

A.I.F.I.
Italian Private Equity and Venture Capital Association

**STATISTICS ON PERFORMANCE: 1989-1998 GROSS IRR ON
REALISED INVESTMENTS**

A.I.F.I.
Italian Private Equity and Venture Capital Association

INTRODUCTION

Following the first edition (1986-1996), the present analysis of the Italian private equity and venture capital industry performance is based upon the results of a detailed survey of the investment and divestment activity carried out between 1989 and 1998.

The present survey has been carried out in order to assess the **performance on realised investments obtained within the 1989-1998 period**, by the private equity and venture capital companies operating in Italy. Overall performance on realised investments has been measured in terms of **pooled IRR**.

In order to estimate the pooled IRR, all cash flows on which data are available, have been considered and aggregated as if they resulted from the operation carried out by a single fund.

Also this year, the analysis has been carried out by KPMG Corporate Finance in co-operation with AIFI.

The survey comprehends 25 of the most important private equity and venture capital companies operating in Italy and analyses a total of 172 transactions which have been realised¹ in the considered period.

For the performance measurement the **IRR Gross Return on Realised Investment** was measured, according to the EVCA Performance Measurement Principles, as reported below in the third paragraph.

In the following, a brief description of the analysed sample is reported.

THE SAMPLE PANEL

Main features of the sample (and the past edition reference) are as follows.

Table 1 – Main sample features

	1989-1998	1986-1996
Number of companies included in the research panel	25	14
Number of companies presenting realised investments	16	12
Number of realised investments	172	100
Average investment dimension (<i>Euro</i> mln)	2,7	2,5
Total Cash Out (<i>Euro</i> mln)	461	250
Total Cash In (<i>Euro</i> mln)	1,140	622

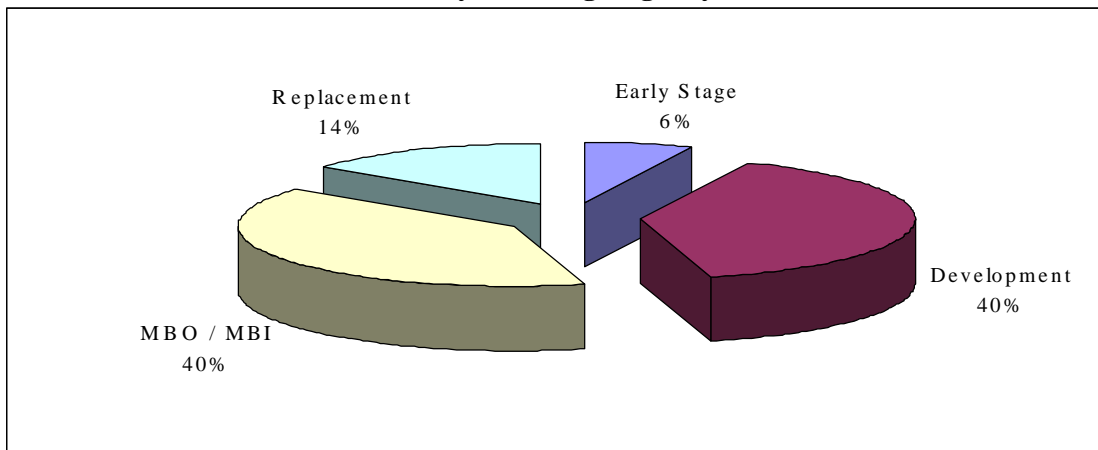
Source: KPMG Corporate Finance

The sample contains 172 realised investments that can be analysed on the basis of the following breakdown.

¹ According to the EVCA (European Venture Capital Association) criteria, mentioned in the third paragraph, in this survey are considered “realised” only the investments 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 the total cash out have been considered.

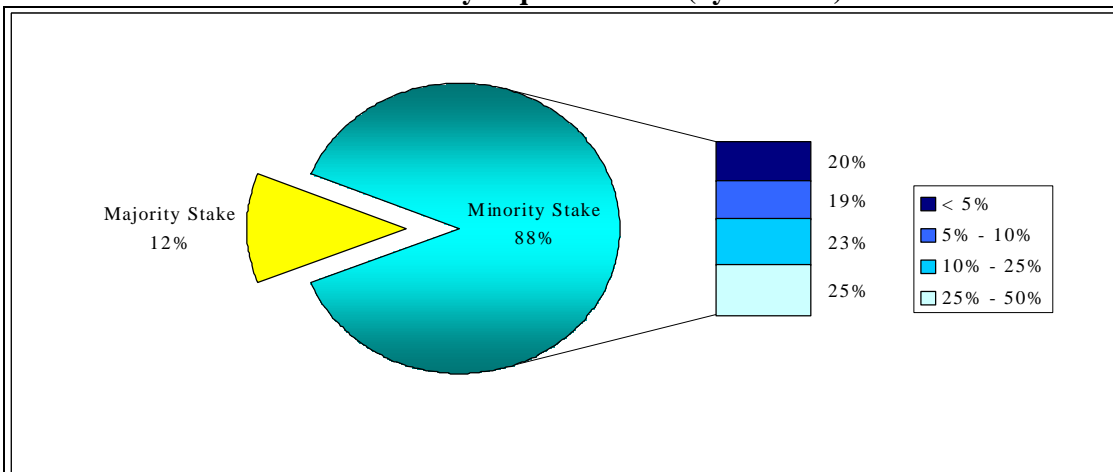
A.I.F.I.
Italian Private Equity and Venture Capital Association

Table 2 – Transactions breakdown by financing stage (by number)



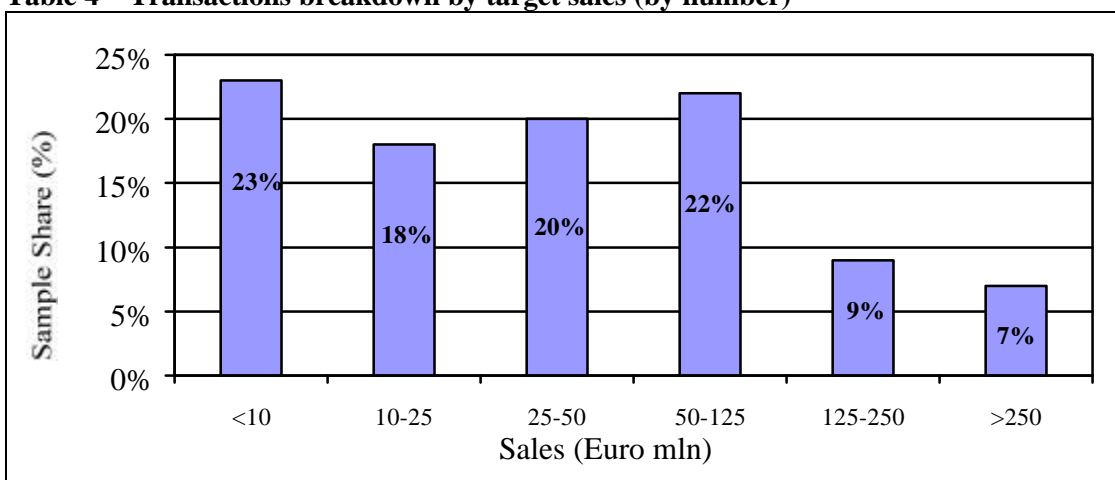
Source: KPMG Corporate Finance

Table 3 – Transactions breakdown by acquired stakes (by number)



Source: KPMG Corporate Finance

Table 4 – Transactions breakdown by target sales (by number)



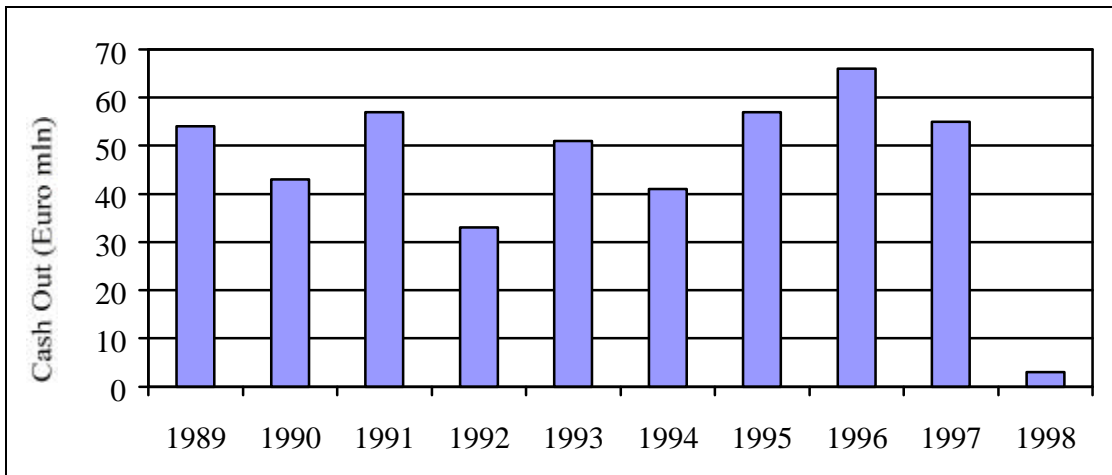
Source: KPMG Corporate Finance

A.I.F.I.
Italian Private Equity and Venture Capital Association

As represented on the charts, most of the transactions have been focused on minority stakes of little-middle size companies, leaded, above all, by operations of development financing or MBO/MBI.

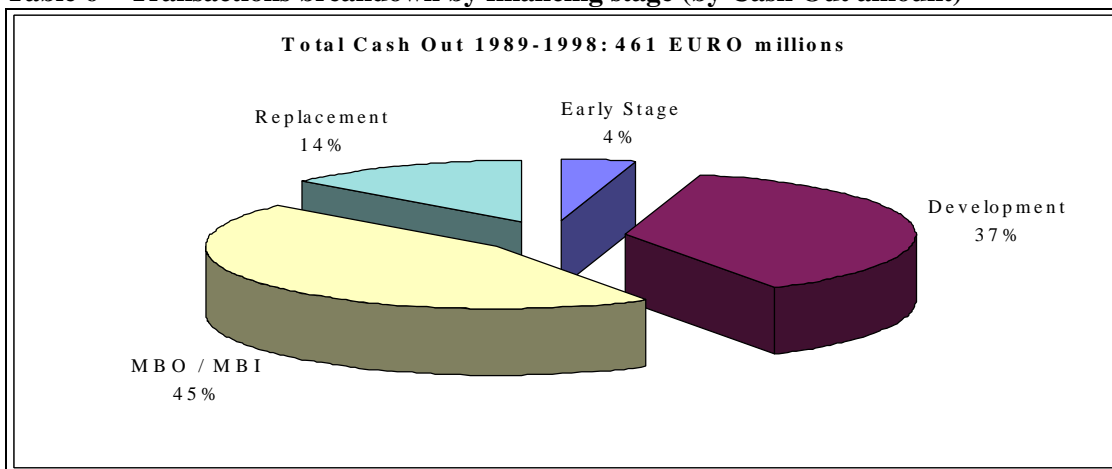
The analysis of cash flows related to the above mentioned transactions is summarised on the following charts.

Table 5 – Annual Cash Out related to realised investments 1989-1998



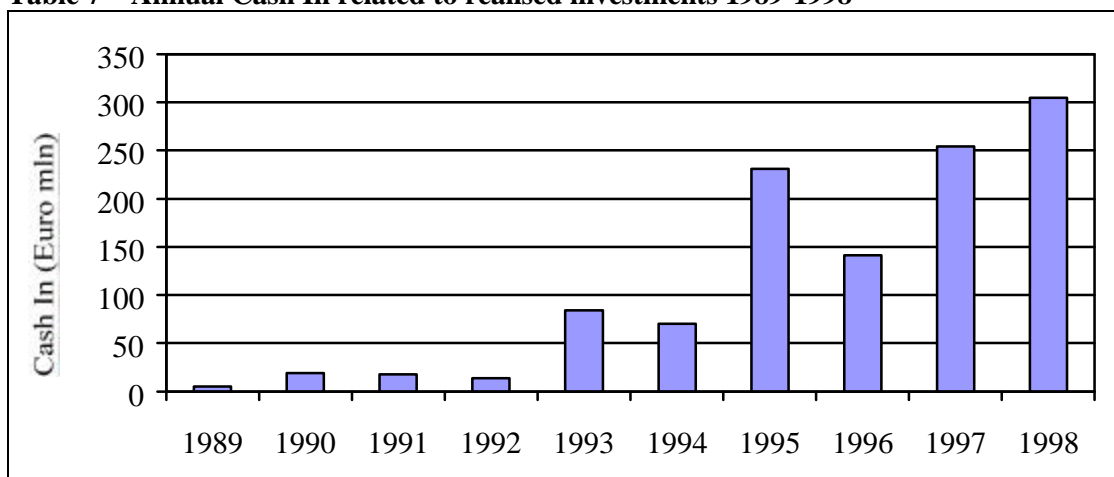
Source: KPMG Corporate Finance

Table 6 – Transactions breakdown by financing stage (by Cash Out amount)



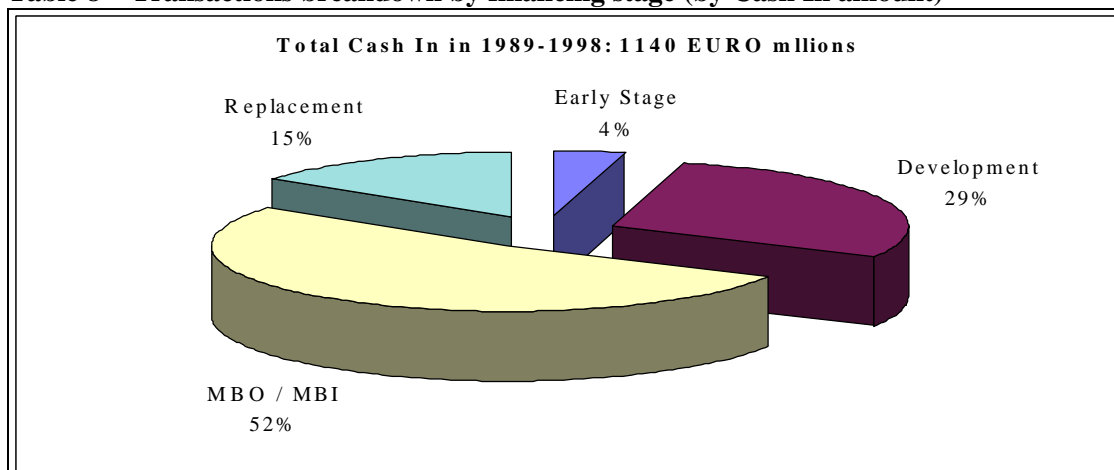
Source: KPMG Corporate Finance

Table 7 – Annual Cash In related to realised investments 1989-1998



Source: KPMG Corporate Finance

Table 8 – Transactions breakdown by financing stage (by Cash In amount)



Source: KPMG Corporate Finance

In the last years the Italian private equity and venture capital market has grown fast in terms of total amounts invested, but, above all, in terms of divestment volumes. It is interesting to note that the majority of the Cash In generated by the analysed transactions can be related to MBO/MBI deals.

THE EVCA PERFORMANCES MEASUREMENT PRINCIPLES: THE INTERNAL RATE OF RETURN (IRR)

In June 1992, the Members of the European Venture Capital Association (EVCA) supported their Valuation Committee’s proposals to prepare a set of standard principles, for the measurement of the private equity and venture capital investments’ performance.

These Principles are intended, primarily, as a means by which Managers can measure their performance on a standard basis. These principles therefore provide an important tool to facilitate the monitoring, analysis and comparison of the performance of individual investments and groups of investments of funds, on a consistent basis.

A.I.F.I.
Italian Private Equity and Venture Capital Association

Common measurement of private equity and venture capital performance requires a common approach to the valuation of portfolios: in the following the text of the original EVCA Principles for the valuation of private equity and venture capital portfolios is reported.

The most common measure of performance within the venture capital sector is the internal rate of return or IRR. The IRR is that rate of discount which equates the present value of cash outflows associated with an investment with the sum of the present value of the cash inflows accruing from it and the present value of the valuation of the unrealised portfolio.

Pure IRRs can only be computed when all investments have been realised and the cash has been paid back to Founders, after the deduction of carried interest, management fees and other applicable professional and ancillary charges. This is the net (“cash-on cash”) return on the wholly realised investment portfolio.

However, users of financial information regarding private equity and venture capital companies need to be able to measure returns on a regular basis. Such interim returns are no more than indicators of the pure IRR. The more mature that an investment portfolio is, though, the more confidence one may generally ascribe to these interim statistics.

Performance calculations must quantify the prowess of the private equity and venture capital managers at two main stages:

- firstly, on their ability to choose suitable investment opportunities, manage them and divest from them;
- secondly, to assess their overall cost effectiveness by computing the return to founders net of the total cost of carrying out these tasks.

The first of these stages, that is the gross return, may be usefully broken down into two levels. This enables the actual return on realised investments only to be identified separately from the gross return on all investments, which by its very nature is estimated; the latter accounts for all wholly and partially realised investments and for the subjective element of valuation on the unrealised portion of the portfolio.

EVCA, therefore advocates that performance be measured at three levels:

1. THE GROSS RETURN ON REALISED INVESTMENTS
2. THE GROSS RETURN ON ALL INVESTMENTS
3. THE NET RETURN TO THE FOUNDER

The level adopted in the present survey is the **Gross Return on Realised Investments**.

The Gross Return on Realised Investments

This return takes account of the Cash Outflows (investments) and Inflows (divestments, including realisation values and dividend) which take place between the Fund and its realised investments.

A.I.F.I.
Italian Private Equity and Venture Capital Association

In deciding which partially realised gains should be included in this category the following rules should be observed:

- Only those realised gains should be included which represent a substantial part (>30%) of the cost of equity investment. In that case all cash inflows relating to that equity investment are to be included at this level.
- If the investment is made at different costs per share at different dates, the allocation of gain to cost should be based on the average cost per share of the realised investment.
- Partial write-off should not be included in this level.
Departing EVCA criteria, as far as Write Off, starting from this survey, it has been considered as Write Off any devaluation over 80% of original investment.
- Full disclosure should be made of those investments where partial realisation are included in this level, in particular as to the allocation of gain to cost.

To enable the returns calculated in accordance with the adopted Level described herein by various users to be fairly compared, necessitates that the relevant parameters are always treated in an identical manner.

It is for this reason that the Valuation Committee has developed the Standard Principles, which are set out on the EVCA 1998 Yearbook.

SURVEY CONCLUSIONS

According to the criteria described above, during the considered period (1989-1998), the Italian private equity and venture capital companies achieved the average annual return on the investments, measured in terms of Gross Return on Realised Investments, which is shown below.

Table 9 – 1989-1998: Annual performance on realised investments²

	1989-1998	1986-1996
Yearly Pooled IRR	33,4%	31,2%
Upper Quarter (per performance)	96,2%	111,3%
Upper Quarter (per investment dimension)	34,6%	30,7%

Source: KPMG Corporate Finance

For the 1989-1998 period the Italian private equity and venture capital market demonstrates strong performances in terms of Gross Return on Realised Investments, with an improve in

² **Yearly Pooled IRR:** the IRR obtained by taking the cash flows from inception and aggregating them into a pool as if they were a single fund.

Upper Quarter (as of performance): the pooled IRR for those transactions in the top quarter of performance.

Upper Quarter (as of investment dimension): the pooled IRR for those transactions in the top quarter per investment dimension (based upon the amount of money invested by the private equity and venture capital company in the transaction).

A.I.F.I.
Italian Private Equity and Venture Capital Association

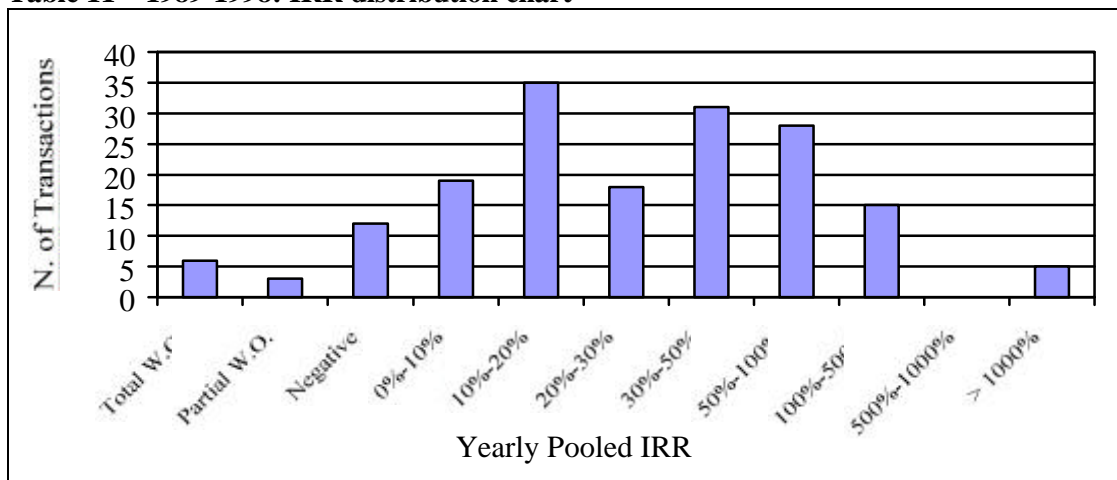
relation to the 1986-1996 survey due, above all, to better performances realised on the bigger transactions (see Upper Quarter per investment dimension) realised in the most recent years.

Table 10 – 1989-1998: IRR distribution

	Number of Transactions	Incidence (%)
Total Write Off	6	3%
Partial Write Off	3	2%
Negative	12	7%
0% - 10%	19	11%
10% - 20%	35	20%
20% - 30%	18	10%
30% - 50%	31	18%
50% - 100%	28	16%
100% - 500%	15	9%
500% - 1000%	0	0
> 1000%	5	3%
Total Transactions	172	100%

Source: KPMG Corporate Finance

Table 11 – 1989-1998: IRR distribution chart



Source: KPMG Corporate Finance

The market's IRR performance can be analysed on the basis of different breakdown, as shown below.

Please note that in the following tables the transactions considered are less than 172, because for some operations of the sample the detailed data are not available. Consequently the percentage incidence is calculated on the number of transaction analysed in each single case.

A.I.F.I.
Italian Private Equity and Venture Capital Association

Table 12 – 1989-1998: IRR distribution by financing stage

	Early Stage	Development	MBO-MBI	Replacement	Total
N. of Transactions	10	63	63	23	159
Incidence (%)	6%	40%	40%	14%	100%
Pooled IRR	35,1%	20,2%	43,6%	45,9%	

Source: KPMG Corporate Finance

Table 13 – 1989-1998: IRR distribution by acquired stakes

	<5%	5%-10%	10%-25%	25%-50%	>50%	Total
N. of Transactions	20	19	23	25	12	99
Incidence (%)	20%	19%	23%	25%	12%	100%
Pooled IRR	13,2%	36,0%	17,4%	36,7%	26,4%	

Source: KPMG Corporate Finance

Table 14 – 1989-1998: IRR distribution by target sales dimension (Euro mln)

	<10	10-25	25-50	50-125	125-250	>250	Total
N. of Transactions	34	26	30	33	14	11	148
Incidence (%)	23%	18%	20%	22%	9%	7%	100%
Pooled IRR	9,0%	31,6%	32,1%	36,6%	55,9%	65,1%	

Source: KPMG Corporate Finance