DGI-176-E

INSTITUTO INTERNACIONAL SAN TELMO

TELEPIZZA S.A.

Case study by Instituto Internacional San Telmo (*San Telmo International Institute*) Research Division, Spain. Prepared by Professor Antonio García de Castro and Research Assistant Mrs Rocío Reina Paniagua for use as a basis of discussion and not as an example of adequate or inadequate management in a specific situation.

This document was drafted as a result of the contributions made by the sponsorship of the companies to which the Members of Instituto International San Telmo's Department of Food and Agrarian Companies Advisory Board belong, which in April 2009 are: AECOC, AGRÍCOLA SAN MARTÍN, AGRO SEVILLA ACEITUNAS, C.C. CARREFOUR, CAJA RURAL SUR, CAMPOFRÍO ALIMENTACIÓN, S.C.A. OLEÍCOLA HOJIBLANCA, COVAP, COVIRÁN S.C.A., DIAGEO ESPAÑA, FIAB, FRIMANCHA INDUSTRIAS CÁRNICAS, GONZALEZ BYASS, PASTAS GALLO, HEINEKEN ESPAÑA, GRUPO YBARRA, INVERALIA, LANDALUZ, MAHOU-SANMIGUEL, MERCADONA, OSBORNE Y CÍA, GRUPO EBRO PULEVA, RABOBANK, RENDELSUR, S.A.T. ROYAL, BODEGAS WILLIAMS & HUMBERT.

TELEPIZZA, S.A.[1]

BACKGROUND

Leopoldo Fernández Pujals, who was well aware of the booming industry of home-delivered pizzas market in the USA, founded Telepizza company in 1987. Leopoldo held 45.45 per cent of the company, his brother, Eduardo, 32.35 per cent and the rest of the share capital was distributed among a group of smaller shareholders. Telepizza opened its first store in Madrid, and then in other Spanish cities, and, in no time at all, became the market leader. On the other hand, it did not renounce its opportunity of international expansion and in 1995, the company set up stores in Portugal, Mexico, Chile and Poland.

Eduardo sold his shares in 1996 and a few months later, following a very successful advertising campaign in the press, a public offering of shares was arranged and 45 per cent of the share capital was placed in the Spanish stock market. Banco Bilbao Vizcaya, one of the most important national banks, bought 9.1 per cent of the capital, with several smaller shareholders continuing to hold 7.9 per cent and Leopoldo holding the rest.

After its listing on the Stock Market, during two highly successful years, Telepizza shares became the highest valued among small investors, entering even the IBEX-35[2]. In November 1996, the company's shares[3] were listed on the stock market at a price of 0.67 euros and in June 1998 they reached their maximum value of 9.92 euros; however, in 1999 the share price fell dramatically, reaching a minimum value of 4.10 euros. Exhibit 1 contains the projects that were started that year.

---

[1] Case study by Instituto Internacional San Telmo, España. Research Division. Prepared by Professor Antonio García de Castro and Research Assistant Mrs Rocío Reina Paniagua, for use as a basis for discussion and not as an example of adequate or inadequate management in a specific situation.

[2] IBEX 35: capitalisation-weighted stock market index listing the 35 companies with the highest liquidity ratio of those operating in the continuous market of the 4 Spanish stock exchanges (Barcelona, Bilbao, Madrid and Valencia).

[3] In 1996 the company had 240 million shares.

OCTOBER, 1999: THE BEGINNING OF A NEW PHASE

In October 1999, the chairman and majority shareholder Leopoldo Fernández Pujals announced to the Board, the CNMV[4] and the market that he was selling his shares -30.2 per cent of the share capital- at a price of €4.6 per share. The brothers Pedro[5] and Fernando Ballvé, together with Aldo and José Carlos Olcese, shareholders of TeleChef Corporation S.A[6] bought 5.4 per cent of the share package; the rest was placed in the market by Lehman Brothers[7]. Following that change in the stakeholders, Fernández Pujals left the Board and Pedro Ballvé was designated as Chairman.

The Ballvé and Olcese brothers initially wanted Telepizza to be used for a capital increase in Telechef, this way reducing the company's leverage (4 million euros). They were convinced that the future of the companies in general and the food industry, in particular, lay in entering the homes of consumers; however, after years of trying this with Telechef, they had not managed to come up with a project with a future.

Telechef offered Telepizza the option of launching two of the "*Fast Food*" segments (rolls and hamburgers) into most of its stores to achieve higher growth with a view to obtaining a market share of 93.6 per cent together with the pizzas. In November, a market trial was carried out in six Telepizza stores to evaluate the potential of incorporating them, with positive results. Sales in the stores increased by an average of 10 per cent above the mean growth of the stores in the region, with 89 per cent of clients considering the product good or very good and 87 per cent saying they would ask for them again. In addition, selling these products had no effect on selling the pizzas since it did not limit the oven capacity or increase the store's fixed costs. The increase in sales came about through three channels: winning new clients who were not pizza-consumers, increasing the frequency of consumption by clients and increasing the average size of the orders.

In December 1999, PriceWaterHouseCoopers considered that Telepizza alone was worth 1,000 millions euros, whereas following the entry of TeleChef, the company worth amounted to 1,153 million euros. The Shareholders Meeting approved the entry and the capital was increased by the shares subscribed entirely by the shareholders of TeleChef. It was considered that Telepizza should hold a share of 69 per cent of that extra value and Telechef, 31 per cent, meaning that for the purpose of the exchange equation, the value of Telechef was 45 million €. Thus the share capital was increased by 4.16 per cent and not by 15 per cent. Great care was taken to ensure that the competition defence requirements were fulfilled in all cases and for this purpose, a Board Committee was set up to monitor the process of incorporating Telechef, formed by the independent Board Members.

In the letter addressed to the shareholders included in the management report for that year, the new Chairman, Pedro Ballvé, wrote: "1999 has laid the foundations of Telepizza based on three channels of growth: increasing its product range,

---

[4] CNMV: National Securities Market Commission.
[5] Pedro Ballvé: Chairman of the family-run meat company Campofrío, leader of the Spanish market, and also Board Member in several companies: *Telefónica*, Banco Santander Central Hispano, ING, González Byass…
[6] Telechef, S. A.: A company specialising in the home delivery of rolls and hamburgers.
[7] Lehman Brothers: A financial and investment institution.

internationalising the company and, finally, exploring new business areas to create synergies with traditional activities”.

After the purchase operation, a stock options plan was approved to retain the management team for a maximum of 4,293,000 shares (2 per cent of the share capital), targeted at certain employees from the main office, plant, stores managers and Board Members. One year later, it was agreed to purchase own equity (4,500,000 shares) to cover those stock option plans, for which purpose it was necessary to obtain finance amounting to 12 million euros. This made it possible to respond to an offer made by the former chairman, which had never materialised.

2000-2005: FORGING A FUTURE

Time for analysis and taking the first decisions

The new shareholders wanted to get to know the company well and they therefore decided to undertake several studies to ascertain the company’s strong and weak points. The first to give an opinion were the company auditors, who identified the following as critical or sensitive areas: self-portfolio, Vending Pizza[8], France and the bad debt of the Pizza World franchises.

During the spring of 2000, Telefónica bought 4.88 per cent of the shares through Atento, and an agreement of intent was signed with the company Terra Networks S.A.-owned by Telefónica-. A mixed company called A TU HORA (IN TIME) was set up whose aim was the sale and distribution of convenience products through a *call centre* or the Internet with the promise to delivery in one hour. The notification of this to the markets coincided with the stock exchange *boom* of new technology companies, and led the shares to reach historic values of more than €10.

In May 2000 the multinational consultant Bain & Co. was hired, and it presented a report indicating a halt in the growth of the Spanish home delivery market. To continue growing, Telepizza would have to focus on pizzas, developing its business through new locations, new formats, new channels, new products and continue with its international expansion.

In the opinion of the consultant, the development of Telepizza should be based on three main strategic lines:

<u>Core business</u>. Focusing on its core business through the correct management of the customer database and increasing sales outlets, mainly through franchise stores, especially in cities with less than 50,000 inhabitants. In addition, it was suggested they should be adapted to allow customers to eat them on the premises. Furthermore, it was recommended that the company increase its product range with more innovation and four launches a year, that it improve its service (reducing late orders from 14 per cent to 10 per cent and non-answered calls to 6 per cent), adapt its prices (price review by homogenous economic zones) and reduce promotions.

---

[8] Vending Pizza: This project was started during the time the company was managed by Leopoldo Fernández Pujals for the purpose of selling pizzas through Vending machines.

Growth in adjacent businesses. They proposed supporting the project *Telepizza Express* for which they recommended opening 90 new stores in three years in shopping centres, airports and areas of passage, with a store model that would have a break-even point of €380,000 per month.

International area. They drew a distinction between businesses to be consolidated (Portugal and Chile), businesses to be strengthened (Mexico, Poland and Morocco) and businesses to be re-assessed (UK and France).

At the same time, the Board entrusted Jose Carlos Olcese with studying the situation in the different countries where Telepizza was operating. His conclusions were:

Portugal had exceeded expectations along with Poland, where the launch of the hamburger/roll formula had been successful. In France, the negative trend continued. Five stores had been closed and considerable losses were being obtained every month, for which reason continuity of the business depended on changing the strategy adopted up to that time. In addition, the company from which the stores had been bought had taken the contact databases and it is prohibited to mail coupons (Telepizza's greatest advertising tool) in France. The United Kingdom was experiencing a downturn, following the conversion of all the HippoPizza stores into Telepizza. In Morocco development was slow due to the lack of this type of eating habits among consumers and not being able to have certain key elements in the Telepizza strategy, due to the low number of telephones installed in Morocco and lack of addresses in many areas of the most important cities. In South America, the situation was quite contradictory: the strong growth rate in Mexico in 1999 was leading to difficulties in the personnel area, and important deviations in profits. However, things were going well in Chile and the company was now the leader in its market.

As regards the group's situation in Spain, a significant fall had been observed in business growth due to the stagnation of the home delivery market and the increase in consumption outside the home, the greater presence of refrigerated pizzas, scarce impact of marketing campaigns and poorer than expected results in sales of hamburgers and rolls.

Incorporation of José Carlos Olcese as Executive Vice-Chairman and his first actions

In October 2000, López Casas, CEO and first executive of the company until that time, resigned from his post and was replaced by the Vice-Chairman, José Carlos Olcese. In May 2001 Fernando Zapater[9] was recruited as CEO and first executive of the company, reporting to both the Board and to the Executive Vice-President. The CEO took charge of the company's day to day affaire and the Executive Vice-Chairman, of its international development, strategic planning and new business. In addition, Gonzalo del Barrio was hired to lead the Telepizza Express project.

[9] Fernando Zapater: He had previously held the post of General Manager in Grupo AZKAR, Fibro-cements and Sales Division Manager in Uralita, General Manager in Grupo BH and CEO in BP SOLAR España.

Firstly, José Carlos studied the franchise stores market. He analysed its historic evolution and observed that it had changed from supporting the granting of franchise stores during the period 92/96 to recovering franchise stores during the period 97/99 and that from the beginning of 2000, it had been granting franchises only to small stores. The Executive Vice-Chairman presented an action plan to improve relations with franchise stores which was approved, with the aim of reassuring franchisees (who were particularly concerned due to the negative sales situation).

The franchise policy was reinforced, and a model created that was similar to that of the most important multinational "*Fast Food*" chains, permitting faster growth and less risk and investment by Telepizza. A Franchise Development department was set up to define a franchise model and the profile of the franchisees, advertise the Telepizza franchise in the market, train and support new franchisees and manage relations with franchisees. A monthly franchisee committee was set up and it was decided to take part in the International Franchise Show and for the first time, hold a Telepizza franchisee convention in November 2000.

In December 2000, the Vice-Chairman provided the Board with the first economic figures of the international expansion: France and the UK would contribute losses of 5.5 million euros a year to the profit and loss account, since these were markets in which Telepizza held a minority share, the situation in Mexico had deteriorated considerably, and obsolete marketing products had been detected for a value of 1.5 million euros. It was recommended to reduce the mailing of coupons to save 4 million € per year.

At the same time, he informed the Board that certain accounting items had been detected that would have a substantial effect on the profit and loss account for the years 1999 and 2000. For example, in Mexico profits of €570,000 had been recorded in 1999 when in actual fact, there had been losses of €3,000,000; in the data for Spain, an item of €2,000,000 had been detected that had not been booked, along with other accounting errors. It was also agreed to allocate an accounting provision for the amount of €12,000,000 in relation to the Vending Pizza project.

In view of this scenario, it was decided to close the stores in Morocco and the UK and an agreement of intent was signed with the Central American company "Pollo Campero" to set up a pilot plan consisting of installing Pollo Campero corners in certain Telepizza stores in Mexico and installing Telepizza corners in certain Pollo Campero stores in Central America.

On the other hand, the industrial director, Manuel Capelo[10], presented a plant management plan to put an end to the productivity, health and legal problems that existed in the plants built during the time the company had been managed Fernández Pujals. For this purpose he hired a team of highly-qualified professionals as well as different companies to work with him as soon as he started working in Telepizza, to

[10] Manuel Capelo: During the last few months of his career in Telepizza, Leopoldo Fernández Pujals hired Manuel Capelo as Purchases Manager. Until then, Manuel had been Purchases Director in Continente and Makro. On entering the company, Pedro Ballvé, who already knew Manuel from previous contacts, encouraged him to lead different projects for the new period of operations of the company. Later, from the end of 2001 until 2004 he was Industrial Director and then from that year until 2008, Telepizza General Manager in Spain.

develop and reorganise the Purchases Department which had practically been non-existent until then.

Following the instructions of Manuel Capelo, the Board agreed to buy land in Daganzo (Madrid) to build a new plant/logistics platform with a view to substituting the five plants and logistics platforms that were scattered throughout Spanish territory. It occupied an area of 40,000m^2 with a developed area of 14,000m^2 and a production capacity of 60 million balls of dough / year. It was scheduled to start operating at the end of 2003. The investment amounted to between €13,000,000 and €16,000,000. The main objectives established for this new industrial centre were the application of the latest technologies and improvements in efficiency and concentration in production. One important aspect was the logistics platform adjoining the plant, which, thanks to all its technological advances, became a key element in the Telepizza production process.

In 2001, work was started on construction and technological development in Luxtor, Telepizza's cheese factory. Experts say that it was the best pizza cheese factory in Europe. At that time, it was also agreed that due to the increase in raw material prices, mozzarella would be replaced by a new reformulated product that, without any reduction in taste or quality, led to an important increase in the industrial margin (3.3 million euros per year) with an investment in a cheese factor in Luxtor for €2.1 million. During 2001 a series of projects studied which eventually materialised in 2002: such as the consolidation of sales of cheese to other companies and to the HORECA[11] channel.

During the time López Casas was the company CEO, a plot of land was bought in San Sebastián de los Reyes with 10,000m^2 available for development for building the new company head office. One year later, at the same time as building the factory in Daganzo, work was started on the new building. At the end of 2001, it was agreed to sign a *sale and lease back*[12] agreement for the building with a German real estate investment fund, which would pay approximately €25,000,000 for it, with a return of 7.43 per cent on that price over a ten-year period.

To end the reorganisation of the operations and logistics area, Telepizza decided to sell off its factory-to-store transport activity. *Delivery Delta*, the group's transport subsidiary, was sold for 7,500,000 euros, and at the same time a transport contract was negotiated that enabled Telepizza to cover its needs.

Despite all efforts, in 2001 the sales evolution was not at all positive, with a fall in orders of 10 per cent in local and 19 per cent in home deliveries, 20 per cent of which was due to product-related reasons, 18 per cent due to the service, 13 per cent due to the price and 7 per cent due to refrigerated pizzas. The marketing director recommended a series of measures including a customer loyalty programme (points that could be exchanged for products), new launches, guaranteed gift offers, combined menus, extra ingredients and a change in the coupon design.

The out-of-home leisure and restaurants project continued to be developed along these lines, given the increase taking place in that segment. In this way, a new brand was launched in this line of business: *La Piazza* de Telepizza. This was Telepizza's

[11] HORECA hotel accommodation, restaurants and catering.
[12] Sales and lease back: Process for selling off assets and then leasing them.

proposal for consumption outside the home, especially in shopping centres, to fill a gap in the fast food service segment.

Through all these measures and several others, the objective was to reach sales of 500 million euros in 2003 in Spain, 200 million euros in other countries and 150 million euros in new countries, making a total of 850 million euros and profits before tax of 114 million euros.

New strategic plan in 2002

The key message of the new Strategic Plan was based on changing the previous model, focused on the product, to a new offer of added value, linked to a strong emotional component. The idea was to enjoy leisure time, the "Telepizza moment", in a different way to other food included in the "*Fast Food*" category. Telepizza was largely for consumption at home (85.8 per cent of its sales), linked to a social moment of leisure shared with others, through a product with a similar nutritional content to that of the Mediterranean diet, made to order and to suit the client's taste.

The new strategic plan was presented by the company's internal auditing team, together with the CEO and Vice-Chairman and with the collaboration of J.P. Morgan y Bain & Co.

A reduction was proposed in the number of own stores in Spain and an increase in franchise stores. Small stores, all of which were franchised, had to increase in number, along with the *La Piazza* restaurants, ending up with 10 own stores and 100 franchise stores. In countries such as Portugal and Poland, both own and franchise stores continued to be opened, but with a larger number of franchise stores.

Telepizza continued with its initiative of modernising the company and the new strategic plan proposed new projects that would drive the company to achieve its objectives; in particular, these projects were the following:

<u>Eureka</u>: An excellence plan with respect to the service provided in the operations area, including teams from own and franchise stores. The programme provided customised training and coaching for future managers. In a few months all the store managers had attended refresher courses.

<u>Telepizza Newsletter</u>: A circulation of one million copies was expected to be reached by December. The monthly publication "*Qué plan!*" was first delivered along with the pizzas in September, with the objective of being an agenda that readers and consumers could use to find out about leisure options at home, for each day of the month.

<u>New store image:</u> In the autumn, the new image and new logo were implanted, in an attempt to make the new "Telepizza moments " campaign take on the values of simplicity, proximity and quality, remodelling seven stores as a test with a view to total implantation in 2003.

<u>Blockbuster</u>: In August, a collaborative pilot plan between both companies was launched. The agreement consisted of adapting areas in three Telepizza stores for

Blockbuster to distribute and market its services and projects. This activity was also included in the leisure time at home campaign: pizza + video.

Refrigerated pizzas: The project consisted of selling this product in the stores. That way, the purchase time and consuming time were separated, increasing comfort and ease for consumers.

In 2003 Telepizza awareness was 99.45 per cent, surpassing the maximum figure reached in 2002, of 98.85 per cent. However, image was not everything and management's aim through all these projects was to make the group's EBITDA[13] increase from 48 million to 96 million.

José Carlos Olcese continued developing the company's strategic plan. He based this on the premise that most of the business was based in Spain and Portugal, which contributed 93 per cent of the EBITDA and 89 per cent of sales, and that the next two countries to function well were Poland, with greater options for the future, and Chile, with limitations in terms of growth. As regards France and Mexico, the company was debating whether to continue with them or close them. Thus, he presented the following fundamental strategic objectives: selling off certain non-profitable activities and sectors [La Piazza de Telepizza, Telepizza Express and *A tu Hora* (In Time)], modernising Spain and Portugal and ensuring the company's core business.

Negotiating the funds

To finance these projects, the self-portfolio of €30,000,000 and accumulated losses in failed international projects, it was decided to refinance the debt of 78 million euros with a new syndicated loan from Banco Santander. Since it was not possible to obtain this, it was agreed that the company would negotiate a potential agreement with Barclays for issuing bonds in the institutional market of the US for the amount of 70 million euros, and at the same time analyse the possibility of issuing convertible debentures for the same amount, in collaboration with Societé Generale. In 2003, an attempt was made to find a solution by issuing bonds for 50 million dollars and 20 million euros with a fixed interest rate of 6.72 per cent (in dollars) and 7.06 per cent (in euros) for placement in the US market, but eventually this financial solution was ruled out.

Finally, after several frustrated attempts to refinance the company, the Board decided to issue a series of convertible bonds which the CNMV approved in March 2003 for the amount of 62 million euros, repayable through conversion into shares on the fifth year or through payment in advance during any of the foreseen three ordinary conversion periods. The issue closed with a subscription of 58.5 million euros.

On the other hand, that same month of March of that year, the Chairman informed the Executive Committee that talks were under way with the company Bitonce (owned by the Chairman and his brother and holder of the stake of both of them in Telepizza) and the fund CVC[14] Capital Partners, owner of Zena[15], which were

[13] EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortisation.
[14] CVC: A venture capital firm and a competitor of Permira.

interested, in principle, in taking a share in Telepizza. The Board agreed to provide access to the requested information, signing a non-disclosure agreement beforehand and installing a *data room*[16] outside the company from where the information could be accessed. In May, the Chairman informed the Board about the ending of the talks with CVC for taking a share in the company, and the start of new talks with ICG[17] and the German bank Bayerische Hypo und Vereinsbank A.G.

The last few months of 2003

In October 2003, the Financial Director submitted a report on the situation of Mexico, which had 20 stores in operation and 80 closed stores and an estimated value of recovery after selling off assets of 5 million euros. In light of this, he proposed a plan to stop the activities in that country and sell off the assets. The impact of closing the Mexican stores on the company's own equity was 40 million euros, meaning that own equity was reduced to 63 million euros. In addition, the situation in France made it necessary to allocate 14.5 million euros in the form of a tax loan, leading to own equity being finally reduced to 53 million euros.

On 19 December, bearing in mind the foregoing, the Board decided to finally approve the closing of the stores in Mexico and France, given that the formulae implemented to try and make operations in those countries feasible during 2002 and 2003 had failed. Although this decision meant an extraordinary loss of approximately 33 million euros, it eventually proved to be the solution for restoring the group's financial position and allowed it to face 2004 on a more solid basis.

In the words of the Chairman, 2003 meant "the end of the reorganisation process and the focus on the countries in which we had obtained profits. This decision led to the ceasing of Telepizza's business activity in France and Mexico and the consolidation of our operations in Portugal, Poland and Chile, where Telepizza has shown its capacity for leadership and generating profits".

Review of the strategic plan in 2004

The objectives of the new strategic plan for 2010 were: to reach a proportion of own stores/franchise stores of 25/75; to reach the appropriate international size; to move ahead and implant the CRM[18]; to develop a marketing strategy based on different client segments and reach strategic alliances with the leaders in each business. In 2003, the Telepizza stores reached a total of more than 10.9 million Spanish homes, which, taking into account its international expansion made a total of more than 17 million. According to the Strategic Committee, the growth of Telepizza was to be supported by opening stores in cities with less than 25,000 inhabitants (150 stores in 3 years), pizza vending machines in areas with heavy urban traffic (100 in 3 years), mobile stores and corners in

---

[15] Grupo Zena: an important multi-brand restructuring company based in Spain with Kentucky Fried Chicken, Burger King, Pizza Hut, Foster´s Hollywood, Cañas y Tapas, Il Tempietto, Cenesa and California.

[16] Data Room: Place where all the relevant information is stored (originals of contracts, etc.) governed by strict security measures.

[17] ICG: Intermediate Capital Group, a venture capital and investment firm.

[18] CRM (Customer Relationship Management): a computer tool that permits the most appropriate segmentation thanks to exhaustive information about the client.

Shopping Centres, the CRM, the store Management Plan (Internet, call centre, sms) and Sogecable. During the course of this review, some projects such as the newsletter, the Blockbuster Project and the sale of refrigerated pizzas in stores were abandoned.

The marketing department started a process of decentralisation, with the aim of maintaining direct and effective contact with consumers, granting greater decision-taking capacity to each of the regional areas through the figure of the regional marketing technician. As the Vice-Chairman put it:

> "The future of the Telepizza strategy involves strengthening the price/value ratio as a differentiating element vs. refrigerated pizzas and consumption times in the home, by restoring the figure of the mother as the person who purchases the product through continuing with the line of consolidating the Telepizza concept by making the product known and transforming it into an element that generates pleasant leisure time, associating the Telepizza concept with the concepts of natural, freshness, Mediterranean and replacing promotions by activities to generate customer loyalty."

Although not included in the strategic plan, a new line of business was started up aimed at a new type of institution client: hotels. Telepizza "*Room service*". This was based on placing orders in the nearest store through the hotel reception. The operation was exactly the same as the home delivery service, except for collection, and customers could pay directly or payment could be deferred and added to the hotel bill. In addition, customised menus were posted for each of the hotel chains. At the end of 2004, the company was working with 195 hotels and 17,000 rooms with this service.

The franchisees and their frustrated hostile take-over bid

At the end of 2003, 57 per cent of the company stores in Spain were run on a franchise basis. At that time, talks had commenced with a view to buying the 16 franchise stores of Medmad and the 15 stores of Asturpizza, due to the constant problems with both franchisee groups, for subsequently reselling them to the Di Boca group. At the same time, it was agreed to purchase 75 per cent of the shares of Fasgel (Telepizza already held a stake of 25 per cent), owner of 8 franchise stores in the north of Spain.

As 2004 advanced, the purchase of the 5 franchise stores in Galicia continued, which were openly hostile to the company. In December, 49 per cent of the Telepizza Insular chain was purchased (Canary Islands, with 7 stores) for 3 million euros.

A group of franchisees who had always adopted a hostile attitude towards the company, and controlled one of the Telepizza franchisee associations filed a claim against the company, asking the court to uphold its authorisation to provide the different types of cheeses for pizzas as a cheaper alternative to the Luxtor products. The supplier requesting to be authorised was in fact, the same person who had previously sold the Luxtor cheese factory to Telepizza.

The filing of this claim was part of a strategy to harass the management group and principal shareholder, coordinated by that group of franchisees and some investors who intended to launch a hostile take-over bid, taking advantage of the low price of the shares and poor results of recent years. They also filed a claim against the company with the Competitors' Defence Service alleging that it was responsible for implementing practices in relation to the franchisees that were contrary to the legislation defending competitors and held several press conferences to inform about their actions and pave the way for attempting to gain control of the company. The claim was dismissed by the magistrate's court and later by the Spanish Court of Justice and the people filing the claim were unable to obtain funds to achieve their purpose.

The company was able to allay the fears of the franchisees with respect to the conditions for extending or renewing their contracts (the standard franchisee contract had a term of 10 years and left the possibility of extension on termination in the hands of Telepizza, with a discretional purchase option for the franchisee at a previously-appraised price), offering to agree to a policy of renewing the contracts for five more years if 80 per cent or more of the franchisees accepted the new contract. To renew it, the franchisee had to prove it had complied with certain ratios, that is had no litigations pending with the company and that it had honoured its obligations, etc. The company's proposal was accepted by almost 90 per cent of the franchisees.

Management team and Human Resources

An Incentives Programme was approved, linked to the revaluation of the shares, in which the yield was subordinated to compliance with the objectives set by the board (sales-EBIDTA-profits) for two periods, 04-06 and 07-08. The beneficiaries were the Board Members, General Managers, General Deputy Managers, Department Managers and certain middle management staff members (some 60 people). The Programme made it necessary to reach the turnover for the chain and one of the other two requirements (EBIDTA or profits). The Board set those objectives at sales of 453 million euros in 2006 and 509 million euros in 2008; an EBIDTA of 60.5 million euros in 2006 and 72.7 million euros in 2008 and profits of 28.6 million euros in 2006 and 40 million euros in 2008.

The initial reference for the purpose of paying the incentives was set at €1.44 per share and an agreement was closed with Société-Générale for it to purchase the self-portfolio belonging to Banco Cooperativo, keeping 5.6 million shares in the name of Telepizza for purchasing the shares necessary to pay the incentives at the appropriate time, and sell the rest on the market. In the middle of this operation, Manuel Capelo was appointed as the new General Manager for Spain.

Personnel management (20,000 employees) was very important to Telepizza; the staff volume was very high and the pizza-delivery staff alone numbered 11,000. In addition, the employment situation up to a few months before and the type of post that was to be filled (working for 12 or 20 hours a week with a high concentration at weekends) meant that the people working in the stores were mostly young students and immigrant workers. Staff rotation was considerably high, including that of supervisors: the 13,000 new staff members and staff leaving the company every month processed by the company give us an idea of the rotation of the staff dealing with the public. Everyone, including the pizza delivery-staff, had part of their salary paid on a variable basis and in the case of supervisors this was linked to the EBITDA.

2005: Establishing of strategies

In 2005 Mr Fernando Frauca[19] was recruited as the new General Director for Marketing and Strategy, and the company organisation chart was as follows:

Executive Vice-Chairman	Mr José Carlos Olcese
Managing Director	Mr Fernando Zapater
General Director for Spain	Mr Manuel Capelo
General Director for Strategy	Mr Fernando Frauca

In May, the new General Director for Strategy submitted the Marketing Management Plan, whose objectives laid the foundations for developing the brand during the period 05/08, achieving sales of 509 million euros and an EBITDA of 72 million euros in 2008, and defining the customer relations.

These objectives meant adding value to the brand and through the *momentos redondos* (round moments) strategy, emphasise its emotional component. Telepizza was a universal company not focused on a specific client segment or age group, social class or type of population, but targeted at the whole of society. The most innovative aspect, what made Telepizza different, was the fact of segmenting by *moments*, and aiming to be present at different times in the life of a person. For this reason it was decided to segment by moments: the football moment, the friends' moment, the family moment… all of them social and for sharing, in an attempt to bring together the largest number of moments and even creating other *Telepizza moments* that were not habitual, such as "crazy Tuesdays". José Carlos defined this quite clearly:

> "From selling the idea of "the secret is in the dough" we changed to offering "round moments". Telepizza is an emotional brand that aims to accompany people at amusing moments in their lives: with their families, watching a film, with friends coming round to watch football…Telepizza is "fun food"[20] and "finger food"[21], we want to be where people are having fun in a group: events taking place in the city, sports…Telepizza is a fun product, not just a meal, but a moment for everyone.
>
> Telepizza is above all a healthy and complete food in nutritional terms, according to experts. It is based on the Mediterranean diet and balanced, there are no fried products, not too much oil, it is cooked in the oven, which completely eliminates germs…In fact several schools in Madrid have a Telepizza menu that obtains a high score on the nutritional scale. Telepizza is a quality product with a wide variety of natural ingredients that customers can

[19] Fernando Frauca: he had previously worked for 11 year at Unilever, later at Terra and afterwards, as an independent consultant.
[20] Fun food: Food consumed on fun occasions.
[21] Finger food: Food for eating with fingers.

choose, and fresh, recently baked dough which maintains all its nutritional properties. “Fast food” is eaten in restaurants, in the form of precooked products that is ready to eat in just 3 minutes, but Telepizza is eaten at home, and is a product that is tailored to the consumer’s taste that takes 15 minutes to prepare.

Although it is true that we serve meals at times of need, we make things easy on occasions such as on Sunday nights when people come back late from the beach and the thought of having to cook supper is not appealing, or if you are alone in a hotel and want to eat something you would eat at home… our clients buy on impulse, as 73 per cent improvise the Telepizza moment, only 23 per cent plan to have it the same day and 4 per cent plan in advance; in addition, it’s for eating at suppertime, as 92 per cent of orders are for suppers, and are usually placed at the weekend, and 67 per cent are eaten on Fridays, Saturdays and Sundays.”

At the same time as the segmentation strategies were defined by the concept of moments, there was also segmentation using more traditional criteria: geographic in launching products and ingredients and regional events, age with the *Tribu Telepizza*, purchasing power with special price promotions. Since it was a universal campaign it had to have universal access, with the most appropriate economic option for each consumer.

The flier was the genuine element of the brand since it first started to be sold and had become the basic direct advertising tool. The flier reached millions of homes, providing clients with information about the store, prices, products, launches and promotions, as well as serving to remind consumers of the brand. Telepizza had gradually adapted and improved that tool in recent years but in 2005 a new strategy was implemented which was first used in the Spanish stores in October. The traditional flier was replaced by a leaflet with two new items: a menu of products containing information that was not subject to change and a flier containing information about new products, promotions, launches, etc., and the sending frequency was modified. All the advertising and promotion campaigns (TV, fliers, local marketing, gifts…) accounted for 16 per cent of sales.

In 2005 the traditional store model that had been developed through the small stores (60 per cent of traditional store investment) was improved, as well as the corner stores (the model within existing businesses, accounting for 30 per cent of the necessary investment for a traditional store) and that year, the module format (from 15 to 20 per cent of traditional store investment), allowing for greater flexibility in adapting to all locations at different times of consumption, such as on the beach during the summer. The break-even of stores in cities with less than 30,000 inhabitants was 30,000 euros per month.

The hotels line started the previous year continued to be consolidated, and at that time there were agreements with more than 450 hotels, with the aim of reaching 1,000 hotels in 2008. All this was done in order to be present at the greatest possible number of moments, both emotional or based on convenience.

Competition was becoming fiercer and fiercer in terms of restaurants and at home, even more so in the latter case due to progress made in preparing precooked foods. All types of restaurants competed with Telepizza, but the groups organised within the pizza segment included Pizza Hut, from the Zena group and Pizza Móvil, from the Ibersol group in Spain, which were focused largely on consumption on the premises. Telepizza's competitors in the *delivery*[22] and *take away*[23] sector were Chinese restaurants, small operators and Fast Food chains such as McDonalds or Burger King. The same occurred in the international scene: in addition to competing against highly fragmented operators, the company was competing with Pizza Hut, which, outside Spain, was becoming much stronger, especially with its restaurants; with Papa John's –3,028 stores and an EBITDA of 54.64 million euros- which was focused on the product; and with Domino's Pizza -8,624 stores and an EBITDA of 144.35 million euros- , which was more similar to Telepizza -940 stores and an EBITDA of 76.11 million euros- as regards the *delivery* business model.

The industrial area continued to develop in accordance with the phases foreseen in the management plan. One of the most important products in 2005 was the pre-stretched pizza which, after a modest start-up, was converted into a key innovative product. Working with a ball of dough in stores was not all that positive in operative terms so it was decided to send the dough to the stores after stretching it to only a certain extent, in the shape of a round, which allowed for more efficient transport, a more uniform pizza and less preparation time. Following the success of this new idea, which consumers regarded in a positive light, a new production line was created in Daganzo which increased the production capacity and allowed the stores to be supplied 100 per cent.

At the end of the year, the company's main risks were: the situation in Poland and the fall in sales in Portugal, the increase in the cost of raw materials, the store-opening pace, the success of the call centre and the Shopping Centres model.

While the business continued to develop, Telepizza's management continued to search for new partners. During the second half of the year, Pedro Ballvé had talks with an Irish industrial group to analyse the possibility of launching a hostile takeover bid over the entire Telepizza share capital, which ended in failure.

FEBRUARY 2006: THE TAKEOVER BID

On 28th February, the Ballvé group, together with the *private equity*[24] from Permira, launched a hostile takeover bid over the whole of the Telepizza capital -265 million shares- offering a price of 2.15 euros per share; that same day, the stock exchange price was €1.88/share. Schedule 2 shows the evolution of the market listing of Telepizza from 1999 to 2005.

The Board, advised by the firm Lazard, issued the regulatory report, recommending the shareholders to agree to the bid, since it considered that the price offered was fair from the financial standpoint.

---

22 Delivery: Home delivery.
23 Take Away: Business mode consisting of picking up the product at the store.
24 Private Equity: a venture capital firm.

The following month, the Zena group, controlled by CVC, submitted a counter bid, offering €2.40 and the same did the Portuguese group Ibersol[25], offering €2.41: In both cases, the bid was subject to eliminating the statutory protection measures making it difficult to become a member of Board and hold the position of Chairman and raising the quorum for modifying the articles through eliminating that protective action.

The regulatory reports were issued on both bids and their effects were considered, not only for the company itself, but for the different interest groups forming part of it, such as shareholders, franchisees, employees, etc. It was concluded that though the prices offered were certainly fair from the financial standpoint, "*in relation to the other terms and conditions, the Board's opinion was negative considering the hostile nature of the bid, since the bidders, as competitors of the company, they represented contradictory interests that were opposed to the social interest of Telepizza, and also, the proposed integration processes would have negative consequences for each of the areas analysed*".

The Shareholders' Meeting agreed, by a large majority, not to eliminate the protective measures and both the groups making the counter bid eliminated those terms from their proposals. In July, the final phase of the sealed bid process took place.

The Ballvé –Permira group offered €3.21 in this new bid, surpassing the other two –Grupo Zena had offered €2.70 and Ibersol, €2.45-, and so the bid was official launched and accepted by 86 per cent of the shareholders.

A short while later, an exclusion takeover bid was launched over all the shares and bonds that had not been included in the previous bid, at the same price as the previous one (3,21 €), as the first step to excluding the listing of the company. Following the closing of this process, only 3.14 per cent of the share capital remained in the hands of other shareholders, with the bidders controlling the remaining 97 per cent - Ballvé (50 per cent) and Permira (50 per cent).

A partnership agreement was signed with Permira in which it was agreed not to change the management team until the parameters established in the 100-day plan implemented after the entry of the new partner were fulfilled. Following the bid by Permira, the incentives referenced at the share value, the tool obliging the management team, were redeemed and a fixed plus variable package was established –depending on the EBITDA for the year – known as "Extra cheese".

During the process of finalising the bid, a strategy was designed and executed, proposing to the Shareholders Assembly a capital decrease through amortising the foregoing 3.14 per cent of the capital, for which it was necessary to have the majority vote of that group of minority shareholders. Participation in the Meeting was encouraged by paying a premium for attending and the necessary quorum was obtained to adopt the decision, meaning that the two majority groups managed to obtain control over 100 per cent of the share capital.

Finally, the company instruments used to launch the takeover bids were merged with Telepizza and the latter assumed the total debt obtained to finance the bids, in accordance with what was foreseen from the start, in the informative prospectus.

[25] Ibersol was the owner of the company Pizza Móvil.

New activities

With the incorporation of Permira into the Board of Telepizza, a 100-day plan was implemented, based on 4 key aspects: marketing, cost, international and franchises.

Several aspects were considered with respect to marketing: the campaigns, the CRM which made it possible to move from general to "one to one" marketing, the call centre to make the order-taking service more professional and the new store formats. As José Carlos Olcese explained:

> "After several years of analysis, it was seen that the increase of 9.5 per cent in sales was obtained through an increase in orders of 4.5 per cent, an increase in the average ticket of 4.9 per cent and reduction of 1.2 per cent in the number of clients. The growth is located particularly in the *take away* channel, which represents 83 per cent of the increase in orders. The reasons for this growth are mainly due to the show-down in consumption outside the home, the revitalising of the Telepizza brand, the focus on the most profitable segments, the family, the reduction in the growth of refrigerated pizzas and the promotions we have made."

As foreseen in the 100-day plan, stores continued to be implanted in Shopping Centres, new points of sale were set up on Trasmediterránea ferries, in Cinesa[26] cinemas, in zoos such as Barcelona Zoo or Faunia[27], in airports… Schedule 3 shows the evolution of shopping centres and the evolution of refrigerated pizzas in Spain.

With respect to cost control, the industrial department had to improve the management of margins, searching for synergies with Permira. It was agreed to develop a sale&lease-back process for all the real estate assets of the company, some 30 stores in Spain and the plant in Daganzo, to reduce the debt, even though the EBITDA was also reduced. At the same time, the company continued to buy franchise stores to achieve new stores of its own, which was much more profitable.

On the international scene, work continued to be done in countries in which the company was already present, and new countries with a potential for growth were studied.

2007- 2008: THE LAST YEARS

Finlandia Project

To ensure the proposals generated by the Strategy Director and his team could be quickly tested and reach the market sooner, it was decided to create a project that could serve as a laboratory for the proposals. As the area of Madrid was the one that was the most outdated, it was decided to let Frauca develop his proposals in that area. Thus, the Finlandia Project was started up for the area of Madrid with the aim of testing

---

[26] Cinesa: Leading cinema theatre company in Spain with more than 392 screens.
[27] Faunia: a biological park (comprising a botanical garden and zoological park rolled into one), with a surface area of about 140,000 sq m near Madrid.

certain procedures, technologies and innovative solutions in that area. This project aimed to identify the future company model.

30 different projects had been designed which were being tested, in an effort to obtain good results. For June 2008, it was planned that all those which had been successful would be put into operation in the other commercial zones.

The idea was to increase the EBITDA, supported by three basic pillars: cutting costs, increasing sales and increasing operating efficiency, with the last two being the most important in the project.

In the middle of 2008, progress had already been made in increasing sales, demonstrating that in stores in which some of the tools developed had been implemented, sales were increasing compared to the rest of Spain. This pillar encompassed the Call Centre, credit cards, gift cards, the Internet site, selling over the Internet, sms messages… All this was supported by new product launches, recovering the children's segment, local marketing in stores and establishing new channels for managing orders, to continue working on segmented marketing and client loyalty through the CRM. The CRM also allowed the company to increase customer loyalty by anticipating their conducts and redefining existing strategies and identifying new ones. Telepizza was reaching 11 million homes in Spain, and supplying 70 per cent of them in 2008, which, assuming 2.5 people in each home, adds up to 15 million consumers, 40 per cent of the Spanish population.

The marketing campaigns had to start allocating weight and play with all the different advertising tools, to make the fliers, TV and CRM complementary items, ensuring they did not advertise the same thing and that the messages were not incoherent or different but that each was adapted to its own function: images through TV, promotion through the flier and association with Telepizza through the CRM.

It was necessary to carry on working on all this, since this was an ongoing improvements process. However, the aspect in which the greatest effort had to be made from 2008 was the third pillar, increasing operating efficiency, by automating and eliminating tasks that did not bring added value, for which purpose it was necessary to continue developing the necessary technological tools. José Carlos Olcese made the following comment:

> "The computer system, which was designed by the company itself, allows us to control and manage all the operations with maximum efficacy. Sending the dough and other material to the stores means making 1,200 deliveries a week, and so the logistics system must be fine-tuned, as occurs with the whole communications system, since for example, 500,000 people call Telepizza in just 2 hours during suppertime on Saturdays, to place their orders. The software and hardware systems are fully updated in both offices and stores, with homogeneous information systems in all countries and communication systems between Spain and the other countries have been improved, with a new Data Warehouse and CRM and the placing of orders through the website."

One of the most important steps consisted of eliminating time that does not generate value among the store managers and supervisors: creating timetables, controlling sales… i.e. just gathering information, since this was an activity that the information systems could do in real time with no effort. They were the ones who knew the profiles of the clients and had to take decisions to increase their sales. In this way, costs were cut, thereby increasing the possibilities of training employees and paying higher salaries.

Another activity was to redistribute resources in a better way: centralised storage of motorbikes, for use in the stores that needed them at each particular time; sharing of tasks and specialisation in stores, external auditors, including mobile teams to collaborate with the different stores whenever necessary. To achieve all this, it was necessary to homogenise the processes in the stores so that everyone knew how to act at each particular time. Another innovative solution in the process was to dispense the cheese and tomato in the factory, an aspect with respect to which differences were perceived among the stores. Through this improvement, the pizzas had just the right amount of these two basic ingredients, which also made the process faster in the stores, and this together with the progress made in the pre-stretched pizzas, made an important contribution to saving costs.

It was thought that this pillar was the most important, but to achieve success it was necessary to develop a highly advanced technology, which meant making investments. José Carlos Olcese summarises the evolution of the business as follows:

> "Telepizza is a leader with a clear business activity that is now experiencing one of best moments in its existence. The situation we found when we arrived was quite different. The company went through hard time… but gradually, with effort and the hard work of a team of which I am very proud, we have managed to create a company with no operating debt that has millions of clients thanks to an excellent data-processing system, highly productive plants and a very efficient purchases department that has achieved positive results despite the increase in the price of flour and milk during the final months of 2007. Due to the increase in raw material prices, representing 30 per cent more of the product price, margins have been reduced and costs have to be controlled. Telepizza is the leader in its market in Spain, with 99.5 per cent of brand awareness. In addition, during the last two years we have gone from losses of 40 per cent among stores to 100 per cent of profitable stores."
>
> On the other hand:
>
> "The proportion of own stores and franchise stores sets Telepizza apart from its competitors, as this rate is 50/50, whereas the ratio among competitors is 75 of franchise stores to 25 own stores. Own stores are more profitable (15 per cent) for Telepizza than franchise stores (between 8 and 10 per cent). In 2007 we implemented a strategy for repurchasing franchise stores, provided a certain price/EBITDA ratio was fulfilled; specifically, the company has purchased the 15 stores owned by Di Boca, 5 franchise stores in Valladolid and two in Palencia."

International

Telepizza only intended to enter and remain in those countries in which it was leader of its market. In September, the Board held a meeting in Warsaw to analyse in depth the situation of the business in Poland, where there were 87 "*classic*" stores and 8 Telepizza *easy* stores (smaller stores in cities with less than 70,000 inhabitants, focused on sales on the premises). After years of poor results, the General Director for Poland was relieved of his duties and the International Division Director, Jose María Fernández, played a much more important role in this business activity. He was responsible for the highly successful expansion and development of the business in Chile. At the beginning of 2008 a certain revitalisation was detected, and an extremely ambitious business plan was designed, requiring considerable investment.

INTERVIEW WITH MR CARLOS MALLO[28]

Q. How did your relationship with "Telepizza" start? What was the plan for buying the company?

A. I met Pedro in 2000 at a lunch meeting, and from the first moment he attracted my attention because he is a very respected business man and I value and admire him very much for the professional career that he's developed since he was very young. That's why, when he contacted me at the beginning of February 2006, I was interested in the proposal he had to make, not only because of the project, but also because of the people I was going to work with. Permira was the first to be considered due to their experience in the food and beverage industry, large business funds and the possibility of acting in a short period of time. We met all the requirements and they made us a very interesting business offer (share), with lots of possibilities and the opportunity to work alongside Pedro. The activity and characteristics of the Venture Capital Company Permira are outlined in Appendix I.

We only had four weeks to prepare for the transaction, something that we wouldn't have achieved without the work capability of all of us who were involved and the resources that José Carlos Olcese, Fernando Zapater and the rest of the Telepizza management provided us with to collect all the necessary information together. During this time due diligence was carried out, a business plan was elaborated and all the necessary funding was raised. We worked non-stop, even more than 18 hours a day, since a working day was very important. The key was working together.

Q. How did you get the funding?

A. By analysing the market, we were sure that we only wanted a few banks to participate in the transaction so we decided on two, to be more precise. The banks to be chosen would be those showing the most interest in the company and the project, being capable of providing the funds. So, we chose the ING and the Royal Bank of Scotland (RBS) to work with us in the project. We had a lot of connections with these financial organisations. They knew Telepizza and Permira and they liked the transaction and the companies that were involved. We were lucky and we didn't have any problems with them, especially given that we only had 15 days to get the whole amount. They were supportive and their behaviour towards us was excellent when we had to make adjustments when competing with the other takeover bids.

[28] Carlos Mallo: General Manager of Permira Spain and Portugal, and member of the Permira Board of Directors. Agricultural Engineer and holder of a Masters in the Instituto de Empresas, he started to work in the purchasing department of Continente until he was contracted by 3i (leader in Venture Capital) where he worked until 2003, when he started working for Permira. In April 2004 he set up a Permira office in Madrid.

Q. What do the banks request in return?

A. Banks that finance these kinds of operations do so based on their ability in generating future cash flow. The banks, together with Permira, adjust the money lending conditions to the specific circumstances, based on the cash flow for the next 10 years, by extrapolating 5 years the forecasting for 5 years that we establish. The funding comprises different stages: the first stage refers to the senior debt, which corresponds to 7 years. It's the payment that offers the most security, the first to be paid, and, therefore, the cheapest, since it has a lower uncertainty, which is, for example, at euribor +250 basis points. In the eighth year, the second lien or second guarantee comes into play, with an annual coupon bond payment and euribor + 350 basis points. The Mezzanine debt follows in the ninth year whereby one part of the debt is paid in cash (coupon bond) and the remaining half is capitalised so that interest may be received throughout the year at the current euribor + 900 basis points. In the final year the payment in kind (PIK) loan applies whereby the entirety of the interest accrued is capitalised and which is the most expensive, at euribor + 1100 basis points.[29].

Pledge of assets is the real guarantee for banks and which is done in two events: when the borrower fails to make the payments and when they breach the covenants[30]. Each quarter the company should make enough EBITDA for debts and cover interest which, if they are not met, will lead to, unless negotiated, the seizing of assets.

Q. Is it difficult to think of the long term situation of a Venture Capital company?

A. I don't think so. It's true that the capex (capital expenditures)[31] have already been considered in the business plans, and they have been calculated in accordance with the expected growth so that they don't limit the desired growth. However, if we would like to carry out certain operations, we will have to obtain extra funding from partners, banks…But, in my opinion, a strict financial discipline is produced, which is highly beneficial, and those strategic and profitable projects will succeed, by fully taking care of the investments. I don't think that investments will have a negative impact on growth. For example, I don't think that many businesses have programmed their capital expenditures to double their EBITDA over the next five years, which is something that has already been planned in Telepizza.

Q. How did you beat the rival bidders?

A. The truth is that it was really hard. When we found out that Zena had put in a rival bid for €2.40 per share, and then later Ibersol for €2.41 per share, we were really surprised. The only option that remained, once we were clear that we still

[29] These refer to the current rates during the time in which the transactions are carried out.
[30] Covenants: series of indicators in the loan agreements that determine on different levels, how the debtors can function and manage financially.
[31] Capex: initial investments, maintenance and improvements made to expand and replace assets.

wanted to go ahead, was to carry on working and keep quiet. However, despite a hard start, the worst part was our second revision of the business plan, and raising the funds that we needed. To have a better idea of the situation we were in, the LBO normally consisted of 3 Permira committees; however we had 5 meetings during those months, in which I explained the need to go on as it was a single asset, quite inflexible in moments of crisis, an excellent position in the market and a spectacular growth. But with all this, despite it being a very difficult experience, we came out stronger. A summary of the progression of the pizza segment in Spain from 1999 to 2005 has been included in appendix II.

Q. You drafted a 100 day plan at your entrance in Telepizza. What did it involve?

A. With this plan, Permira tried to speed up and structure the achievement of the objectives outlined in the Business Plan. One of the first moves was to syndicate the debt and create an associate structure via the merging of the takeover bid instruments. Then we carried out a sales and lease back process of the factories and shops in order to reduce the debt. We were involved in the management team incentive plan and we collaborated with them in the business plan implementation. We're not claiming to be, nor are we, part of the management team, but an added value as investor.

Q. What are the main strengths of Telepìzza?

A. Well, there are many. The company has a strong client base, based on sentimental reasons and on good moments. Furthermore, Telepizza is a company whose marketing has a lot of influence, a company that has an excellent network of shops and franchises, an excellent logistics network, unbeatable factories and a very innovative and competitive product. We must not forget its complete team, despite having experienced difficult times over the past years. Our aim is to double the EBITDA within 5 years time and we have advanced one year. The main financial and economic indicators from 1999 to 2007 appear in exhibit 4, and the 2006 and 2007 balance sheets appear in exhibit 5. The profit and loss statements for the last two years appear in exhibit 6.

Q. When will your association with Telepizza end?

A. If the circumstances allow, we will leave from now to 5 years since we joint the company. The most probable ways of doing so are the following: a completely flexible flotation, selling to another Fund, and finally Permira selling a part of Telepizza to another manufacturer. We will be looking for a good return, meeting the concerns of Pedro and finding a partner that will be good for the future of Telepizza.

INTERVIEW WITH MR. PEDRO BALLVÉ: CHAIRMAN

Q. Why, despite participating and managing many other projects, did you set out to acquire Telepizza?

A. Though I had to manage Campofrío at an executive level, as well as being a member of various Board of Directors, my entrepreneurial calling has always influenced my decisions. It all started because, within the business practices of the family holding company, there was a sales project in the fast-food domain, although with a wider range, within the company Telechef Corporation. At that point, we had to make a decision regarding whether we wanted to continue investing to allow possible growth or to abandon the idea entirely, which coincided with the news that Fernández Pujals wanted to sell Telepizza, a reference company for Telechef. So, both projects ended up being carried out at the same time. Leopoldo Fernández Pujals sold his share of the company and we joined the firm (we bought 5 percent of the business at first) as reference shareholder and new Telepizza management team. I joined as the Chairman of the Board of Directors. The evolution of the Board of Directors from 1999 to 2007 is included in exhibit 7, and an interview held with the Board of Directors Secretary is included in appendix III.

Q. What stood out the most during the time in which Telepizza was listed on the Stock Exchange?

A. As business professionals, we always looked for the best for the company, not for us as investors playing the Stock Market. To establish a stable and healthy base for growth, we had to endure decline in growth, restructuring, even losses, but more than anything , we had to confront the fact that the stock market didn't understand us, as well as and banks, since they were only looking for expansion and growth in the short term. The market didn't acknowledge the important decisions that we had to make for the future of the company and for solid growth based on the business and its profitability. Despite making conference calls[32] every three months, they didn't listen to our explanations.

Q. What would you highlight about the Telepizza management team?

A. Currently, Telepizza's management team is one of the company's most valuable aspects. At first, we maintained the former team, but I later decided to put someone I trusted in charge of the company. The business needs someone that is present every day, since the results are known constantly, and the necessary steps need to be taken. That's why I chose José Carlos Olcese, a friend who is completely involved in our Project, with a lot of experience working in business. Then we needed to find someone with broad management experience, and we found that Fernando Zapater was the perfect person for that job. The rest of the management team was made up of experienced and very able professionals, such as Manolo Capelo and Fernando Frauca. So, the management team passed from

[32] Conference call: a meeting with shareholders, investors and stock market analysers where the projects and outcomes of a company listed in the stock market are explained, as it must present its financial situation on a quarterly basis.

being a management team adjusted to Fernández Pujals' perspective, to a totally professionalised team where the people are measured in accordance with their talents and the results they achieve.

Q. How do you keep a management team like that?

A. At this level, the financial or money aspect is secondary. It's still an important aspect but the people that have this kind of management position look to take on more responsibilities, gain work autonomy, and have a bigger role in decision making processes thus allowing them to make suggestions regarding activities and refute proposals, as well as be more trusted. In this way they participate in the results of the company. We allow them to grow on a personal, professional and financial level.

Q. And after all this time, how is your relationship with Permira?

A. We have a good professional relationship. For Permira, Telepizza is a company with a good potential, a good growth, an excellent management team, and the results back us, since we are one year ahead in accordance with the Business Plan forecast. Our capital expenditures are limited, which means that we have to reduce possible structural operations, however, they're enough to function.

Q. What are the options for the future with Permira?

A. Permira withdrawing the company was one of the key points of the partnership agreement. Venture Capital companies don't stay within a company for very long. They simply seek to gain profits from a large investment. We reached an agreement whereby the entire decision making would be done together. In year 2000 Telepizza assets were worth 10 euros per share, and we could have left the company when it was highly profitable. But, at that moment, we showed our commitment to stay.

EXHIBIT 1

TELEPIZZA ACTIVITIES CARRIED OUT IN 1999 (BEFORE THE ENTRANCE OF BALLVÉ-OLCESE)

In 1999, the main strategy of the group was to strengthen Telepizza's presence on a national level. For this reason, some shops that had been purchased previously were opened and others converted to Telepizza shops, such as PizzaWorld and TeleGrill. Telepizza thus had 512 shops at the time in Spain. PizzaWorld was mainly found in Catalonia, where it was hugely popular, thus allowing the company to advertise on the local television. Furthermore, "Play Lands"[33] were installed in 39 shops in order to improve the image of the company and obtain more customers.

Marketing was a fundamental pillar of the group strategy. They carried out various publicity campaigns to promote the launch of new products and any current promotions, broadcasting 17 new spots. They launched new products such as new speciality pizzas, desserts or pasta dishes. Furthermore, they carried out guaranteed gift campaigns to promote customer loyalty, and they designed new and more attractive fliers with clearer messages.

The logistics activity was important for the shop services, therefore Telepizza preferred to control the entire process thanks to the company Delivery Delta. The transport fleet was improved, thanks to a bi-temperature system, thus allowing the transportation of frozen and refrigerated products together. By doing so, they had managed to integrate this value chain so as not to depend upon external providers at such a strategic point. However, a company was subcontracted for the transportation of dry products as they were not considered as important.

Before the success of Telepizza, the Iraqi businessman Mr Zandi contacted the company to carry out a Telepizza business expansion project through the use of vending machines. Leopoldo Fernández Pujals loved the idea and the project was rapidly initiated.

International activity has become one of the key driving forces of the group. 1999 was a key year for international business as the company had 255 shops at that point. Growth of the company in countries where Telepizza was already operating (Portugal, Mexico, Chile, Poland), in combination with the opening of the same in three new countries (France, United Kingdom and Morocco) was going to contribute to the increase in influence of the international divisions of the chain.

In February 1999 the first shop in France was opened and a company in Morocco was founded called Tele Pizza Atlas, S.A., that started operating on the Moroccan market in November that same year. The English pizza chain "Hippo Pizza" was also bought for 1.75 million pounds (approximately 2.5 million euros) through the English subsidiary Telepizza UK Plc. Negotiations were carried out with regards to buying an English restaurant chain that is listed in the London Stock Market, however

[33] Play Land: children play area with slides, plastic balls…

an agreement was not reached. The “fast food” market in the United Kingdom was one of the most competitive in Europe due to the large variety and number of operators and due to the expenditure per capita of the consumers there being the highest. Furthermore, 50% of the home delivery services segment was controlled by independent companies that sold low quality products and whose delivery services were poor.

They strongly bet for Mexico, where that same year 70 shops were opened, with an increase in sales by 122.5 percent. It was considered a great opportunity for growth in the sector as well as due to the number of potential consumers that lived in Mexico. Telepizza was the third largest operator within the pizza sector in that country and the second for delivery services, although quite far from the main companies: Domino’s Pizza, the leading company, and Papa John’s.

In Portugal, a good rhythm of growth was also being experienced, although the planned number of openings was not as significant as that in other countries due to the presence of Telepizza, being the leading company in the pizza delivery segment, and due to the geographic and demographic limitations with an urban concentration of 34 percent.

The activity of the group in Chile was affected by the country’s economical climate that got worse in the second quarter of the year. Furthermore, the geographical and logistical limitations of the country, with more than 2,600 km between the north and the south, made it difficult to provide delivery services in certain areas, thus contributing to a slower rhythm of growth in the number of shops.

In Poland, the “Fast Food” market was in full development in this sector, thus Telepizza had to take advantage of the situation, bearing in mind that it constituted a suitable platform for extending operations to other Eastern European countries.

EXHIBIT 2

EVOLUTION OF TELEPIZZA IN STOCK MARKET

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
No of outstanding shares	214,658,500	223,597,400	223,597,400	223,597,400	223,597,400	223,597,400	223,597,400**
Annual trading (millions of euros)	n.a.	n.a.	871.76	228.26	382.62	447.65	769.52
Annual trading (No of shares)	421,283,918	610,108,945	371,696,778	185,736,075	314,282,788	295,348,544	438,676,491
No of bargaining sessions	250	250	250	250	250	251	256
Average daily trading (millions of euros)	n.a.	n.a.	3.49	0.91	1.53	1.32	1.96
Average daily trading (No of shares)	n.a.	n.a.	1,486,787	742,944	1,257,131	1,176,687	1,713,580
Maximum share price	10.54	10.60	3.45	1.78	1.52	1.74	2.01
Average share price	5.44	6.04	2.34	1.22	1.21	1.52	1.75
Minimum share price	4.00	2.50	1.16	0.74	0.73	1.24	1.52
Final share price	4.20	2.52	1.74	0.75	1.23	1.50	1.86
Stock market capitalisation (millions of euros)	901.57	563.46	389.06	167.70	275.02	335.40	415.89
EBITDA per share (euros)	0.21	0.02	0.24	0.25	0.22	0.23	0.24
Adjusted EPS (adjusted net e*/No of shares)(euros)	0.13	0.12	0.10	0.10	0.12	0.08	0.10
Adjusted PER (closing price/adjusted EPS*)	32.30	21	17.96	7.55	10.19	17.87	17.98

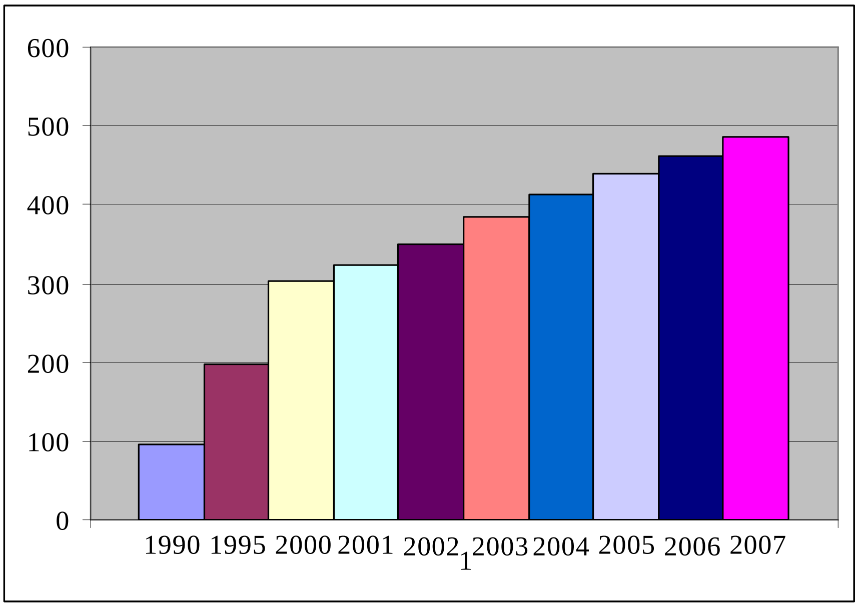
*The net earnings of the financial year have been adjusted to extraordinary income after tax with the aim of homogenising the data and so that it may be compared.

**The first period for converting convertible bonds into Telepizza shares began on the 1st of December 2005. This conversion would give rise to an increase in shareholders' equity in 2006. The capital would thus amount to 795,077.66 euros, corresponding to 265,035.922 shares. As of the 7th of February 2006, negotiations will open to businesses seeking to buy new shares.
The shares that do not belong to the principal shareholders belonged to foreign investors.

Source: Telepizza records.

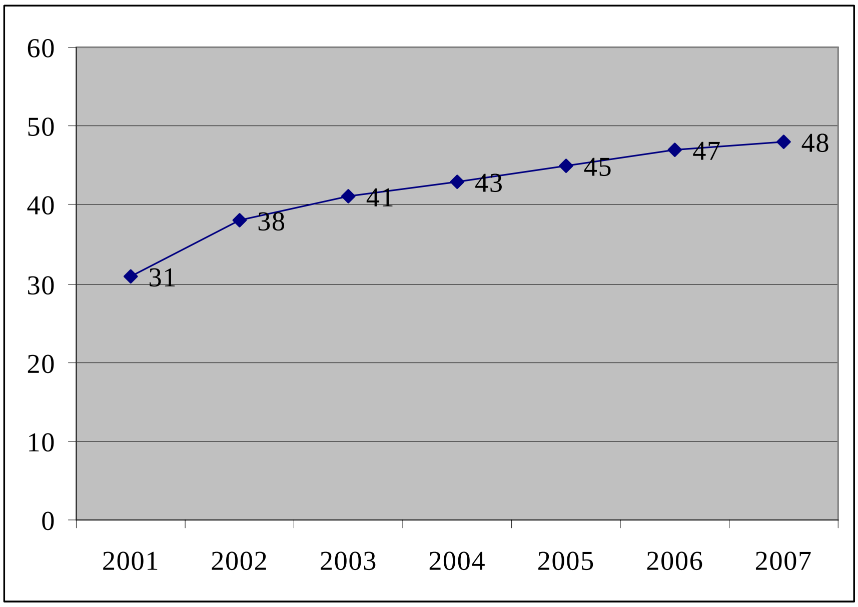
EXHIBIT 3

CHANGES IN THE NUMBER OF SHOPPING AND LEISURE CENTRES IN SPAIN



CHANGES IN REFRIGERATED PIZZA TRENDS 2001 – 2007 IN SPAIN

(THOUSANDS OF TONS)



Source: Telepizza

EXHIBIT 4
CHANGES IN KEY FINANCIAL INDICATORS

Income Statement*

	1998	1999	2000	2001	2002	2003	2004	2005***	2006	2007
Total operating income	249.64	306.53	345.36	342.85	301.12	291.02	288.54	311.59	228.86	272.29
Earnings before interest, taxes and amortisations****	46.56	54.93	51.71	53.16	55.12	49.30	54.05	53.63	39.81	51.63
Trading profits	33.53	38.07	31.74	32.73	35.10	30.29	36.15	38.04	37.62	-0.28
Profit from ordinary activities	31.82	35.23	25.61	24.22	27.69	24.39	31.40	35.68	28.13	-0.29
Extraordinary income	0.34	0.83	-14.18	-18.793	-19.28	-56.06	-2.34	23.96	-	1.80
Consolidated income (before tax)	32.16	36.07	11.43	5.43	8.41	-31.67	29.07	-0.82	29.92	-0.16
Profits from Holding Company	21.89	27.05	5.04	5.13	5.414	-13.635	19.30	23.13	27.83	n.d.

Balance sheet*

	1998	1999	2000	2001	2002	2003	2004	2005***	2006	2007
Total operating assets[1]	138.97	197.51	252.81	268.29	245.52	210.42	212.13	202.24	181.36	899.57
Capital and reserves	56.57	84.37	88.05	93.12	83.11	60.45	75.34	155.29	179.66	174.95
Net borrowing[2]	29.70	53.09	106.04	117.44	104.18	90.14	67,25**	-23.49	-80.21	496.92
Other liabilities	52.71	60.05	58.72	57.73	58.23	59.83	69.54	70.45	75.11	221.11

* Millions of euros.
**Including 8.66 million euros of the quarterly financial information (QFI) that correspond to short term financial assets paid.
*** From 2005, inclusive, the consolidated data have been prepared in accordance with the International Accounting Norms (IAC) adopted by the EU.
****EBITDA
(1) Total operating assets. Assets minus company assets, minus treasury operations, minus temporary financial investments.
(2) Net borrowing: Long term bank debts plus short term bank debts, minus company shares, minus treasury operations, minus temporary financial investments.
(3) Negative extraordinary profits due to Vending Pizza provisions and the expenses from previous financial years that have not been counted.
(4) Due to counting the extraordinary expenses amounting to 27 million euros for some shops in Spain and other countries, staff reductions, closing factories in Mexico, expenses and provisions.
(5) The principal causes are closures in Mexico and France.

Source: Telepizza annual accounts.

EXHIBIT 5
CONSOLIDATED BALANCE OF TELEPIZZA, S.A. AND DEPENDENT COMPANIES

(IN THOUSANDS OF EUROS)

ASSETS	2007	2006
Start-up expenses	1,972	1,092
Intangible fixed assets	671,369	16,413
Tangible fixed assets	39,202	49,950
Financial fixed assets	136,973	56,562
Debtors due to long term operations	565	643
TOTAL FIXED ASSETS	850,081	124,660
Deferred expenses	17,910	50
Stock	5,307	4,196
Accounts receivable	23,805	31,973
Short term financial investments	27,039	75,173
Cash account	4,066	2,360
Accruals and prepayments	2,468	1,747
TOTAL CURRENT ASSETS	62,685	115,449
TOTAL ASSETS	930,676	240,159

LIABILITIES	2007	2006
Subscribed capital	7,717	7,951
Share premium	176,286	66,897
Reservations	3,228	57,172
Losses in financial year	-12,275	18,701
SHAREHOLDERS EQUITY	174,956	150,721
Deferred income	2,381	2,844
Provisions for liabilities and charges	4,196	5,626
Bank loans	520,889	-
Other accounts payable	106,600	455
Issue of debentures and other negotiable stock	-	1.769
Bank loans	7,142	582
Debts with group companies	68,801	26,974
Trade accounts payable	32,274	34,408
Other non-accounts payable	13,436	16,779
Accruals and prepayments	1	1
Accounts payable (short term debts)	**121,654**	**80,513**
TOTAL LIABILITIES	**930,676**	**240,159**

Source: Telepizza Annual Accounts.

EXHIBIT 6
CONSOLIDATED INCOME STATEMENT OF TELEPIZZA, S.A. AND DEPENDENT COMPANIES

(IN THOUSANDS OF EUROS)

	2007	2006
COSTS		
Supplies	69,769	63,028
Variation of work in progress and semi-finished products	-	11
Personnel expenses	83,247	69,300
Provisions for depreciation of fixed assets	52,639	11,385
Variation of operating provisions	331	79
Other operating expenses	69,110	56,633
Total operating expenses	275,096	200,436
Operating profit	**-**	**28,432**
Financial and similar expenses	10,921	1,422
Exchange losses	201	9
Total financial expenses	11,122	1,431
Financial profits	-	2,819
Profit from ordinary activities	**-**	**31,251**
Variation of provisions for financial fixed assets	-560	934
Losses on fixed assets	701	348
Extraordinary expenses	387	832
Expenses and loss from previous years	50	160
Total losses and extraordinary expenses	578	2,274
Extraordinary profit	**1,807**	**-**
Financial year profits before tax	**-**	**29,922**
Corporation Tax	**10,663**	**11,221**
Financial year profits	**-**	**18,701**

Source: Telepizza Annual Accounts.

EXHIBIT 6 (Continued)
CONSOLIDATED INCOME STATEMENT OF TELEPIZZA, S.A. AND DEPENDENT COMPANIES

(IN THOUSANDS OF EUROS)

	2007	2006
INCOME		
Net sales	260,441	216,968
Casual income and other current management costs	11,855	11,900
Total operating income	272,296	228,868
Operating losses	**2,800**	-
Income from shareholdings	5,650	1,334
Income from tradable shares	3,884	1,254
Other interest and similar income	884	1,662
Gain on Exchange	85	-
Total financial income	10,503	4,250
Financial losses	619	-
Loss from ordinary activities	**2,940**	-
Profits from disposal of tangible fixed assets	1,361	36
Capital subsidies transferred to the financial year profit	463	421
Extraordinary income	440	451
Income and profit from previous years	121	37
Total profit and extraordinary income	2,385	945
Extraordinary losses	**-**	**1,329**
Losses from financial year before tax	**1,612**	**-**
Losses in financial year	**12,275**	**-**

Source: Telepizza Annual Accounts.

EXHIBIT 7

DEVELOPMENT OF THE BOARD OF DIRECTORS
1999-2007

With the arrival of Ballvé and Olcese, the first changes began to be noticed on the Telepizza Board of Directors. Firstly Mr Fernández Pujals stepped down from the board, as did the Executive Secretary Mr José Ortiz and Board member Mr de Arespacochaga. In their place, Mr Pedro Ballvé was named as President and Mr Claudio Boada, General Manager of Lehman Brothers Spain and Mr Guillermo de la Dehesa, Board member of the Banco Pastor and Unión Fenosa were named as Board members. Mr Javier Gaspar was named as Secretary of the Board. Mr Carlos López Casas (Managing Director), Mr Antonio Catalán, Director of the NH group and another three board members remained. However, at the next council meeting, the Board Member Mr Azcargorta resigned and was replaced by Mr Raniero Vani D'Archirafi, former Italian ambassador in Spain and President of the RCS Group[34].

The General Shareholders Meeting was held in April 2000 and certain modifications to the articles of association were agreed upon for their adaptation into the *Code for Good Corporate Governance.* The modifications to the share option plans were approved, as was the naming of the new members of the board, the brothers José Carlos and Aldo Olcese, and creating a new International Strategic Development Committee at the same time.

During this same month, a new Internal Conduct Regulation was approved to replace the previous one and which complied with NSMC (National Share Market Commission) guidelines. During the spring of 2000, Telefónica became a Telepizza shareholder with 4.88 percent. In June, the board member Mr Lozano was replaced by Mr Rafael Hernández, named by Telefónica.

At the end of 2000, the board agreed to hold an annual meeting for self assessment purposes, a practice which continued during subsequent years following responses from a questionnaire prepared by the Secretary of the Board.

Changes to the Board continued to happen. Throughout 2002, the Board member Mr Boada tendered his resignation and was replaced by the Secretary of the Board, Mr Gaspar. Telefónica's designated board member, Mr Hernández García, was replaced by Mr Alberto Horcajo, the Chief Executive of Atento.

The board agreed the publication of a separate report (together with the annual report) relating to Audit Commission activities and the compliance and review of the 23 recommendations of the Olivencia Code[35], although at this point this action was not as necessary as it later became. From this year on, a separate report was always presented to the Council which related to the compliance of the recommendations from the Code of Good Corporate Governance.

---

[34] Grupo RCS: Italian group of media companies.
[35] Olivencia Code: A series of recommendations set up in 1997 by the Ministry of the Treasury with the basic aim of promoting transparency in Spanish companies.

In 2004 the Board agreed for the first time ever that the company would fix their share price at €0.04 (this received 50% approval in the June Council of 2004 and the remaining 50% in the January Council in 2005). This meant a payout of 47% with regards the results from 2004.

The Board agreed that in each monthly session, a report would be produced with specific indicators relating to the development of sales (growth of sales, net growth, growth of orders and net orders, growth of the average cost of an order, number of clients, number of new clients, variation of clients, percentage of launches/orders, comparison with previous launches and percentage of new clients, launches/new clients).

In January 2006, the Board agreed to increase the registered capital to issue new exchangeable shares for the debentures converted during December 2005. The Ballvé group converted all the debentures which it had underwritten and it increased its share acquisition to 11%.

Following the public takeover bid in September 2006, all board members resigned and an extraordinary council was called where statutes were modified and a new Board was chosen, made up of three representatives from each of the two groups: Mr Pedro Ballvé, Mr Fernando and Jose Carlos Olcese and Mr Carlos Mallo, Managing Director of Permira in Spain, and two more representatives from the Venture Capital company, namely Mr Francesco de Mojana and Mr José Múgica, as well as Mr Javier Gaspar as legal advisor.

APPENDIX I

PERMIRA: VENTURE CAPITAL COMPANY

Permira is a leading European-based venture capital company. Permira has 19 funds totalling approximately 22 billion Euro that have been raised since 1985. These funds have been invested in some 300 transactions in over 15 different countries, in companies across a variety of sectors and geographies, at all stages of the business lifecycle. Among the thirty different companies involved are Ferretti, Intelsat, Seat Pagine Gialle and TDC.

The Permira team is made up of 130 professionals and comprises individuals from more than 20 different nationalities (3% Spanish, 3% Japanese, 6% American, 7% French, 13% Italian, 32% British, 22% German and the remainder from various other nationalities) based in their 10 offices around the world (London, Frankfurt, Luxembourg, Milan, Madrid, Guernsey, New York, San Francisco, Tokyo and Hong Kong), each counting with a deep local or sectorial expertise. On every deal, they involve professionals from multiple offices in order to bring the right blend of local experience, industry knowledge and transaction expertise to the Permira funds.

The Permira office was opened in Spain in April 2004 and comprised of a professional and specialised team. Very soon they began to carry out huge deals of great importance for the company. The first of these was in December of that year, with Dinosol, the largest venture capital deal in history, due to the amount of invested capital; and in September 2005, the Cortefiel deal, one of the first stock market exclusions, and the most recent in September 2006 with Telepizza.

Their competitors in Spain are CVC and Apax, whilst on a worldwide scale their number of competitors is larger: KKR, Blackstone, TPG, Carlyle, etc, all of whom, as is the case with Permira, are dedicated primarily to carrying out significant LBOs[36].

Permira is a worldwide business with European origins and although all their competitors are involved in leveraged buyouts, there are significant strategic nuances between them. The majority of the Permira team is from the consultancy or industry sectors, they are not limited to being financiers alone. They create industrial values. Their strong points are their prominent geographical presence, which allows them to have a local knowledge of the different deals and the working culture in each market, knowledge of each of the different sectors in which they are involved, namely the consumer sector, TMT[37], the chemical and industrial sector, products and services... There are also specialised team members within the company; financiers, accountants, consultants, etc. This means that they can offer a worldwide service and that all their processes and operations are perfectly clear.

[36] LBO Leveraged Buyouts: purchasing operation financially stuck.
[37] Technology, Media and Telecoms.

Permira has specialized funds, differentiated by two criteria. The first criterion is the type of product; pure venture capital, buyout of medium-sized companies, for capital increases and for large deals. The second criterion is the division of the funds by sectors. In 2007, Permira carried out 4 of the largest investments in the venture capital sector, with an investment of €3.4 billion, making €3.5 billion.

Permira was involved in the following sectors: the chemical sector, the consumer sector, the industrial sector, products and services sector and Technology, Media and Telecoms (TMT).

They had more than 30 companies in their portfolio, such as:

Aearo Technologies, Grupo Ferretti, Intelsat, Rodestock, Takko, Telepizza, Acromas, Arysta Lifescience, Birds Eye Iglo, BorsodChem, Cognis, Cortefiel, Debitel, Dinosol, Feescale Semiconductor, Gala Coral, Galaxy Entertainment, Jet Aviation, Maxeda, New Look, Principal Hayley Group, ProSiebenSat, Provini, Seat pagine Gialle, Sisal, TDC and Valentino Fashion Group.

APPENDIX II

THE PIZZA SECTOR IN SPAIN FROM 1999 TO 2005

In 1999, the fast food market in Spain was in its second decade of development, having registered 17% growth that year. The areas which have seen the most positive performance have been the hamburger and sandwich sectors, driven by the expansion of the different chains (mainly sandwiches) and the dynamism of tourist demand.

The habit of eating out of the house also grew, although consumption in the home, predominantly in the pizza sector, was also significant. At the same time, there began to be an important demand for ready-made sandwiches and hamburgers that could be eaten at home, and at this point in time there were almost no operators who did home deliveries.

The pizza sector, although it experienced 9% growth, lower than the other sectors, continued to lead the market with a 39.2% share. The table below shows the market share in this segment from 1999 to 2005.

Market Share in the Pizza Sector in Spain*

(percentages)

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Telepizza Group	59.80	62.10	60.00	60.60	61.60	61.90	62.80
Second Operator	11.20	11.10	15.90	14.10	14.20	14.40	14.40
Other	29.00	26.80	24.10	25.30	24.20	23.70	22.80

Source: DBK

*Includes sold in-shop, delivery and for collection.

Thanks to the North American fast food market survey, in its fifth decade of development, a negative correlation was seen between economic growth and the growth of the pizza sector; in periods of economic boom the growth of the pizza sector was lower.

A study carried out in Spain on a panel of consumers revealed that this type of food was becoming more and more present in the daily habits of the consumer. It was seen that half of Spaniards over the age of 10 consumed fast food approximately once a month, with an average spend in the region of €8. A growing concern was noted for food quality and health, with Telepizza coming out as the most valued brand with regards consumer confidence, quality and being family oriented.

In the year 2000, the fast food market continued to be one of the most dynamic sectors in the Spanish economy. The pizza sector was the area which saw the worst overall performance, although it continued to be a market leader with regards value, with 39.1% market share. Higher growth was seen in the eating-out consumer section, due to the country's good economic situation.

During the last quarter of 2000 the disease Bovine Spongiform Encephalopathy (Mad Cow Disease) came to light, mainly affecting the hamburger chains.

The market in which Telepizza is embedded is changing every year; women are becoming more involved in the labour market which leaves less time for cooking and leads to a greater need for ready-made foods; there is an increase in the number of one-person households; suburban areas are growing and there is an increase in rural immigration, and there have been changes to the importance of free time being spent whereas the home was becoming a central point for cohabitation and a place to enjoy such free-time.

APPENDIX 3
INTERVIEW WITH MR JAVIER GASPAR[38]: SECRETARY OF THE BOARD OF DIRECTORS, AND QUESTIONS FROM THE 2004 TELEPIZZA BOARD SELF-ASSESSMENT QUESTIONNAIRE WITH ITS RESULTS

Q. You joined the Telepizza Board of Directors in 1996 along with Mr Pedro Ballvé. Had you previously worked with him? If so, what did you work on together?

A. Yes, I have been working for the Ballvé family since 1979 in the various companies which they have shares in, except Campofrío, which has always relied on its own internal legal consultancy.

More specifically, I have worked as a lawyer and company secretary for the Carball and Uniball family-held holding companies, including companies specialising in real estate such as Cuybal, mining companies such as Moltumi, Internet Service Providers such as Servicom and hotel and catering companies including *Proyectos de Hostelería* and Telechef. I was the chief legal adviser and company secretary for all of these companies.

Q. Which have been your main responsibilities within Telepizza?

A. My responsibility as Director of the Telepizza legal consultancy was to manage the department, which was made up of a variable number (between 10 and 12), of internal lawyers, both in the national and international divisions. As Secretary of the Board of Directors and Committees, my responsibilities included taking minutes, providing legal advice for the directors, ensuring that the agreements complied with the legislation, coordinating communications with the CNMV (National Commission of Market Values), producing and communicating the relevant facts, monitoring the meetings of the company departments, and notarising and registering the Departmental and Board agreements. The development of the Board of Directors from 1999 to 2007 is included in exhibit 7.

Q. What legal aspects should be noted regarding the acquisition of Telepizza in 1999?

A. The most relevant legal aspect is that, as Telepizza is a listed company, and Fernández Pujals maintains a share of 30.2% in the company, Pedro Ballvé had to buy the entire block of shares in order to control the management of the company (something which Fernández Pujals had also stated as a requirement). Pedro Ballvé and his team, the owners of Telechef, did not have sufficient economic means to do this, thus they had to rely on Lehman Brothers. Pedro and his partners acquired approximately 5 percent, and the investments company

[38] Javier Gaspar: Secretary of the Telepizza Board of Directors since 1999. Active member of the ICAM (Madrid Lawyers´ Association) since 1979. Graduate of Law from the Universidad Complutense de Madrid. Graduate of Politics and Sociology from the Universidad Complutense de Madrid. Partner in the firm VCGH Abogados, specialists in Commercial Law.

invested the rest in the market. This made the property exchange and desired management viable. A Board of Directors was subsequently appointed which was principally made up of independent Directors, both nominated by Fernández Pujals, before he left the company, and appointed by Pedro Ballvé.

Q. How was the valuation of the merger of Telepizza and Telechef carried out?

A. From the beginning, the integration of Telechef established something fundamental for the new shareholders. The Ballvé-Olcese group was initially not interested in acquiring a share in Telepizza, although it had been negotiating the integration of the two chains with Fernández Pujals during the course of the previous year. Although Telechef was very small in comparison with Telepizza, it was thought that there could be a collaborative joining of the two companies, and that the Telechef products could be incorporated into the Telepizza shops. Thus, on appointing Pedro as President, the transaction was initiated with a capital increase. In order to allow this increase to take place, the Ballvé-Olcese group added the Telechef shares to those of Telepizza, thus allowing them to increase their shares in the company.

The transaction had certain special characteristics and difficulties as the Ballvé-Olcese group were also the owners of Telechef and so they were unable to vote in favour of the expansion. It was therefore necessary to illustrate the benefits of the transaction to the rest of the directors. A series of procedures was established to safeguard the independence of the company, including the creation of a special *ad hoc* committee called "Committee for the integration of Telechef", which was not made up of any directors representing substantial shareholders[39], and which led the process and took charge of contracting independent experts to carry out the valuations. It is notable that the directors representing substantial shareholders abstained in order not to interfere with the process. In addition, there were no opposing votes, nor abstentions and the opposing vote from within the department were insignificant and did not challenge the shares.

Q. What legal obligations did the stock market require?

A. It created substantial additional work for the legal department, firstly because it required communication with the CNMV regarding any relevant facts which occurred within the company. There had to be a constant and fluid dialogue. In addition, since 2001-2002, the regulations require an increase in the information offered to the markets, such as corporate governance reports and other documents which considerably increase the volume of work. But most important is the fact that being listed determines how business decisions are made. Unfortunately, they depend on the reaction of analysts, journalists, and all those who follow the share price. Thus, decisions which may or may not be made, which may be postponed or brought forward are influenced more by the effect which they would have on the stock market rather than by the ordinary management of the company. For example, the new management team in

[39] Directors representing substantial shareholders: they enter the Board of Directors as they own or represent the owners of shareholdings of the Company with capacity for influencing by themselves or after agreement with other, in the control of the Company.

Telepizza realised from the beginning that continuing operations in different companies was not beneficial for the company, but the decision to end operations in these countries took a long time, as the consequence of ceasing operations would have had a substantial impact on the shares.

Q. Which contributions have the legal department made to the relationship with the franchises?

A. There have not been substantial changes made to the Telepizza franchise model over the years, although there have been different phases and aims. There have been times when the initiative of the franchised shop predominated, and other times when the situation was the reverse. The reality is that the Telepizza owned shops are more profitable than the franchised shops as all the profits from the former go to Telepizza. Nowadays, since the take-over bid went ahead, the company policy is to support the shops and the purchase of the franchises. However, independently of the different phases, the franchise contract has always been very similar. What have actually changed are the terms of the contract, as it is a constantly changing document and almost every year new modifications are introduced which are not capricious, but a result of legislative modifications, or jurisprudence criterion, and the experience of the company itself. However, it is notable that there have been practically no disputes, especially judicial disputes, with the exception of Pizza World and the Telepizza Franchise Association, but each case has been resolved without too many problems.

Q. What can you say about the negotiation attempts with venture capital companies in 2003?

A. Since 2003 or 2004 they began to consider the possibility of some type of business operation by establishing contact with different banking entities and venture capital companies. However, for various reasons, none of these alternatives materialised. These reasons included the financial situation of Telepizza, which had become delicate as a consequence of the difficulties in renewing a syndicated loan. This financial situation played a role in determining the possibilities for this type of operation. At all times there was a thorough provision of information, the relevant data protection documents were signed, data rooms were organised where the interested parties could access the information and the directors were informed of every operation. No operations took place until the transaction with Permira in February 2006.

Q. What stands out from the take-over bid process in 2006?

A. The take-over bid preparations began in the first few days of February 2006 as, amongst other reasons, an exclusivity agreement ended in January with a company with which there had been previous negotiations, but due to financial difficulties it never took place. Dialogue began with Permira very quickly, and within three or four weeks we were in a position to present the prospectus and launch the operation. A relevant legal fact was that we only had 72 hours to present the prospectus to the CNMV. Until then, we had to observe a strict confidentiality code; however, there must have been some leak and the market started to become aware of the take-over bid. The Sunday night prior to the launch of the take-over bid we explained our intentions to the CNMV. If the share prices were to rapidly increase, this would have had a great impact on the company. We then agreed something with the CNMV which until then had never been done: the publication of breaking news which would announce that in the next few hours a take-over bid would be presented, in such a way that the resultant fluctuations in the share price would not affect the offer price. The condition imposed was that the offer was signed within a period of 48 hours to avoid a situation of uncertainty.

From then on, there was a single process where groups, which may have expressed a certain interest in the operation and those which had previously held talks, entered into the action. The question is why they didn’t do so before when the share price was even lower. But the reality was that they launched rival take-over bids, thus opening the remaining stages. The most relevant legal aspect was that, even when Zena and Ibersol incorporated a significant improvement in price, the Board, with abstentions from the directors representing substantial shareholders, gave a verdict on the take-over bids, and having taken all the interests into account, not just those of the shareholders, they considered that the bids were counter-productive for the company.

Another notable element was the difficulty in completely excluding the company from the stock market, given the fragmentation of the shareholders, which ended with the repayment of the shares in an extraordinary meeting with the existing legal difficulties.

Q. Which was your role as Secretary when Zena and Ibersol launched their rival take-over bids?

A. When the two rival take-over bids were launched, I arranged a meeting of the members of the board and briefed them on our stance regarding the rival take-over bids, advising the members of the board on their obligations and responsibilities. I produced the necessary communication documents regarding the board reports on the three take-over bids; I advised the board to call an extraordinary meeting to vote on the lifting of the statutory protections which the two rival bidders demanded, obtaining the necessary quorum for this vote, and finally, I organised the meeting of the directors. I discussed with the rival bidders and the CNMV about the bidders´ access to non-public Telepizza information; I advised the Board on what they could and could not facilitate in their role as competitors and I set up a data room to allow them to access the information.

Q. What are the most important aspects which a partnership agreement with a company like Permira should contain?

A. There are two fundamental aspects: first, its participation in the management of the company, to what extent, how often and in what way it can intervene. In Telepizza it was agreed that as long as Permira´s expectations were met in accordance with its business plan, the board of directors would continue as decided by the management team. If the results began to drop, Permira would have a greater intervention. The second aspect concerns the procedures for leaving the company. Venture capital companies look to leave the company after four or five years and the main shareholder may have another interest. There are clauses through which the main shareholder reserves the right to buy the venture capital if it is being sold. The venture capital company has the legal authority to demand, if necessary, upon leaving the company, that the main shareholder also leaves the company in order to sell the entire block of shares. In the case of Telepizza there are three hypothetical situations: a new public offering, the purchase by an industrial group, or the purchase by a new venture capital company. This will depend on the wishes of both parties and the market situation at the time.

Q. How have all these changes affected the Board?

A. Prior to the arrival of Permira, the appointment and departure of the directors happened for natural reasons: too much work, changes in the management teams of the shareholder companies... but never for reasons which were out of the ordinary. Since the investment from Permira, the number of directors is much lower, but the meetings are still very interactive involving a lot of debate, which makes them very productive. However, since leaving the stock market, the self-assessments, which were very useful as they allowed the directors to take stock of the situation and to improve each year, are no longer carried out. Although having said this, the Board of Directors´ meetings continue to be as important. Exhibit 8 contains the questions from a Telepizza Board of Directors´ self-assessment questionnaire and the results.

Q. Which are the main changes to the Statutes which have been made during this period of time?

A. The most relevant statutory changes were those which were required by the legislation for listed companies in relation to the statutory proof of the Board Committees, its functioning and responsibilities. Also those regarding the regulation of the Board and the Department and as regards the possibility of redistributing company shares amongst the directors and senior executives. Finally, following the success of the take-over bid, the protective statutes, which Zena and Ibersol had wanted to remove when they launched their take-over bid, disappeared. The aforementioned statutes stated, without restricting the voting rights, that in order to become a director a person must have a certain number of shares unless he/she was unanimously elected, and the President of the company must have previously served a certain period of time as a director. Moreover, it was very difficult to achieve the necessary quorum for the elimination of these practices.

Q. Which do you consider to be your principal achievements during your career at Telepizza?

A. I feel that my main achievements have been: the management and execution of the integration process of Telechef; the creation of a contentious internal legal department which avoids the externalisation of civil actions therefore saving money and providing greater efficiency; the participation in the design of the legal strategy to resolve tensions with franchises in 2003, reaching a global agreement with a collective which represented 90 percent of the establishment, and successfully litigating with the rebelling franchises. The installation and design of a self-assessment process for the Board; the production and publication of a report on the Auditing and Compliance Committee, providing the market with an account of the degree of compliance with the corporate governance rules of the Olivencia Committee, although this was not mandatory and in this respect we were almost pioneers. Additionally, achieving very good results in the levels of compliance with the Corporate Governance Rules in different indices and analyses of the Corporate Government; the direct intervention in the closure and exit process from the non viable countries (United Kingdom, Mexico, France and Morocco); the intervention in the design and execution of the issuing of the convertible obligations in 2004; departmental organisation and the acquisition of the necessary attendance quorum as well as the delegations of the necessary votes; the participation in the negotiations with Permira and in the production of the prospectus for the take-over bid, as well as in the different legal vicissitudes generated by the process, and the organisation and briefing of the departments which had to give an opinion on the three take-over bids.

1.1. Number of Board Meetings

TelePizza had been holding an average of 7[40] Board meetings a year. The Directors consider the number of Board meetings to be adequate.

1.2. Duration of the Board Meetings

The meetings of the TelePizza Board tended to last between 2 and 3 hours[41]. The Directors consider the duration of the sessions to be adequate. Although, the idea of a "less formal" lunch following some of the Board meetings has been suggested.

1.3.- Information Received by the Directors

According to the S.S Report 25 percent of Spanish companies did not send any information to their Directors prior to the meetings, and of those which did, like Telepizza, 81 percent sent information of a financial nature, 78 percent sent information regarding the company activity, 62 percent regarding investments and 35 percent regarding alliances. The Directors continue to complain about the need to receive information in advance of the meetings, especially financial information, although in general information regarding all relevant issues.

1.4.- Appointments and Remuneration Committee

The S.S Report considered the Appointments and Remuneration Committee to be useful in 69 percent of the cases and not useful in 31 percent of the cases. In the later case it was not considered to be useful as all it did was approve the Executive Directors´ proposals. All the Directors thought that this Committee's activity was useful, but they complained that it was only there to confirm the appointments and was not used in an advisory capacity.

1.5.- Succession Plan for the Senior Positions in the Company

Only 8 percent of the companies analysed in the S.S. Report had a succession plan for the senior posts although 92 percent of those without such a plan stated that they should in fact have one. The Board was divided over the need to approve a succession plan for the senior posts.

---

[40] According to the Spencer Stuart Report on the Boards of Directors in Spain in 2004 (henceforth S.S Report) The annual average for Board meetings was 9 times per year and the statistical mode (most frequently occurring value) was 12 times per year.

[41] According to the S.S Report the duration of the Board meetings of the Spanish companies varied between 2 hours (22%), 3 hours (47%) and 4 hours (22%), with the modal value being 3 hours.

1.6.- Assessment of the Top Executives

58 percent of the companies analysed in the S.S. Report stated that they would assess the top executives, even if in the majority of the cases this assessment would only take place in the form of the approval of the annual bonus by the Appointments and Remuneration Committee, which is what happens in TelePizza. The majority of the Directors needed a more detailed assessment of the performance of the top executives.

1.7.- Self-assessment of the Board

There was frequent self-assessment of the Board in companies which were listed on the New York and London stock markets, but it was not a widespread practice in our country where only 19 percent of the Boards carried out self-assessment such as TelePizza had been doing since the year 2000. Almost all the Boards felt that the content of the annual self-assessment questionnaire was adequate, although they requested more questions regarding the functioning of the Committees.

1.8.- Election of the Independent Directors

93 percent of the independent Directors in the companies analysed by the S.S. Report had been appointed following the proposal of the President and/or a shareholder representing substantial shares. Only 14 percent of the companies appointed their independent Directors through a previously established system without influence from the President and/or the substantial shareholders. The Directors were divided over the installation of a preestablished system for the appointment of Independent Directors.

1.9.- Quality of the Participation of the Independent Directors

According to the S.S. Report, the quality of the participation of the independent Directors was considered, in 42 percent of the cases as passive, in 28 percent as active and in 30 percent as very active. The Directors unanimously considered that the quality of the participation in Telepizza was active.

1.10.- Remuneration of the Directors

52 percent of the external Directors of the companies analysed in the S.S. Report felt that their remuneration was not adequate. In the majority of cases, the Board considered that the remuneration was adequate.

1.11.- Duration of the Independent Directors´ Term of Office

In 74 percent of the companies analysed in the S.S. Report, the term of office of the Directors was the maximum allowed by law (5 years), although recently the different Codes of Corporate Governance advocated ways to limit the continued re-election of the independent Directors. Almost all the Directors felt that the aforementioned procedure was advisable.

1.12.- Audit Committee

The Audit Committee for TelePizza almost exclusively dealt with the supervision of the financial states and annual accounts, supervision of the internal auditor and proposals for the appointment and renewal of the external auditor. The Corporate Governance rules required the Audit Committee (in the absence of a Risk Committee) to revise the risk management systems, establish a risk management and assessment policy and to periodically revise, with the internal auditor, the significant risks and compromises out of the balance sheet. The whole Board thought that it was appropriate to include the duties of the Risk Committee amongst the functions of the Audit Committee.

1.13.- Sustainability Report[42]

Until that time, TelePizza had not published a separate report with any information which addressed the questions in its annual report. The Board considered that the publication of a sustainability report was appropriate.

1.14.- Website

TelePizza had included all the information required by the current regulations on its company Website. There were also a growing number of companies, following international trends which included the opinions and recommendations of company analysts in an easily accessible format. TelePizza did not include this information on their website. The majority of the Directors felt that it was appropriate to expand the content of the website in this area, even after studying the costs which this would incur.

1.15.- Strategy and Investment Committee

The powers of the Strategy Committee include the power to submit proposals to the Board regarding the strategic lines and plans of the company. Since its establishment, the fundamental activities of the Strategy Committee have consisted of the reception of reports and presentations on behalf of the company's management staff. The recommendations of the codes and reports of the Corporate Governance insisted that the strategic planning of the companies must originate from the proposals submitted to the Board by the aforementioned Committee. The Directors, almost unanimously, felt that the more active role was appropriate for the Strategic Committee. It was shown by the Directors that, in order for the S.C. to develop this role, it was necessary to spend more time on it and to obtain more information.

[42] The number of listed companied in Spain which annually published a sustainability report (along with the annual information) has been increasing, involved, to mainly the environmental issues, proceedings linked to social responsibility, risk treatment and the policy of third party relationships (suppliers, clients, analysts, investors, etc).

2.- Reports and Presentations to the Directors

The periodical presentations relating to the monitoring of sales and marketing were especially unsatisfactory as were the reports on the monitoring and control of the budget, although to a lesser degree.

3.- Global Assessment of the Board´s Performance for the Period 99-04

The areas where the Board was most satisfied with its performance were the reorganisation and clean up of the international division, the appointment and monitoring of the executive board management and the industrial plan. They were less satisfied with the sales and marketing policy, the new projects and the relations with franchises and franchise policies.

Source: Telepizza Board of Directors