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"VALUE CREATION THROUGH M&A – THE CASE OF VECCHIA TOSCANA GROUP SPA"

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Firma dello studente

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INTRODUCTION

Nowadays, Italian and Europe market are characterized by the presence of Small and Medium Enterprise for the most part. The small size has been, and it is still today, for these regions a symbol of international performances and success. However, at the end of the century and the beginning of the new millennium, the globalization, Internet, and a stronger competition pushed the companies to transform themselves from small sizes family-owned, to large multinationals. Keeping fixed the principles of flexibility and adaptability to the market, the firms needed to increase their dimensions to remain competitive in a global environment, exploiting the productive and economic benefits. It is almost mandatory to pursue a growth strategy, especially for small and family run business, to contrast the competition since the business faces an international context, where each competitor, periodically, pursues improvement in its strategic market position. The two available alternatives are internal and external growth, such as the usual balance between make and buy.

The internal growth is realized with direct investments in new businesses or new segments. The external growth is performing aiding the resources and capabilities that are not internally developed by the company itself externally. Rather, these resources are obtained through the merger or acquisition or partnership with other companies.

Up to some years ago, M&A were considered as extraordinary operations. Nowadays, instead, they can be defined as a significant strategic tool to increase the sizes and the company value. M&A happens when one firm acquires another existing and working organization. The advantages related to the external growth are faster development, higher possibilities to get financing and the value achievable through synergies, efficiencies, fiscal benefits and new activities and projects thanks to the mixing of skills and knowledge. In the meantime, M&As involve many dangers, from the costs and time needed for the integration to cultural clashes. Generally, M&A is pursued when firms operate in highly competitive industries with a low growth rate. In this situation, M&A allows to increase the concentration of the market and decrease the excess production capacity.

This work will illustrate the process of M&A valuation with appropriate models, methods and parameters. Firstly, it is studied the M&A trends during the last years, the bidder and target motivations, the causes of failure and the difficulties for SMEs. Successively, it is specifically analysed the creation of value by an acquisition, starting from the valuation stand-alone of the

target, adding the synergies and the differential risks (stratification model) to achieve the acquisition value. This latter is the base for the quantification of the value created by M&A, given that from this value will be deducted the price paid, the integration and transaction costs, in order to achieve the Net Present Value of the acquisition.

The second part of the work will apply the principles, models and theories previously mentioned to a specific case study, the Vecchia Toscana Group S.p.A. The Italian company, one of the important in Tuscany in tanning leather industry, pursued a risky acquisition of a Turin tannery in liquidation. After a brief introduction about the tanning industry, the company, its products and its points of strength, will be evaluated GVT's ability to create value through its M&A long-term strategy. In the last paragraph of chapter five, ILCEA acquisition will be illustrated and analysed, studying how their sales and margins changed post-acquisition. This latter is challenged by the application of the fundamental analysis and the stratification model, above-mentioned.

In the end, the goal of this work is to answer the following question: "Does Vecchia Toscana Group S.p.A. create or destroy value with its long-term strategy of M&A?".

PART I –

MERGER AND ACQUISITION, ANALYSIS AND VALUE CREATION

The first part of the thesis proposes an initial study of Merger & Acquisition topic. Chapter 1 discusses the M&A Waves, as it pertains to the global trend and focuses on the Italian market, the acquisition process. It will also explore the motives to implement a M&A from the perspective of both buyers and sellers, and the reasons of failure. Chapter 2 analyzes value creation and the important topics of the valuation of created synergies, the measuring of risk and the calculation of value created. Then the focus will be on distressed M&A and acquisitions between Small and Medium Enterprises.

CHAPTER 1: MERGERS AND ACQUISITIONS

Mergers and acquisitions play an important role in the strategy of a company and provide plenty of opportunity for growth. M&A acts as a strategy for corporate restructuring and control change, in addition to external corporate expansion. The two terms are frequently used interchangeably in referring to any process by which two companies become one, although there is a difference in the economic implications by definition (DePamphilis, 2018). In a merger, two companies integrate their operations, management, stock and other business processes to form a ‘‘new’’ legal entity; however, in an acquisition, one company buys another one through an asset or a share deal. M&A can be classified depending on different parameters. The acquisition of a target can occur through a hostile takeover or a friendly takeover. In the former case, the target has no desire to be acquired and actively rejects the buyer, refusing to provide any confidential information. This situation is possible only in case of listed companies, as in the case of private companies the acquisition of shares is not feasible without mutual agreement. In the latter case, the target company is willing to be taken over.

A first classification among M&As is based on the relatedness of the business (Zotti, 2019):

- Horizontal M&As are transactions between two companies that offer the same or similar product lines and services to the final consumers. This means that it is in the same industry and at the same stage of production. In this case, companies are usually direct competitors and the acquisition can increase the market share, revenues, profits and can

reduce the competition. Moreover, due to the similarities of the business, it allows economies of scale and/or scope and encourages cost efficiency since the redundant and wasteful activities are removed from the operations and combined departments.

- Vertical M&As are combinations of companies in the same industry's supply chain of a final product or service, but that operate at a different level. These kinds of mergers are usually undertaken to secure the supply of essential goods and to avoid disruption of value in the supply chain, that could result in fewer types of final products or services. This is the typical approach used by producers of high-quality goods, for which the provenience of the raw material, the production process and the customer service must be controlled in each particular characteristic. Moreover, vertical mergers result in cost-saving, and a higher profit margin since the intermediary cost is eliminated and the competition is restricted in the upper and lower stages of the supply chain.

The advantages of these strategies are not always enough to induce family-run firms in the manufacturing industry to merge their facilities and their capabilities. Few people know the secrets of their product value, and they protect it, refusing to spread and share their know-how. Nevertheless, in some cases, the compensation is so great that it overshadows the desire for preservation and the sense of ownership for the product.

- Concentric M&As are mergers between firms that serve the same customer targets in a particular industry, but their offered products and services are different. They are products that may be compliments or products which go together, but technically they are not the same product. This strategy could help the company to diversify the business, without change, and then reach a new customer target. The advantage is that the selling of the first product will also encourage the sale of the other. In addition, the companies usually have the production processes, business markets and the primary technology in common, so then they can reduce costs. This kind of merger offers the opportunity to enter new markets and provide access to new resources not available otherwise.
- A conglomerate is a merger between companies that are involved in totally unrelated business activities, in a completely different industry, regardless of the stage of production. This is usually done to diversify into other sectors, which helps reduce risks. There are two types of conglomerate mergers: pure and mixed. Pure conglomerate mergers involve firms with nothing in common, while mixed conglomerate mergers involve firms that are looking for product extensions or market extensions.

- A market-extension merger takes place between two companies that trade the same products but in separate markets. The main purpose of the market extension merger is to make sure that the merging companies can get access to bigger or more challenging markets. Thereby, a product-extension merger takes place between two business organizations that trade products related to each other and in the same market. The product extension merger allows the merging companies to group their products and get access to a more significant set of consumers.

The last strategies are hard to implement for small and medium enterprises in the manufacturing sector because the capital needed to achieve the target is typically excessively high. In most cases, the results of these kinds of investments are visible in the long term, and the risk that the small firms can incur and potentially not overcome during difficulties is very high.

A second classification considers the type of buyer (Clark, 2013):

- Financial M&As are the objects of venture capital funds, private equity funds or a particular company, that conclude deals and acquisitions to gain a premium when they will sell the target. For these kinds of firms, acquisitions and disposals are their principal business, and their main objective is to optimize the working capital and the capital structure, making the company as efficient as possible with the aim to generate cash. The financial buyer does not look for the realization of synergies, but their main goal is to identify private companies with attractive future growth opportunities and realize a return on their investment with the next sale. A financial buyer does not have an interest in operating in the market, and then, it does not care about the integration of the business. In contrast, it is involved in meeting the right industry, size of company and phase along the target life-cycle, to capture the opportunity of the stand-alone entity to be an efficient investment and generate cash.
- A strategic buyer is interested in a strategic fit with the target, to integrate it and produce incremental long-term shareholder value, to a sustainable growth strategy. This is a difficult topic to analyze because the amount of the different variables between company combinations make a deal unique, and several possible reasons can lead a company to the decision to implement a strategic M&A. The buyer can decide to implement an M&A for different reasons. Some of most common can derive from competitive purposes, for example, the possibility to acquire strategic or critical assets (such as R&D and expertise), or technologies (patents and superior product offering); or from potential entering in a new market and creation of synergies. These kinds of buyers are

interested in evaluating how the targets or the business units will fit with the acquiring company and have the focus on the synergies and the integration capabilities.

Thereafter, in Chapter 4.2.1. and 4.2.2., the analysis of the contribution that these different situations can deliver in terms of creation of value is evaluated focus on the sector case study.

1.1. M&A waves

Over the years, M&A activities faced different flows. Merger waves common peculiarity is that all occurred when an industry shock. The reason an industry experiences shock can be due to high economic growth, quite always matched with a period of a low or declining interest rate and decreasing cost of capital. Otherwise, the M&A period can be the consequence of a phase of a rising stock market. It can be classified into six different waves. (Harford, 2010):

- Horizontal Consolidation (1897 - 1904): driven by efficiency, lack of enforcement of antitrust laws and technological changes. This effect was seen in the concentration of metals, transportation and mining industries, with the consequent creation of many monopolies. The end of the period occurred due to a stock market crash.
- Increasing Concentration (1961 - 1929): driven by the economic changes due to the entry of the US in WWI and by the post-war boom. The period ended with the 1929 stock market crash.
- Conglomerate Era (1965 – 1969): characterized by the buying of earnings streams to improve share price, that results in the acquisition of undervalued high growth firms. The higher target purchase price and increasing leverage caused the end of the era.
- Retrenchment Era (1981- 1989): involved strategic multinational buyers in the first half of the decade, and financial buyers in the second half. The end is marked by the bankruptcy of several LBOs.
- Strategic Megamerger (1992 – 2000): marked by a record volume of transactions each year and the consolidation within many industries, thanks to the technological innovation and gentile antitrust policies. The collapse in global stock markets and the worldwide recession sealed the end of the period.

- Cross Border and Horizontal Megamergers (2003 – 2007): driven by globalization needs, low-interest rates and increasing equity prices. The end is connected to the 2008-2009 recession.

Nowadays, M&A is a common strategy to reach foreign markets, products, distribution channels or sensible assets. The interest of financial buyers in acquisitions is increasing all over the world and their curiosity for SMEs is improving (Reuters 2019). Figure 1.1. shows the Global M&A volume and the deal count.

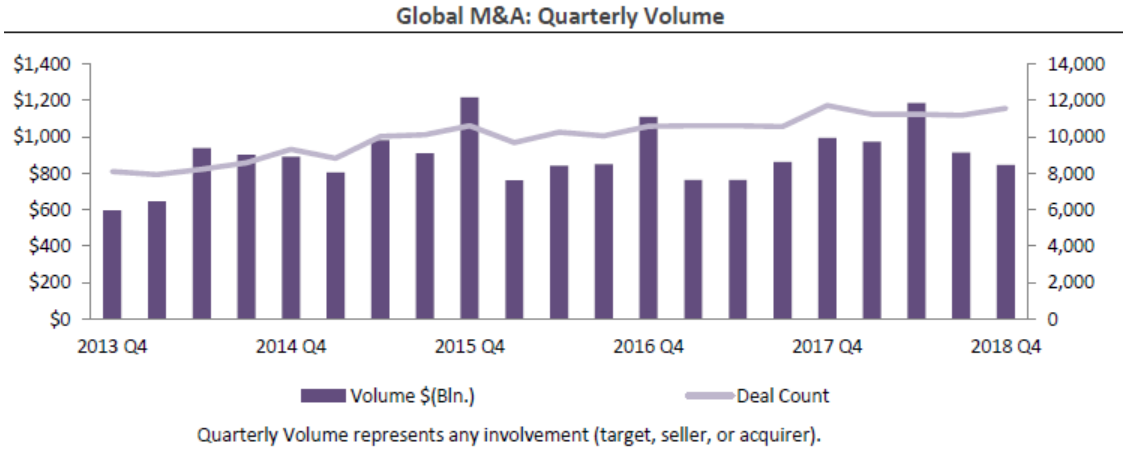

Figure 1: M&A value and number in the last five years (Bloomberg L.P.,2018)

In 2018, the value of M&A in global terms amounted for US$ 3.53tn, 11.5% ahead of 2017 (MergerMarket,2018). Figure 1.1. shows that the principal amount of market share in global M&As is held by the USA, where the M&A value accounts for US$ 1.5tn. Europe falls into the second position with an M&A value of US$ 989.2 billion. The third area is Asia, with US$ 717.4 billion.

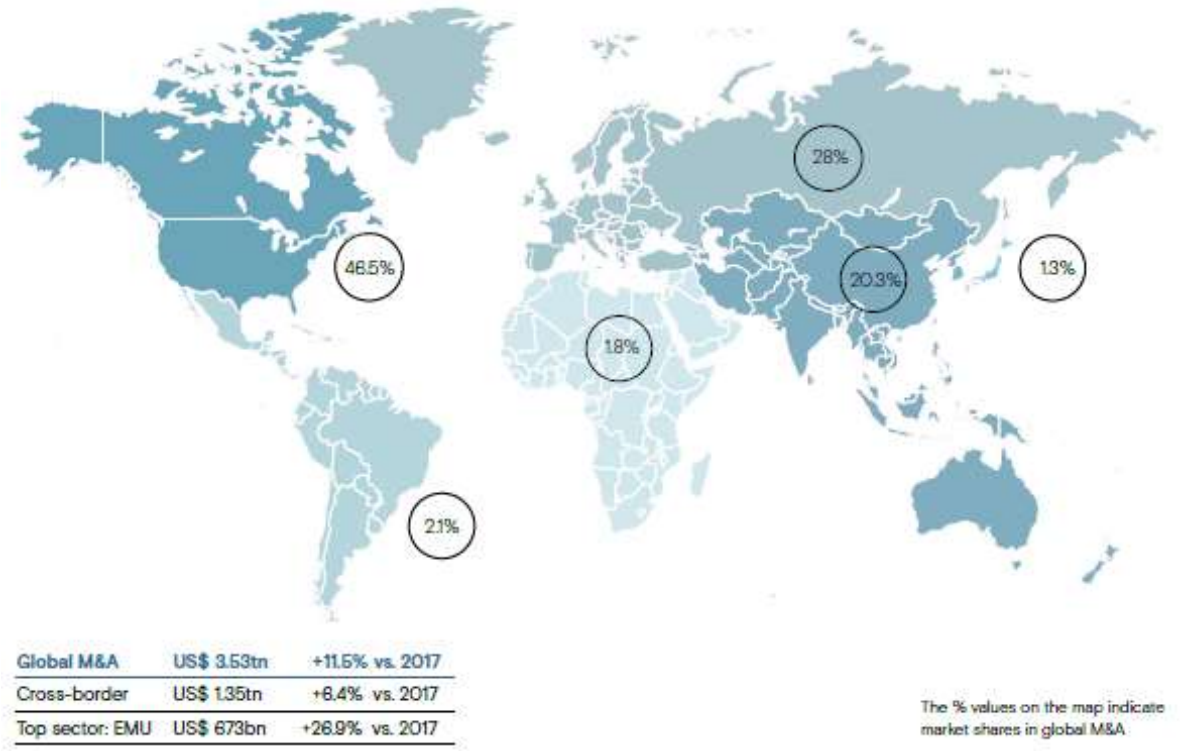

Figure 2_Global Overview, Regional M&A comparison (Mergermarket,2018)

1.2.M&A activity in Italy

After a substantial stagnation in the most acute period of the crisis, from 2013, but especially from 2014, M&A operations have become increasingly important in Italy (Scannavini, 2019).

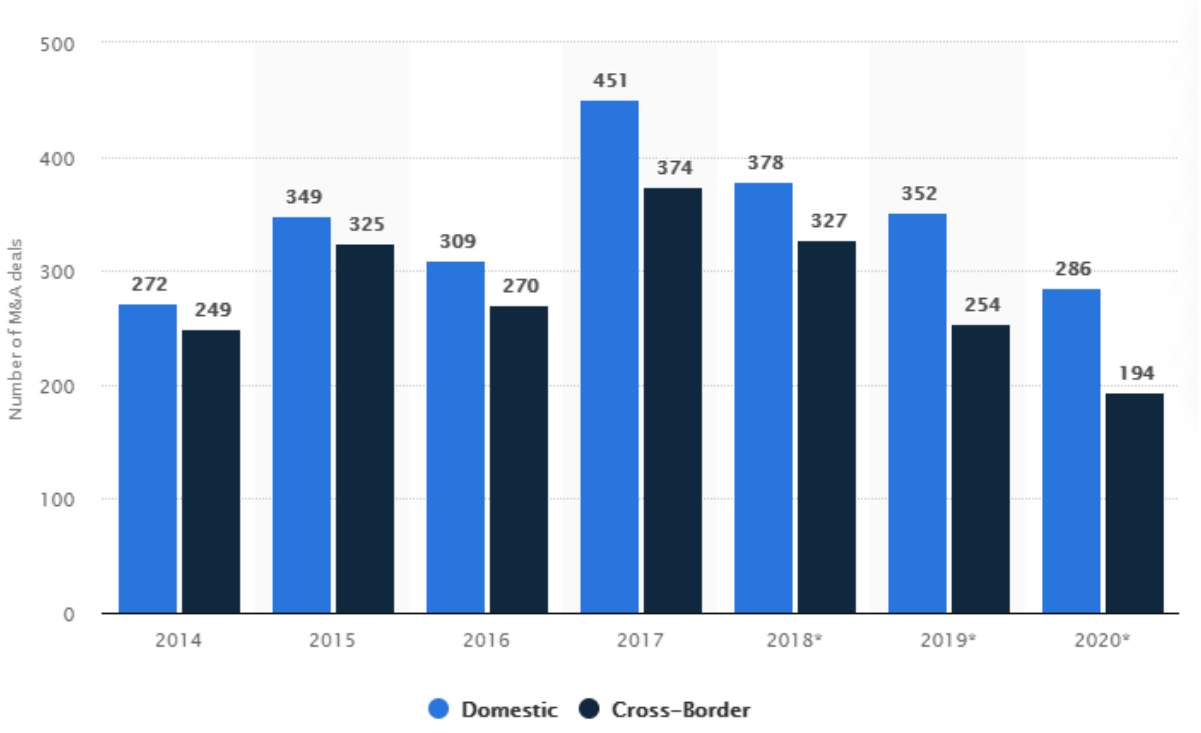

Figure 3_Number of M&A transaction in Italy 2014-2020 (Statista,2018)

Figure 1.3 and Figure 1.4 show the M&A activity in the Italian territory in 2014-2017 adding a forecast until 2020, based on the M&A announcements (Statista,2018).

The data expresses a discrepancy with the forecasted one. In fact, there were just 268 M&A deals announced in Italy in the first half of 2019, recording a 53.8% drop (Mergermarket, 2019). The trend is reflected in most European countries which have registered depressed M&A figures this year; for example, macro concerns around Brexit have compromised UK M&A volumes. However, the dealmakers believe that investors are now familiar with Italy's political state and can be optimistic about pockets of activity in the second half of 2019. In terms of value the Italy M&A markets represent 3.3% of GDP, differing with the Global M&A market, that represents 4.3% of global GDP (KPMG and Borsa Italiana,2019). Italian companies still make limited use of M&A

1.3. M&A process

M&A process is developed in different steps, each of them, are important in the creation of value (DePamphilis, 2018). Especially in SMEs, the complexity of the decision-making process during all phases of the transaction requires the support of professional figures. Often, the management does not have the capability to evaluate the best choice or practice. The skills of expert advisors are needed from the pre-transaction evaluation to the post-integration step. Following, the phases of the process are reported and discussed (Zotti, 2019).

- Strategic Planning and Organization – The acquisition process starts before the effective transaction. In this phase, the future acquiring firm and the advisor perform a business diagnosis, evaluating the financial performance, the underlying technology and the internal capabilities. Successively, they evaluate and discuss, focusing on SWOT analysis, the possible alternatives and define the strategic objectives. With clear goals, the planning and organization of all the aspects of the transaction are drafted, and a definition of target screening criteria is listed. This phase presents a series of obstacles that will be discussed in chapter 1.6.1.
- Target Scouting and Screening – First, a list of possible target candidates are assembled, using a variety of databases, industry experts and industry participants. In this research, SMEs can have problems with large scale database access or to gather information. In contrast, small firm owners have the advantage to be actively present in the industry and in the firm activities. Then, they can capture essential insights and information from sales forces, clients or suppliers. After a first list, the screening criteria are applied to

identify the best strategic fit. A first in-depth analysis and confidential meetings are organized with the best candidates to determine the final target.

- Negotiation and Deal Structure – Different valuation techniques are used to evaluate the acquisition price and the value of the combined entity, based on the information provided by the target. The deal structure is developed, and the potential source of capital is evaluated. With a letter of intent, the companies secure a period of exclusivity and the negotiations of each detail start.
- Target Company Due Diligence – Advisors and professional figures accomplish financial, legal, commercial and operational due diligence and draft the purchase agreement. Due diligence is the activity that gives consent to the buyer to achieve information through access to the target data room. This phase is complicated. Professionals and owners must collaborate to try to evaluate all the aspects of the target. Sometimes, the target is not willing to disclose all the useful information, and firms that are not familiar with M&A transactions can be negligent in some fundamental factors. This theme is also discussed in Chapter 1.6.1.
- Transaction Closing – In this phase, after a long negotiation about the closing terms and conditions, the party's sign the agreement. The closing includes the payment of the purchase price, the transfer of the shares and the appointment of new directors and auditors.
- Post-merger integration –This phase is crucial, but frequently undervalued. The implementation of the post-merger integration allows the implementation of a shared strategic vision and capture the value created from the synergies. It is essential to define actions and roles to integrate the two entities and ensure a smooth and speedy process. In Chapter 1.5, a lot of mistakes carried out in this phase will be discussed.

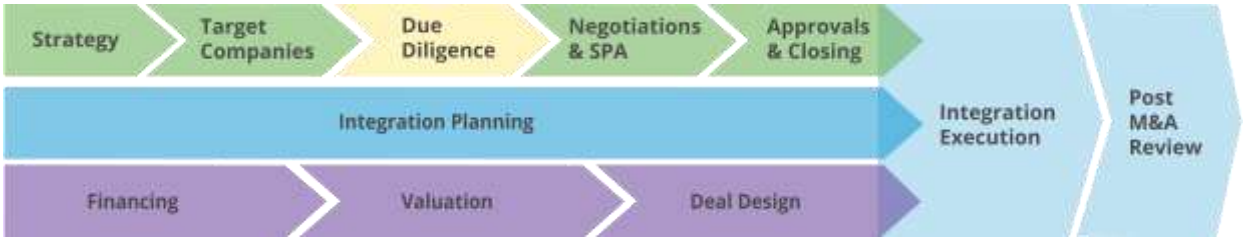

Figure 4_M&A Process (imaa institute, 2019)

Figure 1.4 expresses how an efficient process includes planning at every step. The strategy must be the guide of the transaction and the structure of each stage must be implemented to achieve the planning goals and create value.

1.4. Motives of failures

Despite the high and increasing amount of M&A transactions, many combinations generate negative synergies and cash flows. The failure rate in 2017 is between 70 and 90 per cent of the total M&A deals (Clayton M. Christensen, 2011). Corporate finance literature implies the unsuccessfulness of acquisition to the planning and strategic aspect, managerial and evaluation mistakes, integration problems and cultural and human aspect. The gap, between the theoretical valuation and the practical situation, results in complicated implications. The graph 1.5 shows the major causes of M&A failure.

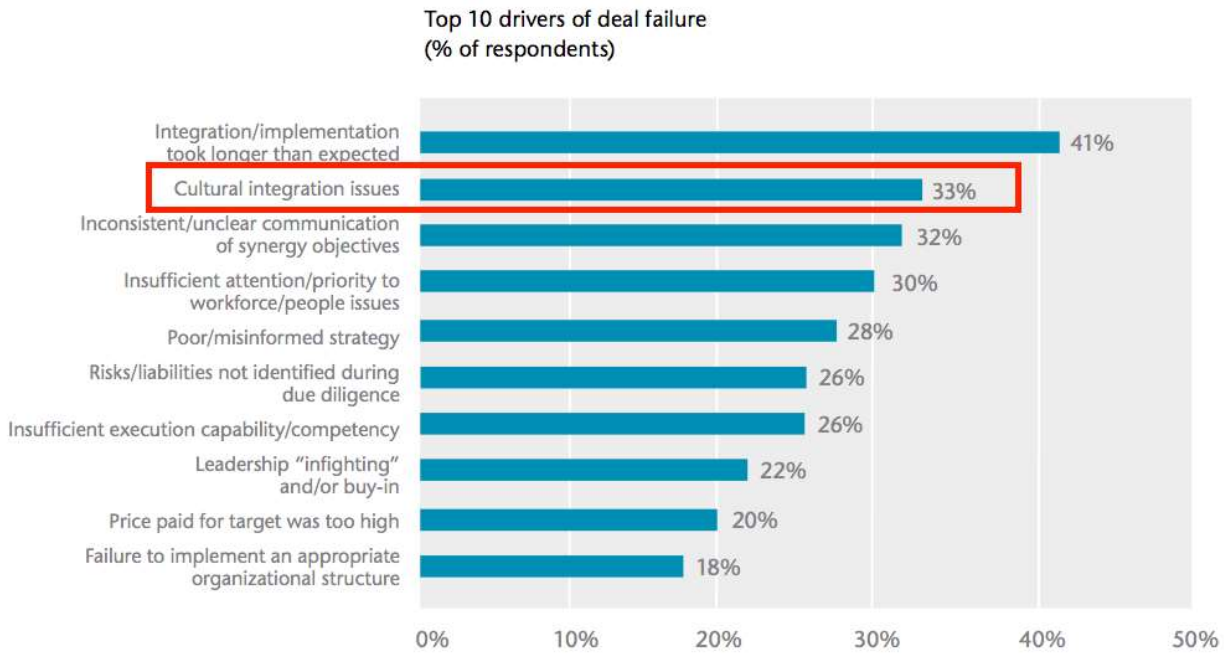

Figure 5_The overlooked reason behind poor M&A results (Xquardant,2019)

Integration problems represent the first common reason for failure. These indicate merging entities on paper is often far easier than combining the operations, culture and personnel. The probability of incurring difficulties decreases if there is a clear plan regarding this critical post-transaction phase (Koi-akrofi 2016).

- Integration/implementation took longer than expected – As discussed in the previous chapter, the transaction is pursued by M&A advisors and professionals. Once the deal is concluded, professional figures leave the company to its ownership and management. Leadership management can bring delays to the implementation of the integration strategy. Difficulties can arise from the non-participation of the owners to the acquisition process, the lack of communication from the higher-ups to middle

management or to the absence of involvement of middle management and employees in the process. The participation of such figures can accelerate the integration process.

- Failure to implement an appropriate organizational structure – The integration must include all functional groups and areas, with the opportune communication and clearness. The lack of opportune communication and clearness among the company, can hinder the achievement of a proper organization in the combined entity, In contrast, the new entity cannot be efficient and able to generate enough earnings, destroying value.

Other reasons that can raise the probability of failure are linked to the managers' decisions and capabilities. Frequently managers are overconfident in their capabilities to extract synergies from the combined firm, while they are unfamiliar with the fundamentals of the acquisition strategy. Sometimes, the expectation the directors will contain a lack of experience and competence to face a process so complicated. This hubris often results in various valuation problems:

- Risk/liabilities not identified during due diligence - Sometimes, due diligence is treated more as a necessary formality rather than a chance to learn about the financial functioning, the ownership and the structural situation of the target. Mistakes in evaluating risk and liabilities may be caused by the undervaluation of the importance of each kind of due diligence. Especially in SMEs, since it is very costly, the owners, failing to recognize the relevance of DD, prefer to conduct an elementary assessment. Often, the assumptions that are made turn out to be shallow or false. Due diligence is one of the most critical processes in the acquisition of a target, and it must be comprehensive.
- The price paid to target was too high - Frequently, the impetus to close the deal quickly pulls the company to accept a high price. Moreover, evaluation errors can result in an overvaluation of future synergies. When the acquisition premium is high, the potential for value generation decreases. The overpayment results in an impossibility to carry on the business due to its colossal undertaken expenditure.
- Insufficient execution capability/competencies - When external factors create obstacles in the success of the deal, the directors can not have the capability to contrast the difficulty. The lack of adequate competences can lead to a poor choice. In terms of time management, for example, the execution capabilities are essential for the success of the deal. Both the moment in which the target is acquired and the spreading of time in the negotiation phase of the target, influence the closing and the transaction conditions.

- Leadership "infighting" – When two entities are merged, the role structure will change. In some circumstances, mainly if an SME acquires another SME, the leaders remain active in the business, since their presence is a value-added to the entity. The decision-making process can be different between the previous owners and the new ones, resulting in conflicts and division in the leadership, and a consequent difficulty to carry on the strategy (Timothy J.Galpin, 2014).

Most deals fail since the companies do not recognize the M&A as a change strategy. The management and the shareholders usually focus their attention on the returns that the merger creates, leaving aside the real aim for which the M&A makes sense (Werner Rehm, January, 2012). Basing the focal point in the short-term profit, the transaction could not sustain a long-term creation of value, and then it would fail (Price Water House Cooper, 2019). Planning and strategic deficiencies can result in:

- Inconsistent/unclear communication of synergies objectives - The creation of value in a disorganized and weak communication entity is challenging to develop. Otherwise, the lack of clearness and the adequate communication of synergy objectives produces mistrust toward the firm.
- Poor/misinformed strategy - The most popular error is to design a plan only for the mere deal procedure, without taking into account the linked pre and post phases. Frequently, this fallacy culminates in an erroneous selection of the target company, that can not be the best reasonable option for the acquiring company. Another consequence is the market cannibalization. It happens when two companies offer practically the same product or service. The new entity will face redundancy or competition and therefore needs to repackage its offer to avoid a drop in sales.

M&A transactions generate changes in organizational values, structures and roles. The changes in the organizational structure, in role and responsibilities, can end up in dissatisfaction of personnel and generate resistances. Consequently, the business does not run efficiently how it should (Keys, 1993). Resistance can derive from:

- Cultural integration issues – Often, the norms and values of the acquiring firm differ significantly from that of the company being acquired. It is also difficult to combine two of them or substitute one of them with the other. Many times, the acquisition generates problems like resentment and distrust by the acquired firm's employees, actual efforts at sabotaging operations post-acquisition and talent flight (Lester and Lipinksi 2015).

- Insufficient attention priority to workforces/people issues - The protection and development of know-how and intellectual property is a vital goal of an M&A, as much as to prevent the loss of key people. These figures guide the success of the merger, especially in SMEs or in business in which innovation and newfound development are an important success factor to compete.

The lack of attention in cultural and human issues causes the loss of human talent. Employees and management want to leave the company after the merger because they feel disoriented and unfitted with the culture and attitudes of the new combined entity. It is possible to reduce the problem through a "people plan", with which the company can schedule activities for better managing the cultural integration at every level (Mendenhall 2005).

1.5.Motives of M&A

Firms have a variety of reasons to pursue an acquisition strategy. The choice of an acquisition strategy is subordinated to the goal that the firm wants to achieve. Secondly, the company must evaluate the best strategy between internal or external growth. The M&A is valuable when the internal growth implementation is too expensive or not feasible when the resources needed are difficult to achieve with internal development or when an alliance is convenient (Motis 2007).

1.5.1 From the buyer's perspective

From a strategic buyer's perspective, the reasons to implement an M&A can be various (DePamphilis, Mergers, Acquisitions and Corporate Restructuring 2018):

- Synergies – The realization of synergies is the primary motive. Synergy is when two factors combine and become an entity that is worth more than the sum of the two parts. In an acquisition, this means that the corporate combination is more profitable than the sum of the two combined companies' stand-alone values (Halpern 1982). In theory, the result is that the combined firm has created more value than the two firms could have independently of each other, or to put it another way, 2+2=5 (Mintzberg 1989). The identification and evaluation of synergies have relevant importance in various stages of the acquisition process. The selection of the target is first driven by the goal of choosing where the best fit will be achieved, considering the future integration phase. Moreover, identifying the synergies is important to settle the acquisition price. Different types of synergies can arise:
    - Operating synergies emerge from the increase of the production capacity through the acquisition of target workforce and facilities. They also emerge

from the enhancement of operational efficiency and the expertise of human resources.

- Cost synergies produce incremental gains as a result of the reduction of costs. They can arise from economies of scale, economies of scope or complementary strengths (O'Sullivan & Sheffrin, 2003). The first is the result of the spreading of fixed costs in a higher amount of input, translating into lower fixed costs per unit. Economies of scope increase when the businesses share centralized functions or when they form interrelationships at other points in the business process or value chain (Economist, 2008). Complementary strengths appear combining different relative strong points of the firm that allow them to be more competitive (Rehm, Uhlaner, and West 2012).
- Financial synergies are a benefit due to the reduction of the cost of capital with a consequent reduction of risk. The decrease in WACC can derive from an expansion of debt capacity, and, then a reduction of cost of debt. Other financial synergies can derive from the reduction of cash flow variability or from an improvement in bank market access (Zenner 2009).
- Revenue synergies arise when additional revenues are achieved as a result of external growth (Chartier et al. 2018). Three dimensions exist among a company which can produce the most effective and direct way to capture revenue synergies: where to sell, what to sell (offering) and how to sell (go to the market).
    - ‘Where to sell’ is comprehensive for causes such as taking each company’s products and selling them to new or existing customers, launching them in new geographic markets, or selling them through additional channels. An additional source of revenue growth is the cross-selling, which means action or practice of selling another product or service to an existing customer (Harding, 2002).
    - ‘What to sell’ dimension includes causes such as the creation of new bundles and solutions, the change in the features of the products, and the development of new offerings or new products. The synergy can also arise from a rebranding position or brand extensions, due to the acquisition of a strong brand target.
    - ‘How to sell’ involves the sources of synergies relative to distributional and commercial capabilities. For example, the acquisition of an essential

target for increasing distribution channels or an extremely strong salesforce.

Figure 1.4. Resume the opportunity for revenues synergies in a graph

Figure 6_Three dimension for revenue synergies (McKinsey,2018)

- Acquire strategical/critical assets – Critical assets that cannot be internally produced, can be achieved with the acquisition of a target that already owns them, both tangible and intangible. The opportunity to obtain resources with an acquisition deal, in some cases, is more convenient in terms of capability, time, know-how and costs (Motis 2007). This scenario is typical when the asset needed is too expensive or impossible to produce for lack of resources. The acquisition of the target is worthwhile when the asset is sensitive and rare, suitable only with professional knowledge and experiences. Considering the craftsmanship sector, such knowledge is usually intrinsic in one or few people and it is protected by them.
- Market access - The M&A is also interesting for firms that want to enter a new geographical market or segment. Some markets have cultural entry barriers, for which the difficulty to enter is high for a foreign company, and they are better off with acquiring a domestic company already accepted and known among the customers. An

acquisition can be an opportunity to achieve an already existing distribution network that can facilitate the expansion of the business in a new market or customer target.

- Diversification – Firms can consider the acquisition of a target that produces different or similar products that are oriented to a different target or geographical area. It allows securing a higher stability in earnings, increasing debt capacity and an increased value of the company. In the world of business, subsequent studies have shown that from the perspective of large enterprises, those that are somewhat diversified in products and services, sectors, or geographical regions are likely to outperform those with a narrow focus (Grant, 1988). Small and medium businesses can have higher-risk exposure than large firms. For instance, SMEs often maintain significant exposure to a single major client or offer just one product or service line, even if a business has a broad customer base (Corner 2015). An example is the Italian luxury industry which tends to be characterized by having just a few large firms at the top of the supply chain with considerable market power.
- Vertical integration – Vertical integration allows control of the whole or a part of the value chain. This is common in sensitive goods businesses, where the production secrets make a significant part of the product value and the opportunity to supervise it constitute a higher competitive advantage. For example, in luxury goods, the famous brands required traceability and transparency of the whole production process, from the acquisition of the raw material, for quality and socio-cultural requisites. In this sense, vertical integration can be a winning strategy.
- Eliminate/reduce competition – When acquiring direct competitors, the market penetration of a company in its sector increases. Consequently, the market power, which also includes price decisions, reinforces both competitors and along the value chain. Moreover, the elimination of excess capacity renders the entry of new competitors more painful and expensive. In a high fragmented industry, this phenomenon is less effective, since the market share does not increase enough with the acquisition, due to the presence of a lot of companies.

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1.5.2. From the seller's perspective

In a friendly takeover, the transaction will not occur if any of the two parties don't agree. M&A deals are structured with a win-win logic and the seller must be willing to be acquired. A firm has a variety of motives for which is agreeable to be undertaken (DePamphilis, 2018).

- High offer –An apparent reason to sell a business is related to the high premium that the owner will obtain. The most popular motive for which shareholders sell for an economic return is the belief that the business has reached the highest profitable point. SMEs' owners, usually, are attracted by the possibility of high remuneration, considering that their profit margin is limited with the ordinary running of the proper business.
- Financing problem – Firms can incur financial problems during the run of the business and are not able to reimburse the debt. The owners may still believe that the idea is profitable, and the right financial provisions can move forward and grow. Especially for small entities, it is difficult to find funding. A solution can be selling ownership to obtain the correct financial provision and leadership. Generally, if a company has a problem with debt, it can be challenging to achieve a shares deal. In this case, it is preferable to have an asset deal initially to reimburse the debt with the cash paid. In this scenario, a principal role is represented by financial buyers, such as an equity fund.
- Generational transaction problem –Family managed firms, at any moment of their cycle, can face the possibility that the remaining family does not want to manage the firm (JG Longenecker, 2013). This alternative is also contemplated in case that the next generation is too young, not able, or not interested in running the family business.
- Market exit – When there is an expectation of a difficult time for the future of the industry or the business, a feasible strategy can be selling business units or the whole target.

1.6. SMEs M&A activity

In the European context, SMEs are thought to represent about 99% of all firms, employing overall about 65 million people, and driving innovation and competition. At a global level, SMEs may even be responsible for anywhere between 40% to 50% of the world GDP (Commission, 2005). Figure 1.5. illustrates the activity and number of SMEs. The considerable presence of small and medium enterprises in the European territory made the M&A activity very important among small realities. The craftsmanship value of that business turns out to be very important for strategic acquisitions, both to expand the control among the value chain, or to achieve strategic skills and knowledge. In the last few years, financial buyers were also attracted to small but growing businesses.

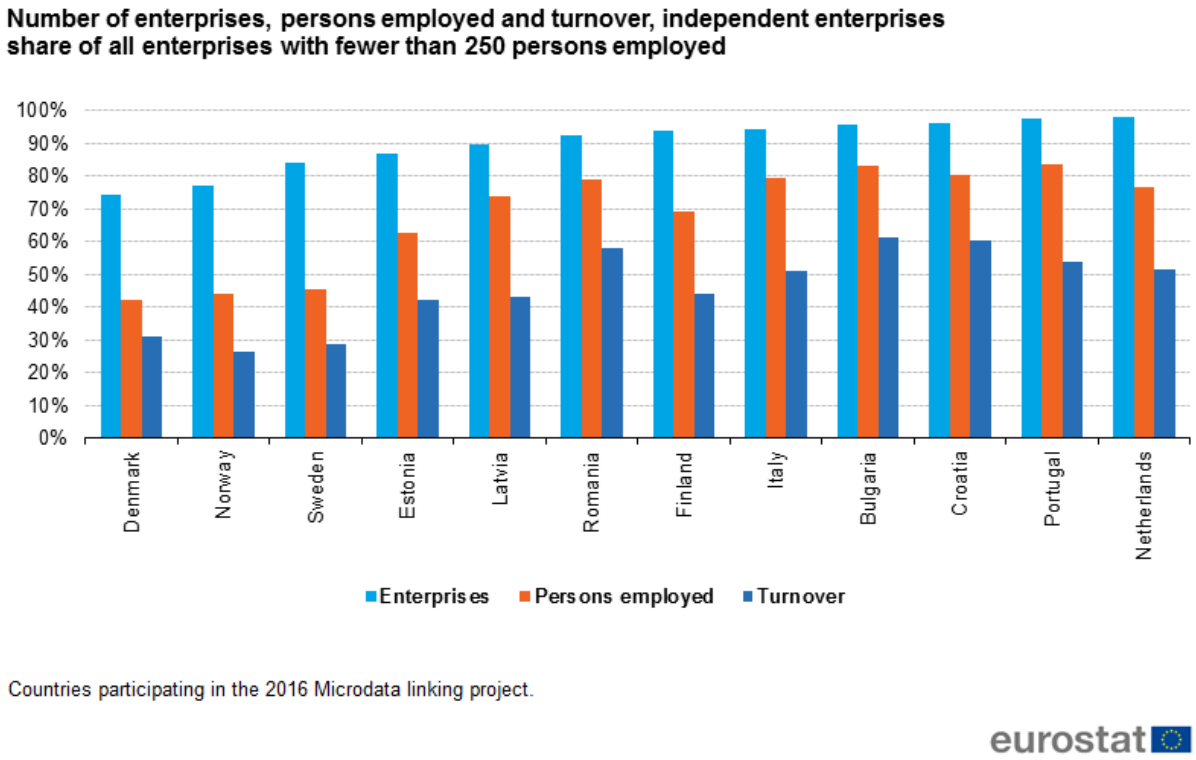


Figure 8_ SMEs Analysis in Europe Area (eurostat,2016)

Italian competitiveness depends on the presence of a majority of SMEs, mostly family-managed. Eighty per cent of Italian firms recognize the importance of M&A transactions in the creation of value and growth opportunities; 43% are ready to make a deal and already have a target list (BorsaItaliana, 2019). SMEs have several valid reasons for pursuing acquisitions.

The most cited drivers of acquisition activity include overcoming entry barriers, reduced risk, the potential for a bargain, and mainly the acquiring SME's knowledge base that can immensely increase the value of the company (Steve Mariotti, 2015). An acquiring SME can immediately increase sales, market share, and market power by horizontally acquiring another SME in the same industry niche (Education et al. 2004).

Several difficulties faced by a small firm to interpret an M&A process are as follows:

- Financial Resources – The main obstacle is the availability of financial resources. Often, SMEs generate a low-profit margin that does not allow them to make further investments. Internal cash reserves remain the preferred source of capital for SMEs but, because of their unique features, the relative costs and benefits of using debt and equity will differ (Weitzel and McCarthy 2011). Often, the deal is too large to be financed with internal cash/retained earnings. In contrast, cash in SME transactions will more likely come from external debt sources; this is a relatively costly option.

- Too expensive deal - Smaller companies tend to be less transparent than larger companies, and this creates difficulties for banks or buyers and raises costs. SMEs are unlikely to have the necessary liquid resources to cover the cost of each acquisition process step.
- High risk – SMEs or family managed businesses, often, have low market power, due to the high fragmented level of the business or to client market power, the business performance is uncertain and subordinated to others' decisions. In this scenario, the risk to produce an incorrect forecast of cash flow generation is concrete (Business and Bank 2015). In consequence, the threat of not being able to reimburse the debt increases. Acquisitions between SMEs are also risky in terms of integration, later in the paper, this topic will be discussed.
- Lack of skills – Owners of SMEs are almost always in charge of the managing of the business. The knowledge of the product and process is high, but managerial skills are not sufficient to pursue an M&A transaction or to understand what decision is the right one during it (Lester and Lipinksi 2015). Moreover, they could not be able to implement and to advance with a structured and efficient integration plan, failing in the objective of long term perspective of M&A.
- Fear to lose control – SMEs leadership often includes the founder or his family that runs the business from the foundation until the current days, and they made it grow. The commitment is stronger than in a big firm; the entrepreneur sees its firm as a personal creation.

To family-run firms, the choice to implement an M&A transaction is challenging and risky. Moreover, a focal point is the human capital and their specific knowledge. The SMEs usually maintain the same structure and people for a long time, and the relationship is also more intimate between the different roles. The integration of this firm structure with a large buyer's firm, whether both strategic or financial, can result in inclusivity obstacles or in negative attitudes of the employees as described in the previous chapter.

CHAPTER 2 : VALUE CREATION IN PRIVATE MARKET

Research shows that the most crucial error, that the companies carry out, is to concentrate their attention on short-term results and benefits. In doing this they don't consider the creation of the newly merged entity as a sort of change in the long-term environment, to pursue a sustainable competitive advantage in the future (Werner Rehm, January, 2012). Executives have even become willing to undertake high-risk strategies to accelerate the growth and achieve returns, but in most cases, a desperate strive for growth does not bring to value creation. The focus of acquisitions may be to contribute value to its strategy, facilitating a sustainable competitive position. A strategic acquisition does not aim to improve the company's operating performance in the short term focusing on the returns but instead, it has a goal to secure a competitive edge and enhance the company's value.

2.1. Value creation framework

Acquisitions create value when the cash flows of the combined companies are higher than they would have otherwise been (Koller, 2015). The cash flows can increase for different causes and due to different strategies, as previously discussed. The concept of strategic fit focuses on potential synergies. When operations are merged, companies achieve synergies as they become more efficient and effective than they were as separate entities (Lubatkin, 1983). The value of synergies is calculated as the difference in the value of the newly merged entity created after the acquisition and the sum of the acquiring company and the target. If the amount is positive, the combination has created value (DePamphilis, Mergers, Acquisitions and Corporate Restructuring 2018).

$$NPV\ of\ Synergies = V_{A+B} - (V_A + V_B)$$

As soon as the transaction is accomplished, the transfer of knowledge and the reconfiguration and realignment of structures and processes create value by generating new business opportunities (Margaret Cording, 2008). Due to the multiple purposes of an M&A and the different characteristics of the deal, the executives must determine what the most appropriate valuation method is. The critical point is the realistic determination of the target and the synergy's values. For this reason, there are a variety of techniques used in business valuation, with different methods more suitable in different conditions. In this study, the valuation is elaborate with the stratification model, based on the Discounted Cash Flow method (DCF). This method is useful both for a pre-merger assessment of the target, and in post-merger valuation

to examine if the acquisition is destroying or creating value. Moreover, it allows an understanding of the drivers for value creation.

2.2. Stratification Method

In M&A, the value created in a transaction is given by the difference between the expected discounted cash flows of the target after the acquisition and the price paid for it (Massari 1998):

$$NPV_{acq} = W_{acq} - P - C_t - C_i$$

Where W_{acq} defines the present value of future cash flows, and it will be examined thereafter in the chapter. The other components of the formula are briefly discussed as follows:

- *P = Price* The acquisition price is very important for the success of the transaction. Without considering private and non-monetary benefits, it is an amount higher than the stand-alone value of the acquired target and smaller than the stand-alone value plus the synergies created (Massari 1998). An acquirer can pay an acquisition premium. An acquisition premium might be paid to close a deal and ward off competition if the acquirer believes that the synergy created from the merger or acquisition will be greater than the total cost of acquiring the target (Hayes 2019). Acquisition premiums are recorded as goodwill that can include the company's brand name, solid customer base, good customer relations, good employee relations and any patents or proprietary technology acquired from the target company. An acquirer can purchase a target company for a discount, meaning for less than its fair market value. When this occurs, negative goodwill is recognized.
- C_t = *Cost of the transaction* – costs associated with an acquisition can be divided into three buckets (Nicklas 2018):
    - Direct costs of the transaction, which may include due diligence services, accountants, attorneys, investment bankers, advisory fees, etc.
    - Financing costs or debt issuance costs, which may need to be segregated from direct transaction costs, since these costs are "deferred" or netted against the proceeds of the debt liability and amortized over the term of the debt. They include the cost to issue debt that is included in the opening balance sheet.
    - Equity or stock issuance costs related to fees paid to obtain new capital by issuing stock that is classified as permanent equity. Stock issuance costs should

be considered a reduction of the associated proceeds and recorded net with the amount received in equity.

- C_i = *Cost of integration* – they are related to every activity needed to realize the success of the investment. These costs include expenses, charges, and losses directly related to the M&A. They are challenging to understand and calculate, and they vary from transaction to transaction. Transaction costs can include costs for contracts and lease terminations, facility closings or reorganizations and other directly related to the restructuring of the new entity (such as employee retention costs, employee relocation costs, moving and relocation costs of files, equipment, inventory and others, information system integration).

In indirect calculation, the acquisition value is calculated as follow:

$$Wacq = W_{A+B} - W_A$$

Where W_{A+B} represents the value of the combined entity and W_A indicates the stand-alone value of the acquirer.

Indirect methods, the variables of the acquisition value are broken down:

$$Wacq = W_B + W_r + W_s + W_{op}$$

Where:

W_B = Stand-alone value of the target

W_s = Value of the synergies

W_r = Variation of the value of the risk spread

W_{op} = Value of new opportunity

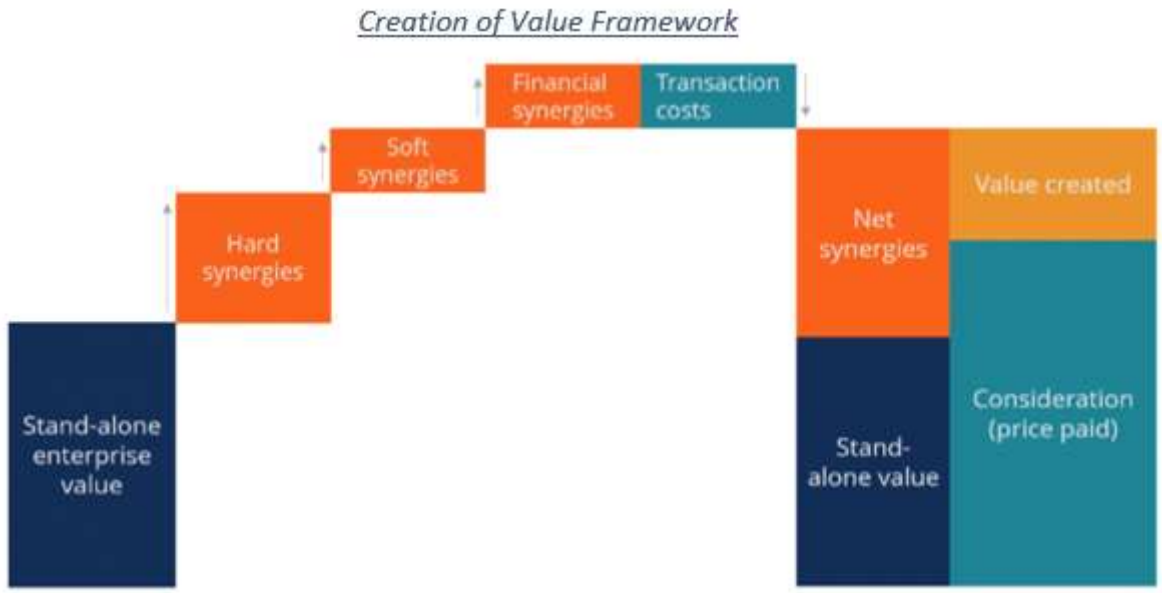


Figure 9_Creation of value (Sully Weaver, 2019)

2.2.1. Stand-alone Value

The most used valuation methods in practice are essentially two: the method of DCF and the market multiples method (Mariani 2017). The latter method idea is to assume that peers with similar characteristics should have the same value as the observed company or transaction to be valued. The sample of comparable companies needs to be built based on peers with similar characteristics as the observed company. These similar characteristics comprise the business sector (such as products, geographies, customers), the size of the company, then market capitalization, sales, assets; the positioning of the company in terms of margins, growth, capital expenditures; and the capital structure, such as debt level or credit rating. This method requires some caveats. It necessitates careful research to find other firms comparable to the target company, it could be difficult to analyze the effect of financing changes, and it may also ignore the time value of money.

2.2.1.1. DCF method

The DCF method is based on the budgeting theory. It attempts to determine the value of the company by computing the present value of cash flows over the life of the company.

$$\sum PV \text{ of } FCF \text{ in forecast period}$$
$$+ PV \text{ of Continuing Value}$$

Value of operating assets
$$+ \text{Estimated Value of non-operating assets}$$

Value of firm (V)
$$- \text{value of debt}$$

Shareholder Value (E)

Whereas the other methods, this method based on three key valuation components: cash flow, long term growth, risk (Zotti 2019). Following the figure resume the calculation of FCF.

+ Sales
- cash operating expenses (no financing expenses)
- non-cash charges (e.g., depreciation)
= EBIT or pre-tax operating income
- Adjusted Taxes
= NOPLAT (Net Operating Profit Less Adjusted Taxes)
+ non-cash charges
= Operating Cash Flow (not operating *free* cash flow)
- Fixed Capital Investment (I.e., capex)
- Required Working Capital Investment

= FCF (Free Cash Flow)

The long-term perspective converts in the present value of the entire future stream of cash flows discounted at the WACC. The WACC considers the risk taken into account the expected value of cash flows and through the opportunity cost of capital. The net present value of discounted cash flows is calculated as follow:

$$PV = \sum Op\ FCF_t / (1 + WACC)^t$$

The continuing value also depends on the growth rate of the market (g). And it is calculated as Gordon's formula shows:

$$CV = FCFn * (1 + g) / (WACC – g)$$

The weighted average cost of capital (WACC) is the average rate of return a company expects to compensate all its different investors. Following a short recap of WACC formulas:

$$WACC = D/V * k_d * (1-T) + E/V * k_e$$

Where:

D: Debt

E: Equity

K_d: Cost of Debt

T: Tax rate

K_e: Cost of equity ⟹ $Ke = Rf + CRP + \beta*(Rm-Rf)$

Rf: Risk-free rate
CRP: Country Risk Premium
β: Beta equity
Rm: Market risk

he cost of equity Ke is determined by estimating the expected return on the market portfolio, adjusted for the risk of the company being valued. The capital asset pricing model (CAMP) is used to estimate the risk adjustment factors using the beta, which measures how a company's stock price responds to movements in the overall market. Since the calculation of beta is difficult and imprecise, a set of peer company betas is utilized. In the analysis of the case study, in chapter 6 this value will be discussed.

2.2.2. Value of synergies

Synergies valuation is difficult and risky because the management overestimates them by giving the illusion of value creation. The value of financial synergies is determined by taking the difference in enterprise values of both firms separately and combined. The value of synergies can be obtained directly and indirectly. With the indirect perspective, it is possible to quantify the total amount of synergies values considering the difference between the value of the combined firms and the sum of the two separate firms:

$$NPV\ of\ Synergies = V_{A+B} - (V_A + V_B)$$

Considering the incremental cash flows induced from external growth operations. These incremental cash flows can be simply identified as the cash flows of the combined firms less the sum of the cash flows of the separate firms:

$$\Delta CF\ (Synergies) = CF_{A+B} - (CF_A + CF_B)$$

In the direct perspective, it is possible to evaluate each type of synergies separately. For each kind of synergy, there are different assumptions to consider new information during the process. Moreover, each firm involved in the merger is valued independently, with discounting cash flows and the appropriate discount rate for each firm. The general form of the valuation model that is proposed can be presented as follows:

$$NPV\ (total\ synergies) = PV\ (costsyn) + PV\ (revenuesyn) + PV\ (growthsyn) + PV(taxsyn) + PV(borrowincapacitysyn) + PV(discratesyn) - PV\ (CostIntegration)$$

The value of synergies can be derived as an actual mean of distribution of NPV outcomes:

$$Value\ of\ synergies = Average\ [Max\ (PV\ (synergies) - PV\ (Integration\ costs)].$$

In the synergy's valuation process must considered requirement investment need to capture them and adverse effects arising from potential conflicts in the combined entity (Mariani 2017).

2.2.3. Value of risk spread

The transaction produces changes in the risk profile of the combined company, due to the different financial structure, the geographical business area and the other variables that influence WACC (Massari 1998). The risk structure of the company modifies in terms of market risk, economic risk and financial risk (Mariani 2017). Regarding market risk, the acquisition can affect the sales variability of the entity. If the revenues cyclicity is reduced, the Beta decreases, reducing the total risk. Regarding the economic risk, the principal aim is to reduce the break-even-point, with a reduction of fixed costs. Any reduction in financial risk has a positive impact on K_d and K_e and a lower WACC in the discounting process.

2.2.4. Value of new opportunity

In an acquisition, the valuation must consider some additional opportunities that the transaction could open in the future (Mariani 2017). Real options are those that exist on the strategic level and are different from stand-alone ones. The literature stays that in the long run the success of the acquisition is determined by the options required, created or developed and the action taken for the optimal exercise of these options. They are challenging to hypnotize in value and timing.

2.3. Empirical results

Despite a broad empirical literature on the determinants as well as the economic performance of mergers and acquisitions, the focus of the research is on the larger M&A events, and precious little attention is devoted to the question of small and medium-sized enterprises. This neglect of M&A studies may be traced back to the fact that most empirical studies rely on stock market-based measures. As such information is not available for many SMEs, the performance of M&As is almost exclusively analyzed for large M&As. Probably the most prominent reason for this is because most SMEs are not publicly quoted. It makes it difficult to obtain reliable data on their general activity, let alone to evaluate their M&A performance records (Weitzel 2011). The volume of acquisitions involving privately-held targets far surpasses that of publicly-traded firms (ME 2004), but purchases of private firms remain mostly unexplored. Regarding the valuation, the DCF method is the most commonly used valuation method, but this requires that the financial information be normalized first. Overall, five significant challenges are often encountered concerning the valuation of SMEs (Kroes 2015) :

- Less reliance is placed on historical financial statements. Financial information is limited and uncertain, due to the lack of accounting obligations
- SMEs have limited access to capital markets
- The company's shares are often illiquid
- There is a strong dependence on the owner
- There may be risks impacting the company's value, such as non-diversification, among others

Due to the above considerations, although the principles are the same, the valuation of an SME is often more difficult than the valuation of a publicly traded or larger company.

A big opportunity for SMEs to expand its business and increase its market share, with a limited cost, is a distressed company acquisition. It permits to reach assets and facilities that SMEs usually could never acquire with their availability (Canada 2016). The empirical literature dedicates many studies on the valuation of distressed M&A and target. The acquisition of a distressed company is more challenging for the acquiring company, because it may be difficult or impossible to turn around a failing business. For example, the purchaser may be exposed to successor liability or fraudulent conveyance claims. In such a situation, a small or medium firm cannot have the capability and the force to overcome some difficulties (Karol, Buying a

Distressed Business: A Winning Strategy 2018). In chapter 2.4.3. the topic will be treated in depth. Moreover, the study needs to focus attention on the next considerations.

2.3.1. Transaction among private companies

The principles of valuing private companies are similar to those of valuing public companies. However, there are estimation problems that are unique to private companies (Zotti, 2019). Private transactions experience an illiquid market and, due to their lower visibility and higher control over their own information, are less known to the public. The public information available is limited, due to the lack of reports in terms of performance and accounting. In contrast, acquirers can better appropriate the value of private information on private targets because of reduced bidder competition and lower dissemination of private information associated with acquisitions of private targets. Lower bidder competition decreases the control premium paid to the target and increases the acquirer's ability to appropriate the value of its private information (Jarrell, Brickley, and Netter 1988). Since acquirers incur higher search costs when buying a private firm, they can extract more benefits in terms of abnormal returns, from their private information on private targets. Another significant obstacle is the difficulty of estimating risk parameters for discount rates. Actually, they cannot raise money from the public market and must resort to debt financing, venture capital, or other private forms of funding. Moreover, private target asset values are highly uncertain. If the seller cannot send to the buyer a credible signal that enables the buyer to distinguish high-quality private firms from low-quality ones, it creates a risk of adverse selection, which often leads to fewer transactions (Litalien et al. 2009).

Due to the previous consideration, some assumption in the calculation of the ratios and rates are needed (Damodaran 2018a).

- Cost of debt the assumption is that the private firm can borrow at the same rate as similar firms (in terms of size) in the industry.

  Cost of Debt for Private firm = Cost of Debt for similar firms in the industry

  If the debt on the books of the company is long term and recent, the cost of debt can be calculated using the interest expense and the debt outstanding.

  Cost of Debt for Private firm = Interest Expense / Outstanding Debt

- To estimate Beta it is necessary to collect a group of publicly traded comparable firms, preferably in the same line of business, but more generally, affected by the same

economic forces that affect the firm being valued. The estimation of beta develops in more steps:

- Estimate the average beta for the publicly traded comparable firms, estimate the average market value debt-equity ratio of these comparable firms.
- Calculate the unlevered beta for the business.

$$\beta unlevered = \beta levered / (1 + (1 - tax\ rate)\ (Debt/Equity))$$

- Estimate a debt-equity ratio for the private firm, estimating the optimal debt ratio for the private firm, based upon its operating income and cost of capital.

$$\beta private\ firm = \beta unlevered\ (1 + (1 - tax\ rate)\ (Optimal\ Debt/Equity)$$

- Estimate a cost of equity-based upon this beta.

Buyers of private firms earn superior returns because they are able to exploit the higher information asymmetry and uncertainty associated with buying private targets (Capron and Shen 2005). Studies find that private firms are purchased at an average of 18% on book multiples, or 20-30% of earnings multiples and 20% of cash flow multiples discount compared to equivalent public firms (Koeplin, Sarin, and Shapiro 2000). Finance scholars have named this phenomenon: "private firm discount". Because the acquirer is able to buy private firms at a substantial discount relative to public firms, the shareholders of the acquiring firm benefit from a more advantageous split of the value among the merging firms.

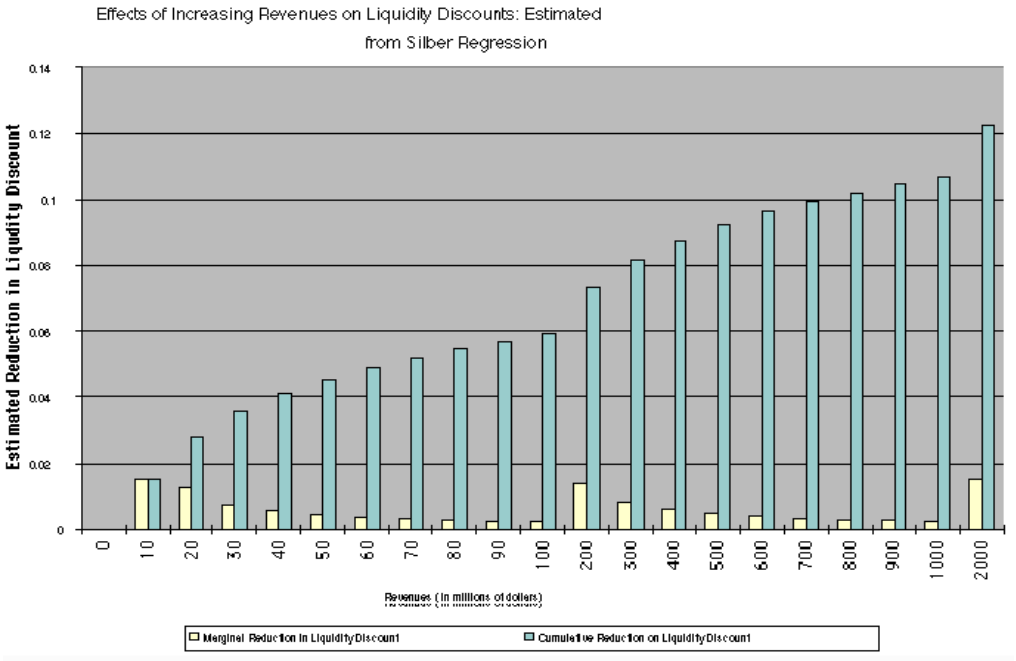


Figure 10_ Liquidity Discounts estimation (Siber, 2018)

Further, private targets are typically sold through negotiations based on voluntary exchanges. Private firm managers usually have greater autonomy in decision making. The personal motivations of the owner-managers of private firms are of particular importance in the sell-off decision, such as cultural fit or employee welfare (Graebner and Eisenhardt 2004).

2.4. Family M&A

It is a well-documented fact that strategic decisions of family firms are not motivated by financial considerations only, but to a large extent by non-financial factors summarized under the concept of socioemotional wealth (SEW) (Miller e Breton-Miller 2014). SEW expresses itself in the form of the emotional and non-financial value attached by family members. It fulfils affective needs of the family, such as preserving the family dynasty, values and family identity as well as the ability to exercise control. Even though diversified firms tend to be low return and low-risk firms, family firms tend to be less diversified than non-family firms because of their need to preserve control (Michael Carney 2015). Aiming at protecting their SEW, family firms are loss averse, which is an often stressed reason for family firms' reluctance to engage in risky activities.

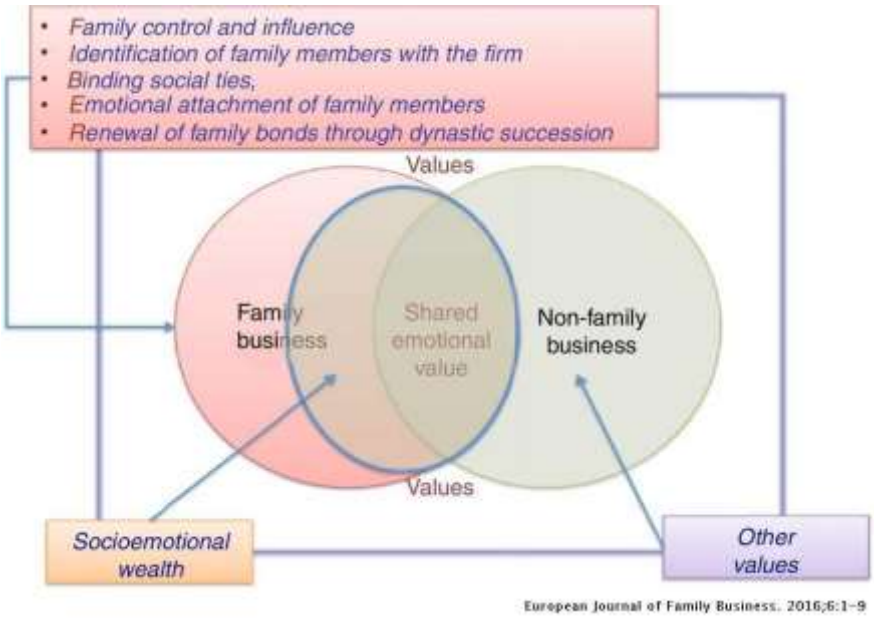


Figure 11_ Family Value (European Journal of Family Business, 2016)

In M&A theory, one reason for failure is the existence of informational and agency problems between management and owners. For family-managed firms, the value-destroying approach will not apply because there is often no separation of ownership and control (Weitzel and

McCarthy 2011). As a consequence, the exclusion of agency problems increases the likelihood of a successful M&A. Of course, the issues of self-overvaluation coming from the acquired firm or "hubris" of owners remain as potential sources of value-destruction as previously seated (Miller e Breton-Miller 2014).

Estimation of cost of equity for family firms is more complicated than for non-family firms due to the deep connection between the family and the firm. The family's total return is more than just a financial return on equity. Family firms require an emotional return in addition to financial performance when considering selling the business, and this may positively or negatively influence the value of the firm (Hasso and Duncan 2013).

$$Total\ Return = f\ (\ Financial\ Return + Emotional\ Return)$$

Emotional value is supposed to be affected by the achievements and efforts of the entrepreneur subjectively considered as unpriced or not sufficiently priced by the market.

If we consider this argument within a cost of capital framework, there are additional consequences (Zellweger 2006):

- Family firms display loss aversion regarding investment decisions associated with control risk. The cost of capital is higher, as profitable investment projects are not followed to avoid control risk.
- Family investors have tied a large amount of their fortune to their firms. Their investment is often undiversified. The undiversified investment is riskier than a diversified one.
- The market for corporate control, even in the case of publicly quoted family firms, is less liquid. The cost of capital increases, as the illiquidity of the asset, reduces its value.
- Agency costs are lower in family firms than non-family firms, decreasing the risk.
- The longer time horizon of family firms reduces annualized normal risk of an investment and cost of capital.

Taking into consideration the previous points in the case of acquisition, the cost of equity formula can be adjusted as follow:

$$Ke = Rf + CRP + \beta^{*}(Rm - Rf)^{*}\mathbf{(\ 1 + IP\ )(\ 1 - FE\ )}$$

Where:

IP: Illiquid premium

FE: Family effect

The closer the IP gets to 0, the more the market is liquid, and the closer to 1, the more the market is illiquid. FE nearer to 0, means the family members are not involved in the business, the contrary is true the closer the number gets to 1 if the family members are involved in the business.

2.5. Distressed M&A

A financially distressed business may appear to be an attractive M&A opportunity. (Karol, Buying a Distressed Business: A Winning Strategy 2018). The most attractive reason to buy a distressed business is the depressed price.

The target situation can be the consequence of a lot of motives and mistakes, and the goal of a buyer is to understand why the company is currently in a trouble situation and to be sure to be able to turn it around (Novikoff et al. 2010). Careful due diligence is critical in connection with distressed businesses, the study of its historical background is costly, both in terms of time and people involved in the process. Among other things, the likelihood of limited or complete lack of resources, once the business has been bought, makes the due diligence and the knowledge of specific topics even more fundamental. Of course, in a transaction with a distressed company, time is one of the most critical issues. Indeed, the situation can change and deteriorate in a short time in these business conditions. Then, it is important to have a full team engaged in it, to get all the required information quickly. Buyers need to be sure that they have what it takes to achieve this. It is essential to be realistic about risk and calculate how to limit the downside, to consider how to run the business differently and what additional resources are already existing.

The value of a distressed company is difficult to ascertain and depends on the high risk derived from the above considerations. Due to the lack of all the information in such troubled situations, the value associated with a distressed company is uncertain.

Consequently, the model should be reformulated in order to take into account explicitly the increasing role of the costs associated with default, which are weighted by the probability of default (Moyer, Martin, and Martin 2012).

$$Equity\ Value = Enterprise\ Value - Total\ Face\ Value\ Debt - Bankruptcy\ Cost$$

When firms are pushed into bankruptcy, the proceeds received on a distress sale are usually much lower than the value of the firm as a going concern. Conventional valuation models understate the impact of distress on value, by either ignoring the likelihood of distress or by

using ad hoc adjustments for distress. Valuation models have to be adapted to incorporate the effect of distress. There are more methods to add the likelihood of distress in the valuation model. In this thesis, will be treated the calculation of distress values of the firm as a going concern.

2.5.1. DCF Valuation + Distress Value

This calculation is used if there is a significant likelihood of the firm failing and if the assets will then be sold for a value less than the present value of the expected cash flows (Damodaran 2018b).

Value of Equity = DCF value of equity (1 - Probability of distress) + Distress sale value of equity (Probability of distress)

When firms are pushed into bankruptcy, the proceeds received on a distress sale are usually much lower than the value of the firm as a going concern. Conventional valuation models understate the impact of distress on value; they either ignore the likelihood of distress or use ad hoc adjustments for distress. Valuation models have to be adapted to incorporate the effect of distress. There are more methods to add the likelihood of distress in the valuation model. In this thesis, the calculation of distress values of the firm will be treated as a going concern.

2.5.2. Modified DCF Valuation

If the probability distribution of distress is predictable, it is possible to estimate the expected cash flow in each period (Damodaran 2019). This expected cashflow should reflect the likelihood of default. In conjunction with these cashflow estimates, the discount rates must be estimated using bottom-up betas and updated debt to equity ratios to estimate the cost of equity and using updated measures of the default risk of the firm. If the estimation of the entire distribution is not possible, it is useful to estimate the probability of distress in each period and use as the expected cashflow:

$$Expected\ cashflow_t = Cash\ flow * (1 - Probability\ of\ distress)$$

2.6. Blueprint for value-creating acquisitions

The implementation of an M&A strategy and the management of the deal execution is fundamental. In this way, research proves that deals made with both a definite strategic plan and an established execution blueprint, are much more likely to create value than an opportunistic one (Rehm, Uhlaner, and West 2012). M&A success depends on several factors:

- A clear blueprint for bringing strategic goals into deal-sourcing discussion is essential in order to study the market trends, determine if the target is the best strategic fit and finally if the success of the deal is real. First and foremost, the strategic aim must be focused on long-term returns, and not on accreditation or dilution of earnings in the short term. Focusing on accounting measures is, therefore, dangerous and can lead to poor strategic decisions. Empirical analysis evidence that the strategic rationale for an acquisition that creates value typically fits one of the following archetypes (Koller, 2015):
    - Improving the performance of the target company, improving its margins and cash flows. Private-equity firms pursue this strategy.
    - Consolidating to remove or reduce excess capacity from an industry constitutes another successful strategic goal, that consents the company to acquire market power. Lower excess capacity in the industry decreases the threat of new entrants and the market power of clients or suppliers.
    - Creating market access for the target's or buyer's products or services, as previously explained, represents an important aim to acquire a target, especially in a market with cultural entry boundaries.
    - Acquiring skills or technologies more quickly or at a lower cost than could be built in-house. The importance of intangible assets or new technological developments in some industries is essential to maintain or increase their competitive position and value.
    - Exploiting a business's industry-specific scalability or picking winners early and helping them develop their business.

  In conclusion, the acquisition rational must have a tangible and specific goal, and not the vague growth concept.
- A designed, clear and comprehensive plan helps the companies to focalize their attention in a long-term vision despite short-term results. The company should give greater importance to the creation of value from the start and focus on all planning activities on this principle. The planning activities must be in contemporaneity with the due diligence activities to best fit the measures with the resources. From the choice of the target, since the post-acquisition activities, the full plan must be well structured and clear. This helps the manager to make better decisions and the other staff members understand critical issues and implement them at best.

- The importance of human capital must not be undervalued. In each phase of the transaction, the human capital must be a focal point to consider, both for not losing essential skills and know-how and to create a positive environment. This topic is fundamental to talent engagement and to concentrate the attention on key people and critical roles. Especially in IT or manufacturing business, the knowledge or the experiences of key people is essential for the company performance. Achieving knowledge from acquiring a target can incredibly move up the competitive position of the company and create immense value.
- Right planning of integration activities, since the due diligence phase. With integration activities planned, the company can also prevent the resilience between the employees, that is common, especially in small firms. The manager and professionals dealing with the transaction activities must have clear if the integration between the entities is feasible or not. Otherwise, moving on with the deal could lead only to huge expenses and poor results.

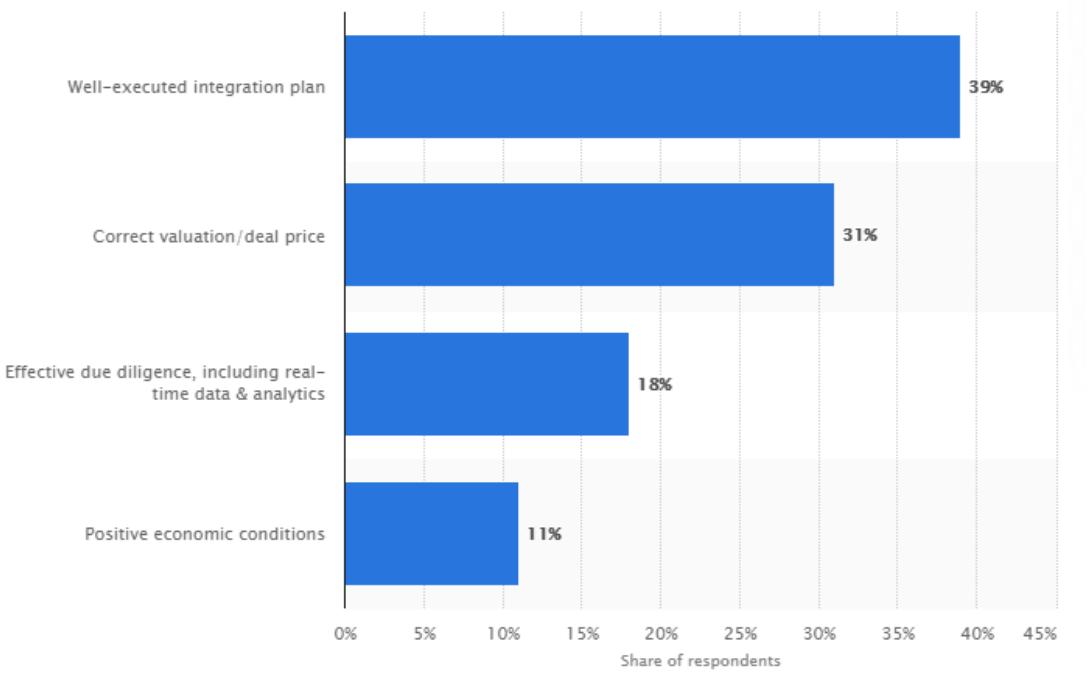


Figure 12_Key drivers for a successful M&A (Statista,2018)

PART II –
'Vecchia Toscana Group S.p.A.' Case

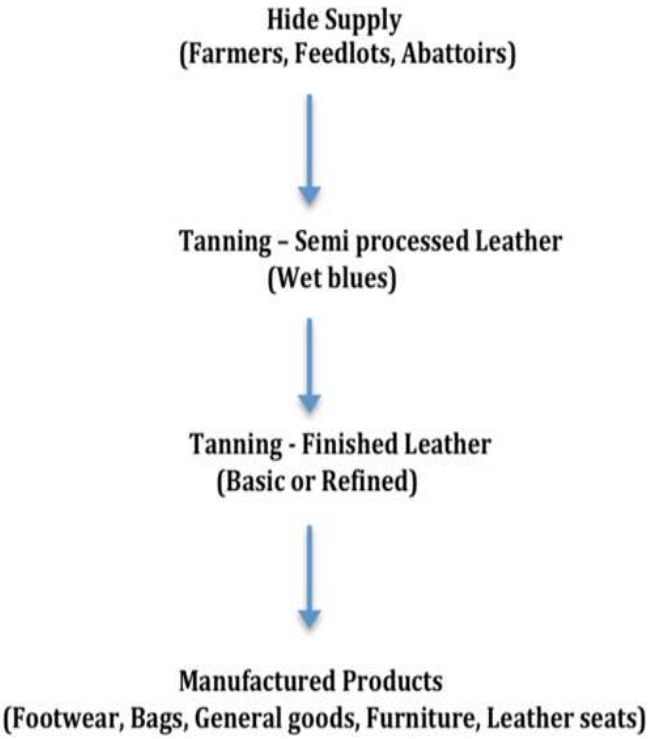
In this section, the thesis analyses the specific M&A case of 'Vecchia Toscana Group S.p.A.', an Italian firm, operating in the tanning sector. Chapter 3 summarizes, in a brief, the tanning industry analysis as a whole, to focalize the attention in the 'Santa Croce Sull'Arno' district, the Tuscan area where the tannery is situated. Paragraphs 3.2. analyses the market trend, also in terms of different qualities and price ranges, and the changes in the geographical segmentation. Paragraph 3.3. treats about the Tuscan district characteristics and end-use market, analysing M&A movements during the years, with some interesting cases. In chapter 4, after a brief firm history, the focus shifts to the actual company performances, with the application of DCF methods and stratification model to evaluate 'Vecchia Toscana' enterprise value. Chapter 5 is dedicated to the deal structure and details, assess the ILCEA enterprise value, considering its distressed situation. To evaluate the target, the Scenario Discounted Cash Flow is used, using Adjusted Present Value, considering the troubled context. After that, the stratification model, synergies and valuation as well as assumptions, forecasting and cost of capital will be the core of Chapter 6

CHAPTER 3: TANNING INDUSTRY

The leather tanning industry is an ancient manufacturing sector producing a broad range of goods such as leather for footwear, bags, garments, and so on. Leather is natural and renewable, and the tanning process is the high value-added recovery of an activity that is fundamental for human food needs. Every year in the world, the tanning industry, as a whole, recovers approximately 1,700 square kilometres of raw hides and skins in total (UNIC 2018). Tanning is the process of treating skins and hides of animals to produce leather. The final product is the result of a process that transforms the raw material, that can be of bovine, caprine or ovine origin, in crude form or semi-fabricated form. The leather produced can be destined to fashion goods manufacturers, such as footwear, bags and clothing; to upholstered furniture, to produce sofas, armchairs and furnishing accessories; and car interiors, for example, seats, steering wheels and dashboards. To deepen in the competitors' scenario of Vecchia Toscana Group S.p.A. it is useful to understand the global Italian and Santa Croce district context.

3.1. Brief introduction of the industry

The tanning industry is present all over the world. The tanning business is a B2B market, that supplies rawhide materials to transform them and sell the tanned product to the manufacturing firms. Often, the clients are important luxury brands, and the production depends on their requirements.



The process produces loads of wastes of many types, and the costs to environmental protection are very high. For analysis purposes, it is necessary to underline that, even if the production of tanned leather is present all over the world, it is difficult to have a homogeneous view of the industry. In some countries, especially in the east, the production is not regulated, and therefore the costs of production are lower. Furthermore, some data are difficult to verify.

Leather is a 'living product' (Gliozzi 2019), deriving from organic material from different animals. The manufacturing nature tends to focus the attention in the production process inputs, both transforming and transformed. The choice of raw material and the knowledge of the process is essential for the differentiation in terms of quality and customer target.

3.2. Values and Volumes

The global tanning sector counts 50 thousand firms, with more than one million employees and business of 150 billion dollars (Lineapelle 2019).

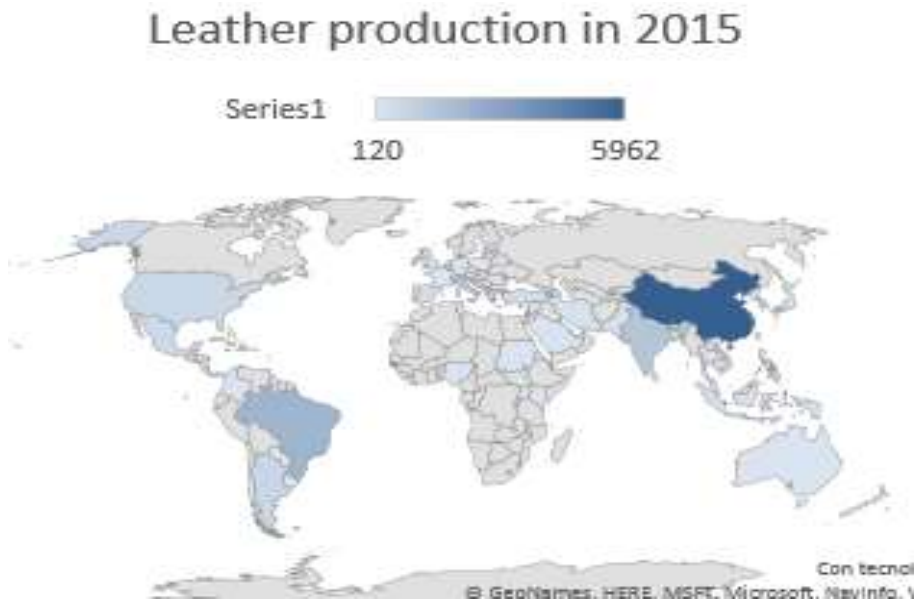


Figure 13_ Elaboration of UNIC data (2019)

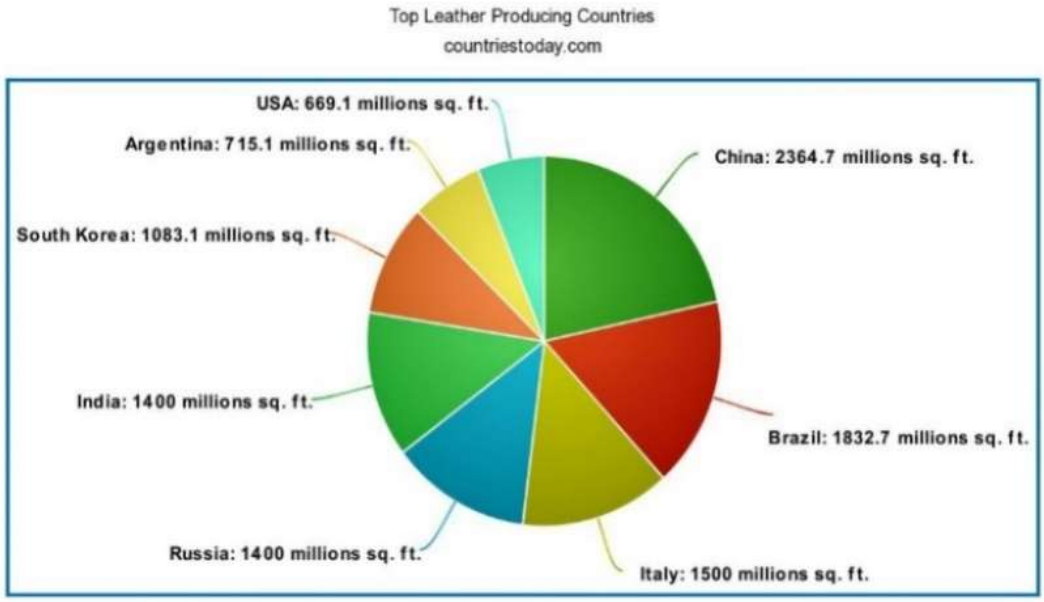


Figure 14 Exporter countries 2016 (Statista, 2017)

Figures 13 and Figure 14 show the global leather exporters and importers. It is necessary to underline that China in the very last year has increased its market share in the leather sector and this datum can affect the export/import data. The figures identify the percentage of the total global export/import attributed to each country. The overall trading of this business has crossed US $85 billion by some estimates and growing (go4WorldBusiness 2017).

As regards to the revenue in the Luxury Leather Goods segment, which amounts for US$41,013m in 2019. The market is expected to grow annually by 3.9% (CAGR 2020-2023).In relation to total population figures, per person revenues of US$5.51 are generated in 2019. In

contrast, revenue in the Leather Footwear segment amounts to US$168,798m in 2019. The market is expected to grow annually by 1.8% (CAGR 2020-2023). Concerning total population figures, per person revenues of US$22.67 are generated in 2019 (Statista, Reports 2020).

3.2.1. Price trend

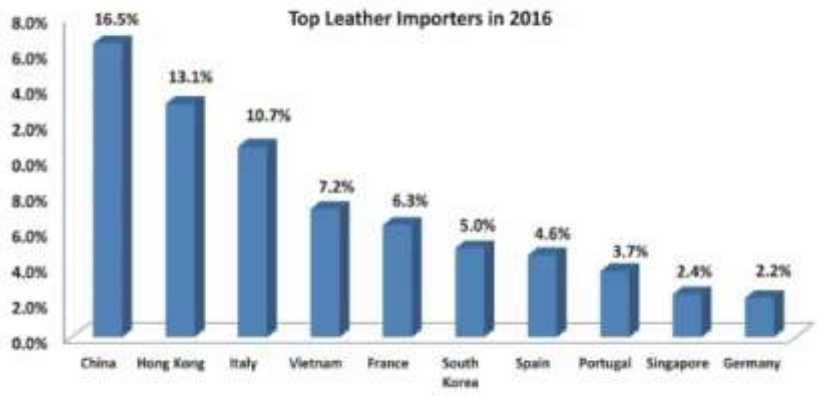


Figure 16_ Top Leather importers (Statista,2017)

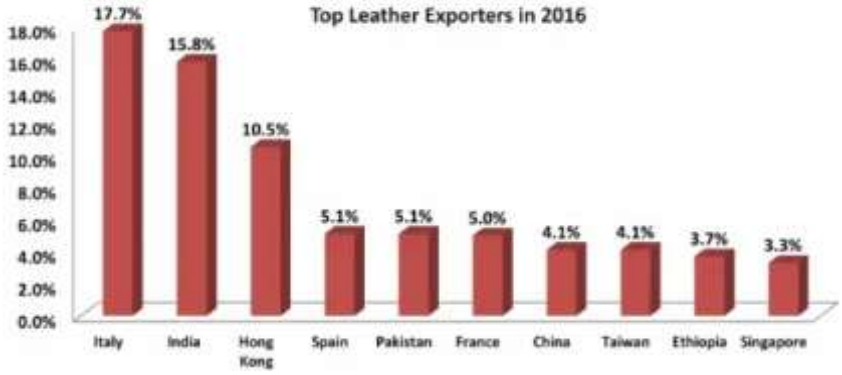


Figure 15_ Top Leather Exporters (Statista,2018)

Leather goods are produced by both luxury brands and economic and low-quality brands. Consequently, the quality of different produced leather can be very different, and therefore the price too. Some leather products are $2 a square foot while other products are $15 a square foot or more. Many factors drive the price of leather, first of all, the geographical origin. The tanning process includes different types of raw hides and skins: ovine, caprine, bovine. The output produced results in several kinds of leather, differently treated, to different final product.

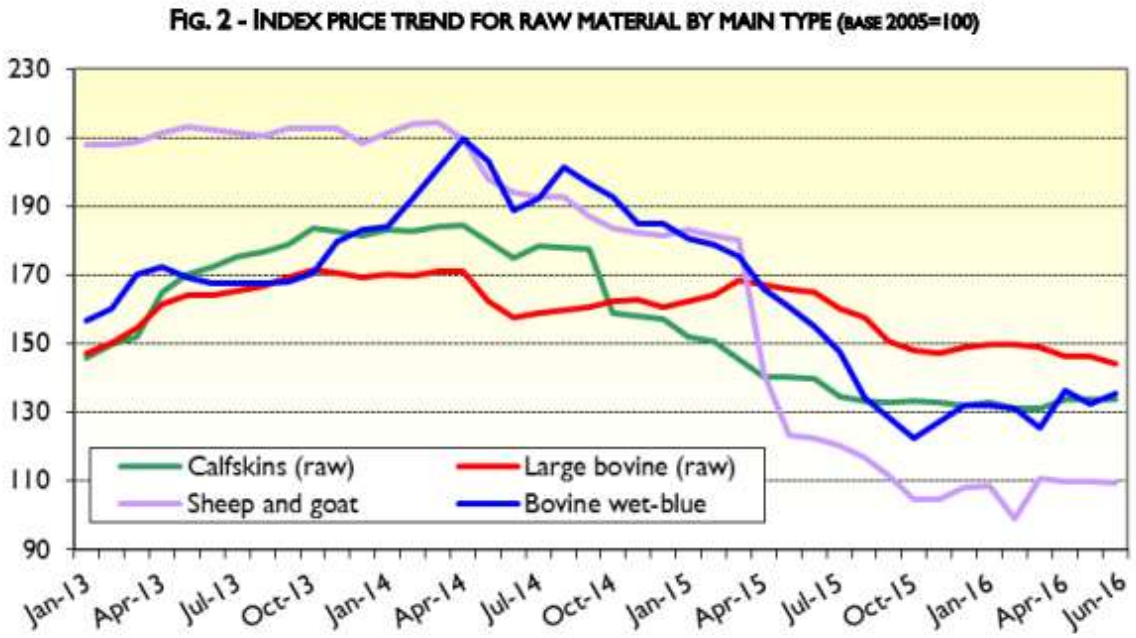


Figure 18_ Price trend for raw materials (UNIC,2018)

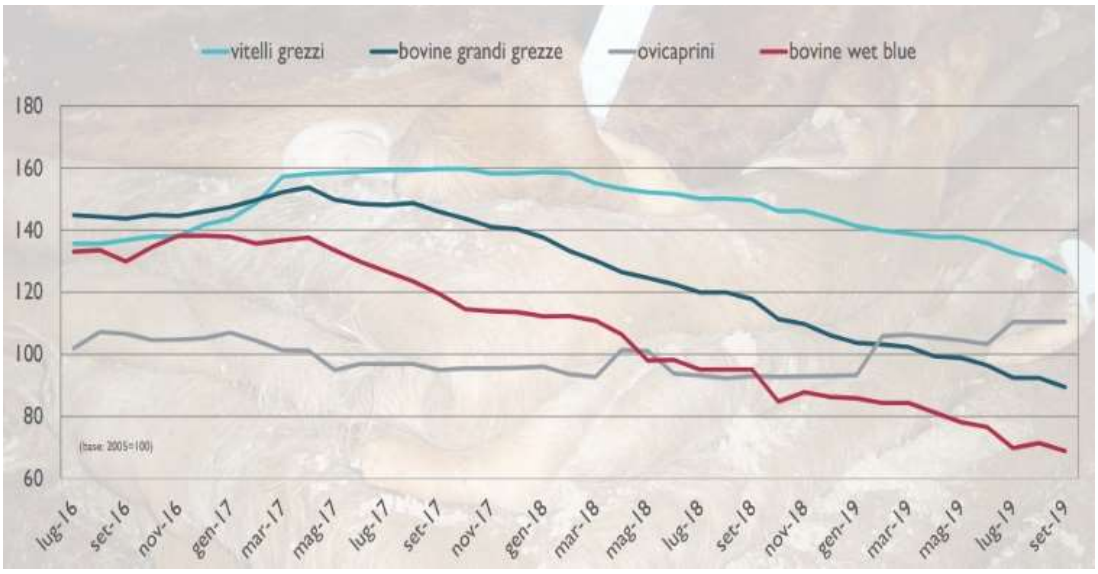


Figure 17_ Price raw hide trend (UNIC, 2018)

The prices are decreasing in the last years, from 2015 (Servizio Economico Lineapelle 2019).

This trend seems to characterize only this sector, different from the previous changes that were in line with the dynamics of international commodities. The decrement is imputable to the decline of global demand for leather for the production of footwear and furniture, in favour of other materials. Moreover, the offer of bovine rawhide is increasing due to the growing consumption in the food sector. The following figures (Figure 19 and Figure 20) show the trend of the bovine hide prices in a different step of the processing. The leather of bovine origin is

the most treated in Europe, and is the principal transformed product of Vecchia Toscana Group S.p.A.

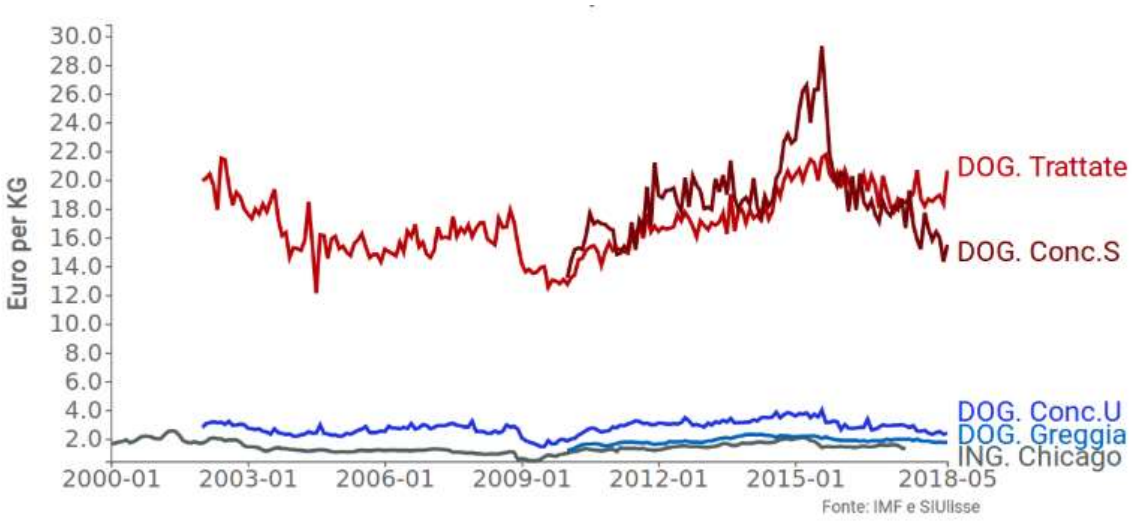


Figure 19 Price of different kind of leather (IMF,2018)

From the graph the difference in prices of different transformed leather is immediately clear. The difference is due to processing grade and trimming, that ensure a high-quality product (Ranocchia 2018). Previously, the study anticipated the reliance of the tanning sector on luxury brands. In particular, the European market is recognized as a high-quality market of leather. Then, the luxury brands industry is the direct downstream step in the value chain. But, the trend of the prices differs.

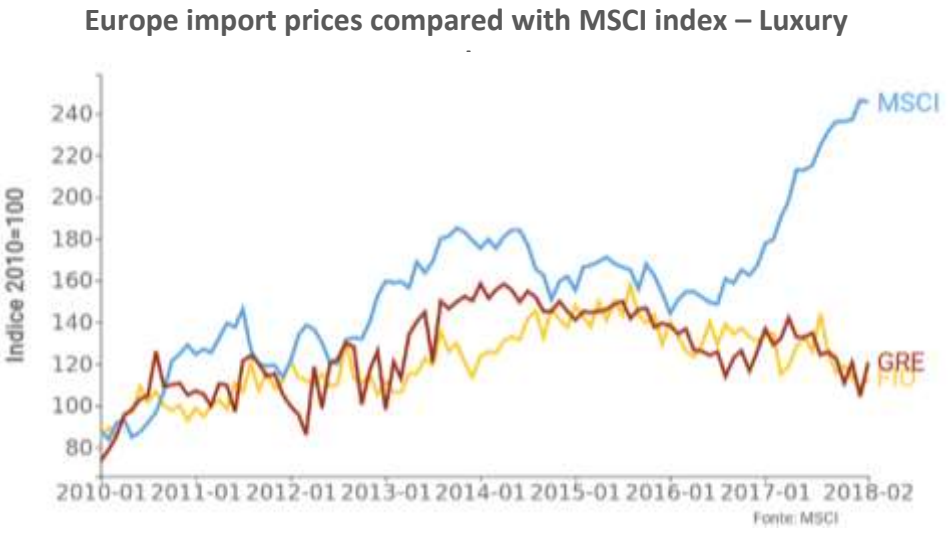


Figure 20_Europe import prices compared with MSCI index – Luxury (MSCI,2018)

The difference depends on the emergence of new competitors in the Asian market, especially China. The eastern countries become the major importers of European leather and major competitors (Gliozzi 2019). Processing leather is a highly labour-intensive task and such work

is much cheaper in Asia, also in terms of cost labour (Echanges, Echanges, and Cuir 2018). The manufacturing of leather shoes and clothing in the far eastern countries is done in high volumes, differently to the small production in Europe, especially in Italy, so the cost is lower.

3.3. Italian sector overview

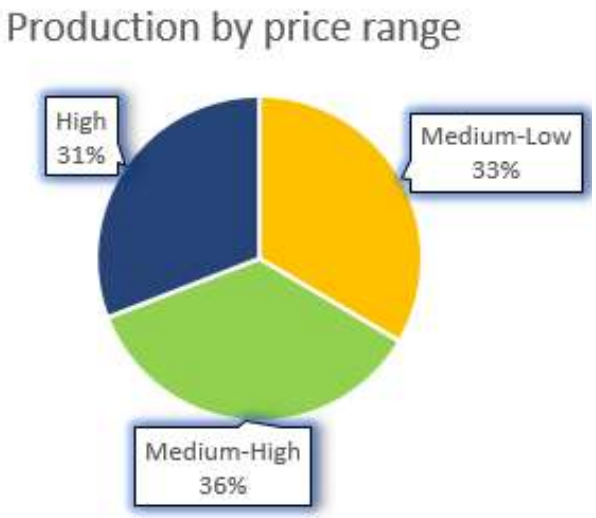


Figure 21 Italian leather price range (UNIC, 2018)

Italy is a global leader in the production of high-quality leather. The Italian tanning industry is characterized by a very high technological development and continuous innovation, both in the production process and in the use of organic and chemical products. The unique design and characteristic of Italian leather attracts the interest of the most famous luxury brands.

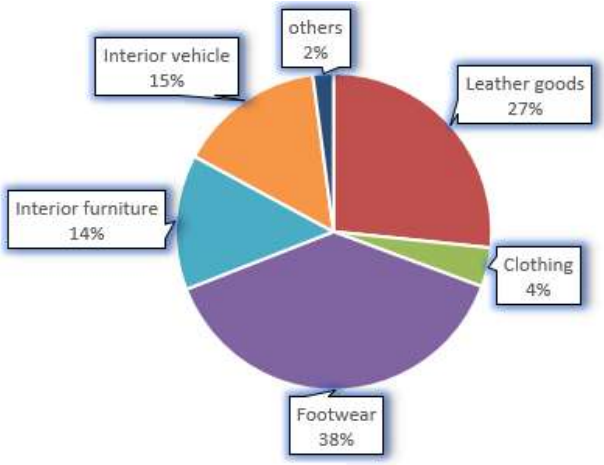


Figure 22 Italian leather production by end-use (UNIC,2018)

Data show that in 2018 the Italian tanning industry documents 1,201 firms present in the territory and 17,698 people employed. The production of the Italian industry amounts for 128 million square metres of ended up leather and 10 thousand of sole leather, for a total value of € 4.9 billion. The baseline geographical target is the global market more than 70% of the production is exported (UNIC 2018). Italian tanneries produce leather to different destination and end-use.

The Italian sector environment is constituted by a majority of small and medium firms, that are mostly organized in districts. The configuration in the district is a huge advantage to a high capital business, such as tanning leather firms. First of all, as stated above, the tanning process produces a lot of wastes that the firms must dispose of. The district permits to dramatically reduce this kind of cost, with the implementation of common specialized water treatment plants consortia. Fifty-five per cent of the total production is attributable to the Arzignano district, in the province of Vicenza in the Veneto region. The neighbourhood is dominated by the presence

of the industry's large international groups, that have developed more significant enterprise and production volumes in the last decades. It specializes in the processing of sizable bovine leather for car interiors, furniture, and, in a lesser part, for footwear and leather goods. Differently Santa Croce sull'Arno district, in Tuscany, is characterized by small and medium firms, providing the 28,5% of the production of leather. The continuous innovation and investment in the district in terms of high-quality product and traceability and transparency of the process, make the district very attractive for the luxury brands.

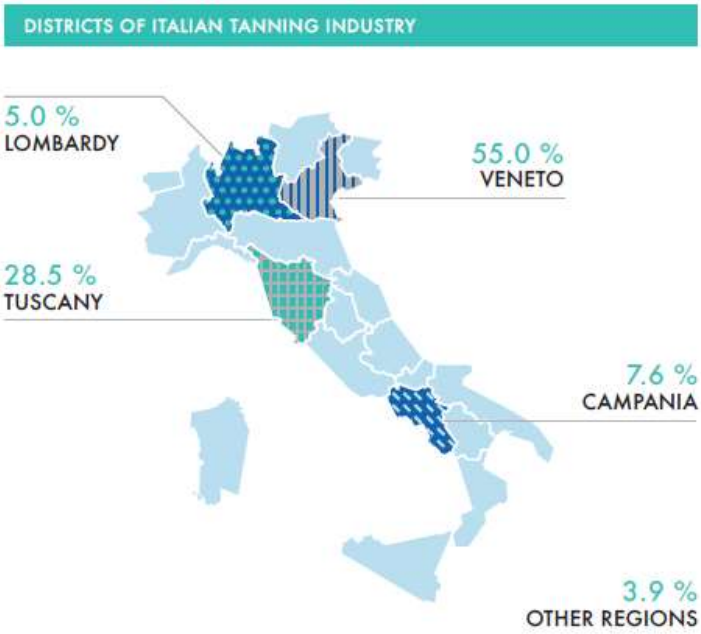


Figure 23_Italian districts representation (UNIC,2018)

To a competitor analysis, the thesis will focus on the Santa Croce District Area, in the following chapter.

3.3.1. Competitor analysis Santa Croce District

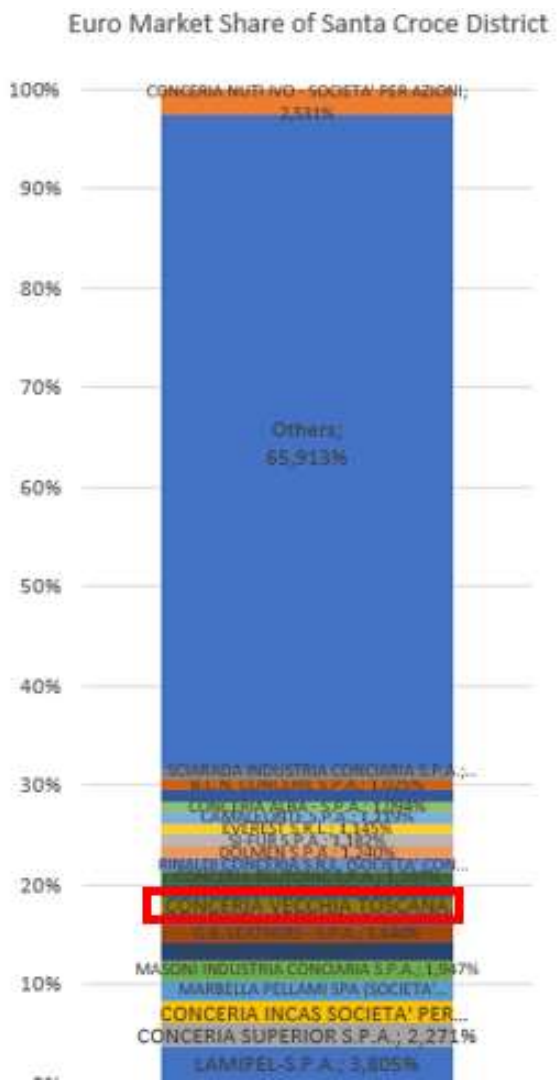


Figure 24 Elaboration of AIDA report: market share analysis of S. Croce District (AIDA,2019)

The district is made up of six municipalities[1], within a 10km radius for 100,000 citizens, employing 12,700 workers. A substantial economic source of value for the territory. The tanneries that form part of the district are around 250, with a total turnover per year of € 2,400 million. The production of the area represents 35% of total Italian leather production and 98% of the national production of sole leather (Associazione conciatori SantaCroce 2018).

The graph shows the market is extremely fragmented and 'Vecchia Toscana Group S.p.A.' own 1.39% market share in terms of value. Considering the high fragmentation of the market, where 'Lamipel S.p.A.' holds 3.805% and it is the higher portion positioning in the district. Most of the tanneries in the district suffer from the presence of a big client, that represents the 70-80% of the orders received. The revenues, then, depend mostly on a singular client, often directly a luxury brand or on a related outsourcing partner, with a market power higher than the supplier tannery (Cavallini 2019).

It is necessary to underline that the craftsmanship nature of the Tuscan tanneries, as well as the small firms' size, is visible in the involvement of the owner/founder or members of its family in the management of the company. Each of them protects its knowledge and experience from the other competitor as a 'father' protects his 'child' (Gliozzi 2019). The communication and cooperation between the tanners' Tuscany people are quite inexistent. Because of it, mergers

[1] The municipalities are: Castelfranco di Sotto, Fucecchio, Santa Croce sull'Arno, San Miniato, Montopoli in Val d'Arno.

or acquisitions between competitors in the district are uncommon, except in cases of extreme necessity.

3.3.2. M&A Waves in Santa Croce District

In the first 2000s, the capital present in the Tuscan area was local as a whole. The most important transaction and events are reported below:

- Gucci Group in 2001, through 'Gucci Logistic', acquired 51% of the ownership of 'Caravel Pelli Pregiate S.p.A.', a historical tannery situated in Fucecchio, that produces very high-quality leather for luxury goods. Successively in 2008, the Group purchased the remaining 49%, becoming the only owner of the tannery.
- In the last years, the regard of competitors from Arzignano district was made explicit through acquisitions of Tuscan historical tanneries. An example is an acquisition in 2018 of 100% of the ownership of 'Conceria Miura' (e. d. t24 2018), by 'Gruppo Peretti', one of the most important operators in the Veneto tanning district.
- Important joint-venture between the Dani Group, a Veneto big reality, and 'Volpi concerie Srl' (e. d. t24 2018), a historical family conducted tannery with an investment of around € 10 million;
- Construction of a new tannery in the Tuscan area by Gruppo Mastrotto with an investment of €15 million (e. d. t24 2018).
- In September 2019, the important brand 'Chanel' signed a deal to acquire the tannery 'Samanta' (Minà 2019), recognizing the competitive value of the know-how present in the firm.
- The last movement in terms of M&A observes the involvement of investment funds, also because the Veneto groups are participated by equity funds. An example is an acquisition by the equity fund 'Xenon Private Equity VII' of the firm 'A&A Pelli Pregiate', that holds two important tanneries for the retile leather production, 'Zuma' and 'Casadacqua' (Ferraro 2019).

Even if the Santa Croce sull'Arno district is an attractive territory to invest for external players, seldom the Tuscan tanneries engage their resources externally to the district[2]. A proactive

[2] This information derives from the interviews with the experts and from the interviews with the CEO and the owner of 'Vecchia Toscana Group'. The private investigation confirms their statements to a lack of articles or news about external acquisition by a Tuscan tannery.

M&A activity comprehends, during the years, transactions between Tuscan competitors. Most of the times, acquisitions satisfy to necessities derived from ownership succession or environmental requirements, with just a few exceptions that had the intention to increase the business and grow in a competitive position. The expansion of a Tuscan tannery outside the district is rare. For these reasons, the 'Vecchia Toscana Group S.p.A.' case is interesting in this context and without comparison.

3.3.3. Prices and Competitor Overview

As previously mentioned, Tuscan leather is recognized as a very high-quality product. This is reflected on the prices, far above the global average prices. The satisfied customer target is the luxury one, for all the different markets, like fashion, furniture, accessories, etc.

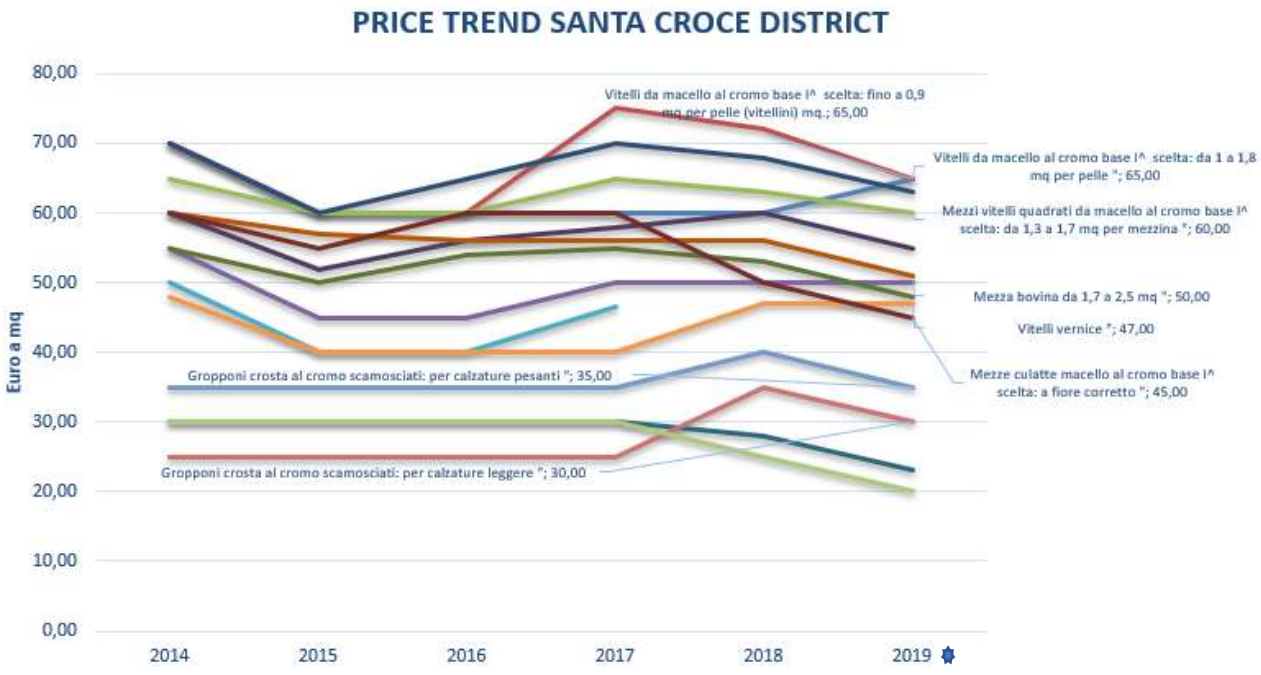


Figure 25 Price trend of bovine leather in District of Santa Croce in the last years. The analysis is made only for bovine leather. (Camera di Commercio Pisa, 2019)

CHAPTER 4: Vecchia Toscana Group S.p.A.

The chapter will talk about Vecchia Toscana Group S.p.A. Firsts paragraphs will focus on an initial overview of the company, including the history and the changing in ownership structure from the setting up until the current days. In paragraph 4.3., the analysis of products and market segments is developed, focusing on the adjustments introduced in the production process during the years as a consequence of different strategic choices. The incidence of product lines on the total sales, the geographical segmentation and the impact of principal clients on total revenues are the bases to the elaboration of the strategic objectives in chapter 4.4. The chapter carries on with the analysis of the strategic goal and its implementation. The last paragraphs are dedicated to GVT financial analysis in the years preceding the acquisition.

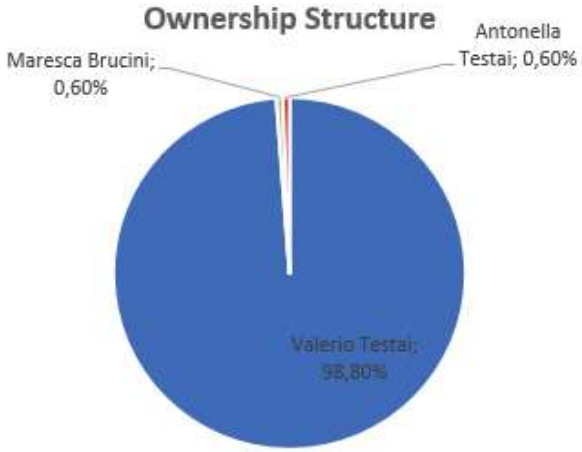
4.1. Vecchia Toscana Group History

Nowadays, Vecchia Toscana has become one of the most important Tuscan tanneries worldwide. Guglielmo Testai founded Vecchia Toscana in 1957 in Fucecchio, in the Province of Florence. From the beginning, the company stood out for the quality of its products and the product supply capacity, making it one of the largest in the district (V. Toscana 2017). This enables it to move closer to foreign markets quickly and to initiate collaborations with major European customers. During the '60s, the company expands the production facility to cope with the continuous increase in demand from foreign markets. At the end of the '70s, a completely new plant was built with over 10,000 square meters, equipped with all facilities and machines necessary to ensure important production volumes and high standards of quality. With the sudden death in 1991 of its founder Guglielmo Testai, the leadership of the company is assumed by his son, Valerio Testai. Under his direction, Vecchia Toscana manages to become a leading provider of the most renowned names of the fashion world, ensuring quality products and continuous assistance in the development of unique and innovative materials.

In 2014, Vecchia Toscana acquired ‘Ilcea Conceria’, a Turin tannery specialized in quality calf skins for the world’s leading footwear manufacturers. With a research and development department continuously available to customers, GVT has a specialized laboratory to test all articles that it produces and timely respond to the demands of the most demanding customers. Only this way GVT (‘Gruppo Vecchia Toscana’) can assure their customer's full traceability of products and consistent quality. Many resources are devoted to the continuous improvement of its production facilities in order to maintain a leadership position in terms of production capacity and technological innovation.

4.2. Corporate Governance and employees

As said above, 'Vecchia Toscana Group S.p.A.' is a family-owned firm. The ownership structure is composed as follow (GVT SpA Report 2018):



Ownership structure	
Valerio Testai	98,80%
Maresca Brucini	0,60%
Antonella Testai	0,60%

B.o.D	
Valerio Testai	Chairman
Marco Fazzini	Member
Francesco Billeri	Member
*Francesco Testai**	Commercial director

Figure 26_ Ownership Structure (GVT Statements,2018)

The board of director, however, is composed of external to the family figures. Marco Fazzini was the CEO at the time of the transaction, and he was concerned with the acquisition process.

Being part of a District and of a consortium, the reports are entrusted to the supervision of statutory advisors.

Nowadays, GVT counts 53 employees as a whole company. In the graph, the external administrator and the statutory advisors are not included, and then the expenses are shown in the report separately. The amount of total personnel expenses is of €3.890.149 in 2018, with an increase of € 373.362 since 2017.

4.3 Product and Segmental analysis

Vecchia Toscana is specialized in the production of ½ calves and breeches both chrome or vegetable for leather goods and footwear. It offers a wide range of final product to the clients, transforming the raw materials with different processes. The composition of production line changes over the years. Initially, in past times, GVT had two product lines.

- GVT finished goods – the traditional production of leather for quality goods. It represents the main product line for the company. It consents to the company to achieve

a consistent contribution margin and to promote 'Vecchia Toscana' brand among fashion houses.

- GVT Raw hides – production line that allows the company to reduce the inventory stock of raw materials among the periods. It generated a low-profit margin, and the management decided to drop the line in 2014.

A small part of the production regards manufacturing on behalf of others, which means the part of tanning production carried out for the other tanneries. This part of the production and the semi-finished goods are in sharp decrease, to focus on the finished products. Nowadays, the composition of revenues is different. The growth strategy of GVT focuses its importance on the diversification of the final client target, and the changes respect the goal. The final products are grouped in three production line:

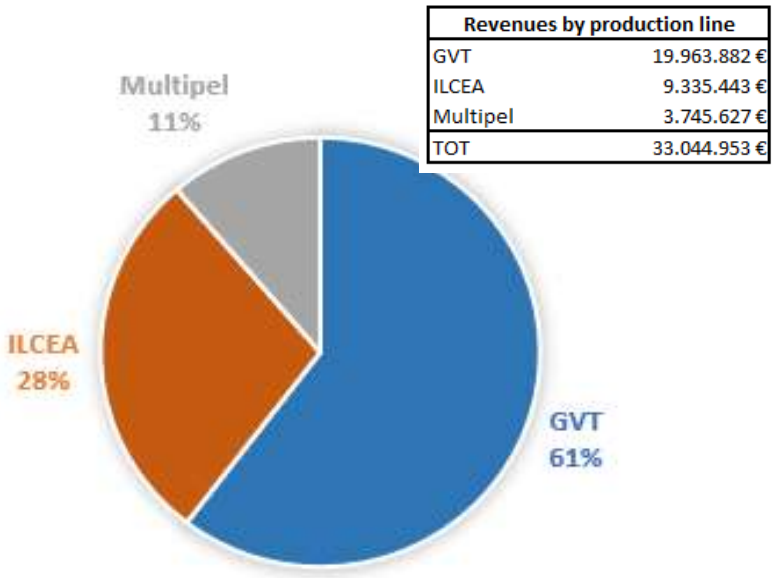


Figure 27_Product lines distribution (GVT Statement,2018)

- *GVT line* – the traditional production of leather for quality goods represents the main product line for the company and the original business of Vecchia Toscana since its constitution. GVT line products aim at satisfying the quality requests of the luxury brands of clothes and leather products market, especially the European ones. During the years this line saw a steady growth, slowing down owing to the leather market crisis in 2015. Especially in the last decade, fashion brands collections reflect even more the culture of respect for animals and environmental issues. In some cases, some brands decided to exclude leather goods from their collection, and such decisions influenced the line growth negatively.
- *ILCEA line* – Leather for the production of footwear products of high and supreme quality. The line was created following the acquisition of 'ILCEA concerie'. It

comprehends the products transformed in ILCEA facilities. It is the original business of 'ILCEA concerie', and it played a fundamental role in the growth of the tannery, and nowadays, it is an important brand known all over the world. The ILCEA line leather is designed for high-quality footwear and it is targeted to a luxury niche market. From a geographical perspective, the product is exported mostly in Asia, especially in Japan.

- *MULTIPEL line* – Medium market segment products. These line products are oriented to a medium quality market, then the transformation process of this type of leather is less accurate. It was implemented in 2014 to level the shocks of the demand and smooth the inventory volumes, to the lower volatility of the medium-quality market. The line had a huge increase during the years from its implementation. Nowadays, the amount of inventory during the years after the implementation of the line is almost constant in terms of percentage on revenues.

The graph below (Figure 28) illustrates the change in sales in the last years. First and foremost, it is possible to appreciate the constant increase in revenues achieved by Vecchia Toscana. Over 10 years, Testai family has been able to increase the turnover of the company, passing from € 21 million of sales in 2008 to € 35 million in 2018 (V. Toscana 2008-2018).

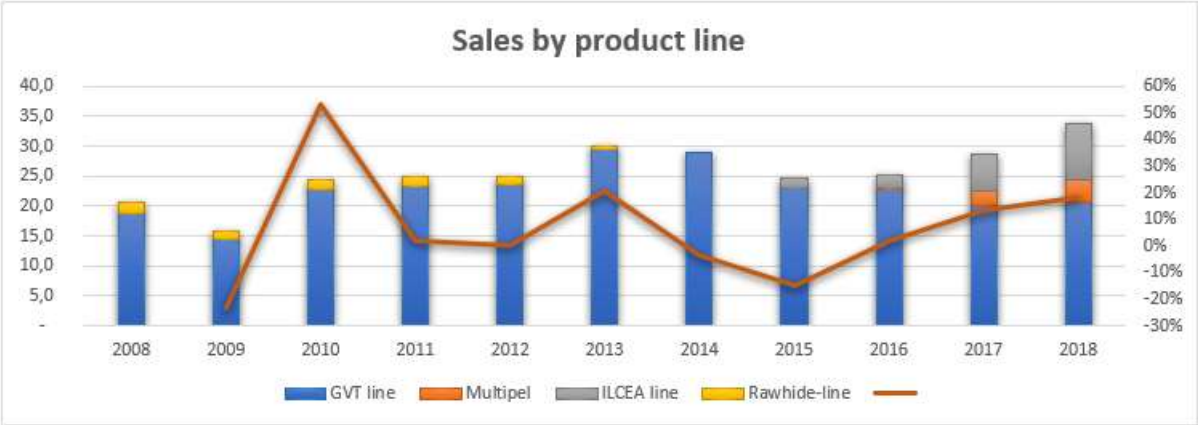


Figure 28_Elaboration of GVT data from 2008 until 2018 (GVT Statements, 2008-2018)

The geographical segmentation analysis shows that more than 60% of the GVT business is constituted by the export. Europe and Italy are the territories of the luxury brand, both for fashion clothes and footwear. Figure 29 represents the composition of revenues by the geographic market in 2018:

Revenues by geographic market	
	2018
Italia	12.942.958 €
EU	18.914.780 €
Asia	672.293 €
America	505.426 €
Others	9.495 €
Tot	33.044.952 €

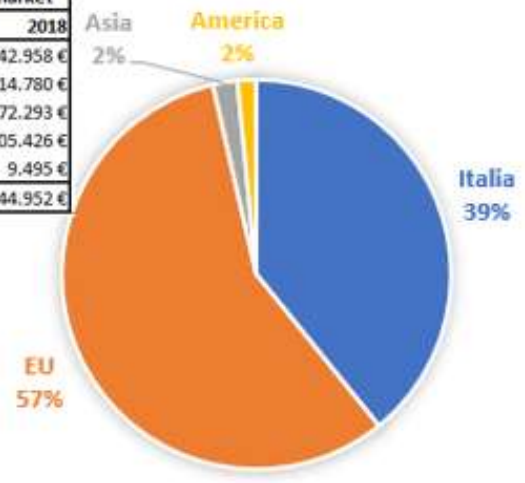


Figure 29_Geographical distribution of GVT revenues (GVT Statement, 2018)

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- European Union – European market represents the biggest market area of GVT. France is the principal market that represents 40% of the total revenues, followed by the UK and Spain (GVT SpA Report 2018).
- Asia and America - CAGR of 76% from 2015. It is still a small business area, which offers good opportunities for development in future. The development is strictly correlated with the acquisition of 'ILCEA concerie', which principal business area represents high price range Asia market.
- Italy – CAGR of 1.2% from 2008. It is the mature business area of GVT. In past years, due to the target client differentiation strategy undertook from management, the growth of this area has slowed down, to focus on other markets.

As Figure 30. shows GVT presents a multiplicity of clients. 30% of total revenues depends on the principal client. This is a rare situation in the Tuscan business, as previously mentioned, almost all the tanneries of the area depend for 70-80% of the total revenues on a single client. The specificities of each client are not available, but the firm invested in new products in 2018 to satisfy a different target of clients. The presence of the son of the owner, Francesco Testai, as Commercial Director, is critical in the client portfolio, also thanks to the marketing and the propaganda campaign developed addressed to the big luxury brand.

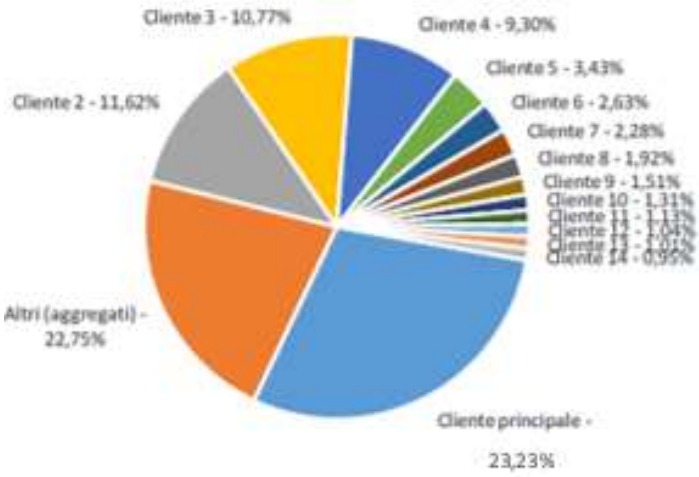


Figure 30_Clent incidence on total revenues (GVT Statement,2018)

4.4. Growth strategy objectives

GVT strategic growth aims at differentiating the customer target pool, to reduce the dependence on the principal client. The management pursues this goal to ensure more stability in production and inventory turnover. How previously mentioned, the tanning industry production is subordinate to the fashion trend and the luxury brand choices. The volatility of the market results in the risk of negative peaks that can hurt company performance. Moreover, the uncertainty linked with external factor does not allow the company to follow possible growth strategies due to the likelihood not to be able to face the economic and financial risks associated.

Although tanning leather sector is a mature industry, where the scenario presents few big realities and the almost totality of small family-run companies, GVT wants to achieve a stability and even an increase of the market share, through the following objectives (Fazzini 2019):

- Better Brand Image – As previously explained ,the tanning leather industry is driven by a high customers power and by their possibility to easily shift supplier. The improving brand image and of the loyalty, in terms of existing clients, is fundamental to smooth the picks due to orders or economic external forces. Moreover, a strong brand image is pursued in order to reach new customers targets, through new channels and new products.

- Lower economic and financial risks – GVT aims to increase the stability of the orders and then of the production forecast, to assure a more stable economic situation.
- Increase Margins – The Cost of good sold in tanning leather industry is high, especially when rawhides are high-quality ones. The improvement of internal efficiency is also related to the achievement of economies of scale and scope given by better management of production costs.

4.5. Growth strategy implementation

Vecchia Toscana Group's growth strategy aims to combine organic growth through marketing, brand building, innovation and expansion of the acquired brand, with external growth through M&A. The end goal is a heterogeneous customer target pool, in order to increase sales and decrease risks. According to the Group, the growth should come via 50% organic growth, with the implementation of the new product line 'Multipel', and 50% by the acquisition of ILCEA.

First of all, each year, GVT dedicates 5% of revenues to marketing and promotions activities. It allows building a premium positioning, to improve prices and therefore to generate higher returns in the medium or long-term. Testai family focuses its company campaign on creating a loyal relationship with its clients. The other two objectives are reached with internal and external growth.

The implementation of the new product line 'Multipel' allows GVT to enter a new target segment. The high-medium quality product line focuses on fashion and accessories leather company, but exclude the famous brands. In this market segment, the dependence on the fashion trends of the moment is lesser, even if consistent. It makes the demand less fluctuating, providing a more stable production forecast. Following in the chapter, the thesis will analyse the growth due to the only implementation of the internal line.

As regards to external growth, the acquisition offers the opportunity to follow the strategic goals. ILCEA has an important brand image value, due to the important market position of its extreme high-quality products, especially in the high luxury industry. The enhancement of GVT brand is facilitated because of the combination of the two companies and, then, brands. The differentiation of the product portfolio is achieved for the different feature of the ILCEA products compared with GVT ones. Moreover, ILCEA products achieve a high-profit margin due to their target market, increasing the margins of the company. The following chapter will analyse the goal of the acquisition in more details.

4.6. Financial growth analysis

Before discussing the M&A process and evaluation, it is interesting to analyse GVT performances before the deal. The starting points of Vecchia Toscana valuation are the past financial statements to extrapolate historical data and trends. The examined reports go from 2009 to 2014.

Table 1_ GVT Income Statement 2009-2014

INCOME STATEMENT	2009	2010	2011	2012	2013	2014
Net Sales	15.887	24.382	24.890	24.904	30.040	28.978
Variable costs	12.899	20.551	20.524	20.526	25.733	25.286
Inventories variation	(1.026)	794	388	288	333	1.336
Purchases	7.302	15.174	14.944	14.908	20.884	21.701
Selling expenses	4.571	6.170	5.968	5.907	5.182	4.921
CONTRIBUTION MARGIN	2.989	3.832	4.365	4.378	4.306	3.692
Fixed costs	2.562	2.945	3.380	3.665	3.336	3.401
Payroll	2.358	2.681	3.004	3.075	2.734	2.742
Administrative expenses	38	98	122	107	99	52
Rent	166	167	254	483	503	606
EBITDA	426	887	985	713	971	291
D&A	226	244	384	470	566	674
EBIT	200	643	601	243	404	(383)
Interests	(98)	(110)	(204)	(208)	(182)	(228)
Extraordinary income/losse	3	(258)	37	141	(85)	665
Exchange income/losses	1	(4)	-	1	(2)	2
Dividends	0	84	-	75	56	2
EBT	106	354	433	253	192	59
taxes	78	215	345	119	147	21
Net Income	28	139	88	134	46	38

A first review shows a turbulent net sales trend during the years. The raw material procurement and the planning of the production are complicated to manage in such a situation. The income statement reflects the inconstancy of the business. As a consequence of the peaks, both negative and positive, the number of orders, the production process and the number of employees change each year.

Looking at GVT balance sheet statement, the increase in invested capital amount during the years reflects the growth of the business.

Table 2_ GVT Balance Sheet 2009-2014

BALANCE SHEET	2009	2010	2011	2012	2013	2014
Net Working Capital	7.430	10.616	10.807	10.166	11.060	12.447
Cash and Bank	360	106	38	637	112	29
Inventories	4.350	6.317	6.636	6.365	7.720	9.056
Receivables	5.678	8.726	7.828	6.736	6.048	7.545
(Payable)	3.047	4.596	3.820	3.725	3.305	4.535
Net Accruals	90	63	125	154	486	351
Other financial Activities	110	110	110	110	110	110
Fixed Assets	3.815	3.989	4.634	5.199	5.261	5.191
Total operating funds	(525)	(508)	(508)	(544)	(563)	(616)
Accumulated TFR	525	508	508	544	563	616
Invested Capital	10.831	14.208	15.043	14.932	15.868	17.132
Net Financial Position	5.594	8.795	9.580	9.297	10.187	11.413
Bank negative account	5.415	8.627	8.825	8.724	9.904	11.119
Financial Debts (Mortgag	50	50	717	495	222	-
Partner financing/Other l	128	117	38	78	61	295
Partner financing	38	38	38	38	38	38
Provisions	91	80	-	40	23	257
Equity	5.274	5.413	5.501	5.635	5.681	5.719
Share Capital	5.000	5.000	5.000	5.000	5.000	5.000
reserves	246	248	255	259	266	311
Net Income t-1	-	26	159	242	369	369
Net Income T	28	139	88	134	46	38
Total Equity and Liabilities	10.868	14.208	15.081	14.932	15.868	17.132

Net Working Capital increased from 2009 until 2014, with a 10.87% CAGR. Receivables, inventory and payables increased as related to Net Sales growth.

Table 3_GVT Working Capital Variations 2009-2014

	2009	2010	2011	2012	2013	2014
Net Sales	15.887	24.382	24.890	24.904	30.040	28.978
Receivables on net sales	36%	36%	31%	27%	20%	26%
Variable costs	11.873	21.345	20.912	20.815	26.066	26.622
Payable on costs	26%	22%	18%	18%	13%	17%
Inventory	4.350	6.317	6.636	6.365	7.720	9.056
Inventory on net sales	27%	26%	27%	26%	26%	31%

Fixed Assets amount growth demonstrates the necessity of new equipment and machinery to satisfy the increased revenues trend. The following table 4 shows the amount of D&A calculated on fixed assets each year.

Table 4_ GVT Fixed Assets Variation 2009-2014

	2009	2010	2011	2012	2013	2014
Fixed Assets	3.815	3.989	4.634	5.199	5.261	5.191
D&A	6%	6%	8%	9%	11%	13%

As regards to debt structure, equity structure remains mainly stable during the years. The increasing trend is due to net financial debt growth. Bank negative account reflects the increasing external funds needed to sustain the rise of production.

Directing the discussion on return analysis, graph 32 shows ROA and ROE percentages. The Return on Assets ratio measures the efficiency with which the company is managing its investment in assets and using them to generate profit. It measures the amount of profit earned relative to the firm's level of investment in total assets. The Return on Equity measures the return on the money the investors have put into the company. It is the ratio potential investors look at when deciding whether or not to invest in the company. The instability of ROE is due to the net income fluctuations, the equity, indeed, is quite stable during the years. As regards ROA, the ratio experience a sharp decline in 2014, due to the low amount of EBITDA with respect to the previous years.

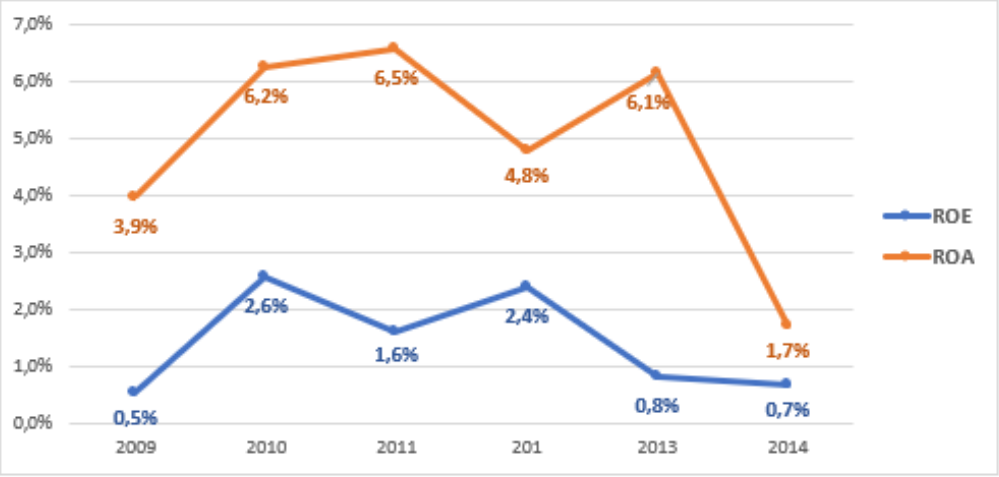


Figure 31_ GVT Returns analysis 2009-2014

This chapter aims at converging on the investigation of historical data to build the assumption in the following scenarios to the enterprise valuation. The focus on some historical item will help to develop projections:

- As regards Net Sales, the growth from 2009 to 2014 is around 10,5% CAGR. The trend, even if increasing during the years is unstable. In 2014, due to the leather market crisis, Net Sales decreases from the previous year.

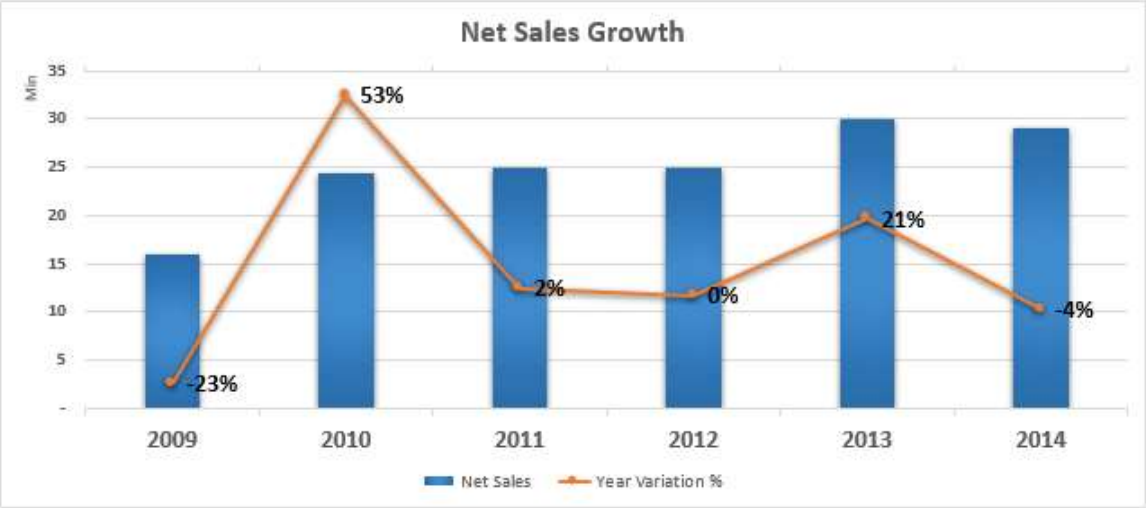


Figure 32: GVT Net Sales trend 2004-2019

- An important key point of GVT growth is related to the cost efficiencies and margin improvements. Focusing the attention on EBITDA margin analysis, after an initial increasing trend, in following years EBITDA growth is not linear. To successively evaluate if the growth strategy earned from the acquisition of ILCEA in this respect, the EBITDA/sales ratio analysis is fundamental. In the graph below emphasis the instable relation with the sales, and the low-profit margin of the business.

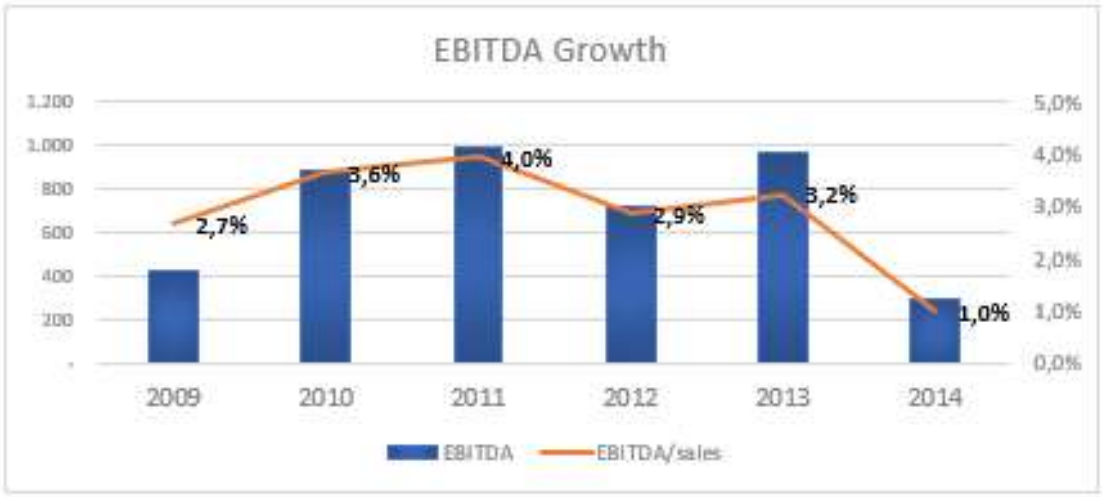


Figure 33: GVT EBITDA trend 2009-2014

- As previously discussed, variable costs constitute, on average, 86% of the total production costs. Among these, the most significant is the expenses for purchase, which

corresponds to 65% on net sales. GVT production is based on the quality of raw material and that represents a very high cost for the company.

Table 5: GVT Variable costs Variation 2009-2014

INCOME STATEMENT	2009	2010	2011	2012	2013	2014
Variable costs Variation	81%	84%	82%	82%	86%	87%
Inventories variation	-6%	3%	2%	1%	1%	5%
Purchases	46%	62%	60%	60%	70%	75%
Selling expenses	29%	25%	24%	24%	17%	17%

- As regards to the fixed costs structure, payroll expenses constitute the most prominent portion. The growth of rent expenses, with a 24% CAGR, is particularly evident. The increasing demand produces the necessity to have more spaces to enlarge the production process environment, renting facilities.

Table 6: GVT Fixed costs Variation 2009-2014

INCOME STATEMENT	2009	2010	2011	2012	2013	2014
Fixed costs on net sales	16%	12%	14%	15%	11%	12%
Payroll	15%	11%	12%	12%	9%	9%
Administrative expenses	0,2%	0,4%	0,5%	0,4%	0,3%	0,2%
Rent	1%	1%	1%	2%	2%	2%

CHAPTER 5: THE DEAL

The chapter will present ILCEA with its history and original ownership structure. The high-quality ILCEA product line and the geographical market are taking in consideration as a fundamental topic that drives the transaction. In paragraph 5.2. ILCEA performances in the years before the acquisition are discussed, with a particular focus on the distressing situation that in 2012 lead the company to stop the production. After ILCEA overview, the chapter focus on the deal in terms of implementation time and conditions. The strategic and operative importance of the deal for GVT ownership will be treated in paragraph 5.4. Chapter 5 ends with the construction of the acquisition price, with a liquidation value method.

5.1. ILCEA Overview

'ILCEA concerie' is a historical tannery situated in Turin. It produced exceptionally high-quality leather for the luxury footwear industry. ILCEA brand was recognized all over the world for its product features until the final client. This is quite unusual, and luxury brands chose ILCEA leather due to the relevance for last clients (Fazzini 2019). ILCEA production was targeted for a niche luxury market segment. In terms of geographical segmentation, the company was oriented to the Asian market, in particular, Japan, where the brand is very well-known, and China. Being an extremely high-quality leather, the price at which it is sold is very high and this allows to gain a high-operating margin compared to the GVT one. The price premium is due to client loyalty and high brand image, along with the selection of the best rawhide. ILCEA products goal is to reach a small, but luxurious part of the market to satisfy them with a total customized goods. As for each niche targeted business, the relationship among the supply chain, with both clients and suppliers is fundamental. ILCEA business relies on human and trustful interactions to build the real value of the product. Consequently, the returns depend on the quality/customization of the product and the services around all the steps of the production and sale to the final client.

As regards to the organizational structure, ILCEA embodies the small family-run enterprise concept (conceria 2018)The owner manages the business, and the manufacturing activities were concentrated among a few workers and expert technicians. In 2001 the founder died and the direction passed to his son. The second generation never had the same passion and involvement

in the leather business: the inability and the lack of interest in managing the firm led it to a troubled financial situation.

Starting from 2005 ILCEA performances declined every year more. As previously mentioned, the human and the trustful relationship among the supply chain are the foundation for ILCEA business. Because of the lack of passion and the negligent approach to the family business, it led to a deterioration of the relationship between the ownership and their stakeholder. In a niche market, where the quantity is marginal instead of the choice of a specific client, these circumstances extremely affected ILCEA returns. During the following years, the negative financial situation prevented the company from facing the clients' orders, and from paying suppliers, losing important market share. Despite the negative position of the ILCEA leadership, the importance of the brand and the quality of the products remained in the mind of the customers. Since 2008 with the economic crisis, the scenario has become drastic, and the impossibility to pay suppliers, distributors, employees, led the company to stop the production and to pursue an insolvency procedure. In the next paragraph, ILCEA performances will be illustrated from 2008 ahead to the insolvency procedure.

5.2. ILCEA performance

As mentioned above, ILCEA faced a troubling situation in the last years of activity as a stand-alone company. To understand the company performances and calculate the Enterprise Value a historical overview of its financial statements is needed. The paragraph focuses on the analysis of the last five years before the opening of the insolvency procedures in 2013.

The financial statements mirror the critical circumstances in which ILCEA runs its business.

Table 7: ILCEA income statement 2008-2012

INCOME STATEMENT					
	2008	2009	2010	2011	2012
Net Sales	16.334	8.680	8.115	10.831	7.436
Variable costs	11.739	5.246	5.465	7.465	6.776
Inventories variation	(3.477)	(975)	132	(698)	(74)
Purchases	4.672	2.524	4.231	5.429	5.176
Selling expenses	3.590	1.747	1.366	1.338	1.526
Contribution Margin	4.594	3.435	2.650	3.366	659
Fixed costs	3.354	3.049	2.612	2.863	3.694
Payroll	3.138	2.881	2.389	2.631	3.470
Administrative expenses	95	44	98	94	76
Rent	121	124	126	138	149
EBITDA	1.240	386	38	503	(3.035)
Depreciation and ammortization	348	337	437	412	263
Provisions	9	5	5	5	5.837
Unexpected loss on receivables	5	4	2	16	(0)
Extraordinary losses	-	(81)	750	(36)	142
EBIT	878	(41)	345	33	(8.992)
Interests	806	422	300	392	526
EBT	72	(463)	44	(359)	(9.519)
taxes	250	81	55	81	-
Net Income	(178)	(544)	(10)	(439)	(9.519)

Table 8: ILCEA Balance Sheet 2008-2012

Balance Sheet					
	2008	2009	2010	2011	2012
Net Working Capital	**15.346**	**11.001**	**11.573**	**12.154**	**8.660**
Cash and Bank	22	1	9	16	7
Inventories	12.008	11.276	11.259	11.492	8.780
Accounts Receivables	5.108	2.334	2.810	3.108	2.535
(Accounts Payables)	(1.751)	(2.589)	(2.614)	(2.397)	(2.576)
Net Accruals	(41)	(21)	109	(66)	(86)
Total Net Fixed Assets	**5.523**	**5.208**	**5.198**	**5.430**	**4.601**
Total operating funds	**(934)**	**(798)**	**(807)**	**(771)**	**(759)**
Accumulated TFR	934	798	807	771	759
Net Invested Capital	**19.935**	**15.411**	**15.964**	**16.813**	**12.501**
Net Financial Position	**11.856**	**7.876**	**7.392**	**8.080**	**13.287**
Bank Negative account	7.502	3.521	499	5.042	4.717
Financial Debts (Mortgage)	3.654	3.660	6.660	2.776	2.547
Partner financing	520	520	52	77	-
Provisions	181	175	181	185	6.023
Equity	**8.079**	**7.535**	**8.572**	**8.733**	**(786)**
Share Capital	929	929	1.976	1.976	1.976
reserves	7.328	7.150	6.606	7.196	6.757
Net Income t-1	-	-	-	-	-
Net Income T	(178)	(544)	(10)	(439)	(9.519)
Total Equity and Liabilities	**19.935**	**15.411**	**15.964**	**16.813**	**12.501**

The economic situation derived from the financial crisis of 2008. From that moment, the firm was forced to increase its financing sources and to require public debt to temporarily mitigate the consequences of the crisis. The economic crisis signed a drastic decrease in sales volume and production, due to the extremely low demand until the first month of 2010.

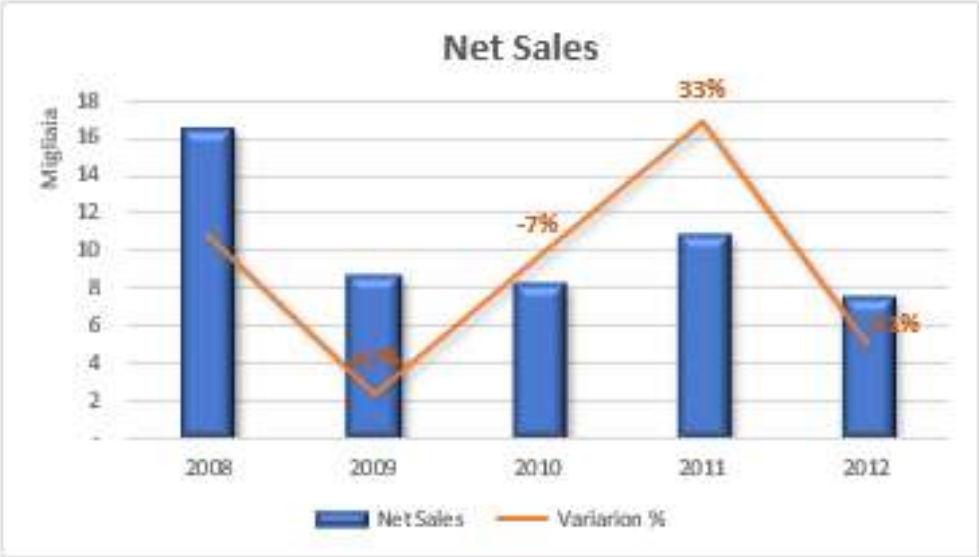


Figure 34: ILCEA Net Sales trend 2008-2012 (ILCEA Statements, 2008-2012)

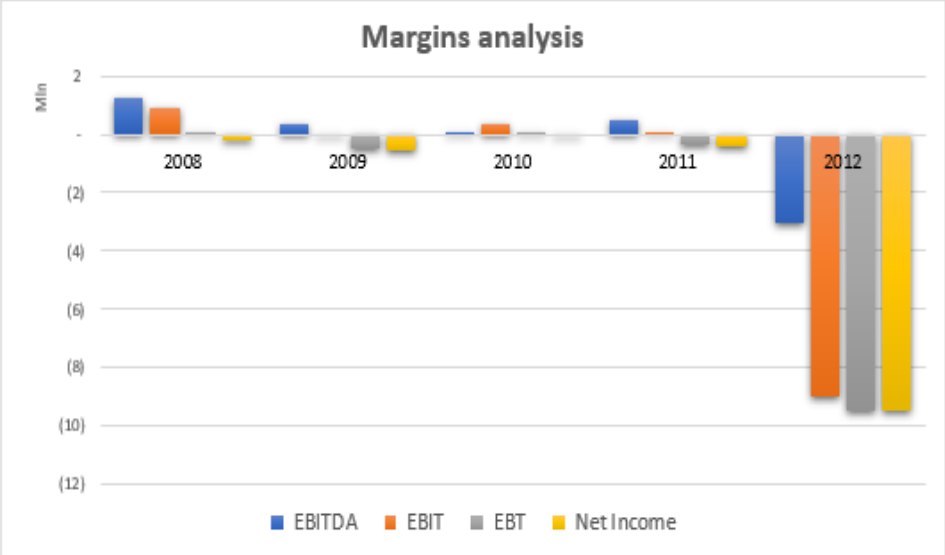


Figure 35: ILCEA Margin Analysis (ILCEA statements, 2008-2012)

As the Figure 36 shows, after a drastic decrease in net sales in 2009, the trend seems to change course in 2011, thanks to a big order from an important brand (Esercizio and Anagrafici 2011). In 2012, how margin analysis says, also the operating results appear drastic, with a negative EBITDA for € 3 mln. The Net Sales decrease from 2008 to 2012 of 15% CAGR.

Ratio analysis shows the inability, compared with the average of the industry, to repay short-term debt with the current assets. Debt ratios indicate higher leverage compared with the average level of the industry.

Ratio Analysis						
	2008	2009	2010	2011	2012	Av. 2013
Current ratio	1,85	2,22	4,56	1,96	1,54	3,56
Quick ratio	0,55	0,38	0,94	0,41	0,34	1,89
Debt ratio	0,63	0,58	0,54	0,55	1,05	0,30
Deb to Equity	0,59	0,51	0,46	0,48	1,06	0,42

Figure 36: Ratio Analysis comparing ILCEA ratio, with the average ratio of the industry (2012)

In 2009 the management decided to reorganize the production and the sale of the product, to maximize the exploitation of the inventory, by using rawhide already presents and unsold (Esercizio and Anagrafici 2009). This strategic decision brings the difference between the inventory amount of the first years, to the highest possible utilization of stocks in 2012, with a view of the liquidation of the company.

On the other hand, in 2010 the fashion luxury industry renewed the interest in leather goods, increasing the volume of orders. In this context, the raw material prices increased, and the rawhide market trend was very fluctuant, creating frictions in the relationship with suppliers. Despite this, the clients were willing to accept the inevitable rise in selling price (on average 7% more) for ILCEA products (Ilcea 2010). Cash Flow statement reflects the trend of 2010, but the successive countertrend of the following year, until the drastic situation in 2012.

Table 9: ILCEA Cash Flow Statement 2009-2012

CASH-FLOW STATEMENT - Indirect method	2009	2010	2011	2012
NET INCOME	**(544)**	**(10)**	**(439)**	**(9.519)**
D&A	337	437	412	263
Delta working Capital	**2.689**	**(354)**	**(489)**	**3.086**
Delta receivables	(2.774)	475	298	(573)
Delta payables	(838)	(25)	217	(179)
Delta inventories	(732)	(16)	233	(2.712)
Accruals	21	130	(175)	(20)
Taxes	81	55	81	-
NET CASH FLOW FROM OPERATING ACTIVITIES	**2.563**	**127**	**(436)**	**(6.170)**
CAPEX	(22)	(426)	(645)	566
Withdrowal	-	1.047	-	-
NET CASH FLOW FROM INVESTING ACTIVITIES	**(22)**	**621**	**(645)**	**566**
Debt repayment	(3.975)	(490)	658	(605)
interest	422	300	392	526
NET CASH FLOW FROM FINANCING ACTIVITIES	**(3.553)**	**(189)**	**1.050**	**(78)**
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	**(1.012)**	**559**	**(30)**	**(5.682)**

To overcome the financial difficulties and the super-fast improvement of the demand, ILCEA board of directors decided for an injection of equity. For the unavailability of the current shareholders, the opportunity for a recapitalization from a financial and commercial partner, Conceria Crotti S.r.l. in 2010. Additionally in 2011, the shareholder deposited non-interest-bearing financing of € 600.000.

As the bank negative accounts and the financial debts items indicate, ILCEA owners reimbursed company financial and bank debts. But the subsequent crisis, required more financing, drastically increasing the debt financial position of the tannery. In 2010, the management decided to activate an outline of credit on speculation of future earnings of 2.5 mln.

Despite an initial sign of recovery, during 2012 the availability of raw-hide decreases and, consequently, the prices rise quickly. ILCEA, with an unstable financial structure, was not able to face the situation. On the contrary, the competitors with a stable financial structure could buy a bigger amount of raw material contracting on the prices with suppliers. Basically, the competitors removed away from the market a big share of raw-hide. In conclusion, ILCEA didn't have the financial capacity to compete on the supply of raw material, and, as a

consequence, the availability of raw material was certainly insufficient. ILCEA lost purchasing power and it was not able to face the client's request and orders, that were even more.

The situation became even more drastic and not manageable. Bearing this, during 2012 the management adopted a strategy geared on the utilization of the inventory stock even more possible for the production. Besides, the company signed an agreement for 26 weeks of lay-off, after the closing of the fiscal year 2012, and the production was stopped. After a failed attempt for a research of a financing partner (a big French brand and an equity fund investor refused to go on with the transaction after the due diligence (Cadenabbia et al. 2012)), the owners decided for the dissolution of the company and the subsequent liquidation. The management considered useful to reverse almost € 6 mln to provisions for risk. The owners renounced to the reimbursement of their financial credits with the company, as it's visible in the balance sheet statement.

In financial statements, the situation reflects the incredible decrease in net sales, the change in the stock of inventory, and the reverse of nearly € 6 bln to provisions, with huge consequences in net income of 2012.

5.3. The deal structure

After the historical analysis of the two companies in the years before the acquisition, this chapter will focus on the deal, as regards to time and conditions.

As previously mentioned, GVT strategy comprehends the differentiation of the range of the products, through external growth as well. After some researching in potential sellers in the Tuscan district, the attention of the manager moved to ILCEA, that was in liquidation. In 2014, GVT was interested in a preliminary lease of a branch of the business. It comprehended the finishing and refinishing phase of the tanning process. These phases were completely different from GVT old one, but affecting only the last part of the process. This step was considered intermediate before the practical purchase (Fazzini 2019). The lease reflects on financial statements with the increase of inventory, receivables and payables, and a consequent rise of bank account item.

Table 11: GVT Balance Sheet in the years before the acquisition (2013-2014)

BALANCE SHEET	2013	2014
Net Working Capital	11.060	12.447
Cash and Bank	112	29
Inventories	7.720	9.056
Receivables	6.048	7.545
(Payable)	3.305	4.535
Net Accruals	486	351
Other financial Activities	110	110
Fixed Assets	5.261	5.191
Total operating funds	(563)	(616)
Accumulated TFR	563	616
Invested Capital	15.868	17.132
Net Financial Position	10.187	11.413
Bank negative account	9.904	11.119
Financial Debts (Mortgage)	222	-
Partner financing/Other Debt	61	295
Partner financing	38	38
Provisions	23	257
Equity	5.681	5.719
Share Capital	5.000	5.000
reserves	266	311
Net Income t-1	369	369
Net Income T	46	38
Total Equity and Liabilities	15.868	17.132

Table 10: GVT Income Statement in the years before the acquisition (2013-2014)

INCOME STATEMENT	2013	2014
Net Sales	30.040	28.978
Variable costs	25.733	25.286
Inventories variation	333	1.336
Purchases	20.884	21.701
Selling expenses	5.182	4.921
CONTRIBUTION MARGIN	4.306	3.692
Fixed costs	3.336	3.401
Payroll	2.734	2.742
Administrative expenses	99	52
Rent	503	606
EBITDA	971	291
D&A	566	674
EBIT	404	(383)
Interests	(182)	(228)
Extraordinary income/losses	(85)	665
Exchange income/losses	(2)	2
Dividends	56	2
EBT	192	59
taxes	147	21
Net Income	46	38

In 2015 ILCEA was effectively acquired. The conditions and terms of the acquisition plan and its implementation are reported below (Fazzini 2019).

- The deal considered the 'start from zero' of the ILCEA business since the discontinuation of production caused by the interruption of relationships with customers.
  - ↳ The client portfolio is considered inexistent, with a consequent high uncertainty in terms of realization of revenues in the following periods.
    - ↳ This risk decreases the acquisition price.
- GVT acquisition plan provided for the disposal of the units dedicated to the first steps of the production process, maintaining in Turin facilities only the finishing and refinishing phase.
  - ↳ The high brand value depended, and depends, on the last production phases, where the leather becomes even more prestigious.

    - ↳ Grouping the other steps of the production process in Fucecchio facilities, including the supply of raw materials, GVT originated economies of scale.
- The technicians, specialized in the last phase of ILCEA production process, are recognized as an essential value factor from GVT. Their know-how and the experience were crucial for the business
    - ↳ In the merged entity they will be responsible for ILCEA product line.
- The brand value and the comprehensive knowledge of the company made important the maintenance of ILCEA production in the Turin facilities.
    - ↳ The marketing plan focused on the previous clients, with a following expansion of the pool. The customer target of ILCEA was constituted by foreign companies producing man footwear with a luxury niche focus, related to a high price range.

The acquisition purpose focuses its foundation on the relevance of know-how, a critical issue for both companies. The spotlight on brand value, to re-generate ILCEA business, develops a long-term strategy. The strategic intent for GVT comprehends both, and a segmentation aims at reducing the risk of negative peaks and the desire to re-establish the importance of an essential brand in the sector. The strategic intent, the culture's focus, and the vision of the company support the value creation through the acquisition (Lloyd 2019).

5.4. Acquisition as a strategic choice

The choice of 'ILCEA' as the selected target is due to a variety of motives. The operating and strategical fits and the linked benefit from the acquisition are summarized:

- ILCEA produced very high-quality leather for footwear end-use.
    - The target end-user is different from 'Vecchia Toscana' ones. Vecchia Toscana produced leather for accessories and clothes. Then, they had two different markets.
    - Furthermore, the different geographic market target allows to GVT to extend its presence in other markets. Exploiting ILCEA distribution channel and its consideration in the niche luxury market, GVT line can widen its boundaries.
- ILCEA was in a distressing situation but with outstanding orders (Fazzini 2019).
    - The distressed situation, how discussed in Chapter 2.4.3., permits to GVT to purchase the target at an undervalued price. As previously announced, the

ILCEA brand was estimated to have a high value for its worldwide consideration in the luxury market.

- Outstanding orders' presence points to evidence that the distressed situation did not derive from a lack of revenue expectations. Meanwhile, the cause of the troubled state results from a discontinuous owner-management presence or capability in the right running of the business.

- ILCEA was situated in Turin, outside the district influence.
  - It allows to the tannery to expand its boundaries out of the district orientation.
  - GVT can favour from different experience, capabilities and know-how, that add value to its actual business.
  - The non-affiliation of ILCEA to consortium associations made it challenging to write off the costs for waste recycling for the stand-alone company.

5.5. ILCE Acquisition Price

As already discussed, ILCEA had been liquidated in June 2013, but the acquisition was implemented in 2015. The enterprise value calculated in 2015 can not be based on a DCF valuation, since the lack of future cash flows of ILCEA.

An alternative method to the assessment of an insolvency company is based on the analysis of its 'Liquidation value' (Deepak Panda 2018). The 'liquidation value' of a company is the amount that would be realized when an asset or group of assets were sold on a piecemeal basis, that is without consideration of benefits associated with a going-concern business (IVSC 2016). In other words, Liquidation Value is the value of total assets reduced by the total liabilities, considering the distressing situation. For companies going through a decline phase or in the insolvency process, the enterprise valuation may be lower than the liquidation value, since the company should shut, or shut its business. As stated earlier, the Liquidation value of ILCEA in 2015, when it was acquired, is calculated as follow:

Table 12: ILCEA Liquidation Value Calculation

ILCEA VALUATION				
	2012	**2013**	**2014**	**2015**
Fixed Assets	4.600.518	4.600.518	4.554.513	4.486.195
% devaluation		*1%*	*1,5%*	*2,0%*
Net fixed assets	**4.600.518**	**4.554.513**	**4.486.195**	**4.396.471**
Receivables	2.534.669	2.534.669	2.027.735	1.824.962
mortgages in favour of credit institution		*20%*	*10%*	*10%*
Net Receivables	**2.534.669**	**2.027.735**	**1.824.962**	**1.642.466**
Inventories	8.780.374	8.780.374	8.604.767	7.959.409
% devaluation		*2%*	*8%*	*15%*
Net inventories	**8.780.374**	**8.604.767**	**7.959.409**	**6.733.660**
Total Liabilities	**9.840.169**	**9.840.169**	**9.840.169**	**9.840.169**
Liquidation value	**6.075.392**	**5.346.846**	**4.430.397**	**2.932.428**
ILCEA Value Expert Valuation				**2.911.765**
Acquisition price				**2.475.000**

Following the Italian insolvency law, ILCEA was valued 2.911.765 € by insolvency experts (Fazzini 2019). To better understand the conditions behind the creation of ILCEA liquidation value and experts considerations, the analysis of the graph above follows.

- Fixed Assets – The total fixed asset value decreases during the years due to the non-utilization of machinery and equipment. Being the production a high target quality, types of machinery and equipment need constant maintenance to assure the right level of quality and production.
- Receivables – The devaluation of receivables is due to the outline of credit on speculation of future earnings activated with a credit institution. During the years, the credits cashed out were acquired from the credit institution.
- Inventories – Rawhides are perishable goods. In 2015 the inventory was mostly composed of the finished goods, due to the deterioration of raw materials not transformed.

The acquisition price was fixed to € 2.475.000, considering that it was willing to purchase the assets in a unique batch and due to the previous investment for the lease of an ILCEA branch.

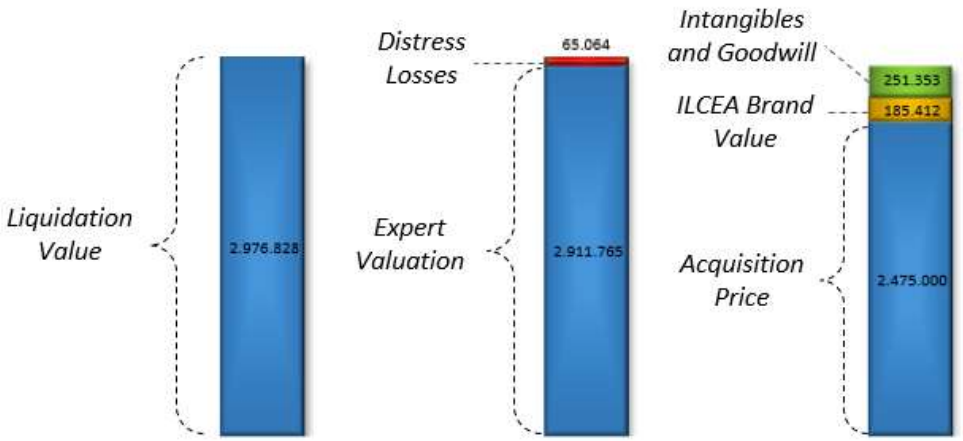


Figure 37: Intangible and goodwill calculation, based on expert valuation and price paid (Fazzini, 2018)

From the deal analysis, it results that GVT acquired ILCEA at a lower price than the valuated one. GVT management, accordingly with the valuation of insolvency expert, valued ILCEA Brand € 185,412, successively accounted. The transaction created a Goodwill of 251,353 €, that reflects the know-how and the experience of ILCEA technicians.

CHAPTER 6: GVT VALUATION AND CONCLUSIONS

At this point, having studied the economic and financial situation of the two companies at the moment of the acquisition and in the previous years, it is worth estimating the value through a fundamental analysis after the takeover. The model bases on the stratification analysis. As explained in chapter 2.3. , to understand the value-creating with the acquisition it is necessary to compare it with the acquisition price. In indirect calculation, the acquisition value is calculated as $W_{acq} = W_{A+B} - W_A$, where W_{A+B} represents the value of the combined entity and WA indicates the stand-alone value of the acquirer (Massari 1998). Following the stratification model, the chapter will analyze W_{A+B} and W_A, applying WACC and DCF. The initial assumption is to construct the study at the time of the acquisition, then in 2015. Paragraph 6.1 examines the first scenario (W_{A+B}), i.e. GVT with ILCEA acquisition (GVT_{A+B}), arguing with the assumptions, the respective projections, to investigate on the GVT_{A+B} value. The second scenario (W_A), GVT without ILCEA acquisition (GVT_A), will be treated in paragraph 6.2 with the same framework. The last part comprehends the comparison between the two different scenarios and the focus on where the value has been created. In practice, always based on indirect methods, the variables of the acquisition value are broken down: $Wacq = W_B + W_r + W_s + W_{op}$ [3]. Paragraph 6.4 investigate each of those components.

In the final paragraph, the results achieved will be tested in order to achieve a definitive conclusion about the creation or destruction of value by the deal.

6.1. First Scenario: GVT with ILCEA acquisition (GVT_{A+B})

The assumption and the projection are built at the time of the acquisition. The analysis focuses on the forecast period from 2015, the year in which the transaction occurs. Assumptions are made on previous years GVT performance.

The following graphs show the consequences of the acquisition in 2015, starting from the balance sheet.

[3] W_B = Stand-alone value of the target
W_s = Value of the synergies
W_r = Variation of the value of the risk spread
W_{op} = Value of new opportunity

Table 13: GVT Pre-acquisition balance sheet situation

BALANCE SHEET	2013	2014	2015
Net Working Capital	11.060	12.447	12.992
Cash and Bank	112	29	57
Inventories	7.720	9.056	9.984
Receivables	6.048	7.545	7.549
(Payable)	3.305	4.535	4.937
Net Accruals	486	351	228
Other financial Activities	110	110	110
Fixed Assets	5.261	5.191	4.734
Total operating funds	(563)	(616)	(546)
Accumulated TFR	563	616	546
Invested Capital	15.868	17.132	17.180
Net Financial Position	10.187	11.413	11.396
Bank negative account	9.904	11.119	11.165
Financial Debts (Mortgage)	222	-	-
Partner financing/Other Debt	61	295	231
Partner financing	38	38	38
Provisions	23	257	193
Equity	5.681	5.719	5.784
Share Capital	5.000	5.000	5.000
reserves	266	311	349
Net Income t-1	369	369	369
Net Income T	46	38	65
Total Equity and Liabilities	15.868	17.132	17.180

Fixed Assets	Pre-acquisition	Variation	Post-Acquisition
Total Fixed Assets	4.734	-	6.592
Intangible Assets	1.300	812	2.113
Patetn rights	-	375	375
GVT intangibles	618	-	618
Brand Value	675	185	860
Other intangibles and goodwill	7	251	259
Tangible Assets	2.945	1.046	3.991
Plants	905	628	1.533
Machineries	1.969	418	2.387
Equipments	39	31	71
Financial Assets	489	-	489

Table 13 describes the pre-acquisition situation. The important amount of variation occurs on assets dimension. It is necessary to remind, that the major change in working capital items occurred in 2014 with the lease of a branch of ILCEA business.

In post-acquisition statement, mortgage item reflects the bank funding activity (Vecchia Toscana Report, 2018), that accounts for € 1.7 mln. The debt is assumed to be written- off in five years.

The increase in fixed assets in 2015 reflects the book-keeping of ILCEA facilities and intangibles, as balance sheet shows.

The projections are made based on the value drivers on which the acquisition focuses and the expected future trend.

In particular, GVT undertakes the acquisition strategy (and the implementation of MULTIPEL) with the principal aim to diversify its customer base (Fazzini 2019). Consequently, the more heterogeneous is the pool of clients, the lower is the economic risk. Keeping in mind the goal of the transaction the assumptions follow:

- On the net sales side, GVT assumption diversifies the growth for product line as in the table below (Mps et al. 2015).

Table 14: Product line estimated growth post acquisition

Product line growth					year to year variation	
	2015	2016	2017	2018	2019*	2020*
GVT line	2%	9%	13%	9%	1%	1%
ILCEA line	100%	45%	32%	25%	20%	10%
Multipel line	-	100%	240%	90%	30%	10%

GVT line maintains stable growth based on the market trend (market growth of 4.7% CAGR during the forecast period 2015-2020 (Statista, Statista 2014)) and the historical GVT trend, considering the recovery of the leather market. The implementation of the new lines produces an initial huge increase, until a following stabilization of the trend. As regards to ILCEA line, as above mentioned, the Turin company has an important brand image and the management is positive about the re-start of this high-quality business. The above data must be considered in terms of quantity produced. ILCEA products have a higher market price and a higher operating margin in terms of value. GVT product line ranks in high-quality leather market, but the selling price is lower than the former. Multipel line has lower margins, due to the medium quality of the goods produced, but it positively affects net sales in terms of quantity.

- As regards the cost side, purchase cost represents a high percentage for GVT, and they will increase as sales grow. ILCEA products derive from high-quality raw material and this is considered in the assumptions since the high-quality skins and hides constitute a high cost for the company. The management assumes that purchase costs represent on average of 65% on net sales.
- In 2015 GVT management decides to maintain only seven, among technicians and employees from old ILCEA facility. But the operating and integration plan foresees to hire some ILCEA employees each year (Mps et al. 2015), to restore an appropriate occupational level for a successful business.

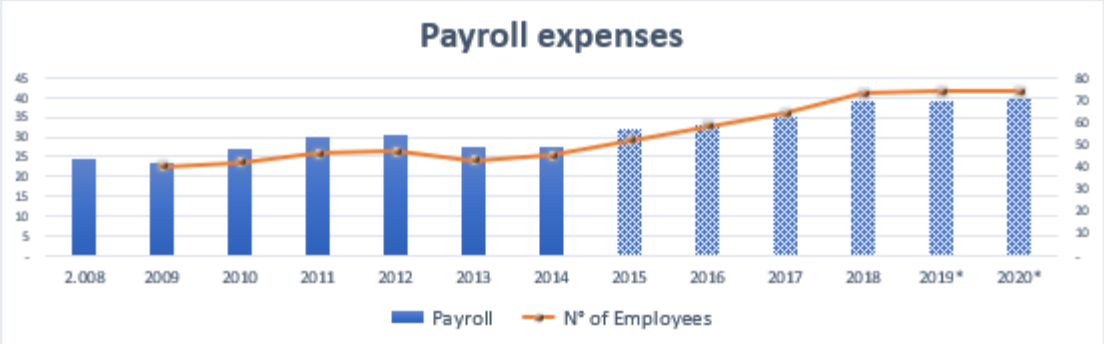


Figure 38: GVT Payroll historical and forecasted expenses (2008-2020)

- With the same logic of purchase costs, inventory stock value even more increases, as strictly related to net sales, and also due to the gathering of high-quality raw materials destinated to ILCEA line. The ending inventory is estimated to be 40% of net sales.
- The new product lines implementation involves the acquisition of machinery and equipment for a total of €2 mln.
- GVT activity needs to be financing to third parties. The management assumes to undertake a financial debt of €1.8 mln to repay in five years.
- The Equity will remain mainly stable due to the lack of share capital injection or withdrawal.

6.1.1. First Scenario projection

The projections are made considering the market trend, and considering the implementation of MULTIPEL line since 2016, which contributes a lot in the growth of the business.

Table 15: GVT (A+B) Forecast Income Statement (2015-2020)

INCOME STATEMENT	Historic		Forecast				Assumption					
	2015	2016	2017	2018	2019*	2020*	2016	2017	2018	2019*	2020*	
Net Sales	24.641	25.167	28.607	33.859	34.197	34.539	2%	14%	18%	1%	1%	Year to year
Inventories variation	(1.590)	(294)	1.660	1.422	1.436	1.450	40%	40%	40%	40%	40%	End inventory % on sales
Purchases	13.428	14.592	19.095	22.142	22.228	22.451	58%	67%	65%	65%	65%	% on sales
Selling expenses	4.674	5.370	5.988	7.052	7.113	7.184	21%	21%	21%	21%	21%	% on sales
CONTRIBUTION MARGIN	4.948	4.911	5.184	6.087	6.292	6.355						
Payroll	3.182	3.319	3.517	3.890	3.929	3.968	4%	6%	11%	1%	1%	Year to year
Administrative expenses	79	134	86	93	96	97	2%	2%	2%	2%	2%	% on net sales
Rent	687	516	612	693	699	706	2%	2%	2%	2%	2%	% on net sales
EBITDA	1.000	942	969	1.411	1.568	1.583						
D&A	797	495	470	574	562	573	10%	10%	10%	10%	10%	
EBIT	203	448	499	837	1.006	1.010						
Interests	(248)	(300)	(287)	(309)	(373)	(371)	2%	2%	2%	2%	2%	% on mortagage and red
Extraordinary income/losses	206	-	-	-	-	-						bank account
Exchange income/losses	3	5	7	12	-	-						
Dividends	0	0	8	112	112	112	0%	5%	10%	15%	15%	% on net income t-1
EBT	164	153	227	652	745	751						
taxes	92	102	113	222	246	248	47%	47%	47%	47%	47%	
Net Income	72	52	114	430	499	503	-28%	122%	276%	16%	1%	Year to year

Table 16: GVT (A+B) Forecast Balance Sheet (2015-2020)

BALANCE SHEET	Historic	Forecast					Assumption					
	2015	2016	2017	2018	2019*	2020*	2016	2017	2018	2019*	2020*	
Net Working Capital	12.882	14.442	13.386	15.626	15.916	16.031						
Cash and Bank	57	195	69	81	81	81						
Inventories	9.984	9.942	11.531	13.594	13.866	14.144	40%	40%	40%	40%	40%	% on net sales
Receivables	7.549	9.765	8.844	9.661	9.854	10.052	39%	31%	29%	29%	29%	% on net sales
(Payable)	4.937	5.594	7.066	7.750	7.905	8.263	38%	37%	35%	36%	37%	% on purchase
Net Accruals	228	134	8	39	19	18						
Other financial Activities	110	129	110	31	31	31	0,5%	0,4%	0,1%	0,1%	0,1%	% on net sales
Fixed Assets	6.592	4.750	7.089	6.888	7.026	7.167		(1.800)	2.000			Machinery replacement
Total operating funds	(546)	(580)	(550)	(561)	(584)	(589)						
Accumulated TFR	546	580	550	561	584	589	15%	15%	15%	15%	15%	% on payroll
Invested Capital	19.038	18.741	20.035	21.983	22.359	22.608						
Net Financial Position	13.254	13.412	14.604	16.148	15.743	15.665						
Bank negative account	11.165	11.769	13.978	15.645	15.355	15.477						
Financial Debts (Mortgage)	1.858	1.464	487	403	203	-	(395)	(975)	(100)	(200)	(200)	Reimburment
Partner financing/Other Debt	231	178	139	100	185	188						
Partner financing	38	38	38	38	38	38						
Provisions	193	141	102	63	148	151	3%	1%	1%	1%	2%	% on Receivables
Equity	5.784	5.329	5.430	5.836	6.616	6.943						
Share Capital	5.000	5.000	5.000	5.000	5.000	5.000						
reserves	349	(81)	(40)	61	747	1.070						
Net Income t-1	369	369	369	369	369	369						
Net Income T	65	41	101	405	499	503	0%	5%	10%	15%	15%	% of dividends
Total Equity and Liabilities	19.038	18.741	20.035	21.983	22.359	22.608						

The expected revenues increase from 2015 to 2018 is of 5.79% CAGR. From 2016, GVT starts to benefit from the constant R&D activity of the precedent years, with a continuous diversification of product.

The incidence of fixed cost is decreasing. This is the signal of more efficient employment of resources and as a consequence of economies of scales raised from the acquisition.

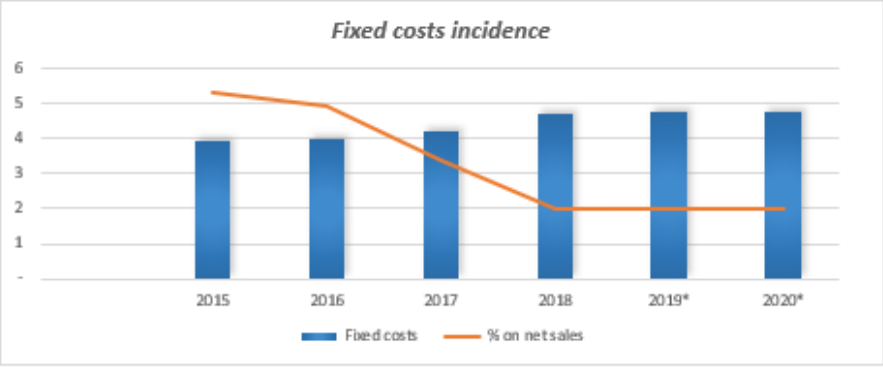


Figure 39: GVT Fixed costs incidence on net Sales (2015-2020)

Operating margins analysis reflect the operating efficiency of the merged firm. The EBITDA margin is, even more, increasing as a result of economies of scope. ILCEA and GVT line shared the production process until the last phase (finishing and refining). Moreover, they share

administrative and selling expenses, that, even though they increased due to the expansion of geographic segmentation, have a lower incidence of unitary costs.

Figure 40:GVT (A+B) Operating Margins trend (2015-2020)

Cash flow statement reflects the operations needed to the stabilization of the two new lines production. In 2015, what's relevant is the variation of inventory stock, due to the utilization of ILCEA raw-hide from the previous year, and the reorganization of the inventory policy in preparation of future year production. The acquisition of ILCEA figures out in an increase in CAPEX, but also in a mortgage loan origination.

Table 17: GVT (A+B) Cash Flow Statement (2015-2020)

CASH-FLOW STATEMENT - Indirect method	Historic		Forecast			
	2015	2016	2017	2018	2019*	2020*
Result before taxes	164	153	227	652	745	751
D&A	797	495	470	574	562	573
Retirement allowance	69	(34)	30	(12)	(22)	(6)
Cash Flow generated by operating activities	1.030	613	728	1.215	1.285	1.319
Delta Net Working Capital	2.016	(1.785)	(864)	(2.228)	(1.629)	(1.647)
Delta receivables	4	2.216	(921)	817	193	197
Delta payables	402	0	(0)	(0)	(0)	0
Delta inventories	(1.590)	(294)	1.660	1.422	1.436	1.450
Delta Cash	28	138	(126)	11	-	-
Paid current taxes	92	102	113	222	246	248
NET CASH FLOW FROM OPERATING ACTIVITIES	3.139	(1.070)	(24)	(791)	(99)	(81)
CAPEX	(1.800)		(2.000)			
NET CASH FLOW FROM INVESTING ACTIVITIES	(1.800)	-	(2.000)	-	-	-
Debt Repaiment	1.700	(395)	(975)	(100)	(200)	(200)
NET CASH FLOW FROM FINANCING ACTIVITIES	1.700	(395)	(975)	(100)	(200)	(200)
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	3.039	(1.465)	(2.999)	(891)	(299)	(281)

6.1.2. Weighted Average Cost of Capital (WACC)

The weighted average cost of capital (WACC) is the rate that a company is expected to pay on average to all its stakeholders, including mainly shareholders and debt holders, to finance its assets. WACC calculation considers, as previously discussed, the economic and financial risk of the companies. Below, a short recap of WACC formulas:

$$WACC^{4} = D/V * k_d * (1\text{-}T) + E/V * k_e$$

Where:

$$Ke^{5} = Rf + CRP + \beta*(Rm - Rf)$$

[4] Where:
D: Debt
E: Equity
Kd: Cost of Debt
T: Tax rate
Ke: Cost of equity

[5] Where:
Rf: Risk-free rate
CRP: Country Risk Premium
β: Beta equity
Rm: Market risk

According to the Capital Asset Pricing Model (CAPM), Cost of equity calculation compares the market risk, where the company operates, with the risk-free rate. β represents the volatility in respect of the investment to the average return of the market.

Table 18: GVT (A+B) Country Risk Premium calculation (GVT, 2015)

CRP Main Market of GVT			
Country	CRP	% Sales	CRP % Sales
Italy	3,1%	52,0%	1,6%
Europe	1,0%	40,0%	0,4%
Asia	3,7%	0,5%	0,0%
Japan	5,8%	3,5%	0,2%
China	5,1%	2,0%	0,1%
USA	0,0%	2,0%	0,0%
CRP			2,32%

The following assumptions take into consideration the analysis of each component of the formula. Starting from the cost of equity, the risk-free rate assumed is Italy's 10-year government bond yield rate on 1/1/2016, equal to 2.3%, being Italy the most important market for GVT. On the other hand, the Country Risk Premium (CRP) changes firm by firm, depending on the number of sales in the different countries and their relative CRP. In the table 18 are shown the calculations of the CRP for GVT, multiplying the relative CRP disclosed by Damodaran (2009) with the percentage of sales in that country in 2015.

By contrast, beta calculation is highly complex and often it is discussed what is the best utilizable method, one alternative could be the covariance between the market's performances and company's performances. In this context, it has been decided to assume a debt risk-free approach, following the formula:

$$\beta l = \beta ul\ (1 + (1\text{-}t)*(D/E))$$

Where:

βul= Beta unlevered

βl= Beta levered

The set of comparable firms is made by companies operating in the tanning industry on the public market. In terms of market capitalization are all larger than GVT. However, there weren't other alternatives, still today, are only few the companies listed being part of tanning sector in Italy or Europe, for the presence of most small and medium enterprise in this sector (see the table 19).

Table 19: Competitors market beta (infrontanalytics website, 2015)

International Peers				
Company Name	Country	Market Cap.	Beta	Year to - date Price Change
Hermes International	FRA	79595	0,65	4,70%
Kuraray Co. Ltd	JPN	3417	0,55	-19,60%
Crocs Inc	USA	1800	3,18	-36,20%
Accenture Ptc.	IRL	123399	0,79	-8%
Prada S.p.A.	ITA	8428	0,88	-20,70%

The market risk premium is Italy's average one at 1/1/2016 6.45 % [6].

Equity risk premium (ERP), the difference between market rate and the risk-free rate, is 4.15%. Then, the Cost of Equity valuation is calculated as in the table below[7]:

Table 20: GVT(A+B) Cost of Equity calculation

Ke	
Beta unlevered leather tanning industry	0,88
D/E target	190%
beta levered	2,11
risk free rate	2,30%
Risk premium	4,15%
CRP	2,32%
Ke	**13,38%**

The cost of equity represents the rate of return a shareholder requires for investing equity into a business. The rate of return an is based on the level of risk associated with the investment. In 2015 GVT acquired an insolvency target and the risk associated with this operation is reflected in the cost of capital. As a matter of fact, the debt to equity ratio of the target is high due to the troubled financial situation, raising a lot the cost of equity.

Turning to Kd, there are several ways to get it. In this case, the utilised method considers the debt spread, based on the Interest coverage.

$$Kd = (Rf + Debt\ spread) * (1 - T)$$

[6] Data from website: http://www.market-risk-premia.com/it.html

[7] Beta Data from : Damodaran database, 'Beta, Unlevered beta and other risk measures', July 2015;

Debt spread value cames from Damodaran's rating table, based on the company interest coverage ratio. GVT interest coverage ratio is equal to 1.91, that correspond to a Default dreap of 4.25%. Tax rate is assumed to be 27%. The following table shows the calculation of the cost of debt after tax:

Table 21: GVT(A+B) Cost of debt calculation

Kd	
Risk free rate	2,30%
Interest coverage rate	1,91%
Default spread	4,25%
% Tax	27%
Kd	**4,81%**

The last consideration before proceeding with WACC calculation is the relation between net financial position and equity with enterprise value. In details, the portion of debt and equity represent respectively 69.6% and 30.4% on total value.

Table 22: GVT(A+B) WACC Calculation

WACC	
Kd	**4,8%**
D/(D+E)	69,6%
% Tax	27%
Ke	**13,4%**
E/(D+E)	30,4%
WACC	6,53%

In the end, in the table above, WACC has been achieved for 6.53% for GVT.

6.1.3. Continuing Value and DCF Valuation

The continuing value (CV) is the value of the company that is not valuable during the explicit forecasted period. For a matter of simplicity, the FCFs are forecasted, usually, for the first five years, the remaining part of the value is gathered in the CV. Looking into the details, the free cash flow after the fifth period might be: equal to zero; keeping it fixed; as well as growing at a constant rate. For the latter alternative, it is needed to assume a perpetual growth in an indefinite horizon. The basic principle is that, even if the company currently has a competitive advantage, in the long-term it will be not able to protect it, being not sustainable because of competition (Koller T. 2015). Being prudent and avoiding concentrating all the value in the CV, the growth rate should be like the expected inflation rate or the GDP's growth of the country in which the company operates. In this specific context, looking to the future of the leather goods and tanning sector, the growth rate must consider the expected inflation rate, that

is 2% in EU, and the industry rate, expected to be equal to 0.7% CARG 2019-2023 (Statista, 2019). Considering that, it has been assumed a growth rate of 1.2%.

The achievement of the CV implies the application of the below formula:

$$CV = FCF_{(n+1)}/(WACC - g)$$

$FCFn_{+1}$ is the free cash flow estimated in the year after the forecast period, in this case, 2021. The calculation takes into consideration the growth of invested capital and working capital and the consequent variation. After the achievement of CV, it needs to be discounted from year n to year 0.

Table 23: GVT (A+B) Continuing Value Calculation

CV	
NOPLAT 2020	732
D&A	573
Change in Invested Capit	(118)
FCF 2020	1.188
FCF 2021	1.588
Growth rate	1,2%
WACC	6,53%
Continuing Value	***29.533***

The last step is the company's valuation, applying the DCF, realized in table 24. A remainder to Chapter 2.3.1.1. DCF valuation base its calculation on Free Cash Flows. FCFs are calculated starting from NOPLAT. By deducting CAPEX and working capital investment from the Cash Flow derived from operating activities, Free Cash Flow is computed. It represents the base for the Discounted cash flow model (DCF), realized in the table below. The value of the companies is given by the sum between the discounted forecasted free cash flows and the present value of the CV, as recapped in the formula:

∑ PV of FCF in the forecast period
+ PV of Continuing Value

Value of the operating assets
+ Estimated Value of non-operating assets

Value of the firm (V)

Enterprise value is calculated as follow:

Table 24: GVT (A+B) Enterprise Valuation

DCF Valuation							€
Thousands	2015	2016	2017	2018	2019*	2020*	
EBIT	203	448	499	837	1.006	1.010	
tax rate	27,50%						
NOPLAT	147	324	362	607	729	732	
D&A	797	495	470	574	562	573	
Gross cash flow	944	819	832	1.181	1.291	1.306	
Net Op. Capex	(1.800)	-	(2.000)	-	-	-	
Change in NWC	(653)	(1.611)	679	(2.167)	(330)	(118)	
Free Cash Flow	(1.508)	(792)	(489)	(986)	961	1.188	
WACC	*6,53%*						
Present Value	(1.416)	(698)	(405)	(766)	701	813	
Continuing Value						29.533	
PV of CV	20.209						
EV	18.438						
Debt	*13.254*						
Market Equity Value	*5.184*						
Number of share	5.000						
Value per share	1,04 €						

g= 1,2%

Concluding the paragraph, the first scenario (GVT_{A+B}) take into consideration the assumption made on the leather market trend, the previous GVT performances and ILCEA characteristics. Calculating FCFs and financial risk mirrored in WACC value, the outcome totalizes a GVT Enterprise Value of € 20 mln, an equity value of € 6.98 mln and a value per share of € 1.40.

6.2. Scenario 2: GVT without Ilcea acquisition (GVT_A)

In line with the goal of the thesis, this chapter will investigate the value of Vecchia Toscana in case the acquisition never happen. The appraisal is developed on the assumption that GVT ongoing as a stand-alone company. In line with the previous analysis and the study, the assumption and the projection are built at the time of the acquisition, then the analysis focuses on the forecast period from 2015.

The projections are made on the bases of the previous years' performance and the market trend. The evaluation takes into consideration also the previously mentioned implementation of the profitable new line, Multipel.

The table below shows the initial balance sheet situation until 2015.

Table 25: GVT (A) Balance Sheet Pre-Acquisition (2013-2015)

BALANCE SHEET	2013	2014	2015
Net Working Capital	11.060	12.447	12.992
Cash and Bank	112	29	57
Inventories	7.720	9.056	9.984
Receivables	6.048	7.545	7.549
(Payable)	3.305	4.535	4.937
Net Accruals	486	351	228
Other financial Activities	110	110	110
Fixed Assets	5.261	5.191	4.734
Total operating funds	(563)	(616)	(546)
Accumulated TFR	563	616	546
Invested Capital	15.868	17.132	17.180
Net Financial Position	10.187	11.413	11.396
Bank negative account	9.904	11.119	11.165
Financial Debts (Mortgage)	222	-	-
Partner financing/Other Debt	61	295	231
Partner financing	38	38	38
Provisions	23	257	193
Equity	5.681	5.719	5.784
Share Capital	5.000	5.000	5.000
reserves	266	311	349
Net Income t-1	369	369	369
Net Income T	46	38	65
Total Equity and Liabilities	15.868	17.132	17.180

The forecast is built on the following assumption and value drivers:

- As regards net sales growth, Vecchia Toscana assumptions on revenues consider the trend of the two product line, GVT line and Multipel. As in the first scenario, GVT line maintains stable growth based on the market trend (market growth of 4.7% CAGR during the forecast period 2015-2020 (Statista, Statista 2014)) and the historical GVT trend, considering the recovery of the leather market. Assumptions must be considered in terms of quantity. GVT line maintains a higher profit margin that Multipel, but does not enjoy of ILCEA line influence.

Table 26: GVT (A) Product lines growth (2015-2020)

Product line growth	2015	2016	2017	2018	2019*	2020*
GVT line	2%	9%	13%	9%	1%	1%
Multipel line	-	40%	240%	90%	50%	40%

- The end inventory stock is predicted to represent 40% of net sales. Furthermore, the amount of purchase is expected to increase after the implementation of Multipel line

from 60% on net sales to 62% on net sales. Selling expenses are forecast to increase with the implementation of the new line.

- Fixed costs are assumed to be a stable growth in line with net sales. Payroll is expected to growth of 1.2% in 2017 and 2018 due to the hiring of 2 people each year to manage the new line.

- The new product lines implementation involves the acquisition of machinery and equipment for a total of €1.2 mln.
- GVT activity needs to be financing to third parties. The management assumes to undertake a financial debt of €0.8 mln to repay in three years.
- The Equity will remain mainly stable due to the lack of share capital injection or withdrawal.

6.2.1 Second Scenario projection

Tables 27 and 28 describe the projection of income statement and Balance Sheet Items.

Table 27: GVT (A) Income Statement projections (2015-2020)

INCOME STATEMENT	Historic		Forecast				Assumption					
	2015*	2016*	2017*	2018*	2019*	2020*	2016	2017	2018	2019*	2020*	
Net Sales	24.051	24.460	27.396	31.642	32.022	32.662	1,70%	12,00%	15,50%	1,20%	0,70%	Year to year
% Variation	-17,0%	1,7%	12,0%	15,5%	1,2%	0,7%						
Variable costs	18.554	19.866	22.403	26.305	26.618	27.180						
Inventories variation	928	118	856	1.699	152	256	40%	40%	40%	40%	40%	End inventory % on sales
Purchases	14.451	14.676	17.095	20.725	19.853	20.250	60%	60%	62%	62%	62%	% on sales
	60%	60%	62%	66%	62%	62%						
Selling expenses	5.051	5.308	6.164	7.278	6.917	7.186	21%	22%	23%	23%	22%	% on sales
	21%	22%	23%	23%	22%	22%						
CONTRIBUTION MARGIN	5.498	4.594	4.993	5.337	5.403	5.482						
Fixed costs	3.989	3.730	3.888	4.022	4.037	4.059						
Payroll	3.182	3.192	3.230	3.262	3.269	3.275	0,3%	1,2%	1,0%	0,2%	0,2%	Year to year
Administrative expenses	120	122	137	158	160	163	0,5%	0,5%	0,5%	0,5%	0,5%	% on net sales
Rent	687	416	521	601	608	621	1,7%	1,9%	1,9%	1,9%	1,9%	% on net sales
EBITDA	1.509	865	1.105	1.316	1.366	1.423						
D&A	797	403	491	452	416	382	10%	10%	10%	10%	10%	% on fixed assets
EBIT	712	461	614	864	951	1.041						
Interests	535	476	548	619	638	641	24,7%	24,7%	24,7%	24,7%	24,7%	% on mortgage and red
Exchange income/losses	3	5	7	12	5	5	3,2%	3,2%	3,2%	3,2%	3,2%	% on net income t-1
Dividends	0	0	0	5	27	32	0%	0%	10%	15%	15%	% on net income t-1
EBT	182	(9)	73	252	291	373						
taxes	92	-	20	70	80	103	28%	28%	28%	28%	28%	
Net income	90	(9)	53	182	210	270						

Table 28: GVT(A) Balance Sheet Projections (2015-2020)

Balance Sheet	Historic		Forecast				Assumption					
	2015	2016	2017	2018	2019	2020	2016	2017	2018	2019*	2020*	
Net Working Capital	12.882	12.412	12.717	14.415	14.911	15.209						
Cash and Bank	57	24	27	32	32	33						
Inventories	9.984	10.102	10.958	12.657	12.809	13.065	41%	40%	40%	40%	40%	% on net sales
Accounts Receivables	7.549	6.604	6.849	7.910	8.005	8.166	27%	25%	25%	25%	25%	% on net sales
(Account payable)	4.937	4.403	5.128	6.218	5.956	6.075	30%	30%	30%	30%	30%	% on purchase
	-	30%	30%	30%	30%	30%						
Net Accruals	228	84	11	34	20	21						
Other financial Activites	110	110	110	110	110	110						
Total Operating Funds	(573)	(574)	(577)	(580)	(581)	(582)						
Accumulated TFR	573	574	577	580	581	582	18%	18%	18%	18%	18%	% on payroll
Fixed Assets (equipments)	4.734	4.032	4.909	4.516	4.155	3.823		1.200				Machinery
Invested Capital	17.153	15.980	17.159	18.462	18.595	18.560						
Net Financial Position	11.396	11.413	12.329	12.259	12.176	12.094						
Bank negative account	11.165	11.276	11.389	11.503	11.618	11.734						
Financial Debts (Mortgage)		-	800	600	400	200		800	(200)	(200)	(200)	Reimbursmen
Partner financing/Other Debt	231	137	140	156	158	160						
Partner financing	38	38	38	38	38	38						
Provisions	193	99	103	119	120	122	1,5%	1,5%	1,5%	1,5%	1,5%	% on Receivables
Equity	5.758	4.567	4.830	6.203	6.420	6.466						
Share Capital	5.000	5.000	5.000	5.000	5.000	5.000						
reserves	630	(797)	(611)	599	792	825						
Net Income t-1	38	369	369	369	369	369						
Net Income T	90	(6)	71	234	258	271						
Total Equity and Liabilities	17.153	15.980	17.159	18.462	18.595	18.560						

The expected revenues increase from 2015 to 2018 is of 5.23% CAGR. The growth is lower than the first scenario, due to the lack of ILCEA line, that contributes with high margin to the revenue increase.

The EBITDA margin describes profitability in line with the product lines. Anyway, the variable costs represent a considerable portion of total expenses, always due to the high costs of raw materials. Selling expenses increase as the number of net sales grows, especially in last year, in which further expansion of Multipel line is expected. The fixed costs contribute to a higher percentage in first years due to the smaller amount of revenues.

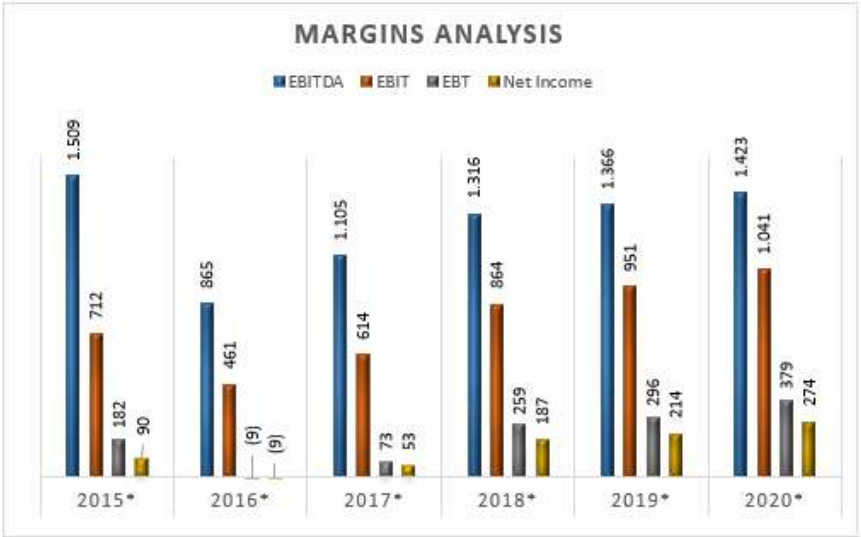


Figure 41: GVT (A) Forecasted Margins Analysis (2015-2020)

A quick look at the leverage analysis shows Net Financial Debt to Total Asset investigating on how much a company's assets are leveraged after accounting for their cash and short term securities. GVT ratio is decreasing over time, but it remains quite elevated. The higher the ratio the more leveraged the company and the greater the probability of adverse conditions affecting the company (or its dividend) in a negative manner. NFP/EBITDA investigates on how many years it would take to pay back company financial debt if they could use all their cash, short term securities, and current annual EBITDA. For GVT, to reduce its debt is very difficult and critical, since the ratio is always above seven and ratios over three could be an important warning sign.

Table 29: GVT (A) Net Financial Debt on Total Asset ratio (2015-2020)

Ratio Analysis						
	2015	2016	2017	2018	2019	2020
Net Financial Debt/total Assets	71,0%	73,7%	74,5%	70,8%	69,8%	69,7%
Net financial Debt/EBITDA	7,6	13,2	11,2	9,2	8,8	8,4

Concluding the paragraph, below is presented the cash flow statement considering the sources of financing and the investing activities assumed in the second scenario.

Table 30: GVT (A) Cash Flow Statement (2015-2020)

CASH-FLOW STATEMENT - Indirect method						
	Historic		Forecast			
	2015	2016	2017	2018	2019*	2020*
Result before taxes	**182**	**(9)**	**73**	**252**	**291**	**373**
D&A	797	403	491	452	416	382
Retirement allowance	43	(1)	(3)	(3)	(1)	(1)
Cash Flow generated by operating activities	**1.022**	**393**	**561**	**701**	**705**	**754**
Delta Net Working Capital	**(502)**	**260**	**(372)**	**(1.667)**	**(508)**	**(297)**
Delta receivables	4	(945)	245	1.062	95	160
Delta payables	**402**	**(534)**	**726**	**1.089**	**(262)**	**119**
Delta inventories	**928**	**118**	**856**	**1.699**	**152**	**256**
Delta Cash	**28**	**(33)**	**3**	**4**	**0**	**1**
Paid current taxes	92	-	20	70	80	103
NET CASH FLOW FROM OPERATING ACTIVITIES	**612**	**653**	**209**	**(896)**	**277**	**561**
CAPEX		-	(1.200)	-	-	-
NET CASH FLOW FROM INVESTING ACTIVITIES	-	-	**(1.200)**	-	-	-
Debt Repaiment	-	-	800	(200)	(200)	(200)
NET CASH FLOW FROM FINANCING ACTIVITIES	-	-	**800**	**(200)**	**(200)**	**(200)**
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	**612**	**653**	**(191)**	**(1.096)**	**77**	**361**

Cash flow statement reflects the operations needed to the stabilization of the new line production MULTIPEL. The inventory variations, especially in 2015 and 2018, are due to the

reorganization of the inventory policy to include the new line, and as a consequence of the increase in net sales. The implementation of the new line figure out in an increase in CAPEX, but also in a mortgage loan origination.

6.2.2. WACC, Continuing Value and DCF Valuation

WACC calculation is built on the previous paragraph investigation, with some different consideration due to the different business and company structure of GVT in the two opposed scenarios.

- The country risk premium is calculated on the geographic segmentation, basing on Multipel and GVT line, excluding ILCEA market.

Table 31:GVT (A) Country Risk Premium Calculation

CRP Main Market of GVT			
Country	CRP	% Sales	CRP % Sales
Italy	3,1%	53,5%	1,6%
Europe	1,2%	41,0%	0,5%
Asia	3,7%	0,5%	0,0%
Japan	5,8%	3,0%	0,2%
China	5,1%	2,0%	0,1%
USA	0,0%	0,0%	0,0%
CRP			2,42%

- WACC calculation[8] takes into consideration a lower default risk due to the absence of the acquisition of potential financial risks. The interest coverage ratio is equal to 2.43% and corresponds to 3% of the default spread in Damodaran's risk table.
- The portion of Debt and Equity on total capital invested differs from GVT_{A+B}

Calculation of WACC is developed as follow:

Table 32: GVT (A) Cost of debt Calculation

Kd	
Risk free rate	2,30%
Interest coverage rate	2,43%
Default spread	3,00%
% Tax	27%
Kd	**3,90%**

[8] Information about rates by the Damodaran website

Table 33: GVT (A) Cost of Equity Calculation

Ke	
Beta unlevered leather tanning industry	0,88
D/E target	210%
beta levered	2,24
risk free rate	2,30%
Risk premium	4,15%
CRP	2,42%
Ke	**14,01%**
D/(D+E)	66,43%
E/(D+E)	33,57%
WACC	***6,61%***

Continuing Value is calculating following the logic of the previous paragraph, and the DCF is developed in the table below.

Table 34: GVT (A) Continuing Value Calculation

CV	
NOPLAT 2020	758
D&A	378
Change in Invested Capit	(297)
FCF 2020	639
FCF 2021	924
Growth rate	1,2%
WACC	6,61%
Continuing Value	***16.930***

Table 35: GVT (A) Enterprise Value Calculation

DCF Valuation						€
	2015	**2016**	**2017**	**2018**	**2019E**	**2020E**
EBIT	712	514	620	869	955	1.045
tax rate	**27,50%**					
NOPLAT	516	372	450	630	693	758
D&A	797	473	485	446	411	378
Gross cash flow	**1.313**	**846**	**935**	**1.077**	**1.103**	**1.135**
Net Op. Capex	-	800	(200)	(200)	(200)	(200)
Change in NWC	(502)	260	(372)	(1.667)	(508)	(297)
Free Cash Flow	**811**	**1.905**	**363**	**(790)**	**395**	**639**
WACC	***6,61%***					
Present Value	**761**	**1.677**	**299**	**(612)**	**287**	**435**
Continuing Value						16.930
PV of CV	**11.534**					
EV	**14.381**					
Debt	*11.396*					
Market Equity Value	*2.986*					
Number of share	**5.000**					
Value per share	**0,60 €**					

g= 1,2%

Concluding, Scenario 2 (GVT_A) takes into consideration the assumption of internal growth, with the development of Multipel products and the growth of GVT original product line. Calculating the risk associated and the FCFs generated, DCF valuation method computes an Enterprise Value of GVT_A of € 16 mln, an Equity Value of € 4.7 mln and a Value per share of € 0.93.

6.3. Synergies valuation and conclusion

After the Enterprise Valuation on GVT in the two different scenarios, the analysis can move to the synergies valuation.

Reverting on the focal point, this thesis previously treated the empirical evidence on the creation of value. The creation of value is strictly related to the generation of synergies. Recalling Chapter 2, synergy is "*the joint effect of two or more factors is different from their simple sum"* (Li Destri, Minà, Picone, 2012). The valuation of synergies is complex and liked with the deal strategy and motives. Stratification Model strictly relates the creation of Value with the creation of synergies. The method will be applied to the evaluation of ILCEA acquisition.

$$NPV\ of\ Synergies = V_{A+B} - (V_A + V_B)$$

Under consideration aforesaid, synergies increase when:

$$V_{A+B} > V_A + V_B$$

Where:

V_{A+B}: Value of merged entity (in this case GVT_{A+B})

$V_{A:}$ Value of the acquiring company (in this case GVT_A)

V_B: Value of the target (in this case ILCEA)

Considering V_{A+B} Vecchia Toscana Group, V_A Vecchia Toscana Group in the absence of acquisition scenario valuation, and V_B the target ILCEA, the calculation of NPV of synergies is calculated as follow:

Table 36: Net Present Value of improvements

NPV of improvement	€
VALUE A+B	*18.438*
VALUE A	*14.381*
VALUE B	*2.977*
NPV of improvements	***1.080***

The table above illustrates that the transaction arises improvements for an amount of around € 1 mln, and then, the acquisition has created value. The following step is to understand what type of synergies originate the merger. However, the value created by the synergies is assumed not to be immediate but gradually implemented.

6.3.1. Revenue Synergies

Revenue synergies arise when additional revenues are achieved as a result of external growth (Chartier et al. 2018). Three dimensions exist among which a company can meet the most effective and direct way to capture revenue synergies: where to sell, what to sell (offering) and how to sell (go to the market).

In GVT case the net sales increased more than in non-acquisition scenario.

Table 37: Net Sales Growth comparison among GVT (A+B) and GVT (A)

Net Sales Growth						
	2015	2016	2017	2018	2019*	2020*
Scenario 1 (GVT A+B)	-15,0%	2,1%	13,7%	18,4%	1,0%	1,0%
Scenario 2: (GVT A)	-17,0%	1,7%	12,0%	15,5%	1,2%	0,7%

ILCEA product line consented to GVT to expand its client portfolio in terms of both 'where to sell' and 'what to sell'. The principal market of ILCEA was the Asian market, in particular, Japan, and the target produced a different quality of leather to different end-use. Other than that, ILCEA product line smoothed the negative peak in 2015 due to the leather market crisis. The increasing trend of ILCEA line brings the signal that GVT management was able to recuperate the old client base.

Table 38: Revenue Synergies calculation, comparing the different scenarios (2015-2020)

Revenue Synergies						
	2015	2016	2017	2018	2019*	2020*
Scenario 1 (GVT A+B)	24.641	25.167	28.607	33.859	34.197	34.539
Scenario 2: (GVT A)	24.051	24.460	27.396	31.642	32.022	32.662
Revenues synergies	**589**	**707**	**1.212**	**2.217**	**2.176**	**1.877**

Thanks to the sharing of companies' sales network, the merged entity can access to new markets with the traditional products and can introduce the new product in its actual market.

6.3.2. Cost synergies

Cost synergies produce incremental gains as a result of a reduction of costs. They can arise from economies of scale, economies of scope or complementary strengths. The acquisition increased payroll expensive.

Table 39: Cost Synergies calculation, comparing the scenarios (2015-2020)

Payroll Expenses						
	2015	2016	2017	2018	2019*	2020*
Scenario 1 (GVTi)	3.182	3.319	3.517	3.890	3.929	3.968
Scenario 2: (GVTw)	3.182	3.192	3.230	3.262	3.269	3.275
Cost synergies	-	***(128)***	***(287)***	***(628)***	***(660)***	***(693)***

Payroll costs in scenario 1 escalate even more each year. GVT integration plan included the re-employment of ILCEA workers on layoff. With the acquisition, in 2015 the merged company counts 52 employees, comprehending managers and technicians, 9 of them from ILCEA company. In 2016, two old ILCEA employers were rehired and in 2018 GVT hired five new employees, 2 in the Turin facilities and 3 in Fucecchio.

Moreover, ILCEA acquisition results in a generation of economies of scales and scope. GVT production is centralized in Fucecchio facilities for a significant part of the production process. The Turin unit receives the semi-finished product and transforms it only for the last phase of the production (refining and finishing). The businesses share centralized functions and other points of the value chain, for example, the purchase of raw material phase, decreasing (in percentage) the administrative and selling costs.

6.3.3. Operating synergies

Operating synergies can emerge from the increase of the production capacity through the acquisition of target workforce and facilities or from the enhance of the operational efficiency and the expertise of the human resources.

The importance of human resources is mentioned in the script more time. GVT integration plan intends to enhance the know-how and the skills of ILCEA workers. In this sense, the acquisition of their expertise, not only favoured the re-introduction of ILCEA products in the market but

also improve the efficiency of the entire company. The graph below shows an increasing trend in EBITDA margin in GVT_{A+B} and greater than GVT_A one.

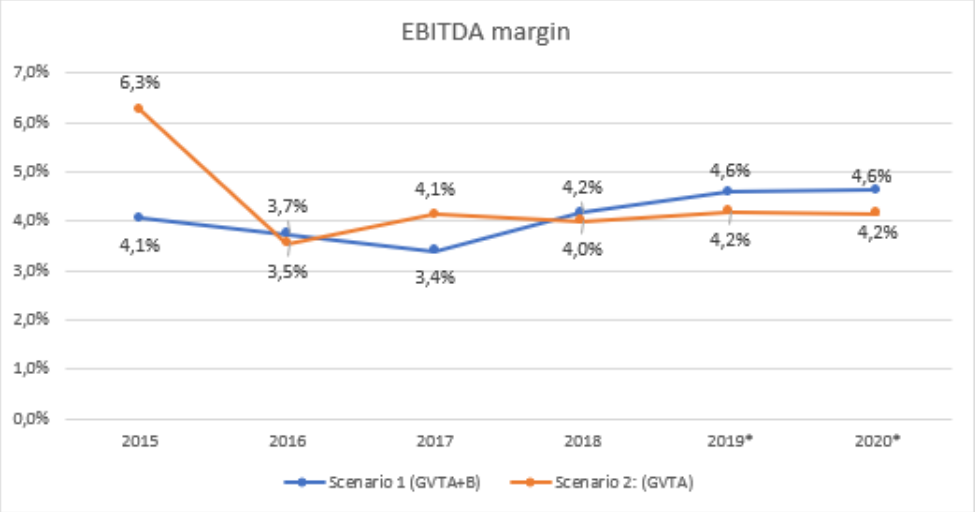


Figure 42: EBITDA Margin comparison (2015-2020)

EBITDA margin in the acquisition scenario is higher. The high price of ILCEA line products contributes to increasing the operating margin. Moreover, the entry in a new geographical market segment favourites also GVT original line in terms of quantity and margin.

EBITDA Margin is helpful when gauging the effectiveness of a company's cost-cutting efforts. The higher a company's EBITDA margin is, the lower its operating expenses are in relation with total revenue. The graph n.n shows a higher operating efficiency gain from the acquired resources.

More generally, the assets acquired with the target purchase (GVTi) initially represented a high cost for the company. Nevertheless, it is necessary to underline that the company can generate profit from its assets. In other words, with return on assets (ROA), it is possible to measure how efficient a company's management is in generating earnings from its economic resources on its balance sheet.

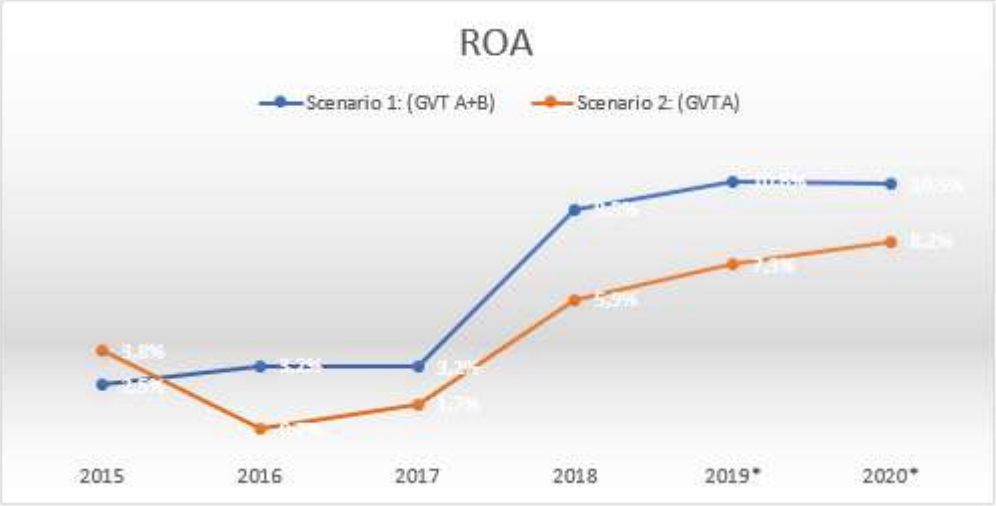


Figure 43: ROA trend comparison (2015-2020)

ROA in GVT_{A+B} has an increasing trend during the years, the signal of efficient management of the production process and resources. On the contrary, in Scenario 2 (GVT_A) it has a fluctuant trend.

As previously mentioned, the fixed cost incidence on total revenue decreases in GVT_A. The efficiency of operating areas raised, since the sharing of capacities and facilities resulting from merging the two entities. Concluding operation Synergies must resume in the table below.

Table 40: Operating Synergies calculation (2015-2020)

EBITDA/Net Sales						
	2015	**2016**	**2017**	**2018**	**2019***	**2020***
Scenario 1 (GVTi)	4,1%	3,7%	3,4%	4,2%	4,6%	4,6%
Scenario 2: (GVTw)	6,3%	4,0%	3,6%	3,7%	3,9%	4,0%
Operating Synergies	***-2%***	***-0,3%***	***-0,2%***	***0,5%***	***0,7%***	***0,6%***

6.3.4. Financial Synergies and Real Options

As previously stated, in chapter 1.5.1. financial synergies can derive from an expansion of debt capacity, and, then, a reduction of cost of debt. Other financial synergies can arise from the decrease in cash flow variability or an improve in bank market access. Acquisitions could modify the risk profile of the companies. Usually, the purchaser diversifying its business reduces its risk, as the GVT case study. Moreover, a significant increase in sizes improves organizational structure and bargaining power. The risk changing can have a positive or negative impact on WACC (Massari 1998). It is necessary to make a comparison between the WACC[9] of Vecchia Toscana as

[9] WACC is considered constant over time.

a stand-alone (scenario 2) company and the one post-acquisition (scenario 1) to evaluate the differential risk.

WACC calculation takes into consideration the assumption in chapter 2 and the Damodaran table (Damodaran, 2009) for the calculation of risk premium and default spread. No-acquisition scenario presents a WACC higher than 0.08%, which could seem to be insignificant, however, it is a source of value creation. In particular, the assumptions made in the two cases of no purchase bring with them some differences:

- Kd – Different interest coverage ratios (1,91% in GVT_{A+B} and 2.43% in GVT_{A}) influence differently the cost of debt. Assuming the same tax rate and the risk-free rate, a higher default spread increases Kd. With the acquisition, the net financial position increases, due to the need for external financing activity and then, the risk associated, increasing WACC.
- Ke – Regarding the cost of equity, the difference arises for two main reasons. The Country Risk Premium differs as the distribution market diverge. ILCEA products are targeted to Asian countries, especially Japan and Hong Kong, and American high luxury footwear market. GVT product lines are oriented to a European market, especially Italian and France, of high-luxury clothes brand. A heterogeneous customer target pool is less risky, the cost of equity decreases. Moreover, GVT_{A+B} and GVT_{A} differ in the D/E structure, influencing the Market Value of Equity.

In table 4.38 are illustrated the comparison between the WACC stand-alone company Vecchia Toscana and the one post-acquisition. Some of the assumptions, as the unlevered β, the ERP or the risk-free rate are the same as the section 4.4.3.

Table 41: Comparison between GVT (A+B) and GVT (A) WACC

WACC		
	GVT (A)	GVT (A+B)
Risk free rate	2,30%	2,30%
Interest coverage rate	2,43%	1,91%
Default spread	3,00%	4,25%
% Tax	27%	27%
Kd	3,90%	4,81%
Beta unlevered leather tanning industry	0,88	0,88
D/E target	210%	190%
beta levered	2,24	2,11
risk free rate	2,30%	2,30%
Risk premium	4,15%	4,15%
CRP	2,42%	2,32%
Ke	14,01%	13,38%
D/(D+E)	66,43%	69,62%
E/(D+E)	33,57%	30,38%
WACC	6,61%	6,53%

The differential risk is calculated in the table below, considering the Enterprise valuation with the different WACC. The FCFs of $GVT_{(A+B)}$ are discounted first by the combined entity's WACC of 6,53% and then, by stand-alone entity WACC of 6.61%. Subtracting from the equity value of the combined entity the value stand-alone of $GVT_{(A)}$, it has been achieved the value created by the differential risk

Table 42: Differential Risk Calculation

Differencial risk						
	2015	2016	2017	2018	2019*	2020*
Net FCF	(1.508)	(792)	(489)	(986)	961	1.188
WACC	6,53%					
Present Value	-1.614	-906	-599	-1.291	1.347	1.781
Continuing Value	22.562					
PV of CV	14.493					
EV	13.210					
Net FCF	(1.508)	(792)	(489)	(986)	961	1.188
WACC	6,61%					
Present Value	-1.615	-908	-601	-1.296	1.353	1.790
Continuing Value	22.234					
PV of CV	14.208				g=	1,2%
EV	12.932					
Differential risk	278					

In conclusion, the value created is around € 278 thousand thanks to lower risk and consequently a lower cost of capital.

As regards real options value, an acquisition could create value also creating new opportunities for the purchaser, such as the entering in a new market or a new customer or product segment. M&A with the goal of acquiring real options are always more frequent, especially for a strategical differentiation objective. However, it is difficult to make assumptions and estimations about them, not having enough data and certainness. For these reasons, it has been preferred to avoid a speculative valuation of them, and the value is discussed ex-post, extracting it starting from the NPV of the acquisition (chapter 6.5). Moreover, the importance of real option value will be discussed in terms of strategic goal in the conclusion paragraph.

6.4. Acquisition Value and creation of Synergies framework

To remind to the focal and principal point of the study, acquisitions create value when cash flows (FCF) of the combined companies are greater than they would have otherwise been. Going back to chapter 2.3., in M&A, the value created in a transaction is given by the difference between the expected discounted cash flows of the target after the acquisition and the price paid for it (Massari 1998):

$$NPV_{acq} = W_{acq} - P - C_t - C_i$$

$$_{with}\ Wacq = W_{A+B} - W_A$$

The transaction costs (Ct) are, instead, indicated in GVT 2015 report and are equal to € 194 thousand. Usually, the integration costs account for 5-10% of the final price (Prouty, 2014). In GVT case, considering the distressed situation of ILCEA, the integration cost are higher, due to the necessity to restore ILCEA business and the related production process organization. The total integration costs (Ci) assumed are equal to € 307 thousand, 12% of the price paid. Applying the formula the NPV of the acquisition of the deal is achieved through the indirect formula.

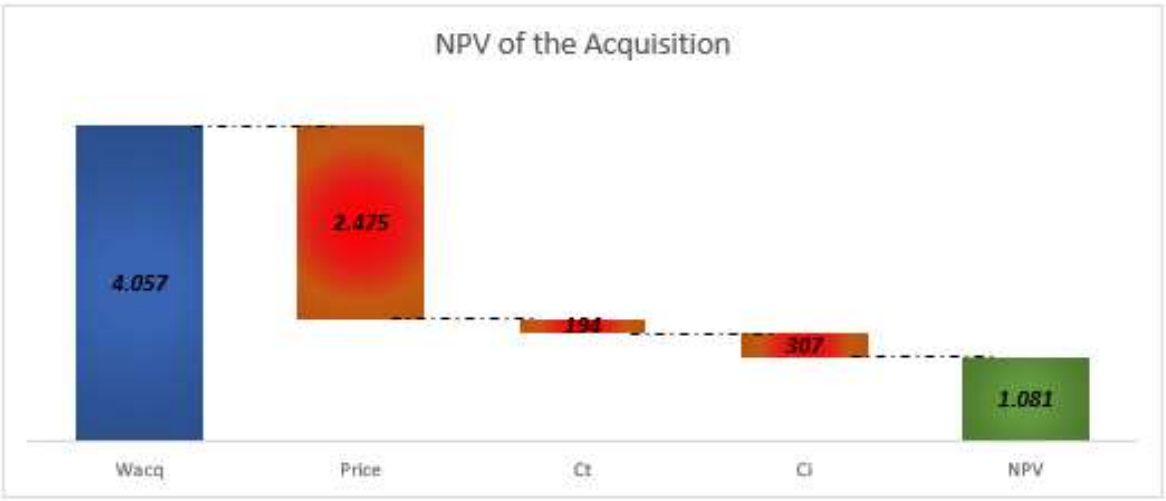
Table 43: Net Present Value received by the acquirer (GVT)

Value for GVT	€
GVTa+b	18.438
GVTa	-14.381
Wacq	*4.057*
Price	2.475
Ct	194
Ci	307
NPV	***1.081***

The Value for the acquirer corresponds to the value that receives, then the target stand-alone value and synergies created, minus the price paid.

In GVT case the total value created with the acquisition is € 4 million and the net present value created for the acquirer is around €1.1 million.

Table 44: NPV creation framework



On the other hand, the net present value of synergies represents the creation of the value of the transaction.

$$NPV\ of\ Total\ Improvements = V_{A+B} - (V_A + V_B)$$

In this case :

Table 45: NPV of the improvements

NPV of improvements	€
VALUE A+B	*18.438*
VALUE A	*14.381*
VALUE B	*2.977*
NPV of improvements	***1.080***

Focusing the point on synergies, the above formula corresponds to the direct method. To remind, the indirect method is explained in the formula:

$$NPV\ (total\ synergies) = PV\ (costsyn) + PV\ (revenuesyn) + PV\ (growthsyn) + PV(taxsyn) + PV(borrowincapacitysyn) + PV(discratesyn) - PV\ (CostIntegration)$$

Following the indirect method valuation, the NPV of total synergies is reported in the table below.

Table 46: Total Synergies Calculation (Stratification model)

Stratification model - indirect method						
	2015	**2016**	**2017**	**2018**	**2019***	**2020***
Revenues synergies	589	707	1.212	2.217	2.176	1.877
Operating synergies	-2,2%	-0,4%	0,0%	0,5%	0,7%	0,7%
Cost synergies	-	(128)	(287)	(628)	(660)	(693)
Lay out costs						
Tot Synergies	(13)	(3)	(0)	13	19	18
FCF	(12)	(3)	(0)	10	14	12
Tax	30%	30%	30%	30%	30%	30%
Net FCF	**(9)**	**(2)**	**(0)**	**7**	**10**	**8**
WACC	6,53%					
NPV	(9)	(2)	(0)	9	14	13
CV						160
NPV CV	**103**					
TOT SYNERGIES	**127**		g= 1,2%			

From the stratification model, total synergies result in € 127 thousand. At the same time, considering the direct method, the Value of the acquisition can be calculated by the following formula:

$$W_{acq} = W_B + W_{Synergies} + W_{\Delta risk} + W_{newop}$$

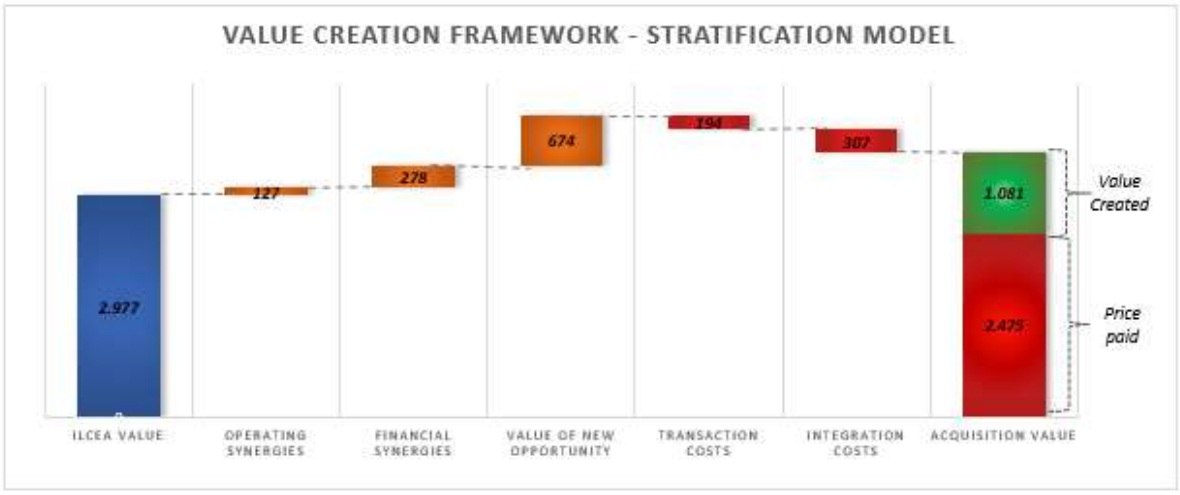
Knowing all the previous consideration, and with the pre-computed values, the value of new opportunities can be estimated, as follow:

Table 47: Value of new opportunities

W_{acq}	**4.057**
W_B	2.977
W_{syn}	127
W_{risk}	278
W_{newop}	**674**

Summing up, the evaluation proves the creation of synergies from the acquisition transaction. The graph below shows the synergies structure compared with the Value received with the acquisition, considering the price paid.

Table 48: Value Creation Framework (Stratification Model)



6.5. Discussion and Conclusion

The conclusions start from the introduction, a perfect circle closure. The introduction left us with the following question: "Does Vecchia Toscana Group create or destroy value with its long-term strategy of M&A?". At the end of this work, the answer, without doubt, is: "Vecchia Toscana long-term M&A strategy creates value".

In part I, M&A and its valuation process have been introduced, with reference to particular topics, like SMEs, Family management and distressed companies. Chapter three starts from the analysis of the global tanning industry and the description of the Italian market, focusing on Santa Croce district. Chapter four analyses Vecchia Toscana. After an illustration of its current situation in terms of products and geographical markets, the importance of a heterogeneous pool of clients and the ability to relate with the stakeholders, the work analyses GVT growth strategy. Vecchia Toscana stated that part of its pattern of growth should comprehend an internal growth, with the implementation of a new product line and an M&A strategy, buying ILCEA conceria. In the last five years, GVT has improved its margins thanks to a strong refocusing plan, by the diversification of its client target and thus, facing the negative peak of the market and demand more efficiently. The internal growth is mainly explained by the implementation of MULTIPEL line, a medium quality leather, with a lower margin than GVT historical product. It faced incredible growth, due to the change in leather demand, after the crisis of 2015, nowadays it represents 25% in terms of volume of production and 11% in terms of revenue value. On the other hand, the goal of GVT holders focuses on lowering the

economic and consequent financial risk of negative peak, especially after the rise of new global competitors, such as China and India, that are increasingly gaining market shares. With this perspective, the acquisition of ILCEA embodies the possibility to reach a higher quality market, more stable and far away from Asian large-scale production companies competition. Although the top-line implementation and growth represented a reorganizational and a long-term integration plan, just after three years from the acquisition, ILCEA line represented 28% of revenue value for Vecchia Toscana. It is an important achievement, considering the financial distressed situation of the Turin company, adding to the stopped production since 2012. The acquisition of a company under liquidation process, allows GVT to acquire the target at a cheaper price. Obviously, buying cheaper, it is easier to create value. After that, exploiting its long-standing and new marketing competences it relaunches the brands' reputation and image, restoring the premium products business and increasing the GVT product line one. The acquisition goals are never exclusively related to the revenue's growth, but behind it, there is always a strong rationale, a strategic fit in terms of markets access, new product categories, different client target and operation synergies. Chapter 5 explains the previous companies situation before the deal and the strategic goal that GVT wants to achieve with it. In fact, for Vecchia Toscana Group ILCEA acquisition is an important turning point in its strategic growth and also a satisfactory challenge for the family-owners.

Considering the most economic aspect, in chapter 6 the application of some methods and procedures, such as WACC, DCF and the Stratification Model are elaborated for the estimation of value. The work, in fact, takes into consideration the empirical valuation of the two scenarios (GVT_A, as though the acquisition never happened, and GVT_{A+B}, the real and actual situation), comparing them with each other to understand if and where the value created came from. Results demonstrate that, with the acquisition of ILCEA in 2015, the acquisition created value around €4 million, against a price paid of €2,5 million. The stand-alone value estimated for the Turin company was around € 2,9 million. Furthermore, the stratification model suggests that the total synergies (operating and financial ones) achievable are equal to € 405 thousand and the value of new opportunity around € 674 thousand. After that, subtracting the price paid, the transaction and integration costs, the NPV of the deal is of € 1.08 million, 44% of the price paid. In conclusion, the deal creates, according to this work, value for € 0,44 per share.

Turning to a practical aspect, for a more punctual commentary, the acquisition and the ILCEA products trend pondered the leather market crisis in 2015. In contrast, without the acquisition, the crash would have affected more the economic situation of the company. The extremely high-quality market for footwear was only partially impacted by the leather crisis in 2015-2016

(Statista, 2018), since the higher price range luxury market remained substantially loyal to its products. Consequently, the lack of the ILCEA product line emphasises the negative peak due to the market crash. Furthermore, as repeatedly stated, GVT strategic aim founds its bases on the diversification of the target clients' pool and thus, the decrease of the principal client incidence on total revenues. It is the cornerstone of the company external growth. The incidence of the principal client on net sales in GVT_A decreases due to the implementation of MULTIPEL, but with a lower impact than in GVT_{A+B}, in fact, it decreased from 29% in 2015 to 20,5% in 2019.

It is necessary to provide particular importance also to the emotional aspect. Chapter 2.4.2. discussed the relevance of the emotional return, in case of a family-run firm (Hasso and Duncan 2013). Emotional value is supposed to be affected by the achievements and efforts of the entrepreneur subjectively considered as unpriced or not sufficiently priced by the market. It is also quite impossible to evaluate in economic terms the emotional value received by the owners, but it must be added to total understand the value created by the acquisition.

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