

## **STATISTICS ON PERFORMANCE<sup>1</sup>**

### **INTRODUCTION**

Following the first four annual editions (1986-1996, 1989-1998, 1990-1999 and 1991-2000), the analysis of the Italian Private Equity and Venture Capital industry performance is based upon the results of a detailed survey covering the investment and divestment activity conducted between 1992 and 2001. The present survey has been carried out in order to assess the performance on realised investments achieved over the 1992-2001 period by the private equity and venture capital companies operating in Italy. Moreover, in this edition, in order to better understand the real impact on the industry performance related to the specific market momentum, a special focus has been put also on a 'stand alone' analysis of the transactions completed within the year (2001). 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 operation carried out by a single fund. Also this year, the analysis has been carried out by KPMG Corporate Finance in co-operation with A.I.F.I. The survey comprehends 62 of the most important investors operating in Italy and analyses a total of 290 investments which have been realised<sup>2</sup> in the considered ten years period (the historical database includes almost 400 transactions, since 1986).

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 third paragraph). A brief description

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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 (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.

of the analysed sample is reported in the following.

#### THE SAMPLE PANEL

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

**Table 1 – Main sample features**

|  | '92-01 | '91-'00 | '90-'99 | '89-'98 | '86-'96 |
|--|--------|---------|---------|---------|---------|
| N. of companies included in the research | 62     | 56      | 35      | 25      | 14      |
| N. of companies presenting realised      | 35     | 33      | 25      | 16      | 12      |
| N. of realised investments               | 290    | 245     | 202     | 172     | 100     |
| Average investment dimension (Euro MIn)  | 3.7    | 3.1     | 2.8     | 2.7     | 2.5     |
| Total Cash Out (Euro MIn)                | 1,063  | 750     | 576     | 461     | 250     |
| Total Cash In (Euro MIn)                 | 2,564  | 2,182   | 1,607   | 1,140   | 622     |

Source: KPMG Corporate Finance

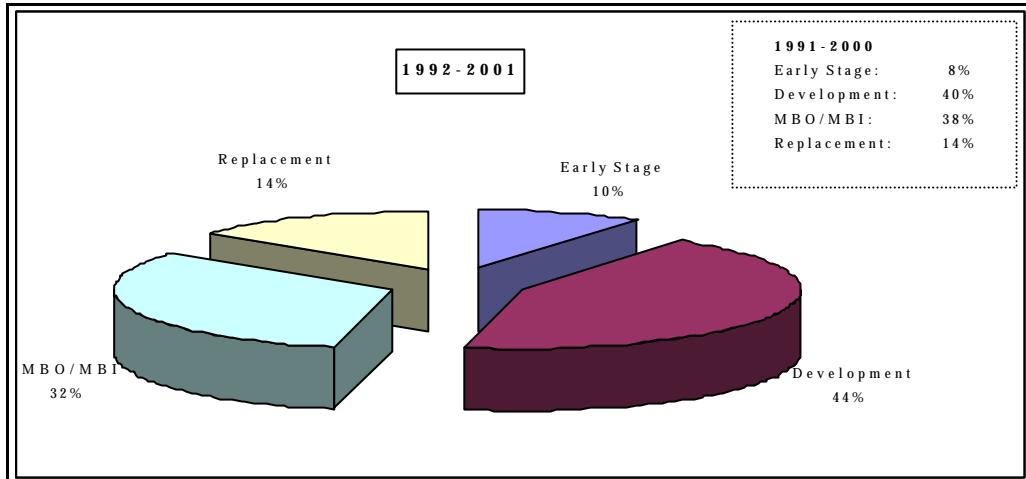
As shown in Table 1, the sample panel, in comparison to the first survey, has become wider and increasingly representative in terms of number of companies and number of realised investments analysed.

Moreover it is important to note the constant increase of average investments dimension, moving from 2.5 Euro MIn of 1986-1996 over 3,7 Euro MIn over 1992-2001 (+20.0% in comparison to 1991-2000). The sample contains 290 realized investments that can be analysed on the basis of different breakdowns.

Most of them, as shown below, have been compared to the previous surveys results in order to highlight the main trends.

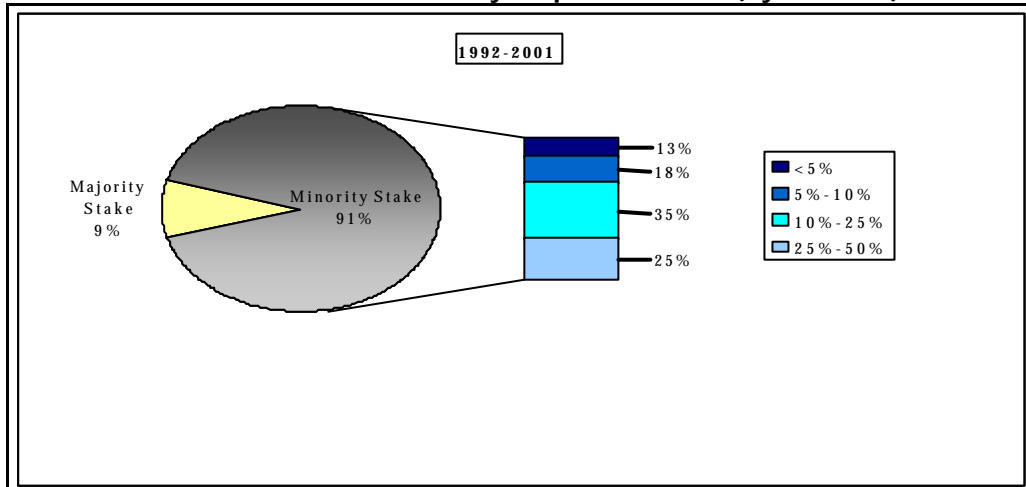
The investments breakdown by financing stage shows, as well as in the past, that most realised transactions have been related to Buyouts or Development financing investments and confirm the trend of the last edition, with a gradual relative decrease in the number of MBO/MBI in comparison to a constant slight increase in the Development (and the Early Stage) transactions.

**Table 2 – Investments breakdown by financing stage (by number)**



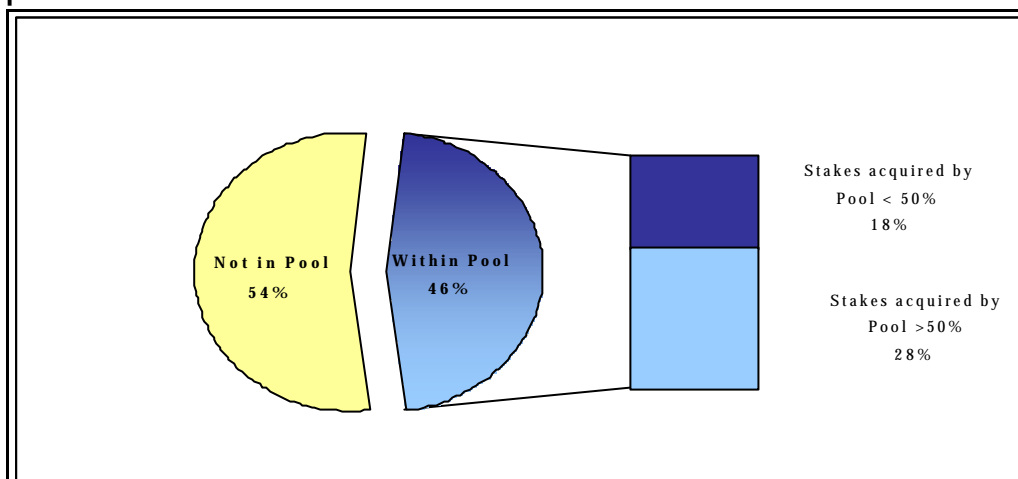
Source: KPMG Corporate Finance

**Table 3 – Investments breakdown by acquired stakes (by number)**



Source: KPMG Corporate Finance

The above presented chart shows the investments breakdown by acquired stakes: all investments are 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 majority stakes.

**Table 4 – Transactions managed within pool vs transactions not realised in pool**

Source: KPMG Corporate Finance

For instance, as shown below, almost half of the investments were realised in pool and most were related to the acquisition of a majority stake<sup>3</sup>.

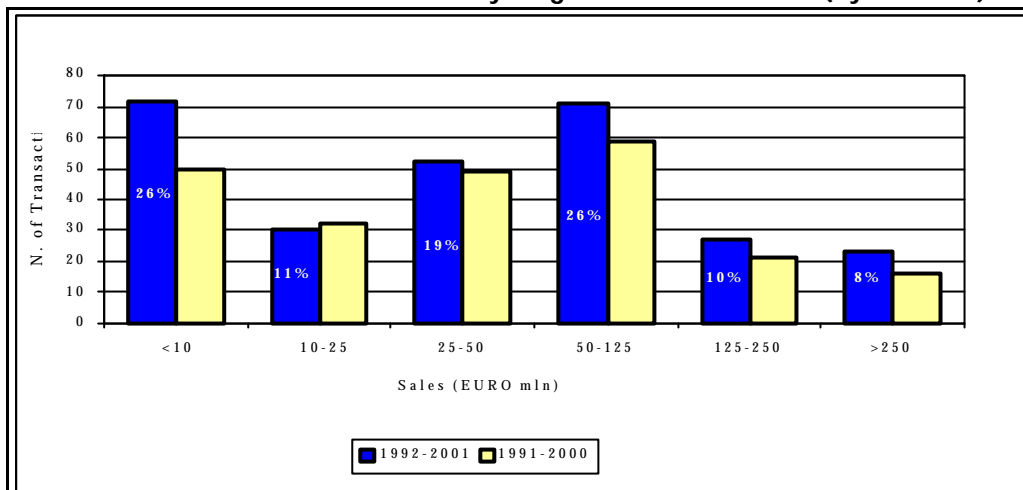
The investments breakdown by target sales, not substantially changed in comparison to the previous survey, shows that most realised transactions were related to target companies with less than 125 Euro Mln of turnover.

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

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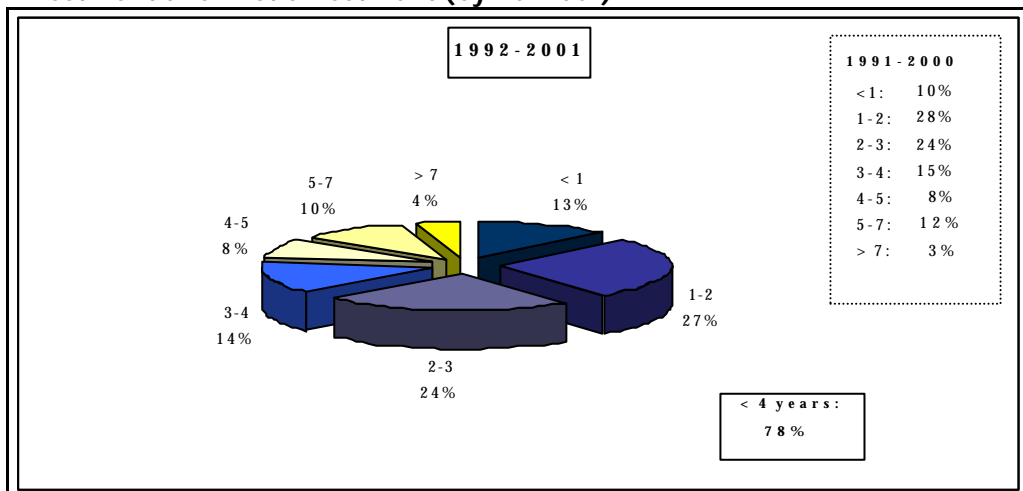
<sup>3</sup> This criteria was introduced two editions ago. Consequently the analysis is based mainly on the investments realised between 1999 and 2001. However the sample, covering more than 200 investments, can be considered significant.

**Table 5 – Investments breakdown by target sales dimension (by number)**



Source: KPMG Corporate Finance

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

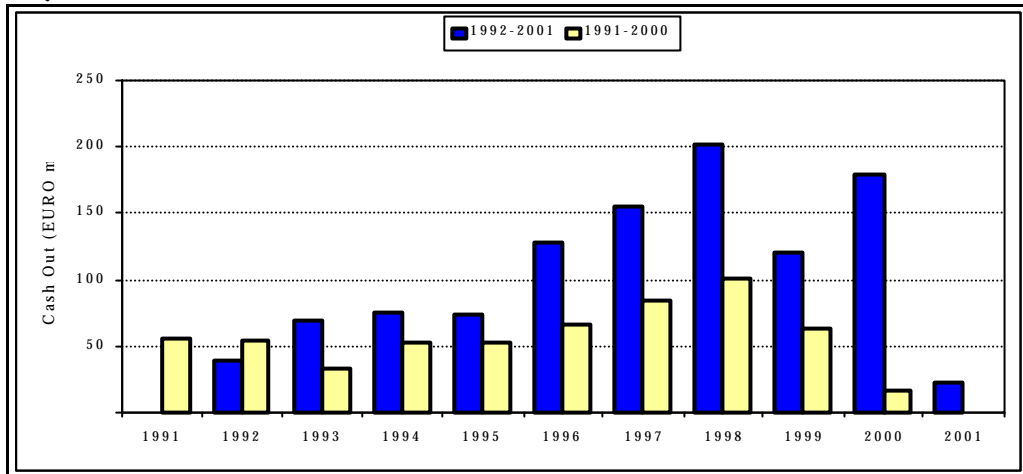


Source: KPMG Corporate Finance Table

As represented in the charts, the majority part of transactions have been focused on investments in little-middle size companies, mainly related to deals of Development financing or MBO/MBI, with a time frame between the first investment and the first divestment lower than 4 years. The analysis of cash flows related to the above mentioned investments is resumed in the following

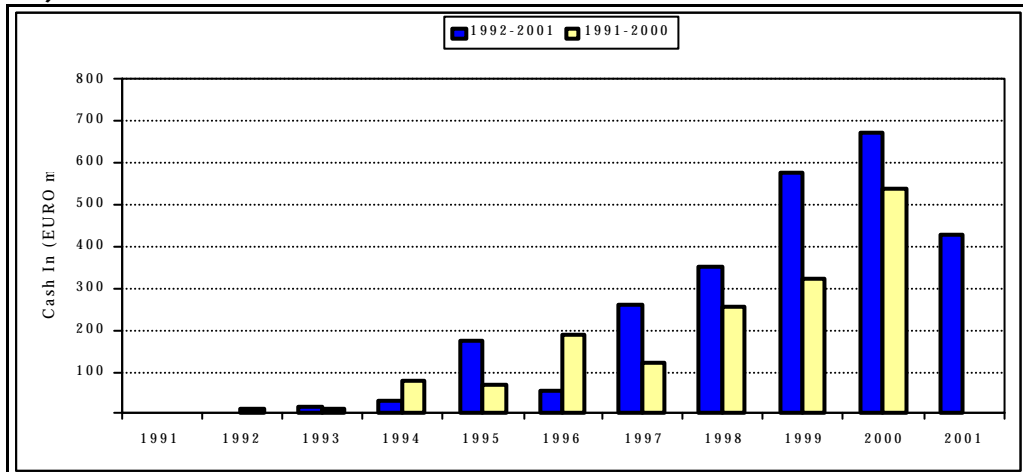
charts.

**Table 7 – Annual Cash Out related to realised investments ('92-'01 vs. '91-'00)**



Source: KPMG Corporate Finance

**Table 8 – Annual Cash In related to realised investments ('92-'01 vs. '91-'00)**



Source: KPMG Corporate Finance

Since the first edition, the Compounded Average Growth Rate (CAGR) in terms of cash outs invested has been around 45.0% per year. Confirming a positive trend, growth over 1992-2001, when compared to the previous decade, has been over 40.0% (+30.0% between 1991-2000 and 1990-1999 and +25.0%

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between 1990-1999 and 1989-1998).

Since the first edition, the CAGR related to the divestments' cash ins has been over 40.0%, but the growth rate, in that case, is showing a constant decreasing trend: in 1992-2001 the growth, in comparison to the previous decade, has been less than 20.0% (+36.0% between 1991-2000 and 1990-1999 and +41.0% between 1990-1999 and 1989-1998).

### **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 Private equity and 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 Private Equity and 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 Private equity and Venture Capital portfolios is reported.

The most common measure of performance within the Private Equity and 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

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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:

- The Gross Return on Realized 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 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 EVCA criteria, as far as write off, 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 Realized 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 Realized Investments in comparison to the net Return to the founder is that the first one it is gross of carried interests and management fees.

### **SURVEY CONCLUSIONS**

According to the criteria described above, during the period taken as reference (92-00), Italian private equity and venture capital companies achieved an

average annual return on the investments in terms of Gross Return on Realised Investments as shown below.

**Table 9 – '92-'01: annual performance on realised investments<sup>4</sup>**

|   | '92- '01 | '91-'00 | '90-'99 | '89-'98 |
|---|----------|---------|---------|---------|
| Yearly Pooled IRR                                 | 49.2%    | 47.5%   | 40.3%   | 33.4%   |
| Upper Quarter ( <i>per performances</i> )         | 140.8%   | 145.5%  | 115.1%  | 96.2%   |
| Upper Quarter ( <i>per investment dimension</i> ) | 39.8%    | 46.2%   | 43.4%   | 34.6%   |

Source: KPMG Corporate Finance

For the 1992-2001 decade, the Italian private equity and venture capital market, confirming once again a positive historical trend, demonstrates strong performances in terms of Gross Return on Realised Investments.

However, the improvement in comparison to the previous survey is due more to how the panel is defined than to a any real improvement between 2000 and 2001: for instance, the improvement of the 10 years pooled IRR is basically related to the fact that the investments made in 1991 (taken off by the panel) had in average realised lower performances than the transactions realised in 2001 (added this year to the panel).

The measurement of the Yearly Pooled IRR from inception by year<sup>5</sup> shows in fact a significant decrease in industry performance between 2000 (47.1% aligned with the ten years pooled IRR) and 2001 (34.2%, even slightly lower than the 1999 performance, equal to 36.2%).

<sup>4</sup> **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).

<sup>5</sup> This analysis defines the aggregated performance of all divestments (partial or total) as referring to investments included in the historical database (since 1986) and realised in one specific year/period (i.e. 2001).

**Table 10 – IRR by transactions divested in and 2001, 2000, 1999, 1998**

|                   | 2001  | 2000  | 1999  | 1998  |
|-------------------|-------|-------|-------|-------|
| N. of Transaction | 69    | 78    | 58    | 51    |
| Yearly Pooled IRR | 34.2% | 47.1% | 36.2% | 30.1% |

Source: KPMG Corporate Finance

The historical performance from inception (yearly pooled IRR 1986-2000)<sup>6</sup>, equal to 31.5%, shows a lower aggregated IRR in comparison to the last edition, confirming a decrease in terms of performance between 2000 and 2001.

The IRR breakdown analysis substantially confirms the results of the last edition: the majority of the realised transactions in the panel demonstrated a performance, in terms of Gross IRR, higher than 30.0%.

For instance, more than 35.0% of the total transactions show an IRR higher than 50.0% and a significant group, around 17.0%, realised performances in excess of 100%. In terms of IRR analysis, it is important to note that divestments thorough IPO, even if they represent (by number) less than 10.0% of the total panel, represent also in the decade 1992-2001 about 25.0% of total cash ins amount: the yearly pooled IRR over 1992-2001 of divestments through IPO reached 78.3% (64.5% over 1991-2000, 49.6% over 1990-1999).

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<sup>6</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.

**Table 11 – '92-'01: IRR distribution**

|                    | 1992-2001<br>Number | 1992-2001<br>Incidence (%) | 1991-2000<br>Number | 1991-2000<br>Incidence (%) |
|--------------------|---------------------|----------------------------|---------------------|----------------------------|
| Negative/Write Off | 32                  | 11.0%                      | 21                  | 8.6%                       |
| 0%-10%             | 53                  | 18.3%                      | 37                  | 15.1%                      |
| 10%-20%            | 44                  | 15.2%                      | 36                  | 14.7%                      |
| 20%-30%            | 14                  | 4.8%                       | 17                  | 6.9%                       |
| 30%-50%            | 45                  | 15.5%                      | 42                  | 17.1%                      |
| 50%-100%           | 53                  | 18.3%                      | 50                  | 20.4%                      |
| 100%-500%          | 35                  | 12.1%                      | 32                  | 13.1%                      |
| > 500%             | 14                  | 4.8%                       | 10                  | 4.1%                       |
| <b>Total</b>       | <b>290</b>          | <b>100.0%</b>              | <b>245</b>          | <b>100.0%</b>              |

Source: KPMG Corporate Finance

However, using different breakdowns, the industry performance in terms of pooled Gross IRR ('92-'01, ten year panel) can be analysed from many point of view, as shown below.

**Table 12 – '92-'01: IRR distribution by financing stage**

|                           | Early Stage | Development | Replacement | MBO/MBI | Total |
|---------------------------|-------------|-------------|-------------|---------|-------|
| <b>N. of Transactions</b> | 27          | 121         | 40          | 90      | 278   |
| <b>Incidence</b>          | 9.7%        | 43.5%       | 14.4%       | 32.4%   |       |
| <b>Yearly Pooled IRR</b>  | 44.1%       | 34.5%       | 41.7%       | 71.3%   |       |

Source: KPMG Corporate Finance

**Table 13 – '92-'01: IRR distribution by acquired stakes**

|                           | < 5%  | 5%-10% | 10%-25% | 25%-50% | > 50% | Total |
|---------------------------|-------|--------|---------|---------|-------|-------|
| <b>N. of Transactions</b> | 33    | 46     | 93      | 67      | 23    | 262   |
| <b>Incidence</b>          | 12.6% | 17.6%  | 35.5%   | 25.6%   | 8.8%  |       |
| <b>Yearly Pooled IRR</b>  | 31.6% | 42.1%  | 33.6%   | 38.2%   | 63.6% |       |

Source: KPMG Corporate Finance

**Table 14 – '92-'01: 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> | 37                 | 56         | 108                | 201   |
| <b>Incidence</b>          | 18.4%              | 27.9%      | 53.7%              |       |
| <b>Yearly Pooled IRR</b>  | 8.7%               | 58.7%      | 41.1%              |       |

Source: KPMG Corporate Finance

**Table 15 – '92-'01: IRR distribution by target sales dimension (Euro Mln)**

|                           | < 10  | 10-25 | 25-50 | 50-125 | 125-250 | > 250 | Total |
|---------------------------|-------|-------|-------|--------|---------|-------|-------|
| <b>N. of Transactions</b> | 72    | 30    | 52    | 71     | 27      | 23    | 275   |
| <b>Incidence</b>          | 26.2% | 10.9% | 18.9% | 25.8%  | 9.8%    | 8.4%  |       |
| <b>Yearly Pooled IRR</b>  | 12.3% | 68.6% | 25.8% | 65.2%  | 65.5%   | 43.1% |       |

Source: KPMG Corporate Finance

**Table 16 – '92-'01: IRR distribution by time gap between first investment and first divestment**

|                           | < 1    | 1-2   | 2-3   | 3-4   | 4-5   | 5-7   | > 7   | Total |
|---------------------------|--------|-------|-------|-------|-------|-------|-------|-------|
| <b>N. of Transactions</b> | 37     | 78    | 69    | 41    | 23    | 30    | 12    | 290   |
| <b>Incidence</b>          | 12.8%  | 26.9% | 23.8% | 14.1% | 7.9%  | 10.3% | 4.1%  |       |
| <b>Yearly Pooled IRR</b>  | 203.1% | 77.3% | 64.7% | 74.8% | 32.2% | 18.3% | 17.0% |       |

Source: KPMG Corporate Finance