

Investment opportunities in distressed Italian companies: an insight on the new “Composition” procedure

Contents

1. The Composition procedure
2. Impact on the Italian market

The global crisis started in 2007 has hit Italian businesses like an improvise tsunami wave, dividing them into two groups. Those that were prepared, which had a sustainable debt and a business model based on export have escaped the disaster and have continued to grow. On the contrary, those businesses which were too small, too indebted, too much based on local sales, or with an obsolete business model have suffered greatly. Leaving aside those that have been forced to shut down operations, there is a large number of companies that have tried to stay in business making some adjustments, often supported by Italian banks and utilizing the restructuring tools provided by Italian laws. However, the reality is that many of them cannot and will not survive in the long term without rethinking their industrial plan and without an infusion of cash, ideas and new energies.

Among these, there are companies that are real jewels and that could be very successful. Certain Italian products are rightly known for their quality, like food and fashion. “*Made in Italy*” is also generally known and valued by foreign investors. Still, there are several additional sectors which should be considered by foreign investors, both for the attractiveness of their products and for their growth potential.

Sadly for Italy, but fortunately from the point of view of the foreign investor, the timing is perfect now for acquiring some of the best Italian businesses (as well as great real estate targets) at a fraction of their value. The Italian government has created the legal conditions allowing investors to participate in expedited restructurings, thus allowing Italian businesses that are still viable to be rescued.

In the following paragraphs we are providing some information with respect to the new restructuring proceedings. Since 2005 Italy has seen a number of changes in the Bankruptcy Law, initially prompted by the insolvencies and rescues of large Italian corporations such as Parmalat, Cirio and Alitalia. What we have now is a modern legal framework which provides a variety of restructuring tools, similarly to the ones that have been successfully tested in other advanced jurisdictions such as the US and the UK.

1. The Composition procedure

Focusing our attention on one of the reformed restructuring tools which have shown to be greatly appreciated and therefore utilized by Italian companies in distress, the preventive composition with creditors (the “**Composition**”) is a traditional pre-bankruptcy restructuring instrument through which the debtor can agree upon a plan with creditors in order to avoid bankruptcy, under the control of the relevant bankruptcy court.

According to the current version of the Bankruptcy Law, as recently reformed in 2012 and 2013, the debtor may file a request for admission to Composition even when the company is in a situation of financial difficulties but has not technically reached insolvency.

Importantly, once the request is published in the Companies Registry, creditors are prohibited to start or continue enforcement and foreclosure proceedings and seizure over the assets of the company (similarly to the US so-called “automatic stay”).

Such request can now be made retaining the right to file the complete proposal, *i.e.* the plan and all the related documentation, within a term determined by the court, between 60 and 120 days (extendable for additional 60 days).

This document is delivered for informative purposes only.

It does not constitute a reference for agreements and/or commitments of any nature.

For any further clarifications or research please contact:

Hong Kong

Stefano Beghi

Tel. +852 55979001

Tel. +86 13296109029

sbeghi@gop.it

Milan

Alessandro Giuliani

Tel. +39 02 763741

agiuliani@gop.it

Alessia Pastori

Tel. +39 02 763741

apastori@gop.it

Rome

Milan

Bologna

Padua

Turin

Abu Dhabi

Brussels

London

New York

www.gop.it

After filing the request, the debtor remains in possession and runs the business as usual. The supervisory powers of the court relate to any transaction outside of ordinary course of business, such as settlements and payments of pre-petition claims.

The plan may provide for the restructuring of debts and satisfaction of creditors through any technical or legal means, including payments in cash, bonds or debt-for-equity swaps, assumption of debts, mergers or other corporate transactions. The debtor may split creditors into different classes and then differentiate the economic treatment for each class, in any case not altering the priority treatment provided by law.

According to the new regime, the debtor may be authorized by the court to terminate any executory contracts or to obtain a suspension (of 60 - 120 days) for the performance of the same, if considered no longer functional to the business purposes. Moreover, during the proceeding and in execution of the plan, the debtor may be authorized by the bankruptcy court to request and obtain new finance, which is granted with super priority.

The debtor must file an expert opinion on the feasibility of the plan. The court does not have the power to examine the content of the plan, limiting its activity to checking if the legal requirements have been fulfilled. The outcome of the procedure depends on the acceptance of the plan by the creditors holding the majority of the debt. Abstention is equal to a positive vote. Secured creditors cannot vote on the plan unless the proposal provides for a partial payment of their secured credit, in which case they could vote for the portion of such credit that will not be paid. Importantly, this approval binds all creditors, including those that rejected the plan.

If the court finds the debtor's restructuring plan unfeasible, the court may reject it, even if the majority of creditors voted in its favor. In this case the court, following a motion from the debtor, a creditor or the public prosecutor, may, if the requirements are met, declare the debtor bankrupt causing the debtor to lose control over the business, and liquidating all assets to creditors according to priority.

The new Composition may be proposed "with going concern" when the plan aims at preserving the value of the business. In such case, it is possible to provide that the creditors' satisfaction will derive from the financial flows produced by the continuation of the business activities, rather than from the proceeds deriving from the liquidation of the company's assets, as in the case that the plan anticipates the continuation of the company business by the same company and that the creditors are satisfied, partially or totally, with a debt-for-equity swap. Otherwise, the plan may provide for the sale or contribution of the going concern to a third party, including to an entity or vehicle, which may also be newly incorporated. The winding-up of non-core assets is always allowed.

Under this particular type of Composition the debtor can be authorized by the court to pay prior strategic creditors for the provision of goods and services if considered essential for the continuation of the business activity and functional to ensure the best satisfaction of creditors.

Additionally, the debtor may ask for a moratorium until a maximum of one year from the court validation of the Composition, for the payment of secured creditors, unless the assets on which the security is granted are sold.

2. Impact on the Italian market

The new Composition procedure may help to preserve the going concern and productive assets of Italian companies undergoing a period of crisis. In addition, the recent reforms enacted by the Italian government will likely have a positive impact, granting distressed Italian companies the possibility to be more attractive for international investors and to be rescued more easily.

"The procedure summarized above is one of the tools that we have used many times when representing foreign investors interested in buying an Italian business. Once the target has been identified, it is important to effect a thorough planning of the purchase strategy, normally with the participation of some of the target's "insiders". Per our direct experience, if the transaction is carefully planned and executed, the results are quite attractive. In many cases, a low bid has been sufficient to acquire very appealing assets, often with payment terms very convenient for the purchaser. The advantage of this procedure is that, at the end of the day, the purchaser gets a virtually debt-free asset with a lot of potential, sometimes with great technical content and with the "made in Italy" tag", said Alessandro Giuliani, our M&A Partner often involved in cross-border acquisitions concerning distressed companies.

INFORMATION PURSUANT TO ARTICLE 13 OF LEGISLATIVE DECREE NO. 196/2003 (Data Protection Code)