



## STATISTICS ON PERFORMANCE<sup>9</sup>

### INTRODUCTION

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

More specifically, the present survey has been carried out in order to assess the performance achieved on divestments realised in 2002 by private equity and venture capital companies operating in Italy.

The analysis of the Italian private equity and venture capital industry performance is based upon the results of a detailed survey historically covering the investment and divestment activity conducted during 1986-2002 period, with a specific focus on the transactions completed within the year 2002 (compared with the result of the previous years), in order to better define and understand the real impact on the industry performance related to the specific market momentum.

Moreover, in order to underline the general trend, in term of performance, of the Italian private equity and venture capital industry, it has been reported and analysed also the results coming out from the historical (1986-2002) aggregate investment and divestment activity.

The survey includes 59 of the most important investors operating in Italy, 20 of which having realised divestments in 2002, and analyses a total of 62 transactions realised<sup>10</sup> in 2002. The historical database includes 450 transactions, realised

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<sup>9</sup> The analysis has been realised in co-operation with KPMG Corporate Finance.

<sup>10</sup> According to the EVCA (European Private Equity and Venture Capital Association) criteria, as mentioned in the third paragraph, in this survey only the investments in which the private equity and venture capital companies have sold at least the 30% of the initial investment in equity are considered "realised". In case of partial divestments only the related part of total cash out have been considered.



by some 40 investors that operate and/or operated in Italy in the period 1986-2002.

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 transactions carried out by a single fund.

The performance measurement has been based upon to the IRR Gross Return on Realised Investment, calculated according to the EVCA Performance Measurement Principles (as reported in the following).

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

In June 1992, the Members of the European Venture Capital Association (EVCA) supported the 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: in the following, the text of the original EVCA Principles for the valuation of 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 additional 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 that an investment portfolio is, though, the more confidence one may generally ascribe to these interim statistics.

Performance calculations must quantify the prowess of 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 performance to 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 account of 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 EVCA criteria, as far as Write Off, in 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.

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 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.

A preliminary brief description of the analysed sample is reported in the third paragraph.

#### THE SAMPLE PANEL

Main features of the considered sample (and the past editions' reference) are as follows.

**Table 1 - Main sample features**

	2002	2001	2000	1999	1998
N. of companies included in the research panel	59	62	56	35	25
N. of companies presenting realised investments	20	22	22	18	17
N. of realised investments in the year	62	69	80	58	51
Average investment dimension (Euro Mln)	5.1	5.1	2.8	3.3	3.2
<b>Total Cash Out (Euro Mln)</b>	314	350	225	191	164
<b>Total Cash In (Euro Mln)</b>	641	679	713	636	357

Source: KPMG Corporate Finance

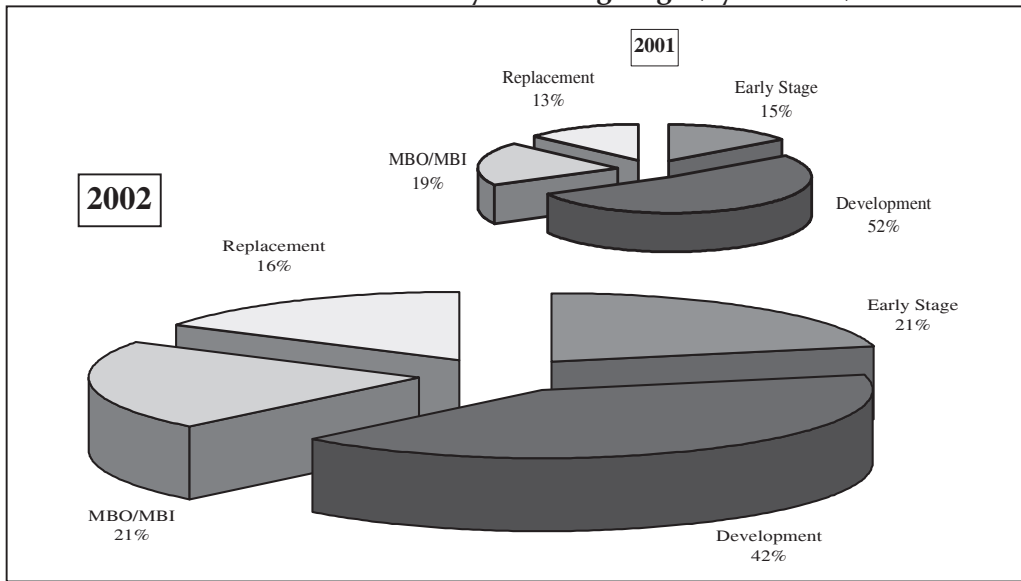
As shown in Table 1, the sample panel, in comparison to the first survey, has become wider and increasingly representative in terms of number of companies and number of realised investments analysed, achieving in the last 3 years a substantially constant structure. Moreover it is important to note that, after a constant increase between 1998 and 2001 (CAGR<sup>11</sup> over 15%), the average investments dimension in 2002 was aligned to 2001's value. Generally speaking, 2002 sample shows, compared with 2001, a slight decrease in all the features analysed.

<sup>11</sup> Compounded Average Growth Rate.



The sample contains 62<sup>12</sup> closed transactions that can be analysed on the basis of different breakdowns. Most of them, as shown below, have been compared to previous surveys results in order to highlight the main trends.

**Chart 1 – Transactions breakdown by financing stage (by number)**



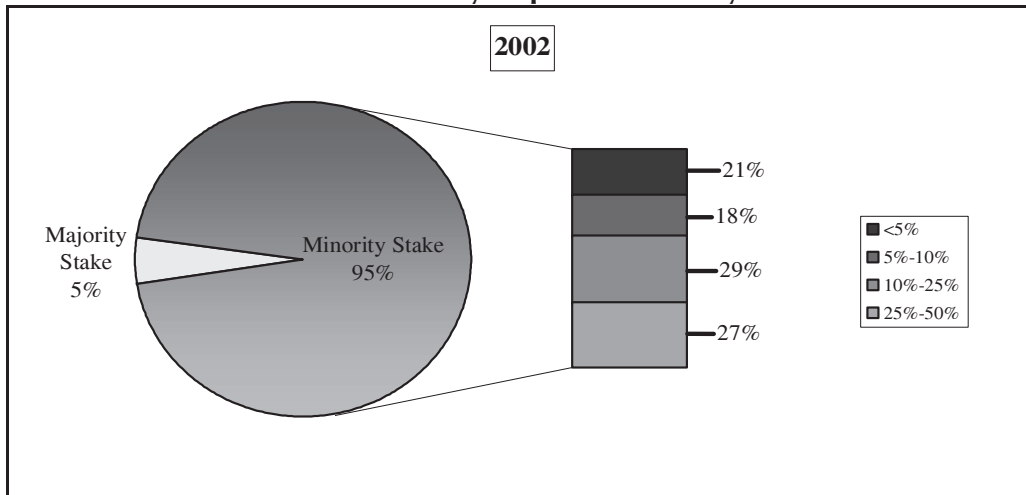
Source: KPMG Corporate Finance

The transactions breakdown by financing stage shows that most realised transactions, as well as in the past, have been related to Development stage investments. However, the significant decrease in the number of Development transactions, has to be noted in comparison with the increase of all the other kind of investments and, especially, of the Early Stage transactions.

<sup>12</sup> This number is substantially aligned with the data coming out, in term of total number of 2002's divestments, from the market's survey carried out by A.I.F.I.-PWC and reporting 143 divestments completed in the year. In fact, A.I.F.I.-PWC's survey includes also (1) investments carried out by public players, (2) divestments related to less than 30% of the stake initially acquired and (3) partial write-off up of less than 80% of the total original investment.

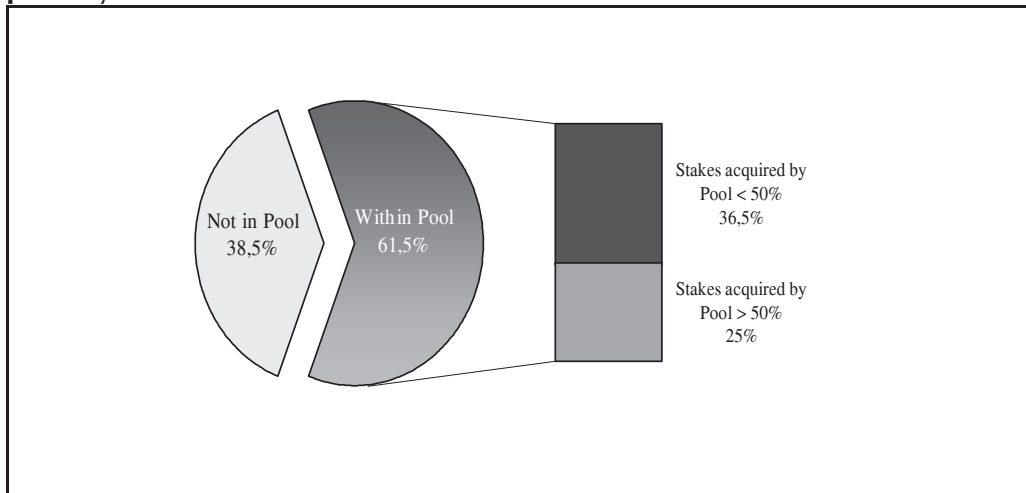


**Chart 2 – Transactions breakdown by acquired stakes (by number)**



Source: KPMG Corporate Finance

**Chart 3 - Transactions managed within pool vs transactions not realised in pool (by number)**



Source: KPMG Corporate Finance

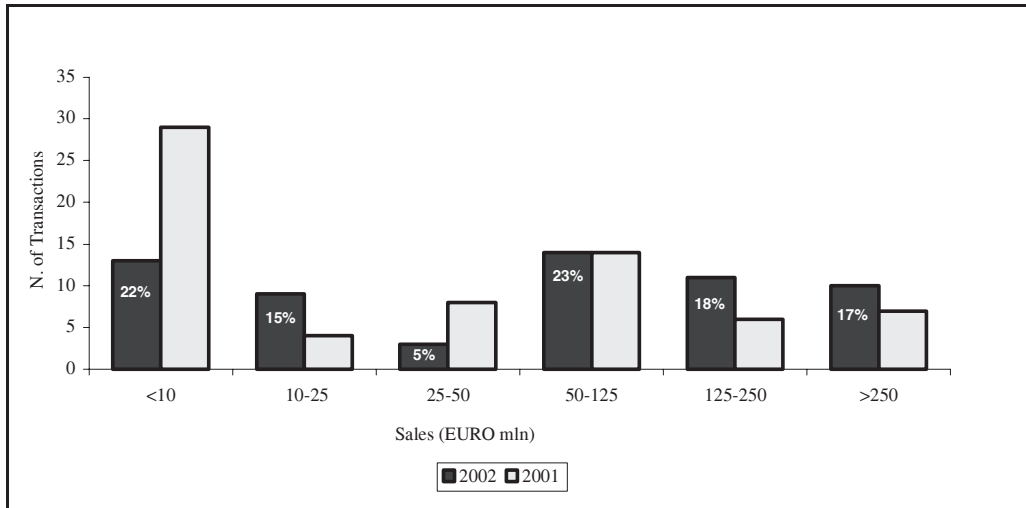
Chart 2 shows the transactions breakdown by acquired stakes: the majority of them has been related to minority stake acquisitions. It has to be noted that all



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.

For instance, as shown in Chart 3, over 60% of investments were realised in pool and most of them were related to the acquisition of a minority stake.

**Chart 4 – Transactions breakdown by target sales dimension (by number)**



Source: KPMG Corporate Finance

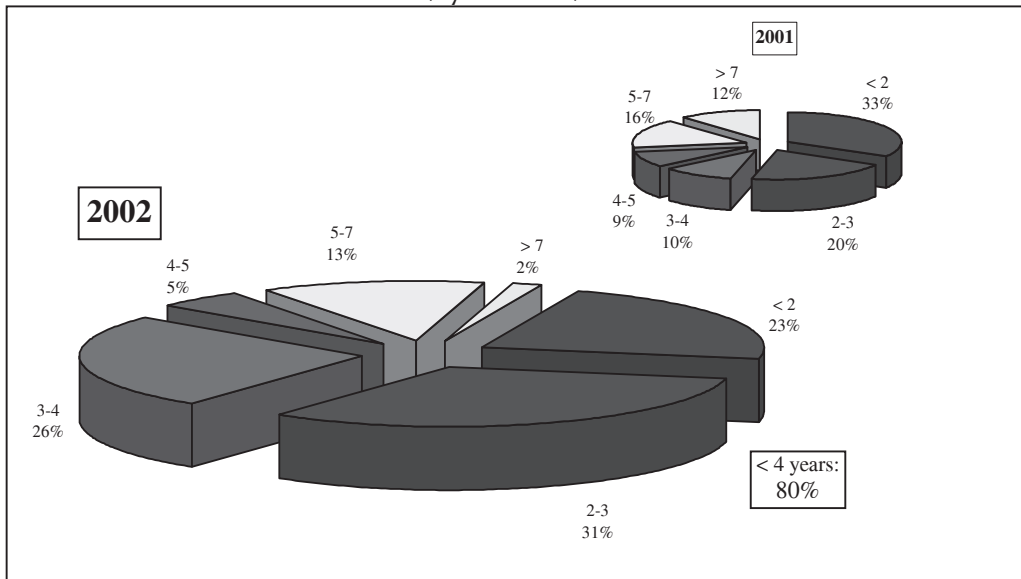
In comparison to 2001, the transactions breakdown by target’s sales shows a strong decrease in the number of investments in companies with less than 10 Euro Mln of turnover, and the contextual increase in the upper target sales clusters. Most of realised transactions have been related to target companies with more than 50 Euro Mln of turnover.

Confirming the past edition analysis, as shown in Chart 5, most of realised transactions had a time frame between the first investment and the first divestment of less than 3-4 years.



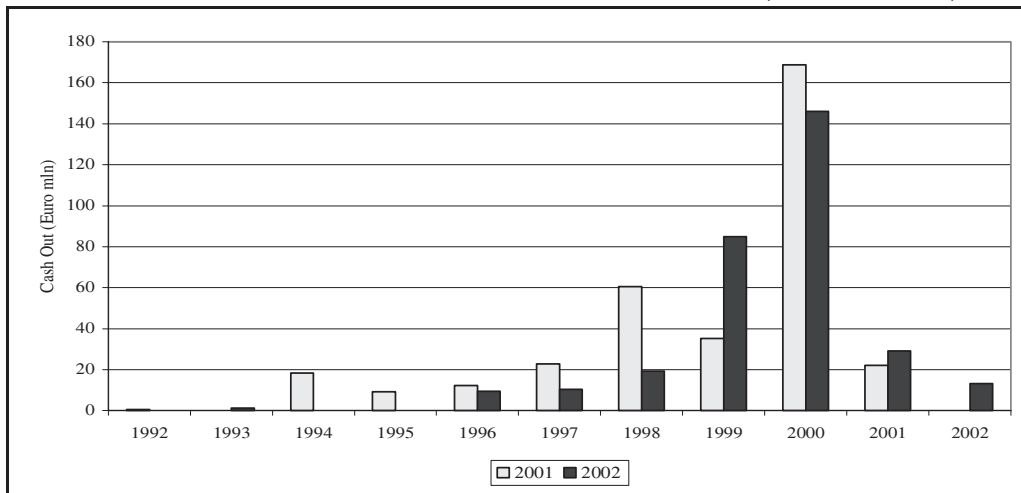


**Chart 5 – Transactions breakdown by time frame (years) between first investment and first divestment (by number)**



Source: KPMG Corporate Finance

**Chart 6 - Annual Cash Out related to realised investments (2002 vs. 2001)**



Source: KPMG Corporate Finance



As represented in the charts, the major part of the transactions has been focused on investments, not often made in pool, in minority stake of middle size companies, mainly related to Development stage, but also of MBO/MBI and of Early Stage (showing a significant growth compared with the past) and with a time frame between the first investment and the first divestment lower than 4 years.

Despite the constant growth shown by total cash outs since the first editions until 2001, in 2002 total cash outs over slightly, while the average investment dimension remaining substantially stable.

Moreover it has to be noted that the total divestments' cash ins shows a constant decreasing trend after 2000, while the average in flows has registered a slight constant growth.

#### SURVEY CONCLUSIONS

According to the criteria above described, Italian private equity and venture capital companies achieved, in the last five years, an average annual return on the investments in terms of Gross Return on Realised Investments as shown below.

**Table 2 - Yearly Gross Pooled IRR on realised investments from inception by year in 1998, 1999, 2000, 2001 and 2002**

	2002	2001	2000	1999	1998
N. of transactions	62	69	78	58	51
Yearly Pooled	34.9%	34.2%	47.1%	36.2%	30.1%

Source: KPMG Corporate Finance

The Yearly Gross Pooled IRR on realised investments from inception by year<sup>13</sup> in 2002 has been equal to 34.9%, substantially aligned to the 2001's performance

<sup>13</sup> This analysis defines the aggregated performances of all divestments (partial or total) as referring to investments included in the historical database (since 1986) and realised in one specific year (i.e. 2002). The focus of this year's survey (as already anticipated in the past edition) has been concentrated on the Yearly Gross Pooled IRR on realised investments "from inception by year", instead of on the average performance of "the last ten years



(34.2%) and, generally speaking, to the average of the previous years' performances, excluding the exception of year 2000.

**Table 3 – 1998-2002 annual performance on realised investments:  
Upper Quarters**

	2002	2001	2000	1999	1998
<b>Yearly Pooled IRR</b>	34.9%	34.2%	47.1%	36.2%	30.1%
<b>Upper Quarter (per performances)</b>	108.2%	168.0%	200.5%	218.6%	78.2%
<b>Upper Quarter (per investment dimension)</b>	42.6%	8.8%	53.9%	35.2%	38.7%

Source: KPMG Corporate Finance

In comparison to the past editions, the Upper Quarter per performances analysis shows values closer to the year average. For instance, the Upper Quarter per investment dimension reports an increase compared to the low results of 2001.

**Table 4 – 2002 vs 2001: IRR distribution**

	2002	2002	2001	2001
	Number	Incidence %	Number	Incidence %
Negative Write Off	12	19.4 %	17	24.6 %
0%-10%	16	25.8 %	20	29.0 %
10%-30%	17	27.4 %	11	15.9 %
30%-50%	6	9.7 %	7	10.1 %
50%-100%	4	6.5 %	6	8.7 %
100%-500%	5	8.1 %	4	5.8 %
>500%	2	3.2 %	4	5.8 %
<b>Total</b>	<b>62</b>	<b>100.0 %</b>	<b>69</b>	<b>100.0 %</b>

Source: KPMG Corporate Finance

period". In fact, considering that it is today available a statistically meaningful panel (with, at least, a five years horizon), the IRR from inception by year, being also free from statistic distortions related to the average calculation of performances registered in a long period of analysis (i.e. ten years), seems more appropriate in order to define the trend of the private equity and venture capital market year by year.



The IRR breakdown analysis substantially shows that in 2002 around 27% (more than 20% in 2001) of the realised transactions in the panel reported a performance, in terms of Gross IRR, higher than 30%.

Moreover, around 45% (more than 53% in 2001) of the realised transactions in the panel reported a performance, in terms of Gross IRR, lower than 10%. It has to be noted that realised transactions showing performances between 10% and 30% have been around 27% in 2002, significantly more than in 2001 (less than 16% in 2001).

**Table 5 – 2002: IRR distribution by way out**

	Trade Sale	IPO/Sales post	Other	Total
<b>N. of Transactions</b>	34	5	4	43
<b>Cash Out (Euro Mln)</b>	159	42	52	253
<b>Cash In (Euro Mln)</b>	353	159	75	587
<b>Yearly Pooled IRR</b>	32.2%	124.6%	13.2%	

Source: KPMG Corporate Finance

In terms of IRR analysis, it is important to note that divestments thorough IPO (and sales post-IPO), even if they represent (by number) about 13% of the total panel, represent more than 25% of total cash ins amount. The 2002 performance of divestments through IPO was 125% (339% in the 2001).

However, using different breakdowns, the industry performance in terms of Yearly Gross Pooled IRR on realised investments from inception in 2002 can be analysed from many angles, as shown below<sup>14</sup>.

<sup>14</sup> Please note that, in the following tables, the total transactions considered can be less than 62, due to a lack of specific information/details related to certain transactions: accordingly, the perceptual incidence is calculated, case by case, on the number of transactions effectively analysed.

**Table 6 – 2002: IRR distribution by financing stage**

	Early stage	Development	Replacement	MBO/MBI	Total
<b>N. of Transactions</b>	13	25	10	13	61
<b>Incidence</b>	21.3%	41.0%	16.4%	21.3%	
<b>Yearly Pooled IRR</b>	191.5%	22.8%	27.1%	38.0%	

Source: KPMG Corporate Finance

**Table 7 – 2002: IRR distribution by acquired stakes**

	< 5%	5%-10%	10%-25%	25%-50%	> 50%	Total
<b>N. of Transactions</b>	13	11	18	17	3	62
<b>Incidence</b>	21.0%	17.7%	29.0%	27.4%	4.8%	
<b>Yearly Pooled IRR</b>	13.1%	13.2%	41.1%	50.9%	38.6%	

Source: KPMG Corporate Finance

**Table 8 – 2002: IRR distribution by transactions managed within pool and transactions not realised in pool**

	Trans. within Pool		Trans. not in Pool	Total
	Pool < 50%	Pool > 50%		
<b>N. of Transactions</b>	19	13	20	52
<b>Incidence</b>	36.5%	25.0%	38.5%	
<b>Yearly Pooled IRR</b>	13.1%	53.4%	54.3%	

Source: KPMG Corporate Finance

**Table 9 – 2002: IRR distribution by time gap between first investment and first divestment**

	< 2	2-3	3-4	4-5	5-7	> 7	Total
<b>N. of Transactions</b>	14	20	16	3	8	1	62
<b>Incidence</b>	22.6%	32.3%	25.8%	4.8%	12.9%	1.6%	
<b>Yearly Pooled IRR</b>	14%	42.9%	40.8%	17.4%	33.2%	25.7%	

Source: KPMG Corporate Finance

The historical performance (Yearly Gross Pooled IRR on realised investments from



inception 1986-2002)<sup>15</sup> has been equal to 31.5% in 2002 as well as in 2001, confirming the substantially stable situation in terms of performances between 2002 and 2001, underlines by the above presented analysis year by year.

According to the year by year analysis, the most part of the transactions have been focused on investments in minority stake of middle size companies, mainly related to Development stage and MBO/MBI, with a time frame between the first investment and the first divestment lower than 4 years.

The total cash outs from inception related to realised investments in the period 1986-2002 reached 1,596 Euro Mln, of which 1996-2000 cash outs have accounted for more than 65%. The total divestments' cash ins accounted for 3,640 Euro Mln in the period, with a constant increasing trend, in particular showing a strong growth in 1999 and 2000.

The financing stage breakdown analysis by cash flows substantially confirms the breakdown analysis "by number", underlining a significant incidence of Development and MBO/MBI transactions.

According to that, in order to give a more complete general overview, the following tables report the main analyses related to the historical performances from inception of all the transactions analysed in relation to the 1986-2002 period.

**Table 10 – Main sample features**

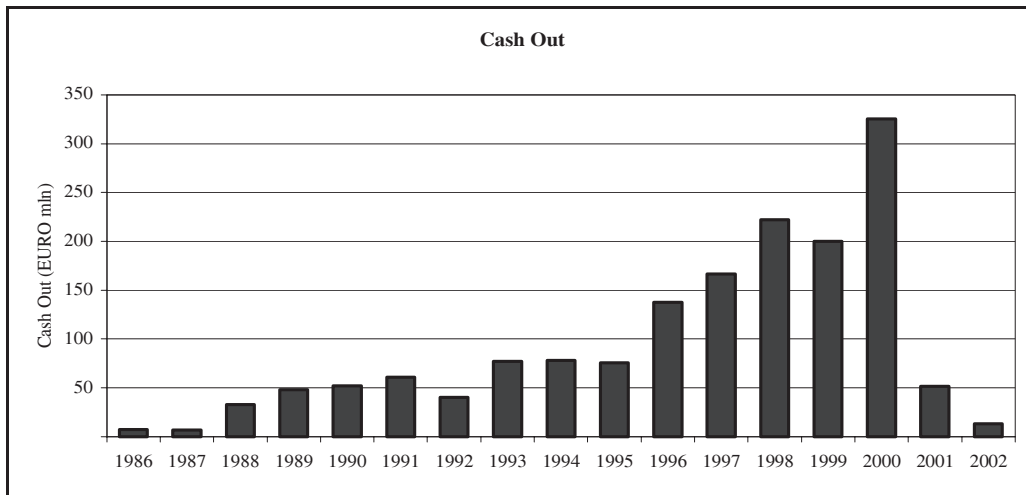
	1986-2002
N. of companies presenting realised investments	37
N. of realised investments	450
Average investment dimension (Euro Mln)	3.5
Total Cash Out (Euro Mln)	1 596
Total Cash In (Euro Mln)	3 642

Source: KPMG Corporate Finance

<sup>15</sup> This analysis defines the aggregated performance of all divestments (partial or total) included as referring to all investments included in the historical database since 1986.

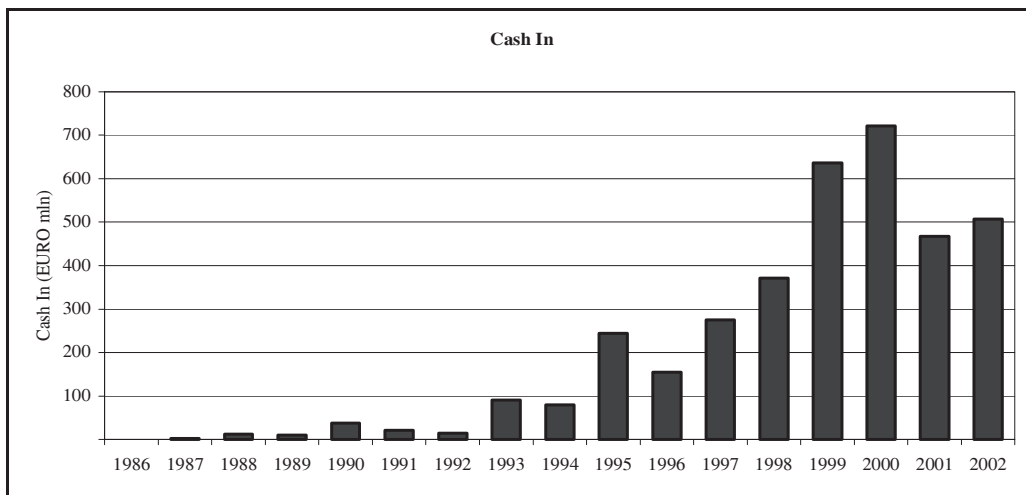


**Chart 7 – Annual Cash Out related to realised investments**



Source: KPMG Corporate Finance

**Chart 8 – Annual Cash In related to realised investments**



Source: KPMG Corporate Finance



**Table 11 – 1986-2002 annual performance on realised investments:  
Upper Quarters**

	1986-2002
Yearly Pooled IRR	31.5%
Upper Quarter ( <i>per performances</i> )	155.1%
Upper Quarter ( <i>per investment dimension</i> )	29.6%

Source: KPMG Corporate Finance

**Table 12 – 1986-2002 IRR distribution**

	1986-2002	1986-2002
	Number	Incidence (%)
Negative/Write Off	63	14.0%
0%-10%	88	19.6%
10%-30%	113	25.1%
30%-50%	63	14.0%
50%-100%	62	13.8%
100%-500%	44	9.8%
>500%	17	3.7%
<b>Total</b>	<b>450</b>	<b>100.0%</b>

Source: KPMG Corporate Finance

**Table 13 – 1986 - 2002: IRR distribution by financing stage**

	Early stage	Development	Replacement	MBO/MBI	Total
N. of Transactions	47	188	65	135	435
Incidence	10.8%	43.2%	14.9%	31.0%	
Yearly Pooled IRR	33.1%	21.5%	34.2%	48.0%	

Source: KPMG Corporate Finance



**Table 14 – 1986-2002: IRR distribution by acquired stakes**

	< 5%	5%-10%	10%-25%	25%-50%	> 50%	Total
<b>N. of Transactions</b>	55	64	128	91	30	368
<b>Incidence</b>	14.9%	17.4%	34.8%	24.7%	8.2%	
<b>Yearly Pooled IRR</b>	15.0%	32.3%	21.4%	35.1%	43.9%	

Source: KPMG Corporate Finance

**Table 15 – 2002: IRR distribution by time gap between first investment and first divestment**

	<2	2-3	3-4	4-5	5-7	> 7	Total
<b>N. of Transactions</b>	141	95	69	30	68	47	450
<b>Incidence</b>	31.0%	21.0%	15.0%	7.0%	15.0%	10.0%	
<b>Yearly Pooled IRR</b>	78.8%	52.7%	52.9%	26.6%	19.4%	9.8%	

Source: KPMG Corporate Finance

