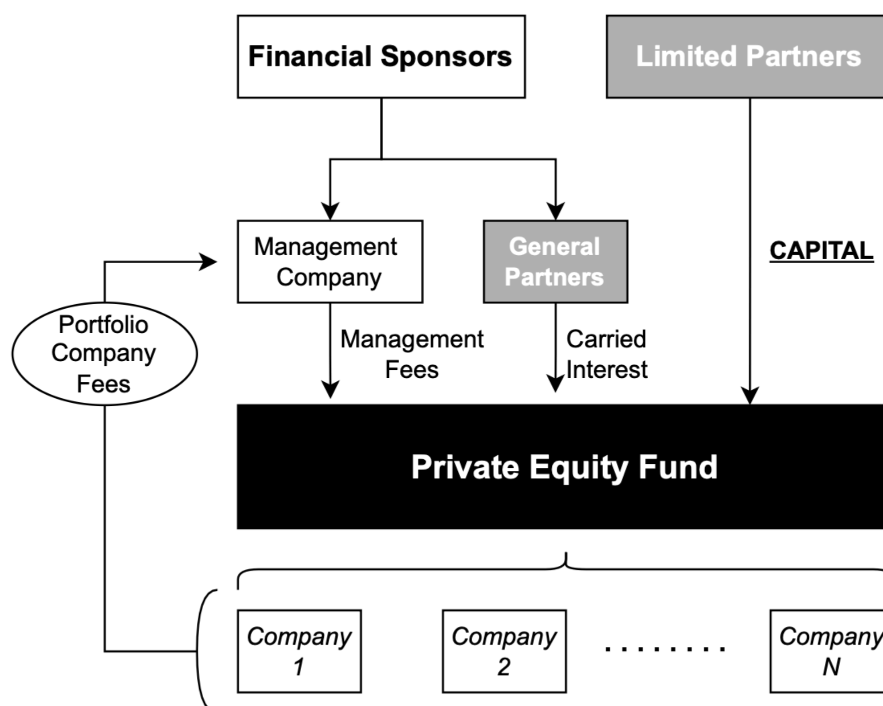

Figure 6 PE Fund Structure

The General Partners (GP) will administer the investment vehicle and lead the acquisitions. Limited Partners (LPs) are the investors who pledge the majority of the capital; however, they commonly do not have control over the investment choices. Nevertheless, GP and LP interests are easily aligned with the inclusion of performance-based rewards. Private equity differs from regular investment because each party's objectives align somewhat. The administrators of the PE firms are often found to provide portfolio businesses with

[31] Jonathan Blake and Lorraine Robinson, "Private Equity Fund Structures -- the Limited Partnership," 2015, p. 9–11.

multiple resources and work very closely with the companies to help them advance their operations with a focus on a common goal: profit generation. The fund structure is often a limited partnership (LP) or limited liability (LLC). These two are most widely used for the following advantages they provide:[32]

- These structures have limited liability, so if anything goes wrong, the investors would only risk the capital they have committed.
- LPs and LLCs are considered pass-through entities when it comes to taxes.

In limited partnership funds, the limited partnership agreement (LPA) is the main contract defining the partnership involving the limited partner shareholders and the general partner, who runs the investment company and possesses unlimited responsibility. A fund's leadership team's performance plays a key role in deciding whether or not to invest in it. Since most of these funds' investors are banking institutions, both parties' attorneys negotiate the partnership agreement. Investors generally try to resolve constraints on the kinds of investments the fund can engage in and the other activities of the fund management team once they have internally decided to undertake an investment. This partnership agreement finalized by the two is said to be the LPA or mandate which sets restrictions on term, fundraising, investments, geography, security type, and scale of the fund. The the Institutional Limited Partners Association and their set of recommended governance principles are an optimal guideline to draft an LPA.[33] Critical corporate governance terms within the fund must be better understood to comprehend the working of the funds. These would include:[34]

- Disclosure and Confidentiality: there is no obligation for the firms to disclose their financial performance publicly, differently from what is seen in public organizations. Some mandates would also limit this information to the investors.
- Waterfall Distribution: the mechanism implemented to ensure that the limited partners would be paid first. It would ensure that the general partner would not carry any interest. Often two types of mechanisms are used. First is the deal-by-deal waterfall, and second is the total return waterfall. Waterfall distribution is a good practice more visible in Europe than in the United States, which addresses the *timing issue*. ILPA recommends holding accrued carried interest in escrow accounts with at least 30% of carry distributions reserves and more for potential or unexpected clawbacks.
- Key Man clause: If a key executive quits or is fired, the GP will be prohibited from making new investments until replacement.

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[32] Blake and Robinson, "Private Equity Fund Structures -- the Limited Partnership." 2015

[33] ILPA is the Institutional Limited Partners Association that provides a set of private equity principles for the best practices of general partners and limited partners with respect to the private equity industry.

[34] Cendrowski, *Private Equity : History, Governance, and Operations*; 2011; Viral V. Acharya et al., "Corporate Governance and Value Creation: Evidence from Private Equity," 2013.

- No-Fault divorce: it refers to the removal of a GP if the majority of LPs favor it.
- Investment restrictions: a set of restrictions or boundaries placed to diversify or to emphasize the limits that need to be followed when it comes to borrowing and then deploying.
- Clawback provisions: at a fund liquidation, LPs can enforce their right to reclaim part of GPs carried interest in order to normalize the total final carry to the initial percentage agreed in the fund mandate. Such a provision aims at protecting LPs' interests as promised returns may diverge at the final stage of the liquidation. On the other hand, it also neglects excess profit to GPs. A waterfall capital distribution generally limits the insurgence of clawback liabilities.
- Tag-along, Drag-along rights: This term is about any future acquirer that needs to extend their acquisition offer to all the investors or shareholders within the fund, including the management.

Alongside the most relevant corporate governance technicalities, funds implement some specific economic-financial indicators and rates:

- Management fees: determining the desired returns is important to ensure that the promise between the investor and a manager is carried out and creates a core value of the fund; this is not the primary source of income. The main source of income is generated from what is referred to as management fees, known to be around 1.5 to 2% on average. These are the fees that the LPs would have to pay the GPs. The performance does not influence this payment and serves to help the fund with its operating expense.[35]
- Ratchet: a mechanism used to determine the equity allocation among the various shareholders and the management team.
- Transaction fees: fees paid to GPs for their advice on investments and their services for transactions carried out on behalf of LPs.
- Terms of the fund: these can last between seven to ten years, and they could be extendable for shorter periods provided that it is agreed upon.
- Vintage year: refers to the year the fund would be launched, and this is the base with which the comparison of funds is made for the same stage and industry focus.
- Hurdle rate: what the GP needs to achieve in terms of IRR before receiving any carried interest. If such a clause is included, the GP's carried interest is based only on the portion of profits that exceeds the LPs' preferred return. This is optional, however it enforces the alignment of interests between GPs and LPs.

[35] Samuel Fellin and Albin Ostervall, "The Governance Asymmetries of Private Equity" 2022.

- Carried interest: represents the GPs' profit share based on the fund's total or investment-related profit. Some general directions on the calculation of carried interest would involve net profits and on an after-tax basis.

Through their investment in PE, investors expect a steady cash flow from the companies, a higher return on investment above the average market return, and a risk-adjusted return that would account for the possible capital loss and validate the risk the investors took. Funds follow multiple strategies to offer promising returns. These include:

- Leveraged Buyout Funds: they employ investment vehicles to conclude an acquisition or merger or gain access to controlling shares of highly capitalized organizations. The fund would buyout the company mainly through debt and a small component of equity sponsored by the investors with the goal of delisting it from any public market in which it is listed. Multiple broker-dealers are involved in debt financing and advisory. These are considered risky, complex, and highly expensive to execute investment strategies. The company being bought would have shareholders who would also be expected to ensure their money would be returned as promised. So, the LBO fund would often need to take loans or borrow money to ensure they could make up the shortfall. This fund is found to be more attractive for investors who are in search of high returns in the short term. Once the company's acquisition is completed, it is noted that the companies are often made public again through an IPO, or their shares are sold to other funds to achieve the promised returns.

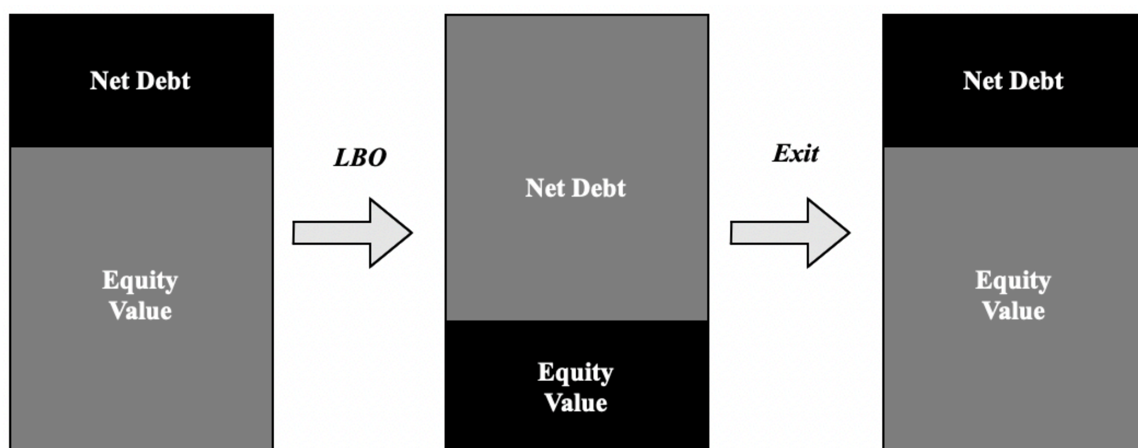

Figure 7 Leveraged Buyout Fund Value Creation

- Venture Capital fund: governments, businesses, and private investors pledge finances into this fund which is used early on in a company's life intending to make money from either management fees or

capital gains.[36] Such funds provide exposure to both debt and equity markets and have the potential to participate in the stock upside. The key benefit of these funds is the availability of high-quality debt funding and growth equity. Investors have often been observed to combine their venture capital money to have access to various investments rather than concentrating on just one. According to this, investors may diversify their risk and increase their exposure to various alternative investments. Nevertheless, a higher minimum investment is required to promote a company's growth and achieve returns, consequently increasing the risk. Increasing the company's total worth through predicted profit sharing is the ultimate purpose of venture capital.

- The last type is the absolute return fund, which is focused on returns that could be reliant on the value growth that would underlie the investments without considering any risk or the level of risk involved. Returns are achieved through investment in assets that would provide safety and growth.[37] One of the most common types of funds which would fall under this category is the diversified fund. These funds are also said to hold multiple, often large numbers of investments, all with different return and risk profiles. Through a strategic selection of the investment, the absolute return of the funds would be aimed at achieving returns that would be uncorrelated with the overall market and each other. These funds could provide investors with downside protection and upside potentiation, which is not commonly seen with traditional investments.

The aforementioned lists the distinct forms of PE funds and their structure and associated critical terms. The upcoming section discusses how the investment process is structured.

[36] Gihyun Kwak, "What Drives Venture Capital Fund Performance?," 2020; Robert S. Harris et al., "Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds," 2020.

[37] Bradford D. Jordan, Christopher P. Clifford, and Timothy B. Riley, "Are Absolute Return Mutual Funds Absolutely Absurd?," 2012; Joachim Klement, "Liquid Absolute Return Funds: An Alternative to Alternatives?," 2015.

1.4 The Investment Process

Multiple steps are to be undertaken when it comes to the investment process. The fund's structuring, marketing, and organizing would take over a year or more. The first of the steps in this process would be undertaking preliminary meetings to help identify interested investors and highlight the type of investors the fund would be targeting. Based on this, the sponsor would need to create an offering memorandum to attract investors and commence the fundraising process, which could take anywhere between 12-18 months and include both new and old investors.[38] The process is also referred to as "Capital Call" and occurs through multiple stages. Prior to the creation of the memorandum, the firm would send out teasers or pitch books to the said investors they have identified to document all the investment opportunities and provide some basic information regarding the fund, its experience or track record, and its vision and strategy. Multiple methods like networking, internal analysis, market and equity research, meetings, screening for specific factors or variables, conversations with industrial experts, and multiple other techniques are used to develop the teaser. The teaser is a concentrated summary, no longer than two pages, with information on the investment opportunity. The critical information, like the seller's name, would be hidden, and only specific details on the business, its services or products, and key financial ratios would be highlighted. Once these are created, the next stage is to develop the structure that the funding process would follow and the detailed term sheets based on the legal and tax advice received by the company. When laying-down the terms, there is a need to ensure that the offering complies with the securities laws. Jurisdictional differences apply; nevertheless, compliance is critical.

The private placement or offering memorandum sent to the clients is the essential information to be disclosed to a prospective investor when expected to raise funds. The content of the memorandum includes:[39]

- The business description. Covering the investment strategy and process, commentary or findings from the market, and a sponsor description.
- The legal description summarizes the governing documents the fund must uphold and encloses relevant considerations on risk factors, conflict of interest, and any other legal disclosures such as regulatory information, tax information, and the applicable securities act.
- The track record is, again, the investment firm's experience. It focuses on the investment strategy, performance, record, issues that need to be considered when preparing the track records, and any other information that could cover the firm's performance. The performance would also be based on the

[38] Debevoise & Plimpton, "Private Equity Funds Key Business, Legal and Tax Issues" 2020, p. 24.

[39] Debevoise & Plimpton, 2020, p. 25.

investment standards that various trade organizations have promulgated for the members to follow, like the Global Investment Performance Standard.[40]

The document offering memorandum must comply with all the required securities acts and applicable regulations. Other supplements are added to the document, reflecting the material developments seen during the course of the offering.[41] The process of attracting funds is led by a business plan sent to multiple equity firms covering the capital required and the exit possibilities.

Follows then the negotiation process entailing several stages. The initial negotiation makes the counterparty aware of both sides' prospects and highlights interest. If interest exists on both sides, the transaction conditions are offered, and the initial memorandum is provided. Due diligence is then performed on financials and non-financials. PE firms would highlight the need and negotiate for some level of control based on their satisfaction regarding the board or management team. Negotiations will also cover the financial and legal structure of the investment, which should consider and balance the risk and returns effectively. Fund managers could use multiple financial instruments, like equity and debt, quasi-equity instruments, or preferential shares.

The price negotiation is critical in determining the percentage of ownership. The PE firm's price would be based on its investment objectives. The target's valuation is covered in the negotiation and agreement. Once completed, the investor would send an offer with the conditions of investment; it is not a formal engagement but a vague sketch of the aims of investment and the points discussed and agreed upon by the PE firm's board or the manager. The offer letter would set the conditions for the next stage in the process and what conditions would need to be met for the agreement to be finalized.

In due diligence, lawyers, accountants, tax experts, environmental risk forecasting experts, and many others are to analyze the various aspects of the target entity based on the information provided.[42] Meanwhile, the investors will receive all the relevant target information and make their structural considerations. The due diligence focuses on the management systems, forecasting tools, assumptions made in the projections, and other details, providing advice on the feasibility and validity of the findings. In the event of a successful and thorough due diligence, a final offer is advanced by the PE. The legal and financial frameworks are finalized based on the agreements reached during the initial negotiations or the findings proposed during the negotiation process. During this stage, the investment managers also identify and propose the various shareholdings.

[40] Global Investment Performance Standards (GIPS) are a set of guidelines for investment management firms encouraging full disclosure and fair representation of investment performance.

[41] Debevoise & Plimpton, 2020, p. 29-31.

[42] ECVA, 2007, p.27.

Equity-based compensation plans often make up a large portion of the rewards available to the business. The investors impose a period known as "vesting," in which the stock option beneficiaries need to stay in the company for a specific time before they can benefit from the preferential conditions.[43] In the final agreement, the PE firm, through the managers, could introduce anti-dilution clauses which provide them the right of refusal of any future equity issuance, and along with this, they could also have the veto on the stock-split operation. Based on the final negotiation, the lawyers develop the agreement, which covers all critical information about the investment criteria and conditions that were agreed upon. Legal information, board of director composition, timetable, investment protocol, warranty letter, the changes needed in the statutes, and other necessary procedures and information are also included. Once done, the agreement is signed, and the investment is executed.

[43] ECVA, 2007, p. 27-28.

1.5 Screening and Identifying the Target

Identifying the right target companies that meet the established vision of the funds is paramount. Investment is made based on specific criteria that need to be satisfied in order to process the acquisition, and such criteria frame the overall attractiveness of the investment opportunity. The criteria or process could differ based on the acquirer's expectations or strategy. In a study that was undertaken with a focus on exploring the decision guide and the rules regarding PE investment through a qualitative approach, it was found from the interviews with professionals that the success would differ based on strategy and the type of financing.[44] One of the criteria often highlighted, which is used in screening, is the internal rate of return (IRR). It is also critical to understand that while there is more information concerning the screening process in VC, there needs to be more information for PE in general. Some of the research highlights this because the PE firms and the managers often do not divulge information regarding their internal practices, and the market itself is imperfect, inevitably leading to asymmetric information.[45]

Based on the VC investment process, four underlying dimensions are used for screening or considered investment criteria: market attractiveness, product differentiation, environment threat avoidance and resistance, and management capability to create value.[46] Rules are significantly different when it comes to buyouts as compared to VC. Studies have shown that buyout funds prefer well-consolidated companies with higher retained profit and capable of servicing debt thanks to a constant cash stream. In general, this perception would lead to the conclusion that companies with high-profit potential and cash-generative while having lower net worth are more attractive to PE investors.[47] It is also important to note that decisions would also be influenced by lower equity and lower-than-average productivity, which would help and provide an opportunity for the investors to help achieve performance improvement and growth after the investment. PE investors are said to focus on single service or product firms, meaning they are more interested in supporting companies with defined markets and product lines that are simple enough.[48]

[44] Mark Broere, "*Decision-Making in Private Equity Firms: An Empirical Study of Determinants and Rules*, *Decision-Making in Private Equity Firms: An Empirical Study of Determinants and Rules,"* 2014.

[45] Karin Ljungberg and Sandra Svedman, "The Private Equity Investment Process - An Aggregated View on Information Asymmetry Reduction." 2017.

[46] Erik Halvord and Maja Wassen Fagerberg, "Systematising Early Evaluation of Potential Acquisition Targets of PE Investments," 2019.

[47] Nicholas Wilson, Shima Amini, and Mike Wright, "Determining the Characteristics of the Private Equity Targets: UK Evidence," 2022.

[48] Wilson, Amini, and Wright. 2021.

The decision-making is also heavily reliant on the perception of the decision-makers. Opportunities need to be attractive, timely, and durable and are often anchored in products and services that would create or add value for the buyers or their end users. It is stated that most successful private equity financiers would focus on the opportunities and thus ensure the consumer's understanding of what they want and keep sight of it.[49] Undertaking formalized market research provides critical information. That said, the final decision would be based to a certain extent on intuition and experience, which are critical when judging the potential of the opportunity presented.[50] Financiers are looking for opportunities to find a balance between rights and cash sharing; these two forms most of the criteria when making their decisions. Lastly, factors like team, market, and technology are dimensions that the financiers value when considering an opportunity.[51]

Equity-worthiness and equity-willingness are two additional factors impacting the target selection. The two are critical factors in determining the outcome of negotiations, and their ex-ante analysis would help provide reliable insight when predicting the outcomes of the negotiation process. Figure 8 provides a 2x2 matrix for private companies based on equity-worthiness and equity-willingness criteria. The matrix describes the possibilities that can arise with different companies and helps strategize and understand if they are worth pursuing.

[49] Noel J. Lindsay and Justin B Craig, "A Framework for Understanding Opportunity Recognition: Entrepreneurs versus Private Equity Financiers," 2002.

[50] Lindsay and Craig, 2002.

[51] Lindsay and Craig, 2002, p. 14.

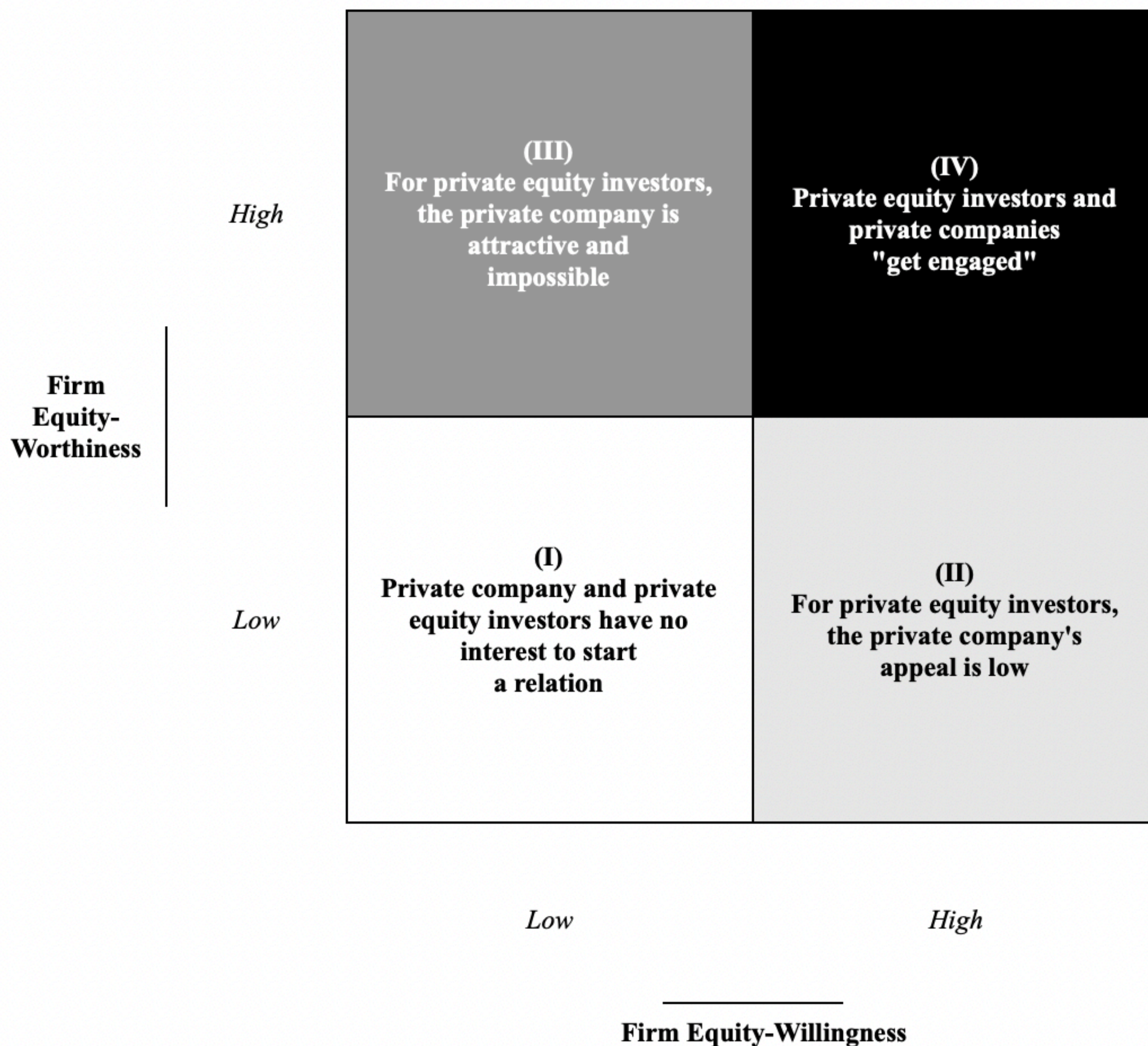

Figure 8 Equity-Willingness/Worthiness Matrix[52]

For instance, if the company is in cell one, there is less to no chance of a deal happening and hence can be ignored completely. On the other hand, if the company is in cell four, then these are ideal, and there is a high chance of a deal being worked out, making the company more attractive to investors.[53] While all these factors must be considered, it is also critical to note that the company should have a strategic fit with the fund. It should be within the geographic boundaries and the expected goals of the company. If the said companies cannot meet the goals set by the fund, then these could not be a part of their portfolio. Thus, these companies' strategic fit with the fund is critical. If there is no strategic fit, they can be funnelled out based on the fund's characteristics or areas they consider important. As mentioned before, some funds are willing to invest in high-

[52] Arturo Capasso, Rosario Faraci, and Pasquale Massimo Picone, "Equity-Worthiness and Equity-Willingness: Key Factors in Private Equity Deals," 2014

[53] Arturo Capasso, Rosario Faraci, and Pasquale Massimo Picone, "Equity-Worthiness and Equity-Willingness: Key Factors in Private Equity Deals," 2014.

risk areas compared to others. Ultimately, the decision depends on the overall expectation of the investors of the fund and their objectives.

Chapter 2 – Leveraged Buyout Structuring

At this stage and onwards, the focus is set only on leveraged buyouts. In this chapter, in-depth LBO knowledge is shared, allowing us to apprehend who the target companies of this acquisition strategy are, how the financing is structured with a focus, particularly on the debt sources, and finally, the whole empirical model and its main areas.

LBO deals have surged in awareness and importance alongside private equity funds activity. The increased activity of leveraged deals was primarily driven by relatively low-interest rates in recent years, which facilitated PE firms borrowing and deploying. Moreover, public markets have been significantly volatile, with risk-averse investors and companies favoring private markets because of fewer regulatory requirements and costs. Buyout firms are addressing this risk-aversion by delisting public companies that can benefit from a reorganization in private markets, far from the burden of regulation. In turn, funds can offer alternative investments to potential investors who have significant capital to deploy. Adding up the COVID-19 pandemic and the challenges the markets faced afterward, many firms were left in distress and subsequently targeted by PE funds.

2.1 Leveraged Buyouts

As anticipated in the previous chapter, a Leveraged Buyout (LBO) is probably the most renowned acquisition strategy implemented by Private Equity funds. Through an LBO, the target is acquired using a large portion of debt to finance the purchase price – commonly in the range of 60% to 80%. The outstanding portion of the purchase price corresponds to an equity contribution provided by a financial sponsor. The underlying idea behind such an aggressive and risky acquisition strategy is that the target company will be able to service the debt repayments with the cash flows generated by its core activity. In addition, it is often the case that the company's assets being acquired, and if necessary, also that of the acquirer, are pledged as collateral for the loans.

While an LBO investment process would align with the steps noted in Chapter 1.4, the ideal target company must present specific criteria. If one of these criteria is to come less during the screening phase, the riskiness of the investment will consequently surge. Prior to the prerequisites, the primary screening questions are "How much debt can the company sustain?", and "How will the company service the new debt?". When answering these questions, we want to assess the company's ability to generate cash and its asset basis. The crucial consideration is generating stable and predictable cash flows, which will be channeled to the debt and interest repayments. Mature companies, almost in a steady state,[54] will generally have a constant stream of cash and are hence preferred for an LBO. While cash flow generation is an essential indicator, the financial institutions providing the financing want some form of collateral or guarantee. Target companies with a substantial asset basis can leverage it and pledge it as collateral for the secured loans. It is often common to see entire target companies being pledged as collateral.

Target companies identified by private equity funds, specifically buyout funds, will commonly exhibit most of the following characteristics:[55]

- Attractive purchase price: as in any deal, the purchase price is pivotal. Funds will screen the market in search of undervalued companies that can be bought out at a lower multiple.
- Constant and predictable cash flow generation.
- Large asset base: assets that can be pledged as collateral to secured loans or divested to generate cash and efficiency improvements.
- Good debt indicators: little amounts and a good debt capacity and credit rating for better lending conditions.

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[54] A steady state is an immovable situation. A company reaches it when all sources of competitive advantage are exhausted, and no growth nor decline can occur.

[55] Joshua Rosenbaum, Joshua Pearl, Investment Banking, Valuation, Leveraged Buyouts and Mergers & Acquisitions

- Low capex and net working capital requirements: all else equal, capex and net working capital reductions increase the free cash flow. During the due diligence phase, advisors must differentiate between “maintenance” and “growth” margins to determine what is the appropriate level for the two variables.[56]
- Growth opportunities and realizable synergies: undervalued companies related to peers but with the same capacities are optimal as they present a growth outlook. Organic growth, bolt-on acquisitions, and potential synergies with the private equity fund’s portfolio companies are good indicators in growth terms. The growth of the company assumes more importance, especially if the desired exit strategy is an IPO.[57]
- Efficiency enhancement opportunities: improvements and cost savings stem commonly through headcount reduction[58], contracts renegotiation with customers and suppliers, and cuts in investment activities such as R&D, marketing, and capex. Cost reduction measures must be well planned to avoid severe downturns.
- Leading and defendable market position: a recognized brand, superior products, reliable client base, and economies of scale and scope are among some of the characteristics a good LBO target is likely to present. In addition, a high market share, market barriers to entry, and other sector-related barriers are additional positive characteristics that a target should exhibit. Some industries are generally more attractive than others for LBOs because of their predictable dynamics. These are, for instance, industrials as a whole, energy, consumers, and concession-related ones.
- Reliable and proven management team: a strong management team is well seen, and private equity funds mostly want to retain them and align their interests to the sponsors’ one by allowing them access to a relevant equity share and milestone-based agreements.[59] On the contrary, if the management team of the target has room for improvement, then fund experts are called to replace them and run the business; these individuals are sector experts with proven track records.
- Viable exit strategy: sponsors aim to monetize their investment at the end of the holding period. At the same time, LPs expect returns in this timeframe. Historically, holding periods are on average of five years. However, the ultimate decision regarding when to monetize an investment depends on the

[56] A company with substantial capex requirements may still represent an attractive investment opportunity if it has a strong growth profile, high profit margins, and the business strategy is validated during due diligence.

[57] Companies with robust growth profiles have a greater likelihood of driving EBITDA “multiple expansion” during the sponsor’s investment horizon, which further enhances returns.

[58] Full time employees, mostly high-ranked, can easily be replaced by the fund’s experts if deemed too expensive and detrimental to the ongoing activity of the acquired company.

[59] Private equity funds often agree on some form of compensation to the management of the firm acquired when some pre-determined objectives are met.

target's performance and prevailing market conditions. At the end of the holding period, the sponsor expects to have increased the targets' EBITDA and the relative multiple, and consequently have reduced the debt substantially and increased the equity value.

Concerning the exit strategies, several considerations must be added. Firstly, exit and returns generations routes are several. The sale of the business to a strategic buyer willing to pay a premium for the potential realizable synergies is commonly the favored route, leading to price maximization. Moreover, with the proliferation of PE funds in the last years, sales to other sponsors have been an increasing trend. A secondary route which however has lost its appeal is an Initial Public Offering[60] (IPO) exit. While highly preferred in the early 2000s, this strategy has lost its appeal because of strict market regulations following the past financial crisis. Furthermore, sponsors are not able to fully liquidate their ownership in an IPO and end up retaining a significant share which will have to divest through a follow-on offering or sale of the company. While not a true "exit strategy", a dividend recapitalization provides the sponsor with a viable option for monetizing a sizeable portion of its investment before exit.[61] Through this strategy, the target repays a substantial amount of dividends by incurring more debt. It is important to note that the existing ownership is unchanged when this occurs. While still not exiting their investment, sponsors can generate returns through a below-par debt repurchase. During distress, sponsors may be able to purchase the company's debt instruments at a significant discount to its face value, in the belief that market conditions and the company will improve. If the latter occurs, the debt instruments price will have increased, and sponsors will have gained alternative returns while preserving their ownership. Lastly, it is worth mentioning that unsuccessful investments will have to consider liquidation when exposed to bankruptcy.

The planning of the exit strategy is often under looked, which may hinder the return the sponsor expects. The sponsor is therefore responsible for planning the strategy with the fund at the initial investment stage. The sponsor has the right to renegotiate documents and agreements. The most common rights internationally applicable and renegotiated are:[62]

1. Control and veto: while sponsors have a significant amount of ownership, the daily operations are managed by the fund or the retained management and it is essential in his interest to secure a veto right on the most critical decisions, particularly the exit strategy, which will represent his primary source of return.
2. Registration rights: the right to trigger or participate in a public offering of the company's shares.

[60] An Initial Public Offering refers to the process of offering shares of a private corporation to the public market in a new or secondary stock issuance on a regulated stock exchange.

[61] Joshua Rosenbaum, Joshua Pearl, Investment Banking, Valuation, Leveraged Buyouts and Mergers & Acquisitions, p. 211

[62] Thomson Reuters Practical Law, Private Equity Strategies for Exiting a Leveraged Buyout

3. Drag-along and tag-along rights to modify the ownership structure to ensure enough liquidity to generate the desired return.

Sponsors' rights and agreements however are not absolute. Creditors of the target company are, in most cases, granted rights that override the sponsor's and the fund's own.

2.2 Debt Financing in Leveraged Transactions

Leveraged buyouts initially relied on a 100% debt contribution. Following the Dot-com crisis, the equity contribution rose to an average of 38% to cushion the risk of default. Indeed, the credit boom and bust that occurred in 2008 brought practitioners to focus more on the right balance between debt and equity funding. Debt financing is a major component of leveraged buyouts. In an LBO, the buyer uses a significant amount of debt to finance the purchase of the target company. This is typically repaid over a specified period, with the cash flow generated by the target company. The use of debt financing in LBOs can be a risky proposition. The high interest rates and short maturities of debt used in LBOs can put considerable pressure on the company's cash flow, and if the company is unable to meet its debt obligations, it could be forced into bankruptcy. However, if the acquirer can successfully turn around the target, the private equity firm or other investors can profit significantly. Despite the risks, debt financing can be a powerful tool for private equity firms and investors looking to acquire companies. When used effectively, debt financing can help to achieve significant returns on investment. On the other hand, equity plays a minor role in terms of financing. Equity investors or financial sponsors are entitled to dividend payments and profits from sales of their shares within the target. The more concentrated the ownership, therefore the minor the equity financing, and the greater will be the return at the exit for the sponsors. While LBOs rely prevalently on debt funding, a good portion of equity funding functions, as well as a cushion for credit holders' claims in the event the target company acquired, is incapable of servicing the newly incurred debt. In the upcoming, the focus is shifted toward the financing and capital structure implemented in an LBO.

	Equity Financing	Debt Financing
Ownership	Dilute ownership	No dilution of ownership
Control	Investors may have a say in how the company is run	Lenders don't have a say in how the company is run
Repayment	No need to repay the money	Must repay the loan plus interest
Tax benefits	Interest payments are not tax-deductible	Interest payments are tax-deductible
Qualification	May be difficult to attract investors	Easier to qualify for debt financing
Risk	Less risky	More risky

Figure 9 Equity vs Debt Financing

The debt financing in an LBO is commonly highly structured and counts a broad array of different solutions as loans, securities, and other debt instruments subject to diverse terms, rates, and covenants. The financing will be structured according to the needs and risks perceived. Exhibit 10 provides a graphical representation and a quick grasp of the principal debt instruments. As a rule of thumb, the higher the rank of the instrument, the lower the risk and intuitively the cost of capital, however, the stricter the conditions and covenants.

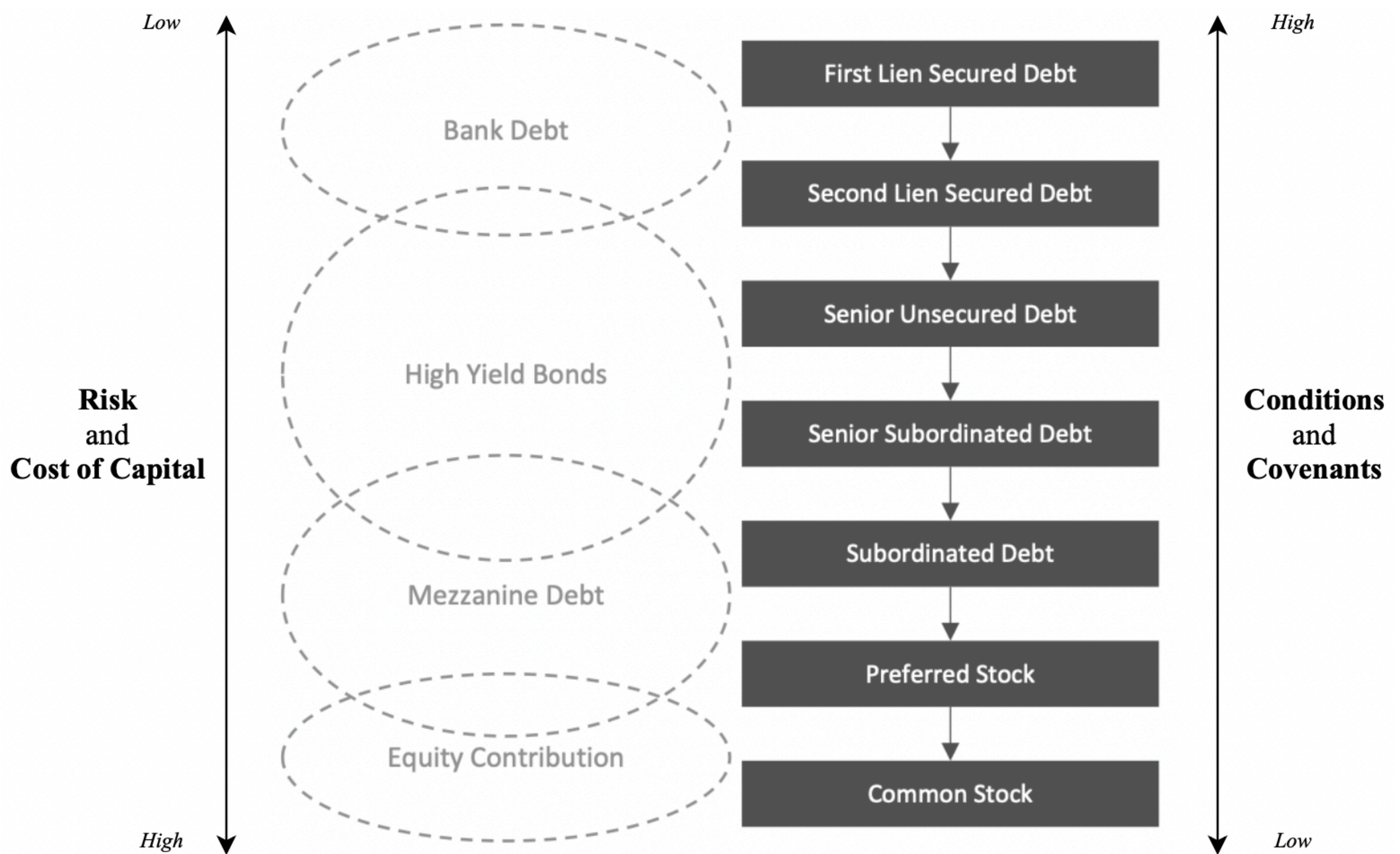

Figure 10 General Ranking of Financing Sources in an LBO Capital Structure

Exhibit 11 moreover summarizes the main characteristics these instruments present. With the term "security" we refer to the pledge of, or line on, the collateral provided by the borrower to the creditor. The "collateral" refers to a target's asset or more (current or non-current) whose maturity matches the debt instruments. For instance, a revolver will match current assets as account receivables and/or inventories, whereas a term loan will be matched to a tangible asset as PPE. "Seniority" is about the priority status of a creditor's claims against other creditors. The higher the seniority, the greater the priority. The expression "maturity" ("term" or "tenor") is used in relation to the duration of the debt instrument, from issuance to complete repayment. Bank debt commonly has the smallest tenure of five years, whereas high-yield bonds can stretch to ten. As a rule of thumb, the shorter the maturity, the lower the risk and cost of capital because repayment has to occur first. These two instruments are subject to interest payments defined as "coupons".

Bank debt pays coupons quarterly according to a benchmark rate as the LIBOR plus a spread based on the borrower's credit. High-yield bonds' coupons are instead paid semi-annually and in accordance with a benchmark Treasury. To protect investors from deteriorations in the credit market and interest rate drops, coupons, "call protections" and "call premiums" are set forward. The first are forms of restrictions that often translate into the second: the payment of a fee in the event that the lender wants to prepay or redeem ahead of maturity. Call protections are standard for high-yield bonds. For instance, a bond with a maturity of seven or eight years will be protected for four years ("Non call-4" or "NC-4"), and a bond with a maturity of ten years will be protected for five ("NC-5"). The pricing and schedule of the call depend on the term and coupon and are summarized in a table for quick vision. Lastly, the "covenants" on the debt instruments are provisions contained in the credit agreement that protect the investors from a deterioration of the borrower's credit quality.[63]

Bank Debt	High Yield Bonds	Mezzanine Debt
Secured ←	Security	→ Unsecured
Senior ←	Seniority	→ Junior
Shorter ←	Maturity	→ Longer
Lower ←	Coupon	→ Higher
More Pre-payability ←	Call Protection	→ Negotiated
More Restrictive ←	Covenants	→ Less Restrictive

Figure 11 Summary of Selected Key Terms[64]

Lastly, exhibit 12 summarizes the main distinctions between the instruments.

[63] Joshua Rosenbaum, Joshua Pearl, Investment Banking, Valuation, Leveraged Buyouts and Mergers & Acquisitions, LBO Financing: Selected Key Terms

[64] Joshua Rosenbaum, Joshua Pearl, Investment Banking, Valuation, Leveraged Buyouts and Mergers & Acquisitions, p. 223

Bank Debt Senior secured credit facilities	High Yield Bonds Non-investment grade debt securities7	Mezzanine Debt Lies between traditional debt and equity
Revolving credit facilities ▶ May be borrowed, repaid, and reborrowed ▶ Traditional "cash flow" revolver ▶ Asset Based Lending facility *Term loans* ▶ May not be reborrowed once repaid ▶ Amortizing Term Loans ▶ Institutional Term Loans ▶ Second Lien Term Loans	Due to their junior, unsecured position in the capital structure, longer maturities, and less restrictive *incurrence* covenants as set forth in an indenture, high yield bonds feature a higher coupon than bank debt to compensate investors for the greater risk. High yield bonds obligate the issuer to make interest payments to bondholders at regularly defined intervals and repay principal at a stated maturity date (nonamortizing).	Mezzanine Debt is a hybrid debt issue subordinated to another debt issue from the same issuer. Mezzanine debt has embedded equity instruments (usually warrants) attached, which increase the value of the subordinated debt and allow for greater flexibility when dealing with bondholders. Mezzanine debt is tailored to meet the financing needs of the specific transaction and required investor returns.

Figure 12 Summary of Key Differences

Bank Debt

Also referred to as "senior secured credit facilities", bank debt comprises a revolving credit facility (revolver) and different term loan (TL) tranches. The revolver can be structured as a "cash flow" revolver or an asset-based lending (ABL) facility. Bank debt is issued privately and regulated by financial markets authorities, and it bears restrictive covenants that the debtor must comply with. Bank debt is interest-bearing and quarterly payable. The rate is generally the LIBOR to which an applicable margin or spread is added depending on the creditworthiness or credit rating of the borrower (or qualities of the asset in the case of an ABL). The rate is floating (subject to changes according to market conditions), and the spread can be adjusted if tied to a performance metric.

Revolving Credit Facility: Traditional and Asset Based Lending

A revolver is generally the least expensive instrument but less flexible as it is subject to a first or second-priority security interest ("lien"). The term is usually not less than five years, and it is arranged by one or more investment banks and, in turn, provided by a group of commercial banks or specialized institutions. It is typically used for working capital needs or capex expenditures. A traditional revolver allows one to borrow and repay varying amounts within its term. Limits and amounts are agreed upon in the credit agreement. An ABL is similar, however secured by current assets as accounts receivables and inventory, and therefore its limits are tied to a borrowing base formula fixed on these assets.

Term Loan Facility: Amortizing, Institutional, and Second Lien

A term loan is a credit with a predetermined maturity date and is subject to principal repayment. It often requires borrowers to maintain a certain credit profile and meet maintenance covenants. Depending on the term, the amortization schedule, and seniority, it is classified with a letter. The first type is the Amortizing (term loan A or "TLA") which requires consistent principal repayments throughout the term and its duration

is often aligned to the revolver. Follows then the Institutional (term loan B or "TLB"), which is more common in LBOs as it has smaller repayments and a greater bullet payment at maturity. Moreover, it has a longer duration than a TLA or revolver – up to seven years. The third type is the Second Lien term loans, and unlike the aforementioned, they do not amortize and have a longer term. Consequently, they are riskier.

High Yield Bonds

Along with bank debt, high-yield bonds are the most used form of financing. These are non-investment grade debt securities subject to interest payments on a semi-annual basis and a principal repayment (non-amortizing) at the maturity date, which can extend from seven to ten years. Commonly unsecured, with permissive incurrence covenants and no maintenance covenants, they bear greater coupon payments because of the risk.[65]

Bridge Loans

If the debt securities (usually high-yield bonds) cannot be issued before the closing of the LBO, an investment bank may provide a Bridge Loan. Essentially, this is an unsecured, short-term, costly, and last resort loan which most of the times is not intended to be funded but provides assurance to the seller that the deal will take place. Bridge loans are typically secured by the assets of the target company. The interest rates on bridge loans are typically higher than those on long-term debt, and the repayment terms are shorter. Most of the times it is used to finance the initial purchase of the target company, while the acquirer seeks to secure permanent financing, such as high-yield bonds or bank loans.

Mezzanine Debt

Mezzanine Debt is a hybrid source of financing with maturity and terms often similar to high-yield bonds but at the cost of capital still lower than equity cost. This is a handy solution for small to medium-sized enterprises whose access to debt markets is cumbersome because of their size and limited credit history.

Equity Contribution

The rest of the funding comes in the form of Equity and accounts on average for 30%. This can stem from one more financial sponsor[66] and often from the existing management of the target firm ("rollover" contribution).

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[65] Details about terms and conditions of bonds are found in a bond indenture, a legally binding document between the issuer and the holder.

[66] In the event of more financial sponsors investing as one, we are speaking of a "club deal".

2.3 The Credit Agreement and Debt Covenants

We now define the legal and commercial relationship that is born between the target company and the commercial banks and institutional lenders, the former being the borrower and the latter the lender. In this regard, all crucial terms and conditions are defined in what is the most relevant document when undertaking an LBO, the credit agreement.

A credit agreement is a legally binding contract agreed upon and signed by the relevant parties involved in the deal structuring. As it encompasses all terms and conditions of the loans incurred by the target company, it is essential for the success of LBOs. The stipulation occurs between the target and the lenders, however figures as advisors, security investors, and loan guarantors as well may be called to sign. Contents may change, however it will always include the following:[67]

i. The definitions of the keywords and parties involved.
ii. The loan amounts and terms as the interest rates, collaterals, extensions, prepayments, repayments, payments-in-kind[68], and penalties.
iii. Affirmative covenants.
iv. Restrictive covenants.
v. Financial covenants.
vi. The events of default of default on a loan which generally are missed payments or covenants breaches.[69]
vii. Remedies and recourse actions in case of default.
viii. The rights and obligations of the parties and the governing law and administrative agent of the contractual relationship.

As highlighted, a substantial portion of the credit agreement is devoted to the covenants. Debt covenants are conditional terms in lending agreements to ensure that the borrower's financial performance can meet his obligations. If a borrower violates a covenant, he is in "technical default," with consequences ranging from the breach being "waived" by the lender or accepting a payment-in-kind followed by worse lending

[67] The US Securities and Exchange Commission, The Credit Agreement Exhibit 10.20

[68] A Payment-in-Kind is a non-conventional form of payment for a debt which can occur in the form of a service, good, or also new debt.

[69] The concept of default is not to be misinterpreted with that of bankruptcy: the former is a contractual matter which meaning implies the termination of the agreement. The concept of bankruptcy on the other hand, is implemented by the court and the relevant regulatory authorities. Bankruptcy is declared when an entity is no more capable of meeting is legal and financial commitments.

conditions to the lender bringing the issue to court. Debt covenants have numerous functions. For starters, they safeguard lenders by assuring that borrowers will be able to repay their debts. In addition, they assist in ensuring that borrowers act responsibly and avoid acts that might damage their financial health. Finally, they can boost a firm's credit rating, making it easier to the company for future borrowings.[70] Because of their restrictive nature, borrowers often try to renegotiate the covenants if deemed too strict.

There are three specifications of debt covenants.[71]

1. Affirmative

Affirmative or "positive" covenants require the borrower to take predetermined actions or meet reasonable expectations to ensure the timely repayment of the loans. These can be:

- Maintenance of the corporate existence and a good standing with the regulatory authority of reference.
- Regularly and timely filing of financial statements to allow thorough auditing.
- Payment of taxes and law compliance
- Proper insurance hedge

2. Restrictive

Restrictive or "negative" covenants instead prohibit certain actions. The main goal is to protect creditors by limiting the total amount of debt the borrower can incur. This is achieved through:

- Limitations on the amount of debt outstanding.
- Restrictions on debt prepayments and amendments.
- Several further limitations regarding dividends, stock repurchases, investments, significant capital expenditures, mergers or acquisitions, and the disposition of certain assets and those pledged as collateral.
- Prohibitions of major structural changes to the business without the lender's approval.

3. Financial

Financial covenants require the borrower to maintain pre-determined levels of credit ratios and operational metrics and may moreover require an improvement of these through time. Checks are performed regularly by the lender in order to modify the metrics if necessary. In this last regard, there are two types in nature of financial covenants, which are reflected in affirmative and restrictive covenants:

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[70] The Corporate Finance Institute, Debt Covenants

[71] The US Securities and Exchange Commission, The Credit Agreement Exhibit 10.20

a) “Maintenance” covenants requiring the borrower not to breach pre-determined limits on credit ratios.
b) “Incurrence” covenants occurring if the borrower takes a specific action or breaches a maintenance limit.

Total Leverage	Total Debt/EBITDA	*4.5x - 5.5x*
First Lien	First Lien Debt/EBITDA	*3.5x - 4.0x*
Second Lien	Second Lien Debt/EBITDA	*0.5x - 1.0x*
Other Debt	Other Debt/EBITDA	*0.5x*
Interest Coverage	EBIT/Interest Expenses	*2.5x - 3.5x*
Debt-to-Equity	Total Debt/Total Equity	*n.a.*

Figure 13 Key Credit Ratios in a Leveraged Buyout[72]

Figure 13 provides the key credit ratios to keep track of and their range in LBO deals.[73] Financial covenants will require the borrower to maintain pre-determined thresholds, which may trigger an incurrence covenant if exceeded. For instance, the lender may set a maintenance total leverage ratio not to exceed 5.0x. If exceeded, an incurrence covenant may not allow him to raise more debt. However, suppose the total leverage ratio is increased because of a decrease in the level of EBITDA. In that case, the borrower will still be compliant with this covenant, but he might have breached other covenants. Moreover, including a “step” in financial covenants is reasonably ordinary. The lender will expect the borrower to improve his credit profile and operating profitability over time and consistently; therefore, he could demand a decrease in the total leverage of 0.5x and an increase of 0.5x in the interest coverage ratio semi-annually or quarterly.

Covenants are a matter of agreement between the lender and the borrower, and depending on several factors such as their relationship, industry, credit market conditions, and the target’s projections, they may vary significantly, making it hard to pinpoint general values. Nevertheless, the aforementioned values in figure 13 provide a trustful range to an LBO's most relevant credit metrics.

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[72] Marina Lukatsky, Pitchbook, With LBOs scarce, leverage in syndicated US loan market sinks to 7-year low
Macabacus, the Corporate Finance Institute

[73] The minimum and maximum values are obtained from the historical time frame from 2012 to 2022. A weak credit market will present low leverage multiples. Conversely, the multiples will be at their highest during a robust credit market. The debt-to-Equity ratio is among the most tracked, however it changes dramatically according to the industry of reference.

2.4 Leveraged Buyout Model

A Leveraged buyout model is built by analysts and practitioners in the extraordinary finance industry, or as they say, on the "buy-side", to evaluate the buyout of a target. Essentially, it is a highly complex valuation methodology that ultimately measures the Internal Rate of Return (IRR) from purchasing a company funded with cash provided by an equity sponsor and a significant amount of debt. The model serves as a depiction of the leading financial considerations a fund necessarily has to evaluate when considering the deal's feasibility. Through time, the fund will aim at improving the operational efficiency of the target to generate cash flow to pay down the debt and increase the equity ownership. Ultimately, the fund will sell the target commonly after five but within ten years.

An LBO model should determine the following information:

- Entry Valuation: the pre-LBO entry equity and enterprise value with a focus on the latter as the capital structure of the target will be replaced by the buyer.
- Default Risk: the evaluation of the debt impact through relevant credit ratios (e.g., leverage ratio, interest coverage ratio, solvency ratio).
- Free Cash Flow (FCFs): the projection of the cash generation of the target necessary to repay down the debt incurred.
- Exit Valuation: the post-LBO exit equity and enterprise value to determine the return metrics.
- Return Metrics: the Internal Rate of Return (IRR) and Multiple of Money (MoM).

An LBO model is highly complex, and several areas must be determined and evaluated individually for the analysis. Commonly speaking, there are five main steps:

1. Transaction Assumptions
2. Sources and Uses
3. Levered Free Cash Flow
4. Debt Schedule
5. Exit Value, IRR, and MoM
6. Sensitivity Analysis

Transaction Assumptions

As in any intrinsic valuation, gathering the correct and unbiased assumptions is the most critical step and often the most time-consuming. Assumptions are instilled with subjectivity; knowledge of the market and macro developments are crucial. However, building an understanding of the current and future market

developments is the hardest. Intrinsic valuation methodologies as an LBO are often subject to subjectivity bias errors.

The assumptions to be made are several and increase with the deal size and complexity. Every LBO will necessarily present the following inputs and assumptions:

- Purchase Price – the total purchase amount paid by the sponsor and PE fund for the target.[74]
- Fees and Expenses – general fees and expenses for lawyers, accountants, and advisors, among others.
- Debt – the debt tranches and related interest rates.
- Operating Assumptions – the growth rate of revenues and related profit margins.
- Exit Price – the total amount the target is then sold for at the end of the holding period.
- Financials – historical financial statements are needed to have a starting point to then plug in the assumptions.

Sources and Uses

As in a balance sheet, the Sources refer to the funding required for the deal, whereas the Uses to the capital used to purchase the target. Intuitively, sources and uses will amounts have to be matched.

The sources (or funding) are the New Debt and the Sponsor Equity. The new debt is the additional leverage brought in to finance the buyout. As PE firms are highly involved in leveraged acquisitions, thanks to their expertise and involvement with lenders, they are capable of refinancing debt with more favorable interest rates. The Sponsor Equity can instead be viewed as the down payment to finance the acquisition. All else equal, the lower the equity contribution, the greater its return.
At this point, financing assumptions are made on the total debt financing and the leverage multiples, the lending terms for each debt class, the management rollover, and excess cash.

The uses comprise fees, expenses, and the existing debt and equity liquidation. Because of their complex nature and deal size, LBOs involve several professional figures from multiple sectors. PE funds will sustain legal fees for transaction lawyers, accounting expenses, and advisory fees toward investment banks and specialized advisory firms. On top of general fees and expenses, the PE firm will have to purchase the existing equity from the shareholders and liquidate debtholders' claims as well.

[74] If "Cash-free, Debt-free'' (CFDF), the purchase price will match the estimated enterprise value.

Levered Free Cash Flow

The company's financial performance is generally projected on five year holding period and all three statements are modeled accordingly. The Levered Free Cash Flow is the cash flow a company has outstanding after meeting its financial obligations, therefore mandatory debt repayments. It is found as follows:

$$\text{LFCF} = \text{Net Income} + \text{D\&A} - \text{Change in NWC} - \text{CapEx} + \text{Net Borrowing}$$

LFCF represents what is available to shareholders or to the business itself after the debtholders' claims have been satisfied. Seen as an indicator of a company's ability to expand its business, Levered Free Cash Flow can also be devoted to dividend payments or share buybacks.

Assuming everything else stays constant through time, net income will ideally increase as the company profits, debt will mature, and interest payments will come down.

Debt Schedule

A debt schedule (or debt waterfall) is the time schedule of annual interest and principal repayments and the cash flow projections to evaluate how much debt can be paid off. Tracking the debt payments and maturities allows to prepare for ''cash sweeps'' – the action of paying off debt before maturity to avoid upcoming interest expenses.

Debt Schedule structure:

i. Beginning debt balance
ii. Interest
iii. Paydown amount
iv. Ending debt balance

The debt schedule is used to closely track the paydown of the revolver and the mandatory amortization, as well as all the optional prepayments and interest expenses.

Exit Value, IRR, and MoM

As noted earlier, a typical PE fund holding period is three to five years. However, it is worth noting that LBOs are carried out on mature, well-developed companies. Businesses in earlier life stages experience a steeper growth curve and shorten the holding period, whereas mature ones require more time to transition and increase operating profitability. As a natural consequence, average holding periods are extended to six or seven years.

At the end of the holding period and exit from the investment, a last assumption is made on the final value for which the company will be sold. The most common method is to assume an EV/EBITDA multiple. This is set to reflect the views on the market; a conservatism assumption is to set the multiple et exit equal to the multiple at entry. Adding then then net debt on the balance sheet, we obtain then equity value attributable to the sponsor at exit.

Once the enterprise and equity value are computed at exit, the most relevant return on investment metrics can be determined. The first relevant metric is the Multiple of Money (MoM)[75] and it is computed as:

$$\text{Multiple of Money (MoM)} = \frac{\text{Total Cash Inflows}}{\text{Initial Investment}}$$

Computed as the ratio between all cash inflows and outflows, MoM is the first critical measure calculated by the PE fund to value the sponsor's return on investment. Total Cash Inflows are the total of the proceeds from the sale, the management fees, and the dividends paid. Net MoM can be easily computed deducting expenses from fees and carried interest. Some shortcomings of MoM are that returns are not time-weighted and therefore do not consider capital calls or distributions.[76]

The second infamous metric highly used in PE is the Internal Rate of Return (IRR), which essentially is the rate of discount that makes the present value of the sum of annual nominal cash inflows equal to the net cash outlay for the investment.[77] The IRR is computed with the Net Present Value (NPV) formula, setting the result equal to zero, and solving for the IRR:

$$0 = \text{NPV} = \sum_{t=1}^{T} \frac{CF_t}{(1 + IRR)^t} - C_0$$

Where CF_t represents all the cash inflows occurring in the holding period and C_0 the initial investment. More simply, in the context of LBOs, the IRR can be defined as follow:

$$IRR = \left(\frac{\text{Equity Value}_{\text{Exit}}}{\text{Equity Value}_{\text{Entry}}} \right)^{\frac{1}{\text{Holding Period}}} - 1$$

[75] MoM is also known as Cash on Cash (CoC), Multiple of Invested Capital (MOIC), or simply Equity multiple.

[76] Capital calls are also addressed as ''Drawdowns'' or ''Capital Commitments''. LPs agree to a certain capital commitment as part of their Limited Partner Agreement (LPA) with a PE fund. GPs notify LPs when they are about to make an investment and need a portion of LPs' commitment. Capital calls can occur on a monthly basis as GPs are typically not able to make all the fund investments at once.

Moonfare, Glossary, Capital Call

[77] Investopedia, Internal Rate of Return (IRR) Rule: Definition and Example

Because of its insightful nature, the IRR can be implemented in any capital budgeting or investment decision. Intuitively, the greater, the better; as the IRR increases, our confidence level in the potentiality of the investment venture follows along. PE firms seek to earn superior returns, and historically an IRR threshold of 20% has been considered typical in order for an acquisition to be deemed attractive.[78] On a historical basis, IRR reached peaks of above 40% driven by strong momentum post-crisis while, nowadays, with markets becoming more efficient and analysis more precise, IRR has settled to the aforementioned 20% threshold.[79]

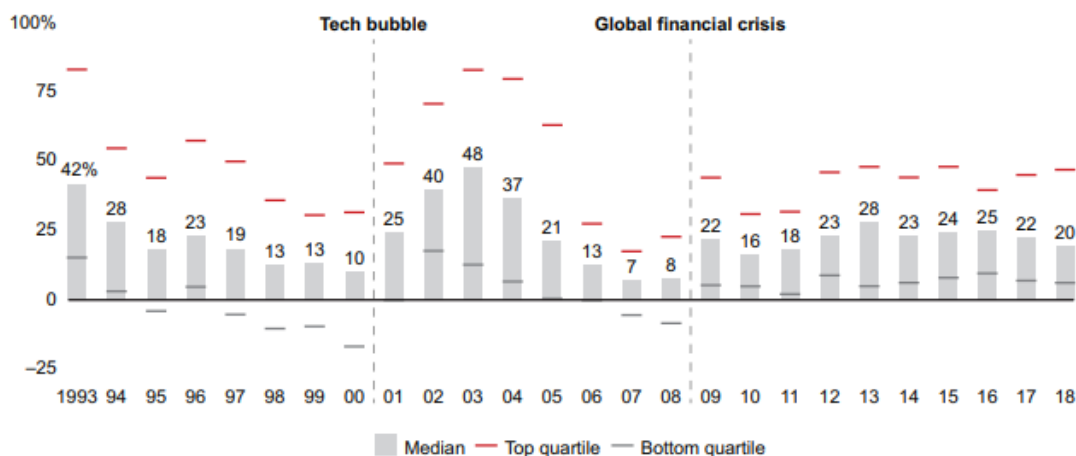

Figure 14 Global Buyout Deal IRR by Year of Entry[80]

Although practitioners in late-stage deals as buyouts prefer IRR to MoM, it is worth computing both for valuation purposes. The MoM states the absolute growth of the investment, whereas the IRR, by considering annualized returns, provides the time-sensitive discount rate to break-even. For a given MoM, the IRR is inversely related to time – e.g., for a 3.0x MoM and holding period of 1 year, IRR is 200%. Conversely, for the same MoM but a 10-year holding period, IRR is 12%. The table beneath provides a general overview of what the IRR on a general investment could be given an MoM and holding period.

[78] Selling, Törnblom, Hypothetical Leveraged Buyout Valuation, Copenhagen Business School 2016

[79] Bain & Company, Global Private Equity Report 2023

[80] Bain & Company, Global Private Equity Report 2023

		Hold Time									
		1	2	3	4	5	6	7	8	9	10
Multiple	1.2x	20%	10%	6%	5%	4%	3%	3%	2%	2%	2%
	1.4x	40%	18%	12%	9%	7%	6%	5%	4%	4%	3%
	1.6x	60%	26%	17%	12%	10%	8%	7%	6%	5%	5%
	1.8x	80%	34%	22%	16%	12%	10%	9%	8%	7%	6%
	2.0x	100%	41%	26%	19%	15%	12%	10%	9%	8%	7%
	2.2x	120%	48%	30%	22%	17%	14%	12%	10%	9%	8%
	2.4x	140%	55%	34%	24%	19%	16%	13%	12%	10%	9%
	2.6x	160%	61%	38%	27%	21%	17%	15%	13%	11%	10%
	2.8x	180%	67%	41%	29%	23%	19%	16%	14%	12%	11%
	3.0x	200%	73%	44%	32%	25%	20%	17%	15%	13%	12%

***Figure 15 IRR & MoM Time Relationship*[81]**

[81] The representation of the relationship is general and does not stem from a specified investment.

Chapter 3 – The Applicable Regulatory Spectrum

Chapter 3 is the culmination of the theoretical notions tied to leveraged buyouts. At this moment, we want to address the applicable regulatory framework through the two prevalent jurisdictions we are interested in: the European Union and the Italian one. The Italian buyout regulation is tied to the European one, as expected by Union member states. The EU adopts a number of mandatory and optional directives that apply to all member states to freely trade financial products properly and functionally. These regulations are designed to protect consumers, promote financial stability, and prevent financial shortcomings. The Italian jurisdiction, in turn, applies its national regulations to supplement the EU's and address issues specific to the Italian buyout market. The close alignment of Italy's buyout regulation with the EU's reflects Italy's commitment to the single market for financial services.

Firstly, it is of vital importance to address and understand the characteristics of PE and LBOs in the Italian landscape. While most individuals associate LBOs with mega-deals[82], Italian LBOs are rarely in that range because of country-specific factors such as company sizes, investors' sentiments, financing, relatively small PE funds, and ultimately regulation. On a structural basis, LBOs are carried out as in the US, however distinctions occur on a legal basis. Common law countries as the US or UK generally provide a more elastic regulatory framework, and LBOs are structured and concluded with more ease. On the other hand, civil law countries such as Italy present a profoundly detailed and structured regulatory spectrum that often binds the parties for extended periods. Nevertheless, the Italian buyout market is growing; after a period of uncertainty and structural impediments, successful regulatory changes started attracting prominent players.

[82] A mega-deal is a merger or acquisition whose value exceeds a billion dollars.

3.1 Private Equity Characteristics in Italy

The Italian private equity market has been active for decades, but because of some country-specific characteristics and limitations, funds activity has been relatively overlooked. However, following diverse financial crises, capital markets reorganization, and new regulations, private equity investments are on an increasing trend and in a brighter spotlight. Despite more favorable regulation and the growing market attractivity for international players, the Italian PE market is still small in volumes and numbers compared to American and European peers.

To better understand why the activity of PE funds in Italy, particularly highly leveraged buyouts, is less than in other adjacent markets, we must first dive into the structural characteristics of Italian corporations. A crucial and driving feature of Italy is the presence of only small to medium-sized (SMEs), primarily family-owned enterprises. Interestingly enough, 95% of all non-financial firms in Italy are SMEs. A further breakdown by the OECD reveals that 95% of firms are actually micro firms, while small and medium-sized ones account only for 4.6% and 0.5% respectively.[83] SMEs are undercapitalized and have difficulty accessing credit. This structural deficiency is exacerbated during periods of financial crisis when credit markets also become inconvenient to large enterprises. Consequently, private equity as an alternative source of financing is growing in importance and becoming a valuable route for Italian SMEs.[84] The majority of these SMEs are family-owned, and while family-owned businesses can offer attractive investment opportunities, they showcase some common issues related to succession and ownership. The latter is often very concentrated and in the hands of the family or a member. PEs may struggle in successfully concluding an investment, and because of the ownership structure and regulatory provisions (e.g. squeeze-out provisions), they are often forced to conduct a buyout. The last and the most critical characteristic influencing PE investments, and specifically LBOs, is the highly detailed level of regulation typical of the Italian jurisdiction. The latter has been a delicate matter; adaptations are still occurring to render the Italian market as competitive as its peers. The Italian regulatory landscape will be further developed in the following chapters.

PE and infrastructure funds, primarily international, are increasing their operativity within the Italian private market. Remarkably, 2022 showed the highest-ever total deal value of € 62,4 billion, with more than a deal out of three being PE-related and 347 buyouts. As mentioned in chapter 1.2, PE's spotlight is growing year-on-year, and Italy is no different; PE funds' investments have been on an increasing trend and gained more awareness during and post-COVID-19 pandemic, with investors being more diffident toward public

[83] OECD Capital Market Review of Italy 2020

Creating Growth Opportunities for Italian Companies and Savers

[84] Gianni Mugnaini, Roberto Barontini, Attività di Private Equity: Caratteristiche ed Analisi Empirica del Mercato Italiano

markets. PE activity has more than doubled from 2016, going from 15.6% to a deal market share of 35.7%, as reported in exhibit 16.

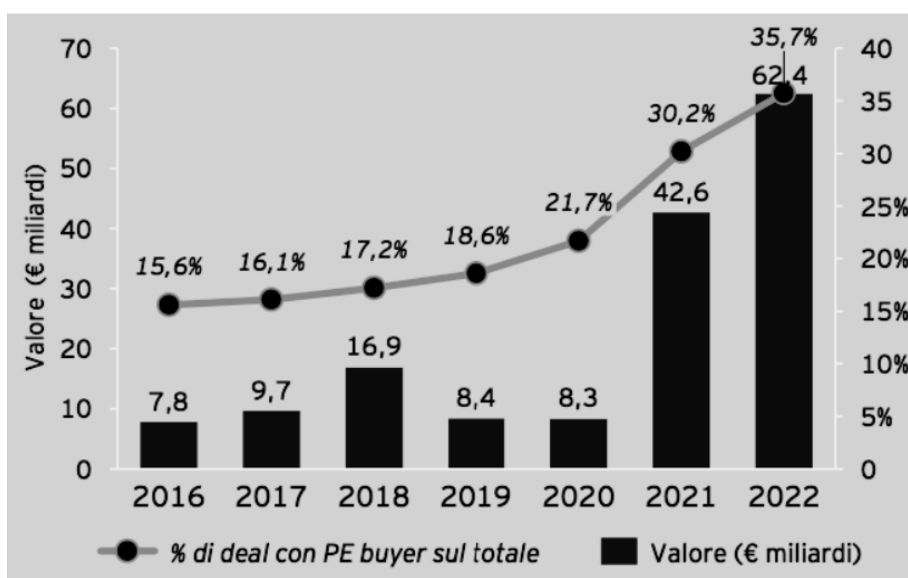

Figure 16 Private Equity Investments in Italy[85]

Moreover, we notice some swings from 2021 within the targeted industries, with Industrials, Consumer, and Technology still on top. The first two, being steady and relatively predictable industries, are intuitively preferred for PE investments and buyouts in particular. The technology industry, instead, is renowned for providing potential upsides and returns despite its intrinsic volatility. Exhibit 17 provides a breakdown of the industries and their share compared to 2021.

[85] Ernest & Young, “EY M&A barometer- Review 2022 e preview 2023”, 2023

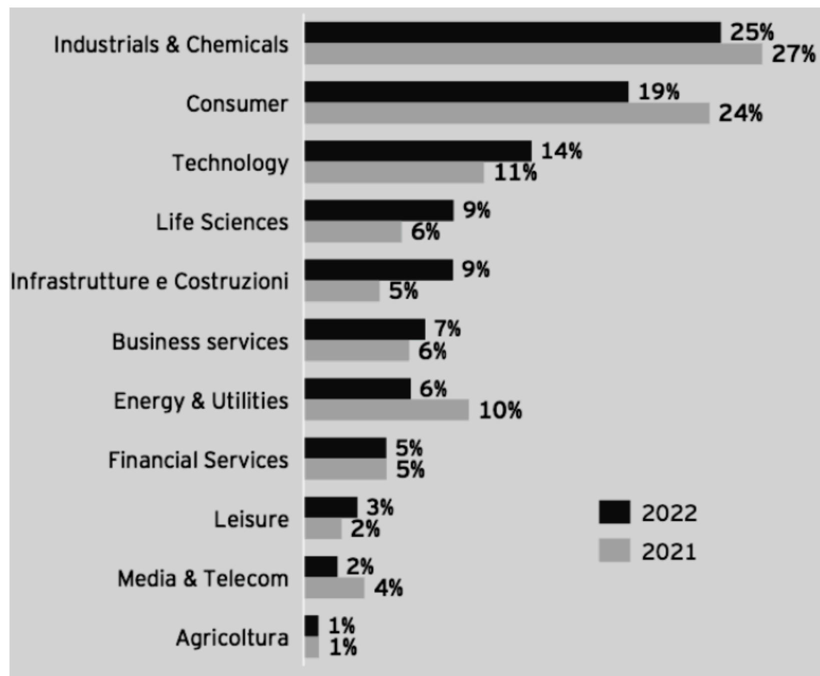

Figure 17 Breakdown of Targeted Industries for Private Equity Deals 2022 vs 2021[86]

[86] Ernest & Young, "EY M&A barometer- Review 2022 e preview 2023", 2023

3.2 The Investment Vehicle

Broadly speaking, an investment vehicle is any financial instrument that allows an individual, institution, or group to allocate their capital toward an investment with the expectation of generating a return. Historically, these are linked to securitization[87] practices – their most common use because of their convenience in legal and taxation terms. Commonly implemented to securitize loans and receivables, investment vehicles functioned as a "pot" to all the securitized mortgages during the US subprime crisis. A comprehensive definition would now be:

"A Special Purpose Vehicle (SPV), sometimes referred to as a Special Purpose Entity (SPE), is an off-balance sheet vehicle (OBSV) comprised of a legal entity created by the sponsor or originator, typically a major investment bank or insurance company, to fulfill a temporary objective of the sponsoring firm. SPVs can be viewed as a method of disaggregating the risks of an underlying pool of exposures held by the SPV and reallocating them to investors willing to take on those risks. This allows investors access to investment opportunities which would not otherwise exist and provides a new source of revenue generation for the sponsoring firm."[88]

Narrowing down the definition, an investment vehicle in the private equity spectrum is an entity serving the purpose of allocating the financing obtained from LPs and investors toward a potential investment opportunity, the identified target company. Investment vehicles assume many forms. PE funds are itself investment vehicles, indirect and public ones. Specifically, they are usually established as closed-end funds. Indirect because retail investors choose voluntarily to invest through an intermediary (in this case the fund) who takes care of the process on his or their behalf. Close-end funds are not listed on exchanges and shares are not traded on a regular basis. Investors can purchase shares at inception and sell them at liquidation. The illiquid nature of their shares and of the investments the fund makes is both a positive and negative aspect for investors: they can benefit from alternative investments while the fund does not have to focus on the short term. However it is difficult to sell shares ahead of time.[89] Earlier reference can be found in chapter 1.3.

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[87] Securitization pools assets and repackages them into interest-bearing securities. An issuer designs a marketable financial instrument by merging financial assets, commonly mortgage loans or consumer or commercial debt. Investors who purchase these securities receive the principal and interest payments of the underlying assets.

[88] Pwc financial regulation, The next chapter – Creating an understanding of Special Purpose Vehicles, December 2011

[89] Seth Chertok and Addison D. Braendel, Closed-End Private Equity Funds: A Detailed Overview of Fund Business Terms, Part I, The Journal of Private Equity, Vol. 13, No. 2 (SPRING 2010), pp. 33-54

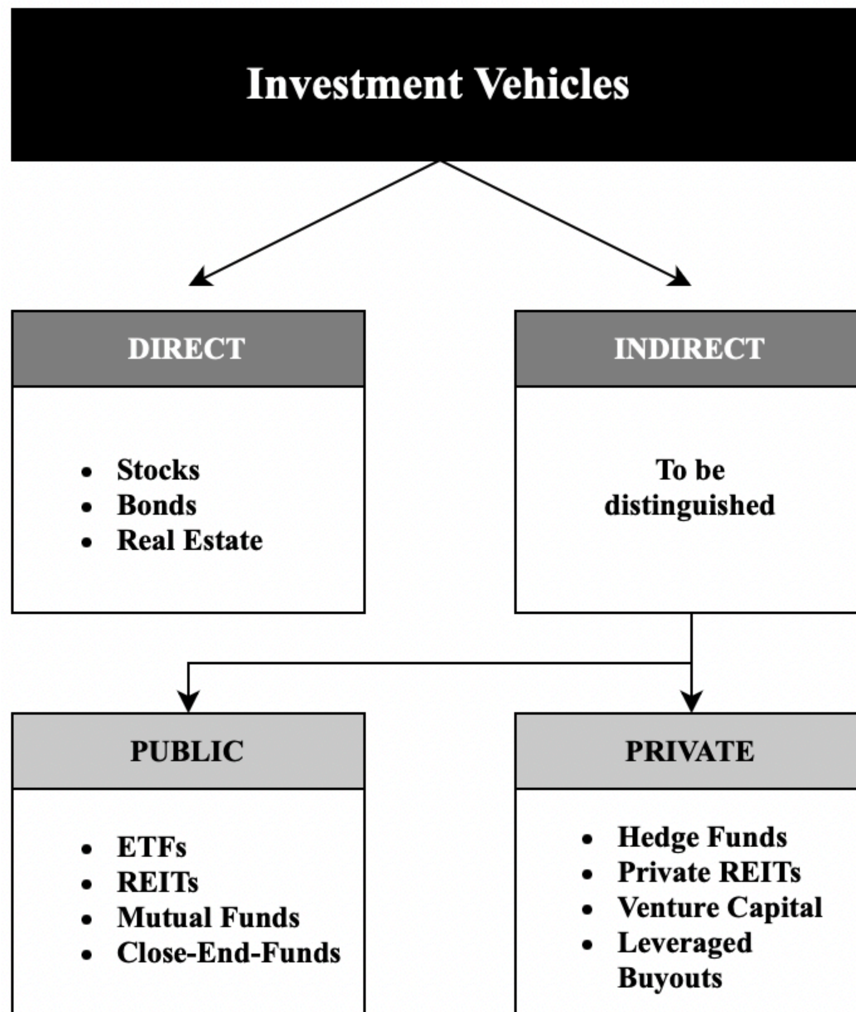

Figure 18 The Investment Vehicles

The investment vehicle plays a core role in a buyout, specifically in an LBO. The investment vehicle assumes the form of a "new company", referred to as "NewCo". The latter is a special-purpose entity or vehicle (SPE or SPV) created with the sole purpose of acquiring the target company. As explained earlier, an SPV is a separate legal entity established by an organization for a limited purpose, which often is an acquisition, the financing of a project, or as a vehicle to another vehicle.[90] These are easy to create and in an acquisition context they provide several benefits. SPVs allow for risk sharing and isolation as they usually bear the financing for the project. Moreover, they can be quickly and readily registered in any jurisdiction to benefit from the regulatory environment and favourable tax rates. Nevertheless, they are exposed to all forms of financial risk, and as a reason, they are always established as limited partnerships or limited liability companies.[91]

[90] Thomson Reuters Practical Law, Glossary, Special purpose vehicle

[91] The Corporate Finance Institute, Special Purpose Vehicles

The LBO is conducted through the creation of a NewCo. In a simple case, the acquirer forms a single NewCo, bearing the equity and debt capital necessary to finance the acquisition. The NewCo simplifies the new ownership structure by becoming the majority or sole shareholder of the target. The company will only present the financing on its balance sheet, isolating the risk from the fund. This separation is a handful in the event that the acquired target experiences difficulties in repaying the debt incurred. The NewCo will be the company acquiring the target through the financing received from the sponsors and the loan providers; the process through which the target incorporates the debt financing from the NewCo is called "debt push-down". If the newly formed entity experiences hardships in repaying the debt and, in the worst case bankruptcy, the acquirer's assets will not be at risk because of the separation. Nevertheless, an investment vehicle as this entails some extra costs. Establishing a NewCo to conduct the acquisition is more expensive than a traditional acquisition as the acquirer will need to pay for the legal and accounting fees involved. Moreover, this has to be appropriately structured in accordance with the applicable laws and regulations.[92] While the adoption of a NewCo is widespread in an LBO, we often see more than one SPV in large and complex buyouts.[93] There are several reasons for the establishment of multiple acquisition vehicles. When there are several layers of financing, a number of acquisition vehicles are formed into which corresponding financial instruments are invested. Senior lenders take comfort in having subordinated or equity invested into vehicles further away from the cash-generating target group. Effectively, this constitution establishes structural subordination.

[92] Andrea Silvestri, Giulio Mazzotti, Ordine dei Dottore Commercialisti e degli Esperti Contabili di Roma

Le operazioni di investimento dei fondi di private equity, November 23, 2018

[93] Speechly (2008) for further discussion on this issue.

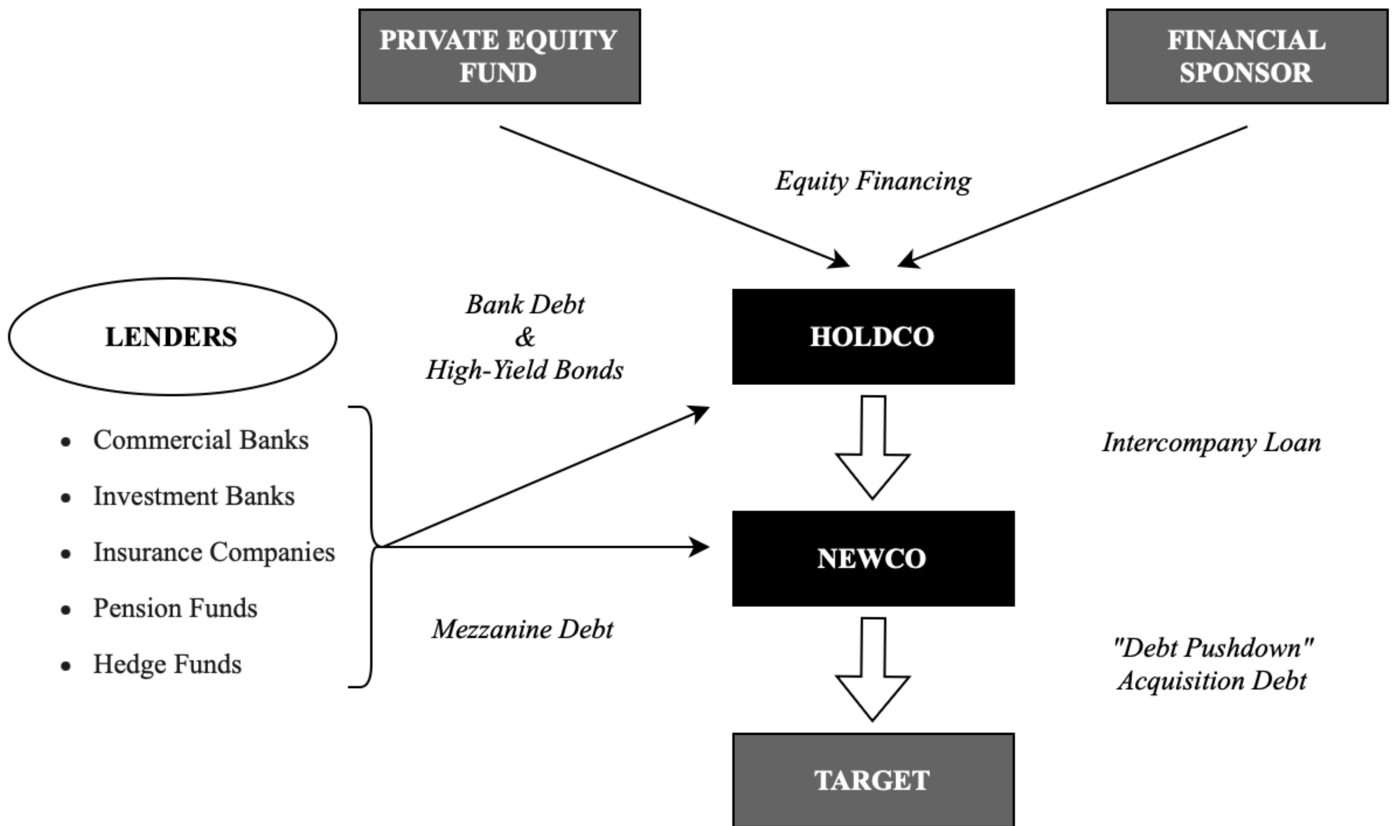

Figure 19 Leveraged Buyout with Two Acquisition Vehicles

SPVs' regulation varies according to the jurisdiction in which the vehicle is registered and to the that in which the acquisition takes place. Nevertheless, some general principles are similar throughout the European Economic Area (EEA). SPVs must necessarily be established and registered as a separate legal entity from the leading company in order to isolate it from any experienceable financial risk, particularly liability ones stemming from debt obligations incurred by the SPV. They must be adequately capitalized to meet their financial needs and safeguard investors from potential failures – depending on the jurisdiction, SPV may require a minimum equity capital. In addition, as any registered entity, they are subject to reporting requirements toward the regulatory authorities for monitoring purposes. Again, SPVs registered within the EEA must comply with European directives such as the Capital Requirements Directive (CRD IV), the Capital Requirements Regulation (CRR), and the Solvency II Directive. These were introduced with the goal of regulating SPVs for insurance and reinsurance purposes. Nonetheless, it applies as well to acquisition vehicles. Following the Directives, SPVs are subject to supervisory approvals, which verify that the assets withheld are equal to or exceed their aggregate maximum risk exposure. In other words, SPVs, like any other entity, must be able to meet their commitments in the short and long term. Particularly in an LBO, SPVs should cover in

full the buyout debt. Moreover, to enforce supervision, SPVs are subject to reporting requirements.[94] When adopting an investment vehicle to conclude an acquisition in and within the EEA, companies must abide by broad European regulations as well as that of the country of reference. Failure to comply or meet the minimum requirements could result in substantial fines or the termination of the vehicle.

SPVs in Italy are similar elsewhere in terms of regulation. However, the Italian and European jurisdictions have set further requirements, and some specifications apply. The vehicle must be established with a sole purpose in mind and shall not deviate or take other actions unnecessary to conclude the acquisition. This will take the form of a limited liability company ("società a responsabilità limitata" or "S.r.l.") or joint stock company ("società per azioni" or "S.p.a.). Furthermore, at the moment of registration, a minimum equity capital is required. Although the minimum capital requirement does not guarantee the failure of the SPV, it protects the investors and the financial system by ensuring that it has sufficient financial resources to support the acquisition or unexpected losses, primarily debt and interest related. Although SPVs used in LBOs do not issue securities and are therefore not required to be registered with the Bank of Italy they do meet the requirements and depending on the scope and deal size they may still need to register themselves. The SPV registered with the Bank of Italy will have to provide information about its financial resources through the three primary financial statements as well as information on its shareholders and management, therefore increasing the level of transparency available to investors.[95]

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[94] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance

[95] La Banca D'Italia, Disposizioni in materia di obblighi informativi e statistici delle società veicolo coinvolte in operazioni di cartolarizzazione

3.3 The European Buyouts Regulative Framework

The most relevant piece of regulation at a European Union level is undoubtedly the Alternative Investment Fund Managers Directive introduced by the European Commission. Shortly the AIFMD, is a set of directives setting out rules for alternative investment funds (AIFs), therefore including Private Equity at large, as well as leveraged buyout funds. Adopted in 2011 and enforceable since 2013, it is now implemented throughout the Union. The AIFMD introduced a new set of more stringent directives applicable to all funds, within and afar from the EU, that intend to market their activity in the EU.[96] The first relevant provision that applies to buyout funds is the requirement of authorization by a competent regulatory authority within the EU and compliance with the Directive's requirements. Moreover, managers are required to disclose all relevant and significant information inherent to the fund's investment strategy, risk profile, and fees. A significant restriction is placed on the amount of leverage AIFs can incur to mitigate the inherent financial risks that come with it. Intuitively, the AIFMD's fundamental goal is to increase investors' protection and the financial market integrity and stability. The regulation and monitoring through increased transparency and disclosure requirements protects investors at single and multitude levels by frauds or defaults. Moreover, the set of rules and regulations eases cross-border operations; buyout funds interested in carrying out an acquisition within the EEA will make their considerations in light of the AIFMD. The set of provisions is considered to certain extents too complex and burdensome, and different provisions apply depending on the specific country, fund size, buyout target and size, and several more factors.[97]

It is not a necessary condition that a takeover is conducted through an LBO, however, because of taxation benefits, it is often the case. Takeover bids for the shares of a company trading on a regulated market in the EEA are regulated in the Directive 2004/25/EC of the European Parliament and Council. At first adopted in 2004, this was later amended a number of times to include new rights increasing stability and interest protection of shareholders, stakeholders, and the market as a whole. The Directive has been implemented in the national laws of all EU member states and mandates that offers must be public to all shareholders of the target, disclosing the price, the reason behind it, and the financing arrangements. Remarkably, the Directive protects the interests of minority shareholders through the definition of squeeze and sell-out rights. Each member state is allowed to set its threshold, obliging the launch of a mandatory tender offer to achieve full control of the target. Most set it at 30% of voting-right shares. By including a threshold after which a

[96] KPMG, Navigating Through AIFMD

A Guide for Private Equity and Venture Capital Funds in Ireland

[97] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 Text with EEA relevance

mandatory tender offer is compulsory, the acquirer cannot exploit his controlling shares over minority shareholders in leading the company decisions and acquire the outstanding portion at a discount or a price below the acquisition. The takeover bid shall come with a minimum offer period and right of withdrawal, and importantly, minority shareholders will have the right to sell their shares to the offeror at the offer price. Specifically, the Directive states:[98]

"Member States should take the necessary measures to enable an offeror who, following a takeover bid, has acquired a certain percentage of a company's capital carrying voting rights to require the holders of the remaining securities to sell him/her their securities. Likewise, where, following a takeover bid, an offeror has acquired a certain percentage of a company's capital carrying voting rights, the holders of the remaining securities should be able to require him/her to buy their securities. These squeeze-out and sell-out procedures should apply only under specific conditions linked to takeover bids. Member States may continue to apply national rules to squeeze-out and sell-out procedures in other circumstances."

Squeeze-out provisions and sell-out rights are contractual clauses requiring a majority shareholder to acquire minority shares at a fair price. PE funds and minority shareholders typically use these provisions in the completion of an acquisition after the latter has obtained the majority. Although functional in safeguarding the minority ownership, squeeze-out provisions and sell-out rights are controversial; minority shareholders can often achieve a premium from the acquirer for the full ownership of the target — articles 15 and 16 of the Directive center on the squeeze-out and sell-out rights. An acquirer can squeeze-out minority shareholders at a fair price, determined by an independent and external expert if it has secured more than 90% of the voting right shares or more than 90% of the shares with a nominal value of the target.[99]

The Directive moreover specifies two influential takeover regulative measures, the passivity rule and the breakthrough principle. The passivity rule is set out in Article 9 of the Directive. The rule prohibits the target company's board of directors from taking any action that could frustrate a takeover bid, such as issuing new shares, selling assets, or entering into a merger or acquisition agreement. Exceptions to the rule can occur when the board of directors can demonstrate that the action is necessary to protect the company's or its shareholders' interests. The breakthrough principle is then cited in Article 11 of the Directive. The principle neutralizes specific defensive measures that a target company may have in place to prevent a takeover, such as share transfer restrictions and voting caps. It applies if and where the acquirer has gained a stake of at least 30% in the target company. There are a few exceptions to the principle, such as where defensive measures are necessary to protect the company's or its shareholders' interests. It is important to note that, while highly

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[98] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance)

[99] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance), Article 15, Article 16

recommended to safeguard takeovers and protect a company from a hostile bid, these regulations are optional. National legislations, according to Article 12 of the Directive, have the right to implement or disregard (to opt-out) the passivity rule and breakthrough principle. Companies will in turn have the right to implement them and, as in Italy, modify their application within the articles of association and in accordance with the relevant regulatory authorities. The reciprocity principle[100] applies in the event of a foreign bid from an entity subject to a different regulatory system.[101]

[100] Reciprocity is the mutual exchange of privileges between states, nations, businesses, or individuals for commercial or diplomatic purposes.

[101] Parlamento Italiano, Opa e Misure Difensive nei Paesi Europei

3.4 The Takeover Spectrum in Italy

While a takeover is not necessarily a leveraged buyout, the latter always implies the former, as the nature of this acquisition strategy aims at taking over the control of the target company. The takeover process is a highly structured one, especially in Italy, and the inherent regulation has been constantly changing and adapting to the market in order to render the market more competitive and attractive relative to EU peers. The process can be initiated in more ways, but the most common is for the acquirer to make a public offer for the target company's shares. A public offer is an offer to acquire all of the shares of a company from all of the shareholders of the company. The offer is made at a fair price determined by an independent advisor. The offer period is open for at least 30 days. The Italian jurisdiction sets a threshold of 30% of voting rights shares, which, once surpassed, triggers a mandatory bid for the remaining shares of the same class. The board of directors of the target company has the duty to recommend the offer to its shareholders. If reasonable grounds exist to reject the bid, the board is asked to explain the reasons to the market through a public statement. If there are reasonable grounds for rejection, the board is asked to explain the reasons to the market through a public statement. As the process has to be conducted in a fair and orderly manner, buyouts often occur through a negotiated takeover. In this case, the management of the acquirer and the target negotiate the takeover terms with a particular focus on the price of the shares and the composition of the board post-acquisition. The process is complex and lengthy, with the first step being the public offer from the acquirer to the target's shares. Simultaneously, the intention of the takeover will be announced to the regulatory authority. Once the target receives the offer, its board of directors will recommend it to its shareholders and the offer period will stay open for at least 30 days. If the offer is successful, the acquirer will gain control of the target. The takeover process is never a simplistic one and different requirements apply depending on a number of variables.

Italian PE and VC funds are mostly registered as closed-ended funds (Fondo Chiuso) and are established and managed by an asset management company known locally as Società di Gestione del Risparmio (SGR). Most funds will be reserved to “professional/qualified” investors and its assets will be separated from the management company and its shareholders. The minimum commitment for professional/qualified investors provided by the fund agreement is often in the range of € 250,000 to € 500,000 per unit. Managers typically invest about 2% of total commitments in the fund. In most cases, the investment term is seven to ten years, and it gets longer for specific industries as infrastructures. The management company is authorized by Bank of Italy (BoI) alongside the Commissione Nazionale per le Società e la Borsa (CONSOB). The BoI supervises the SGR on matters regarding risk management and financial stability, whereas the CONSOB for matters about general conduct and transparency requirements.[102] CONSOB and BoI

[102] The Bank of Italy

Commissione Nazionale per le Società e la Borsa

are the primary regulatory authorities alongside the Italian Stock Exchange (Borsa Italiana S.p.A.) and the Italian competition authority (Autorità Garante della Concorrenza e del Mercato, shortly AGCM). Other authorities will intervene depending on the sector and the Italian Government may also be involved in national strategic companies. The level of expected involvement varies according to the situation, mainly if the target company is private or public and if the buyout triggers a tender offer. The buyout of private companies is smoother, involves less scrutiny by the regulatory authorities, and commonly occurs through a share purchase by an SPV. Often, it may take place as an auction. The buyout through an auction is a procedure that is generally non-regulated but follows a standard process. After gathering the potential buyers, an auction commences typically with distributing the information memorandum[103] to skim down the bidders. At a later stage, non-binding offers are submitted, and a restricted number of potential investors are selected and then allowed to conduct due diligence on the company. At this stage, the data room[104] is open to access and receives particular attention from the bidders. Bidders who received a draft of the share purchase[105] agreement will advance their final bid, regularly at a premium of the initial price. Once the best offer is made, the parties proceed with the final negotiations. On the contrary, public companies' buyouts may be subject to a cumbersome and lengthy tender offer procedure.

The Italian Financial Act (Testo Unico della Finanza, shortly TUF) was enacted in 1998 through the Legislative Decree 58/1998 and has been amended several times. It represents the fundamental piece of law governing the Italian financial markets and takeovers included. Enforced by the CONSOB and the BoI, it is designed to protect investors and ensure the orderly functioning of the financial markets and, in this regard, the smoothness and legality of takeover procedures. While highly structured and often challenging to interpret, the TUF has proven to be essential to the Italian financial markets' functioning and helped render it more attractive to foreign investors. Key provisions of the TUF require market participants to disclose all relevant financial information and risk factors to the public, prohibiting market abuse and regulating the securities to promote and protect investors' rights and interests. It is a constantly evolving regulative piece that has been amended to address the new financial developments. TUF provides a combination of mandatory and voluntary provisions in relation to takeovers. In addition to the TUF, there are a number of other laws and regulations that apply to takeovers in Italy, such as the Civil Code and the Securities Markets Act. These laws and

[103] A Confidential Information Memorandum (CIM) is a document used in mergers and acquisitions to convey important information about a business that's for sale including its operations, financial statements, management team, and other data to a prospective buyer.

[104] A data room is tailored to streamline and support due diligence processes. In the Data Room, the company can share confidential documentation and perform Q&A rounds in a user-friendly, intuitive and secure environment. The Data Room is designed to provide easy-to-use procedures for all parties.

[105] A share purchase agreement (SPA) is an agreement between a buyer and seller(s) of a target company, setting out the terms and conditions relating to the sale and the purchase of a specific number of shares in the target company.

regulations provide further detail on the mandatory and voluntary provisions of the TUF and also cover other aspects of takeovers, such as the disclosure of information and the protection of creditors. The Italian takeover market is relatively active, with a number of large takeovers taking place in recent years. The TUF has played an important role in ensuring that these takeovers have been conducted in a fair and orderly manner.

Five are the mandatory tender offer options (*Offerta Pubblica di Acquisto Preventiva,* shortly OPA) specified within the TUF: [106]

i. OPA Totalitaria

Article 106 par. 1 TUF sets the threshold to launch a mandatory tender offer for the totality of voting shares at 30% of the voting rights for one or more investors acting in concert. The threshold for targets that are not considered Small to Medium Enterprises (SMEs) is lowered to 25% of the voting securities or rights.[107] The offer must be promoted within 20 days of hitting the threshold at a price not lower than the highest price paid by the investor(s) for the voting securities of the same class in the previous 12 months or, if no purchases were made by the offeror(s), the weighted average market price[108] of the voting securities in the previous 12 months or the shorter period for which market prices were available.[109]

ii. OPA Preventiva Parziale

Article 107 TUF specifies that this kind of OPA takes place only if two conditions occur: (i) the offeror has not acquired, directly and indirectly, voting rights above 1% in the target in the last year, (ii) and that the efficacy of the offer is approved by a majority of shareholders, excluding the offeror and people in concert with him. If, within one year from the OPA Preventiva Parziale, the offeror and who is acting in concert with him acquired voting securities above 1%, or in the event of a merger or spin-off, an OPA Totalitaria shall follow. [110]

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[106] Baker McKenzie, Global LBO Guide – Italy, pp 190 – 207

[107] Italian Financial Act (TUF), Art. 106 par. 1

Borsa Italiana

[108] The weighted average market price applies also in the event that the threshold is hit as a result of the kick-in of the increased voting rights referenced in this answer, provided the offeror(s) did not purchase any voting security at a higher price in the previous twelve months.

[109] Italian Financial Act (TUF), Art. 106

Baker McKenzie, Global LBO Guide – Italy, pp 190 – 207

[110] Italian Financial Act (TUF), Art. 107

Borsa Italiana

iii. *OPA Totalitaria a Cascata*

Article 106 par. 3 TUF, in relation to the OPA Totalitaria, clarifies that if one or more investors acting in concert, either indirectly or by computing together their ownership, exceed the 30% or 25% threshold, they are required to launch an OPA Totalitaria to the outstanding voting right shares.[111]

iv. *OPA Incrementale o di Consolidamento*

Article 106 par. 3 point *b* TUF states that if one or more investors acting in concert, who already own more than 30% but less than 50% of voting securities or rights and have acquired directly or indirectly more than 5% of voting securities or rights in less than 12 months, are required to make an offer to buy all outstanding voting shares.[112]

v. *OPA Residuale*

Article 108 TUF par. 2 states that if exceeded 90% of the voting securities, the outstanding shall be acquired, and the holders can extend the offer at the last price paid in the previous offer or a price determined by the CONSOB in the event of no offer.[113]

A peculiar instance in Italy about exceeding the threshold is due to an increase in the voting rights of loyalty shares. This is clarified in Article 49 of the Consob Regulation on Issuers. The change of corporate control justifies the mandatory tender offer, however it must not be triggered if another shareholder retains control of the company.[114]

Similarly to Articles 15 and 16 of the Directive 2004/25/EC of the European Parliament and of the Council, the Italian regulation about takeovers defines the rights of sell-out and squeeze-out. Article 108 TUF par. 1 refers to these rights and sets the threshold at 95% of all voting securities. If the threshold is exceeded, the investor is forced to acquire all outstanding voting shares. If the target has issued more voting shares, the investor is expected to purchase only the outstanding shares of the same class for which the threshold was exceeded – sell-out right. Conversely, if he reserved the right in the offering document, he is moreover entitled to acquire the remaining voting shares within three months of the closure of the offer – squeeze-out right.[115]

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[111] Italian Financial Act (TUF), Art. 106 par. 3

Borsa Italiana

[112] Article 106 TUF par. 3 point b

Borsa Italiana

[113] Article 108 TUF par. 2

Borsa Italiana

[114] Consob regulation on Issuers, Art. 49 par. 1

[115] Baker McKenzie, Global LBO Guide – Italy, pp 190 – 207

Buyouts targeting listed SMEs are subject to the same rules aforementioned, except for the Law Decree 91 (also known as the 2014 Competitive Decree). Citing the Decree, listed SMEs may vary the standard 30% threshold of voting rights and securities that trigger the launch of an OPA Totalitaria, if specified in its articles of association. The percentage can be anyone ranging from 25% to 40% and needs shareholders' meeting approval.[116] A buyout in Italy is initiated by communicating the intention to the CONSOB and preparing an offering document for publication. In the event of a foreign tender offer, the "passivity" and "breakthrough" rules are applicable only if there is reciprocity with the foreign country. The passivity rule and the breakthrough principle are two corporate takeover defense mechanisms used to protect target companies from hostile takeovers. The passivity rule prohibits a target company from taking any action to interfere with a takeover offer, such as issuing new shares, selling assets, or entering into mergers or acquisitions, without the approval of its shareholders. This rule is designed to ensure that shareholders have the ultimate say in whether or not a takeover offer is successful. The breakthrough principle eliminates certain restrictions on the transfer of shares during a takeover offer. This means that the offeror can acquire shares in the target company even if those shares are subject to pre-emption rights or other restrictions on transfer, making it easier for the offeror to acquire a controlling stake in the target company. The passivity rule and the breakthrough principle are not universally adopted, and there are some countries where companies can choose not to adopt them. In Italy, for example, the passivity rule was amended in 2009. The Decree reversed the principle introduced by Decree-Law 185/2008, which allowed the passivity rule to be applied only when it was expressly called for in the by-laws. Since then, if a listed company's by-laws do not provide for an alternative rule, the passivity rule will be applied by default.[117] The passivity rule (*difese*) in Italy was last amended through the Law Decree 146/2009[118] and its provisions are contained within articles 104 TUF. In addition, article 104-bis TUF refers to the breakthrough rule (*regola di neutralizzazione*) and article 104-ter to the reciprocity principle (*clausula di reciprocità*).[119]

Foreign direct investments (FDI) in Italy are subject to every aforementioned regulatory consideration. If the entity interested in acquiring an Italian company is found within the EU, it will be subject to the Italian applicable regulatory system. In the case of an acquisition originating from a non-EU country, the entity abroad will be subject to the reciprocity principles embodied or supplemented by international bilateral or multilateral treaties between Ital and the non-EU party's home.[120] Specific regulations are applicable depending on the targeted industry. Of particular relevance is the Defense and Homeland Security industry which, if targeted,

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[116] Law Decree No. 91, June 24, 2014 converted by Law August 7, 2014

[117] Cleary Gottlieb Steen & Hamilton LLP, Amendments to the Regulation of Takeover Bids – Passivity Rule Once Again in Force (with Opt-out Mechanism), 2009

[118] Borsa Italiana

[119] Commissione Nazionale per le Società e la Borsa, Article 104 TUF

[120] Baker McKenzie, Global LBO Guide – Italy, pp 190 – 207

is subject to a final say by the Italian Prime Minister. He may exercise three designated special powers in relation to a transaction seen as a "threat of serious harm to the essential interests of the national defense and homeland security", as stated in the Law Decree 21, 15 March 2012. Among the three powers, he may exert (i) an ex ante veto right on resolutions approving extraordinary operations[121], (ii) an *ex post* imposition of specific conditions for safety and security purposes, (iii) and *an ex post* blocking of the purchases of participations by an entity other than the Italian Government.[122] Similarly, the Italian Prime Minister may exercise the special powers as well within the Energy, Transportation and Communications industry in relation to strategic assets.[123] Other sectors subject to prior authorization of the regulatory authorities are the Insurance, Banking, and Aviation. In this regard, the Golden Power rule is a piece of legislation of high relevance. This peculiar power (as the name suggests) granted to the Italian Government limits or stops foreign direct investments and corporate transactions that involve Italian "strategic assets". As stated earlier, the prime minister is the figure who embodies the Government and who has the final say. Originally entered into force in 2012, and limited to sectors such as defense, national security, and infrastructure (transportation, energy, communications), it was then extended to additional sectors such as high technology and fintech as a consequence of the Covid-19 pandemic.[124] The Government is granted the power to review any investment in the mentioned sectors that give the investor a controlling stake within the target company. In several instances the Golden Power rule was enforced. For instance, in 2020 conditions were imposed on the acquisition of a stake in Leonardo by BAE Systems to prevent the access and proliferation of sensitive military technology. Another case occurred in 2019 when the Government blocked the acquisition of a stake in Telecom Italia by China Mobile to prevent a surge in control over Italy's telecommunications infrastructure.

The typical corporate structure the parties implement when carrying out a buyout is aligned with the one described in chapter 3.2. Exhibit 20 offers an overview of the argument.

[121] Extraordinary finance operations are among other mergers & acquisitions, spin-offs, transfers and divestures of assets outside of Italy, winding up, changes in the articles of association, transfers of ownership or utilization of assets.

[122] Law Decree 21, 15 March 2012

[123] Presidential Decree 85, 25 March 2014

[124] Law Decree 23/2020, Gazzetta Ufficiale, April 2020

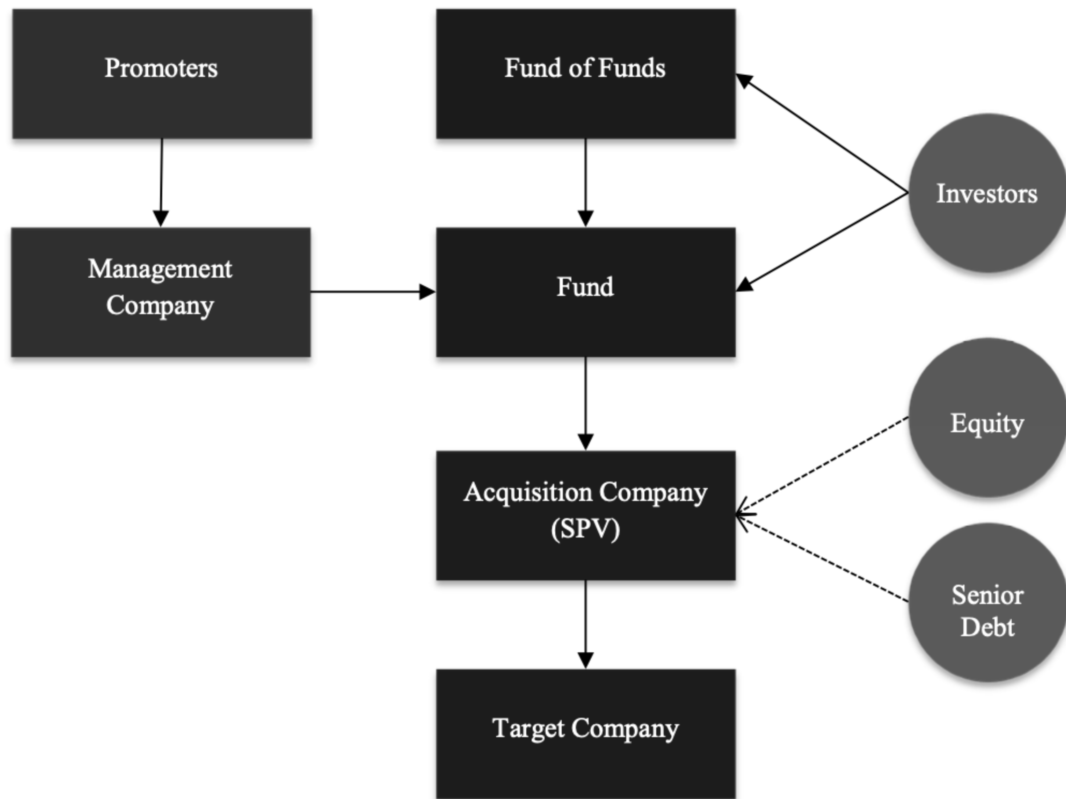

Figure 20 Leveraged Buyout Simple Structure in Italy

As described earlier, the acquisition is completed through a NewCo, a special purpose vehicle. The scenario depicted in Figure 20 is simplistic, with only one acquisition vehicle. The NewCo is generally incorporated as a *società per azioni* (S.p.A.), a joint stock corporation, or a *società a responsabilità limitata* (S.r.L.), a limited liability company. The S.p.A has a minimum capital requirement of € 50,000 and is mostly adopted in large buyouts for large, listed businesses, whereas an S.r.L. has a minimum capital requirement of € 1, which can be divided into quotas or shares and it is implemented chiefly with more minor activities and often private.

3.5 The Italian Leveraged Buyout Regulation

The previous chapters have by now built up a significant understanding of the regulation behind takeovers and leveraged buyouts, pointing out primarily an entangled structure. It is fair to state and apparent at this point that, in Italy, LBOs are subject to more stringent regulatory requirements than in the US or other EU peers. The Italian jurisdiction has been an utterly dense one since ever, and LBOs are no exception. As a matter of fact, LBOs have been a controversial topic within the Italian jurisdiction and throughout the late 90s and until the early 2000s, the practice was seen as unlawful and severely restricted.

As in any deal, several are the legal issues and contractual clauses that must not be overlooked. While the legal issues involved in an LBO are several, the most important are market, tax, and labor related. As is often the case, if the parties on the buy-side deal on public markets, they must comply with the Italian securities laws. Moreover, they will also need to consider the tax implications and the consequent fiscal treatment of debt and interest payments. Further legal issues often arising will require the buy-side to ensure compliance with labor laws, such as those governing collective bargaining and employee terminations. The first relevant contractual clauses in an LBO are those inherent to the debt financing, therefore including the amount of debt that will be raised to finance the buyout, the interest rates the debt instruments will bear, and the repayment of schedule these two. The acquirer will care about the clauses granting him control and those protecting his interests in the target company. To avoid performance downfalls, he may insert restricting clauses that on the target's ability to take on additional debt or risky financing, make major changes as M&A, spin-offs, or divestitures, and limit the sale of some assets. In an LBO, we will typically see a number of debt covenants. Chapter 2.3 explained that these provisions require the target to maintain and improve specific financial key indicators and ratios over time. Additionally, they often require the target to comply with certain negotiated terms and not take restricted actions such as incurring additional debt or making major business changes. Finally, as mentioned at the conclusion of chapter 2.4, the financial sponsor will care about his exit strategy from the investment to gain the largest share of the profit. As explained, this can occur in multiple ways as the sale or merger to a strategic buyer, a public offering, or even through another LBO. In addition, the buyer may negotiate some additional clauses to protect himself further. A buyer will likely include two typical negotiated provisions: a change in control provision and an indemnification provision. The former is triggered by a change in control of the target and may in turn trigger certain events as an acceleration of debt repayments or insertion or termination of specific terms. The latter, instead, are triggered by a breach of the contractual terms or negligence and will require the target to indemnify the buyer for the liabilities arising from such breaches. The exact clauses will be subject to the deal, the industry, the participants, and a few of many more factors. However, the clauses just listed are some of the most important ones that need to be considered. While the clauses' main goal is protecting the buyer's interests, they are also functional in driving the target company

towards a successful restructuring by achieving performance targets while complying with the regulations and provisions implemented.

The most relevant Italian piece of regulation for LBOs is represented by Article 2501-bis of the Italian Civil Code. Introduced in 2003 and amended in 2015, it is now the source of a specific set of rules that leveraged acquisitions must comply with. It applies to all LBOs, regardless of the size of the target company or the amount of debt financing involved and the necessary condition is that an entity has used considerable leverage to acquire a controlling share in a target company which, once merged, the resulting entity will be the guarantee to the debt and will carry out the debt repayment.[125] The Article has been criticized by some for being too restrictive, but others have also praised it for providing a much-needed level of transparency and accountability for LBOs. The first initial requirements set by the Article are standard ones commonly expected in a proper LBO.[126]

i. The target company must be solvent at the time of the LBO.
ii. The LBO will not drive the target to insolvency, and the company will be able to service the debt incurred for the deal.
iii. The deal needs to be approved by the majority of the target company's shareholders.
iv. The target's creditors must be aware of the LBO and have access to its specifications.

If the requirements set forward by article 2501-ter are met, an LBO carried out through a NewCo can benefit of the simplified merger procedure detailed in article 2501-ter. The requirements are essentially the acquisition of a controlling stake of at least 90%, the approval of the target shareholders and creditors, and lastly, no harm should be brought to the target employees. If the requirements are met, the acquirer can apply the simplified merger procedure by drafting the merger plan and having it approved by the shareholders of both companies. The merger plan will necessarily deeply detail the financial resources available to repay the debt incurred by the new entity.[127] Article 2501-quater requires then that the management of the companies involved presents its latest available balance sheet – within 120 days from the registration of the deal. If the companies are listed on a regulated stock exchange, the year-end balance sheet suffices if within six months from the day of registration of the deal.[128] Moreover, article 2501-quinquies sets further provisions that need to be met in an LBO deal. The management of both companies shall present a report showcasing and justifying

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[125] G. Bonilini, M. Confortini, C. Granelli, The Italian Civil Code Commentaries

[126] Articolo 2501 bis Codice Civile (R.D. 16 marzo 1942, n. 262)

Fusione a seguito di acquisizione con indebitamento

[127] Gazzetta Ufficiale, Art. 2501-ter Codice Civile Italiano

G. Bonilini, M. Confortini, C. Granelli, Codice Civile Commentato, Art. 2501 bis c.c. - Fusione a seguito di acquisizione con indebitamento

[128] Gazzetta Ufficiale, Art. 2501-quater Codice Civile Italiano

the legal and economic matters inherent to the merger, with a peculiar focus on the exchange of the shares or quotas and the method used to determine the valuation and its difficulties.[129] Article 2501-sexies states that one or more experts for each company shall draft a report on the correctness of the information provided at every level with an express focus on the method implemented to determine the shares or quotas price.[130] Lastly, Article 2501-septies requires both companies to deposit and publish on their official websites, within thirty days before the merger decision: (i) copy of the merger plan with the reports required by article 2501-quinquies and sexies,[131] (ii) balance sheets of the last three financial years with inherent reports, (iii) and balance sheet required according to article 2501-quater.[132]

Countries such as Italy have implemented legal reforms and regulations that have significantly affected, and often slowed, the PE industry activity. The decade post 2008's financial crisis has been characterized by consistent critiques and adversity toward LBOs, particularly because of their high leverage levels. The PE industry and practitioners have been accused of providing insufficient disclosure and being "asset strippers" because of a lowly regulated market. As a result, new enactments and directives as the AIFMD were introduced. Prior to 2003 (effectively January 2004), LBOs were deemed unlawful as they were opposing the provisions set forward in article 2358 cc, which essentially impeded companies from obtaining financial assistance for the purpose of acquiring shares in an existing company, leverage included. Therefore, through establishing a NewCo and the successive debt incurred that the target would bear and repay, LBO deals were going against the provisions set forward in article 2358 cc as the repayment of the debt by the target would be interpreted as financial assistance. Another view instead did not deem the merger and debt repayment by the target company as financial assistance because of the unification of the capital structure. The latter view was the one implemented; however, further research was conducted to determine if there was an intent to avoid the provisions of Article 2358 cc and therefore conduct an unlawful deal.[133] Prior to the early 2000s, the uncertainty surrounding the legality of LBOs was intense and it culminated on February 4, 2000, with the Supreme Court declaration number 5503: [134]

"*The LBO scheme born in the United States" (...) "cannot be imported into the Italian system because it is in contrast with the principle stated by article 2358 of the Civil Code*".

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[129] Gazzetta Ufficiale, Art. 2501-quinquies Codice Civile Italiano

[130] Gazzetta Ufficiale, Art. 2501-sexies Codice Civile Italiano

[131] The official document is often referred to as the "Offer Document" which details details the terms of the offer, such as the price per share and the rationale for the acquisition.

[132] Gazzetta Ufficiale, Art. 2501-septies Codice Civile Italiano

[133] Riccardo Guarino, Le Operazioni di Leveraged Buyout nell'Ordinamento Italiano

[134] Corte di Cassazione, dichiarazione n. 5503, February 4, 2000

Further debates pointed out that LBOs were often confused with share buy-backs[135], more precisely, a leveraged buy-back through the assistance of the NewCo and going against not only article 2358 but also article 2357 cc.[136] Nevertheless, article 2358 cc lied at the core of the debate. The article provisions impede companies from making loans or granting assistance for purchasing their own shares, whether directly or indirectly through a third party.[137] These provisions effectively protect the firm's creditors and the equity cushion from potential deteriorations. Additionally, it functions as a preemptive measure against the abusive behaviors of the company's directors. For instance, directors could misuse the firm's funds and direct them toward a third party outside of the business (a trustee) which in turn could purchase the shares and overtake the majority ownership, all in their favor.[138] With the NewCo being interpreted as an intermediary acting on behalf of the target company, as a mentioned earlier, a particular interpretation advanced that the only purpose to an LBO is to elude the provisions set forward in article 2358 cc.[139]

With the corporate governance reform introduced by the Legislative Decree 6/2003, Italy became the first country in Europe to regulate leveraged buyouts, well before the global financial crisis and the subsequent European AIFMD regulation. The introduction of article 2501-bis led the "new LBO era", with more stringent provisions to protect investors and market participants' interests. Despite the reform, the Italian Tax Authority continued challenging LBOs and the interpretation of the nature of the underlying debt and the deductibility of related interest expenses. Moreover, inconsistencies in the fiscal treatment and deductibility of related interest expenses arose in the applicable regulation. The debate accentuates when the acquisition is a cross-border one and structured as a pyramidal or multi-layered one, therefore involving multiple NewCos with one established abroad because of tax benefits, and the second in Italy to carry out the buyout. The adoption of draconian regulations, especially on debt treatment, and the consequent limitations to the market laissez-faire made countries as Italy less appealing and attracted fewer investments. Even after abiding by all rules and legal conditions introduced by article 2501-bis, LBOs practitioners faced higher taxes and fiscal sanctions. PE investors and their community commenced to raise public pressure about the fiscal interpretation of LBOs. The criticism eventually led to the introduction of a set of guidelines on the matter by the Italian Tax Authority, which clarified the inconsistencies and ceased the debate. Essentially, by abiding by the underlying condition

[135] A buyback is a repurchase of outstanding shares by a company to reduce the number of shares on the market and increase the value of remaining shares. A leveraged buyback is a corporate finance transaction that enables a company to repurchase some of its shares using debt.

[136] Douglas Cumming, Simona Zambelli, Illegal Buyouts, May 5, 2008, pp. 7

[137] Gazzetta Ufficiale, Article 2358 Codice Civile Italiano

[138] Douglas Cumming, Simona Zambelli, Illegal Buyouts, May 5, 2008, pp. 8

[139] Zambelli, 2008

of meeting all requirements set forward by article 2501-bis, LBOs would be deemed legitimate and could benefit from the deductibility of the interest expenses.[140]

[140] Simona Zambelli, Department of Management, School of Economics, Management and Statistics, University of Bologna, Bologna, Italy
Recent Challenges of LBOs in Italy and Institutional Insights; The Devil Lies in the Details

Chapter 4 – The Blackstone and Benetton Family Deal for Atlantia

Chapter 4 is the conclusion to the understanding that has been provided so far on the private equity landscape and leveraged buyout transactions. Chapter 1 introduced the private equity industry and its characteristics, analyzing the current trends and historical activity. Chapter 2 deeply detailed how an LBO occurs, from the analysis to the practical implications, investment process, and debt financing. Chapter 3 centered on the regulatory spectrum for LBOs carried out in Italy and, therefore subject to both regulatory requirements of the EU and the Italian government. Ultimately, we provide a case study that will recall all the most relevant information in the previous chapters. This major LBO, performed by the most prominent PE fund, represents a turning point for the Italian infrastructure and PE industries.

We will initially explain the transaction's context, analyzing in detail the parties involved and how the deal has progressed through time. The multi-billion-dollar deal for Atlantia was not concluded in a short time window. The deal announced on April 5th 2022 was concluded almost a year later, in March 2023, and involved several financial and legal advisors, financial markets, and regulatory entities. Furthermore, we will showcase the deal structure through the investment vehicles involved and the determination of the per share consideration. As anticipated, LBOs are performed through investment vehicles known as SPVs, specifically NewCos. The complexity of this deal is also due to the involvement of multiple investment vehicles located in Italy and Luxembourg. Finally, a complete analysis of the most relevant legal terms and the debt financing is delivered. The offering triggered the aforementioned OPA totalitarian and legal provisions explained in Chapter 3, while the debt financing structure used in the acquisition is a perfect example of the debt classes, instruments, and terms discussed in Chapter 2.

4.1 The Buyout Background and Rationale

In order to understand the complexity entailed within this major LBO, we must first outline in detail the players involved and the events that brought to the announcement and conclusion of the deal. The target company, Atlantia, is a major Italian joint stock company active in the infrastructure and mobility industry. The American renowned private equity fund Blackstone targeted the company in tandem with the existing major shareholder of Atlantia, the Benetton family, mostly known for their clothing apparel and prestigious heritage.

Atlantia

Atlantia S.p.A. is an Italian holding company internationally active in the motorway and airport infrastructure and mobility-related services industry. On March 15th, 2023, following a renewed shareholder base, a new management team, and a new growth strategy centered on overseas expansion, Atlantia changed its name to Mundys S.p.A. Through toll roads and airports management, Atlantia operations extend to 24 countries within Europe, Americas, and Asia. Its line of business is fragmented into five primary sectors, with Italian and French airports being the main: Italian motorways, foreign motorways, Italian airports, foreign airports, Atlantia and other activities as engineering services, maintenance and repairments, and electronic payments through its subsidiaries. Atlantia's history can be traced back to 1950 during the posteriors of World War II when "Società Concessioni e Costruzioni Autostrade S.p.A." was created to cooperate for Italy's reconstruction. Till its listing in 1987 on the Milan stock exchange, the company built its roots within the business of the motorways connecting the main Italian cities. A decade later, in 1999, the company was acquired and privatized by Schemaventotto. S.p.A., a consortium[141] of companies led by majority holder Edizione of the Benetton group. Shortly after, in 2003, the company received a tender offer by Newco28. The merger, carried out as an LBO, induced a massive reorganization of the group, separating the highway business line and creating a devoted subsidiary, later named Atlantia S.p.A. The upcoming years were then characterized by geographic expansion and diversification of the business line through international deals in America, Asia, and Europe. In 2007 the company name was officially changed to Atlantia S.p.A. In October 2018, Atlantia and Hochtief, a German construction company part of the Spanish ACS Group, stipulated an agreement to purchase a controlling share of 98.7% in Abertis Infraestructuras. The eye-watering € 16.5 billion deal granted the parties access to an additional 8,600 kilometers of toll roads worldwide. Through its strategic investments and acquisitions, Altantia now counts more than 14,000 kilometers of motorways all over the

[141] A consortium is a group of two or more individuals, companies, or governments that work together to achieve a common objective. Entities participating in a consortium pool resources but are otherwise only responsible for the obligations set out in the consortium's agreement. Therefore, Every entity under the consortium remains independent regarding their everyday business operations and has no say over another member's operations that are unrelated to the consortium.

globe. Over the years, Atlantia has been involved in several scandals and controversies, with the most relevant occurring recently. On August 14th 2018, the bridged Ponte Morandi in Genova collapsed due to poor infrastructure maintenance, leading to the death of 43 people. The bridge security was managed by its subsidiary Autostrade Per l'Italia (ASPI), and its subsequent collapse drove Atlantia into a lousy eye from the public. The share price dropped more than 25% in the days following the tragedy, and the company was called to be held accountable and ended up being fined € 300 million, a significant financial damage, but primarily reputational. In order to address the implications, Atlantia took meaningful steps back. It appointed a new CEO and then pledged to invest € 1.5 billion in infrastructure maintenance. Lastly, the Italian Government agreed to revoke the concessions granted to ASPI then, however, acquired for € 8.2 billion by a consortium formed by Cassa Depositi e Prestiti (CDP), the Italian sovereign wealth fund, through its subsidiary CDP Equity, alongside Blackstone and the Australian asset manager Macquarie.[142] The sale allowed ASPI to held on to its concessions, however it deprived Atlantia of a major profitable subsidiary. Like most of the global economy, Atlantia faced COVID-19's hardships, with its public mobility line of business one of the most exposed. Motorways, airports, and toll roads suffered from the lockdown period, reduced tourism and remote working.

The Benetton Family

Considered one of the most influential families at a global level, the Benetton family is one of the most renowned and prestigious in Italy. Founded in 1965, the main line of business centers until now on prêt-à-porter and related apparel. By building its international presence and diversifying its sources of revenues with strategic investments in sectors such as hospitality, telecommunications, and infrastructure, the Benettons have grown to become a major international family. Edizione is an investment holding company entirely controlled by the Benetton family. Founded in 1981 to manage the family's investments, it now includes a wide range of ownerships and participations in different sectors and major entities like the Benetton Group, Atlantia, the Italian leading investment bank Mediobanca, and many more. Its main sectors are textiles and clothing, food & beverage, travel retail & duty free, infrastructure, and mobility services. The first investment in Atlantia by the Benetton family is traceable back to 1995, when it acquired a stake of 30% through a consortium that also involved Mediobanca. The family has since then been involved in the management with the outlook in mind of a profitable investment that would have scaled within the infrastructure market and become a major European player. The buyout allowed them to take Atlantia private and release some market pressure from the drop in the share price induced by the tragedy of the Morandi bridge and the pandemic downturn. The bidding process has not occurred smoothly for the consortium led by the Benettons and Blackstone. At the same time, the famous entrepreneur Florentino Pérez, chairman and CEO of Group Actividades de Construcción y

[142] Redazione Milano Finanza, "CDP, Blackstone e Mcguire completano l'acquisto dell'88,06% di ASPI", Milano Finanza, 2022

Servicios SA (ACS) and president of the football club Real Madrid, was the most interested in acquiring Atlantia. Pérez already demonstrated interest in acquiring ASPI, and now, with Atlantia, he himself envisioned the potential of their portfolio and assets and the growth of the infrastructure market in Europe. Similarly however to the ASPI bidding, the Benetton family preferred retaining ownership within the company and within Italy as well, and after rejecting to deal with him, the Benetton family opted for Blackstone. The Benetton family was also attracted to the partnership with Blackstone, a major investor in infrastructure with a strong track record of success. The Benetton family felt that Blackstone would be a good partner for Atlantia and would help the company grow in the future. Blackstone has a wealth of experience in managing infrastructure assets and a strong network of relationships with other investors and businesses. The Benetton family felt that Blackstone would be able to help Atlantia to attract new investors and to grow its business.

Blackstone

The third player involved in the buyout is the well-renowned global investment Blackstone, which, as of 2023, reached assets under management (AUM)[143] of $1 trillion, consolidating its position as the largest alternative investment firm. Headquartered in New York, Blackstone operations expand to 27 countries and are divided into four main segments: private equity, real estate, infrastructure, and credit. Blackstone is the most prominent player in the LBO market and holds significant stakes in major multinationals such as Hilton, Thomson Reuters, and Versace. There are a few reasons why Blackstone was interested in the buyout of Atlantia; some have already been foreshadowed. Atlantia is undoubtedly among Italy's leading infrastructure companies and one of the most prominent in Europe. Its acquisition does not get any more strategic than this. From Blackstone's perspective, the company owned a diversified portfolio of cash-generating assets with a strong track record of growth and expansion. The infrastructure sector is among the most targeted for LBOs, as mentioned in Chapter 2.1. PE funds, particularly Infrastructure funds, are deepening their roots in the related Italian market because of the predictability and certainty of cash flows this sector can generate, particularly to Atlantia, parts of its line of business, toll roads mostly. Moreover, debt finance can come with more favorable rates considering the significant asset base that can be pledged as a guarantee and the constant involvement of the Government and its concessions. This sector is considered by PE practitioners an ever green, and Blackstone is a leading investor in infrastructure. The deal was indeed attractive from a valuation perspective. Atlantia had just finished facing two major hardships – the collapse of the Morandi bridge and the pandemic losses – and the surging inflation and global distress of companies brought multiples significantly down. Adding to these reasons, Blackstone may also have been interested in buying out Atlantia to expand its

[143] Assets under management (AUM) is the market value of the investments managed by a person or entity on behalf of clients. AUM is used in conjunction with management performance and management experience when evaluating a company.

When calculating AUM, some financial institutions include bank deposits, mutual funds, and cash, while others limit it to funds under discretionary management from individual investors.

presence in Europe. The firm's European investments have been growing and this last acquisition gives it a massive foothold in the region — the buyout marks Atlantia's commencement of a new period of growth and global expansion.

The Deal Timeline and Rationale

On April 5th 2022 (the Reference Date), the Benetton family and Blackstone announced that they would take Atlantia private in a deal worth € 54.3 billion. The deal between these parties is a major transaction in the infrastructure sector and will likely significantly impact Atlantia and the European infrastructure market. The deal has been met with mixed reactions. Some believe it to be a promising strategic move for Atlantia, as it will give the company the financial resources it needs to grow and invest in new projects. Instead, Others are concerned that the deal will give Blackstone too much control over Atlantia, eventually leading to higher prices for consumers. In 2021, the Benetton family hired Goldman Sachs to explore strategic options for Atlantia. The family was considering a number of options, including a sale of the company. In January 2022, Blackstone made a non-binding offer to acquire Atlantia. The offer was valued at € 53 billion. On April 14th 2022 (the Announcement Date), the Benetton family and Blackstone announced that they had reached an agreement to take Atlantia private. The deal is valued at € 54.3 billion. Meanwhile, on June 30th, Atlantia confirmed the acquisition of a 100% stake in Yunex Traffic from Siemens Group for € 950 millions of enterprise value. Shortly after, for a total consideration of € 577.8 million, Atlantia sold to ACS the entire stake it held in Hochtief. On October 7th, in compliance with regulatory requirements, Atlantia published on its official website the voluntary public tender offer for all its shares launched by the investment vehicle Schema Alfa S.p.A.[144] The SPV used in carrying out the LBO had the Benetton family, through its investment vehicle Sintonia, as the majority owner with 65% of share and the remaining 35% owned by Blackstone. Schema Alfa's capital was at the time entirely owned by Schema42, an additional investment vehicle managed by both Edizione and Blackstone through two limited companies registered in Luxembourg. According to Article 38, paragraph 2, of the Issuers' Regulation, the offer document relating to the voluntary tender offer pursuant to Articles 102 and 106, paragraph 4 TUF was published on the 7th, and on the 10th the offer or acceptance period commenced. In the official declaration, Schema Alfa stated:[145]

"*Please note that the period for accepting the Offer (the "Acceptance Period"), agreed with Borsa Italiana, will start at 8:30 a.m. (Italian time) on October 10th 2022 and will end at 5:30 p.m. (Italian time) on November 11th 2022 and therefore will be equal to 25 trading days (unless extended). Therefore, November*

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[144] Initially named "Schema43", the SPV name was then changed after public critiques associated the "43" in the name with the number of deaths that occurred in the Morandi bridge tragedy – La Repubblica.

[145] Mundys, Press Release, Voluntary public tender offer launched by Schema Alfa S.p.A. for all the shares in Atlantia S.p.A. (the "Offer"): Publication of the Offer Document: Publication of the Offer Document, 7th October 2022

11th 2022 will be the last day to accept the offer, unless the Acceptance Period is extended without prejudice to the possible Reopening of the Terms."

Following the end of the acceptance period, on November 18th, unless there is any extension, Atlantia pledged to pay each shareholder who validly tendered its Shares to the Offer consideration equal to € 23.00, fully paid in cash for each share tendered to the offer. The offer period was shortly after opened again, and on November 28th Schema Alfa reached 96% of the subscription, leading to a total shareholding of 92.8% and to the exercise of the squeeze-out right on the residual shares, fulfilling its purchase obligation in accordance with article 108 TUF and concluding the delisting or take private of Atlantia S.p.A. As of December 9th, the shares listing on the Milano Stock Exchange was effectively revoked. On February 15th 2023 the merger by incorporation was approved by the Italian regulatory authorities. Later on, Atlantia will change its name to Mundys in a way to express the managerial growth prospectus. With its execution, the Blackstone and Benetton family buyout of Atlantia marks the 2022 global largest deal concluded and Europe's largest private equity deal and take-private transaction. This occurred in a historical moment characterized by global uncertainty, distress, and recession projections, with inflation peaking and Ukraine being under attack by Russia. Nevertheless, Blackstone viewed an opportunity worth the eye-watering price of € 54.3 billion of EV. PEs were reported sitting on huge amounts of dry powder[146] and this deal is significant proof of it.[147] Despite the pessimistic macroeconomic outlook, with the EU in particular, the infrastructure industry, in spite of the traits mentioned earlier, provides stable and predictable cash flows which are highly demanded in unpredictable inflationary periods. Both parties carrying out the deal supported Atlantia's business plan. Moreover, the Benettons, through Edizione, retained the majority of the company's ownership and Italian identity.

Both Blackstone and Edizione intend to fully support Atlantia's long-term investment strategy and sustainable growth, aligned with the projections announced to the market by its previous management. The objective is to consolidate Atlantia's position as a leading global company in the infrastructure and mobility sector by pursuing the development of its existing activities and new potential synergies arising from the change in the corporate structure. Following the debt repayment, Blackstone and Edizione will then have the opportunity to evaluate extraordinary transactions such as mergers and acquisitions, demergers, or disposals. Furthermore, Atlantia will benefit from the status of a non-listed company thanks to a simplified shareholding structure, thus fastening managerial and operating decisions. Moreover, it will be subject to fewer disclosure requirements and the inherent costs.

[146] For venture capital and private equity firms, dry powder refers to the amount of committed, but unallocated capital a firm has on hand. In other words, it's an unspent cash reserve that's waiting to be invested. As a highly liquid asset, investors and corporations use dry powder strategically to gain financial success or ease financial stress.

[147] S&P Global, Global private equity dry powder approaches $2 trillion, 21st December 2022

4.2 The Deal Structure

The deal involved several financial instructions and legal advisors. Blackstone and Edizione were financially advised by the likes of Goldman Sachs, Bank of America, JP Morgan, UBS, Mediobanca, and UniCredit. The legal advisors involved were, among many others, Gatti Pavesi Bianchi Ludovici, Legacy – Avvocati Associati and Simpson, and Thacher & Bartlett LLP. The unsolicited offer was concluded through an LBO merger.[148] The estimated EV was equal to € 54 billion, and the equity consideration amounted to € 19 billion. Depending on the period we consider, the offered per share price of € 23 implies a premium – prior to the deal's announcement – in the range of 24% on April 5th to 41% four weeks before the bid. Adding up to the premium, shareholders will still receive dividends of € 0.74 per share. The Benetton family injected about € 2.9 billion in Schema Alfa, whereas Blackstone, through its two limited companies, provided € 1.6 billion in equity. A total consideration of € 12.7 billion, of which € 8.2 billion in debt, was offered for the outstanding 67% of shares on the market as the Benetton family already owned the difference. The debt was structured as a combination of senior secured and unsecured debt and mezzanine debt and provided by a combination of banks such as BNP Paribas and Credit Agricole, both among the most prominent in Europe for leveraged finance. The mezzanine debt was instead structured by Blackstone and a pool of financial institutions and funds.

Figure 21 provides a graphical representation of how the entities involved took part in the LBO.

[148] A comprehensive list of the institutions involved in the deal is provided in chapter 4.3.

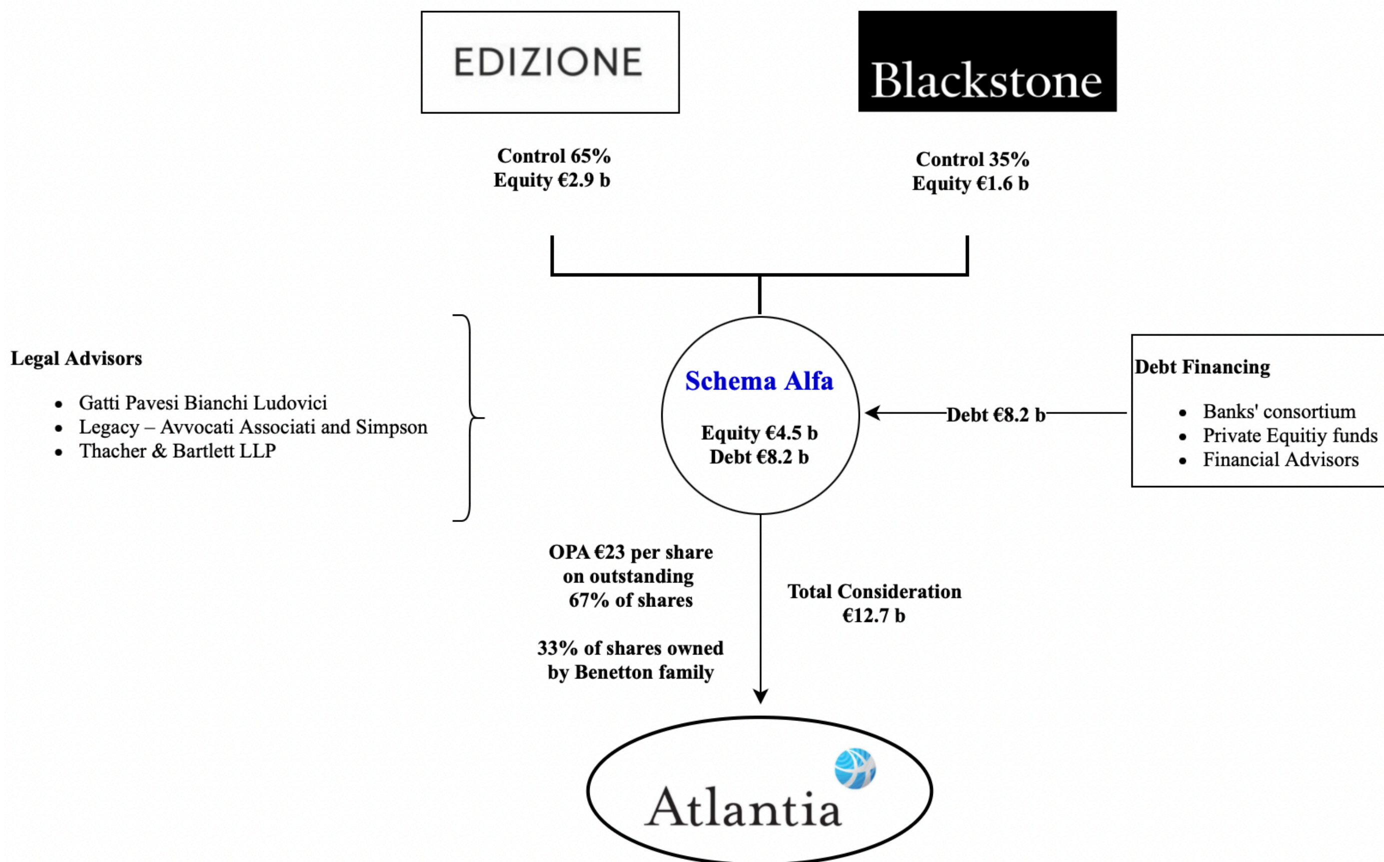

Figure 21 Blackstone and Edizione OPA for Atlantia[149]

The current and actual ownership of Mundys S.p.A sees Edizione with 57% of ownership as the majority shareholder through the investment vehicle Schema Alfa, while Blackstone retains ownership of 37.8%. The outstanding 5.2% of shares are held by the group "Cassa di Risparmio di Torino" (CRT).

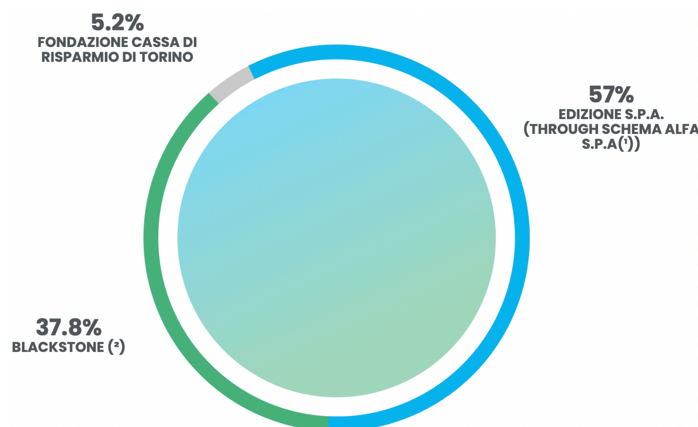

Figure 22 Mundys Ownership at July 27th 2023[150]

[149] The figure is not inclusive of all details and parties. The financial and legal advisors listed in the exhibit are just a few of the many involved in this major deal.

[150] Mundys Shareholding, July 27th 2023

To the consideration of € 23 per share, dividend distribution of € 0.74 per share has to be added following April 29th 2022 shareholders' meeting approval. Atlantia's shareholders therefore received a total per share consideration of € 23.74. The consideration was determined through three diverse assessments.[151]

1. The share price prior to the announcement date and on the reference date

The share price of the Reference Date[152] is equal to € 18.49. Compared to the consideration per share of € 23 and the total consideration inclusive of dividends per share of € 23.74, the premiums paid are of 24.4% and 28.4% respectively.

Prior to the Announcement Date[153] the share price of € 21.84 implied a premium of 5.3% compared to the consideration alone and of 8.7% when including dividends per share.

2. The daily weighted average share price at different time intervals

The next valuation is made on constant fixed intervals of 1, 3, 6, and 12 months prior to the Reference Date and prior to the Announcement Date. The official share price is determined as a weighted arithmetic average of the trading volumes. For each period, the embedded premium is computed on an absolute and percentage basis.

The following table summarizes the results of the two comparisons.

[151] Offer Document, p. 96 – 104, 7 October 2022

[152] The reference date is commonly fixed as the last official trading day prior to the spreading of the rumors of a potential transaction. In this event, the reference date falls on April 5th 2022, when the interest to deal became public knowledge.

[153] The announcement date falls on April 14th 2022 when the parties publicly announced their intention to deal.

Reference Date	April 5th 2022
Announcement Date	April 14th 2022
Per Share Consideration	€ 23.00
Per Share Consideration & Dividends	€ 23.74

Period before the Reference Date	Weighted Average	Difference between Consideration and Weighted Averge	Difference (Premium)
1 month	17.57	5.43	30.9%
3 months	17.01	5.99	35.2%
6 months	16.88	6.12	36.3%
12 months	16.34	6.66	40.8%

Period before the Announcement Date	Weighted Average	Difference between Consideration and Weighted Averge	Difference (Premium)
1 month	19.40	3.60	18.6%
3 months	18.10	4.90	27.1%
6 months	17.57	5.43	30.9%
12 months	16.78	6.22	37.1%

Figure 23 Daily Weighted Average Share Price[154]

3. The target prices indicated by financial institutions

The third method adopted is an arithmetic average of the share price assessed by leading financial institutions after the publication of the results for the financial year 2021, occurred on March 11th 2022 therefore prior to the reference and announcement date.

The table below showcases the financial institutions picked, their recommendation, the target share price, and the date it was posted.

[154] Bloomberg

Offer Document p. 98, 7 October 2022

Financial Institution	Recommendation	Target Price (in €)	Date
Mediobanca	Hold	19.40	05-Apr-22
Equita SIM	Buy	20.50	05-Apr-22
Bestinver Securities	Buy	19.50	05-Apr-22
BNP Paribas Exane	Hold	17.00	04-Apr-22
Santander Group	Buy	21.00	31-Mar-22
Kempen	Hold	18.40	31-Mar-22
Intesa San Paolo	Hold	17.60	31-Mar-22
Banca Akros (ESN)	Buy	18.50	31-Mar-22
Aplha Value/Badeer Europe	Sell	18.10	31-Mar-22
Kepler Cheuvreux	Buy	20.00	30-Mar-22
Societe Generale	Buy	19.00	18-Mar-22
Oddo BHF	Hold	17.60	16-Mar-22
Insight Investment Research LLP	Buy	27.00	16-Mar-22
Intermonte	Buy	19.50	14-Mar-22
Morgan Stanley	Hold	18.90	11-Mar-22
RBC Capital	Buy	21.00	11-Mar-22
Bank of America Securities	Hold	17.50	11-Mar-22
Average Value		**19.44**	

Figure 24 Financial Institutions' Target Share Price[155]

In terms of valuation, it is good practice to benchmark the share price to that of specific comparable companies – companies that ideally operate in the same industry and are relatively similar in several selected characteristics. It is worth mentioning that Atlantia Group has multiple unconsolidated investments. On top of that, because of its highly diversified operativity, finding comparable companies is challenging and it is impossible to find a perfect rival. In addition, several factors affecting the motorway and airport sector have to be taken into account, such as:

- The geographical location of the concession.
- The duration of the concession.
- The nature of the concession – whether it is *greenfield* or *brownfield*.[156]
- The risk involved and the pre-existing capital structure.
- The potential exchange rate risk, particularly when the country involved is an emerging market.

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[155] Offer Document p. 99, 7 October 2022

[156] A greenfield concession is a new concession that is built on a vacant site. A brownfield concession is a concession that is built on an existing site that has been previously developed. Greenfield concessions have typically more advantages as they tend to be less expensive to build, as there is no need to demolish or renovate pre-existing structures and can thus be shaped to preference. Nevertheless, they can take longer in terms of preparations and approval from local authorities. Brownfield concessions instead are faster but often more expensive for the aforementioned reasons.

- The presence of unconsolidated concessions and minority interests.
- The impact an extraordinary financial transaction may have.

In light of the limitations just outlined the valuation through market multiples is of little relevance.

Two are the companies selected as comparable to Atlantia group: Vinci and Eiffage. The former operates in the motorway and airport segment through contracting and concessions. The latter instead is a construction company with marginal exposure to both sectors. Both are of French origin.

The following exhibit outlines their market multiples in comparison to those of Atlantia.

Entity	EV/EBITDA 2021	EV/EBITDA 2020	P/E 2021	P/E 2020	P/BV 2021	P/BV 2020
Vinci	9.4x	12.5x	19.3x	40.4x	2.2.x	2.4x
Eiffage	6.5x	8.4x	11.1x	23.1x	1.6x	1.6x
Average	**7.9x**	**10.4x**	**15.2x**	**31.8x**	**1.9x**	**2.0x**
Atlantia	**12.1x**	**15.8x**	**30.1x**	**n.a.**	**2.3x**	**3.0x**

Figure 25 Market Multiples of Comparable Companies[157]

[157] Factset as of 5 April 2022 and companies' latest available financial reports on the Reference Date.

Offer Document p. 102, 7 October 2022

Multiples calculated on the basis of the Consideration.

4.3 The Terms and Financing

The deal for Atlantia is one of significant importance not only because of its size but also because of the timing and the developments it will induce in the future. This buyout is a sign of confidence in the Italian economy, specifically in the possibilities offered by the Italian infrastructure market. The restructuring that will occur both from a financial and operational perspective will pave the way to noteworthy changes and potentially attract further investments in Italy. Consequently, because of the highly structured Italian regulatory landscape, the buyout was conditional on fulfilling several legal terms. Moreover, the tremendous amount of financing and financial institutions involved in providing it required a well-planned offer document.

Copy of the Official Offer document for the OPA of Atlantia can be retrieved on the official websites of both Atlantia (now Mundys) and Edizione. Within is contained all the relevant information regarding the voluntary tender offer pursuant to articles 102 and 106, paragraph 4, TUF. The parties in question are Atlantia, Blackstone, the Benetton family through Edizione, the group CRT, and Schema Alfa, the Offeror. At the date of the publication of the Offer Document, Schema Alfa's share capital was equal to € 100,000, divided into 200,000 ordinary shares with no specific nominal value. The shares are held privately and not listed on any regulated market. Identified as the Offeror, Schema Alfa is a joint stock company with a sole shareholder incorporated under Italian law. Schema Alfa is the BidCo, whereas Edizione (through Sintonia) and Blackstone are addressed as the HoldCo. The BidCo is the investment vehicle or NewCo used in the merger through LBO, or generally, the SPV adopted in an M&A deal and that ceases to exist at completion of the merger. The HoldCo is the permanent entity that holds the BidCo's capital and deploys the necessary financing for an investment through equity injections or cash obtained through loan financing. Schema Alfa's share capital is entirely held by the HoldCo and structured as follows: (i) Sintonia's stake is equal to 65%, (ii) BIP TopCO1 holds 5.25%, (iii) and BIP TopCo2 holds 29.75%. The ownership at the time was subject to potential reinvestments by CRT, which is now effectively part of the ownership, as shown in figure 22. Prior to the current ownership, CRT held, as of June 17th 2022, 4.39% of the share capital within Atlantia. At the same time, the share capital of Sintonia is entirely held by Edizione, whereas that of BIP TopCo1 and BIP TopCo2 is managed by Luc GP and Blackstone Infrastructure Partners (BIP) affiliates. Blackstone Infrastructure is a division of the Blackstone Group targeting infrastructure investments in the transportation, energy, water, and telecommunications sectors. Applying a long-term buy-and-hold strategy to large-scale infrastructure assets and with over $ 37 billion in AUM, is one the leaders in its sector. Figure 23 extracted from the Offer Document, provides a more explicit and better detailed structure of the ownership and distribution of share capital between the entities involved.

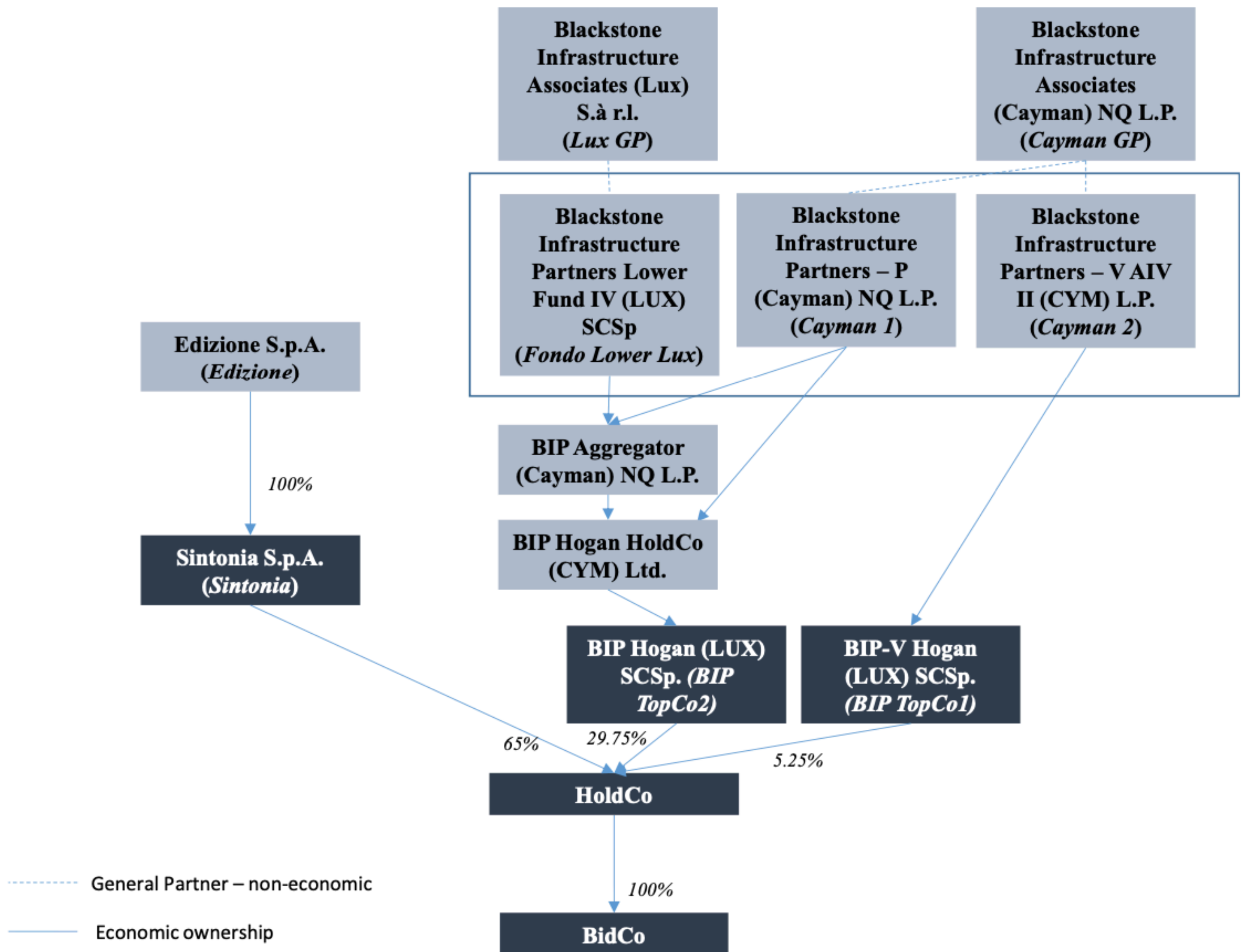

Figure 26 The Tender Offer and Financing[158]

Schema Alfa S.p.A. offered a per share consideration of € 23 per share for a maximum number of 552,442,990 ordinary shares of Atlantia S.p.A. with no indication of nominal value. The effectiveness of the offer was subject to the fulfillment of several conditions. The first and most relevant was for Schema Alfa to achieve ownership greater than 90%; this is addressed as the Threshold Condition. In the event that this condition was not met, Schema Alfa had the option, upon prior agreement, to waive the threshold and purchase a lower number of shares. Additional conditions were tied to the prior authorization and authorization of the relevant regulatory authorities, with these being the CONSOB and the Bank of Italy. Importantly, conditions regarding the occurrence of adverse events or situations that may impact the success of the deal were inserted. For instance, new developments with the Russia-Ukraine political and military crisis may lead to unforeseeable consequences impacting the performance of Atlantia or the effectiveness of the offer.[159] This condition is

[158] Offer Document, p. 50, 7 October 2022

[159] Offer Document, p. 26 – 28, 7 October 2022

defined as the Material Adverse Change (MAC) condition. These conditions in a takeover agreement allow the acquirer to withdraw from the deal if there is a significant change in the target company's business, financial condition, or prospects after the agreement is signed but before the deal is completed, essentially protecting him from unforeseen events that could make the acquisition no longer financially viable. The room for interpretation and range of events the condition can embrace is indefinite and has no limit. Nevertheless, the MAC condition is not always enforceable; the change that occurred must be significant and harm the target company's business enough for the court to allow the acquirer to withdraw from the deal. Some events that could trigger it are a significant loss, a relevant customer or supplier going out of business, issues with regulatory approvals, and natural disasters. If and when the condition is triggered, the acquirer will be granted a time window, such as 30 days, to decide whether to withdraw or not from the deal. If the acquirer decides to withdraw, it will typically be required to pay a termination fee to the target company.

With regards to the financing, two are the main sources to be considered. The foremost is the Cash Bridge Loan Facility, first addressed in Chapter 2.2. This is short-term interim financing that bears higher interest rates and is usually used to finance the initial purchase of the target company while the acquirer seeks to secure permanent financing, such as high-yield bonds or bank loans. The bridge loan has a maturity of 18 months and 3 days after the first drawdown and is extendable upon agreement to 24 months. The terms of the loan may require advanced repayment in case of unlawfulness, significant changes to the corporate structure of the parties involved, a trilateral merger[160] or debt push-down merger, or ultimately extraordinary distributions by the target Atlantia. The bridge loan may be eventually structured to meet the sufficient amount to purchase a lower share threshold in the event that the offeror does not meet the prefixed one. The initial facility provided for this acquisition, as of October 7th 2022, amounted to € 8,225,000,000.00. Further terms and specifications inherent to this loan form can be found in the cash bridge loan facility agreement. Within this legal document, the most relevant sections to the Atlantia deal are:[161]

1. The Lenders: several financial institutions were involved in syndicating a portion of their respective commitments.[162]

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[160] Trilateral Merger means the reverse trilateral merger of HoldCo, BidCo and the Target, with the Target as the surviving entity.

[161] Offer Document, p. 111 – 112, 7 October 2022

[162] The full list of institutions involved comprised Banco Santander SA, Milan Branch, Banco Bilbao Vizcaya Argentaria, S.A., Milan Branch, Banco BPM S.p.A, Bank of America Europe Designated Activity Company, Bank of China (Europe) S.A., Bank of China Limited Zweigniederlassung Frankfurt am Main Frankfurt Branch, Bank of Communications (Luxembourg) S.A., Bank of China Ltd., Milan Branch, BPER Banca S.p.A., Caixabank, S.A., Crédit Agricole Corporate and Investment Bank, Milan Branch, Goldman Sachs Bank Europe SE, Intesa Sanpaolo S.p.A., JPMorgan Chase Bank, N.A., Milan Branch, Mediobanca – Banca di Credito Finanziario S.p.A., Mizuho Bank, Ltd., Milan Branch, MUFG Bank, Ltd., Natixis S.A., Milan Branch, Royal Bank of Canada, Paris Branch, SMBC Bank EU AG Milan Branch, Société Générale and UniCredit S.p.A.

2. The Ranking: commonly senior unsecured for these types of transactions.
3. The Guarantee: a corporate guarantee from HoldCo and BidCo.
4. The Interest: EURIBOR at zero floor[163] and an applicable Margin.
5. The Margin: based on the rating provided by two rating agencies on the target on the first utilization date. If the margins diverge, the average of the "IG" and "Non-IG" margins shall apply.
6. The IG Margin and the Non-IG Margin.
7. The Financial Covenants: no financial covenant was applied to the facility.
8. The Restrictive Covenants: the HoldCo and Schema Alfa were restricted practices as mergers or other reorganizations, acquisitions and joint ventures, further indebtedness, dividends or other forms of distributions, granting of loans to third parties, and the disposal of assets.
9. The Events of Default: as the insolvency or a breach of duties from the parties.

The second major form of financing is the term loan facilities, which details can be found in their related agreement. The term loans (TL) amounted to € 1,400,000,000, and the revolving credit facility (RCF) to € 50,000,000, for a combined aggregate principal value of € 1,450,000,000. The terms within the agreement are similar to those found within the bridge loan agreement with the exception of:[164]

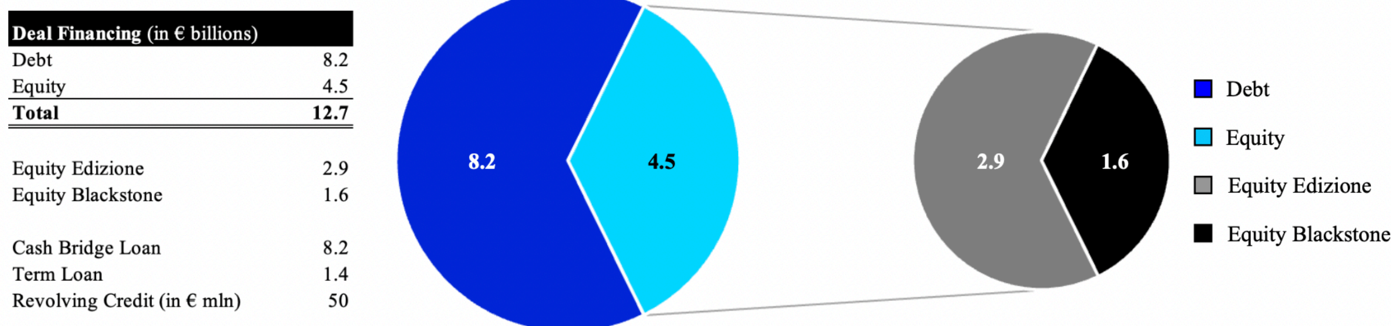
10. The Lenders[165]
11. The Assets Security: assets as accounts, receivables, and shares were pledged as securities with the applicable governing law of Luxembourg and Italy.
12. The Termination Date: five years after the date of first utilization.
13. The Repayment Profile: subject to a bullet repayment with no debt amortization.
14. The Minimum Margin for the TL and RCF: a minimum margin of 3.25% with yearly step-ups not specified.

[163] Zero-floor Euribor clause means that if Euribor is negative, it will be deemed to be zero for the purpose of the loan agreement and the bank will be entitled to the entire margin.

[164] Offer Document, p. 114 – 115, 7 October 2022

[165] The full list of institutions involved comprised AXA Assurance IARD Mutuelle, AXA France IARD, AXA Krankenversicherung AG, AXA Aurora Vida SA de Seguros y Reaseguros – CFM, AXA Versicherung AG, Banco Pichincha Espana, S.A., Banco Santander SA, Milan Branch, Banco Bilbao Vizcaya Argentaria, S.A., Milan Branch, Banco BPM S.p.A, Bank of America Europe Designated Activity Company, Bank of China (Europe) S.A., Bank of China Limited Zweigniederlassung Frankfurt am Main Frankfurt Branch, Bank of Communications (Luxembourg) S.A., Bank of China Ltd., Milan Branch, BPER Banca S.p.A., Caixabank, S.A., Crédit Agricole Corporate and Investment Bank, Milan Branch, Goldman Sachs Bank Europe SE, Infrastructure Finance SCS-SIF, Intesa Sanpaolo S.p.A., J.P. Morgan SE, JPMorgan Chase Bank N.A., London Branch, Mediobanca – Banca di Credito Finanziario S.p.A., Mizuho Bank Europe N.V., MUFG Bank (Europe) N.V., Natixis S.A., Milan Branch, Royal Bank of Canada, London Branch, SMBC Bank EU AG Milan Branch, Société Générale, UniCredit S.p.A., Woori Global Markets Asia Limited and Woori Bank Hong Kong Branch.

15. The Financial Covenants: maintenance covenants tested on regular intervals were applied on the leverage levels and interest coverage.



Deal Financing (in € billions)	
Debt	8.2
Equity	4.5
Total	**12.7**
Equity Edizione	2.9
Equity Blackstone	1.6
Cash Bridge Loan	8.2
Term Loan	1.4
Revolving Credit (in € mln)	50

Figure 27 The Buyout Financing Breakdown

The future plans of Blackstone and Edizione will revolve around the objectives of the management team prior to the change in the corporate structure. Atlantia's goal is to become a global leader within its sector through strategic long-term investments. Three are the business segments that contribute the most to Atlantia's earnings. The first is the motorway activities, which previously comprised ASPI, now rely mainly on the Abertis group and foreign motorway operations. The former manages 34 concessions dispersed in Europe, America, and India, expiring between 2022 and 2070. The latter includes 12 companies holding concessions in Brazil, China and Poland. The second business segment of importance is airport activities. Aeroporti di Roma (AdR) group, with an ownership of 99%, is the main income provider in this segment. It comprises the "Leonardo da Vinci" international airport in Fiumicino and the "Giovan Battista Pastine" airport in Ciampino. AdR is the leading airport operator in Italy and the seventh-largest airport operator in Europe. Aéroports de la Côte d'Azur group is 64% owned and counts airports in Nice, Cannes, and Saint-Tropez, making it the second largest airport pool after Paris. The third and last business segment of relevance is the mobility services, which operate mainly through Telepass group, which is 51% owned and provides services in managing electronic tolling, payments systems, and other mobility services in Italy and 13 European countries. The most recent investment in Yunex Traffic will be instrumental in generating extra earnings by targeting the adjacent market segment for innovative intelligent transport systems (ITS).[166]

The new management will need to consider two relevant terms in its renewed business plan regarding the M&A activities and its financial policies. As per the first, the M&A policy sets a few principles to be followed. Notably, the group will have to restrain to opportunities arising within OECD countries, with particular attention to Western Europe, North America, Latin America, and Australia. The investments will

[166] Offer Document, p. 67 – 68, 7 October 2022

necessarily focus on further growth and/or replacements of assets in the portfolio in the reference sector. Lastly, all of the activities will be carried out by complying with the financial and dividend policy of the company. On the other hand, the financial policy objective is achieving a financial profile compatible with at least three defined ratings from three respective agencies: (a) from S&P of at least BBB-, (b) from Fitch of at least BBB-, and (c) from Moody's of at least Baa3.[167] Under its new name, Mundys' goal is to become the leader in the infrastructure sector over the next 5 years. At the press release on March 15th 2023 in Milan, the company presented its plans, bringing together all the CEOs and management teams across all divisions. The major investments will be deployed in sustainable infrastructure and technological innovation, primarily within the airports and motorway networks. Significant investments, over a billion euros, will be made in Aeroporti di Roma, Aéroports de la Côte d'Azur, and Abertis, among others.[168]

[167] Offer Document, p. 117, 7 October 2022

[168] Mundys, Press Release, Mundys, born to be a global leader in sustainable integrated mobility services, 15th March 2023

Conclusions

Major acquisitions attract much engagement. Great deals involving billions of dollars make the transaction newsworthy and draw attention from the media and the public. The more significant the size, the more widespread will be the impact of the deal on the companies in related sectors, employees, and the economy as a whole. Often, the motives driving a massive acquisition are of a strategic nature, such as to gain access to new markets, acquire new technologies, or reduce competition. With the number of companies constantly growing and the potential opportunities being exhausted immediately, market participants are nowadays relying more and more on strategic acquisitions.

Because of their risky and transformation-driving nature, leveraged buyouts have never ceased to catch the public's interest. These transactions are commonly associated with enormous deals, often falling in the billion-dollar range. Moreover, by relying on excessive amounts of cash financed through debt, companies conducting an LBO are capable of purchasing the entirety of ownership of the target and immediately altering the dynamics of the belonging industry. In recent years, there have been several high-profile LBOs that have attracted negative attention. These high-profile failures have led to increased scrutiny of LBOs and calls for greater regulation. Most of the controversies exhibited the same concerns. The debt burden is the core driver behind the controversies as it puts enormous pressure on operational efficiency. Companies acquired through a debt-pushdown merger will be subject to unavoidable levels of stress to meet the short-term goals and debt obligations. In the worst case, they may need to file for bankruptcy and go out of business if they cannot meet their obligations. Because of the debt burden, the management will seek to reduce costs and improve profitability, thus proceeding with headcount reductions. Lastly, while target companies usually operate in regulated markets, once the buyout is concluded, such enterprises are usually delisted and, therefore, no longer subject to the disclosure requirements imposed. Because of the lack of thorough disclosure requirements in private markets, monitoring the post-buyout is not possible.

Private Equity and Alternative Investment Funds have gained increasing prominence in recent years as sources of financing. Although more costly than debt, equity financing is seen by some investors as more appealing because of its risk-sharing feature and long-term commitment, which supports business growth. PEs' and VCs' investments have favored the growth of many companies in their early stages of operativity, while buyout funds have allowed companies to reach new operating levels and often become the industry leaders. The capital pledged is illiquid, and exiting an investment is not immediate. Funds will generally take active roles within their portfolio companies to improve efficiency and profitability with their comprehensive market knowledge until an exit is viable. The complexity of their investments is found within the investment vehicles implemented. These special purpose vehicles are tailored to allow the fund to manage the taxes,

regulations, and other concerns necessary to carry out a transaction. Often, funds will establish multiple vehicles in different jurisdictions to benefit from the differences in the regulation. Nevertheless, a considerable amount of time is spent identifying and analyzing a potential target company which will need to exhibit some characteristics depending on the life stage and purpose of the investment. The greater the investment and target company size, the longer the due diligence phase. For this reason, LBOs are the most complex and time-consuming form of PE investment.

Contrary to the current market scenario, the past years have been characterized by low interest rates, which have driven an increase in the activity of leveraged deals and risk-aversion in the public markets, which have brought companies and funds to seek growth in the private markets, far from the regulatory burdens. Companies bought out will necessarily have some potential to be exploited, which can be found off the public market. The buyout will favor the growth strategy; however, the initial concern will be repaying the debt incurred for the purpose of the deal. When used effectively, debt financing can help to achieve significant returns on equity investment. It is therefore imperative for the parties involved to develop a proper business plan with foreseeable future cash flows and lay down the appropriate terms and covenants related to the debt and interest repayments. Structuring an LBO requires expert analysts and well-experienced transaction lawyers. The interest payments and debt maturities must be matched to the cash-flow generation of the target company, and the assumed covenants must be instrumental in guiding and monitoring the target's management toward improving its leveraged position.

The future of LBOs is uncertain in light of the current market dynamics, specifically the list of impediments. Higher interest rates, lower valuations, increased regulation, rising risk, and investors' risk adversity are just some limitations imposed by the current markets. However, a handful of factors could make LBOs again attractive in the years to come. Lower interest rates would favor borrowing and debt issuance, supporting the viability of LBOs. Furthermore, with the adjustment of inflation levels and, consequently, the cost of capital, firms buying power and valuations will return strong. Lastly, the increasing availability of capital, such as private credit from PE funds and financial institutions, will be a new driver of LBOs. Private credit has been recently booming, with new funds being established for the sole purpose of providing this new type of financing. Private credit is debt financing not issued or traded on public markets, typically provided by non-bank lenders such as PE firms. The form of debt provided is essentially similar in name to the traditional, going from senior secured to unsecured and distressed debt. However, private credit typically offers higher yields subject to less volatility and greater flexibility in the term. The cost, however, resides in its illiquid nature, making it riskier and subject to higher fees compared to traditional debt. Despite the risk and costs entangled, private credit is growing in adoption as it sees private businesses with little track records benefit from debt financing previously unavailable from bank lenders.

Comparing the EU to the US, the primary impediment is the more stringent regulatory framework to which LBOs are subject. As showcased in chapter 3.5, the matter is critical, and the regulatory spectrum has only recently become more flexible. One of the main reasons for the solid leveraged finance operations in the US is indeed the supportive legal provisions and *laissez-faire* of the government. The EEA takeover regulatory framework allows each country to act on its policies. As a result, countries such as Germany and France exhibit higher activity in PE and buyouts because of their flexible and more attractive bureaucracy when it comes to takeovers. The strict provisions and takeover thresholds set forward in Italy are viewed as too challenging by investors, particularly foreign ones when evaluating an expansion in the EU. The main difference between the regulation of LBOs in Italy and Europe is that the Italian framework has specific sets of provisions regulating the matter. Article 2501-bis of the Italian civil code specifically aims to regulate mergers occurring through debt pushed down by an SPV. Conversely, the EU Takeover Directive does not explicitly address LBOs. The Italian government's end goal is to protect the minority shareholders. The Italian government and competent authorities must better address its impediments and shortcomings if they intend to attract more capital. The period of the illegality of LBOs is another instance of excessive regulation that has been detrimental to the economy as a whole. Adding up, the ownership structure within the Italian companies is mainly family-owned, and the high presence of SMEs discourages takeovers. Despite PE funds' growing presence and transaction volumes, Italy is still well behind its adjacent peers. Regardless, the Atlantia LBO is a perfect example of the possibilities that can arise from cooperating with international players. While it is crucial for the prosperity of the Italian economy to retain ownership within its strategic companies, it is also possible to opt for collaborative acquisitions as the Benetton family did with Blackstone. By targeting Atlantia, a strategic company active in a sector protected by the Golden Power rule, Blackstone had to undergo a time-consuming deal that extended for almost a year. Nevertheless, the deal was a success. The offer triggered an OPA Totalitaria, concluded through a squeeze-out and sell-out of the outstanding shares, and saw full cooperation and subscription by Atlantia's shareholders.

Overall, LBOs remain an unclear matter for non-practitioners, and for the experts, it is one that requires constant and thorough attention to detail. The success of these types of transactions is tied to the understanding of the players involved. The parties should be capable of analyzing and understanding the current and future debt market developments. Moreover, they shall develop a sound model that reflects all their assumptions and inputs. Lastly, the structuring of the transaction will need to consider all the possible regulatory ramifications for it to be approved and concluded. Private equity and leveraged buyouts will be perennial and will adapt to the economic cycles and market needs.

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