

## The Venture Backed IPOs Market<sup>1</sup>

This year Ernst & Young have continued their monitoring of venture backed stocks; the analysis is focused upon a period full of positive steps for the Italian industry exchange which has been characterized by important changes on an institutional scale, by new records set concerning the number of listed companies and trading exchange values and by the irregular performance of certain share categories, in particular hi-tech.

The Italian share market has seen, in the two year period of 1999-2000, a continued increase in the size of the Stock Exchange list: 72 new companies were listed, 33 on the Stock Exchange and 39 on the Nuovo Mercato; the year 2000 saw a new record in terms of the number of IPOs for the domestic market. From all the new listings during this period, *venture backed IPOs* represented 34% of the main Exchange and 36% percent of the Nuovo Mercato.

The period under consideration was characterized by important changes concerning the institutional situation of the markets; one of these, due to the integration projects of various European Stock Exchanges, was the closure, as of the 1<sup>st</sup> January 2001, of the Euro.NM European circuit for high growth potential companies. In no way is this meant to diminish the role which has been carried out by the circuit up to now, in fact it is possible to say that the circuit constituted the link for the European Stock Exchanges to come together and the path towards the unification and harmonization of the exchanges of the member countries. Now that the harmonization has chosen new ways must not forget one of the realized objectives: stimulating the quotation in Europe of medium-small companies with a high growth potential. In the light of these changes, Ernst & Young has decided to reinforce its own monitoring of this type of share by creating an index for the Nuovo Mercato stocks, impeding the definition of development strategies of the European Stock Exchanges and their exchange lists. The second reason that led to the creation of the index has been the importance that the Nuovo Mercato is assuming in the Italian market: the number of companies (42 at May 15<sup>th</sup>, 2001) listed on the Nuovo Mercato allows the construction of a sufficiently important basket of stocks with the aim of monitoring a market in a period of strong growth which is assuming ever increasing importance in the field of the Italian Stock Exchange. In terms of its position in the Italian share market, the Nuovo Mercato represented 71% of the total in 2000, compared with 23% in 1999.

In this context Ernst & Young – Corporate Finance is continuing its monitoring of venture backed stocks through two indexes: the Ernst & Young Venture Backed Index (EYVBI), created in November '99 and including the Venture Backed stocks listed on the main market of the Italian Stock Exchange, and the Ernst & Young Nuovo Mercato Index, which includes the issuers listed on the Nuovo Mercato and held by venture capital and private equity investors in the pre-listing period. Through a comparison of the performance of these two indexes, it emerges that, during the period May 2000 – May 2001, the performance of the Venture Backed stocks on the main market is higher than their counterparts on the Nuovo Mercato (see the chart below).

Even if the period of observation of a year is limited, it is possible to evaluate the principal reasons for such a performance.

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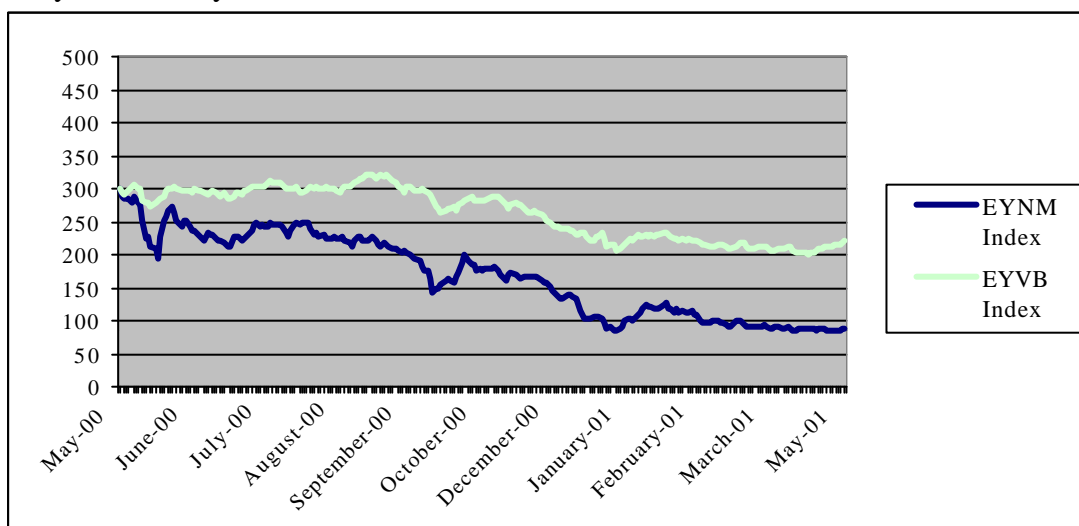
<sup>1</sup> The analysis has been realized by Ernst & Young Corporate Finance.

In the first semester, the so called New Economy stocks were given extremely elevated values based on empirical figures which often do not take into account prospective cash flows and the capacity to generate return on underlying business. Today both venture capital investors and financial markets, when evaluating a company of the so called New Economy, pay increasing attention to the capacity of the stocks to generate positive cash flows in a short and defined time span. This had an immediate effect on the values of many companies, both those listed, and those in the listing process, whose figures were significantly lower compared to the first part of the year.

Seeing as the basket of venture backed stocks of the EYNMI is largely made up of so called New Economy companies, its respective performance is worse than the EYVBI, and index which is mostly composed of traditional companies whose valuation parameters have had much less significant variations.

It will be interesting to monitor the future performance of the two indexes. In fact, away from the general market situation, the Venture Backed stocks of the Nuovo Mercato, by representing firms with high growth potential should show a trend that is more interesting than the main market.

May 2000 – May 2001: EYNM Index and EYVB Index



**Source: Ernst & Young Corporate Finance**

Another important event with respect to this subject is the new articulation of the Stock Exchange, which came into force on the 2<sup>nd</sup> April 2001, and which has introduced a new market segment, Star, dedicated to medium-small firms operating in traditional sectors. The launch of the Star segment constitutes a further incentive for institutional investors to hold interests in this particular category of issuers. The progressive segmentation of the share market, allowing a smoother meeting point between supply and demand, makes listing ever more attractive for this type of firm, facilitating the way out on behalf of institutions which have contributed to their own growth through the contribution of financial and managerial resources.