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STATISTICS ON PERFORMANCE: 1990-1999 GROSS IRR ON REALISED INVESTMENTS[1]

INTRODUCTION

Following the first two editions (1986-1996 and 1989-1998), 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 1990 and 1999.

The present survey has been carried out in order to assess the performance on realised investments obtained within the 1990-1999 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 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 35 of the most important venture capital and private equity companies operating in Italy and analyses a total of 202 transactions which have been realised[2] 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 below in the third paragraph.

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

[1] This analysis has been realized in collaboration with KPMG Corporate Finance.
[2] According to the EVCA (European Private Equity and 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.

THE SAMPLE PANEL

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

Table 1 – Main sample features

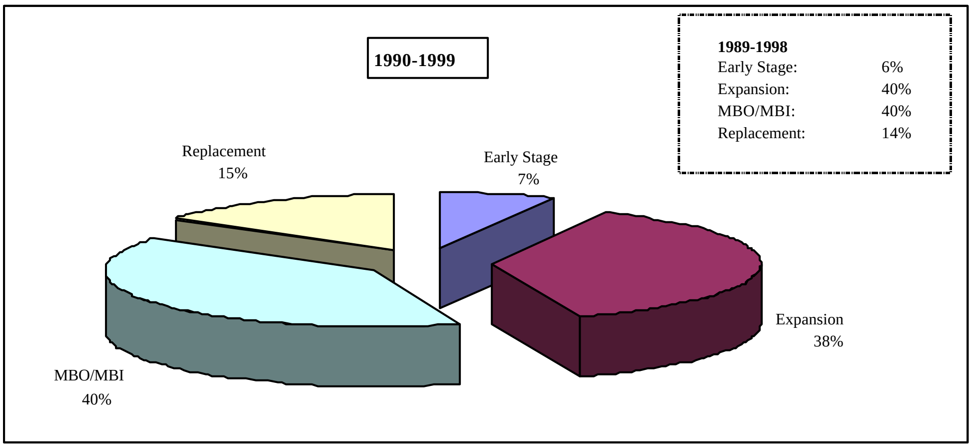
	1990-'99	***1989-'98***	***1986-'96***
Number of companies included in the research panel	35	*25*	*14*
Number of companies presenting realised investments	25	*16*	*12*
Number of realised investments	202	*172*	*100*
Average investment dimension (*EURO* mln)	2.8	*2.7*	*2.5*
Total Cash Out (*EURO* mln)	576	*461*	*250*
Total Cash In (*EURO* mln)	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 analysed. Moreover is important to underline the constant increase of the average investments dimension, moving from *Euro* 2.5 million of 1986-'96 to *Euro* 2.8 million of 1990-'99.

The sample contains 202 closed transactions that can be analysed on the basis of different breakdowns. The most part of them, as shown below, are presented in comparison to the previous survey results with the purpose of highlighting the main evolution trends.

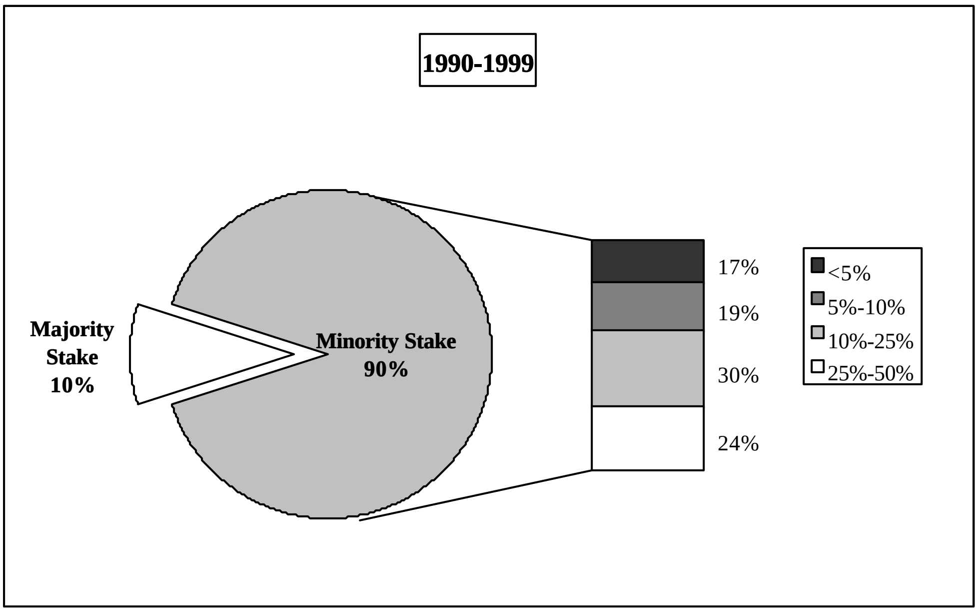
Table 2 – Transactions breakdown by financing stage (by number)



Source: KPMG Corporate Finance

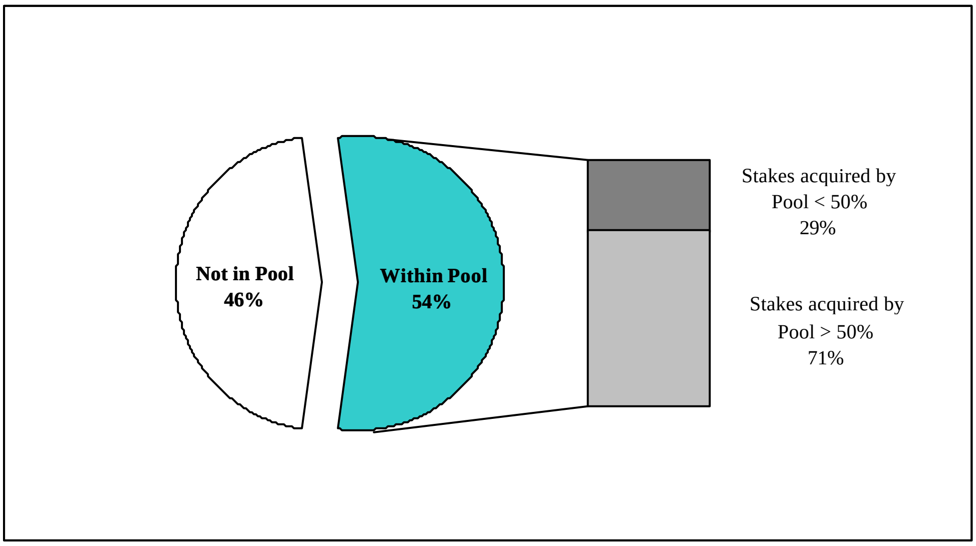
The transactions breakdown by financing stage, substantially unchanged in comparison to the previous survey, underlines that the most part of the realised transactions are related to buyouts or expansion financing investments.

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



Source: KPMG Corporate Finance

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

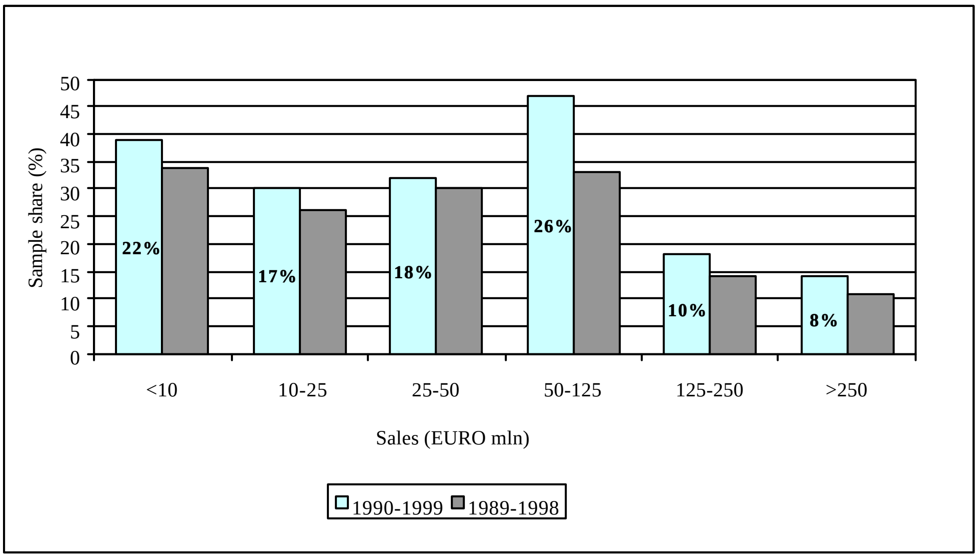


Source: KPMG Corporate Finance

Table 3 shows the transactions 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.

However, as shown on Table 4, more than half of the investments were realised in pool and most part of them was related to the acquisition of a majority stake[3].

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



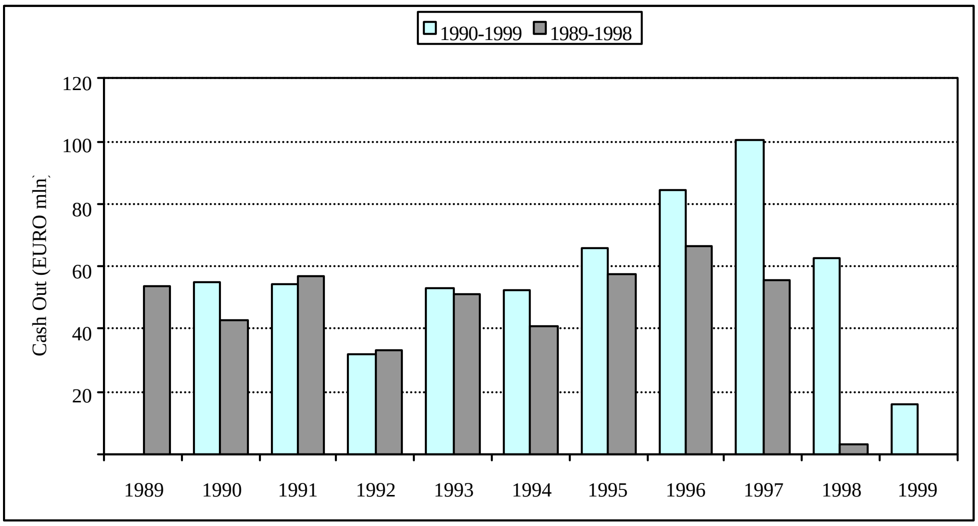
Source: KPMG Corporate Finance

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

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

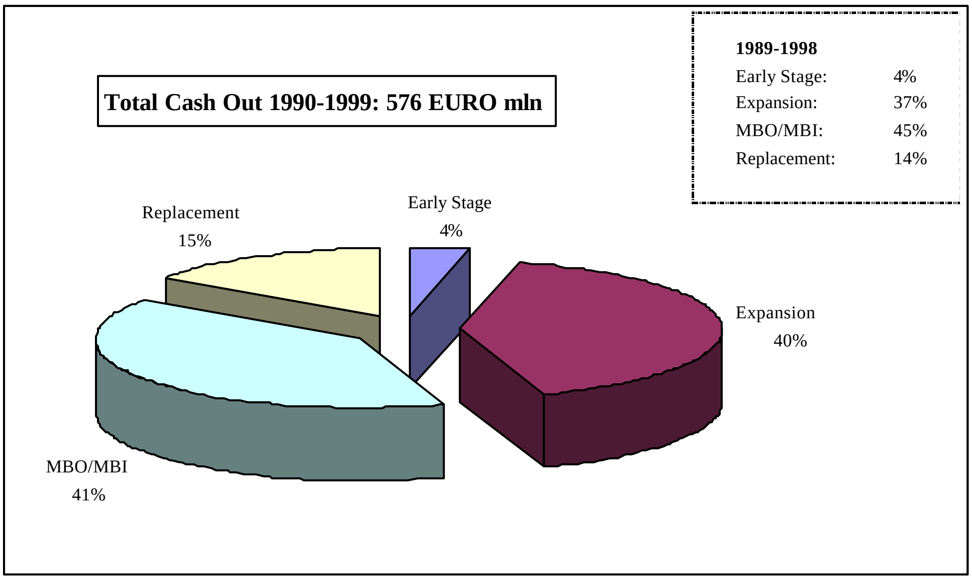
[3] This criteria has been introduced in this edition for the first time. Consequently the analysis is based mainly on the investments realised in 1999. The sample is smaller, but still includes more than 50 investments and therefore can be retained significant.

Table 6 – Annual Cash Out related to realised investments (1990-1999 vs. 1989-1998)



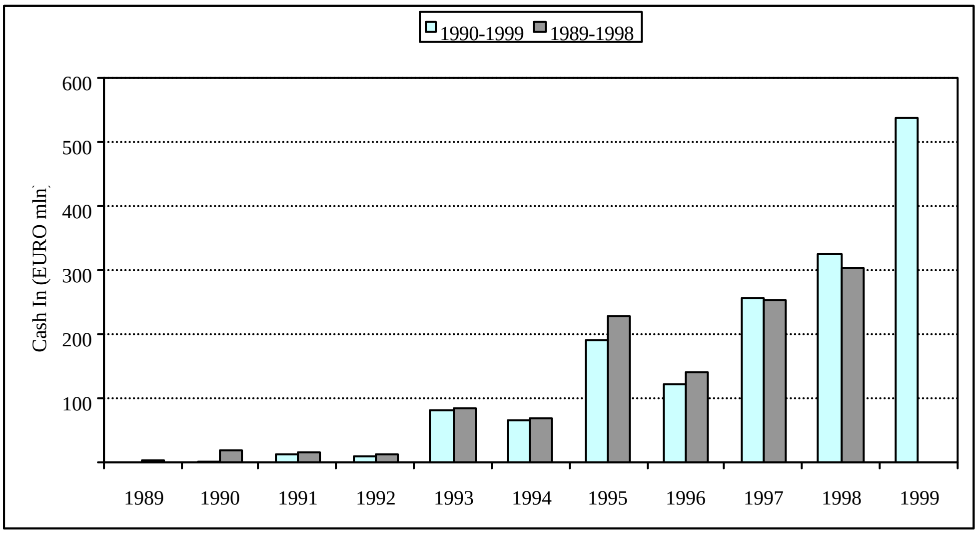
Source: KPMG Corporate Finance

Table 7 – Transactions breakdown by financing stage (by Cash Out amounts)



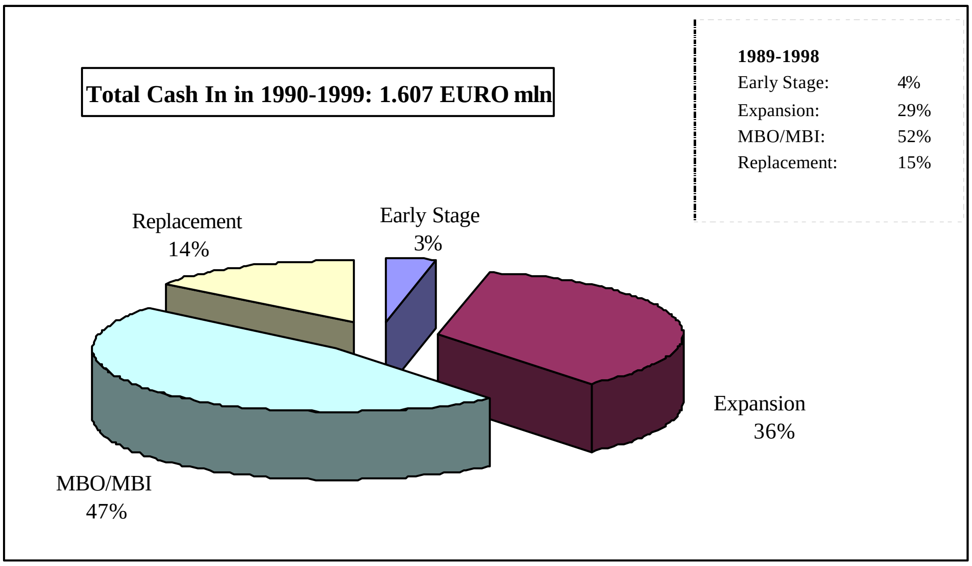
Source: KPMG Corporate Finance

Table 8 – Annual Cash In related to realised investments (1990-1999 vs. 1989-1998)



Source: KPMG Corporate Finance

Table 9 – Transactions breakdown by financing stage (by Cash In amounts)



Source: KPMG Corporate Finance

Reflecting the trend shown in the previous survey, also in the 1990-1999 decade the panel has grown in terms of total amounts invested (25% more than 1989-1999 and 230% more than 1986-1996), but above all in terms of divestments (41% more than 1989-1990 and 258% more than 1986-1996). It is to be noted that the weight of expansion transactions increased both in term of cash out (from 37% of the previous years to 40%) and of cash in (from 29% to 36%), while an opposite trend is shown for MBO/MBI (cash out from 45% to 41%; cash-in from 52% to 47%).

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 their 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 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.

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.

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.

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 period taken as reference (1990-1999), 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 10 –1990-1999: annual performance on realised investments[4]

	1990-1999	*1989-1998*
Yearly Pooled IRR	**40,3%**	***33,4%***
- Upper Quarter *(per performances)*	115,1%	*96,2%*
- Upper Quarter *(per investment dimension)*	43,4%	*34,6%*

Source: KPMG Corporate Finance

For the 1990-1999 period the Italian private equity and venture capital market demonstrates 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.

Table 11 – 1990-1999: IRR distribution

	1990-1999		*1989-1998*	
	Number	**Incidence (%)**	***Number***	***Incidence (%)***
Negative/Write Off	19	9.4%	*21*	*12.2%*
0%-10%	25	12.4%	*19*	*11.0%*
10%-20%	36	17.8%	*35*	*20.3%*
20%-30%	16	7.9%	*18*	*10.5%*
30%-50%	35	17.3%	*31*	*18.0%*
50%-100%	39	19.3%	*28*	*16.3%*
100%-1,000%	25	12.4%	*15*	*8.7%*
>1,000%	7	3.5%	*5*	*2.9%*
Total	***202***	***100.0%***	***172***	***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 202, because for some operations of the sample the data are not available,

[4] **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).

consequently the percentage incidence is calculated on the number of transaction analysed in each case.

Table 12 – 1990-1999: IRR distribution by financing stage

	Early Stage	Development	MBO-MBI	Replacement	Total
N. of Transactions	13	72	76	29	**190**
Incidence (%)	6.8%	37.9%	40.0%	15.3%	**100%**
Pooled IRR	40.8%	32.0%	47.0%	43.7%	

Source: KPMG Corporate Finance

Table 13 – 1990-1990: IRR distribution by acquired stakes

	<5%	5%-10%	10%-25%	25%-50%	>50%	Total
N. of Transactions	25	27	43	35	14	**144**
Incidence (%)	17.4%	18.8%	29.9%	24.3%	9.7%	**100%**
Pooled IRR	30.1%	50.0%	26.6%	38.2%	40.9%	

Source: KPMG Corporate Finance

Table 14 – 1990-1999: 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	9	22	26	**57**
Incidence (%)	15.8%	38.6%	45.6%	**100%**
Pooled IRR	***12.3%***	***46.3%***	***59.2%***	

Source: KPMG Corporate Finance

Table 15 – 1990-1999: IRR distribution by target sales dimension (*Euro* mln)

	<10	10-25	25-50	50-125	125-250	>250	Total
N. of Transactions	39	30	32	47	18	14	**180**
Incidence (%)	21.7%	16.7%	17.8%	26.1%	10.0%	7.8%	**100%**
Pooled IRR	***36.8%***	***31.7%***	***41.2%***	***47.9%***	***47.9%***	***22.0%***	

Source: KPMG Corporate Finance

Table 16 – 1990-1999: 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	20	46	46	30	14	28	18	**202**
Incidence (%)	9.9%	22.8%	22.8%	14.9%	6.9%	13.9%	8.9%	**100%**
Pooled IRR	***155%***	***71.6%***	***61.2%***	***56.8%***	***34.7%***	***20.1%***	***8.9%***	

Source: KPMG Corporate Finance