Italian election: uncertainty on the PE horizon

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Italy's general election has once again left the country with a challenging puzzle to solve, and the political parties could take weeks of negotiation and coalition-building to form a new government. Alessia Argentieri reports

While Italy is no stranger to inconclusive election results, the outcome of the general election on 4 March is particularly daunting for private equity, with a swell in anti-establishment, anti-immigration and anti-EU sentiments resulting in electoral success for populist parties. This could have deep and unpredictable consequences for an Italian economic recovery that has only recently kicked in and is timidly picking up pace.

The eurosceptic Five Star Movement (M5S), which champions a direct democracy system, has become the largest single party, winning around one third of the vote, while the far-right anti-immigration League secured just over 17%. More traditional parties, including the centre-left Democratic Party (PD) and ex-prime minister Silvio Berlusconi's Forza Italia performed poorly, taking only 19% and 14% of the vote respectively.

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Despite having stated the contrary in the run-up to the vote, M5S leader Luigi Di Maio has announced his party is willing to hold coalition talks, opening the door to a possible agreement with PD or the League. Whatever the outcome, a period of uncertainty is on the horizon, which could be challenging for the country's economic development and affect the private equity sector.

"A political scenario dominated by uncertainty and the lack of a government doesn't support investments and doesn't help to attract foreign capital into the country, which can be detrimental for the private equity industry," says Alessandro Marena, equity partner at law firm Pedersoli Studio Legale. "However, especially in the past two years, we have seen the sector thriving, with extremely high EBITDA multiples and increasing liquidity in the market. Therefore, the uncertain political outcome of the election shouldn't, in the coming months, have the effect of making Italy less attractive for foreign investors, nor should it paralyse the industry's dynamic development."

Cross-border appeal

Indeed, there were 65 deals in Italy in 2017, according to the *Unquote Annual Buyout Review* – a substantial increase compared to the 57 transactions recorded in the previous year. The three largest deals were all at or above 10x EBITDA. Many private equity firms investing in the country have hedged against potential political and economic uncertainties by targeting companies that make a substantial portion of their turnover outside Italy.

"The real interest for a GP is the target company more than the country itself," says Fabio Sattin, co-founding partner and president at Private Equity Partners, "especially when the business is able to export a large share of its sales, as we see for several Italian companies with a strong presence in international markets and overseas subsidiaries in Europe or the US. The international nature of these companies is an important factor, allowing them to disconnect from the local political and economic environment and its related issues, such as a low rate of GDP growth and a certain degree of political uncertainty."

The largest deals closed in 2017 involved companies with a strong focus on export and expansion in international markets. Irca, **acquired by Carlyle Group from Ardian**, posted a turnover of €250m, more than a quarter of which was generated outside Italy; Golden Goose, **sold by Ergon Capital to Carlyle Group**, recorded revenues of €100m, 60% of which came from international markets; and IP Cleaning, **sold by Ambienta to US-based Tennant**, recorded sales of about €190m, of which 90% were made abroad.

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Given this very strong international - and particularly European – approach by Italian businesses, a rise in eurosceptic sentiment and a drift towards an EU exit could have extremely serious consequences.

"More than temporary political uncertainty, what could actually discourage foreign investors and have drastic implications for the private equity sector would be an Italian exit from the EU," says Michele Semenzato, founding partner at Wise. "However, this remains extremely unlikely for a European stronghold such as Italy. Even the eurosceptic parties Five Star Movement and the League have toned down the rhetoric about this topic and seem to have revised their anti-EU views."

Private equity wish list

In the aftermath of the election, and while waiting for the new government to be formed, private equity investors and managers are also considering in which direction the lawmakers should move to provide a better environment for the industry and guarantee more attractive conditions for future investments.

The private equity industry has enjoyed favourable developments recently, with carried interest tax laws falling into line with most other European countries. But other items on the sector's wish list, such as increased buyout legislation transparency and laws encouraging pension funds and insurance companies to invest in the asset class, will have to wait until the political picture becomes clearer.