

Forza Italia

The development of the Italian economic system during the last decade, the establishment of the Nuovo Mercato, as well as the improvement of the entrepreneurial environment with a rapid growth in the number and size of MBOs, have all contributed to a maturing private equity industry in Italy. Angela Sormani reports.

The market in Italy continued to flourish throughout 2000, with investments up by 67 per cent to L5.748 billion, according to the Italian venture capital association, AIFI. The number of transactions rose by 66 per cent to 646 deals. Contributing to this healthy activity is the boom in the number of players that have entered the Italian private equity arena recently. The development of the Italian market over the last ten years and the opportunities these changes have provided has resulted in the arrival locally of a number of international private equity firms. In 1990 AIFI had 30 members. This figure stands at over 80 today.

The difference in experience levels of these players is huge making for a fragmented but interesting marketplace. The more established, veteran players are those with their second or third fund on the go and a consolidated structure to their investment portfolio. Among the new entrants, there has been a growing trend for specialised funds, a new phenomenon to the Italian market, and towards which there are mixed feelings.

Early stage at a stand still

There is a freeze on early stage investments in Italy at the moment, says Edoardo Lecaldano, founding partner at Alice Ventures, a prominent Italian early stage investor in the IT and biotech sectors. In 2000, investments in seed and start-up accounted for just over L1 billion of total investments in 339 transactions.

It is a commonly held view that Italians are generally slow to catch onto new technology fashions and for this reason, Italy was a slow starter when it came to

jumping on the Internet bandwagon. Lecaldano says that before the Internet bubble burst, the Italians had just started to latch onto the dot.com trend so, when the market crashed, it was these young start-ups that suffered as they had not yet built up any resilience.

Alice Ventures is now approaching investments with caution. Lecaldano describes the firm as unique in that there are no other Italian VC funds targeting exclusively early stage IT investments and for this reason he can sit back and wait for the deals to come to him. The firm has three quarters of its second fund left to invest and has already started fundraising for its third fund, which has a target of between €40million and €80 million with an imminent first close on the horizon. Alice Ventures is also in the process of setting up an office in Israel, where it has strong links. The firm is already looking at deals out there and has a headhunter on the ground with a view to setting up a team – its first outside Italy.

Wonderland is a non-profit association established by Alice Ventures in collaboration with Mediobanca, Bocconi University in Milan and the Polytechnic of Milan. Wonderland's purpose is to promote Italian business culture and spread awareness of VC activity among the high tech industry. Activities promoted in 2000 were Wonderland Contest 2000, a competition for young entrepreneurs and Wonderland Workshop 2000 that pinpointed difficulties faced by Italian VC's. Next month, the second edition of this workshop will review the issues to see if there has been any progress in improving the mechanics of the Italian market.

One of the major factors holding back this market, says Lecaldano, is the

aptitude of Universities and the academic world in Italy. Until recently, for legal reasons, it was impossible for University professors to mix their research with a profit-making organisation. A professor was simply not authorised to take leave and invest in a start-up company. This issue was addressed in the workshop and the situation appears to be improving, according to Lecaldano.

Last year over 500 teams submitted business plans to the Wonderland Contest 2000. This year Lecaldano says the number has dropped to just 200. This is testament to a dwindling of the Italian entrepreneurial spirit, he suggests. "Young entrepreneurs feel discouraged. This is a great shame," he says. "My feeling is, in this respect, that over the next few years there will be a generational gap in start-ups."

In spite of the current investment climate, in the last 18 months Alice Ventures has only had one failure in its portfolio. Of its six investments in the biotech sector, two have been approached by a large bank wanting to do an IPO by the end of this year. Lecaldano's gut feeling, however, is that as a biotech venture, it would be better as a trade sale. He also feels it is still a rollercoaster at the moment in terms of IPOs. Indeed on the Italian stock market in the first quarter there were only three companies that made successful flotations – Acegas on the Mercato Telematico Azionario and PCU Italia and Datalogic on the Nuovo Mercato. This is nevertheless one more than in the first quarter of the previous year when only e.Biscom and I.NET listed.

Locality is key

Recognised as a landmark in the Italian private equity market, Morgan Grenfell Private Equity's acquisition of a 90 per cent stake in Piaggio marked a turning point in the Italian buyout market. A deal of this size is something that players could not have envisaged two or three years ago. But these mega deals are far and few between in Italy, where there is more of a focus on small to medium sized family-owned businesses when it comes to later stage opportunities.

Guido Belli of Bridgepoint Capital comments on the changes in the Italian



Milan Italy – Roof Galleria Vittorio Emanuele

private equity scene. The ever-increasing trend in Europe for consolidation and restructuring, he says, is having some effect on the Italian market, but he adds that large corporates are not characteristic of corporate Italy. There are some exceptions such as automotive giant Fiat, which is in the process of restructuring, but this is not a phenomenon that is traditionally embedded into Italian culture. In January the Fiat Group, as part of its ongoing strategy to focus on core activities, decided to review all available strategic alternatives regarding its auto parts plant, Magnetti Marelli. This included the possible divestiture of certain of its business lines or potential alliances with other leaders in the automotive components industry.

Bridgepoint Capital set up in the Italian market in 1996 when there were few new entrants. Since then many new players have established funds for investment in Italy, including major US firms such as

Vestar Capital Partners and Bank of America, which set up base in Milan four months ago. Belli stresses the fact that locality is key when making investments: "It is essential to have an Italian team on the floor. If you want to do deals in the Italian middle market, you have to have guys on the ground and a good grasp of the Italian language and culture."

Antonio Perricone of B&S Electra also stresses the importance of a local team: "It is unthinkable to send a foreigner out to source deals. There is so much theatrics involved in seeing through a deal, it is rare that someone coming from a major international financial institution would be able to play by the rules – you must have Italian personnel."

The fact that there are such a large number of competitors makes life very tough if you are fighting for deals in the same space, says Belli. But it also marks Italy's development as a maturing market. In the past, Italy's financial culture was underdeveloped compared to its European counterparts. This is changing. However, looking at the fall in the number of buyouts this year compared to 1999 (in 1999, €630 million was invested in 35 deals, while in 2000 the number fell to €757 million in 14 companies), Belli voices concern. "If in the next two to three years, the private equity market does not go back to the way it was in 1999 – to at least 40 deals a year – it will be a very tough operating environment with all the competitors that are setting up in the region."

He compares the Italian market to when the French buyout market emerged several years ago. The French market was big enough but was made up of small investments that weren't particularly attractive to investors. Now with the mega deals of Lafarge and Picard of the past year France is a booming market and the second largest buyout market in Europe.

One of the more outstanding deals of 2000 was Clayton, Dubilier & Rice's investment in Italtel, Telecom Italia's telecoms switching equipment and systems integration subsidiary, a transaction valued at approximately €1 billion. CDS&R's Fund VI provided €285 million of equity in exchange for 50.1 per cent of Italtel, while Cisco and

Telecom Italia each own around 19 per cent, Advent International holds nine per cent and Brera Capital, two per cent. Will Schmidt, managing director at Advent International in London, said despite the turmoil in the telecoms market, Italtel is still enjoying tremendous growth and there are hopes that the company will float in the near future. He said: "Italtel is protected from much of the current market turmoil because of its advanced technology, as well as the nature of its customer base that is generally well-funded."

Last August also saw a significant step in the internationalisation of Italian business with the sale by Advent International, Apax and 3i of their stakes in TDL Infomedia, publisher of the Thomson Local directories in the UK to SEAT Pagine Gialle, the Italian yellow pages publisher for an equity stake of £308 million and the assumption of debt.

On 23 April, SEAT announced that it has made a recommended exchange offer to all the shareholders and holders of warrants of ENIRO AB, the leading yellow page and business directory supplier in Northern Europe. The offer amounts to a total value of approximately €3 billion. The combined entity will have a presence in 27 European countries representing an estimated potential market of 9 million business advertisers. The merger will provide SEAT with opportunities to continue the roll-out of its directory assistance and marketing information businesses across Europe.

The LBO issue

As far as the legal framework of the Italian market is concerned, a law was introduced in 1999 to remove constraints about interventions of close-end funds in investee companies and provide a wider operating flexibility for all players. From a fiscal point of view, the 2000 Financial Law introduced preferential tax revenue treatment for Italian closed-end funds. The law reduced the fiscal rate from 27 per cent to 12.5 per cent on fund revenues giving a strong impulse to the development of Italian closed-end funds.

However, legal issues continue to hold back the Italian private equity market in some respects, particularly as far as the LBO

is concerned. There is a very hostile environment at the moment with what some players describe as contradictory judgements in terms of financial assistance. Efforts are being made when promoting a new law to clarify the rules for LBOs, but for the moment activity has stopped in the Italian market as far as traditional LBOs are concerned and the Italian private equity industry is treading carefully.

Antonio Perricone of B&S Electra sees this as a major issue that needs addressing and he says the Italian private equity market is eager for developments, but it looks unlikely that anything will happen until at least September.

Funds are flourishing

Funds raised in 2000 grew by 33 per cent, reaching 15.663 billion. Of this total, around 40 per cent is dedicated to buyouts, 33 per cent targets seed and start-up, and expansion is allocated 25 per cent of these

funds. Around 90 per cent of private equity funds have a generalist focus, according to Raymond Totah of pan-European private equity investor Argos Sodic. He is reticent about funds with a specialist focus, saying: "It is so difficult and competitive out there, especially if you are limiting yourself to just one sector. At the moment, there is no need to become specialised in the Italian market. It is still very young and it is early days."

Nevertheless, the Italian market has recently seen the emergence of several specialist funds dedicated to the Italian market. One of the most recent and unique in its sector is Opera, the first international closed-end fund investing in companies that provide Italian-made goods and services. The fund was set up by Renato Preti, former director of Morgan Grenfell Private Equity, and the Bulgari Group, a leading global brand in the luxury goods market, which holds a 50 per cent stake in the management company and has invested up to €26 million in the fund.

Il bel paese

LOOKING AT SECTORS THAT ARE PARTICULARLY HOT IN THE DIFFERENT ITALIAN REGIONS, THE MAJORITY of deals continue to emanate from Milan, the capital of the North, which is particularly rich in high tech opportunities. However, the focus of deals there is varied and in no way comparable to the high tech and biotechnology clusters that are typical of the University towns of Oxford and Cambridge in the UK, Munich in Germany and so forth.

The best deals inevitably lie in the North of Italy, which has a more stable economic environment and corporate culture. There are also areas that have specialised industrial sectors such as Sassuolo for ceramics; Como for silk ties and Mantova for ladies' hosiery.

Around 63 per cent of investments are found in the north, 34 per cent are done in the central Italy and a mere three per cent come from the south and surrounding islands, according to AIFI.

Data reveals an increase in the number of investments in the north in 2000, while opportunities in central Italy and the south appear to be dwindling. The lion's share of deals (157) come from the Lombardy region, followed by Emilia Romagna with 47 and the Veneto region with 36.

Italian cities that are showing promise include Bologna, which is growing its opportunities in IT, and Genoa, which is providing some interesting deals for biotech. Trieste is an interesting city at the moment for early stage investors providing deal flow in physics and engineering-related fields. Pisa, renowned for its expertise in automation, is a city that is also attracting a number VC's thanks to a well-established University, while Rome has been a good source of deals in the software and data management sector.

While there is little going on in the south at the moment, in Naples a sizeable amount of money is dedicated to medical research. Sicily is showing some potential with its oldest University based in Catania and over 800 engineers, focusing on electronics and microchip research in that region.



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Mediolanum State Street SGR p.A.
Via F. Sforza Palazzo Meucci
20080 Basiglio (MI)
Italy

FONDAMENTA MSS™
Chief Investment Officer
Giuseppe Campanella
e-mail: giuseppe.campanella@gruppo.mediolanum.it
telephone: +39 02 9049 2650
fax: +39 02 9049 2040



Duomo

With a target of €250 million, Opera takes into account the fact that many medium-sized Italian companies have good quality products, but a lack of strategic vision, organisation and adequate marketing, branding, commercial and financial policies. Opera has an innovative approach in that it is a combination of a closed fund and a strategic investment company. The fund has significant flexibility in the type of investments, by a strong involvement of the participating companies, as well as a commitment to subsequent acquisitions in the same segment. Last month, Opera completed its first investment in a leading manufacturer of watches, Sector, which has around a 12 per cent of the Italian market.

Merchant banker Livolsi & Partners set up its specialist €200 million fund

Convergenza in 1999 with a focus on telecommunications, media and content technology. Frédéric Arnaud, managing director of the fund, says Convergenza is somewhat of a novelty in the Italian arena and that there are not so many well-established Italian funds with a specific approach. He adds, however, that entrepreneurs in Italy are becoming more experienced and placing more importance on developing their skills in investment, especially in matters of due diligence. "Due diligence in Italy today is much better than five or six years ago when it was a word that virtually did not exist," he says. Convergenza's portfolio is still young with investments that are between six and nine months old and so the fund has not yet witnessed any realisations. Arnaud revealed that of its ten investments so far, half of these are already being investigated by third parties in a manner that could provide the fund with an exit.

Difficult time to exit

According to AIFI, for the first time in three years total value of divestments has decreased to L900 billion while, by number, exits have been demonstrating an upward trend since 1997, up to 186. Trade sales account for the majority of this figure with a 56 per cent share, followed by IPOs with a 17 per cent share. Certain players say that the impact of generational change on the Italian corporate sector has led to an increase in IPOs.

A direct competitor to Convergenza and well-respected player in the Italian private equity community Pino Venture's Kiwi fund started out four years ago as the first high tech fund targeting Italian deals. Founding partner, Elserino Piol, says of the current climate for exits that there has been a recent trend for companies to rush to IPO in less than a year. This, he stresses is impossible if a company has yet to reach a certain level of stability and proved its business model. From its present fund Pino Ventures does not have a company in its portfolio more than two years old and the fact that the IPO route is not at its best does not jeopardise the firm's current activities, says Piol. Kiwi II closed last October with 104 investors in the fund including some of the bigger names in the Italian market such as Banca

Monte dei Paschi di Siena, Banca Popolare di Bergamo, Unicredito Italiano and Banca Popolare Commerciale Industria.

Exits via the secondary buyout route have fallen, taking a 13 per cent share in 2000, compared to 29 per cent in 1999. In spite of this decrease, Antonio Perricone of B&S Electra foresees an increase in secondary buyouts in the coming years because debt is widely available and buyout funds have money to spend. Last year B&S Electra sold Guala Closures SA, Alessandria-based manufacturer of safety closures for alcoholic beverages, for around €245 million to investitori Associati II. Another secondary buyout of sorts completed by the B&S Electra team with Arca Merchant last year was the acquisition of Salmoiraghi & Viganò, optical retailers from De Rigo for L96.8 billion. Previously, De Rigo acquired General Ottica, holding company of Salmoiraghi & Viganò from CVC Capital Partners.

There is great potential in the Italian market for re-leveraging companies and also in the public to private sector, says Andrea Negri of Advent International. He adds that there has been a reversal of rules as far as listed companies are concerned and that by delisting, certain companies become financially more attractive.

Private equity has an ever-increasing role to play in the development of Italy's small to medium sized company segment. With the arrival of more players into the Italian market, it is inevitable that such a small space is becoming over-crowded. However, many of these funds are pan-European and it is not a matter of how many investors there are that should concern players, but the flow of deals. It is the increase in the money available for investment that is sparking opportunities in this market.

Fund-of-funds make Italian debut

EARLIER THIS YEAR MEDIOLANUM STATE STREET SGRPA UNVEILED THE FIRST ITALIAN PRIVATE equity fund-of-funds focusing the majority of its activity in Italy. Fondamenta raised €160 million at its first close. With a duration of ten years, the fund is registered in Italy and is authorised by the Banca d'Italia with Banca Commerciale Italiana acting as custodian. It has taken over a year to authorise the investment vehicle. In addition to State Street Global Advisors and Mediolanum Vita, institutional investors that have committed to the fund to date include Fondazione Cariplo; Fondazione Cariverona and Cassa Forense.

Fondamenta has a fund structure that invests 60 per cent to 70 per cent in Italian private equity funds and 30 per cent to 40 per cent in Italian co-investments, mainly in small-medium sized companies. Giuseppe Campanella, Fondamenta chief investment officer said, that as a pioneer in this market, Fondamenta hopes to play a positive role in setting the best standards and framework for investors.

Mediolanum State Street has a joint venture with Dupont Capital Management and is co-managing its pension fund in the US. Campanella recently spent a week training with the team in the US gaining experience that he is now applying to the embryonic Fondamenta. He says Fondamenta will be playing an active role in structuring the funds in its portfolio.

The fund has already made commitments of around €34 million to Italian funds Arca Impresa and Emerald, which are generalist funds with a focus on expansion capital; Convergenza, which specialises in the media sector; and Opera, an Italian lifestyle fund targeting the luxury goods and fashion industries.

It is hoped the fund will attract mega international funds such as Apax. "Many of these funds do not know where to put their money when investing in the Italian market," says Campanella. "With Fondamenta, they will get up-to-date information on the Italian market and an introduction to the best funds in order to work out a co-investment."

Looking to the future, if the fund structure is a success, the idea is to duplicate Fondamenta in the Iberian market.

Buyouts of Italian companies Jan 1, 1996 to April 27, 2001

Date Announced	Target Name	Target Industry Sector	Investor	% of Shares Acq.	Value of Transaction (\$mil)
02/28/96	Glaxo Wellcome It-Pomezia Mnfr	Drugs	—	100.00	—
02/28/96	Zincocelere(Natwest Equity)	Computer and Office Equipment	—	100.00	58.05
03/27/96	Del Freddo(Standa SpA)	Wholesale Trade-Nondurable Goods	—	—	—
06/05/96	Ducati Motor Holding SpA	Transportation Equipment	Morgan Grenfell GmbH/ Texas Pacific Group Inc	51.00	325.0
06/11/96	Novamont(Montedison SpA)	Chemicals and Allied Products	Bankers Trust New York Corp/ Banca Commerciale Italiana SpA/Investitori Associati/ Union Bank of Switzerland	100.00	25.8
06/14/96	Tubettificio Europeo(Alumix)	Metal and Metal Products	Cambria	100.00	—
09/20/96	Tecnologistica SpA	Business Services	Advent International Corp/ Pechel Industries	73.00	32.895
01/17/97	CremaScoll Ortho	Measuring, Medical, Photo Equipment; Clocks	Brian Steer/Hambro European Ventures	100.00	38.352
01/20/97	Ing C Olivetti & Co SpA-PC Bus	Computer and Office Equipment	—	100.00	190.2
04/03/97	Fidenza Vetrorarredo (Sediver)	Stone, Clay, Glass, and Concrete Products	3i	100.00	1.45
06/02/97	Arcte SpA	Textile and Apparel Products	3i	100.00	26.943
07/24/97	MARR (Castelvetro Finanziaria)	Real Estate; Mortgage Bankers and Brokers	—	100.00	28.448
10/01/97	Stampal SpA,Brabant Alucast	Metal and Metal Products	General Electric Capital Corp/ Sofedit/IMI-ABN Amro Investments	100.00	—
01/20/98	Eisag Bailey (FINMECCANICA/IRI)	Electronic and Electrical Equipment	—	—	277.0
02/06/98	Sefi	Business Services	—	100.00	24.08
07/05/98	Polybox	Rubber and Miscellaneous Plastic Products	B & S Electra	100.00	—
07/31/98	Ducati Motor Holding SpA	Transportation Equipment	Morgan Grenfell GmbH/ Texas Pacific Group Inc	49.00	—
07/31/98	Tring Srl(Tring International)	Retail Trade-Home Furnishings	—	75.00	0.735
09/05/98	Bafin SpA	Construction Firms	Istituto Mobiliare Italiano/ ABN-AMRO Holding NV/ General Electric Capital Corp	70.00	—
12/21/98	Innovative Elect-Italian Ops	Wholesale Trade-Durable Goods	Abacus Polar PLC	—	—
12/31/98	Learnt Group	Transportation Equipment	B & S Electra/NatWest Equity Partners Ltd	100.00	—
12/31/98	Corind Srl	Transportation Equipment	B & S Electra/NatWest Equity Partners Ltd	100.00	—
01/01/99	Comune di Follonica	Holding Companies, Except Banks	—	100.00	—
01/04/99	Siat SpA	Machinery	CVC Capital Partners Ltd	100.00	—
01/22/99	Gori & Zucchi SpA	Miscellaneous Manufacturing	—	100.00	—
02/10/99	OP Computers	Computer and Office Equipment	—	—	—
02/24/99	Bierrebi SRL	Machinery	3i	100.00	—
03/10/99	Braibanti Golfetto SpA	Machinery	Ipef II/B & S Electra	—	—
05/26/99	Galileo TP Process Equipment	Business Services	Sequor Industries NV	100.00	—
05/27/99	EEMS SpA	Measuring, Medical, Photo Equipment; Clocks	Schroder Ventures	100.00	54.6
05/01/99	De Vecchi Group	Printing, Publishing, and Allied Services	Euroknights III	100.00	—

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06/03/99	Fendi Srl	Textile and Apparel Products	—	—	188.3
06/29/99	Vobis Italia SpA	Retail Trade-Home Furnishings	Mediocredito Lombardo	100.00	—
07/06/99	Cartorama SpA	Business Services	Societa Neleo/BC Partners	100.00	—
07/08/99	Confruit SpA	Food and Kindred Products	Mediocredito Fondiario/ Banca di Romagna SpA	—	9.504
07/29/99	Electrolux Zanussi Vending SpA	Machinery	Compass Partners International	100.00	265.32
07/29/99	Pompe Gabbioneta SpA	Machinery	Vermeer Equity(ABN Amro)/ BancBoston Capital Inc	100.00	—
07/31/99	Datamat Ingegneria dei Sistemi	Prepackaged Software	3i	100.00	—
09/16/99	Caravans International	Transportation Equipment	Trigano SA/Schroder Ventures Italian Fund	100.00	—
09/17/99	Nordest Avio SpA	Transportation and Shipping (except air)	—	100.00	64.856
09/24/99	Deroma Holding SpA	Stone, Clay, Glass, and Concrete Products	—	100.00	159.936
10/21/99	Piaggio & Co SpA	Real Estate; Mortgage Bankers and Brokers	Morgan Grenfell Private Equity/Texas Pacific Group Inc	90.00	750.6
11/01/99	Palini & Bertoli SpA	Metal and Metal Products	Schroder Ventures	100.00	—
11/05/99	Carlo Gavazzi Componenti SpA	Wholesale Trade-Durable Goods	—	100.00	—
11/05/99	Unigroup	Transportation Equipment	NatWest Equity Partners Ltd/B & S Electra	100.00	—
11/22/99	Unisource Italia SpA	Personal Services	—	100.00	—
12/21/99	Laverda SpA	Transportation Equipment	—	—	7.0
12/22/99	Magneti Marelli-Lubricants	Oil and Gas; Petroleum Refining	—	100.00	432.066
12/31/99	Macchi SpA	Metal and Metal Products	Interbanca SpA/Fiduciaire Sofinter Sarl	100.00	—
02/03/00	Salmolraghi & Vigano	Miscellaneous Retail Trade	ARCA Merchant ABK SpA/ BS Electra	100.00	48.8
03/23/00	Bacini di Palermo	Transportation Equipment	—	—	—
03/23/00	Italiana Telecomunicazioni SpA	Communications Equipment	Clayton, Dubilier Fund VI/ Cisco Systems Inc	81.00	760.575
05/02/00	MWCR SpA	Computer and Office Equipment	Nuova Holding Subalpina/ MWCRLux Sarl	—	—
05/04/00	Sit Telecomunicazioni	Telecommunications	—	20.00	16.065
06/08/00	Lepel Srl	Textile and Apparel Products	—	75.00	14.326
06/30/00	I&T SpA	Business Services	—	100.00	63.737
08/03/00	Sirti SpA	Construction Firms	Interbanca SpA/Techint/ 21 Investimenti (Edizione Hidg)/3i	—	299.408
09/11/00	Almar Group	Leather and Leather Products	CVC Capital Partners	100.00	—
09/12/00	Omega Bilance SpA	Machinery	MWCR SpA/Schroder Ventures/ San Paolo IMI Private Equity	100.00	—
10/10/00	ASA Italy Srl(ASA Intl)	Prepackaged Software	—	100.00	0.009
11/06/00	Guala Closures SA(B&S Electra)	Rubber and Miscellaneous Plastic Products	—	—	210.994
11/16/00	Ion Energy Research Ltd	Business Services	—	—	9.965
01/31/01	NPO Sistemi(Buhrmann)	Wholesale Trade-Durable Goods	—	—	—
03/23/01	Sara Lee Champion Europe Inc	Miscellaneous Manufacturing	—	100.00	—

Source: Thomson Financial