

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-35². In November 1996, the company's shares³ 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.

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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 CNMV⁴ 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 Pedro⁵ and Fernando Ballvé, together with Aldo and José Carlos Olcese, shareholders of TeleChef Corporation S.A⁶ bought 5.4 per cent of the share package; the rest was placed in the market by Lehman Brothers⁷. 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.

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.

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, 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 Pizza⁸, 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:

Core business. 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

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.