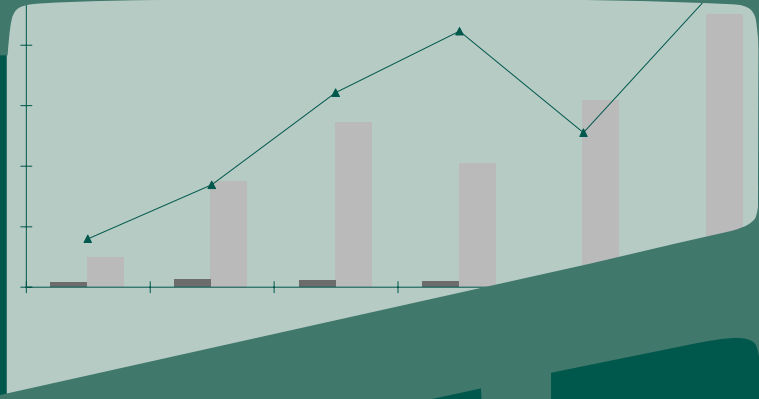


Italian Private Equity and Venture Capital Association



# ANNUAL YEARBOOK 2005

AIFI  
2005 Yearbook



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# Table of Contents

|                                                                       |     |
|-----------------------------------------------------------------------|-----|
| Introduction .....                                                    | 7   |
| About AIFI .....                                                      | 9   |
| The Italian Private Equity and Venture Capital Industry .....         | 13  |
| Tax and Legal Issues .....                                            | 27  |
| Statistics on Performance .....                                       | 31  |
| The Expectation of the Private Equity Players for the Year 2005 ..... | 45  |
| The Venture-Backed IPO Market .....                                   | 53  |
| Statistics on Private Equity and Venture Capital in Italy .....       | 59  |
| AIFI Board Members .....                                              | 99  |
| AIFI Directory: Full Members .....                                    | 101 |
| AIFI Directory: Associate Members .....                               | 187 |



# Introduction

The AIFI Yearbook, which is now at its eighth issue, intends to be a simple guide on the main features and trends related to Italian private equity and venture capital industry.

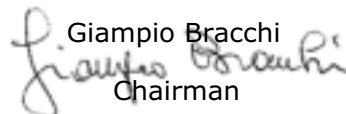
Through the passing of time, the industry has become a strong segment of Italian financial market and represents one of the most important realities in the European context. The significant increase in number and diversification of private equity players and the higher recognition of the instrument by Italian entrepreneurial system show that positive results have been reached.

The volume, after a brief presentation of AIFI's activities, presents the 2004 Italian Private Equity and Venture Capital Industry Survey (conducted with PricewaterhouseCoopers – Transaction Services), followed by an analysis of the main Tax and Legal Issues regarding the industry.

Moreover, the Yearbook contains three different researches: one focused on the Aggregate Performance (IRR) of the Industry (carried out with KPMG Corporate Finance), one related to the Expectation of the Private Equity Players for the Year 2005 (conducted with Deloitte Financial Advisory Services), and the last one about the Venture Backed IPO Market (made with Ernst & Young Financial Business Advisors).

The AIFI Yearbook also includes a statistical data section on private equity and venture capital market in Italy and the members directory.

Enjoy reading,

Giampio Bracchi  
  
Chairman

Milan, April 2005



**AIFI – Italian Private Equity and Venture Capital Association** – was founded in May 1986 in order to promote, develop and institutionally represent the private equity and venture capital activity in Italy.

In particular, the AIFI's objectives are to:

- support and facilitate the development of private equity and venture capital activity in Italy and abroad;
- work with government entities to improve the legal environment of the private equity investment activity;
- increase awareness and understanding of the private equity and venture capital industry in Italy;
- co-ordinate the creation of qualified managerial groups both in associated companies and the connected firms;
- collect and present information about the sector;
- act as an interface and link to Italian and international financial players;
- create a network between research centres and venture capitalists, in order to promote successful entrepreneurial ideas;
- maintain ethical and professional standards in the private equity and venture capital industry;
- line up the Italian financial market to the international standards in collaboration with other trading association.

The Association is a non-profit organisation that comprised 83 full members and 88 associate members at the end of March 2005.

Full Membership is open to private equity players and venture capitalists whose main task is to take equity participations in enterprises. Full members matrix is quite heterogeneous, including Italian and international banks and their subsidiaries, industrial and private investment companies, Italian closed-end funds, international closed-end funds advisory companies

as well as public operators and financial institutions linked to the co-operative system.

Associate Membership applies to organisation providing services to the private equity industry such as accountancy firms, law firms, banks, consultancy groups, institutions as well as Italian and foreign associations.

In order to reach its objectives, AIFI's main activities are:

#### *Institutional and Lobbying Activity*

The Association has an active role in the legislative and institutional process by cooperating and lobbying with the appropriate authorities in order to create a favourable environment for the private equity and venture capital investment activity.

#### *Research Activity*

The Association periodically analyses the Italian private equity market, collecting statistical data on investment, divestment and fund raising activity and on the performance realized by the Italian players. The Association also studies in depth specific industry related issues and the relationship between demand and supply of risk capital.

#### *Information and Publishing Activity*

AIFI participates and organizes many seminars. Once a year the Association attracts the most important Italian and foreign players in a symposium opened to AIFI members and all those interested in the industry. Furthermore, every two years a meeting with international investors is organized for AIFI members, to promote discussion and to share views and ideas on the venture capital and private equity industry's main issues and challenges. AIFI also organizes single theme business seminars on selected items and publishes research papers regarding specific topics about private equity market.

#### *Information Activity for Members*

AIFI highlights for its members useful legal news and information throughout internal drafts and a monthly Newsletter that collects

information on private equity and venture capital industry. In addition, the AIFI website includes a special section reserved to members where they can find and post any relevant information.

### *Educational Programmes*

AIFI organizes specialized courses addressed to institutional investors and to people interested in operating within the industry. Once a year the Association coordinates a five days course, for institutional investors only, that covers a wide range of subjects including a general and institutional overview of the market as well as case histories of the investment activity in Italy. An important role played by AIFI is the analysis and the updating of the sector through the organization of technical seminars and refresher courses.

### *Networking Activity*

AIFI represents a point of reference for all Italian players and is strongly committed to building up stable and solid relationships with other National Venture Capital Associations and key players in the international private equity market, in order to promote private equity and venture capital within the international financial community. Furthermore, the Association facilitates contacts with policy-makers, investors, research institutions, Universities, industrial associations and other relevant organisations.

In order to carry out the above-mentioned activities, AIFI can rely on its permanent staff. Moreover, different Technical Committees composed by full and associated members have been established with the task to carry out activities of study on specific matters and projects and to elaborate reform's proposals related to the private equity and venture capital industry.

## **Code of Conduct**

Participating to the Association, members are committed:

Art. 1. To conduct their own activity in a professionally correct way, keeping away from any action damaging the private equity and venture capital investment activity image, the Association image and the members' image;

Art. 2. To adopt a long run vision of the economy in general and, in particular, of the private equity and venture capital investment activity, in order to create value in target companies, rather than to commit to short run speculation;

Art. 3. Not to disclose to third parties any confidential information gained in the exercise of their activity, unless they receive an expressed authorization;

Art. 4. Not to discredit or criticize other members during their negotiations with potential participated companies and during the conduction of their activity in general;

Art. 5. Not to accept in their fund capital any money coming from an unsure source, not to represent any investor group with an unknown composition and to strictly respect the anti-money laundering law;

Art. 6. To have towards direct investors and subscribers of the fund, both management companies and management teams, a honest conduct not in conflict of interests, with the only aim to maximize performance for investors;

Art. 7. To provide their investors a clear, complete and updated information on a regular basis;

Art. 8. To provide AIFI the information requested to run the Association institutional activity;

Art. 9. To respect this Code of Conduct and make their managers, employees and staff in general respect it.

# The Italian Private Equity and Venture Capital Industry

## Executive summary

In 2004 the Italian private equity and venture capital market has been characterized by a tendential stability on the supply side, even if different trends distinguished the existing segments.

As regards the demand side, the expectations of the economical recovery, together with the presence of auctions concerning important companies, started at the beginning of the year but not concluded yet, didn't help deal flow.

As in the past editions, the AIFI 2005 Yearbook contains results of the traditional annual survey, conducted in cooperation with *PricewaterhouseCoopers - Transaction Services*, analysing the investment, the divestment and the fund raising activity carried out during the year.

The main results of the 2004 survey are:

- in terms of investment activity, the amount reached 1,480 Euro Mln and the number of investments accounted for 248 deals, in 208 different companies;
- the buy out activity got to 916 Euro Mln, equal to 62% of the total amount invested, followed by expansion capital (458 Euro Mln, 31%), replacement (83 Euro Mln, 5%) and early stage (23 Euro Mln, 2%);
- in term of numbers, expansion represented over half of the market with 126 deals (51%), followed by early stage (50 deals, 20%), buy out (48 deals, 19%) and replacement (24 deals, 10%);
- 137 divestments has been reported in 2004 for a corresponding amount at cost of 647 Euro Mln;
- the most used channel of divestment has been trade sale accounting for 31% of the amount with 200 Euro Mln and involving 50 deals in 45 companies;

- with regard to exiting, it has to be noticed the remarkable increase in the use of Stock Exchange (IPO and sales post-IPO), which represented the second most used channel with 14 divestments related to 10 companies and amounted for 186 Euro Mln;
- the total volume of funds raised was quite stable (1,663 Euro Mln) with respect to 2003 and the years before, with an amount of 1,308 Euro Mln raised on the market by independent investors;
- at the end of the year 2004 the total portfolio of Italian investors amounted to about 1,150 target companies, with an equivalent value, calculated at cost, of up to 9.0 Euro Bln.

## Background

During 2004 the whole of the investors analysed, which represented almost the total of Italian private equity and venture capital industry in the considered period, counted for 97 players.

On the basis of the available information regarding the total number of employee of the industry, the average size of private equity and venture capital firm turned out to be 7 persons, counting both executives and staff employers.

**Table 1 – Italian private equity and venture capital players**

|                                                             | <b>2004</b> |
|-------------------------------------------------------------|-------------|
| Italian closed-end funds and other generalist country funds | 49          |
| Early stage funds                                           | 7           |
| Pan-European funds                                          | 19          |
| Italian banks and their subsidiaries                        | 13          |
| Regional/public/cooperative investors                       | 9           |
| <b>Total</b>                                                | <b>97</b>   |

Source: AIFI - PWC

In terms of number, the first category of players is represented by Italian closed-end funds managed by SGR<sup>1</sup> and by other generalist country funds<sup>2</sup>, which represent more than 50% of the market. These players manage on

<sup>1</sup> The SGR is the management company authorized by Italian Law to manage closed-end funds.

<sup>2</sup> With the term country fund we mean non pan-European international players mainly focused on Italy.

average 137 Euro Mln and their activity is mainly focused on mid-market and later stage investments.

The second most relevant category is made up by pan-European funds<sup>3</sup>, accounting for 20% of the total market and active on the buy out segment and mega deals. All the main European private equity players are active in our country, as well as we assist to the increase of the presence of American players, showing, more and more frequently, interest towards big Italian companies.

Italian banks and their subsidiaries, have played, in the last years, a decreasing role within the industry, preferring most often to replace direct investment activity with the institution of SGR managing closed-end funds having an independent structure (today 50% of SGR is owned by Italian banks). Besides, banks keep representing approximately 14% of total players and they are traditionally operative in every stage of investments, with a particular focus on replacement and expansion financing.

Early stage funds, following the stable downward trend of previous years, accounted for 7% of total investors. Even if this kind of players should be an important "actor" for the investments in high-tech companies in Italy, the unfavourable environment for venture capital in general were diminishing this part of the market. Notwithstanding, it's important to point out the recent start of small funds highly focused on particular technologies, which will give results hence next months.

Finally, regional, public and cooperatives investors, which accounted for 9%, were active in the expansion and start up investment activity, with the goal of promoting new entrepreneurship and of fostering the development of some specific areas or industrial sectors.

73 over the 97 considered investors made at least one investment, disinvestment or fund raising activity during the year.

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<sup>3</sup> Players that manage or advise a consistent amount of money, mainly raised from European or worldwide mega funds, often without any specific geographical allocation.

## Investment activity

In the last 3 years an average annual amount of around 2,400 Euro Mln, distributed over almost 300 different deals per year, has been invested in private equity and venture capital in Italy. As concerning 2004, the total amount invested reached 1,480 Euro Mln, distributed over 248 different deals, involving 208 companies.

In general, the industry has been characterized by stability with regard to mid market, whereas mega buy out as well as early stage activity turned down. With particular reference to mega deals<sup>4</sup>, in 2004 only two investments were settled (they stand for 23% of total market in amount), in comparison with four in 2003 (57% of the market), three in 2002 (29%), two in 2001 (33%), four in 2000 (31%). The lack of this kind of deals in 2004 should be explained with the expected auctions regarding important acquisitions, that will be probably closed during the first semester of 2005.

Analyzing the distribution of investments by stage, in 2004 the larger part of the investments flew into buy out deals (916 Euro Mln, equal to 62% of the total), followed by expansion deals (458 Euro Mln, equal to 31% of the total). In terms of numbers, on the contrary, it is worth noticing the clear predominance of expansion investments (126 deals, 51% of the total), followed by start ups (50 investments, 20% of the total).

**Table 2 – 2004: Stage distribution of investments**

|               | <b>Amount<br/>(Euro Mln)</b> | <b>%</b>    | <b>Number</b> | <b>%</b>    | <b>No. of<br/>Companies</b> | <b>%</b>    |
|---------------|------------------------------|-------------|---------------|-------------|-----------------------------|-------------|
| Seed/Start-up | 23                           | 2%          | 50            | 20%         | 36                          | 17%         |
| Expansion     | 458                          | 31%         | 126           | 51%         | 111                         | 54%         |
| Replacement   | 83                           | 5%          | 24            | 10%         | 21                          | 10%         |
| Buy out       | 916                          | 62%         | 48            | 19%         | 40                          | 19%         |
| <b>Total</b>  | <b>1.480</b>                 | <b>100%</b> | <b>248</b>    | <b>100%</b> | <b>208</b>                  | <b>100%</b> |

Source: AIFI- PWC

As far as expansion investments are concerned, it's significant the increase of turnaround deals, attracting 32 Euro Mln, regarding 10 different investments. The development of this sector may bring an important

<sup>4</sup> Investments with an amount of equity invested equal or higher than 150 Euro Mln.

contribution to the economical recovery, in particular in the light of the large number of companies facing difficult financial situations.

A more detailed analysis and comparison between venture capital and buy out activity outlined some significant events following opposite trends.

As far as early stage is concerned, during 2004 the average invested amount was 0.5 Euro Mln compared to 0.9 Euro Mln in 2003, whereas in the expansion case, the average amount was 3.6 Euro Mln compared to 3.3 Euro Mln in 2003.

In 2004, 13 players invested at least once in a seed or start up deal, and 38 players invested at least once in an expansion deal. A high level of concentration both in terms of number of investments and of amount invested characterized the early stage segment (the first 5 players accounted for more than 80% of the market both in number and in amount) whereas the expansion one had a strong dispersion.

**Table 3 – Average invested amount (Euro Mln)**

|                               | <b>2003</b> | <b>2004</b> |
|-------------------------------|-------------|-------------|
| Early stage (Seed + Start up) | 0.9         | 0.5         |
| Expansion                     | 3.3         | 3.6         |
| Replacement                   | 3.6         | 3.5         |
| Buy out                       | 38.3        | 19.1        |
| <b>Total</b>                  | <b>9.0</b>  | <b>6.0</b>  |

Source: AIFI - PWC

In terms of buy out, the already mentioned lack of the biggest deals drove down the average size of investment, which was almost halved from 38.3 Euro Mln in 2003 to 19.1 Euro Mln in 2004.

The average debt/equity ratio resulted equal to 1.5, in reduction compared with the correspondent 2003 ratio (1.9).

Considering also the debt capital involved in buy outs, the gross amount of these investments reached around 2.3 Euro Bln, so that the grand total of resources allocated to the industry is higher than to 2.8 Euro Bln.

During 2004 the number of investors that made at least one buy out deal was 30. A high level of concentration characterized the sector (higher than the previous year), as the first five players invested the 72% of the total

amount and realized the 35% of the total number of deals.

Coming back to the whole market, initial investments in number remained unvaried, while the share in amount increased to 78% of the total. Buy out was made by the most number of initial deals (77%), followed by expansion (56%), early stage (42%) and replacement (17%).

In terms of sectoral distribution of target companies, enterprises operating in traditional sectors (manufacturing, consumer goods and industrial products and service) were the largest category overall both in amount invested (54%) and in number (40%). It's important to remind the increasing interest towards consumer goods and well-known brands, which is replacing interest towards more traditional manufacturing industry.

The number of high tech investments declined from 31% in 2003 to 27%, while the amount invested in this kind of target companies collapsed to a mere 5% of the total, stepping back to levels lower than those recorded in 1998, when the new technology concept started to spread among Italian venture capitalists.

The majority of investments (in terms of number) was in small or middle sized companies, as target companies with a number of employees below 200 units represented almost the 80% of the activity, while the previous year the same ratio was 72%. It is also important to notice the presence in 2004 of only two investments in one company with more than 5,000 employees, while in 2003 they represented the 45% of the total market in amount. This distribution in small and middle sized companies is also confirmed by the turnover figures: 89% of total companies receiving capital from investors had a turnover under 250 Euro Mln.

As far as the geographical distribution of investments is concerned, the rise of Italian target companies confirmed a growth of domestic investments. Whereas in terms of domestic deals there was a small increase of target companies located both in the Centre regions (13% of the number and 5% of invested amount) and in the Southern area (9% of the number and 4% of amount), while the Northern regions decreased their share (74% of the number and 90% of the amount). This change is primarily due to the launch

of new funds specialized on geographical area, other than North of Italy. Anyway, once again the largest number of investment was made in Lombardia (27%), followed by Friuli Venezia Giulia with the 16% and Piemonte with the 13%. It is interesting to note that the number of Italian regions where venture capital and private equity players did not invest during the year continued to decrease (only 3 regions) compared to previous years.

In term of activity, Italian closed-end funds and other country funds made the most number of deals (36% of the total) followed by regional, public and cooperative players (26%) and Italian banks and their subsidiaries. The largest amount was always invested by Italian closed-end funds (46%) followed by pan-European funds (38%).

Early stage deals were mostly carried out, apart from specialized fund's advisors, by regional, public and cooperative investors. At the same time later stage activity was referable to Italian closed-end funds in number and to pan-European funds in amount.

The number of active players that invested for at least one time during the year felt to 61, compared to 75 in 2003.

On 31st December 2004, the total portfolio of Italian investors amounted to about 1,150 target companies, with an equivalent value, calculated at cost, of up to 9.0 Euro Bln. At the same date, the total amount available for new investments, excluding pan-European and captive investors, was about 4.8 Euro Bln.

### **Divestment activity**

On the divestments side, in the period 2002-2004 the Italian market has been characterized by an average divested amount equivalent to around 700 Euro Mln, concerning 170 divestments each year.

In particular, in 2004 the total number of divestments was 137, for a total amount, calculated at cost (not including capital gains), almost equal to 647 Euro Mln.

In terms of way out, trade sales (36%) remained the most common exit

channel in number even if, due to difficulties in finding industrial buyers, this way out category decreased compared to previous years. On this regard, it's significant the increase, in percentage, of secondary buy out, representing in number, 11% of all divestments.

The use of the Stock Exchange as a way out increased in comparison with previous years: during 2004 four "venture backed companies" were listed on the Italian Stock Exchange, for a total amount of 120 Euro Mln (19% of total market).

Write offs increased compared to 2003, accounting for 36% in number and 31% in amount.

**Table 4 – 2004: Stage distribution of divestments**

|                     | <b>Amount<br/>(Euro Mln)</b> | <b>%</b>    | <b>Number</b> | <b>%</b>    | <b>No. of<br/>Comp.</b> | <b>%</b>    |
|---------------------|------------------------------|-------------|---------------|-------------|-------------------------|-------------|
| Trade sale          | 200                          | 31%         | 50            | 36%         | 45                      | 41%         |
| IPO/ Sales post-IPO | 186                          | 29%         | 14            | 10%         | 10                      | 9%          |
| Sale to other VCs   | 71                           | 11%         | 15            | 11%         | 14                      | 13%         |
| Other               | 107                          | 16%         | 27            | 20%         | 23                      | 21%         |
| Write off           | 83                           | 13%         | 31            | 23%         | 18                      | 16%         |
| <b>Total</b>        | <b>647</b>                   | <b>100%</b> | <b>137</b>    | <b>100%</b> | <b>110</b>              | <b>100%</b> |

Source: AIFI- PWC

The majority of divestments was due to previous expansion deals (68 over 137), followed by early stage deals and buy outs (each one accounting for 29) and replacement (11).

Italian banks and their subsidiaries were the most active players in divesting (their preferred channel was trade sale), followed by Italian closed-end funds and other generalist country funds.

During 2004, 42 players concluded at least one divestment.

### **Fund raising activity**

Considering fund raising activity, in the last 3 years resources equivalent to 1,900 Euro Mln flew into the Italian industry on average every year.

In detail, in 2004, the total volume of capital raised showed a tendential

stability with respect to 2003 and the previous years, reaching 1,663 Mln Euro.

In particular, 79% (an amount of 1,308 Euro Mln) has been raised on the market from independent funds focused on Italy, 18% (297 Euro Mln) came from parent organisations of captive players and about 3% (58 Euro Mln) were represented by capital gains available for reinvestments. The value raised on the market was almost the same with respect to the 2003 amount and showed an international contribution of about 62%.

During 2004, the total number of Italian private equity and venture capital organizations that made fund raising activity was 11, down from 12 of the previous year, with an average size raised of 120 Euro Mln per fund. It is also important to notice the high level of concentration that characterized the independent fund raising activity: the first three players represented the 86% of the total amount.

**Table 5 – 2004: Sources of new funds raised by country funds**

|                     | <b>New funds raised (Euro Mln)</b> | <b>%</b>    |
|---------------------|------------------------------------|-------------|
| Banks               | 315                                | 24%         |
| Pension Funds       | 274                                | 21%         |
| Funds of Funds      | 204                                | 15%         |
| Corporate Investors | 181                                | 14%         |
| Insurance Companies | 102                                | 8%          |
| Private Individuals | 75                                 | 6%          |
| Government Agencies | 59                                 | 4%          |
| Other               | 98                                 | 8%          |
| <b>Total</b>        | <b>1,308</b>                       | <b>100%</b> |

Source: AIFI- PWC

In terms of sources of new funds, banks were still playing the role of primary capital supplier (24%), but with a reduction in share as to the total raised, followed by pension funds (21%, with the biggest amount ever recorded in Italy) and funds of funds (15%). It's worth noticing that pension funds rose 80% compared to 2003.

However, with regard to pension funds contribution, it's to be noticed that it came for 100% from non domestic investors, while banks contribution came

for 49% from Italy and for 51% from abroad, funds of funds contribution 7% from Italy and 93% from abroad and corporate investors 78% from Italy and 22% from abroad.

As far as geographical origin of country funds raising activity is concerned, the domestic market decreased by 34%, mainly owing to the international origin of pension funds.

Of the funds raised in 2004, 64% is expected to be allocated to buy outs, 31% to expansion deals, while only 2% to early stage deals.

## **Methodology and definitions**

The research, realized through the use of questionnaires put forward of the investors, analyses the investment, divestment and fund raising activity of the considered period.

The research unit consists of investment organization (management company, advisor,...) and not of the single fund managed.

As far as the investment activity is concerned, the aggregated figures refers to the equity and semi-equity used in the deal and not to the total value of the transaction.

The total dimension of the market is composed by:

- amount invested, in Italian and international companies, by national players;
- amount invested, in Italian companies, by pan-European players with an advisory company in Italy.

Following the international methodology, the Survey uses this investment stage classification:

**Seed** includes:

**Seed** - Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase.

**Start-up** includes:

**Start-up** - Financing provided to companies for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but have not sold their product commercially.

**Other Early Stage** - Financing to companies that have completed the product development stage and require further funds to initiate commercial manufacturing and sales. They will not yet be generating a profit.

**Expansion** includes:

**Expansion** - Financing provided for the growth and expansion of an

operating company, which may or may not be breaking even or trading profitably. Capital may be used to finance increased production capacity, market or product development, and/or to provide additional working capital.

**Bridge Financing** - Financing made available to a company in the period of transition from being privately owned to being publicly quoted.

**Rescue/Turnaround** - Financing made available to existing business, which has experienced trading difficulties, with a view to re-establishing prosperity.

**Replacement Capital** includes:

**Secondary Purchase/Replacement Capital** - Purchase of existing shares in a company from another private equity investment organization or from another shareholder or shareholders.

**Refinancing Bank Debt** - To reduce a company's level of gearing.

**Buy out** includes:

**Management Buy out** - Financing provided to enable current operating management and investors to acquire existing product line or business.

**Management Buy in** - Financing provided to enable a manager or group of managers from outside the company to buy-in to the company with the support of private equity investors.

**Venture Purchase of Quoted Shares** - Venture Purchase of quoted shares with the purpose of de-listing the company.

According to further statistical elaborations, the whole market of private equity has been divided in:

**Venture Capital:** including Seed, Start-up and Expansion;

**Buy out:** including Replacement Capital and Buy out.

The **divestment activity** refers to the total value of the divestments calculated at cost and not at sale price.

Finally, the **fund raising activity** refers to:

- independent investors with specific focus on Italian market (country funds);
- Italian captive investors that did not carry out independent fund raising activity, but receive capitals from parent organizations. In this case the amount invested was considered, by convention, also as raised capital in the same period.

Pan-European and worldwide investors are not considered in fund raising figures.



With reference to tax and legal developments, the year 2004 basically saw the enactment of normatives, resulting from reforms ended in the previous year.

## **Corporate Law**

There have not been significant changes in Italian corporate law in the last months.

From 1<sup>st</sup> January 2004, the reform of Corporate Law<sup>1</sup>, enacted by Legislative Decree n. 6/2003, became effective. Under the new corporate rules, the more relevant items concern:

- the introduction of a specific regulation on LBO that expresses a new generally positive approach towards LBOs, making it clear that a merger between two companies where one has borrowed funds to buy the other, will not necessarily breach the prohibition on financial assistance;
- the possibility for corporations to choose from among a broad range of possible financial instruments, including non voted shares and subordinated equity and hybrid securities between debt and equity. These new rules creates a more flexible corporate law, opening different opportunities for private equity agreements and for corporate governance in the target companies;
- new instruments to incentive management thanks to the new financing instruments that offer an interesting alternative to the classical equity and ratchet structures for management companies: equity providers may assist the management and pay for its initial equity participation, alternatively, the acquisition vehicle may issue subordinated shares cheaper than ordinary equity;
- the possibility for corporations (those incorporated as SpAs) to choose

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<sup>1</sup> For more details see AIFI, Allen&Overly "Italy's corporate reform and private equity transactions", 2004.

between three alternative corporate governance models: in addition to the traditional model, where shareholders appoint a board of directors and a board of auditors, shareholders can set up companies with a dual board system comprising a management board and a supervisory board, or they can set up a company with a unitary board system with a board of directors and an independent internal audit committee;

- the relationship between executive and non-executive directors and their respective duties, tasks and liabilities: in this respect it must be said that the role of non executive directors is completely transformed and that, they will no longer be liable in the same manner and degree as executive directors;
- less restrictions on debt issues; the new rules relax limits on the amount of bonds that SPAs can issue and allow for subordination.

## **Taxation**

The reform of the Italian tax system, effective from 1<sup>st</sup> January 2004, has significantly implemented corporate income taxation<sup>2</sup>. In particular, the key changes under the tax reform regard:

- participation exemption on capital gains on disposal of shareholdings (100%) and on dividends received (95%);
- thin capitalization rules, limiting the tax deduction of interest on loans from or guaranteed by shareholders if the loans exceed a given debt to equity ratio;
- tax consolidation, allowing groups of companies to consolidate profits and losses under certain conditions;
- consortium relief, allowing holding companies to treat their investments in companies which they do not control as transparent for tax purposes;
- corporate income tax rate (IRES) reduced to 33%.

With reference to the taxation of Italian closed-end funds in general, funds

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<sup>2</sup> For more details see AIFI, Pirola Pennuto Zei & Associati, " The taxation of private equity in Italy", 2004.

are not liable to ordinary income tax, therefore they are not subject to IRES, nor IRAP (Regional income tax).

At fund level, Italian closed-end fund may be regarded as a transparent entity depending on the status (resident or not-resident) of its subscribers:

- if the fund is wholly subscribed by non-Italian resident individuals, income deriving from the fund is 100% exempt from income tax;
- if the fund is partially subscribed by non-Italian resident individuals, a substitutive income tax of 12,5%<sup>3</sup> applies to the management result of the investment fund at the year-end; if the result is a loss, this can be carried forward to subsequent periods or the management company may transfer the loss to other funds managed by itself.

Also with regard to the taxation at investors level, a distinction between Italian and non-resident investors has to be done:

- for Italian individual investors, capital gains coming from the fund are not subject to taxation;
- for Italian corporate investors, proceeds from the fund are included in the computation of taxable profits subject to IRES with an entitlement to a tax credit at a rate of 15% of the income received;
- non resident investors collecting proceeds from a wholly non-resident investor subscribed fund, are not subject to any withholding tax at source;
- non resident investors collecting proceeds from a partially non-resident investor subscribed fund, are entitled to the refund of 15% of the income received.

## **Bankruptcy Law**

Italian Bankruptcy Law reform is in process.

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<sup>3</sup> Italian closed-end funds which own a shareholding of more than 10% of the voting rights (in listed companies) or 50% of the voting rights (in non-listed companies), have less than 100 investors and less than 50% of the investors is represented by qualified investors, are subject to taxation at a rate of 27% on the portion of the management result corresponding to the capital gains on such shareholding.

It is to be underlined that some of AIFI's instances have been introduced in the "Action Plan on competitiveness" approved by the Government in March 2005, containing several changes; following the most relevant:

- as regard the lapse provision, the relative term of expiration has been reduced to 5 years;
- the arrangement with creditors, becomes the main instrument to solve cases of distressed companies;
- it has been introduced an exemption from solving debts to creditors for the entrepreneurs who don't impede the procedure of which above.

### **Closed-end funds regulation**

Banca d'Italia, in compliance with the EU Directives no. 2001/107/CE and 2001/108/CE, at press time is drafting a new regulation that provides amendments to the current rules in matter of Management Company and Collective Investments funds. The definitive document, which should be approved in 2005, will contain some important news:

- the possibility, with respect to the activities allowed to management companies, to carry out advisor services for target companies;
- more possibilities for management companies to borrow in special situations;
- the possibility to invest in quoted shares in public to private deals;
- the enlargement, concerning the organizational structure, of the activities to externalize, provided that the management company holds control on the outsourcing activities;
- the forecasting, as regards the approval of information memorandum for management companies, of standard schemes that, if adopted, speed up the approval iter.

On this last point, AIFI has elaborated a new information memorandum on fund of funds and an updating of the standard information memorandum for funds reserved to qualified investors.

## Introduction

Since 1996, KPMG Corporate Finance, in co-operation with AIFI, is carrying out, on yearly basis, the analysis of the Italian private equity and venture capital industry performance.

The present survey includes a significant sample of the most important Italian private equity and venture capital houses and has been carried out in order to assess the performance of the sector, as explained in the following pages.

Until 2003, the analysis has always been conducted on a Pooled Gross IRR on Realised Investment<sup>2</sup> level only. Since the past edition, in order to give a more comprehensive representation of the performance of the Italian market and to align the performance measurement to the European and international standards, Pooled Gross IRR on All Investments<sup>3</sup> analysis has been introduced.

Gross IRR on Realised Investments offers a "realistic" description of the market as it considers divestments transaction only, but it just expresses the performance of the realised segment of the private equity industry, with no reference to the implicit performances of the investments still in the portfolios of the market players.

On the other hand, the second level of IRR, the Gross IRR on All Investments offers a wider perspective of the market performance, even if it might underestimate the overall performance of the market, being stakes in portfolio very often prudentially valued at cost by investors.

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<sup>1</sup> The analysis has been realized in co-operation with KPMG Corporate Finance.

<sup>2</sup> According to the EVCA criteria this level of performance takes account of investments (cash outflows) and divestments (cash inflows) in which the private equity and venture capital companies have sold at least the 30% of the initial investment in equity. In case of partial divestments only the related part of total cash out have been considered.

<sup>3</sup> The second level of IRR considers both realised and in portfolio investments, no matter if the divestment has been partial.

Therefore, in the following pages are reported the outputs of the analysis carried out to better illustrate dynamics and trends of market performances, considering:

- one-year Pooled Gross IRR on Realised Investments from inception (transaction registered in 2004);
- historical Pooled Gross IRR on Realised Investments since inception (1986-2004);
- ten, five and three-years horizon Pooled Gross IRR on All Investments (1995-2004, 2000-2004, 2002-2004).

Performances have been measured in terms of pooled IRR, considering all the cash flows on which data are available, aggregated as if they resulted from the transactions carried out by a single fund.

### **Pooled Gross IRR on Realised Investments during 2004**

Accordingly to the past edition survey, first of all the analysis of the 2004 Gross IRR from inception on realised transactions is presented.

**Table 1 – IRR from inception analysis: main sample features**

|                                                 | <b>2004</b> | <b>2003</b> | <b>2002</b> | <b>2001</b> | <b>2000</b> |
|-------------------------------------------------|-------------|-------------|-------------|-------------|-------------|
| N° of companies included in the research panel  | 39          | 41          | 59          | 62          | 56          |
| N° of companies presenting realised investments | 21          | 18          | 20          | 22          | 22          |
| N° of realised investments from inception       | 69          | 96          | 62          | 69          | 80          |
| Average investment dimension (Euro Mln)         | 6.2         | 4.5         | 5.1         | 5.1         | 2.8         |
| Total Cash Out (Euro Mln)                       | 429         | 432         | 314         | 350         | 225         |
| Total Cash In (Euro Mln)                        | 883         | 672         | 641         | 679         | 713         |

*Source: KPMG Corporate Finance*

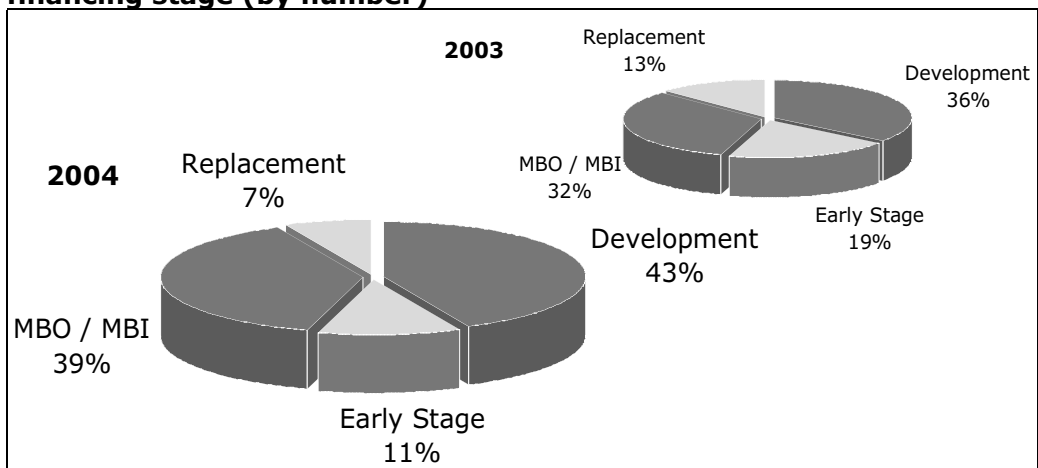
In the present survey, in comparison to 2003 analysis, the number of companies presenting realised investments remained substantially stable, as well as the sample, showing 39 companies included in the research panel. Moreover, it is important to notice the growth of the average investment dimension (+38%) during 2004, confirmed by a total Cash Out aligned to 2003 value in conjunction with a reduction of realised deals' number. After four years, for the first time, total Cash In value exceeded 2000 value. The number of realised investments from inception, on which

has been performed the following analyses, came back substantially to 2001-2002 levels after the exceptional level of 2003, which showed 25 investments written off or divested under the book value (97 Euro Mln of Cash Out and 86 Euro Mln of Cash In), while, in 2004, 15 investments were written off or realized under the book value, corresponding to 74 Euro Mln in terms of Cash Out and 18 Euro Mln in terms of Cash In.

Transactions included in the panel show a decrease in terms of number of investments (-28% compared to last year data).

2004 analysis confirmed last year trend, showing a consolidation of the market around MBO/MBI and Development transactions, while Replacement and Early Stage realised deals confirmed in 2004 a further light reduction in comparison with 2003.

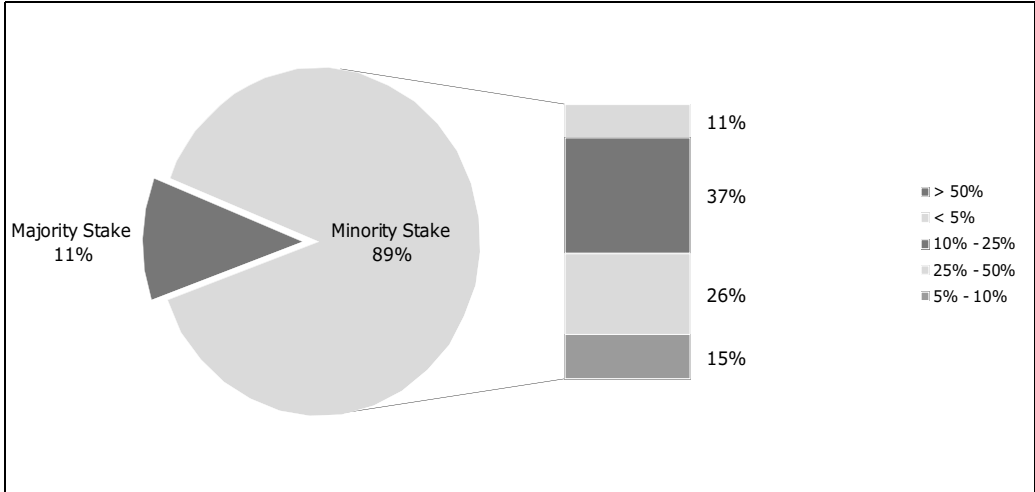
**Chart 1 - IRR from inception analysis: transactions breakdown by financing stage (by number)**



Source: KPMG Corporate Finance

As of 2003, the majority of transactions has been related to minority stakes (respectively 89% and 90% in 2004 and 2003). More specifically, the most common transaction (over 60% of the overall panel) is associated to an acquired stake between 10% and 50%. At this regard, it has to be noted that all investments have been analysed on a stand-alone basis, without taking into account possible pool agreements, among some of the private equity and venture capital houses, which might have acquired, jointly, majority stakes.

**Chart 2 - IRR from inception analysis: transactions breakdown by acquired stakes (by number)**



Source: KPMG Corporate Finance

In terms of target sales breakdown it has to be noted a decrease between 2003 and 2004 in the number of transactions related to companies with a turnover under 25 Euro Mln, bringing to a substantial consistency among the deals distribution by target sales.

**Chart 3 - IRR from inception analysis: transactions breakdown by target sales dimension (by number)**



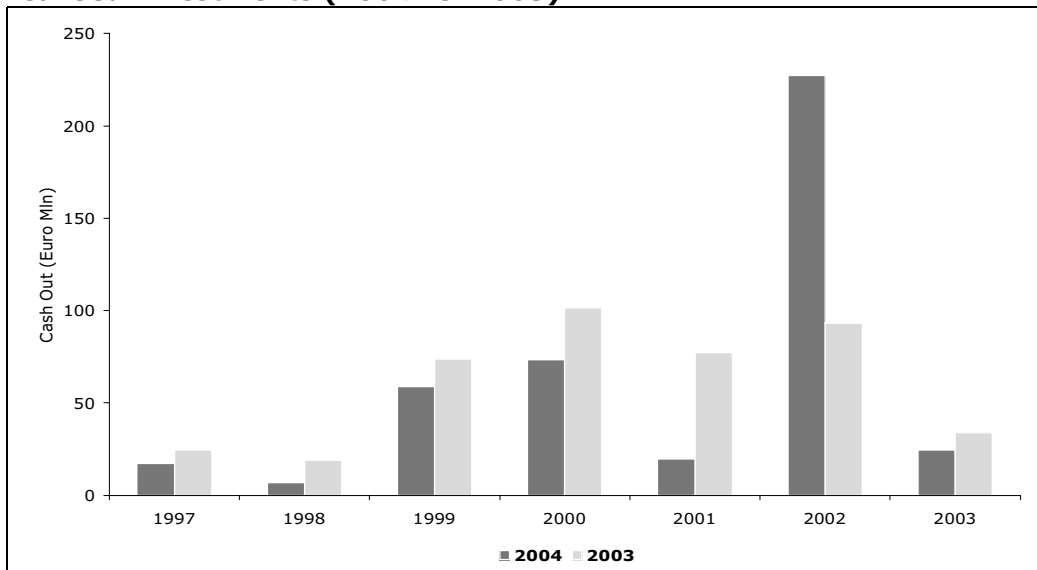
Source: KPMG Corporate Finance

2004 pool breakdown analysis shows that the majority of transaction (51%) has been managed not in pool, with a relative increase, consistent with the trend registered in last few years (respectively 43% and 39% in 2003 and 2002).

Summarizing, the majority of divestments realised in 2004 has been related to transactions of minority stakes invested in middle-size companies during their development stage or subject to MBO/MBI operations, mainly managed not in pool.

In terms of average holding period between the first investment and divestment, transactions realised within five years decreased from 86% in 2003 to 68% of the overall amount. Furthermore, the majority of transactions included in the panel are related to investments performed in 2002.

**Chart 4 - IRR from inception analysis: annual Cash Out related to realised investments (2004 vs. 2003)<sup>4</sup>**



Source: KPMG Corporate Finance

According to the international standard criteria related to the first level of IRR, the Italian private equity and venture capital houses' performances in

<sup>4</sup> The overall amount of Cash Out related to realised investments in 2004 has been 0,31 Euro Mln.

2004 are presented, in the following, as pooled internal rate of return from inception (as shown in Table 2).

**Table 2 – IRR from inception by year in 2000, 2001, 2002, 2003 and 2004**

|                                               | 2004         | 2003  | 2002  | 2001  | 2000  |
|-----------------------------------------------|--------------|-------|-------|-------|-------|
| Number of realised investments from inception | 69           | 96    | 62    | 69    | 80    |
| <b>Yearly Pooled IRR</b>                      | <b>24.7%</b> | 17.8% | 34.9% | 34.2% | 47.1% |

Source: KPMG Corporate Finance

The Yearly Pooled Gross IRR on realised investments from inception in 2004 was equal to 24.7%, showing a substantial increase from 2003 performance despite it did not recover 2000 and 2002 levels.

The Upper Quarter per performances analysis registered values decreasing to 59%, confirming a trend showing a substantial distribution alignment of realised deals to average panel returns. The Upper Quarter per dimension realised an IRR of 27%.

**Table 3 – IRR from inception by year: Upper Quarters**

|                                           | 2004  | 2003  | 2002  | 2001  | 2000  |
|-------------------------------------------|-------|-------|-------|-------|-------|
| Yearly Pooled IRR                         | 24.7% | 17.8% | 34.9% | 34.2% | 47.1% |
| Upper Quarter (per performances)          | 59%   | 79%   | 108%  | 168%  | 201%  |
| Upper Quarter (per investments dimension) | 27%   | 17%   | 43%   | 9%    | 54%   |

Source: KPMG Corporate Finance

**Table 4 – IRR from inception distribution by IRR categories**

|                    | 2004   |               | 2003   |               |
|--------------------|--------|---------------|--------|---------------|
|                    | Number | Incidence (%) | Number | Incidence (%) |
| Write Off/Negative | 15     | 21.7%         | 25     | 26.0%         |
| 0% - 10%           | 22     | 31.9%         | 34     | 35.4%         |
| 10% - 20%          | 9      | 13.0%         | 6      | 6.3%          |
| 20% - 30%          | 7      | 10.1%         | 6      | 6.3%          |
| 30% - 40%          | 3      | 4.3%          | 4      | 4.2%          |
| 40% - 50%          | 2      | 2.9%          | 4      | 4.2%          |
| 50% - 100%         | 5      | 7.2%          | 8      | 8.3%          |
| 100% - 500%        | 4      | 5.8%          | 7      | 7.3%          |
| > 500%             | 2      | 2.9%          | 2      | 2.1%          |

Source: KPMG Corporate Finance

The most frequent range of return is between 0% and 30% (55% of the sample), while the number of write off and negative performances decreased from 26% in 2003 to 22% in 2004. Moreover, performances, which registered a return between 0% and 10%, still remain the most common ones.

**Table 5 – IRR from inception distribution by way out**

|                   | Trade Sale |       | IPO/Sales post IPO |        | Other |        |
|-------------------|------------|-------|--------------------|--------|-------|--------|
|                   | 2004       | 2003  | 2004               | 2003   | 2004  | 2003   |
| N. of Transaction | 51         | 77    | 10                 | 5      | -     | 2      |
| Yearly Pooled IRR | 24.3%      | 21.3% | 50.5%              | 113.2% | -     | 45.28% |

Source: KPMG Corporate Finance

The number of investments realised through trade sales way-out<sup>5</sup> decreased but registered a performance improvement confirming the overall trend. Deals through IPO doubled in terms of number, reaching an incidence (34% in term of Cash Out) significantly higher than previous years levels. IPO performances, instead, decreased to approximately 50% likely due to both specific deals included in 2004 panel and general stock market dynamics.

**Table 6 – IRR from inception distribution by financing stage**

|                    | Early Stage |        | Development |      | MBO/MBI |       | Replacement |       |
|--------------------|-------------|--------|-------------|------|---------|-------|-------------|-------|
|                    | 2004        | 2003   | 2004        | 2003 | 2004    | 2003  | 2004        | 2003  |
| Transaction Number | 5           | 12     | 19          | 22   | 17      | 20    | 3           | 8     |
| Yearly Pooled IRR  | 30.5%       | -10.6% | -6.7%       | 8.4% | 49.3%   | 34.6% | 15.3%       | -3.8% |

Source: KPMG Corporate Finance

IRR analysis by financing stage confirms the MBO/MBI transactions as the most profitable. The 2004 data shows, as well, a recover of the performances of Early Stage and Replacement investments. The Development deals are influenced by written off transactions: excluding them from the analysis, the resulting IRR would be higher than the previous year (14.9%).

<sup>5</sup> Way outs trough trade sales may include secondary buy-outs.

Tables presented below show some further analyses of the 2004 Italian private equity's performance from inception<sup>6</sup>.

**Table 7 – IRR from inception distribution by transactions managed within pool and transactions not realised in pool**

|                   | Within Pool |       | Out of Pool |       |
|-------------------|-------------|-------|-------------|-------|
|                   | 2004        | 2003  | 2004        | 2003  |
| N. of Transaction | 22          | 30    | 23          | 23    |
| Incidence         | 49%         | 57%   | 51%         | 43%   |
| Yearly Pooled IRR | 12.2%       | 28.3% | 40.5%       | 13.0% |

|                       | Pool < 50 |      | Pool > 50 |       |
|-----------------------|-----------|------|-----------|-------|
|                       | 2004      | 2003 | 2004      | 2003  |
| N. of Transaction     | 4         | 13   | 18        | 17    |
| Incidence within Pool | 18%       | 43%  | 82%       | 57%   |
| Yearly Pooled IRR     | 34.0%     | 4.4% | 10.4%     | 54.8% |

Source: KPMG Corporate Finance

**Table 8 – 2004 IRR from inception distribution by time gap between first investment and divestment**

|                   | < 2   | 2-3   | 3-4  | 4-5  | 5-7   | > 7  |
|-------------------|-------|-------|------|------|-------|------|
| N. of Transaction | 16    | 12    | 7    | 12   | 16    | 6    |
| Incidence         | 23%   | 17%   | 10%  | 17%  | 23%   | 9%   |
| Yearly Pooled IRR | 74.9% | 55.7% | 6.0% | 0.9% | 11.2% | 2.1% |

Source: KPMG Corporate Finance

### **Historical Pooled Gross IRR on Realised Investments since Inception (1986-2004)**

In order to analyse the whole panel of transactions realised since inception (from 1986), is presented the analysis of historical Yearly Pooled Gross IRR on realised investments results.

The historical performance showed a slight decrease, realising an IRR of 30.6% due to the incidence of 2004 realised investments on the overall values. Confirming historical trend, the average investments dimension

<sup>6</sup> Please note that, in the following tables, the total transactions considered can be less than 69 due to a lack of specific information/details related to certain transactions: accordingly, the related incidence is calculated, case by case, on the number of transactions effectively analysed.

increased up to 4.0 Euro Mln.

**Table 9 – Historical IRR since inception analysis**

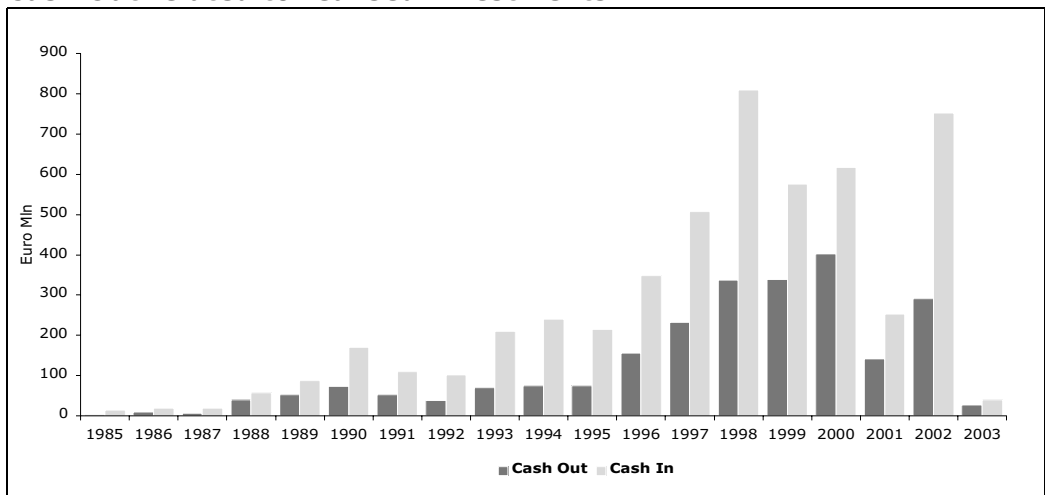
|                                                     | 1986–2004    | 1986–2003    |
|-----------------------------------------------------|--------------|--------------|
| Number of companies presenting realised investments | 43           | 43           |
| Number of realised investments from inception       | 612          | 548          |
| Average investment dimension (Euro Mln)             | 4.0          | 3.7          |
| Total Cash Out (Euro Mln)                           | 2,418        | 2,041        |
| Total Cash In (Euro Mln)                            | 5,149        | 4,310        |
| <b>Yearly Pooled IRR</b>                            | <b>30.6%</b> | <b>30.9%</b> |

Source: KPMG Corporate Finance

The historical sample analysis shows that the majority of realised investments has been concluded within 4 years (67% of the sample). The majority of the deals was focused on companies with no more than 50 Euro Mln turnover (approximately 60% of the sample), related to Development stage or MBO/MBI and well distributed within or without Pool transactions.

In order to give a complete overview, tables below report some analyses related to the historical performance since inception of all the transactions monitored in relation to the 1986-2004 period.

**Chart 5 – Historical IRR since inception analysis: annual Cash In / Cash Out related to realised investments<sup>7</sup>**



Source: KPMG Corporate Finance

<sup>7</sup> The overall amount of Cash In and Cash Out related to realised investments in 2004 has been respectively 0,65 Euro Mln and 0,31 Euro Mln.

**Table 10 – Historical IRR since inception: Upper Quarters**

|                                          | 1986-2004 |
|------------------------------------------|-----------|
| Yearly Pooled IRR                        | 30.6%     |
| Upper Quarter (per performances)         | 121%      |
| Upper Quarter (per investment dimension) | 30%       |

Source: KPMG Corporate Finance

**Table 11 - Historical IRR since inception distribution by financing stage**

|                    | 1986-2004   |             |         |             |
|--------------------|-------------|-------------|---------|-------------|
|                    | Early Stage | Development | MBO/MBI | Replacement |
| Transaction Number | 63          | 239         | 168     | 77          |
| Yearly Pooled IRR  | 30.3%       | 20.2%       | 47.5%   | 31.9%       |

Source: KPMG Corporate Finance

**Table 12 - Historical IRR since inception distribution by IRR categories**

|                    | 1986-2004 |               |
|--------------------|-----------|---------------|
|                    | Number    | Incidence (%) |
| Write Off/Negative | 111       | 18.1%         |
| 0% - 10%           | 135       | 22.1%         |
| 10% - 20%          | 93        | 15.2%         |
| 20% - 30%          | 52        | 8.5%          |
| 30% - 40%          | 38        | 6.2%          |
| 40% - 50%          | 37        | 6.0%          |
| 50% - 100%         | 75        | 12.3%         |
| 100% - 500%        | 53        | 8.7%          |
| > 500%             | 18        | 2.9%          |

Source: KPMG Corporate Finance

**Table 13 - Historical IRR since inception distribution by acquired stakes**

|                   | 1986-2004 |        |         |         |       |
|-------------------|-----------|--------|---------|---------|-------|
|                   | <5%       | 5%-10% | 10%-25% | 25%-50% | >50%  |
| N. of Transaction | 73        | 93     | 175     | 137     | 44    |
| Incidence         | 14%       | 18%    | 34%     | 26%     | 8%    |
| Yearly Pooled IRR | 14.3%     | 29.4%  | 20.5%   | 33.0%   | 44.4% |

Source: KPMG Corporate Finance

**Table 14 - Historical IRR since inception distribution by time gap between first investment and divestment**

|                   | 1986-2004 |       |       |       |       |      |
|-------------------|-----------|-------|-------|-------|-------|------|
|                   | < 2       | 2-3   | 3-4   | 4-5   | 5-7   | > 7  |
| N. of Transaction | 177       | 138   | 93    | 55    | 93    | 56   |
| Incidence         | 29%       | 23%   | 15%   | 9%    | 15%   | 9%   |
| Yearly Pooled IRR | 78.9%     | 53.8% | 50.5% | 15.4% | 18.0% | 8.5% |

Source: KPMG Corporate Finance

### **Pooled Gross IRR on All Investments by horizon**

As anticipated, in order to increase the comparability of Italian private equity performances survey with European ones, since last year, also an analysis of the Pooled Gross IRR on All Investments (by horizon)<sup>8</sup> has been introduced.

**Table 15 – Horizon Pooled Gross IRR on All Investments analysis to 31 December 2004**

|                                            | 10 YR        | 5 YR         | 3 YR         |
|--------------------------------------------|--------------|--------------|--------------|
| Number of companies presenting investments | 50           | 46           | 34           |
| Number of transactions                     | 637          | 333          | 175          |
| Average investment dimension (Euro Mln)    | 8.0          | 10.8         | 14.4         |
| Total Cash Out (Euro Mln)                  | 5,072        | 3,609        | 2,517        |
| Total Cash In (Euro Mln)                   | 7,013        | 4,249        | 2,917        |
| <b>Yearly Pooled IRR</b>                   | <b>22.3%</b> | <b>10.0%</b> | <b>12.5%</b> |

Source: KPMG Corporate Finance

Within Yearly Pooled IRR on All Investments by horizon analysis, it has to be considered the potential different impacts of the dynamics in terms of realised transactions' performances versus valorisation of investments still in portfolio.

Taking into account, as a general reference ten years results, the Yearly Pooled IRR on All Investment by horizon analysis show a decrease due to the different dynamics related to the realised transactions and the

<sup>8</sup> No analytical exercise has been performed in order to estimate the Net IRR. However, in order to provide broad indications useful to estimate the Net IRR, empirical analyses, based on assumptions related to common market practice, would seem to show that, generally speaking, Net IRR (excluding all taxes effects and transaction fees incurred by the investors in disposing of any distributed securities) would fell in the range of 50% - 65% of Gross IRR on All Investments.

investments still in portfolio.

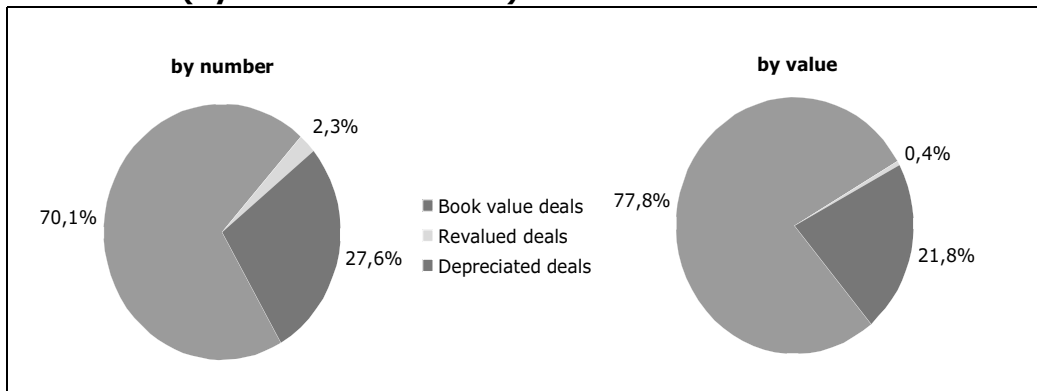
In fact, the ten years analysis panel counts 438 realised transactions for 1,890 Euro Mln (Cash Out) and for 3,814 Euro Mln (Cash In) and 214 investments still in portfolio, counting for 3,182 Euro Mln (Cash Out). It has to be noted that 15 investments has been partially divested in the period: this has been considered, in relation to the above mentioned numbers, both into "realised transactions" sub-panel and into "investments still in portfolio" sub-panel, while, in the performance calculation and in Cash Out terms, these investments have been properly accounted "pro-quota" in both sub-panels.

Realised transactions in ten years panel registered an IRR equal to 43.0% compared to 49.7% in 2003 mainly due to:

- insertion of 69 realised transactions counting for 429 Euro Mln (Cash Out value), which realised an IRR equal to 24.7%;
- exclusion of 43 realised deals (invested in 1994) counting for 102 Euro Mln (Cash Out value), which realised an IRR equal to 60.7%.

Investments still in portfolio in ten years panel registered an IRR equal to -2.7% (compared to -1.4% in 2003), as they have been mostly reported at book values or depreciated as shown below.

**Chart 6 – 10YR horizon IRR analysis: investments still in portfolio breakdown (by number and value)**



Source: KPMG Corporate Finance

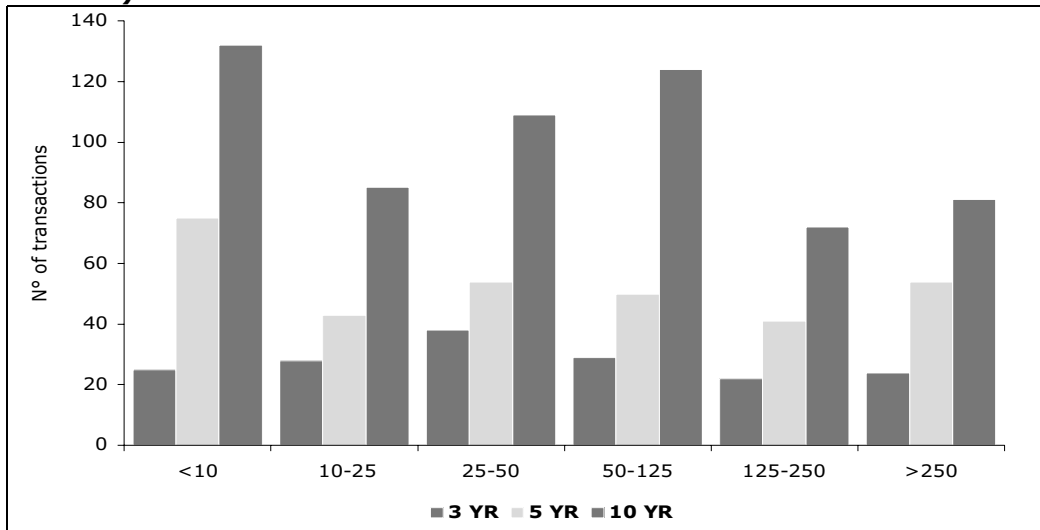
**Table 16 – Horizon IRR distribution by financing stage**

|                   | Early Stage | Development | MBO/MBI | Replacement |
|-------------------|-------------|-------------|---------|-------------|
| N. of Transaction | 6           | 49          | 81      | 23          |
| IRR 3 YR          | -7.7%       | -2.8%       | 16.7%   | 1.8%        |
| N. of Transaction | 40          | 102         | 103     | 37          |
| IRR 5 YR          | -5.7%       | -0.2%       | 16.4%   | 22.4%       |
| N. of Transaction | 61          | 227         | 186     | 75          |
| IRR 10 YR         | 6.4%        | 17.6%       | 47.1%   | 24.9%       |

Source: KPMG Corporate Finance

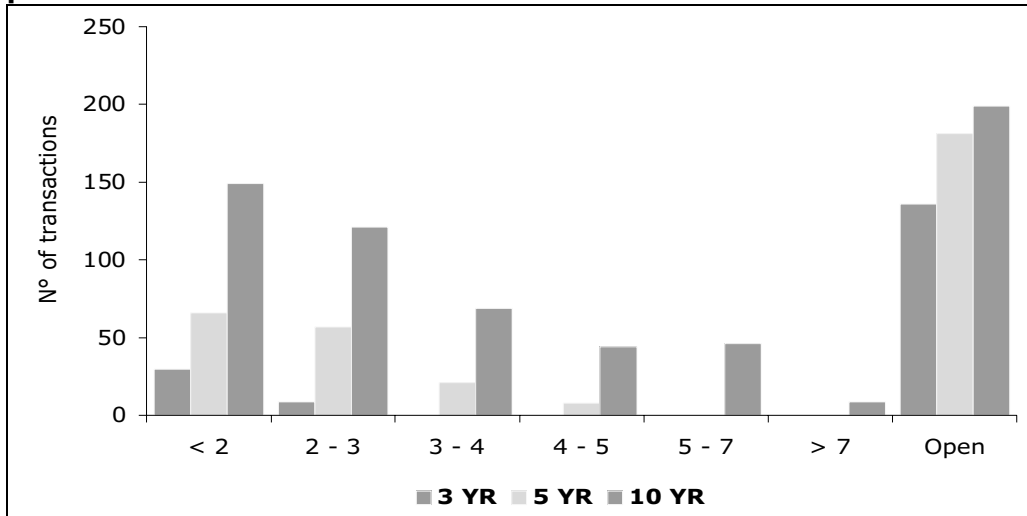
As far as result from Pooled Gross IRR on All Investments by horizon analysis, deals are generally focused on Development stage and/or are related to MBO/MBI transactions (representing together the 82%, 73% and 75% of the sample respectively in 3YR, 5YR and 10YR analyses), coherently with the “from inception” analysis. The examined panel shows a consistent distribution between transaction managed within pool and out of pool (51% in 3YR sample, 52% in 5YR sample and 55% in 10YR sample vs. respectively 53%, 57% and 54% in 2003).

**Chart 7 – Transaction breakdown by target sales dimension (by number)**



Source: KPMG Corporate Finance

**Chart 8 – Horizon IRR analysis: transaction breakdowns by holding period**



Source: KPMG Corporate Finance

The transactions average duration of the analysed panel has been less than 4 years.

The results of the proposed analysis, consistently with the past survey's edition, are illustrated in the following tables.

**Table 17 - Horizon IRR distribution by target sales dimension (Euro Mln)**

|                   | <10    | 10-25 | 25-50 | 50-125 | 125-250 | >250  |
|-------------------|--------|-------|-------|--------|---------|-------|
| N. of Transaction | 25     | 28    | 38    | 29     | 22      | 24    |
| IRR 3 YR          | -22.3% | -0.7% | 12.3% | 21.1%  | 29.8%   | 4.4%  |
| N. of Transaction | 75     | 43    | 54    | 50     | 41      | 54    |
| IRR 5 YR          | -9.6%  | -0.7% | 5.3%  | 7.2%   | 21.3%   | 11.8% |
| N. of Transaction | 132    | 85    | 109   | 124    | 72      | 81    |
| IRR 10 YR         | 48.4%  | 7.5%  | 21.5% | 45.5%  | 24.6%   | 11.8% |

Source: KPMG Corporate Finance

**Table 18 – Horizon IRR: Upper Quarters**

|                                          | 3 YR  | 5 YR  | 10 YR |
|------------------------------------------|-------|-------|-------|
| Yearly Pooled IRR                        | 12.5% | 10.0% | 22.3% |
| Upper Quarter (per performances)         | 54%   | 46%   | 86%   |
| Upper Quarter (per investment dimension) | 16%   | 12%   | 9%    |

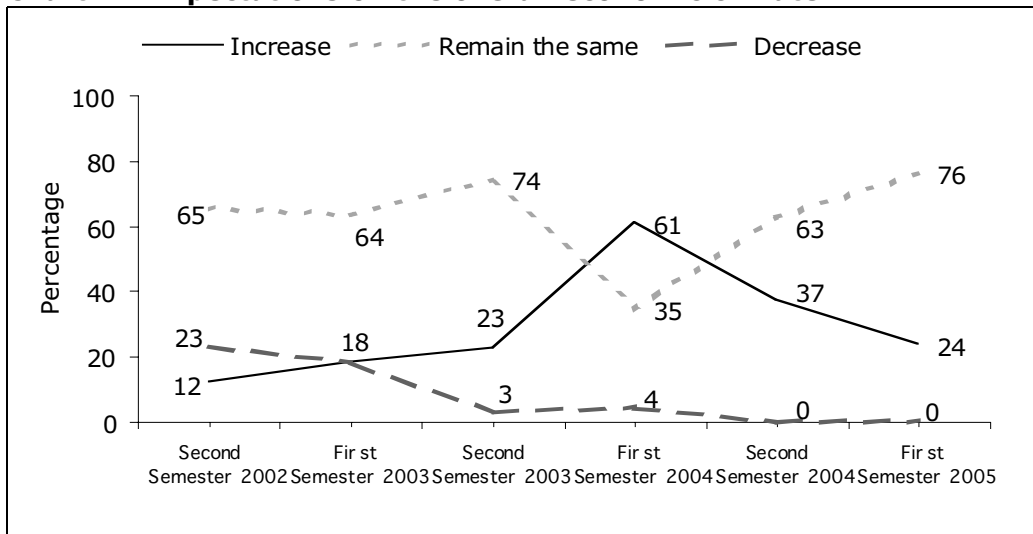
Source: KPMG Corporate Finance

# The Expectation of the Private Equity Players for the Year 2005<sup>1</sup>

The Private Equity Advisory Team of Deloitte Financial Advisory Services has performed its six-monthly review of the Italian Private Equity and Venture Capital market to form a view of the expectations of the main players and to anticipate the possible trends looking forward into 2005.

With respect to the Italian Private Equity Confidence Survey performed during the last months of 2004, the expectations of the future economic trends show an increase in the number of players that believe in a continued stability of the economy; this trend that started in the first semester 2004 is probably due to the perceived lack of competitiveness in the Italian economy from a global perspective. Given this the number of players that believe in an improvement in the economic outlook decreased to 24%, as shown in Chart 1. No one forecasts a decrease in the economic situation compared to 2004.

**Chart 1 – Expectations on the overall economic climate**

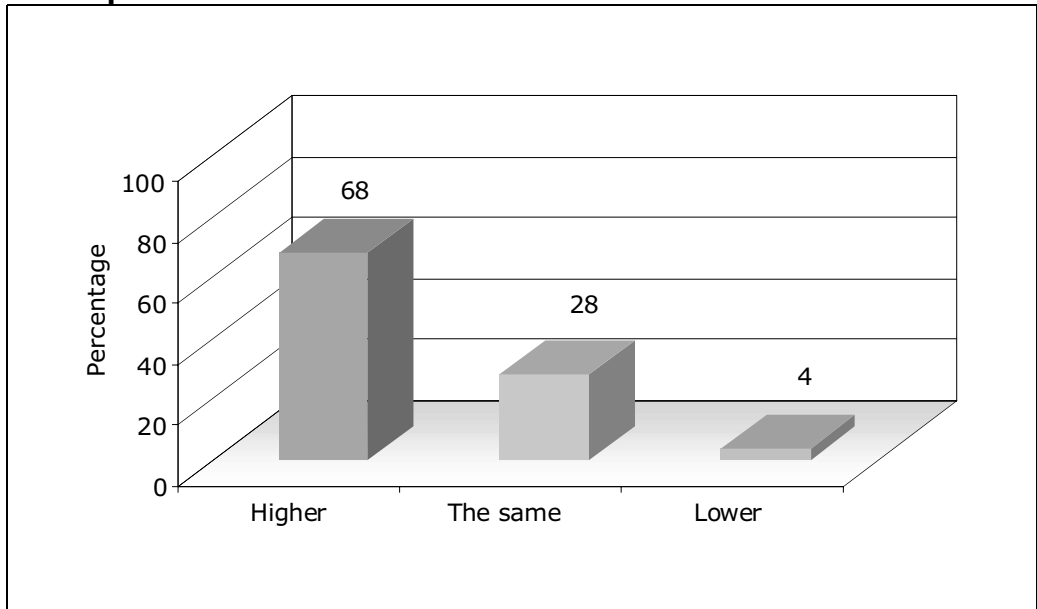


Source: Deloitte Italy Private Equity Confidence Survey

<sup>1</sup> The analysis has been realized by Deloitte Financial Advisory Services.

As reported in Chart 2, notwithstanding the sentiment with regards to the economic climate, the 68% of the players believe that the value of their portfolios will increase in the first six months of 2005 (compared to 70% in the first semester of 2004), while only 4% of them foresee a decrease. These expectations substantially confirm the data from the first semester of 2004 and give positive feelings for the potential growth in the sector.

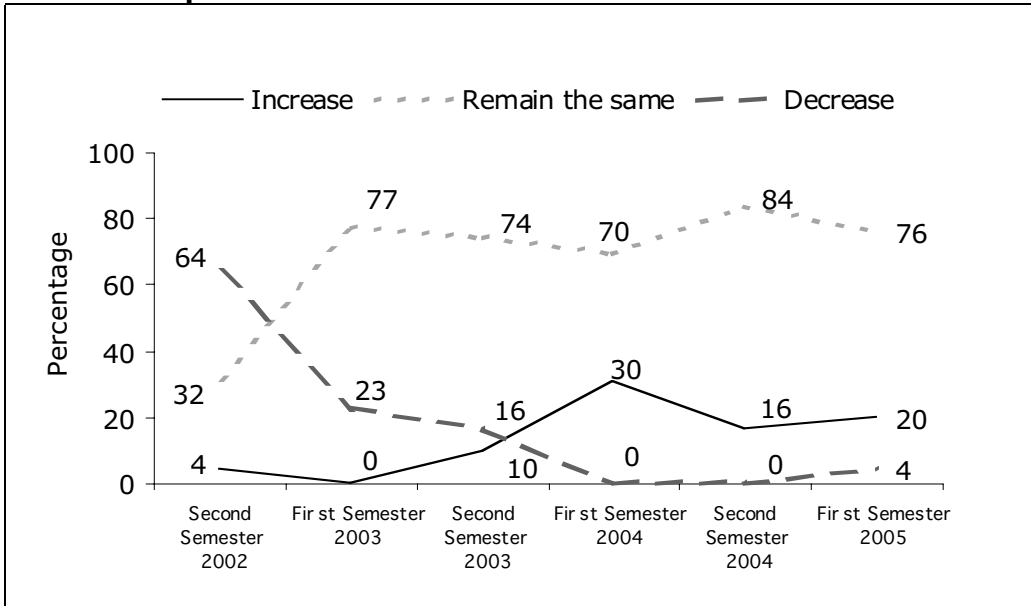
**Chart 2 - 1st Sem. 2005: expectations on the total value of the funds' portfolio**



Source: Deloitte Italy Private Equity Confidence Survey

Regarding divestment activity, as reported in Chart 3, the number of players that believe in no significant changes in exit values, passed from 84% of the first semester 2004 to 76%; as a consequence the number of players that expect the private equity industry to show higher transaction values is increasing, passing from 14% to 20%; this probably reflects the fact that industrial investors are willing to pay higher premiums on firm valuations and stock exchanges are being perceived as more profitable exit alternatives than in the first semester 2004. The remaining 4% believe in a decrease of the exit values.

**Chart 3 – Expectations on exit values**



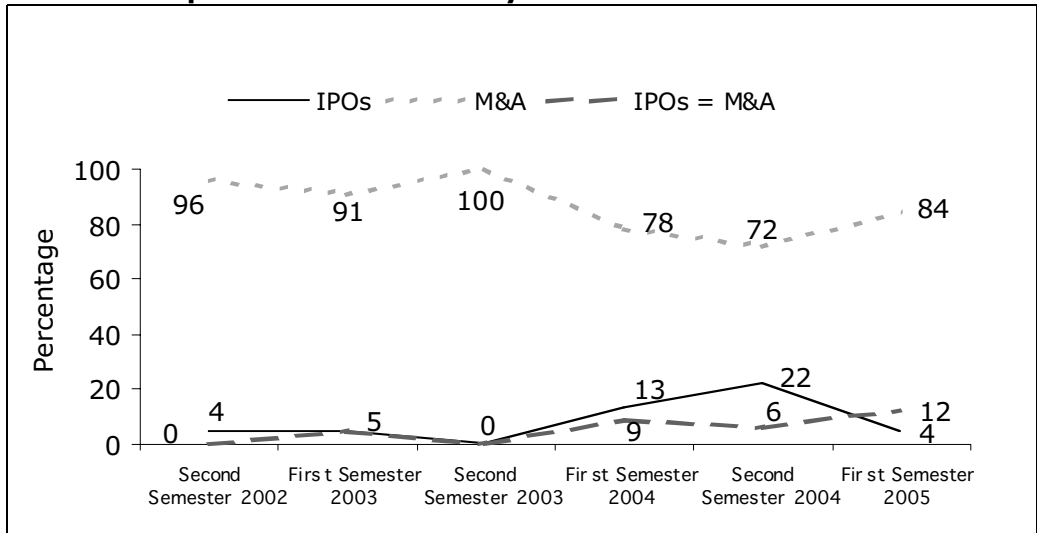
Source: Deloitte Italy Private Equity Confidence Survey

Chart 4 shows how the private equity players will primarily conduct their divestment activity. The results foresee that mergers and acquisitions will continue to be the main form of exit ways, as in 2003 and 2004 (84% of respondents). The number of managers that do not believe in a recovery of stock exchanges and for this reason in an upswing of IPO operations slightly decreased, while the number of players that believe that IPOs and M&A transactions will remain the same has increased. These results highlight the fact that stock markets have been recently characterised by a steady growth with lower volatility.

The closing of new private equity and venture capital funds continued also during the last months of 2004; for this reason the competitive pressure on new investment opportunities increased too; the majority of the players, 68%, support this thesis, while only 4% of the respondents expect a decrease in terms of competition. This trend highlights how the private equity and venture capital industry continues to be considered very attractive for investors and also highlights the increase of requests by companies to private equity and venture capital funds, considering the

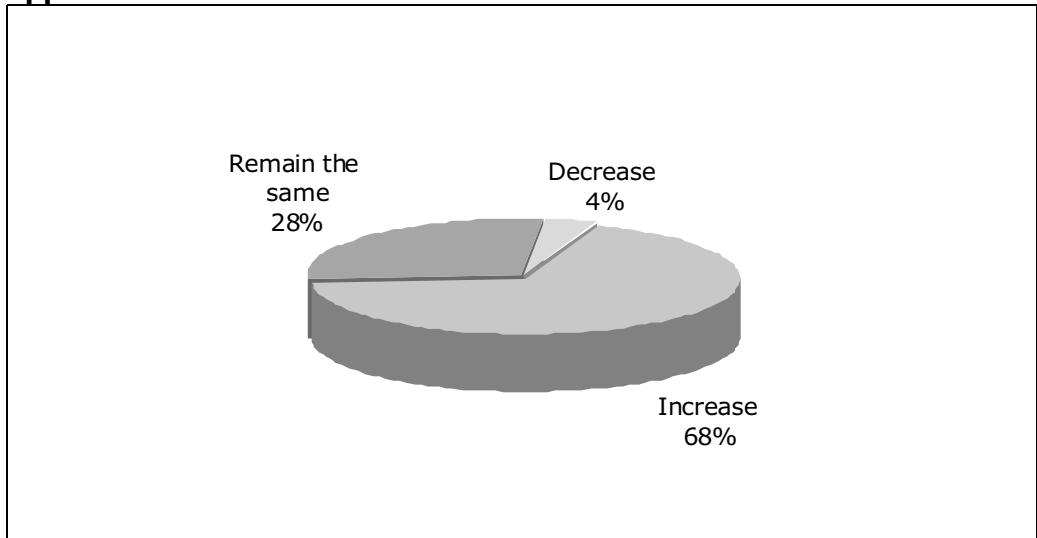
tightening of credit lines from banks caused by the recent bankruptcy cases (Chart 5).

**Chart 4 – Expectations on exit ways**



Source: Deloitte Italy Private Equity Confidence Survey

**Chart 5 - Expectations on competition for new investment opportunities**

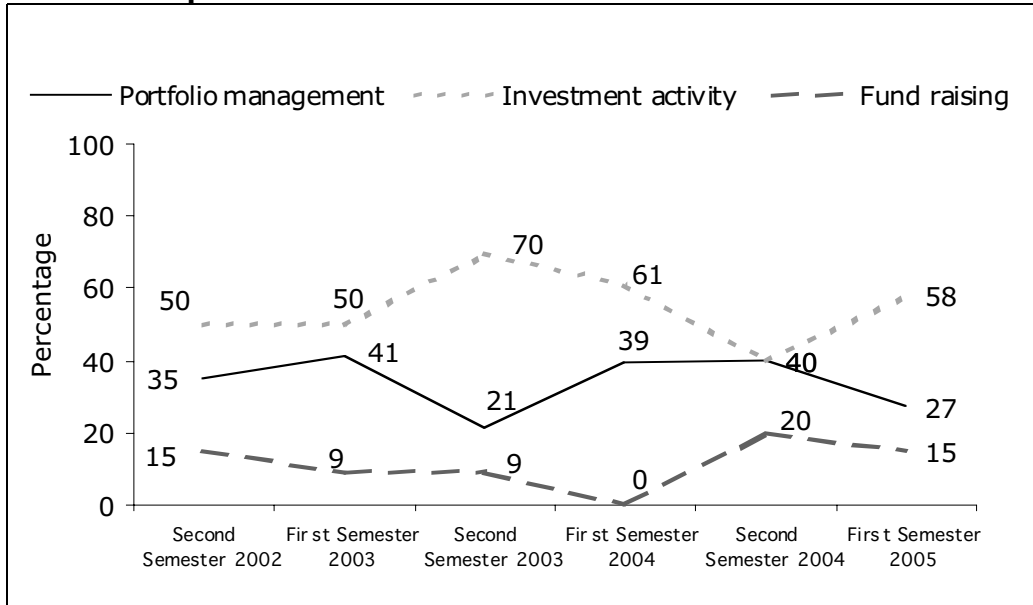


Source: Deloitte Italy Private Equity Confidence Survey

Also for 2005 the majority of the PE players express their intention to continue the investment activity; the percentage has grown compared to

the same time last year, passing from 40 to 58%. Another 27% of the players believe they will focus on portfolio management, while 15% of the interviewees are determined to go to the market to raise new funds (Chart 6). Since the beginning of the Italy Private Equity Confidence Survey the majority of PE players confirmed this intention indicating the attractiveness of Italian companies and the need to invest the large amount of liquidity raised on the market to date.

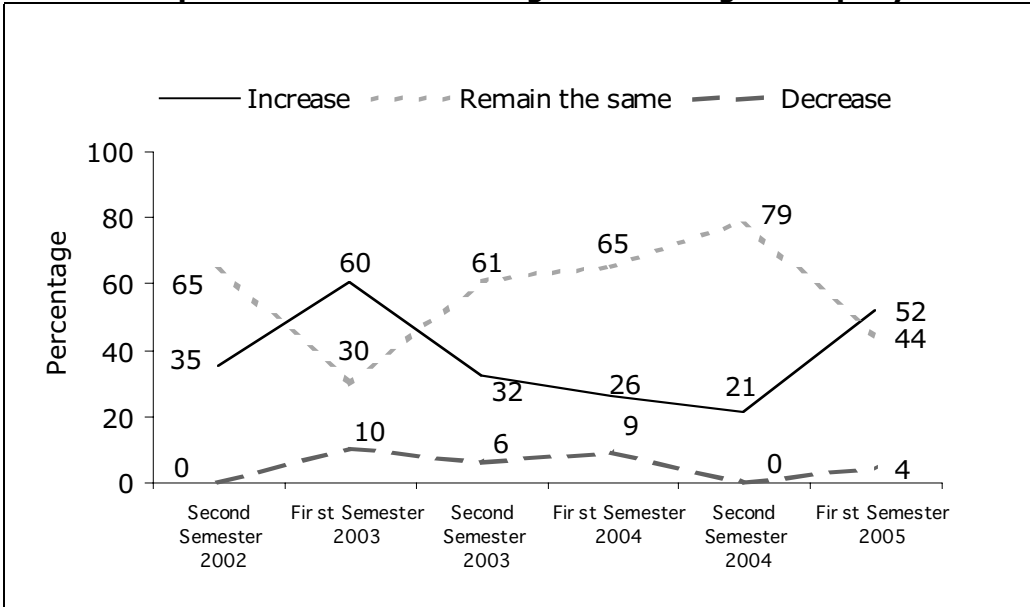
**Chart 6 – Expectations on future activities**



Source: Deloitte Italy Private Equity Confidence Survey

With regard to investment preferences, as shown in Chart 7, the number of PE players that intend to direct their investments into large companies, passed from 21% in the second semester 2004 to 52% in the first semester 2005; 44% of the interviewees believe that they will continue investing in companies of the same size, while the remaining 4% think that they will invest in smaller companies.

**Chart 7 - Expectations on the average size of target company**



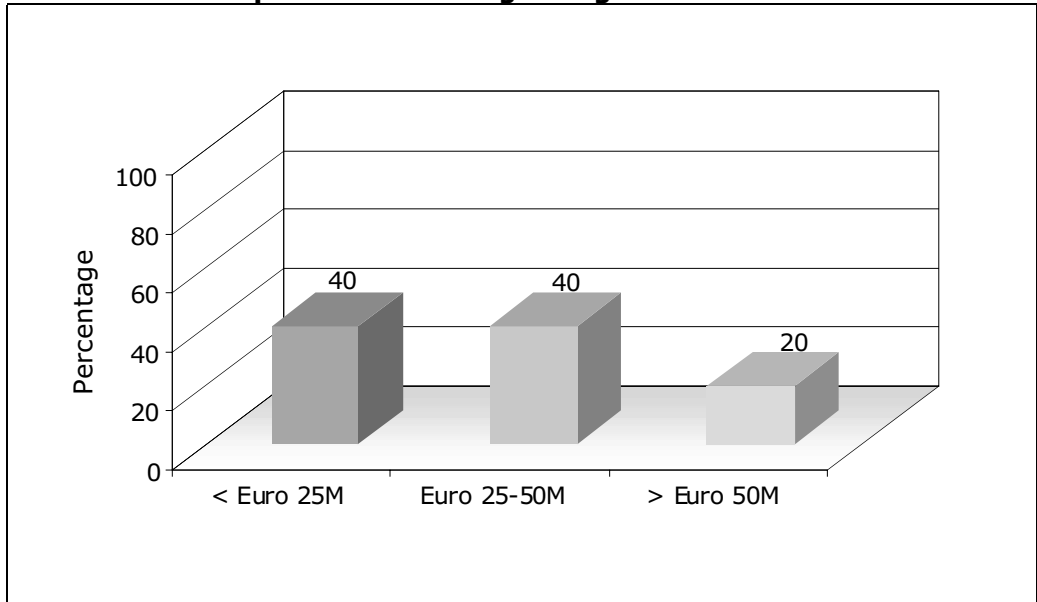
Source: Deloitte Italy Private Equity Confidence Survey

The trend regarding the current preferences of the players on the size of the investments highlights that the majority (80%) of the PE funds are equally divided among those that intended to make transactions whose values are lower than 25 Euro Mln and those that intend to focus their activity on acquisitions ranging between 25 and 50 Euro Mln. The remaining 20% prefer investments higher than 50 Euro Mln (Chart 8). The opinions expressed by the main PE players to go on the market to find medium sized investment opportunities is mainly due to the characteristics of the Italian market that consists of small to medium enterprises that have an interesting potential for growth.

According to Deloitte Italian Private Equity Survey the trend regarding the investment types will continue in 2005; Management Buy Outs and Management Buy Ins will, in fact, go on being the first choice for 64% of the PE and VC players; the 32% of the players anticipate to focus on expansion transactions, while replacement investment will continue to be a marginal activity (Chart 9). The succession problem Italian small to medium enterprises are facing is still a reality and for this reason management buy

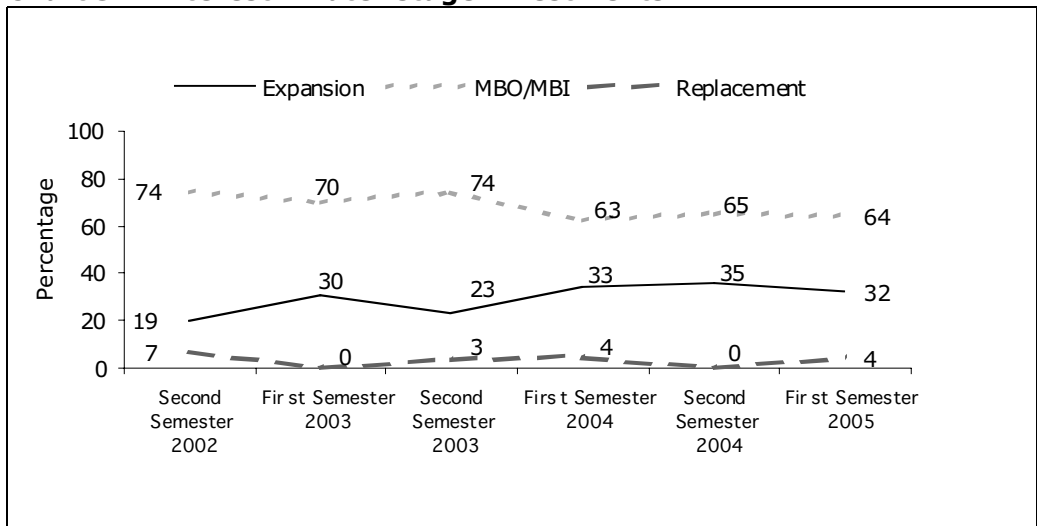
outs financed by PE funds can play an important role in guaranteeing business continuity and providing managerial skills and business know how.

**Chart 8 – Actual preferred size regarding size of investment**



Source: Deloitte Italy Private Equity Confidence Survey

**Chart 9 – Interest in later stage investments**

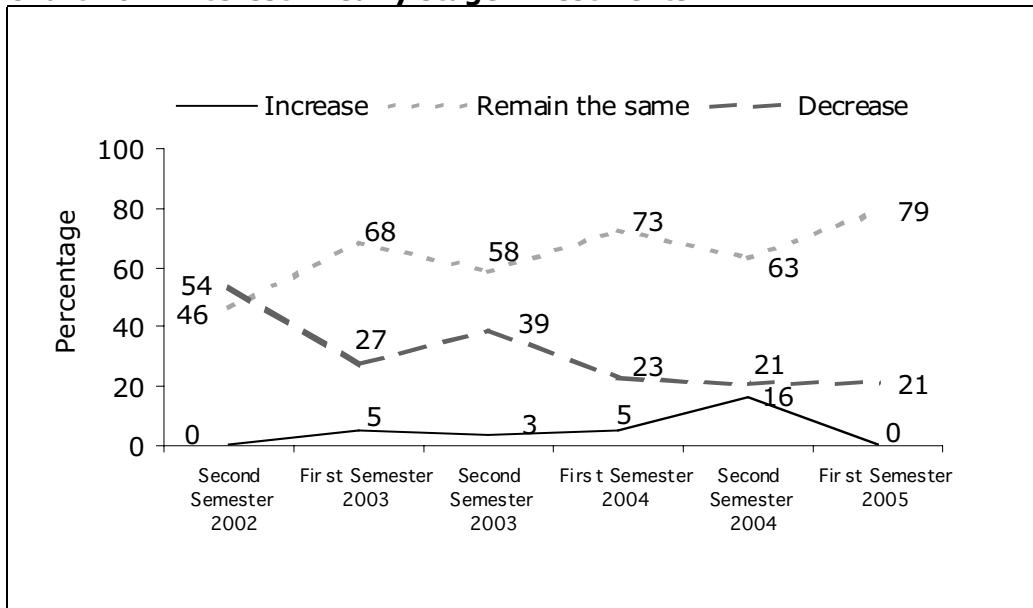


Source: Deloitte Italy Private Equity Confidence Survey

Regarding start-up companies (Chart 10), the interest of the 79% of the interviewees anticipated that such investments should remain unchanged

for the first six months of 2005; for 21% of them the interest in start ups will decrease. The trend, started in 2000, is still continuing and start-up companies do not yet give guarantees to PE and VC concerning their future performance. The operators are, in fact, looking for companies with historical track records that have solid fundamentals, positive performance and already generate cash flows.

**Chart 10 – Interest in early stage investments**



Source: Deloitte Italy Private Equity Confidence Survey

With regard to the attractiveness of different industries, the first semester 2005 will see the activity in the following sectors: leisure, food & wine, luxury and public utilities, communications and financial services, while the real estate industry is the least attractive sector for private equity and venture capital investors.

# The Venture-Backed IPO Market<sup>1</sup>

The 12 month period ended February 28, 2005 was characterised by a strong increase in the value of equity markets driven by a return to a higher performance of the US economy that grew at a faster pace than most economists had expected. The US economy in 2004 grew 4.4%, the highest real growth since 1999 when it grew 4.5%.

In Europe, the recovery is gaining speed and during 2004, GDP grew 2.0% in the Euro-zone and 2.3% in the 25 EU countries, as compared to 0.5% and 0.9% respectively, in 2003. In terms of the single European countries, France and Spain showed the strongest growth, while Italy and Germany dragged the average figure downwards. Outside the Euro-zone, the UK had the highest growth.

In this context, the overall stock market performance was reasonably robust in Europe, where the index value of the European financial markets increased by 14% on average, driven by the Italian stock market that performed better than all the other major markets showing a 17% increase on average. Positive returns were realised by the German, French and British markets of 8%, 7% and 6%, respectively. Meanwhile, the US stock market performance was less positive with the Dow Jones and NASDAQ producing an average decrease of 2% and 1%, respectively.

Buoyed by the positive trends in share prices and the initial public offerings, the overall market capitalisation rose to 580.6 Euro Bln for the Italian national listed companies, representing 43.1% of Gross Domestic Product compared to 37.5% in 2003.

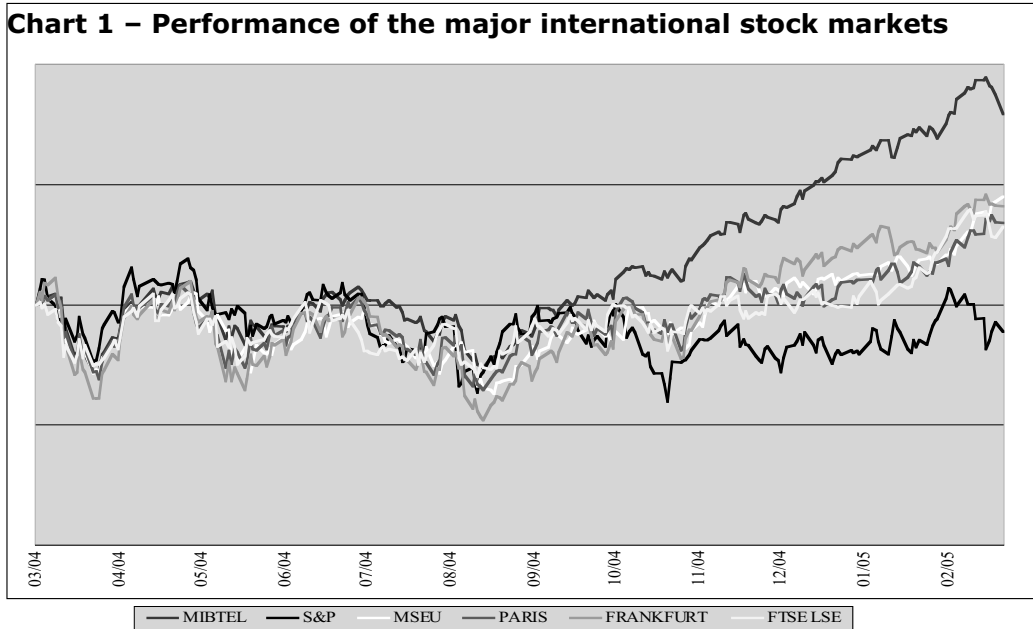
As of January 2005, the Italian stock market was again sixth in Europe in terms of market capitalisation<sup>2</sup> but following recent trends, it is likely that the Italian stock market will soon achieve the market capitalisation levels of the Spanish and Swiss stock markets. In terms of the number of listed companies, the Italian market remains substantially stable.

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<sup>1</sup> The analysis has been produced by Ernst & Young Financial- Business Advisors.

<sup>2</sup> European Securities Exchange Statistics – January 2005.

The chart below shows the performance of the MIBTEL index in relation to the other major international stock exchange indices.



Source: Bloomberg

The strong Italian stock performance is also due to the expected increase in profits of blue-chip companies to a cumulative 29.3 Euro Bln, an increase of some 25% from 23.5 Euro Bln in the previous year.

The period under consideration was characterised by the introduction of changes in the Borsa Italiana structure and in the relative indices. Firstly, Standard & Poor's and Borsa Italiana launched the S&P/MIB Index, a new indicator for Italy offering broader market coverage, while still providing the liquidity needed for an investable index. S&P/MIB aims to cover 80% of the Italian equity universe, but unlike other S&P indices it is not a fixed-numbered index. In line with the Standard & Poor's free-float methodology, this provides investors with a benchmark representative enough to track performance while providing market professionals "with a tool liquid enough for product design and analytics"<sup>3</sup>. In addition, from January 31, 2005, the Nuovo Mercato's NUMTEL and NUMEX indices are no longer calculated,

<sup>3</sup> Borsa Italiana.

while the all-share MIBTEL index has been restyled to include high-growth companies from the Nuovo Mercato. Italy's NUMTEL was particularly influenced by two stocks, broadband players Tiscali SpA and Fastweb SpA, which dominated the index and accounted for most of its market capitalisation. Tiscali and Fastweb are now tracked by S&P/MIB. Of the 38 NUMTEL survivors, 10 are included in the all-share MIB and MIBTEL indices and 28 of them have accepted more rigorous rules on transparency and performance and passed to the TechSTAR-NM index, the Borsa's latest product. The aim of TechSTAR-NM, integrated in the Electronic Equity Market (MTA) of Borsa Italiana, is to meet the needs of small and medium sized companies (capitalisation of less than 800 Euro Mln) operating in high tech sectors or strategically focusing on strengthening their future competitiveness and success.

In this context, Ernst & Young Financial-Business Advisors ('Ernst & Young') has continued monitoring the share prices of venture-backed companies listed on the Italian market through an analysis of the Ernst & Young Venture-Backed Index ('EYVBI').

### **IPO Activity**

Following the positive stock market trend and thanks to the contribution of private equity funds, the year ended February 28, 2005 showed a recovery in terms of number of Initial Public Offerings ('IPOs') in the domestic market, with 7 new listings on the Mercato Telematico Azionario ("MTA") and 2 listings on the Mercato Expandi, against 4 IPO's on all Italian markets in the previous 12 months.

During the period under review, a majority (4 out of 7) of the new listings on MTA was represented by venture-backed companies. It is relevant to note that in Europe, 62% of the venture-backed companies that went public in 2004 received their first rounds of funding between 1997 and 2000, immediately before the recession<sup>4</sup>. Proof of the recovery of IPOs is reflected in the various sectors in which the companies listed in the last 12 months operate: technologies (DMT), utilities (Terna), industrial products

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<sup>4</sup> Thomson Financial.

(Procomac, Panariagroup), financial (Azimut Holding), clothing (Geox) and services (IGD). This is a confirmation for entrepreneurs of the revitalisation of the stock market as an important element of the capital market.

The table opposite summarises the new MTA listings during the past 12 months.

**Table 1 - IPOs on MTA (March 2004 – February 2005)**

| Company name   | IPO date   | IPO price (Euro) | Market cap. (Euro Mln) | Venture-backed |
|----------------|------------|------------------|------------------------|----------------|
| IGD            | 11/02/2005 | 1.45             | 462                    | No             |
| GEOX           | 01/12/2004 | 4.60             | 1.545                  | No             |
| PANARIAGROUP   | 09/11/2004 | 5.60             | 264                    | Yes            |
| AZIMUT HOLDING | 07/07/2004 | 4.00             | 617                    | Yes            |
| PROCOMAC       | 07/07/2004 | 3.50             | 74                     | Yes            |
| TERNA          | 23/06/2004 | 1.70             | 4.320                  | No             |
| DMT            | 22/06/2004 | 21.00            | 288                    | Yes            |

Source: Ernst & Young Financial-Business Advisors, Bloomberg

In the 12 months ended February 28, 2005 the best performance was recorded by companies related to the utilities and environmental sectors.

Procomac is a venture-backed company but after a troubled post-IPO period, the promoters made a public offer to de-list the company.

Based on the strong market performance and considering the growing number of Italian private equity funds now active in Europe and Italy, and the backing given by the private equity investors to the listing of new enterprises on the official markets, it is likely that the number of IPOs in 2005 will increase further in Italy.

### **Performance of venture-backed shares (EYVB Index)**

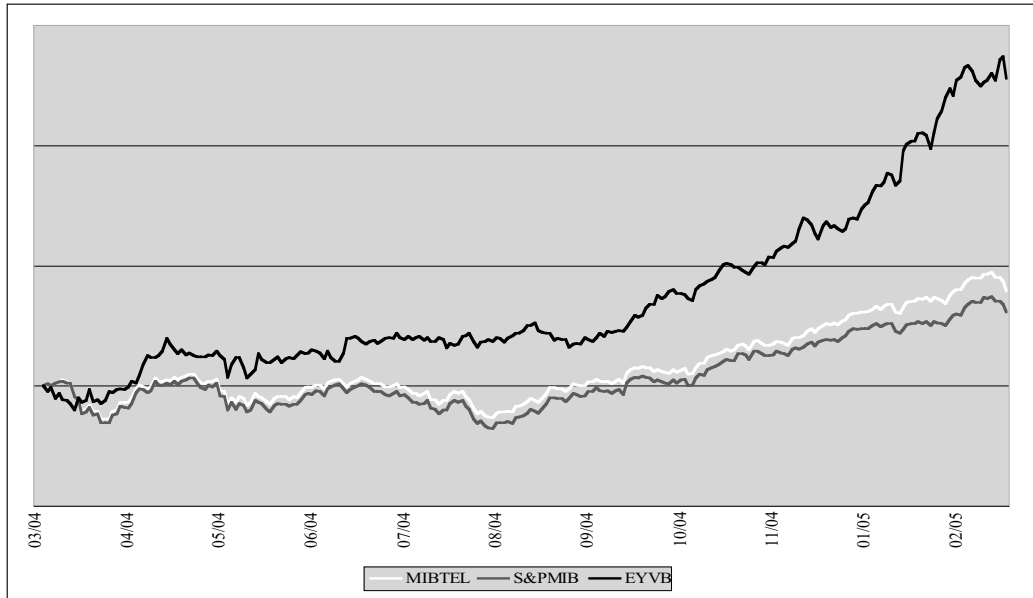
The Ernst & Young Venture-Backed Index, created in November 1999, monitors venture-backed companies with shares listed on the MTA. The basket of companies included in the indices is revised twice a year on May 1 and November 1 and includes venture-backed companies which have been listed for more than three months and less than three years. Companies in the first three months after listing are not included in order to avoid the

effect of 'underpricing' an IPO, whilst those listed for over three years are no longer considered to be influenced by their Venture-Capital investors.

Because of the lack of IPOs on the Nuovo Mercato the Ernst & Young Nuovo Mercato Index ('EYNMI') is no longer computed.

The following chart summarises the performance of the EYVBI from March 1, 2004 through February 28, 2005.

**Chart 2 - EYVBI – MIBTEL – MIB30 (March 2004 – February 2005)**



Source: Ernst & Young Financial-Business Advisors, Bloomberg

The chart above shows that the EYVBI clearly outperformed the market trend. Over the period, the EYVBI value increased by 56% as compared to 17% for MIBTEL and 13% for S&P/MIB. During the last four months, such positive performance was primarily driven by Isagro, that registered an average increase of 132%, and by Astaldi and DMT, which registered an average increase of 43% and of 32%, respectively; three shares collectively represent 48% of the index. Moreover, Astaldi recorded an annual growth rate of 67% compared to 61% in the previous year.

The following table lists the companies included in the EYVBI basket from November 1, 2004 to February 28, 2005 showing the industry sectors in which they operate, IPO dates, market capitalisation and growth over the

four-month period.

**Table 2 - EYVBI basket (November 2004 – February 2005)**

| <b>Company name</b> | <b>IPO date</b> | <b>Market cap.<br/>(Euro Mln)</b> | <b>Change 4<br/>months</b> | <b>Industry<br/>Sector</b> |
|---------------------|-----------------|-----------------------------------|----------------------------|----------------------------|
| NEGRI BOSSI         | 06/11/2001      | 46                                | - 6%                       | Moulding machines          |
| ASTALDI             | 06/06/2002      | 446                               | 43%                        | Construction               |
| ISAGRO              | 05/11/2003      | 145                               | 132%                       | Basic materials            |
| TREVISAN            | 05/11/2003      | 108                               | 8%                         | Industrial                 |
| DMT                 | 22/06/2004      | 286                               | 32%                        | Communications             |
| AZIMUT              | 07/07/2004      | 623                               | 23%                        | Financial                  |

*Source: Ernst & Young Financial-Business Advisors, Bloomberg*

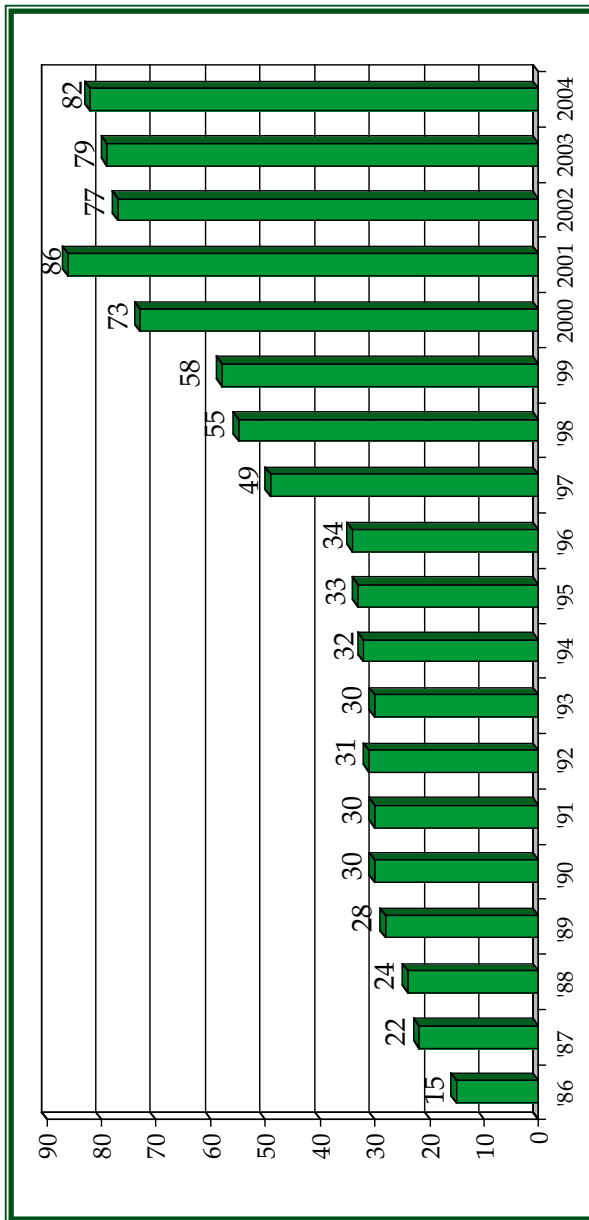
Effective May 1, 2005 Negri Bossi will be removed and Panariagroup will be added to the basket index.

As of February 28, 2005, the total market capitalisation of the companies included in the EYVBI was 1,654 Euro Mln, compared to the total market capitalisation of 615,095 Euro Mln of the MTA listed companies. Therefore, the companies included in the EYVBI represent some 0.3% of the total MTA, which is unchanged from February, 29, 2004.

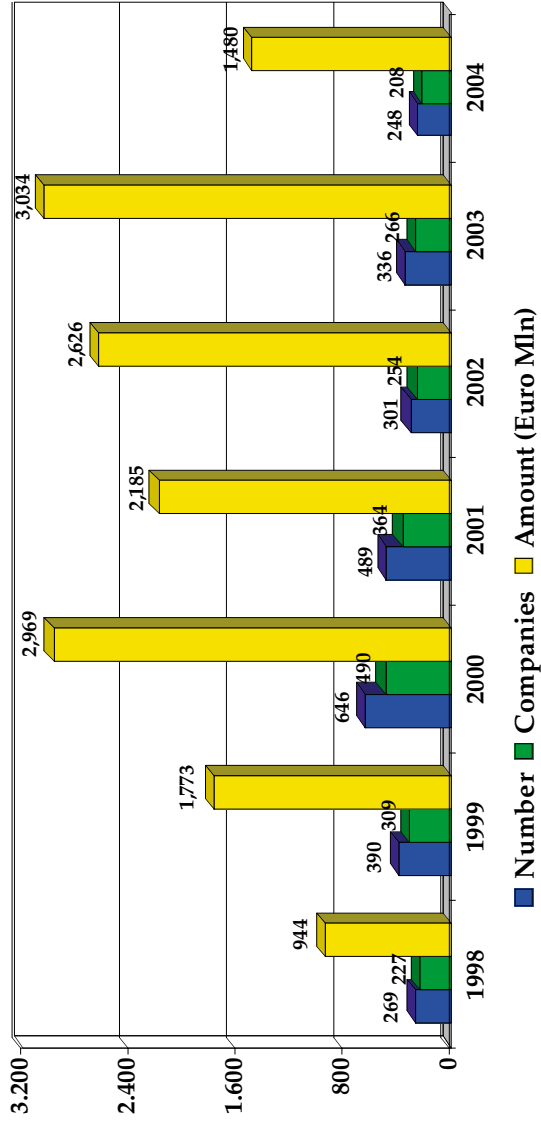
# Statistics on Private Equity and Venture Capital in Italy



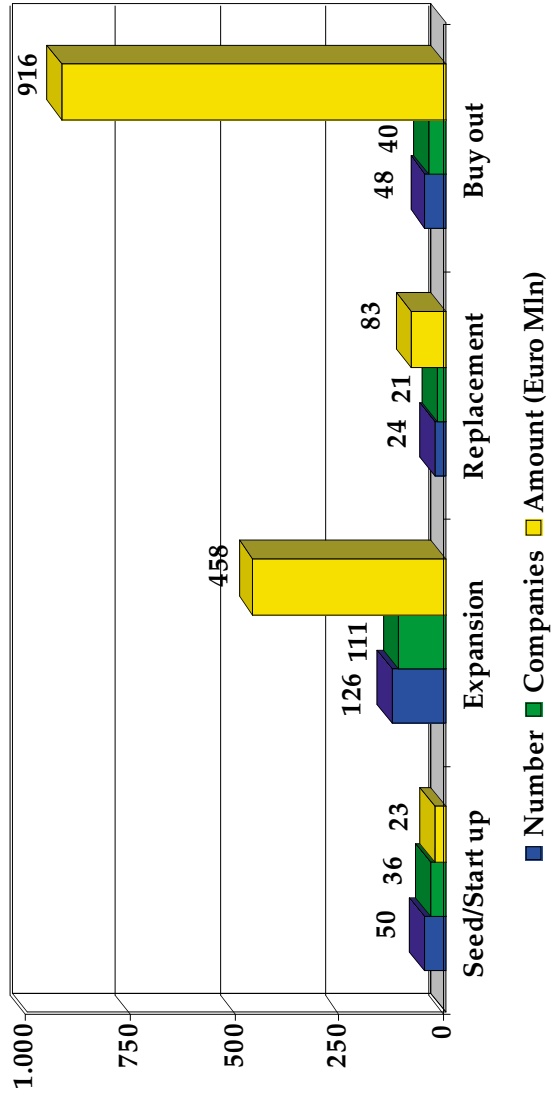
## AIFI Full Members



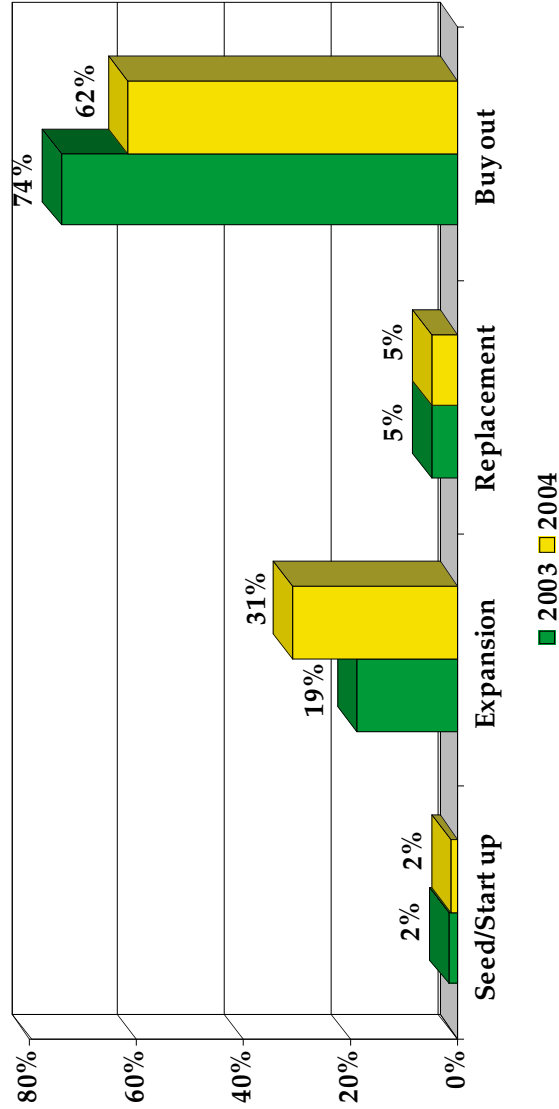
## Investment activity by number, companies and amount



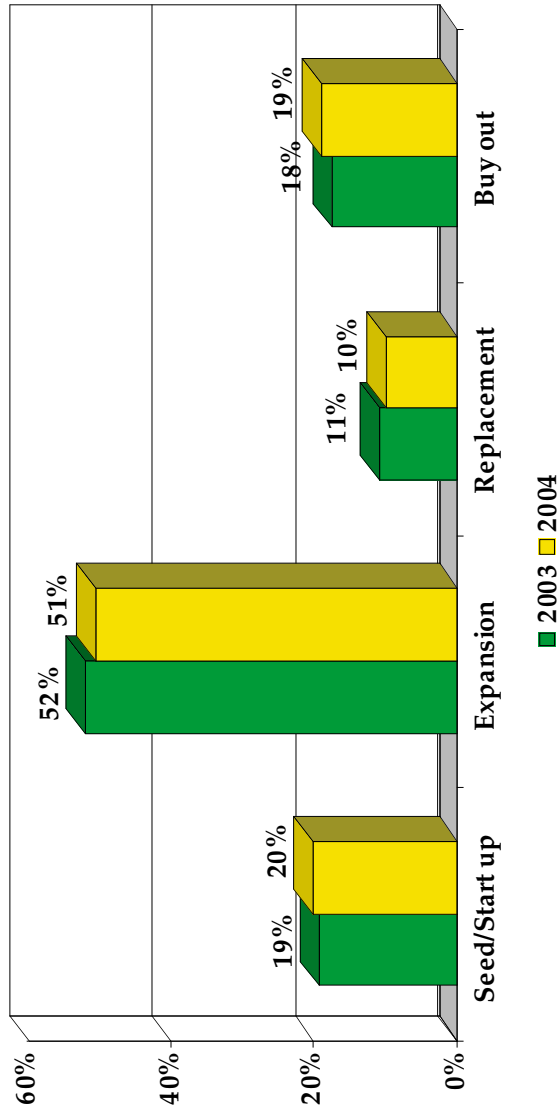
## 2004: Stage distribution of investments



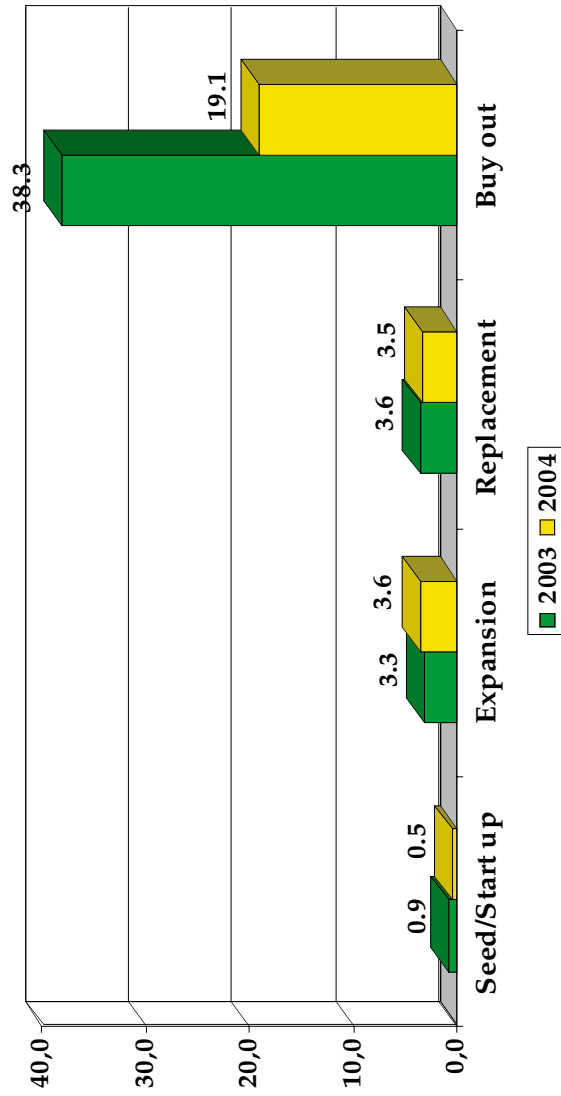
2003 – 2004: % distribution of investments by amount



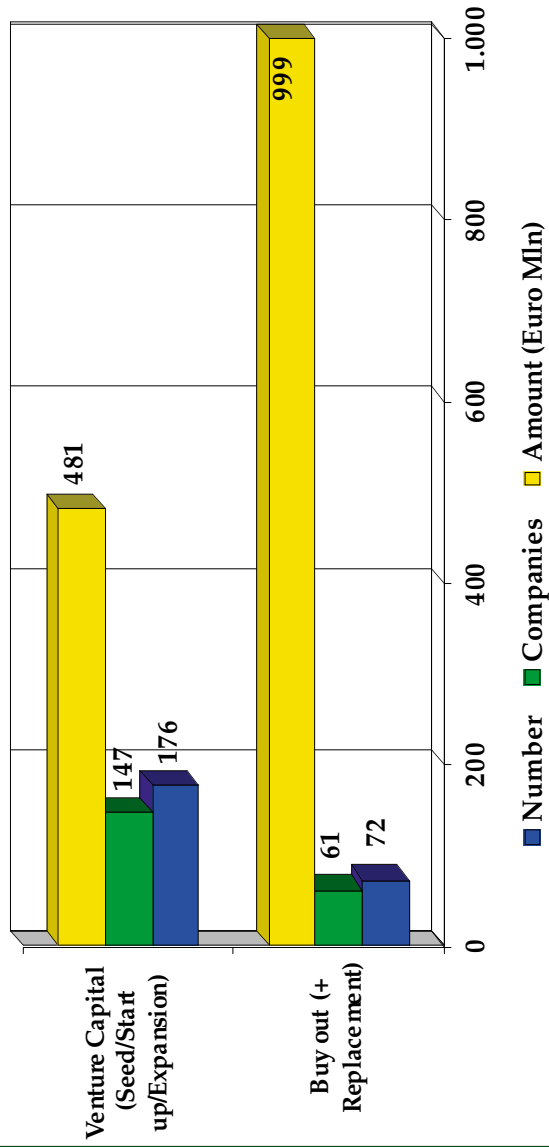
2003 – 2004: % distribution of investments by number



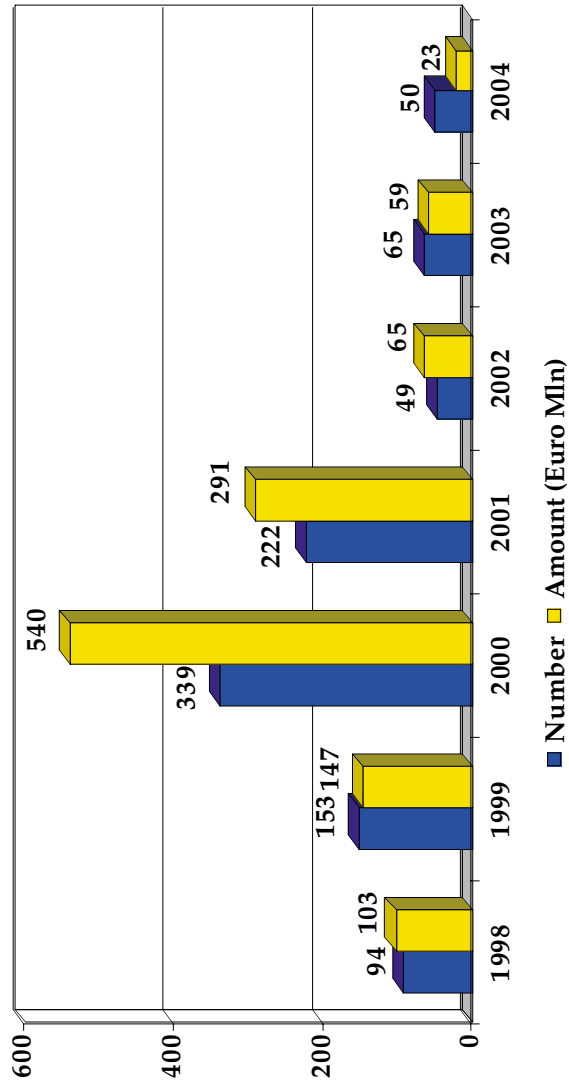
## 2003 – 2004: Average invested amount (Euro Mln)



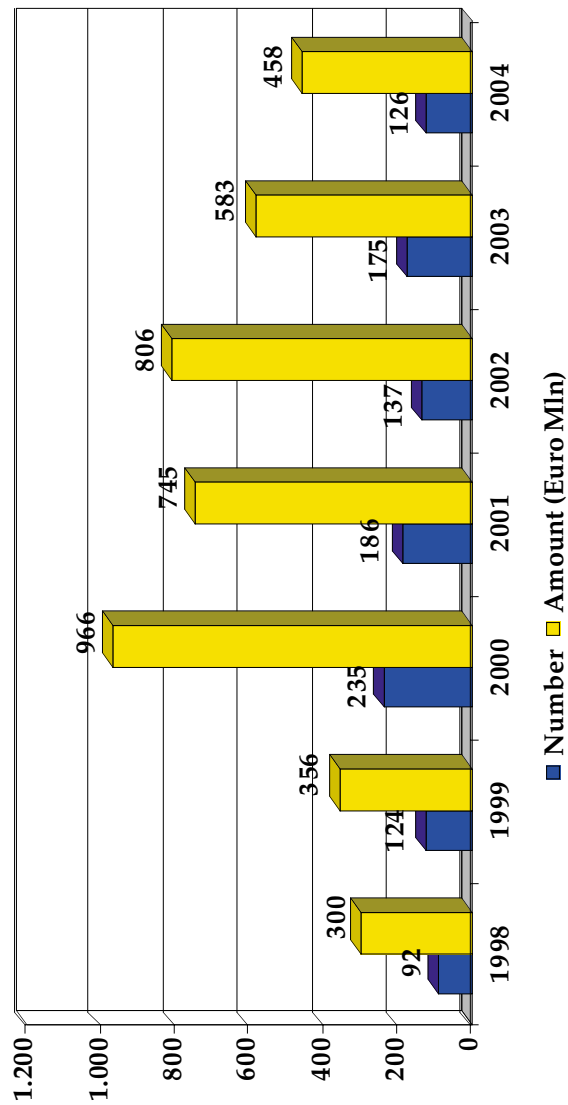
## 2004: Venture Capital vs Buy out



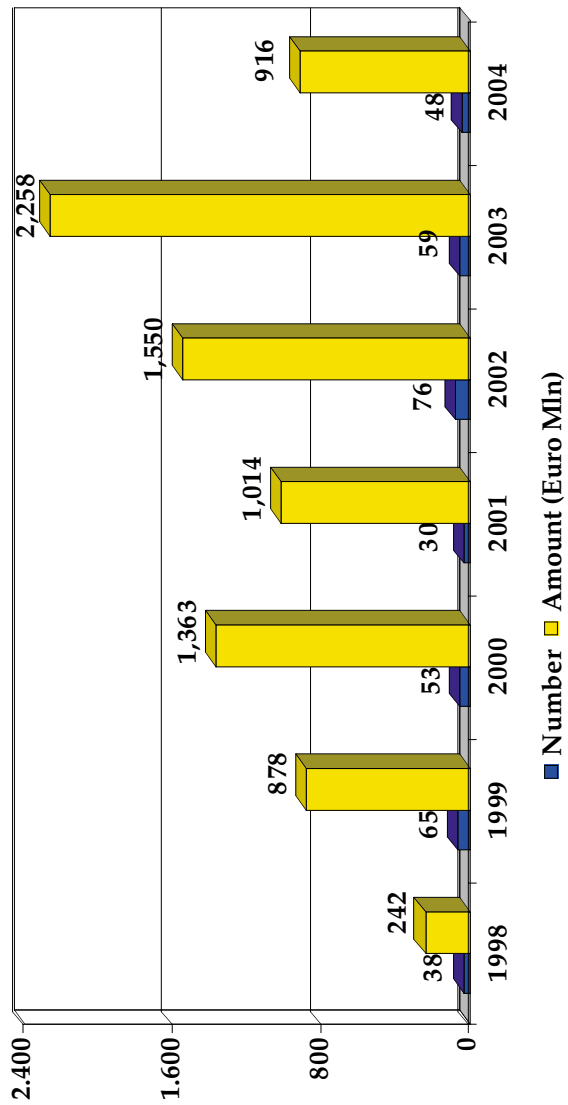
## Early stage investments by number and amount



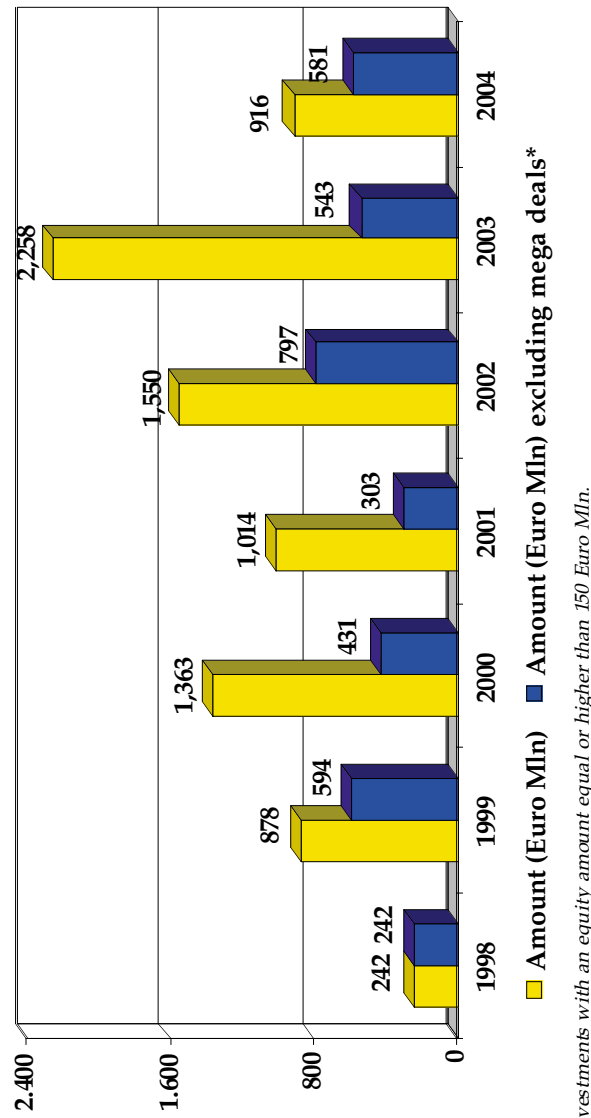
## Expansion investments by number and amount



## Buy out investments by number and amount

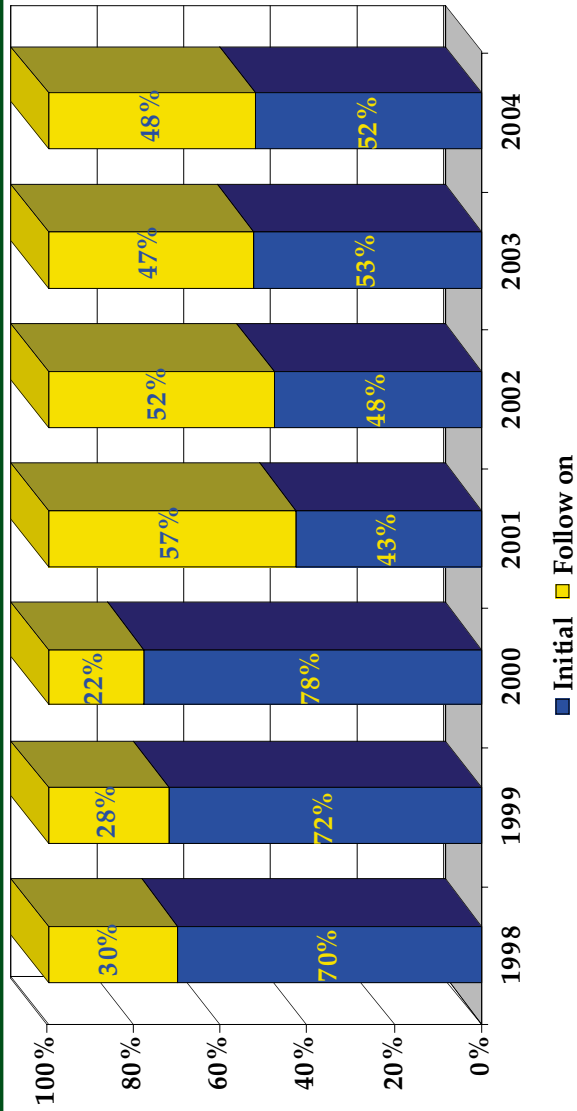


## Buy out investments: The impact of mega deals

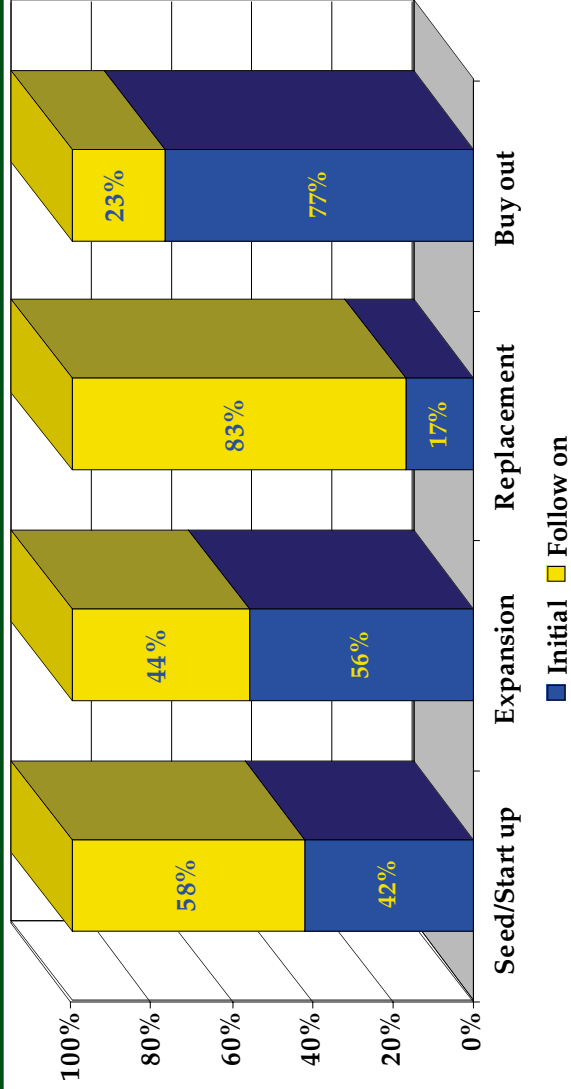


\* Investments with an equity amount equal or higher than 150 Euro Mln.

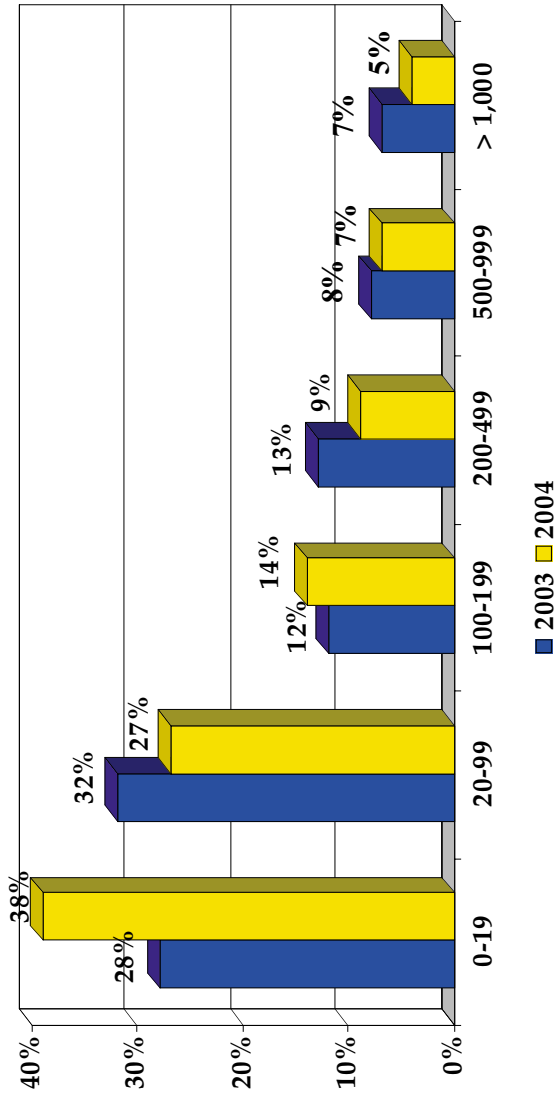
% of Initial and Follow on investments by number



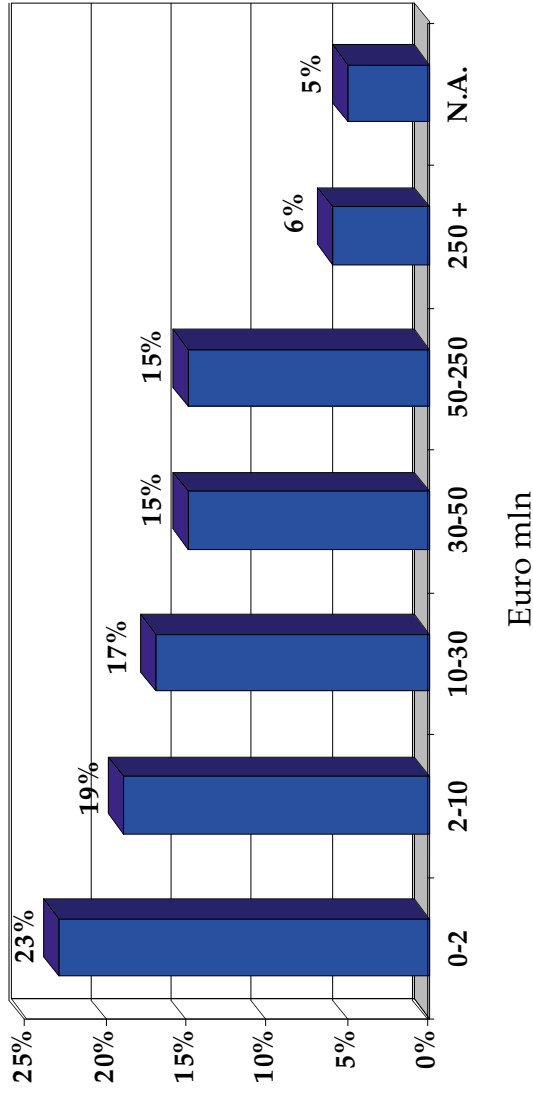
2004: % of Initial and Follow on  
by investment stages (number)



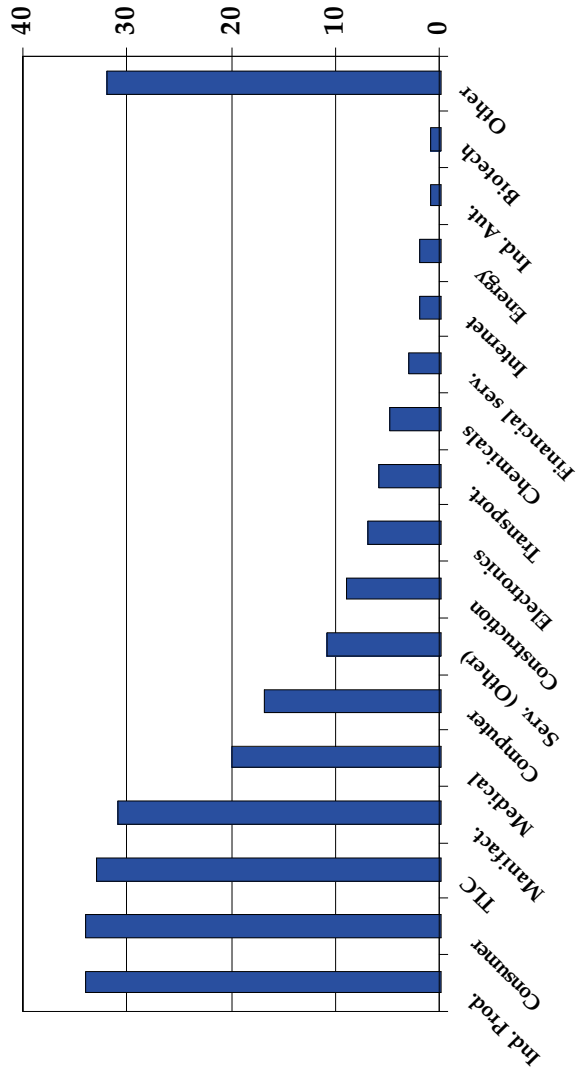
2003 - 2004: % distribution of investments (number)  
by target companies employees



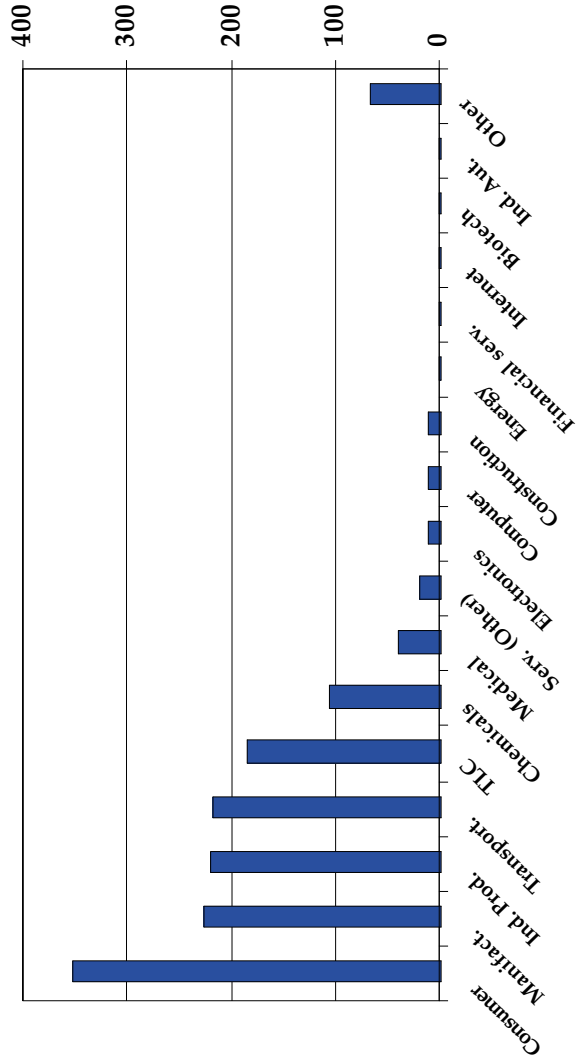
2004: % distribution of investments (number)  
by target companies turnover



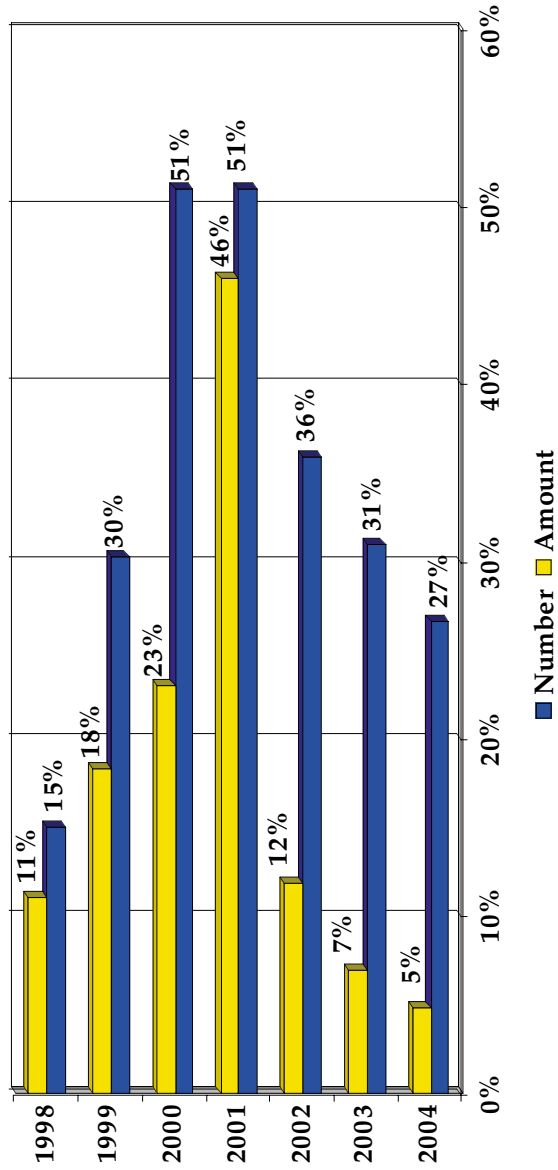
2004: Sectoral distribution of investments by number



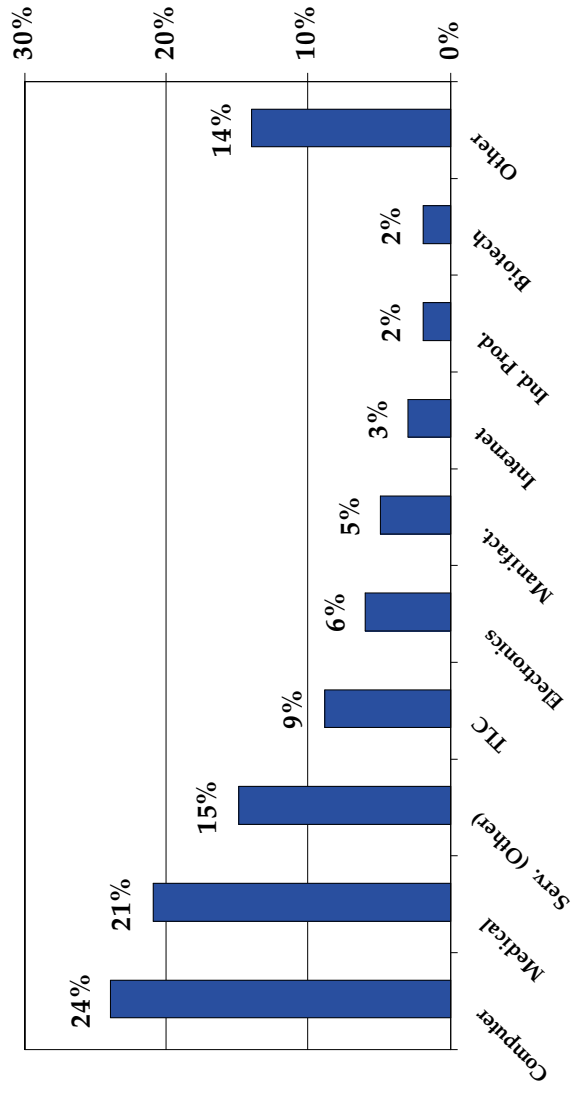
## 2004: Sectoral distribution of investments by amount



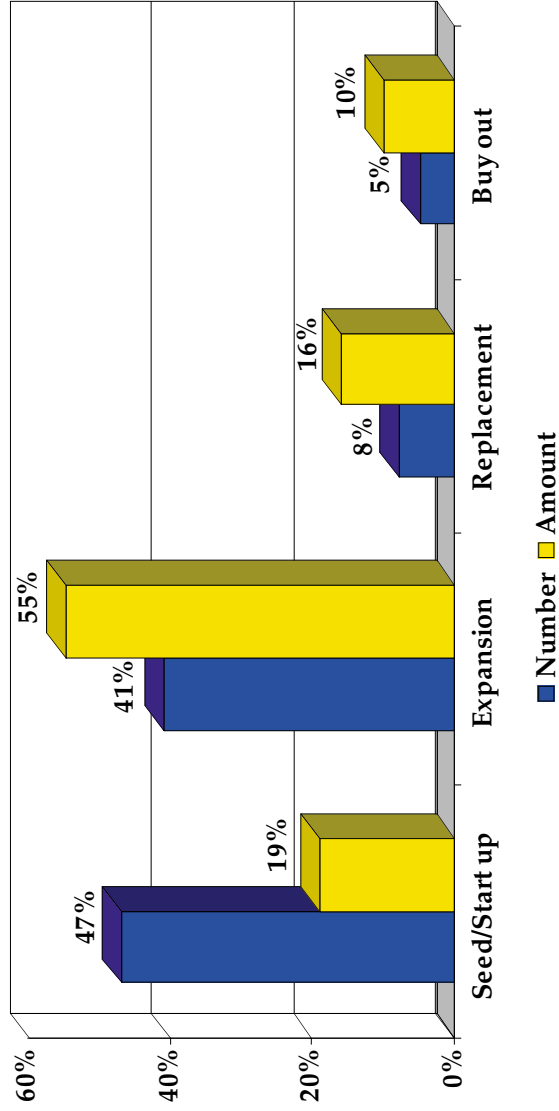
% of investments in high tech companies  
by number and amount



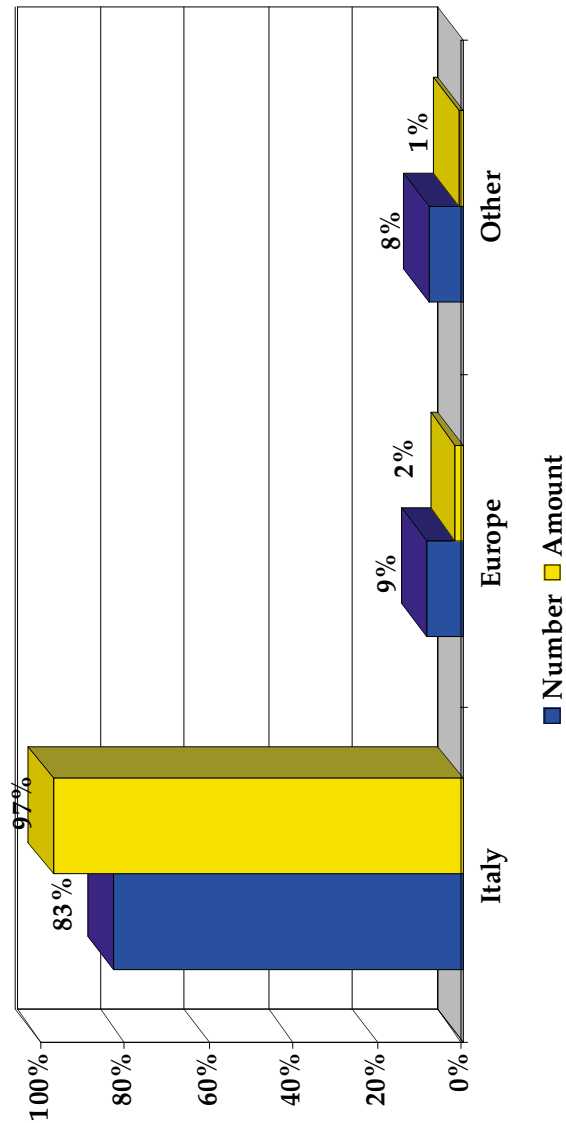
2004: % of investments in high tech companies by sector



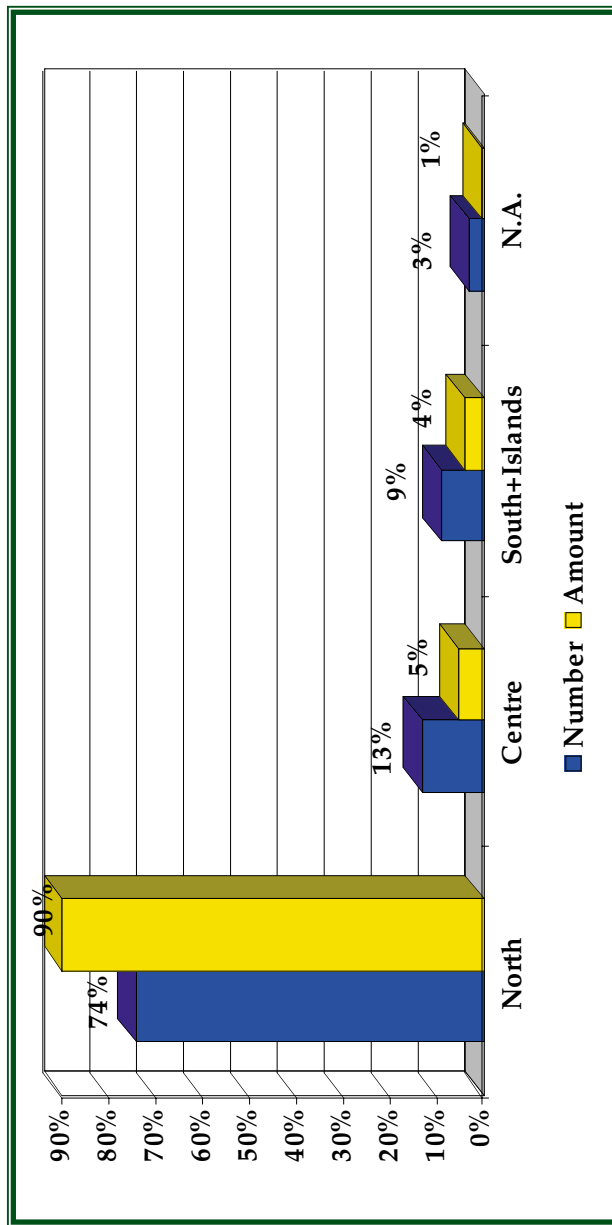
## 2004: % distribution of high tech investments by stage



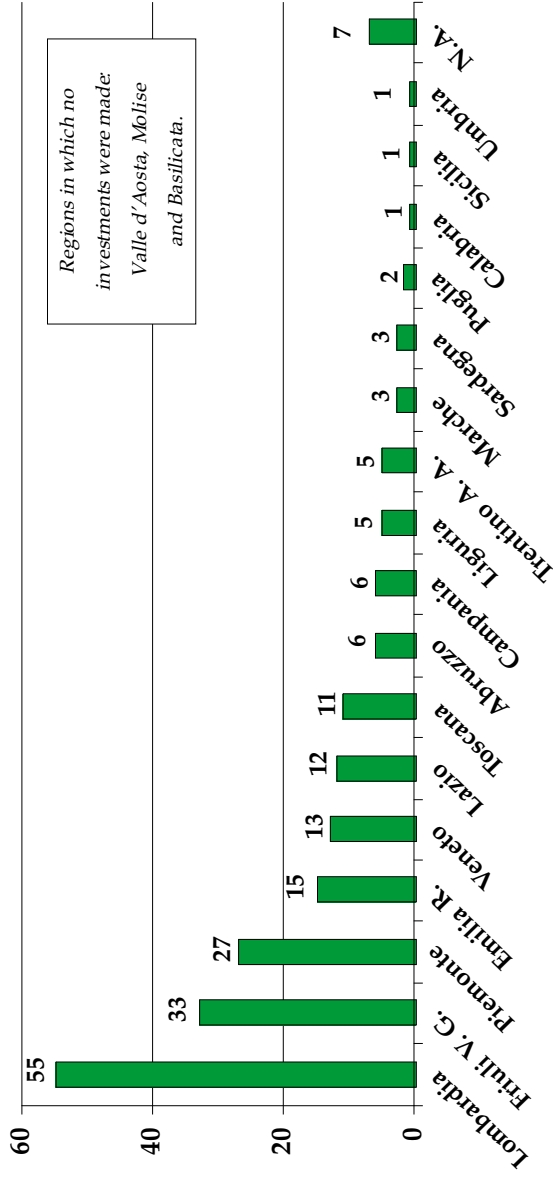
2004: Geographical distribution by %  
of number and amount invested



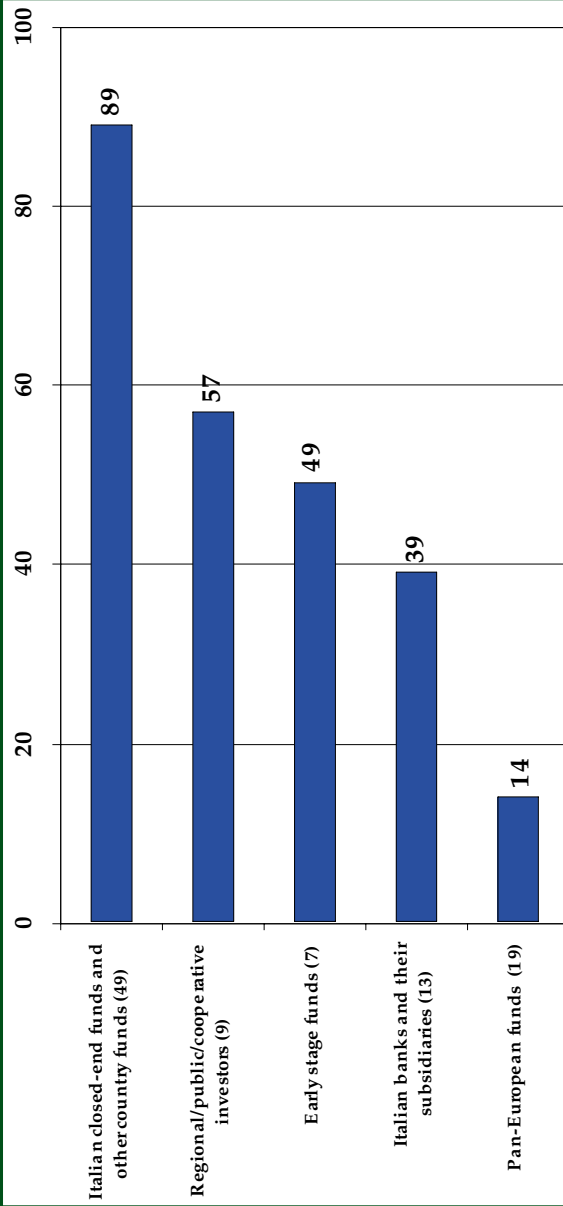
2004 - Italy: Geographical distribution by %  
of number and amount invested



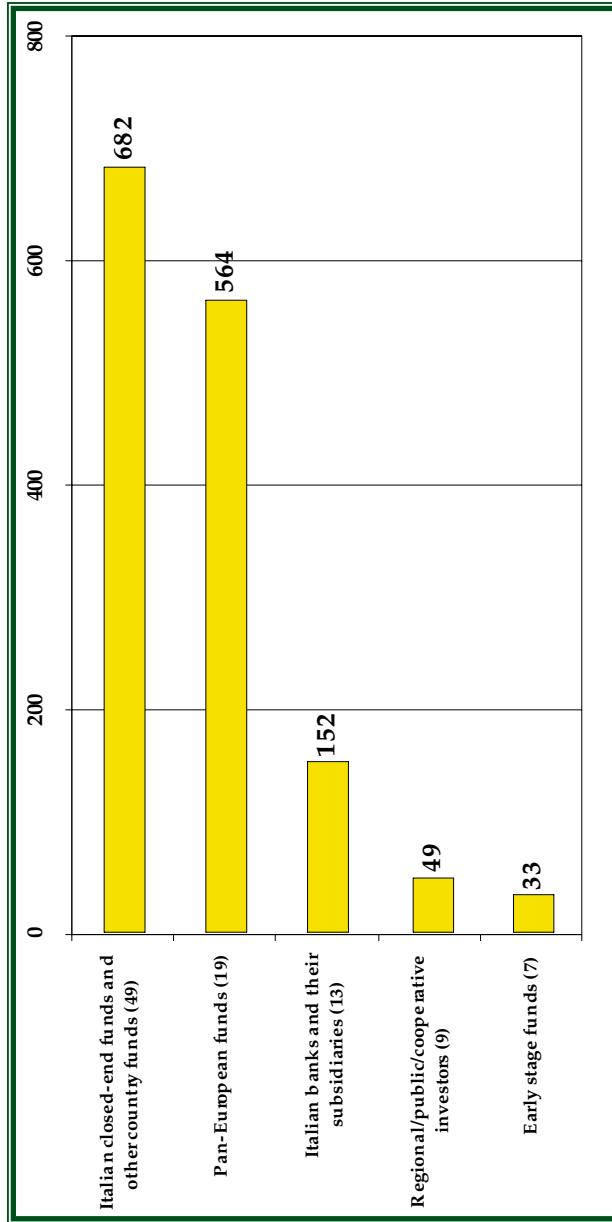
## 2004 - Italy: Regional distribution by number of target companies



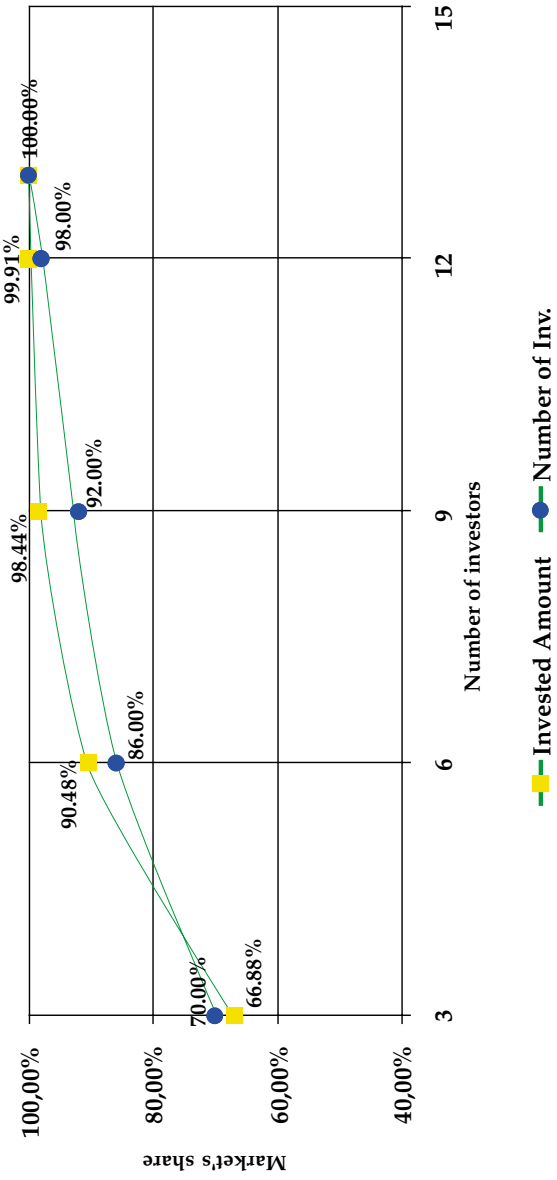
## 2004: Number of investments by type of investors



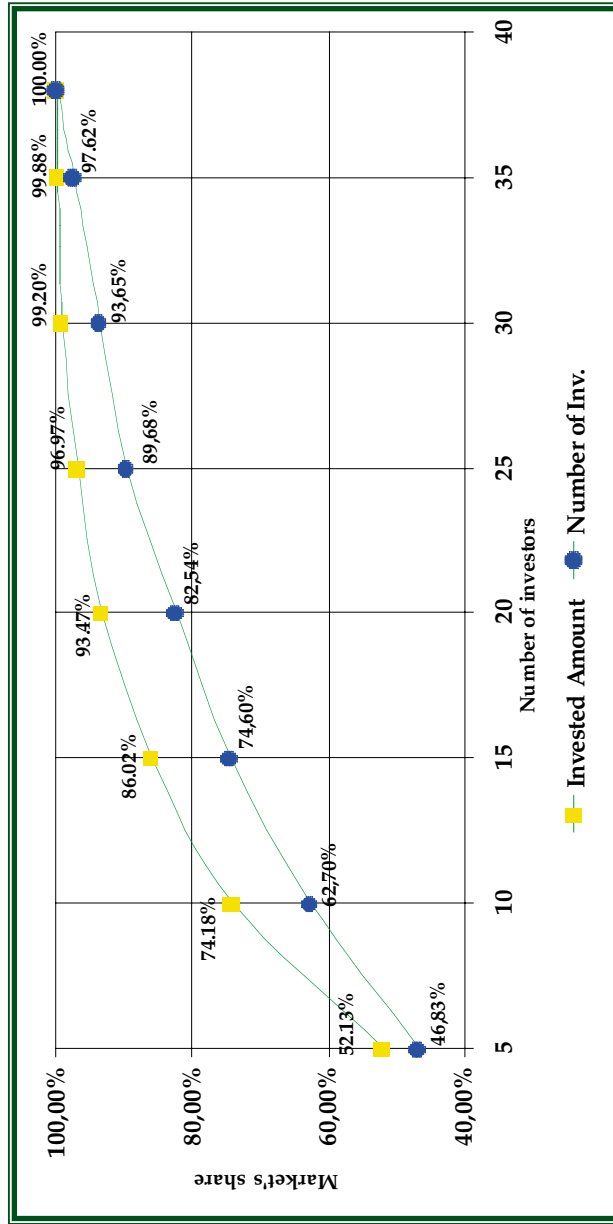
## 2004: Amount invested by type of investors



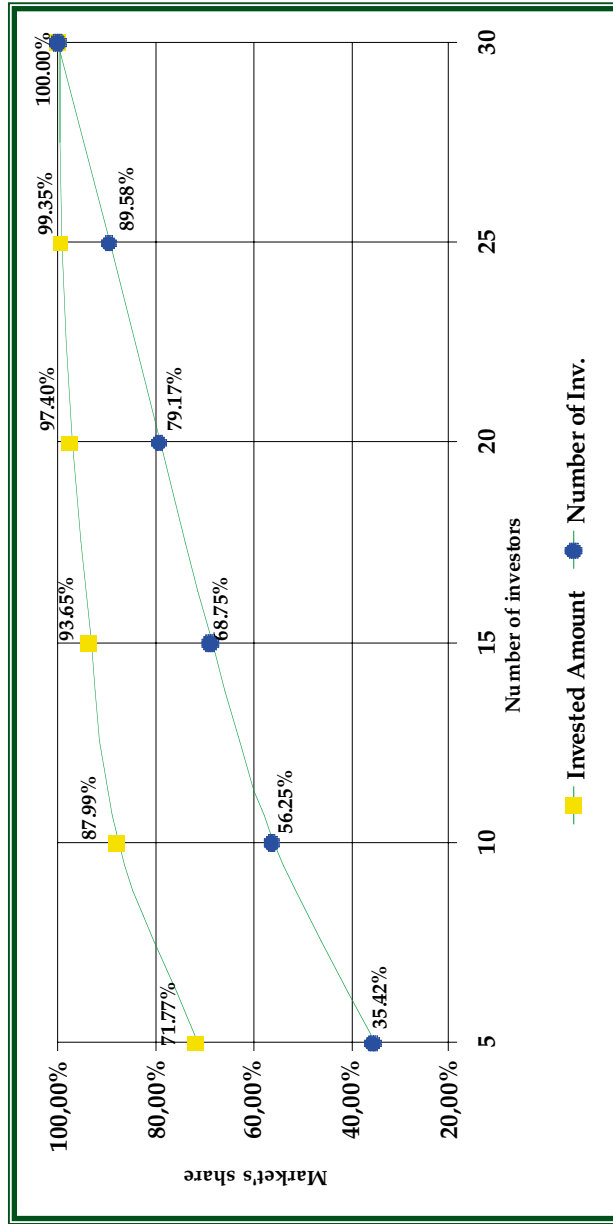
## 2004: Italian Early stage industry concentration



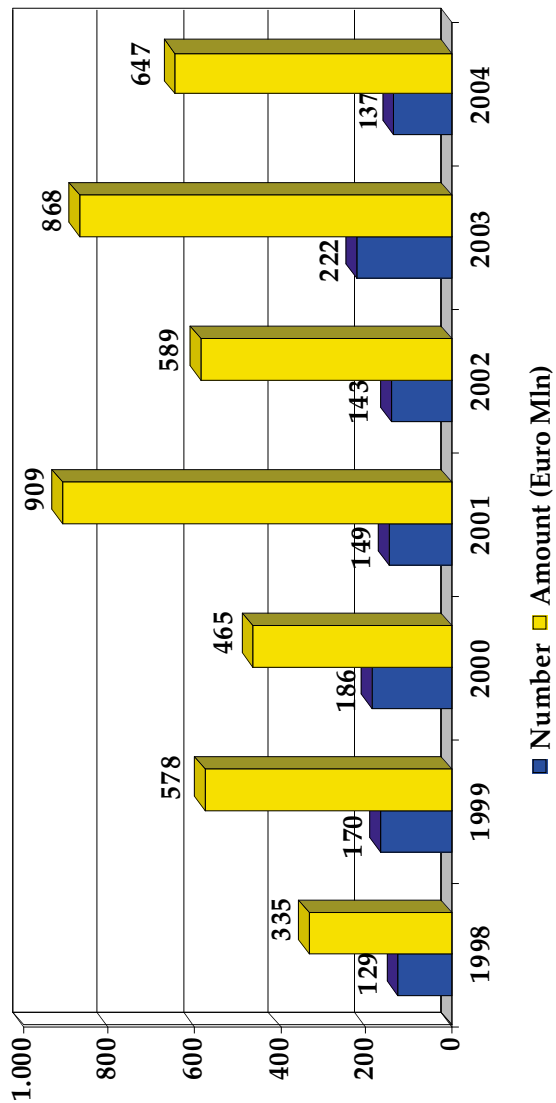
## 2004: Italian Expansion industry concentration



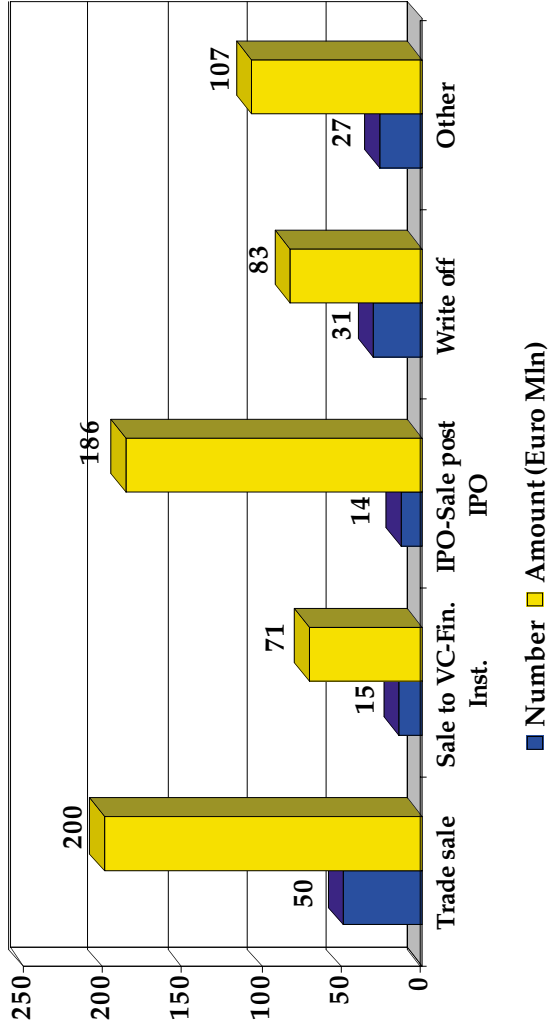
## 2004: Italian Buy out industry concentration



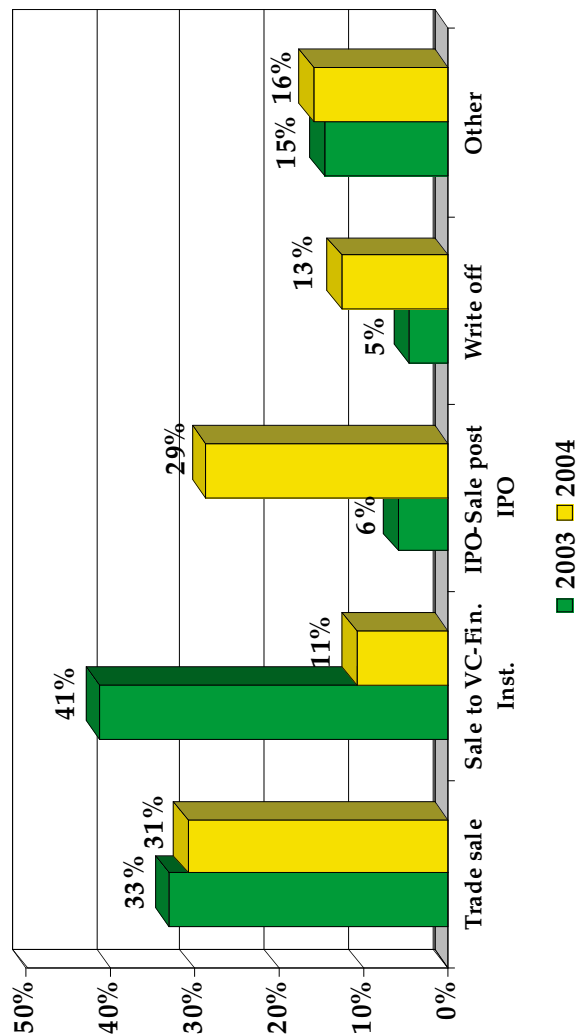
## Divestment activity by number and amount (at cost)



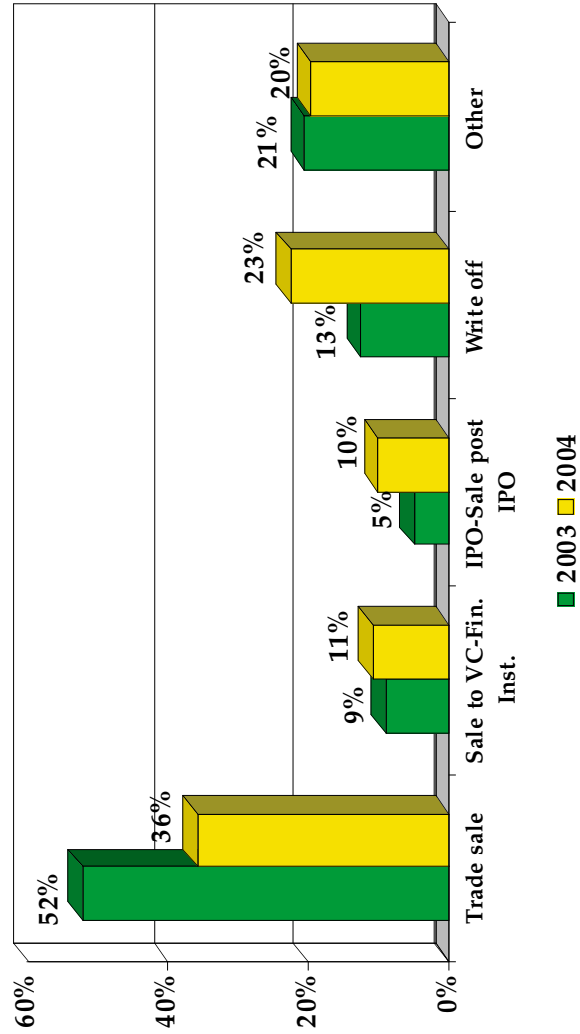
## 2004: Distribution of divestments by number and amount



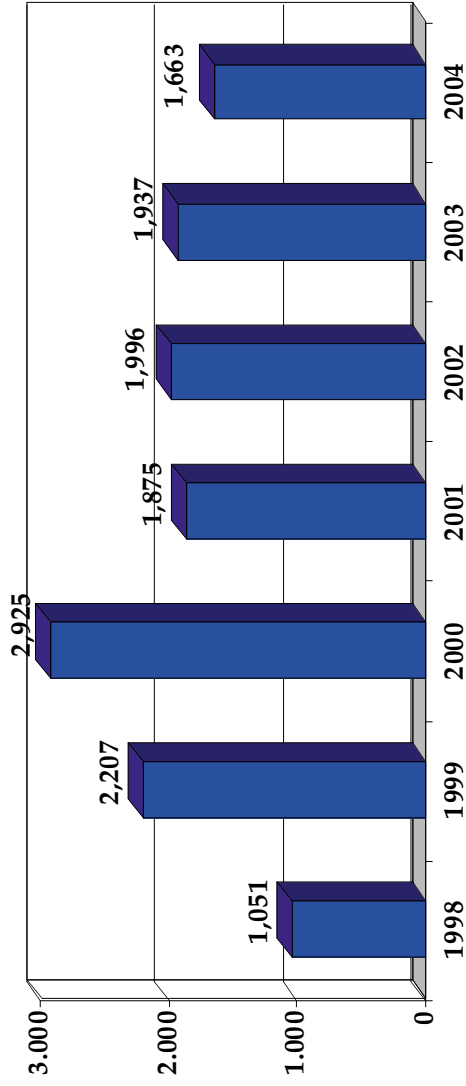
## 2003 – 2004: % distribution of divestments by amount



2003 – 2004: % distribution of divestments by number



## Annual funds raising activity (Euro Mln)\*

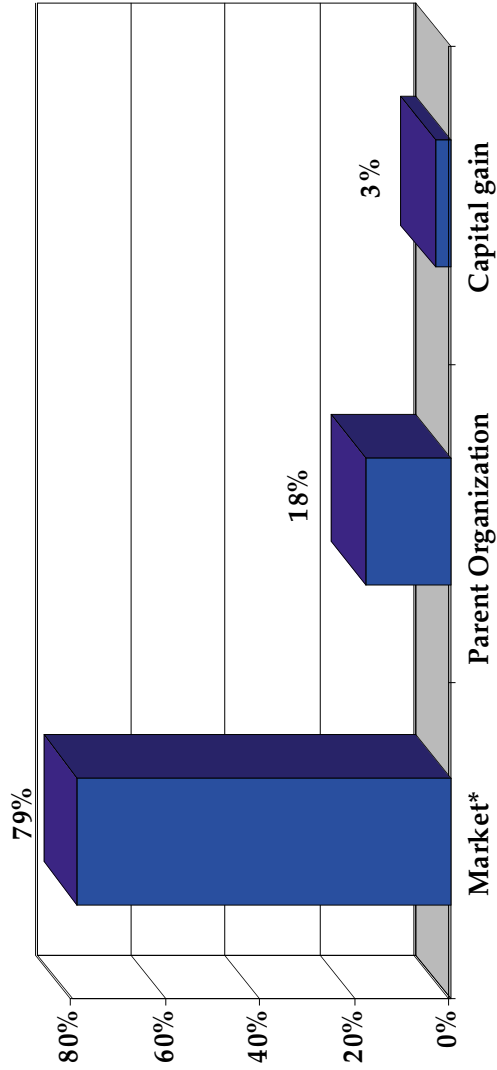


*\*Pan-European Funds not included.*

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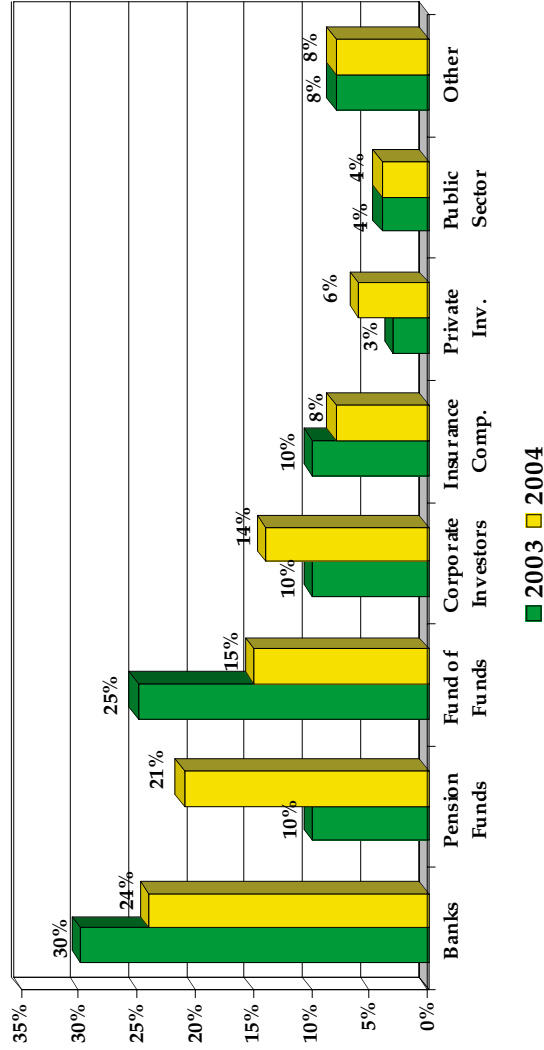
PRICEWATERHOUSECOOPERS 

## 2004: Sources of total new funds raised by %

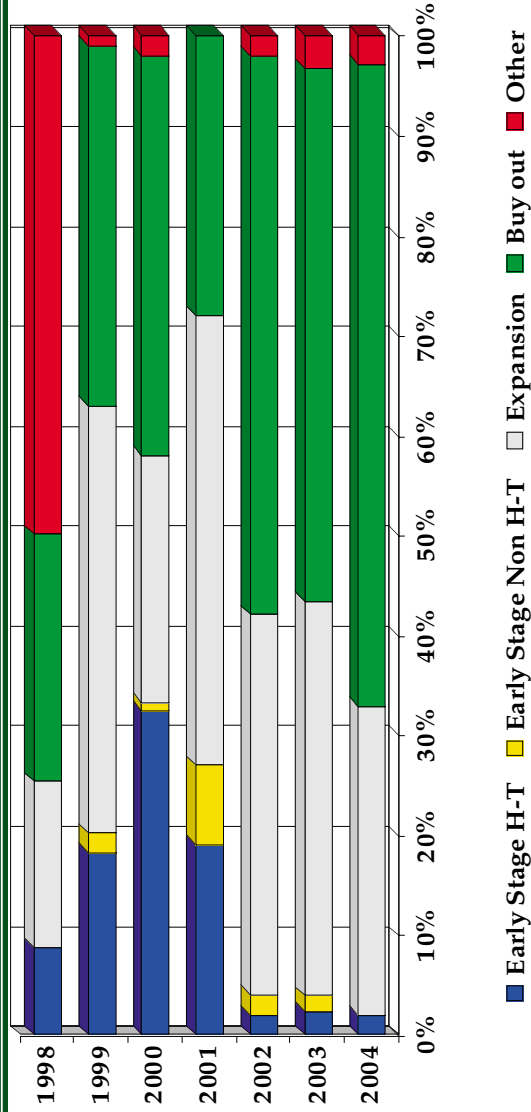


\*New funds raised by country funds.

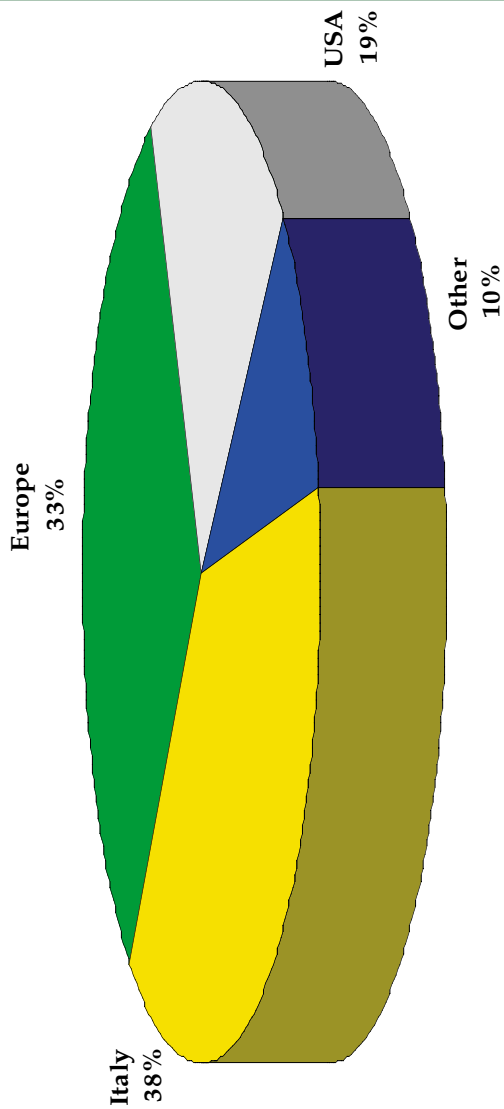
2003 – 2004: % distribution by sources of new funds raised by country funds



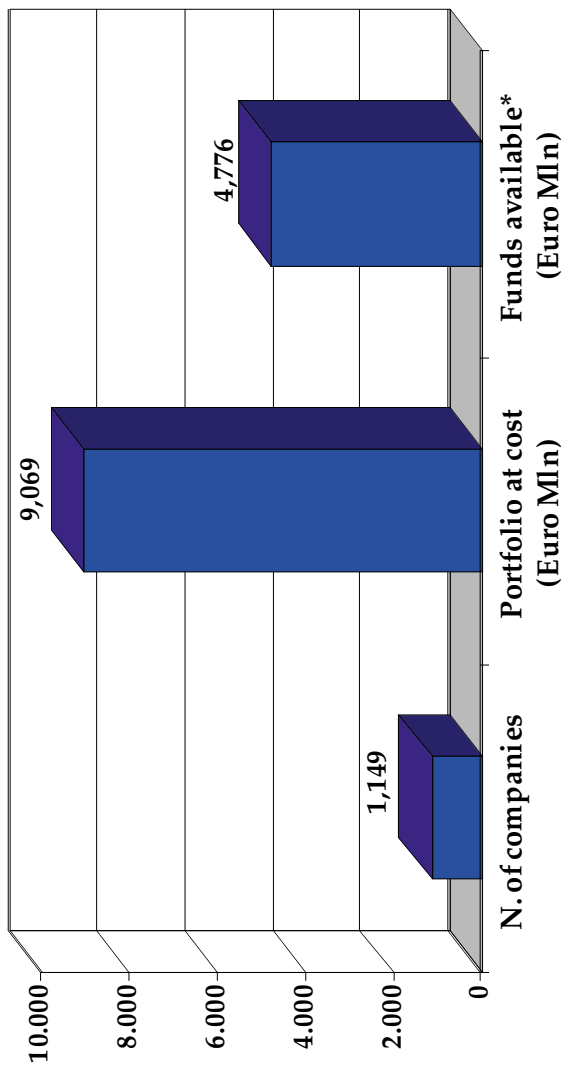
## Fund raising expected allocation



2004: Geographical breakdown of capital raised by country funds



## Portfolio and funds available at 31<sup>st</sup> December 2004



\*Captive investors and pan-European funds not included.

# AIFI Board Members

**Chairman**

Giampio Bracchi

**General Manager**

Anna Gervasoni

**Board of Director**

Gianmaurizio Argenziano

Franco Asquini

Gabriele Cappellini

Matteo Carlotti

Giorgio Ciria

Enrico De Cecco

Mario Carlo Ferrario

Giorgio Gandini

Edoardo Lecaldano

Carlo Mammola

Andrea Negri

Sergio Sambonet

Fabio L. Sattin

Stefano Scarpis

**Honorary Chairman**

Marco Vitale

**Auditing Firm**

KPMG



# **A I F I**

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