CASE 47

Palamon Capital Partners/ TeamSystem S.p.A.

We want to make money by investing in change.
—Louis Elson, Managing Partner, Palamon

In February 2000, Louis Elson looked over the London skyline and reflected on the international private equity industry and the investment processes that would be necessary for success in this increasingly competitive field. Elson, a managing partner of the U.K.-based private equity firm Palamon Capital Partners, was specifically considering an investment in TeamSystem S.p.A., an Italian software company. Palamon was interested in TeamSystem for the growth opportunity that it represented in a fast-changing market. Palamon had an opportunity to purchase a 51% stake in TeamSystem for (euro) EUR25.9 million. In preparing a recommendation to his colleagues at Palamon, Elson planned to assess TeamSystem's strategy, value the firm, identify important risks, evaluate proposed terms of the investment, and consider alternative exit strategies.

International Private Equity Industry

The international private equity industry was segmented into three sectors. Venture capital funds made high-risk early-stage investments in startup companies. Generalist private equity funds provided expansionary funding or transitional funding that allowed small companies to grow and eventually go public. And leveraged buyout funds financed the acquisitions (often by management) of pre-existing companies that had the capacity to take on debt and make radical improvements in operations.

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Private equity funds raised capital primarily from individual investors, pension funds, and endowments that were interested in more attractive risk/return investment propositions than the public capital markets offered. Funds existed all over the world, but, not surprisingly, North America had the largest number of funds and largest dollar value of capital invested as of 1999. Europe and Asia had the next largest private equity industries. **Exhibit 1** presents the number and dollar values of private equity funds by global geographic region.

Most private equity markets saw rapid growth in the 1990s. In Europe, the amount of new capital raised grew from EUR4.4 billion in 1994 to EUR25.4 billion in 1999. Correspondingly, the amount of capital invested by the funds more than quadrupled from EUR5.5 billion to EUR25.1 billion over the same period. **Exhibit 2** summarizes the amount of new capital raised and the amount invested through the 1990s. Some key players in the mid-market sector in Europe included Duke Street Capital (EUR650 million fund based in the United Kingdom), Mercapital (EUR600 million fund based in Spain), and Nordic Capital (EUR760 million fund based in Sweden). Large investment banks such as Dresdner, Deutsche Bank, and Banca de Roma also had notable private equity presences.

Louis Elson and Palamon Capital Partners

Louis Elson began working in private equity in 1990, when he joined E.M. Warburg, Pincus & Co. Soon after joining the firm, he began focusing on European transactions and, in 1992, decided to relocate permanently to Europe. Elson became a partner of Warburg, Pincus in 1995 and was an integral part of a team that built a US$1.3 billion portfolio of equity investments for the firm. The portfolio contained more than 40 investments in seven different European countries. In late 1998, Elson and another of his partners, Michael Hoffman, saw a unique window of opportunity in the European private equity industry. They believed that the European economic landscape was changing in a way that benefited smaller, middle-market companies. Therefore, Elson and Hoffman recruited two additional partners and began laying the foundation for what would eventually become Palamon Capital Partners.

By August 1999, Elson and Hoffman had raised a fund of EUR440 million. They accomplished that despite macroeconomic obstacles like the Russian debt default by marketing their unique pan-European private equity experience. With the fund closed, Elson and Hoffman grew the Palamon team to nine professionals. They hired people with experience in private equity, investment banking, corporate finance, and management consulting. Consistent with Elson and Hoffman's original vision, the Palamon team used their breadth of experience to build a portfolio of investments that would provide investors with a unique risk profile and substantial long-term returns. Essentially, Palamon was a generalist private equity fund that served the segment of investor that was interested in less risk than venture capital, but more risk than the leveraged buyout funds. Accordingly, Palamon targeted a 35% return on a single portfolio investment, and 20% to 25% blended net

return on a portfolio, with an investment horizon of approximately six years. Louis Elson said:

> Our investors include large American public sector pension funds, corporate pension funds, major financial institutions, and large endowment funds. They look for us to beat the return on the S&P Index by 500 basis points per year on average. We have the best chance of getting funded again if we can beat this target, adjusting of course for risk. We look to pick up good businesses at attractive prices, and then add value through active involvement with them.

Like other generalist funds, Palamon's investment strategy was to make "bridge" investments in companies that wanted to move from small, private ownership to the public capital markets. Unlike many private equity funds, however, Palamon did not restrict itself to one specific European country, nor did it limit its scope to one industry. Instead, Palamon focused more broadly on small to mid-sized European companies in which it could acquire a controlling stake for between EUR10 million and EUR50 million.

For companies that fit Palamon's profile, the transition from private to public ownership required both funding and management ability. Palamon, therefore, complemented its financial investments with advisory services to increase the probability that the portfolio companies would successfully make it to the public markets. Elson was optimistic about Palamon's investment strategy. As Elson sat in his office, Palamon was finalizing its first investment, a Spanish Internet content company, Lanetro, S.A., and had three other investments (including TeamSystem) in the pipeline.

Investment Process

Palamon's investment process began with the development of an investment thesis that would typically involve a market undergoing significant change, which might be driven by deregulation, trade liberalization, new technology, demographic shifts, and so on. Within the chosen market, Palamon looked for attractive investment opportunities, using investment banks, industry resources, and personal contacts. The search process was time-consuming, with only 1% of the opportunities making it through to the next phase, due diligence, which involved thorough research into the history, performance, and competitive advantages of the investment candidate. Typically, only one company made it through that final screen to provide Palamon with a viable investment alternative.

Palamon brought its deal-making experience to bear in shaping the specific terms of investment. Carefully tailored agreements could increase the likelihood of a successful outcome, both by creating the right incentives for operating managers to achieve targets, and by timing the delivery of cash returns to investors in ways consistent with the operating strategy of the target. Deal negotiations covered many issues including price, executive leadership, and board composition. Once a deal had been completed, Palamon then offered value-added support to management.

To close the process, Palamon searched for the best exit alternative, one that would help them fully realize a return on the fund's investment. Classic exit alternatives included sale of the firm through an initial public offering in a stock market, and sale

of the firm to a strategic buyer. **Exhibit 3** provides more detail about Palamon's process and the firm's investment screening criteria.

TeamSystem, S.p.A.

Palamon's theme-based search generated the opportunity to invest in TeamSystem, S.p.A. In early 1999, even before Palamon's fund had been closed, Elson had concluded that the payroll servicing industry in Italy could provide a good investment opportunity because of the industry's extreme fragmentation and constantly changing regulations. History had shown that governments in Italy adjusted their policies as often as four times a year. For Palamon, the space represented a ripe opportunity to invest in a company that would capitalize on the need of small companies to respond to this legislative volatility. With the help of a boutique investment bank and industry contacts, Palamon approached two leading players in the market. Neither company was suitable to Palamon, but both identified their most respected competitor as TeamSystem. Palamon approached TeamSystem directly and found a good fit. Due diligence was done and, by the end of the year, a specific investment proposal had taken shape. It was the one Elson now considered.

TeamSystem was founded in 1979 in Pesaro, Italy. Since its founding, the company had grown to become one of Italy's leading providers of accounting, tax, and payroll management software for small-to-medium-size enterprises (SMEs). Led by cofounder and CEO Giovanni Ranocchi, TeamSystem had built up a customer base of 28,000 firms, representing a 14% share of the Italian market.

TeamSystem offered its customers a compelling value proposition. The company's software integrated a business's financial information and automated tedious and complex administrative functions. The software also enabled SMEs and their financial advisors to stay on top of the frequently changing regulatory environment. To that end, TeamSystem continually invested in development to keep its software current. Customers were given access to product upgrades in exchange for a yearly maintenance fee that the company collected (in addition to the initial purchase price of the software). TeamSystem had excelled in customer service and developed loyal customers. Nearly 95% of its customers renewed their maintenance contracts every year.

In 1999, TeamSystem generated sales of (lira) ITL60.5 billion (EUR31.3 million) and EBIT (earnings before interest and taxes) of ITL18.5 billion (EUR9.5 million). Those results continued a strong pattern of growth for TeamSystem. Since 1996, sales had grown at an annualized rate of 15% and operating margins improved. As a result, EBIT had grown at an annualized rate of 31.6% over the same period. **Exhibit 4** provides additional detail on TeamSystem's historical sales and profitability from 1996 through 1999. **Exhibit 5** contains balance sheet information for the same period.

As Elson looked through the numbers, he noted the current lack of debt on TeamSystem's balance sheet. In his opinion, that represented an opportunity to bring TeamSystem to a more effective capital structure that might lower the company's cost of capital. Elson also noted the "pro forma" label on both financial statements. TeamSystem, given its private ownership and multicompany structure, did not have audited consolidated financial information for the previous five years.

Industry Profile

The Italian accounting, tax, and payroll management software industry in which TeamSystem operated was highly fragmented. More than 30 software providers vied for the business of 200,000 SMEs with the largest having a 15% share of the market (TeamSystem ranked number two with its 14% share.) All of the significant players in the industry were family-owned companies that did not have access to international capital markets. **Exhibit 6** shows 1998 revenues for the nine largest players.

Analysts predicted that two things would characterize the future of the industry—consolidation and growth. Consolidation would occur because few of the smaller companies would be able to keep up with the research and development demands of a changing industry. Analysts pointed to three acquisitions in 1998–99 as the start of that trend. As for growth, experts predicted 9% annual growth over the period 1999–2002. That growth would come primarily from increased PC penetration among SMEs, greater end-user sophistication, and continued computerization of administrative functions.

The Transaction

After reviewing TeamSystem's past performance and the state of the industry, Elson returned his attention to the specifics of the TeamSystem investment. The most recent proposal had offered EUR25.9 million for 51% of the common (or ordinary) shares in a multipart structure that also included a recapitalization to put debt on the balance sheet:

- Palamon would invest ITL50.235 billion (EUR25.9 million) in the ordinary shares (i.e., common equity) of TeamSystem S.p.A. Those shares would be purchased from existing shareholders of TeamSystem. Giovanni Rannochi would maintain a 20% shareholding, while noncore employees would be diluted from holdings ranging from 3% to 8% to just 1% each after completion.
- More than half of TeamSystem's ITL28.5 billion of cash was to be distributed to existing shareholders via two dividend payments before Palamon's investment: an ITL8.5 billion dividend to existing TeamSystem shareholders in April 2000, and a ITL6.5 billion dividend to be paid at time of closing. A cash balance of ITL 13.5 billion would remain.
- With Palamon's assistance, TeamSystem would borrow ITL46 billion from Deutsche Bank, in a seven-year loan, offering a three-year principal repayment holiday and an initial cost of 1.0% over base rates (Italian government bonds). Shareholders would receive the proceeds of the debt at time of closing in another special dividend.
- Excess real estate would be sold by TeamSystem, thus removing the distraction of unrelated property investments. A group of existing shareholders had made an offer to purchase ITL2.1 billion of real estate at book value if the transaction closed.

The sources and uses of funds in the transaction are summarized in **Exhibit 7.** An income statement and balance sheet for TeamSystem, pro forma the transaction, are given in **Exhibits 8** and **9.** Palamon, as a majority shareholder, would have full effective control of TeamSystem, although the existing shareholders would have a

number of minority protection rights. For example, Palamon would be unable to dismiss Ranocchi for a two-year period. But Palamon would have the ability to deliver 100% of the shares of the company to a trade buyer should that be the appropriate exit. Furthermore, more than 40% of the cash to be paid to the departing shareholders would be held in escrow for a period of at least two years, under Palamon's control.

Valuation

To properly evaluate the deal, Elson had to develop a view about the value of TeamSystem. He faced some challenges in that task, however. First, TeamSystem had no strategic plan or future forecast of profitability. Elson only had four years of historical information. If Elson were to do a proper valuation, he would need to estimate the future cash flows that TeamSystem would generate given market trends and the value that Palamon could add. His best guess was that TeamSystem could grow revenues at 15% per year for the next few years, a pace above the expected market growth rate of 9%, followed by a 6% growth rate in perpetuity.[1] He also thought that Palamon's professionals could help Ranocchi improve operating margins slightly. Lastly, Elson believed that a 14% discount rate would appropriately capture the risk of the cash flows. That rate reflected three software companies' trading on the Milan stock exchange, whose betas averaged 1.44 and unlevered betas averaged 1.00.

The second challenge Elson faced was the lack of comparable valuations in the Italian market. Because most competitors were family-owned, there was very little market transparency. The nearest matches he could find were other European and U.S. enterprise resource planning (ERP)[2] companies and accounting software companies. The financial profiles of those comparable firms are contained in **Exhibits 10** and **11.** See also exchange rates and capital market conditions in **Exhibits 12** and **13.** Looking through the data, Elson noticed the high growth expectations (greater than 20%) for the software firms and correspondingly high valuation multiples.

Risks

Elson was concerned about more than just the valuation, however. He wanted to carefully evaluate the risks associated with the deal, specifically:

- *TeamSystem's management team might not be able to make the change to a more professionally run company.* The investment in TeamSystem was a bet on a small private company that Elson hoped would become a dominant, larger player. The CEO, Ranocchi, had successfully navigated the last five years of growth, but had, by his own admission, created a management group that relied on him for almost every decision. From conversations and interviews, Elson concluded that Ranocchi

[1]This was roughly the sum of an expected long-term inflation rate in the euro of 3%, and long-term real economic growth in Europe of 3%.

[2]Enterprise resource planning (ERP) systems were commercial software packages that promise the seamless integration of all the information flowing through a company: financial, accounting, supply chain, customer, and human resources information.

could take the company forward, but he had concerns about the ability of the supporting cast to deliver in a period of continued growth.

- *TeamSystem was facing an inspection by the Italian tax authorities.* The inspection posed a financial risk, and therefore could serve as a significant distraction for management. Further, because it was "open-ended," the inspection might delay the company's ability to go public. Elson had quantified the risk, however, through sensitivity and scenario analysis, and believed that the expected monetary impact of the inspection was low.
- *The company might not be able to keep up with technological change.* While the company had begun to adapt to technological changes such as new programming languages, it still had some products on older platforms that would require significant reprogramming. In addition, the Internet posed an immediate threat if TeamSystem's competitors adapted to it more quickly than TeamSystem did.

Finally, Elson wanted to make sure that he could capture the value that TeamSystem might be able to create in the next few years. Exit options were, therefore, also an important consideration.

Conclusion

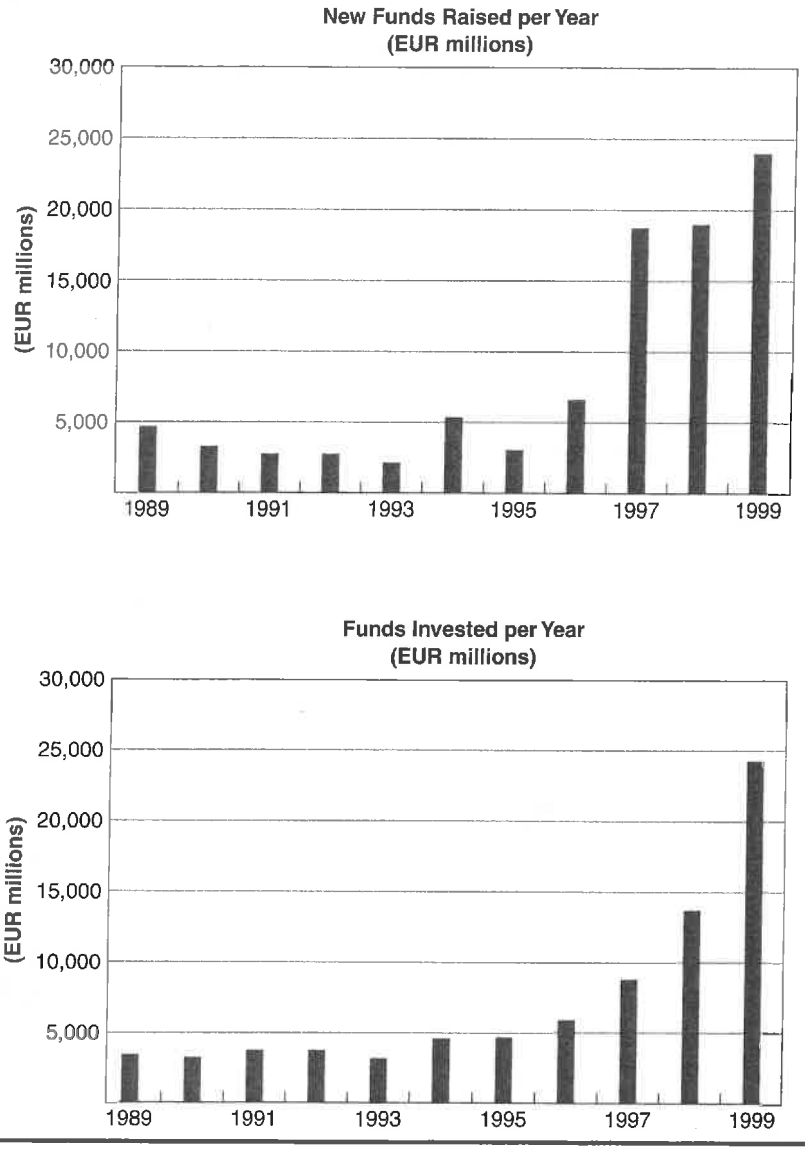
Elson looked at all the information that covered his desk and pondered the recommendation he should make to his partners. How much was a 51% stake really worth? What might explain the valuation results? What nonprice considerations should he make part of the deal? How might Palamon feasibly capture the value from the investment? Were the risks serious enough to compromise the value of the investment?

EXHIBIT 1 | Size of Regional Private Equity Markets, 1999

Region	Number of Funds	Total Value of Funds (in U.S.D millions)
North America	8,376	892,598
Europe	2,556	160,749
Asia	1,360	60,582
Middle East	130	6,469
Australia/Oceania	155	5,741
Central/South America	42	5,044
Africa	13	1,711

Source of data: Thomson Securities Data/Venture Xpert.

EXHIBIT 2 | Historical Data on European Private Equity Market



Source of data: European Private Equity & Venture Capital Association.

EXHIBIT 3 | Screening Criteria and Investment Process

Investment Process

Palamon utilizes an investment process that has been proven over the past decade through economic cycles and across geographic regions. The process is underpinned by a core set of investment principles, which can be summarized by stage of the investment process.

- Determination of Investment Focus—Identify sectors undergoing significant changes, develop industry knowledge, and take a contrarian stance when appropriate.
- Pro-Active Deal Sourcing—Proactively pursue investment opportunities within identified sectors.
- Rigorous Due Diligence—Execute comprehensive yet focused company due diligence; concentrate on "deal breakers" early on.
- Sophisticated Deal Structuring—Base structuring on a sound knowledge of local practices without relying necessarily on ineffective customs; align objectives with the entrepreneur; avoid excess leverage.
- Value-Added Support—Provide strategic direction to portfolio companies; make international network of advisors and expertise available to management teams; commit to longer time horizons sufficient to ensure scope for company growth.
- Proven Realization Strategies—Prepare for liquidity events; utilize in-house expertise to access public market capital or organize trade sales, creating exit options for all shareholders.

Investment Screening Criteria

The partners of Palamon are especially rigorous in their investment selection criteria, identifying those characteristics that will foster high growth combined with manageable risk. The following key elements are sought in each investment made:

- Superior management with unique capabilities and experience
- Leadership in core markets which are either expanding robustly or are experiencing dislocation due to technological, regulatory, or competitive changes
- High potential for operating leverage
- Opportunity to access alternative markets
- Access to undervalued assets

Source: http://www.palamon.com/ (accessed 19 December 2005).

EXHIBIT 4 | TeamSystem S.p.A. Pro Forma Historical Income Statement (values in ITL millions)

	1996	1997	1998	1999
Total sales	39,665	42,922	50,694	60,499
Cost of materials	(9,979)	(11,430)	(12,258)	(15,179)
Cost of service	(9,380)	(8,692)	(10,889)	(12,389)
Rents and leasing	(328)	(394)	(1,493)	(1,553)
Total operating cost	(19,687)	(20,516)	(24,640)	(29,121)
Salaries	(4,875)	(5,382)	(6,282)	(7,151)
Social contributions	(1,855)	(2,047)	(1,917)	(2,011)
Other personnel costs	(456)	(481)	(572)	(753)
Total personnel costs	(7,186)	(7,910)	(8,771)	(9,915)
Other operating costs	(2,793)	(3,052)	(3,133)	(1,339)
EBITDA	9,999	11,444	14,150	20,124
Depreciation & amortization	(1,052)	(1,427)	(1,355)	(1,636)
EBIT	8,947	10,017	12,795	18,488
Interest expense	(185)	(144)	(154)	(210)
Non-op income	1,800	1,305	1,132	1,283
Pretax profit	10,563	11,178	13,773	19,562
Taxes	(5,870)	(6,699)	(6,437)	(9,525)
Earnings before minorities	4,693	4,479	7,336	10,036
Elimination of intercompany invest	(30)	(13)	(139)	(287)
Net income	4,663	4,466	7,197	9,749

Source: Palamon memorandum.

EXHIBIT 5 | TeamSystem S.p.A. Pro Forma Historical Balance Sheet (values in ITL millions)

	1996	1997	1998	1999
ASSETS				
Cash	13,092	19,134	21,144	28,513
Marketable securities				
Receivables	13,257	14,957	16,328	19,443
Inventory	1,333	1,087	1,195	1,235
Total current assets	27,682	35,178	38,667	49,191
Intangible assets	14	22	18	21
Land, PP&E	4,962	2,080	2,489	3,681
Other tangible assets	729	668	1,140	2,055
Deferred costs	327	1,947	1,738	1,865
Securities and other	1,434	1,173	1,229	1,226
Total assets	35,148	41,068	45,281	58,039
LIABILITIES				
Accounts payable	7,661	8,932	8,969	9,669
Tax and other payables	6,796	9,827	8,660	9,956
Deferred income and accruals	1,200	1,127	1,257	4,156
Long-term liabilities	2,688	2,094	2,235	3,055
Total liabilities	18,345	21,980	21,121	26,836
SHAREHOLDERS' EQUITY AND MINORITY INTEREST				
Capital	4,580	4,580	4,580	4,580
Reserves	6,636	9,442	11,662	15,884
Operating income	**4,584**	**4,405**	**7,132**	**9,660**
(Less special dividend)				
Total shareholders' equity	15,800	18,427	23,374	30,124
Minority interest	1,003	661	786	1,079
Total shareholders' equity and minority interest	16,803	19,088	24,160	31,203
Total shareholders' equity and liabilities	35,148	41,068	45,281	58,039

Source: Palamon memorandum.

EXHIBIT 6 | Revenues for Top Companies in Italian Payroll Software Industry, 1998

Company	Revenues (ITL billions)
TeamSystem	50.7
Inaz Paghe	47.0
Osra	38.0
Sistemi	37.0
Zuchetti	36.0
Esa Software	35.0
Omega Data	34.4
Axioma	26.0
Dylog Italia	25.0

Source: Palamon memorandum.

EXHIBIT 7 | Sources/Uses of Cash in Proposed Leveraged Restructuring (values in ITL millions)

Sources:	
Debt	46,000
Excess cash	15,000
	61,000
Uses:	
Special dividend—April 2000	8,500
Special dividend—closing	52,500
	61,000

Note: This table refers strictly to the leveraged recapitalization of TeamSystem. Ignored in this table are (1) the ITL50.235 billion purchase of shares by Palamon from investors in TeamSystem and (2) a purchase of TeamSystem real estate for ITL2.1 billion by investors. Palamon would not receive any of the special dividends.

EXHIBIT 8 | TeamSystem S.p.A. Pro Forma Income Statement (values in ITL millions)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	
					15%	15%	15%	6%	6%	6%	6%	6%	growth
Total sales	39,665	42,922	50,694	60,499	69,573	80,009	92,011	97,532	103,383	109,586	116,162	123,131	
Cost of materials	(9,979)	(11,430)	(12,258)	(15,179)									
Cost of service	(9,380)	(8,692)	(10,889)	(12,389)									
Rents and leasing	(328)	(394)	(1,493)	(1,553)									
Total operating cost	(19,687)	(20,516)	(24,640)	(29,121)	(31,308)	(36,004)	(41,405)	(43,889)	(46,523)	(49,314)	(52,273)	(55,409)	45.00% of sales
Salaries	(4,875)	(5,382)	(6,282)	(7,151)									
Social contributions	(1,855)	(2,047)	(1,917)	(2,011)									
Other personnel costs	(456)	(481)	(572)	(753)									
Total personnel costs	(7,186)	(7,910)	(8,771)	(9,915)	(10,784)	(12,401)	(14,262)	(15,117)	(16,024)	(16,986)	(18,005)	(19,085)	15.50% of sales
Other operating costs	(2,793)	(3,052)	(3,133)	(1,339)	(2,783)	(3,200)	(3,680)	(3,901)	(4,135)	(4,383)	(4,646)	(4,925)	4.00% of sales
EBITDA	9,999	11,444	14,150	20,124	24,699	28,403	32,664	34,624	36,701	38,903	41,237	43,712	
Depreciation & amortization	(1,052)	(1,427)	(1,355)	(1,636)	(835)	(900)	(975)	(1,010)	(1,046)	(1,085)	(1,126)	(1,170)	25.00% of PP&E and Intang
EBIT	8,947	10,017	12,795	18,488	23,863	27,503	31,689	33,614	35,655	37,818	40,111	42,542	
Interest expense	(185)	(144)	(154)	(210)	(3,160)	(3,160)	(3,160)	(2,765)	(1,975)	(1,185)	(395)	—	6.87% interest
Non-op income	1,800	1,305	1,132	1,283	561	1,157	1,855	2,091	2,408	2,813	3,310	4,507	5.00% return on mkt secur
Pretax profit	10,563	11,178	13,773	19,562	21,265	25,500	30,383	32,939	36,088	39,446	43,026	47,049	
Taxes	(5,870)	(6,699)	(6,437)	(9,525)	(10,207)	(12,240)	(14,584)	(15,811)	(17,322)	(18,934)	(20,652)	(22,584)	48.00% of pre-tax profit
Earnings before minorities	4,693	4,479	7,336	10,036									
Elimination of intercompany invest	(30)	(13)	(139)	(287)									
Net income	4,663	4,466	7,197	9,749	11,058	13,260	15,799	17,129	18,766	20,512	22,373	24,465	

Source: Case writer's analysis.

EXHIBIT 9 | TeamSystem S.p.A. Pro Forma Balance Sheet (values in ITL millions)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	
ASSETS													
Cash	13,092	19,134	21,144	28,513	13,500	15,202	17,482	18,531	19,643	20,821	22,071	23,395	19.0% of sales
Marketable securities					11,224	23,143	37,096	41,816	48,165	56,253	66,196	90,144	PLUG
Receivables	13,257	14,957	16,328	19,443	20,872	24,003	27,603	29,259	31,015	32,876	34,848	36,939	30.0% of sales
Inventory	1,333	1,087	1,195	1,235	1,391	1,600	1,840	1,951	2,068	2,192	2,323	2,463	2.0% of sales
Total current assets	27,682	35,178	38,667	49,191	46,988	63,948	84,021	91,557	100,891	112,142	125,438	152,941	
Intangible assets	14	22	18	21	20	20	20	20	20	20	20	20	
Land, PP&E	4,962	2,080	2,489	3,681	1,581	1,581	1,581	1,581	1,581	1,581	1,581	1,581	
Other tangible assets	729	668	1,140	2,055	1,739	2,000	2,300	2,438	2,585	2,740	2,904	3,078	2.5% of sales
Deferred costs	327	1,947	1,738	1,865	2,087	2,400	2,760	2,926	3,102	3,288	3,485	3,694	3.0% of sales
Securities and other	1,434	1,173	1,229	1,226	1,391	1,600	1,840	1,951	2,068	2,192	2,323	2,463	2.0% of sales
Total assets	35,148	41,068	45,281	58,039	53,807	71,549	92,523	100,473	110,245	121,962	135,751	163,776	
LIABILITIES													
Accounts payable	7,661	8,932	8,969	9,669	11,132	12,802	14,722	15,605	16,541	17,534	18,586	19,701	16.0% of sales
Tax and other payables	6,796	9,827	8,660	9,956	11,132	12,802	14,722	15,605	16,541	17,534	18,586	19,701	16.0% of sales
Deferred income and accruals	1,200	1,127	1,257	4,156	3,479	4,000	4,601	4,877	5,169	5,479	5,808	6,157	5.0% of sales
Long term liabilities	2,688	2,094	2,235	3,055	46,000	46,000	46,000	34,500	23,000	11,500	—	—	
Total liabilities	18,345	21,980	21,121	26,836	71,742	75,604	80,044	70,587	61,252	52,047	42,980	45,559	
SHAREHOLDERS' EQUITY AND MINORITY INTEREST													
Capital	4,580	4,580	4,580	4,580	4,580	4,580	4,580	4,580	4,580	4,580	4,580	4,580	
Reserves	6,636	9,442	11,662	15,884	24,544	(24,398)	(11,138)	4,661	21,789	40,555	61,067	83,440	
Operating income	4,584	4,405	7,132	9,660	11,058	13,260	15,799	17,129	18,766	20,512	22,373	24,465	
(Less special dividend)					(61,000)								
Total shareholders' equity	15,800	18,427	23,374	30,124	(19,818)	(6,558)	9,241	26,369	45,135	65,647	88,020	112,486	
Minority interest	1,003	661	786	1,079	1,883	2,504	3,238	3,517	3,859	4,269	4,751	5,732	3.5% of equity
Total shareholders' equity and minority interest	16,803	19,088	24,160	31,203	(17,935)	(4,054)	12,479	29,886	48,994	69,915	92,771	118,218	
Total shareholders' equity and liabilities	35,148	41,068	45,281	58,039	53,807	71,549	92,523	100,473	110,245	121,962	135,751	163,776	

DEBT REPAYMENT								
Starting balance	46,000							
Principal due	0%	0%	0%	25%	25%	25%	25%	
Payment	—	—	—	(11,500)	(11,500)	(11,500)	(11,500)	

Source: Case writer's analysis.

Source: Case writer's analysis.

EXHIBIT 10 | Valuation Measures for Publicly Traded Enterprise Resource Planning (ERP) Software Companies

	Adjusted Market Value[a] as a Multiple of:		Equity Market Value as a Multiple of:						Growth Rates 1 Year		Long-Term Margins	
	Long-Term Revenues	Long-Term Op. Inc.	EPS	Cal. 1999 EPS Est.[b]	Cal. 2000 EPS Est.[b]	Cal. 2001 EPS Est.[b]	Long-Term Projected EPS Growth[b]	CY 1999 P/E to LTGR	Rev.	EBIT	EBIT	Net
Tier 1—Large ERP Players												
Baan	4.0 ×	NM	NM	NM	NM	NM	26%	NM	8.2%	NM	−38.0%	−40.2%
JD Edwards	1.6 ×	26.2 ×	37.9 ×	NM ×	95.0 ×	74.9 ×	27%	NM	44.2%	77.0%	6.2%	5.0%
Oracle	6.8 ×	32.0 ×	47.8 ×	42.1 ×	34.4 ×	27.8 ×	24%	143%	23.6%	32.7%	21.2%	14.6%
Peoplesoft	2.3 ×	23.6 ×	NM	NM	54.8 ×	44.3 ×	24%	231%	61.1%	41.7%	9.9%	2.1%
SAP	8.3 ×	42.1 ×	75.2 ×	61.9 ×	45.8 ×	36.6 ×	25%	182%	41.9%	17.4%	19.7%	11.1%
Low	1.6 ×	23.6 ×	37.9 ×	42.1 ×	34.4 ×	27.8 ×	24%	143%	8.2%	17.4%	−38.0%	−40.2%
Mean	4.6 ×	31.0 ×	53.6 ×	52.0 ×	57.5 ×	45.9 ×	25%	185%	35.8%	42.2%	3.8%	−1.5%
High	8.3 ×	42.1 ×	75.2 ×	61.9 ×	95.0 ×	74.9 ×	27%	231%	61.1%	77.0%	21.2%	14.6%
Tier 2—Middle Market Accounting Software Companies												
Great Plains Software Inc.	4.8 ×	8.1 ×	56.1 ×	48.2 ×	37.8 ×	28.0 ×	35%	108%	57.5%	590.5%	58.9%	9.5%
Intuit Inc.	5.8 ×	42.8 ×	43.6 ×	62.4 ×	52.4 ×	43.2 ×	21%	247%	12.8%	40.1%	13.6%	16.3%
Epicor Software	1.5 ×	NM	NA	54.2 ×	18.1 ×	14.2 ×	28%	66%	NA	NA	−10.0%	−10.2%
Sage Group PLC	16.0 ×	58.5 ×	84.3 ×	71.1 ×	58.2 ×	43.0 ×	35%	165%	25.9%	26.6%	27.4%	17.7%
Symix	0.7 ×	8.2 ×	12.6 ×	13.5 ×	12.1 ×	9.4 ×	28%	43%	48.4%	68.0%	8.4%	5.1%
Low	0.7 ×	8.1 ×	12.6 ×	13.5 ×	12.1 ×	9.4 ×	21%	43%	12.8%	26.6%	−10.0%	−10.2%
Mean	5.8 ×	29.4 ×	49.2 ×	49.9 ×	35.7 ×	27.6 ×	29%	126%	36.2%	181.3%	19.7%	7.7%
High	16.0 ×	58.5 ×	84.3 ×	71.1 ×	58.2 ×	43.2 ×	35%	247%	57.5%	590.5%	58.9%	17.7%
Tier 3—Others												
Agresso	0.8 ×	40.2 ×	42.0 ×	15.6 ×	7.7 ×	3.5 ×	121%	6%	266.4%	3209.1%	2.1%	1.8%
Intentia	1.6 ×	−69.2 ×	NM	62.1 ×	29.5 ×	NA	NA	NA	51.7%	115.6%	−2.4%	−5.5%
Navision	17.6 ×	79.6 ×	126.9 ×	41.6 ×	32.0 ×	NA	NA	NA	91.5%	137.9%	22.1%	14.0%
Brain International	3.1 ×	NM	NM	72.7 ×	31.8 ×	NA	NA	NA	23.1%	−66.0%	−0.2%	1.1%
Low	0.8 ×	−69.2 ×	42.0 ×	15.6 ×	7.7 ×	3.5 ×	121%	6%	23.1%	−66.0%	−2.4%	−5.5%
Mean	5.8 ×	16.9 ×	84.5 ×	48.0 ×	25.3 ×	3.5 ×	121%	6%	108.2%	849.2%	5.4%	2.9%
High	17.6 ×	79.6 ×	126.9 ×	72.7 ×	32.0 ×	3.5 ×	121%	6%	266.4%	3209.1%	22.1%	14.0%

[a]Based on adjusted market capitalization, which is defined as equity market value + long-term debt − cash & equivalents.

[b]Based on I/B/E/S estimates.

Source of: Thomson Financial's *Datastream Advance.*

EXHIBIT 11 | Financial Data for Selected Enterprise Resource Planning (ERP) Software Companies (values in USD thousands, except per-share data)

	Equity Market Value	Long-Term Debt	Cash & Equiv.	Adjusted Market Value[a]	Revenues	Op. Inc.	EPS	Cal. 2000 EPS Est.[b]	Cal. 2001 EPS Est.[b]	Book Value	Total Assets
Tier 1—Large ERP Players											
Baan	2,637,618	200,546	121,697	2,716,467	674,664	(256,446)	$ (1.35)	$ 0.08	$ 0.10	112,821	696,510
JD Edwards	1,829,385	—	211,782	1,617,603	1,001,263	61,842	$ 0.45	$ 0.18	$ 0.23	583,996	950,473
Oracle	62,282,746	301,140	2,562,764	60,021,122	8,827,252	1,872,881	$ 0.87	$ 1.21	$ 1.50	3,695,267	7,259,654
Peoplesoft	3,611,452	—	498,155	3,113,297	1,333,095	131,978	$ 0.05	$ 0.26	$ 0.32	664,292	1,440,605
SAP	41,907,460	718,858	693,411	41,932,907	5,052,321	995,535	$ 5.33	$ 8.76	$ 10.96	2,096,138	4,083,069
Tier 2—Middle Market Accounting Software Companies											
Great Plains Software	767,893	—	123,683	644,210	134,907	79,489	$ 0.86	$ 1.28	$ 1.72	133,193	180,252
Intuit Inc.	6,476,010	36,043	1,761,200	4,750,853	814,889	111,009	$ 2.15	$ 1.79	$ 2.17	1,673,405	2,469,865
Epicor Software	154,977	—	47,304	107,673	73,688	(7,333)	NA	$ 0.21	$ 0.27	122,196	199,735
Sage Group	5,997,648	136,046	78,171	6,055,523	377,477	103,595	$ 0.58	$ 0.83	$ 1.13	11,187	650,375
Symix	84,421	4,109	3,261	85,269	123,010	10,374	$ 0.91	$ 0.95	$ 1.22	36,749	73,346
Tier 3—Others											
Agresso	88,554	1,398	18,680	71,272	85,973	1,771	$ 0.04	$ 0.24	$ 0.53	40,804	89,789
Intentia	557,217	36,833	12,655	581,395	352,988	(8,400)	$ (0.72)	$ 0.74	NA	104,085	275,714
Navision	655,707	—	6,285	649,422	36,875	8,155	$ 0.20	$ 0.80	NA	9,540	25,127
Brain International	256,499	19,991	39,283	237,207	76,686	(164)	$ 0.13	$ 1.26	NA	65,365	107,844

[a]Based on adjusted market capitalization, which is defined as equity market value + long-term debt – cash & equivalents.

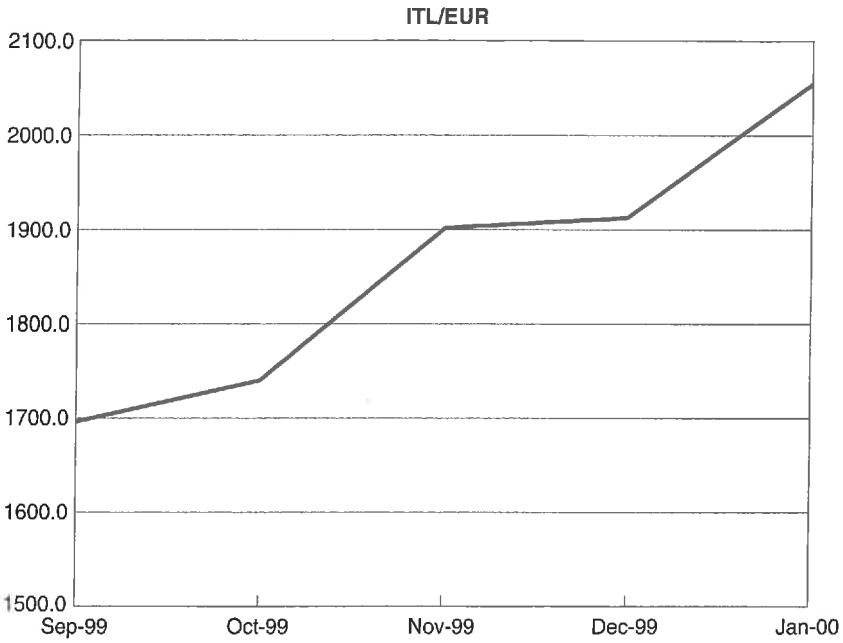
[b]Based on I/B/E/S estimates.

Source of data: Datastream.

EXHIBIT 12 | Recent ITL/EUR Exchange Rates

On January 1, 1999, the European Community fixed the ITL/EUR conversion rate at LIT 1,936.27. The exchange rates that follow were estimated through euro vs. dollar exchange rates,[1] and are proxies for open market rates of exchange.

Date	ITL/EUR
September 1999	1696.3
October 1999	1740.1
November 1999	1901.8
December 1999	1912.6
January 2000	2055.0



Source: Bloomberg LP.

[1]For instance, in September 1999, the EUR/USD exchange rate was 1.0684, and the ITL/USD exchange rate was 1812.32. Dividing the ITL/USD rate by the EUR/USD rate yields an implied ITL/EUR rate of 1696.3.

EXHIBIT 13 | Capital-Market Conditions, February 2000

Instrument	Yield
EURIBOR[1]	
90-day	3.41%
6-month	3.78%
1-year	4.11%
Government Bonds (euro-denominated)	
Italy, April 2004	6.00%
Italy, July 2007	5.87%
Italy, March 2011	9.25%
Euro Area,[2] **5 years**	5.16%
Euro Area, 7 years	5.45%
Euro Area, 10 years	5.61%
Equity Market Index	**Price/Earnings Multiple**
Milan MIB30 Index	37.87
FTSE 100 Index (London)	28.75
DAX Index (Frankfurt)	57.47

Sources of data: *ECB Monthly Bulletin,* European Central Bank (March 2000); Bloomberg LP.

[1]EURIBOR stands for euro interbank offered rates.

[2]Euro area bond yields are harmonized national government bond yields weighted by the nominal outstanding amounts of government bonds in each maturity band.