



Now it is time to understand better the
concept of risk and yield through a
practitioner's point of view
Classis Capital approach

We believe in the supremacy of Knowledge.

We believe in the power of Ideas.

We believe in Inspiration.

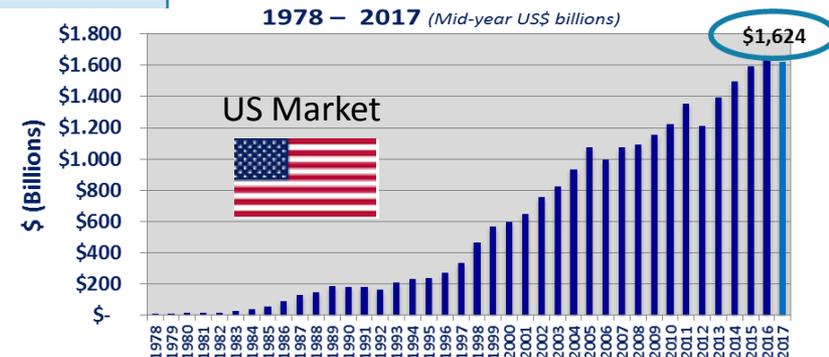
Debt Market is growing faster and faster...

- Corporate Bond market : **30 trillion \$**
- **Since 2008** the US Corporate Bond market growth: **+75%**
- ECB through QE has **100 Billion \$** of Corporate Bond

Main Drivers to analyze the market:

- Net Debt/ Ebitda
- Interest Coverage Ratio

Moody's		S&P/Fitch
Aaa	Investment Grade	AAA
Aa1		AA+
Aa2		AA
Aa3		AA-
A1		A+
A2		A
A3		A-
Baa1		BBB+
Baa2		BBB
Baa3		BBB-
Ba1	High Yield ("Junk")	BB+
Ba2		BB
Ba3		BB-
B1		B+
B2		B
B3		B-
Caa1		CCC+
Caa		CCC
Caa3		CCC-
Ca		CC
C	C	
		D



Source: NYU Salomon Center estimates using Credit Suisse, S&P and Citi data



Debt is not Evil 1/2

Credit Risk

All bond investments face three main risks (**Market, Liquidity and Credit**), but the **most critical mainly** for relatively unknown, smaller enterprises **is perhaps Credit Risk (or insolvency risk)** that means the risk that the debt issuer does not fulfill his obligations to repay partially or completely the capital and / or to pay the interest to his creditors (stakeholders) in the context of a credit transaction

Analysis & Monitoring

Analysis on the main drivers must be set up and track as it is important to study and **monitor the data on going**, in order to check if:

- The data are improving
- There is a clear strategy of the company facing to the debt
- The business plan is reliable and defined in timing and activities

Debt is not Evil 2/2



**Entrepreneurs has to change
their mindset**

From *Company Centricity*
To *Market Centricity*



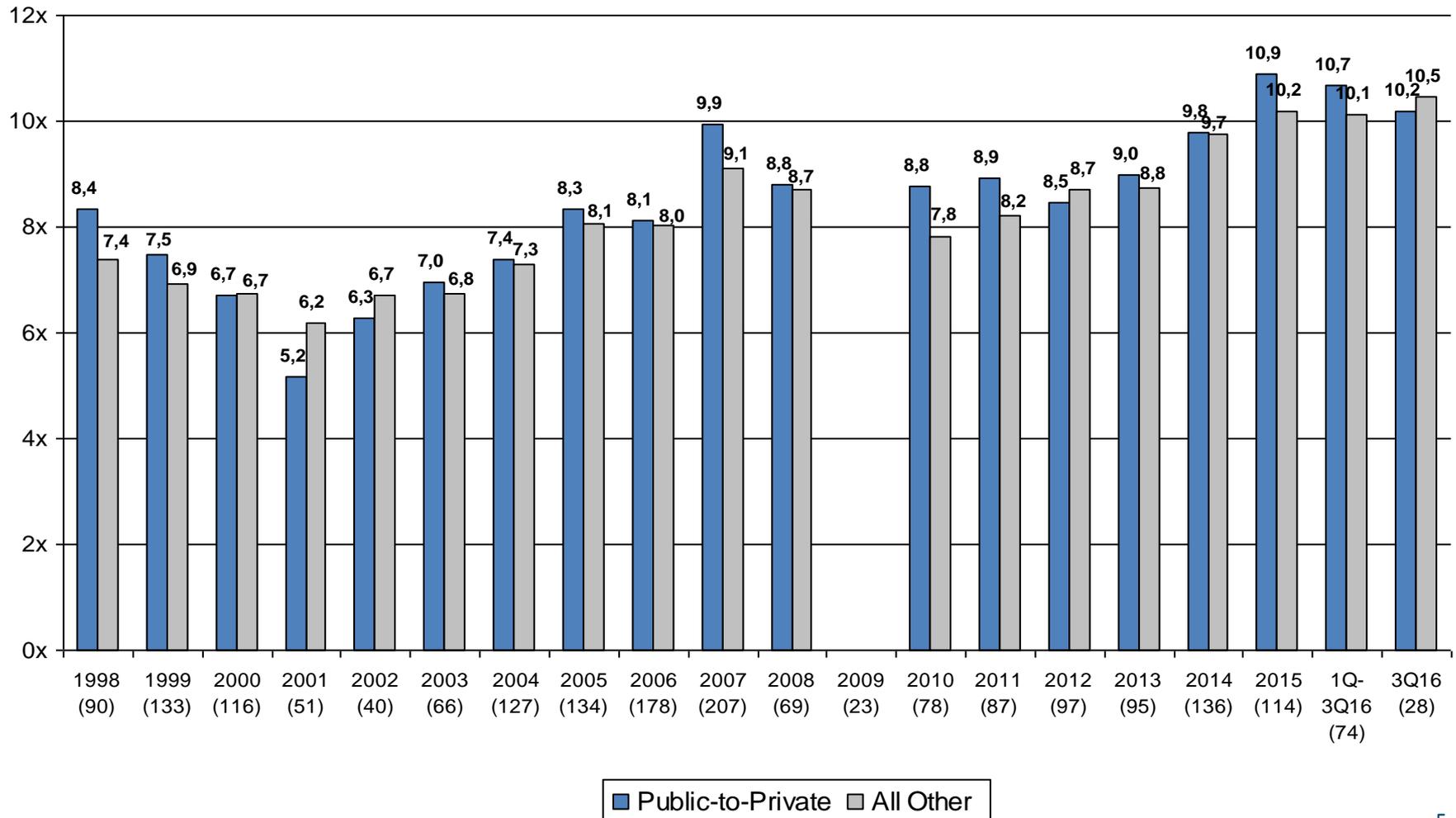
Stakeholder (Bank, Private Equity, Investors) need to know the real
value on the Investments

Rating, Score are fundamental
to be measured in an **objective**
way and versus **competitors**



The enviroment is always changing...

Purchase Price Multiple excluding Fees for LBO Transactions

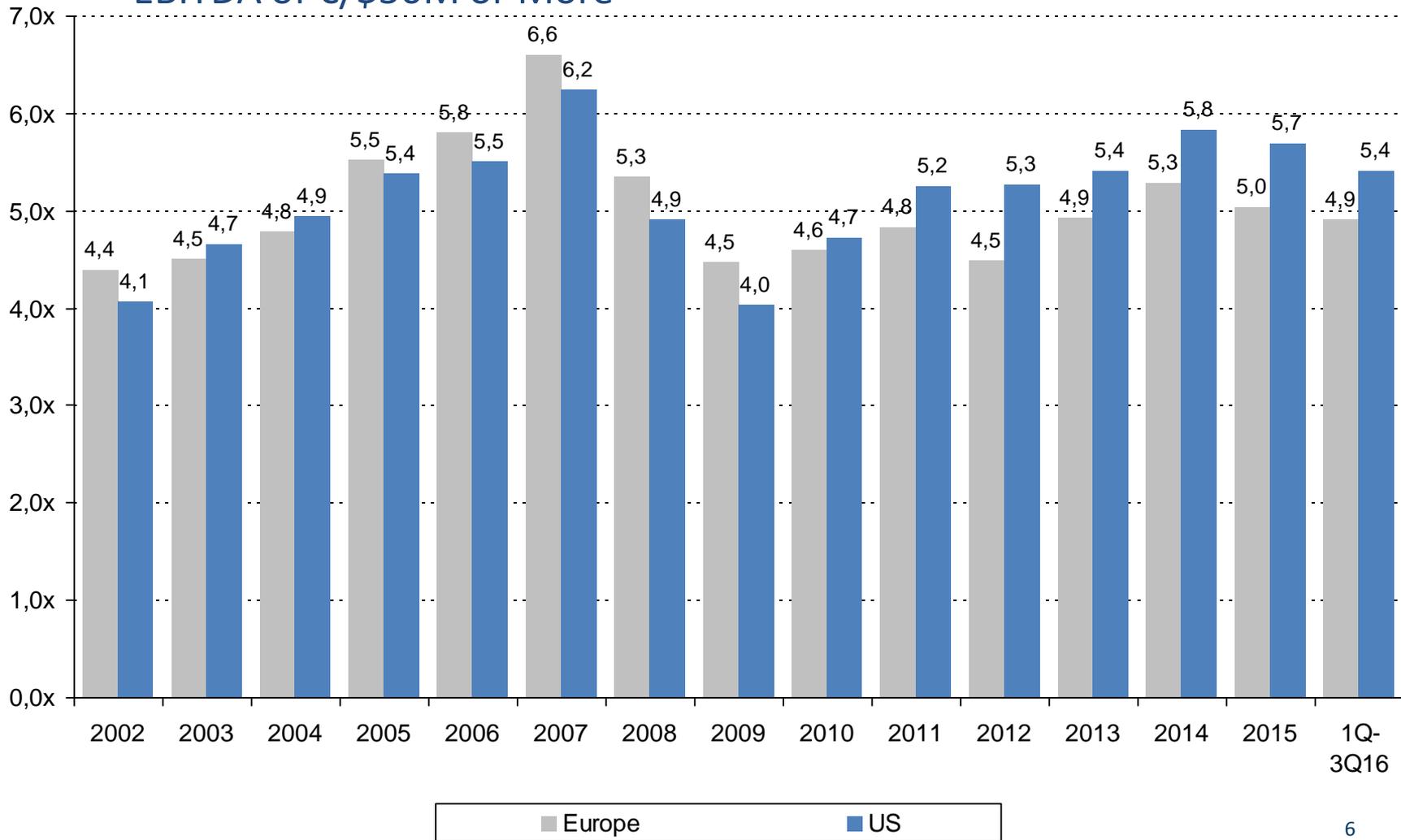


Source: S&P Capital IQ LCD



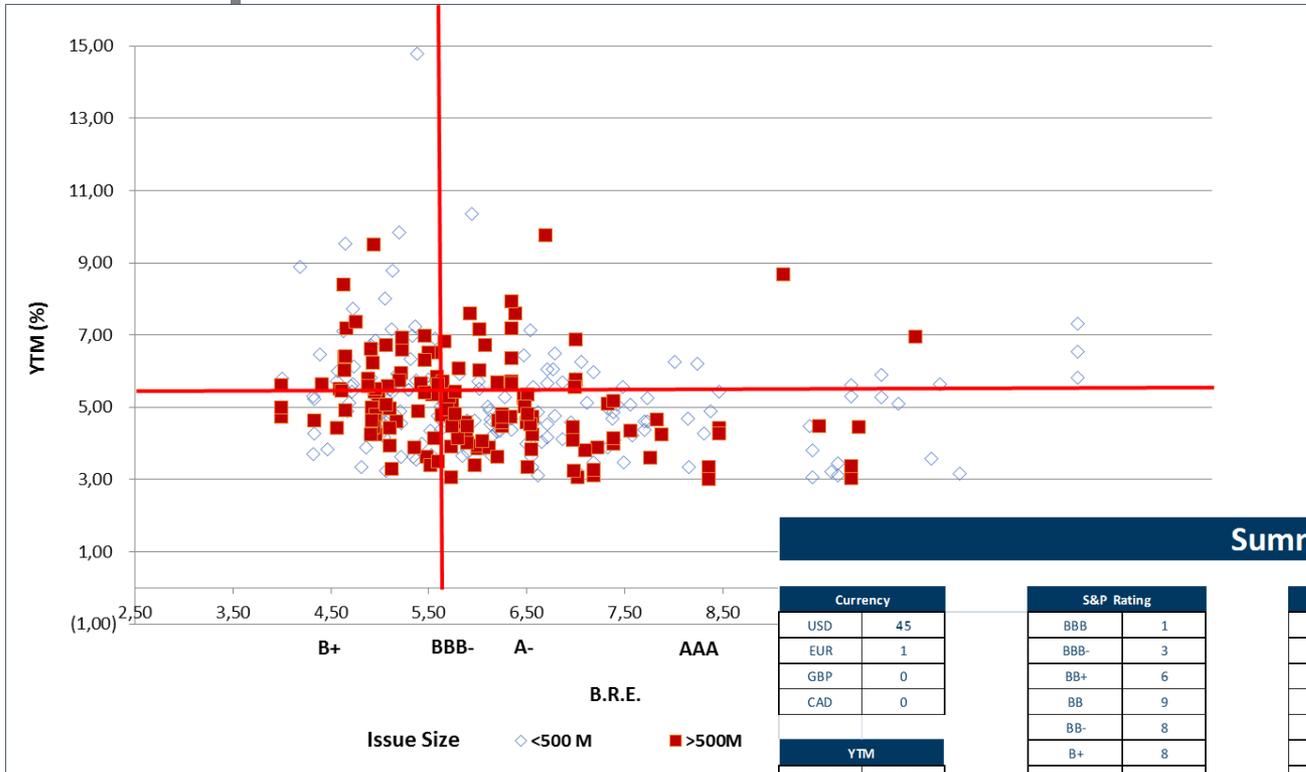
The debt is changing in time

Average Total Debt Leverage Ratio for LBO's in Europe and US with EBITDA of €/\$50M or More



Source: S&P Capital IQ LCD

Debt is not Evil if analyzed and measured



Summary

Currency	
USD	45
EUR	1
GBP	0
CAD	0

S&P Rating	
BBB	1
BBB-	3
BB+	6
BB	9
BB-	8
B+	8
B	5
B-	6

B.R.E.	
AAA	2
AA+	1
AA	2
AA-	4
A+	0
A	7
A-	6
BBB+	5
BBB	7
BBB-	12

Industry	
Consumer Discretionary	1
Energy	11
Financials	1
Health Care	3
Industrials	2
Information Technology	9
Materials	7
Real Estate	8
Consumer Staples	4
Communications	0
Telecommunication Services	0
Technology	0
Utilities	0

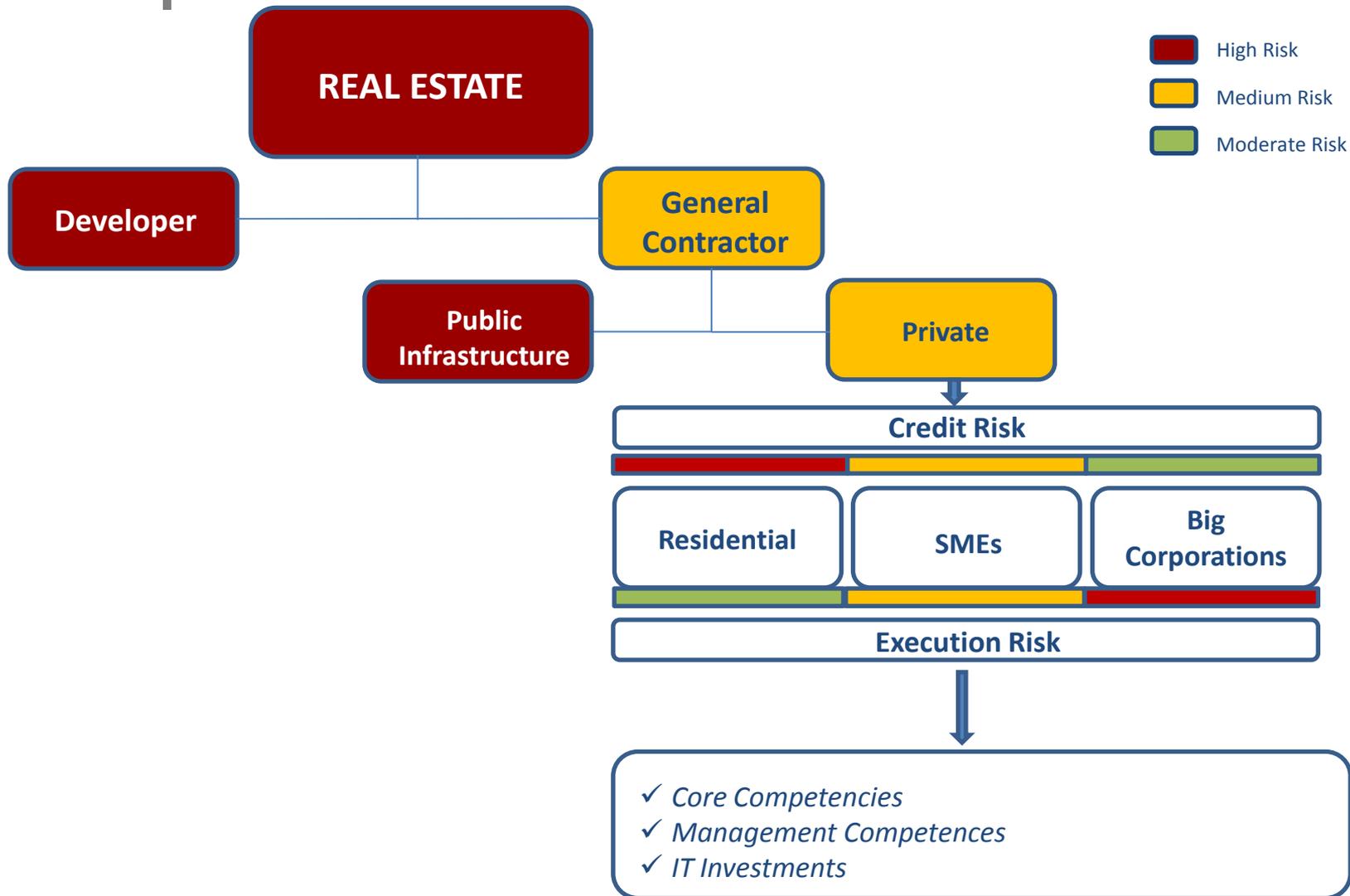
YTM	
3%-6%	36
6%-10%	9
10%+	1

Geographic Area	
Latin America	1
North America	35
EMEA	1
ASIA	9

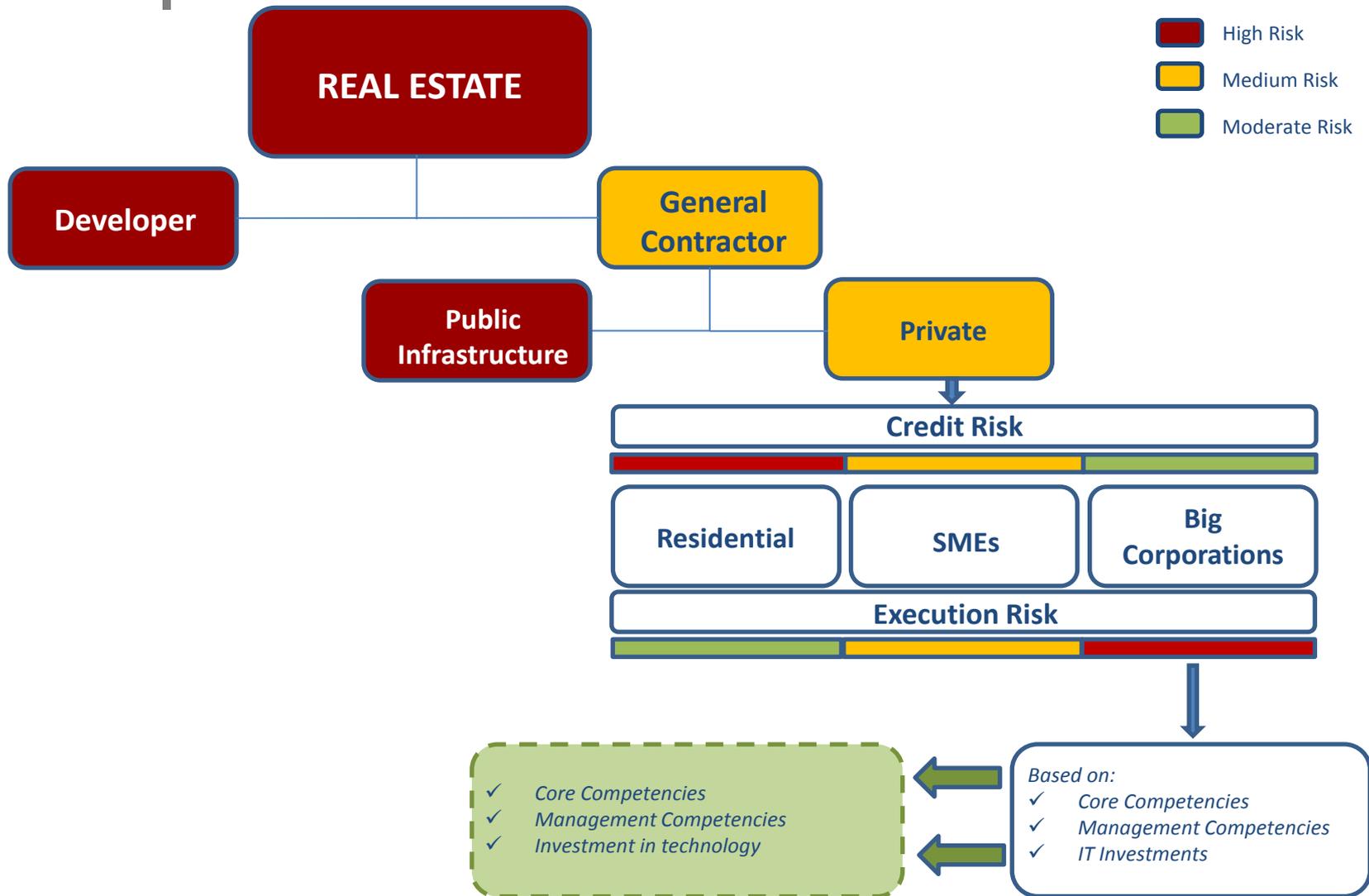
Liquidity	
<500m	0
500 M-1 B	34
1 B +	12

Δ Notches	
0 - 5	19
5 - 10	21
10+	6

Industry profile risk



Company Risk Profile within the Real Estate





Why Alternative Funding is important

Alternative to what?

Corporate Bond are debt securities, in particular **High Yield bonds**, if issued by a SME:

Different reasons to this kind of alternative funding:

- raise **new financial resources**
- **diversify sources of funding**
- mitigate the risks associated with the strong **dependence on the banking channel**

The rationale for an SME issuing bonds is **strategic**. It is an **integrated process, structured in several steps**, involving all business functions and consultants.

Overcome the prisoner's dilemma

In a dramatic context, with a senseless taxation, a steadily growing complexity, and a growing foreign competition, the entrepreneur must return to take risks.

But how **to overcome the structural constraints** that mortify entrepreneurship?

- ❖ The undercapitalization of SMEs in Italy
- ❖ Poor expertise in planning and financial communication
- ❖ «Small is good» Is it still true ?



Overcome the prisoner's dilemma

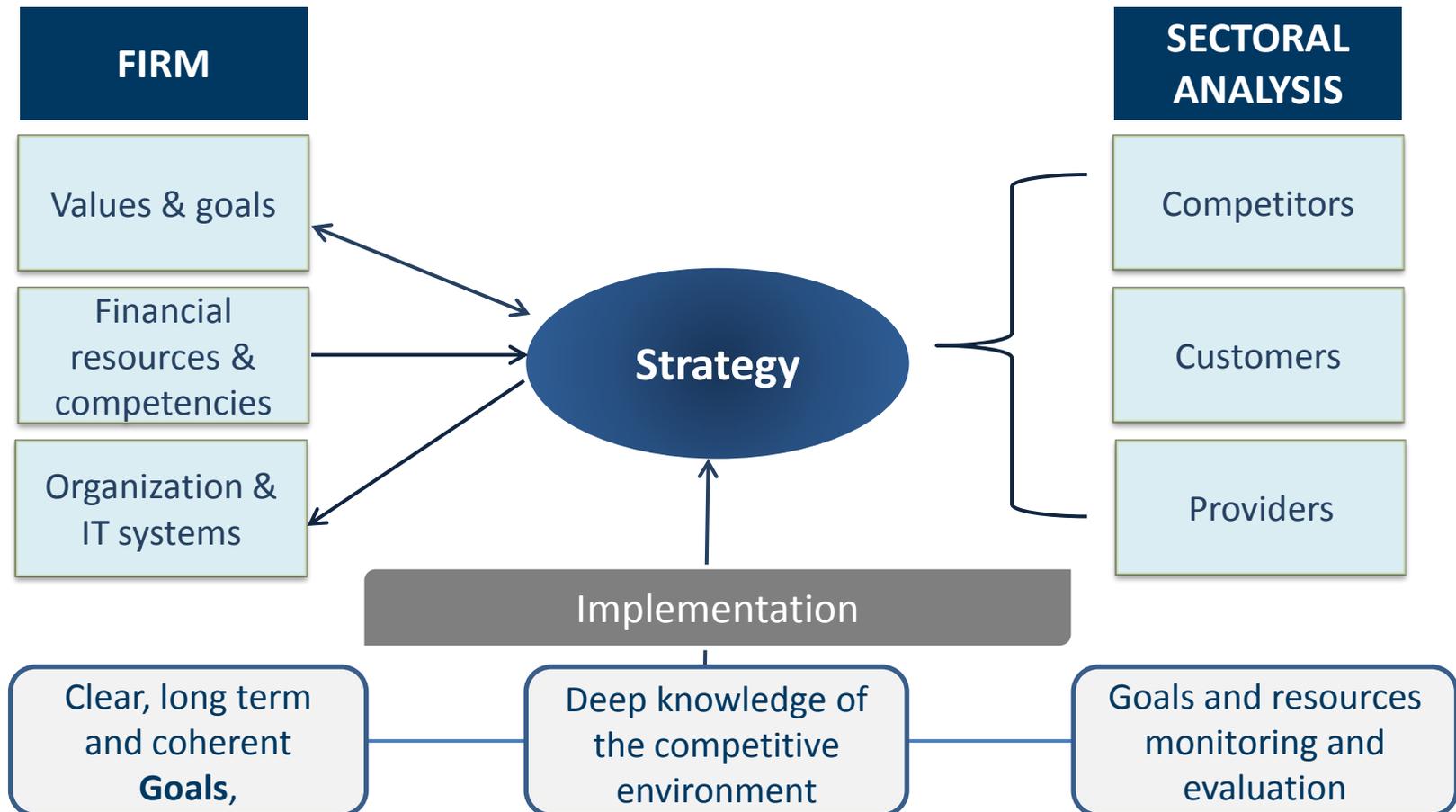
How to find financial resources



**Dependency
on third-
party
judgment**

Corporate finance as a mean...

MUST: Strategic Analysis



«Nice to have» Issuer



Objective requirements	Qualitative requirements
LTD companies	Preliminary valuation of the rating > «B»
Financial statements reviewed	Company with international ambition
Company of <i>good standing</i>	Existence of development projects to be funded
No Start-Ups and no <i>turnarounds</i>	Operating in a <i>sector of excellence</i>
Last two years in profit	<i>Financial control</i> functions

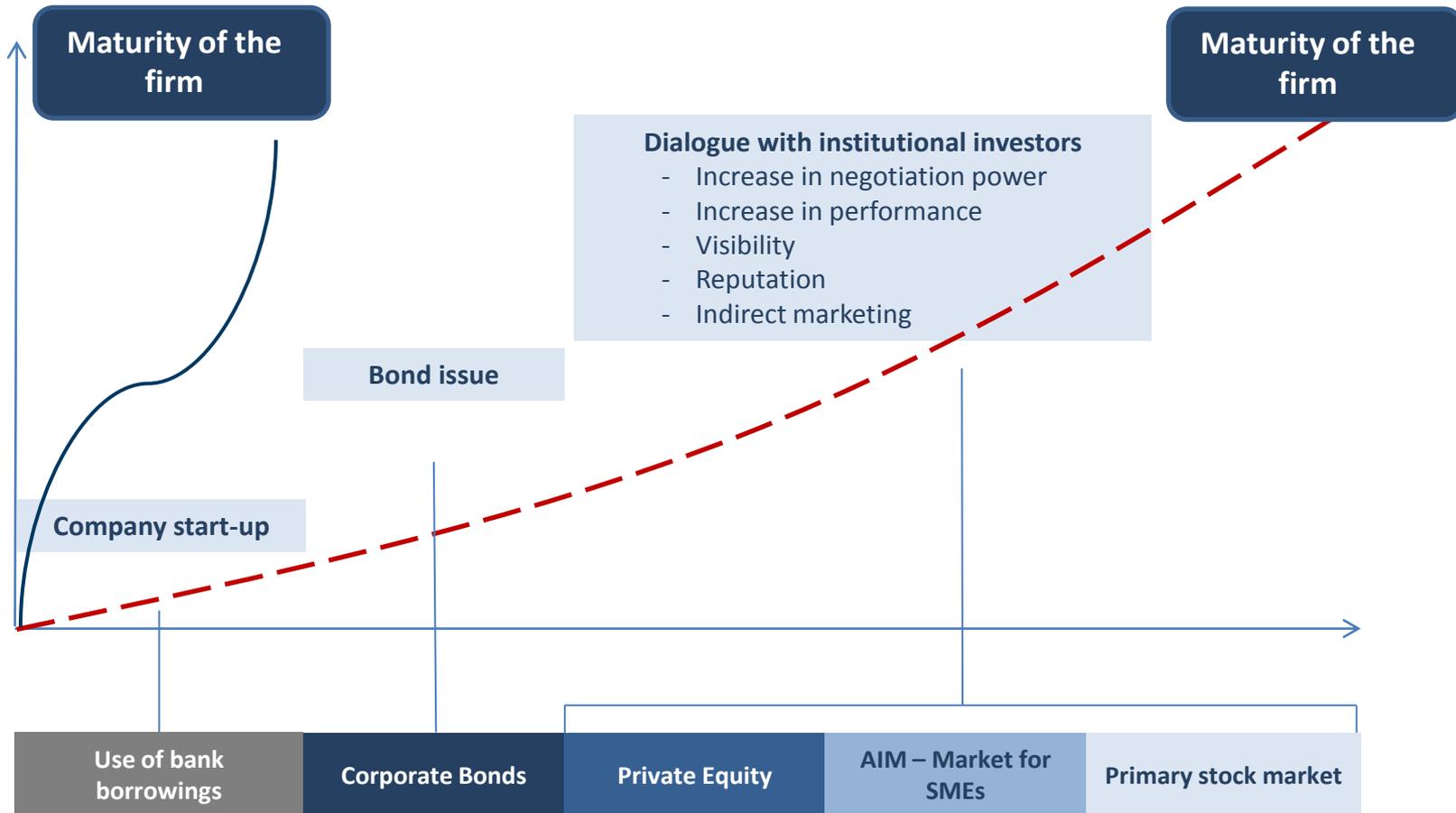


Improving the capital structure

Revenues €



Strengthening the financial structure / capital of the firm



Corporate Bonds are a unique opportunity to rebalance the financial structure of businesses and give a boost to evolution of the debt securities market in Italy.

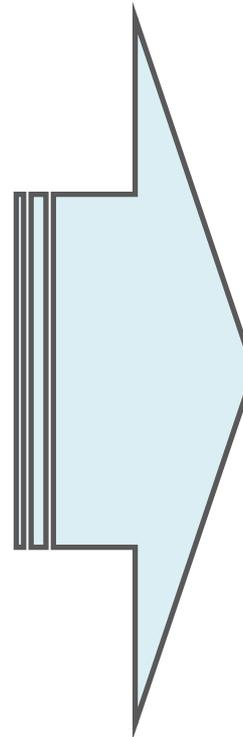
Pricing model



Corporate debt provide an alternative means of financing for Italian SMEs, offering investors **more attractive returns** than those obtained from the traditional corporate bond market.

Ratio Analysis to quantify the Credit Risk

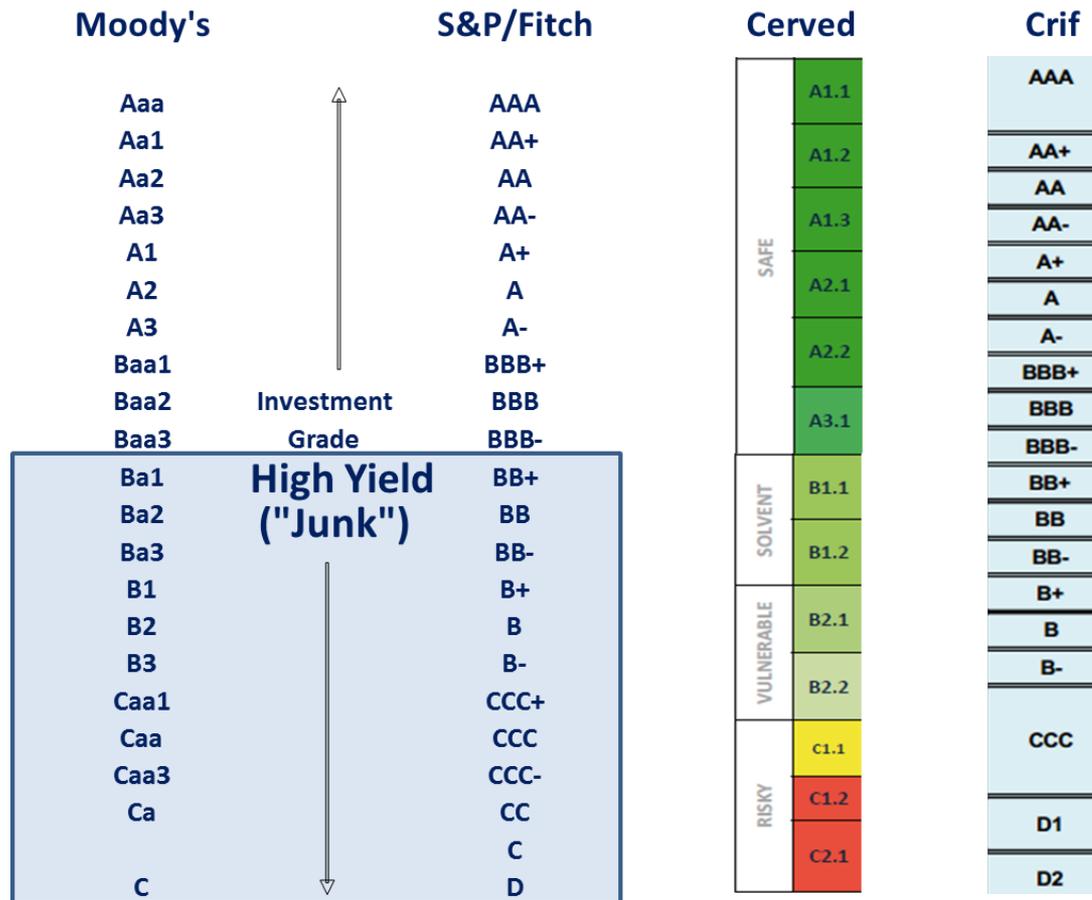
Accounting Ratio Category	Selected Variables
Leverage	Short Term Debt/Equity (Book Value) Equity (Book Value)/Total Assets Current ratio Quick ratio Short Term Debt/Total debt Short term debt/Total Assets Debt/EBITDA Net Debt/EBITDA Change Short term debt in Last 2Y Total debt/Total Assets
Liquidity	Cash/Total Assets Working Capital/Total Assets Tangible/Total assets Intangible/Total Assets
Profitability	Ebitda/Total Assets Net Income/Total Assets Return on Equity Retained Earnings/Total Assets Net Income/Sales
Coverage	Ebitda/Interest Expenses Ebit/Total assets
Activity	Sales/Total Assets Account Payable/Sales Account Receivable/Liabilities



- Consistent with a large number of studies, we choose **5 accounting ratio categories** describing the main aspects of a company's financial profile: liquidity, profitability, leverage, coverage and activity.
- For each one of these categories, we create a **number of financial ratios** identified in the literature as being most successful in predicting firms' bankruptcy and transform them in highly predictive variables
- Next, we apply a statistical forward stepwise selection procedure to the selected variables and estimate the full model for each of the four sectors eliminating the least helpful covariates, one by one, **until all the remaining input variables are efficient**, i.e. their significance level is above the chosen critical level.

Rating: this uncomfortable travel buddy

Rating categories and funding cost depending on the economic cycle





The rating importance

The rating, the final synthesis where different interests cross:

- Firm,
- Investors,
- Supervisory Authorities and Regulated Markets



Prof. E. Altman – Convegno Ascosim, June 2014
“Role of a Credit Culture in the
Italian Corporate Bond market”

- Greater understanding between borrowers and investors
- Create a Shadow Rating Model for SMEs

**The importance of the
*Shadow Rating***

Mortality Rates by Original Rating

All Rated Corporate Bonds* 1971-2015

Years After Issuance

		1	2	3	4	5	6	7	8	9	10
AAA	Marginal	0.00%	0.00%	0.00%	0.00%	0.01%	0.02%	0.01%	0.00%	0.00%	0.00%
	Cumulative	0.00%	0.00%	0.00%	0.00%	0.01%	0.03%	0.04%	0.04%	0.04%	0.04%
AA	Marginal	0.00%	0.00%	0.21%	0.07%	0.02%	0.01%	0.01%	0.01%	0.02%	0.01%
	Cumulative	0.00%	0.00%	0.21%	0.28%	0.30%	0.31%	0.32%	0.33%	0.35%	0.36%
A	Marginal	0.01%	0.03%	0.12%	0.13%	0.10%	0.06%	0.02%	0.25%	0.08%	0.05%
	Cumulative	0.01%	0.04%	0.16%	0.29%	0.39%	0.45%	0.47%	0.72%	0.80%	0.85%
BBB	Marginal	0.33%	2.36%	1.26%	1.00%	0.50%	0.22%	0.26%	0.15%	0.15%	0.34%
	Cumulative	0.33%	2.68%	3.91%	4.87%	5.34%	5.55%	5.80%	5.94%	6.08%	6.40%
BB	Marginal	0.94%	2.02%	3.88%	1.97%	2.34%	1.51%	1.45%	1.12%	1.43%	3.13%
	Cumulative	0.94%	2.94%	6.71%	8.54%	10.68%	12.03%	13.31%	14.28%	15.51%	18.15%
B	Marginal	2.85%	7.72%	7.85%	7.80%	5.70%	4.48%	3.58%	2.08%	1.76%	0.77%
	Cumulative	2.85%	10.35%	17.39%	23.83%	28.17%	31.39%	33.85%	35.22%	36.36%	36.85%
CCC	Marginal	8.13%	12.43%	17.89%	16.32%	4.85%	11.65%	5.44%	4.84%	0.66%	4.28%
	Cumulative	8.13%	19.55%	33.94%	44.72%	47.40%	53.53%	56.06%	58.19%	58.46%	60.24%

*Rated by S&P at Issuance
Based on 2,903 issues

Source: Standard & Poor's (New York) and Author's Compilation



The importance of SMEs

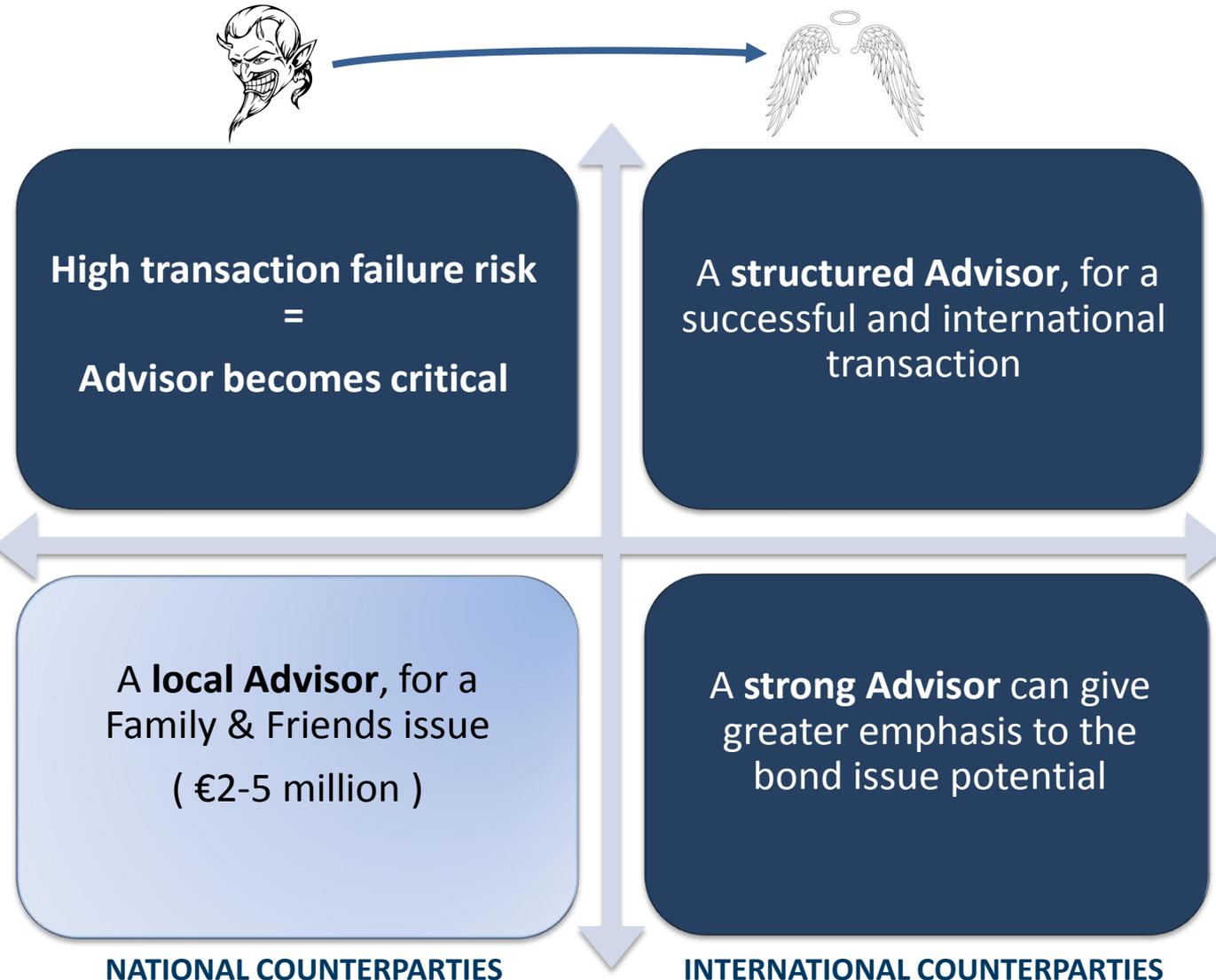
- SMEs comprise a major share of economic activity in advanced economies. They account for **over 95% of enterprises, 60% of employment and over 50% of value added in the Private sector**. In the EU, SMEs have created 85% of net new jobs from 2002/2010.
- After the last financial crisis, being heavily reliant on traditional bank lending, the majority of SMEs were faced with significant financing constraints in a deleveraging environment and with restricted credit availability from banks. Despite recent central banks' supportive stimulus, **capital market bond financing is increasingly attractive**.
- Non-bank market-based financing increasingly appeared as an option to improve the flow of credit to SMEs, while enhancing diversity and widening participation in the financial system.
- Since 2012, new channels have become increasingly important for SMEs to satisfy their funding needs. Examples of these new sources of funding are crowdfunding, P2P lending, equity participation, securitizations, and Mini-bonds. However, in Europe, SME financing is still heavily reliant on bank lending.

How to face capital markets succeeding

COMPLEXITY of the business model;
amount of transaction0

HIGH

LOW



TARGET of the issue



Disclaimer

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Classis (classe, classis) è il termine Latino che indica la Flotta.

Classis era conosciuta come la flotta navale della marina dell'impero Romano. La sua funzione era quella di controllare le acque attorno alle province di Roma. Il suo compito era quello di dare supporto logistico, tenendo aperte le rotte di comunicazione marittime.



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