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Italian elections pose further questions for dealmakers - analysis

Analysis

06 MAR 2018

- Uncertainty could place activity on hold
- Public companies expected to feel biggest pinch
- Markets must react and adapt

Italy's expected swing towards instability following the weekend's election is an unlikely catalyst to spur investment, a variety of banking and legal sources have told this news service. Much like the rise of populist thinking parties sweeping across much of Europe, Italy appears on the brink of electing such a regime.

Such populist campaigners, Movimento 5 Stelle (Five Star Movement) and Lega have been polled as becoming the first and the third most voted for parties claiming 32.7% and 17.4% of the vote, respectively. The centre-right coalition gained the majority of votes (36%) but not enough to form a government, while the Partito Democratico, the most significant centre left party, which has led the country in the past five years, was heavily defeated, collecting just 18.7%.

While the consequences of the results are at present as unclear as the result itself, there is an inevitable air of concern among dealmakers.

Italian M&A has recently benefited from a combination of three factors: growth of liquidity from the Italian Central Bank; the system of investment incentives and reforms structured by the government over the last five years; and the renewed attractiveness of Italian business, Luca Masotti, founding partner at Masotti Berger Cassella, said.

In 2017, significant deals, for instance, included US-based fund Carlyle's [NASDAQ:CG] EUR 440m acquisition of sneakers manufacturer Golden Goose and of chocolatier Irca for EUR 520m.

Yet, the only scenario to likely provide a positive M&A environment would be a broad based government or coalition made up of moderate and progressive forces, which is however unlikely, according by several dealmakers polled by this news service.

At the time of writing, the eventual make-up of any coalition is far from clear and the President of the Republic may mandate a temporary government to vote a new electoral law, according to partner at DWF Italy, Tancredi Marino. Any such decision could delay investment bound for Italy as its economic improvement seen in recent months would be inevitably impacted, he said.

Protracted discussions to form a coalition would be expected to cool any interest international investors have for Italian securities and this, in turn, would weaken the country's IPO pipeline as well as M&A activity of listed Italian companies, Matteo Trapani, equity partner at NCTM said.

While a populist leaning outcome might end up being unavoidable, it would not bode well for dealmakers. But in such an event, M5S would be forced into choosing a coalition partner in order to govern, which would force the party to soften its hard stance regarding the economy, for example, a sector banker said.

Still, this may not be enough to prevent some investors opting to exit Italy, despite the 2016 introduction of piani individuali di risparmio (PIR), a tax savings programme aimed at investors in small and medium-sized companies, might limit the outflows, according to the sector banker.

Private vs public perspectives

Listed and large cap companies are more likely to feel the impact of results than that of private companies, Marco Celani and Silvio Pascali of Sequor Capital said.

A weak or inexperienced government would be less effective supporting Italian companies in the event of attempted foreign takeovers, the sector banker said reinforcing Celani and Pasquali's concerns. For instance, the outgoing government has been actively trying to limit the influence Vivendi [EPA:VIV] has over Telecom Italia [BIT: TIT], of which the French company owns 24%, he said. A newly formed coalition may not have the wherewithal or influence to control such cases.

Additionally, the political turmoil, together with macroeconomic issues and the revision of interest rates could impact valuations, in terms of capital costs on which businesses are valued. The recent trend of "normalising" valuation parameters has already been witnessed among some firms and is likely to continue going forward, Enrico Rovere, managing director at Duff & Phelps, said.

Optimistically, Rovere added the outcome is unlikely to affect M&A strategies and expansion plans of international and domestic investment of Italian companies, as these would be beyond contingent events such as the elections and would have accounted for a probable hung parliament or similar result.

The impact on dealmaking among private companies will be minimal, Celani and Pasquali said. Opportunities for foreign multinationals will remain high, especially among companies in the industrials and fashion sectors. A highly fragmented, but flexible and reactive fashion and textile market, might prove a continued source of opportunities for investors, especially after LVMH's [EPA: MC] EUR 2.6bn acquisition of Loro Piana being a possible signal of the beginning of a successful M&A season in the sector, they added.

The fabric of Italian industrial M&A has performed strongly in recent years, with key businesses attracting large flows of investments into the country, Rovere, said.

Italian M&A activity rose to EUR 55.7bn last year - its second highest level since 2007 - across 480 deals and a 28% increase in value compared to the same period a year earlier, as previously reported by this news service. Yet the full effect of the vote will be far reaching across a variety of asset classes and business decisions.

US and China greenfield investment into Italy has steadily reduced over recent years in favour of M&A, through which eases entry into the country, Rovere said. The strategy also helps bypass bureaucratic hurdles and could be used by would-be investors while the country remains in a state of leadership limbo, he added.

Elsewhere, privatisation processes, including the listing of government-owned railway network Ferrovie dello Stato, might be particularly affected by political instability, the banker said.

According to media reports, the IPO of Ferrovie's long-distance trains business flotation is planned to take place next year, but could become derailed as a consequence of radically changing political parties.

Were Italy to be subsequently considered a riskier market, small cap companies may also face an uphill struggle floating, the banker added.

For instance, Itema, which manufactures weaving machinery and is majority-owned by RadiciGroup, is expected to file its IPO prospectus with Consob, Italy's securities regulator, in the next month, according to media reports.

Stricter listing rules and criteria may be established whereby in a riskier environment, only the cream of the crop may be able to list, making the flow of IPOs potentially limited, the banker said.

Once a structure is eventually in place, a second banker offered some comfort by likening Italy's situation to that of Spain and Germany, which recently also experienced less-than-straightforward political disruption, but have managed to preserve investment. "Markets are resiliant and can adapt," he said. "Much as we have seen under votes electing Donald Trump to power or the UK's decision to leave the EU, the market has more or less managed to adapt."

by Valentina Caiazzo and Micaela Osella in Milan, and Giulia Lasagni and Francesca Ficai in London

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Grade: Confirmed

TARGET

Telecom Italia S.p.A.

BIDDERS

Vivendi SA

TARGET

Loro Piana S.p.a.

BIDDERS

LVMH Moet Hennessy Louis - Vuitton SE

TARGET

Ferrovie dello Stato Italiane SpA

TARGET

Itema

TARGET

Golden Goose SpA

BIDDERS

The Carlyle Group

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Irca S.p.A.

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