

STATISTICS ON PERFORMANCE: 1991-2000 GROSS IRR ON REALISED INVESTMENTS¹

INTRODUCTION

Following the first three editions (1986-1996, 1989-1998 and 1990-1999), the present analysis of the Italian private equity and venture capital industry performances is based upon the results of a detailed survey of the investment and divestment activity carried out between 1991 and 2000.

The present survey has been carried out in order to assess the performance on realised investments obtained in the 1991-2000 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 the cash flows on which data are available, have been considered and aggregated as if they resulted from the deals carried out by a single fund.

Also this year, the analysis has been realised by KPMG Corporate Finance in cooperation with A.I.F.I. The survey investigates 56 of the most important investors operating in Italy and analyses a total of 245 transactions which have been realised² in the considered period. For the performance measurement the IRR Gross Return on Realised Investment was calculated, according to the EVCA Performance Measurement Principles, as reported in the third paragraph. In the following paragraph a brief description of the analysed sample is reported.

THE SAMPLE PANEL

The main features of the considered sample (and the past edition reference) are as follows.

¹ The analysis has been realized in collaboration with KPMG Corporate Finance.

² According to the EVCA (European Venture Capital Association) criteria, as 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 total cash out have been considered.

Table 1 – Main sample features

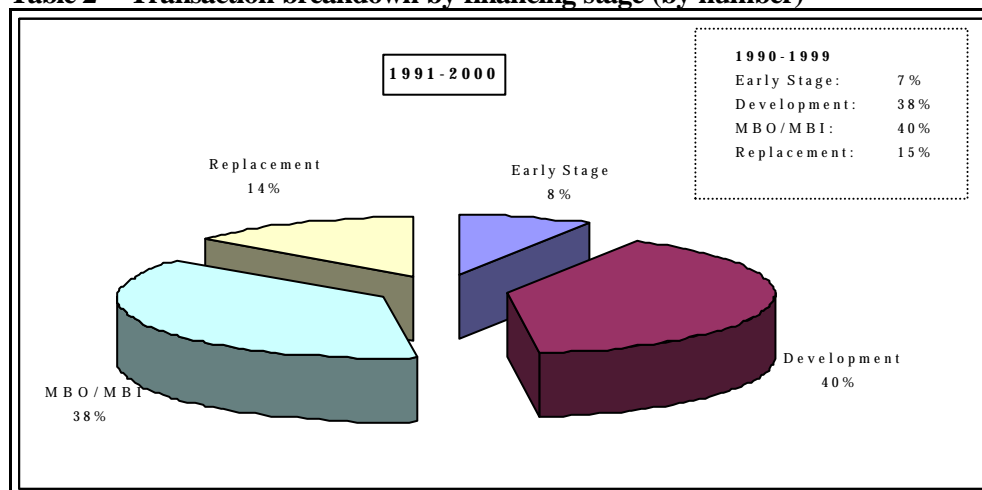
	1991-2000	'90-'99	'89-'98	'86-'96
N. of companies included in the research panel	56	35	25	14
N. of companies presenting realised investments	33	25	16	12
Number of realised investments	245	202	172	100
Average investment dimension (mln)	3.1	2.8	2.7	2.5
Total Cash Out (mln)	750	576	461	250
Total Cash In (mln)	2,182	1,607	1,140	622

Source: KPMG Corporate Finance

As shown in Table 1, the sample panel, in comparison to the first survey, has become wider and more and more representative in terms of number of companies and of number of realised investments. Moreover it is important to underline the constant increase in the average investments dimension, moving from 2.5 million of 1986-1996 to 3.1 million of 1991-2000.

The sample contains 245 closed transactions that can be analysed on the basis of different breakdowns. Most of the transactions, as shown below, are presented in comparison to the previous surveys results with the purpose of highlighting the main evolution trends.

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

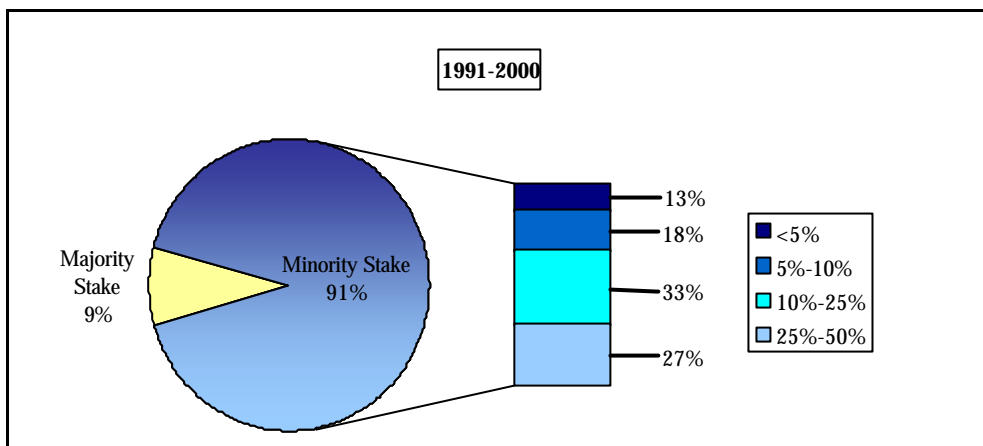


Source: KPMG Corporate Finance

The transaction breakdown by financing stage, substantially unchanged in comparison to the previous survey, underlines that most of the realised transactions

are related to buyouts or development financing investments.

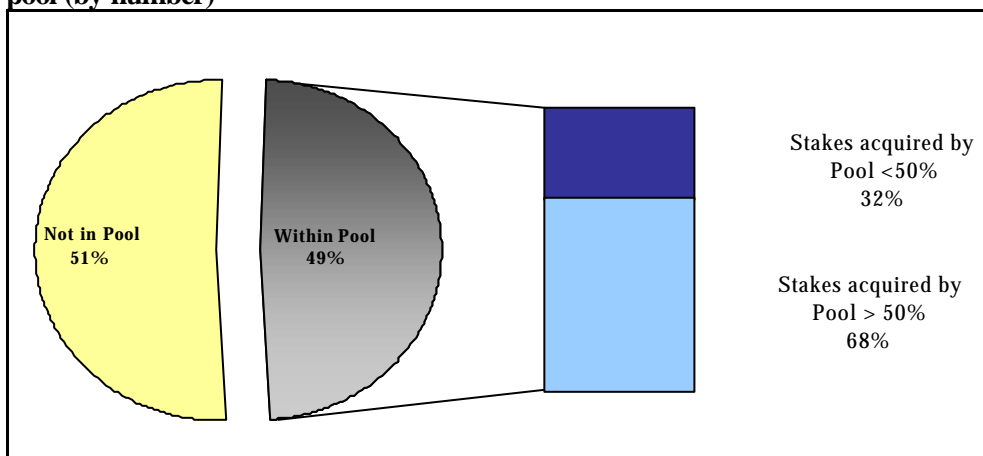
Table 3 – Transaction breakdown by acquired stakes (by number)



Source: KPMG Corporate Finance

The chart above shows the transaction breakdown by acquired stakes: all investments are on a stand alone basis, without taking into account the possible pool agreements, among some of the private equity and venture capital companies, which might have brought to the acquisition of majority stakes.

Table 4 – Transactions managed within pool vs transactions not realised in pool (by number)



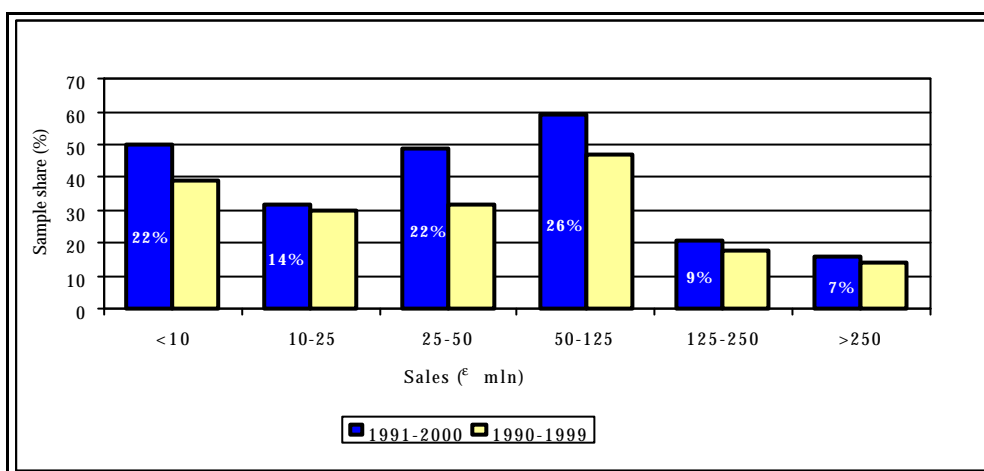
Source: KPMG Corporate Finance

As shown above, almost half of the investments were realised in pool and most of

them were related to the acquisition of a majority stake³.

The transaction breakdown by target sales is substantially unchanged in comparison to the previous survey: most of the realised transactions are related to target companies with less than 125 million of turnover.

Table 5 – Transaction breakdown by target sales dimension (by number)



Source: KPMG Corporate Finance

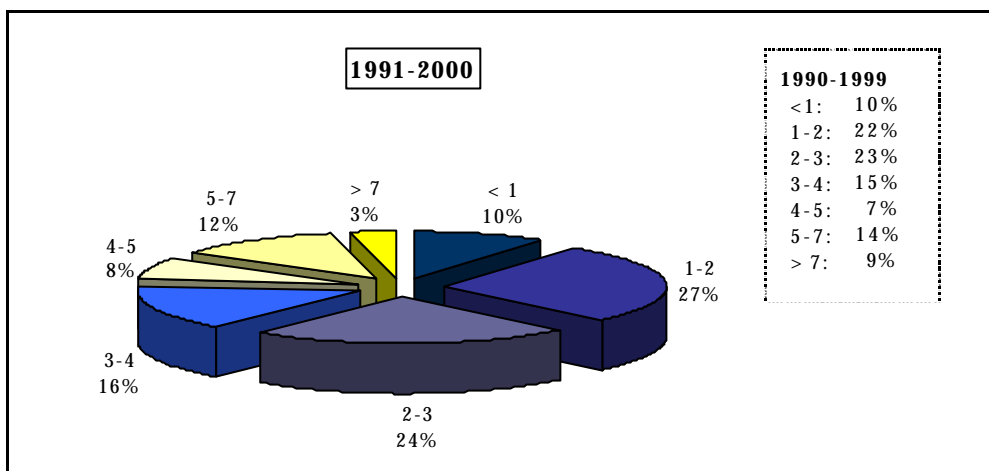
As represented in the charts, most of the transactions have been focused on investments in little-middle size companies lead, above all, by operations of development financing or MBO/MBI with a time frame between first investment and first divestment lower than 4 years.

The analysis of cash flows related to the above mentioned transactions is resumed in the following charts.

Reflecting the trend shown in the previous survey, also in the 1991-2000 decade the panel has grown in terms of total amounts invested (30% more than 1990-1999, 63% more than 1989-1998 and 200% more than 1986-1996), and in terms of divestments (36% more than 1990-1999, 91% more than 1989-1998 and 250% more than 1986-1996).

³ This criteria has been introduced in last edition for the first time. Consequently the analysis is based mainly on the investments realised in 1999 and 2000. However the sample, including more than 130 investments, can be retained significant.

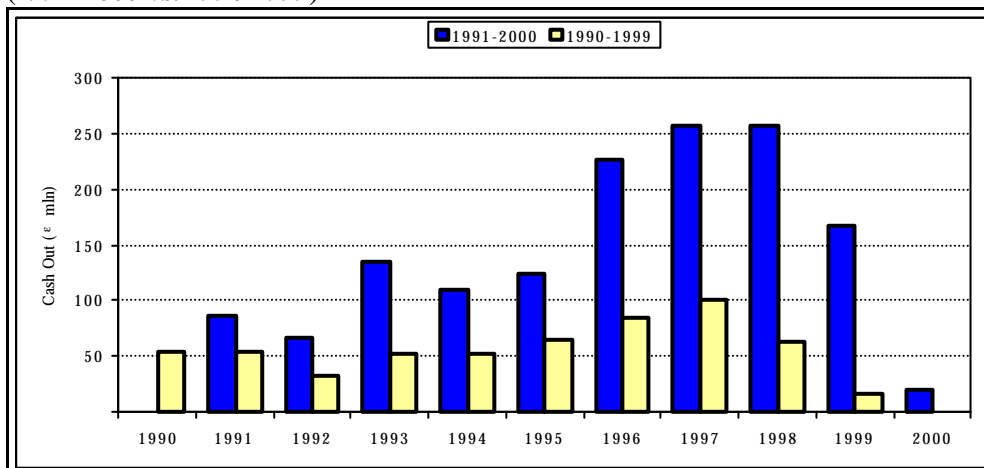
Table 6 – Transaction breakdown by time frame (years) between first investment and first divestment (by number)



Source: KPMG Corporate Finance

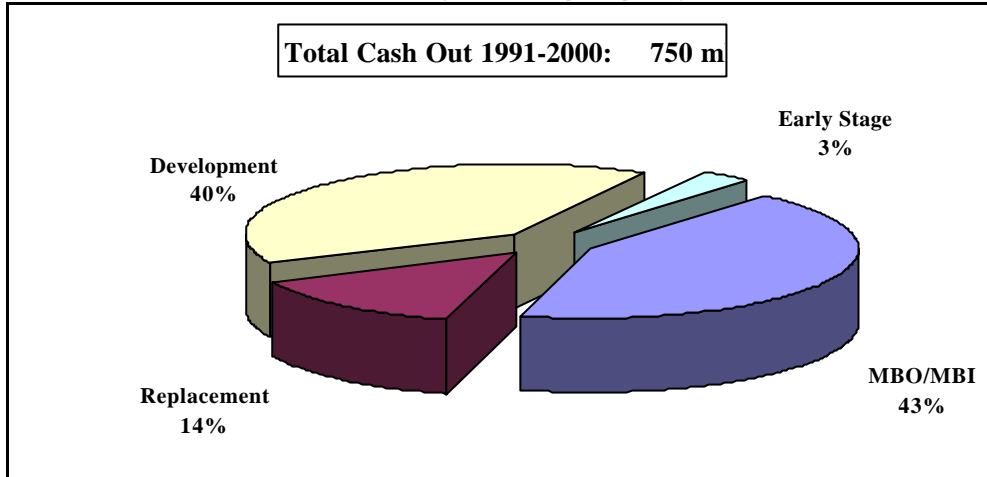
It is to be noted that the weight of Development transactions slightly decreased either in term of cash out (from 41% of the previous years to 40%) and of cash in (from 36% to 33%), while an opposite trend is shown for MBO/MBI (cash out from 40% to 43%; cash-in from 47% to 51%).

Table 7 – Annual Cash Out related to realised investments (1991-2000 vs. 1990-1999)



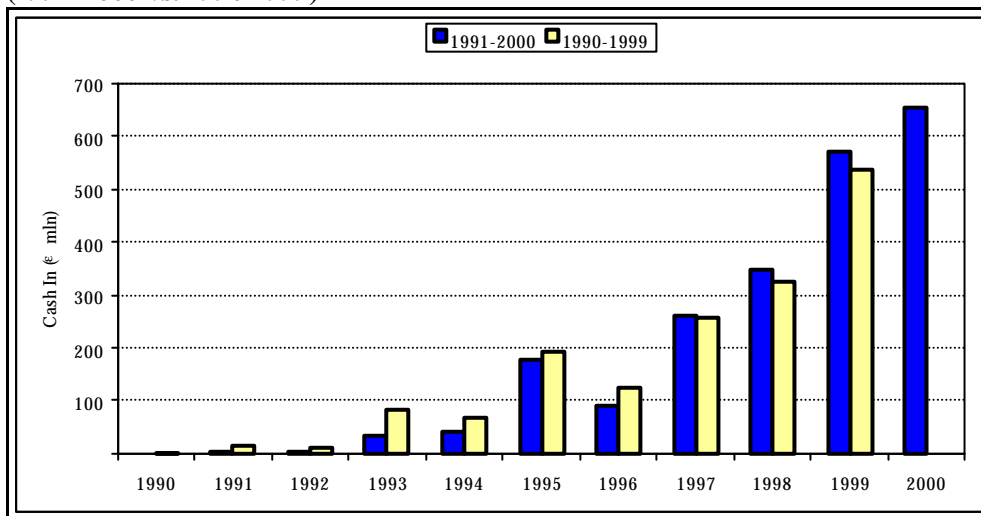
Source: KPMG Corporate Finance

Table 8 – Transaction breakdown by financing stage (by Cash Out amounts)



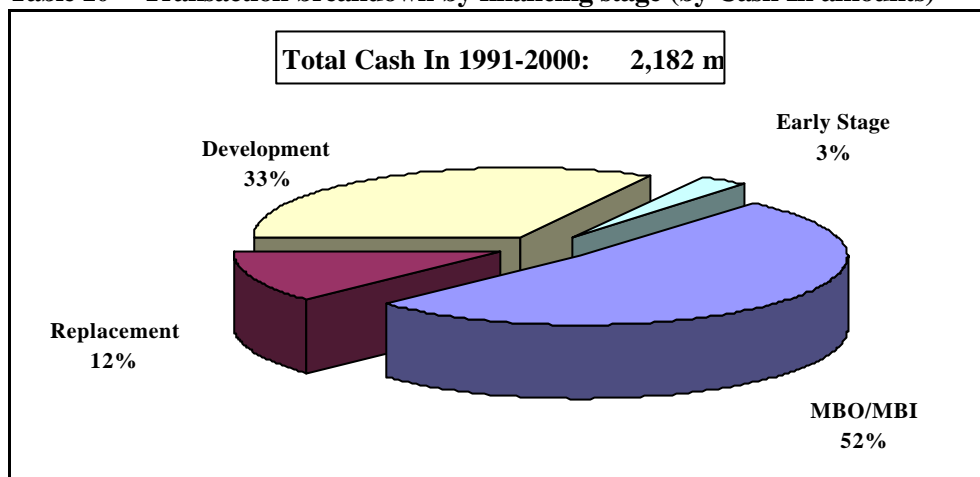
Source: KPMG Corporate Finance

Table 9 – Annual Cash In related to realised investments (1991-2000 vs. 1990-1999)



Source: KPMG Corporate Finance

Table 10 – Transaction breakdown by financing stage (by Cash In amounts)



Source: KPMG Corporate Finance

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

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

These Principles are intended primarily as a mean 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.

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

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 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 an investment portfolio is, though, the more confidence one may generally ascribe to these interim statistics.

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

- firstly, on their ability to choose suitable investment opportunities, manage them and divest 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:

- the Gross Return on Realised Investments;
- the Gross Return on All Investments;
- the Net Return to the Founder.

The level adopted in the present survey is the Gross Return on Realised Investments, also on the basis of the structure of the Italian market, composed by several captive and/or evergreen investors which, by definition, look at the gross

performance and not on the net return to the subscriber.

The Gross Return on Realised Investments

This return takes into account the cash outflows (investments) and inflows (divestments, including realisation values and dividend) which take place between the fund and its realised investments.

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 from EVCA criteria, as far as write offs are concerned, starting from past 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.

The main difference between the Gross Return on Realised Investments in comparison to the Gross Return on All Investments is that the first one does not consider the non realised investments (which, being often evaluated at cost, normally decrease the IRR of the whole panel).

The main difference between the Gross Return on Realised Investments in comparison to the Net Return to The Founder is that the first one is gross of carried interests and management fees.

SURVEY CONCLUSIONS

According to the criteria described above, during the 1991-2000 period Italian

private equity and venture capital market demonstrates (as shown below) strong performances in terms of Gross Return on Realised Investments, with an improvement in relation to the previous surveys due both to better performances of the investments and to a higher profitability of the bigger transactions, also in relation to the recent IPO involving venture capital and private equity backed companies⁴.

Table 11 – 1990-1999: annual performance on realised investments⁵

	1991-2000	1990-1999	1989-1998
Yearly Pooled IRR	47.5%	40.3%	33.4%
- Upper Quarter (per performance)	145.5%	115.1%	96.2%
- Upper Quarter (per investment dimension)	46.2%	43.4%	34.6%

Source: KPMG Corporate Finance

This survey started to monitor transactions from 1986, A.I.F.I. foundation year. The historical performance from inception (Yearly Pooled IRR 1986-2000) is 32.4%.

To better understand high improvement in terms of performances, it is helpful also to analyse the Yearly Pooled IRR related to deals (partially or totally) divested year by year, as shown in the table below.

⁴ Even if the divestments through IPO represents by number a low minority of the total panel, it has generated in the last 10 years about the 25% of the total cash in amount. The yearly pooled IRR 1991-2000 of the divestments through IPO is 64.5% (in 1990-1999 period, the yearly pooled IRR was 49.6%).

⁵ **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 (per performance): the pooled IRR for those transactions in the top quarter of performance.

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

Table 12 – IRR by transaction divested in 1998, 1999 and 2000

	1998	1999	2000
Number of transactions	51	58	78
Pooled IRR	30.1%	36.2%	47.1%

Source: KPMG Corporate Finance

Table 13 – 1991-2000: IRR distribution

	1991-2000		1990-1999	
	Number	Incidence (%)	Number	Incidence (%)
Negative/Write Off	21	8.6%	19	9.4%
0% -10%	37	15.1%	25	12.4%
10% -20%	36	14.7%	36	17.8%
20% -30%	17	6.9%	16	7.9%
30% -50%	42	17.1%	35	17.3%
50% -100%	50	20.4%	39	19.3%
100% -500%	32	13.1%	25	12.4%
500% -1000%	2	0.8%	-	-
>1000%	8	3.3%	7	3.5%
Total	245	100.0%	202	100.0%

Source: KPMG Corporate Finance

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

Please note that in the following tables the transactions considered are not 245, because of for some operations of the sample the data are not available, consequently the percentage incidence is calculated on the number of transaction analysed in each case.

Table 14 – 1991-2000: IRR distribution by financing stage

	Early stage	Development	MBO-MBI	Replacement	Total
N. of transactions	19	94	89	33	235
Incidence	8.1%	40.0%	37.9%	14.0%	100.0%
Pooled IRR	41.2%	37.9%	58.9%	40.5%	

Source: KPMG Corporate Finance

Table 15 – 1991-2000: IRR distribution by acquired stakes

	< 5%	5%-10%	10%-25%	25%-50%	> 50%	Total
N. of transactions	28	37	69	55	18	207
Incidence	13.5%	17.9%	33.3%	26.6%	8.7%	100.0%
Pooled IRR	29.7%	50.7%	35.1%	36.5%	68.8%	

Source: KPMG Corporate Finance

Table 16 – 1991-2000: IRR distribution by transactions managed within pool and transactions not realised in pool

	Transactions within Pool		Trans. not in Pool	Total
	Pool < 50%	Pool > 50%		
N. of transactions	21	44	69	134
Incidence	15.7%	32.8%	51.5%	100.0%
Pooled IRR	39.5%	72.3%	44.4%	

Source: KPMG Corporate Finance

Table 17 – 1991-2000: IRR distribution by target sales dimension (mln)

	< 10	10-25	25-50	50-125	125-250	> 250	Total
N. of transactions	50	32	49	59	21	16	227
Incidence	22.0%	14.1%	21.6%	26.0%	9.3%	7.0%	100.0%
Pooled IRR	13.1%	36.8%	25.4%	75.5%	48.3%	36.4%	

Source: KPMG Corporate Finance

Table 18 – 1991-2000: IRR distribution by time gap between first investment and first divestment

	< 1	1-2	2-3	3-4	4-5	5-7	> 7	Total
N. of transactions	24	68	58	38	19	30	8	245
Incidence	9.7%	27.8%	23.7%	15.5%	7.8%	12.2%	3.3%	100.0%
Pooled IRR	203.5%	71.4%	70.4%	58.6%	39.5%	19.3%	14.5%	

Source: KPMG Corporate Finance