The European Private Equity Market Outlook

EUROPEAN INVESTMENT FUND

EUROPEAN PRIVATE EQUITY & VENTURE CAPITAL ASSOCIATION

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Introduction

This report provides a general overview of the European private equity (PE) market as of June 2010 based on industry data published by the European Private Equity and Venture Capital Association (EVCA), the European Investment Fund's (EIF) proprietary data and other third-party sources. The report is a collaboration between the EIF and EVCA.

Compiling and interpreting PE data is notoriously difficult. We therefore aim to complement the general overview with views from practitioners who can bring insight and a different perspective. We thank Peter Cornelius of Alpinvest, Katita Palamar of Cogent Partners, Helen Steers of Pantheon Ventures and Thomas Meyer of Deutsche Bank for contributing to this report.

The report is organised into three different sections: an introduction to the global economic outlook, followed by an overview of the main activity and performance trends in the European PE market, concluding with some perspectives on the future of the industry. We also compare performance trends with the EIF Direct Return Indices (D-Indices). The latter are calculated using the quarterly valuation of companies in the EIF's portfolio of 330 funds (see Annex 2).

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Executive summary

Global economic outlook

- The recovery remains "multi-speed", with its overall pace slowing as the global economy enters a period of consolidation.
- The slowdown is being driven by a decline in inventory restocking and the withdrawal of the unprecedented policy stimulus that had fuelled the recovery since its introduction in mid-2009.
- A weak labour market, housing market concerns and the process of balance-sheet adjustment in various sectors are holding back private sector spending.
- Having used most of the tools at their disposal, some policymakers have turned to currency interventions to boost their recoveries. The euro has strengthened considerably against various currencies in recent months, affecting the competitiveness of certain peripheral Eurozone countries.
- The economic outlook remains uncertain, and this is reflected in global financial markets, which remain vulnerable to confidence shocks and reliant on government support, and the still reduced availability of leverage.

European private equity market outlook

- In a climate of macroeconomic uncertainty, 2009 was an extremely challenging year for the PE industry. However, preliminary figures for 2010 suggest improving conditions for PE activity, although these are uneven among fundraising, investments and exits.
- Fundraising experienced a modest recovery (EUR 11.0bn raised in H1 2010 compared with EUR 16.1bn raised in the full-year 2009) but remains challenging, with a more significant pick-up expected in late 2011.
- Investments have picked up more substantially: EUR 17.2bn was invested in European companies in H1 2010, just 24% below the full-year 2009 figure.
- Exits have also started to recover (EUR 5.7bn in H1 2010 – only 20% below the 2009 level, excluding write-offs), but they have not fully lived up to expectations.
- Net short-term returns have moved back to positive territory, with overall PE one-year horizon IRRs as of December 2009 at 5.6% and a further upward trend observed to June 2010.
- As of June 2010, long-term PE returns remained steady, with 10-year and 20-year horizon IRRs of 5.4% and 9.4% respectively.
- EIF D-Indices show that the buyout segment has generally outperformed the venture capital (VC) segment since 2004, but the buyout sector has been hit harder by the crisis.
- The VC ICT sector has outperformed the life sciences sector, according to the EIF D-Indices. On the buyout side, tech (ICT and life sciences) and non-tech (generalist) investments have performed similarly over the years.

1. Global economic outlook

Although there has been a pick-up in the global macroeconomic outlook during 2010, countries are recovering at different rates, with emerging economies facing a much stronger V-shaped rebound, and advanced economies experiencing a sluggish, U-shaped recovery. There has been a great deal of economic uncertainty, particularly over fiscal sustainability issues and the competitiveness of certain advanced economies.

More recently, there has been something of a slowdown in the recovery as the global economy has entered a period of consolidation. According to figures from the International Monetary Fund (IMF[1]), the Economist Intelligence Unit (EIU[2]) and Roubini Global Economics[3], global growth for 2010 is forecast to be in the range of 4.0-4.5%, and 3.4-4.3% for 2011, somewhat lagging behind the 4.5% global average for 2004-8. Advanced economies are forecast to grow at 2.2-2.6% in 2010, and only 1.5-2.4% in 2011, while emerging economies are likely to see growth in the range of 6.8-7.0% in 2010 and 6.0-6.4% in 2011. Growth in 2011 is likely to be weaker as base effects[4] dissipate, the effects of fiscal stimuli wane and several countries (particularly in the Eurozone) implement fiscal austerity measures.

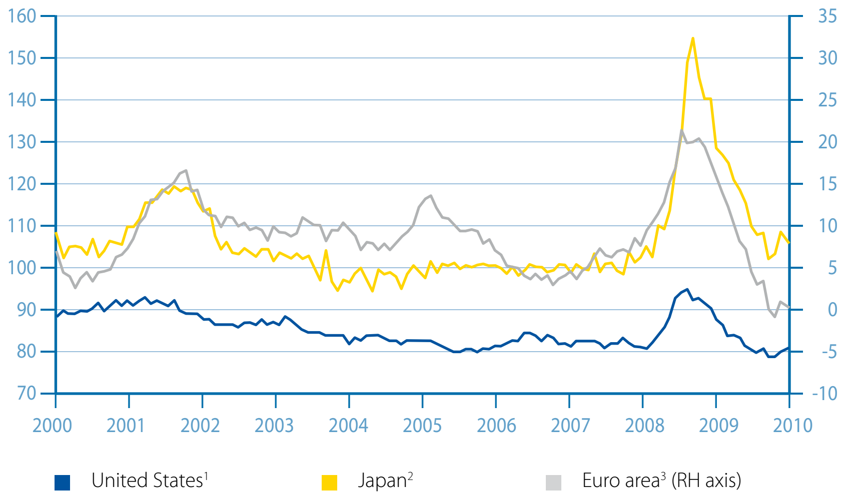
The multi-speed nature of the global recovery is reflected in Europe, with the northern and core Eurozone countries outperforming the periphery. Although overall GDP growth in Q2 2010 in the Eurozone was double that experienced in the US, it was driven by Germany and its main trading partners, Austria and the Netherlands. Sovereign spreads over the German bund remain wide within the Eurozone due to continued financial market turbulence, and there is acute concern in the markets about the potential cost of Ireland's bank rescue. The countries of central and eastern Europe, which were particularly hard-hit by the global crisis, are still lagging behind other emerging economies in terms of recovery, particularly those countries that are export-dependent.

The slowdown in the recovery is reflected in global trade growth, which has started to slow from the buoyant rates earlier in the year (Q2 2010 global trade flows grew by 3.6%, compared with 5.0% in Q1). The sluggish recovery is also reflected in purchasing manager index[5] (PMI) data. The PMI for global all-industry output shows some slowing of growth since the beginning of the year, although it remains above the series average, signalling continued expansion. And although rising inflation may appear to suggest that economies are heating up, this is merely the headline figure, which reflects rising commodity prices and price-level adjustments following indirect tax increases. Core inflation remains moderate because of excess capacity in labour and product markets – especially in advanced economies.

What is causing the slowdown in the recovery? One important element is the fading effects of inventory restocking: much of the recent recovery has been built on the replenishment of global inventories, which had been heavily depleted when the crisis took hold. Figure 1 shows that inventories are now around their long-term trend levels, so growth will no longer be supported by this source.

[1] IMF (2010a).
[2] Economist Intelligence Unit (2010).
[3] Roubini Global Economics (2010).
[4] Base effects are best explained using an example: if GDP is unusually low in year 1, but reverts to trend in year 2, GDP growth between year 1 and 2 will be high due to lower GDP in the base year, rather than high GDP in the second year. If GDP remains at trend in year 3, GDP growth will be weaker between years 2 and 3 than it was between years 1 and 2.
[5] The PMI reflects the percentage of purchasing managers who reported better business conditions than in the previous month.

Figure 1: Global inventory levels



[1] Business inventories/sales ratio, index (Jan. 1992= 100).
[2] Inventories/shipments ratio, mining and manufacturing, index (2005= 100).
[3] Stock of finished goods, net balance, relative to normal.

Source: Datastream and OECD calculations

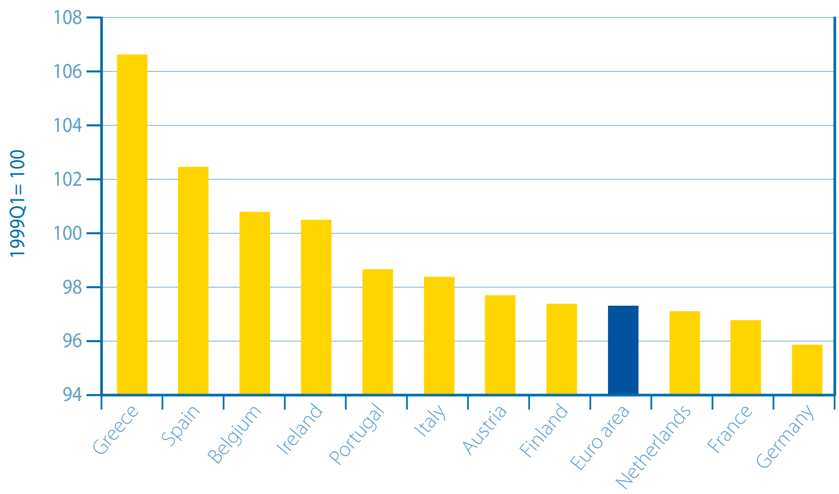
Another important factor is the withdrawal of the policy stimuli that had fuelled the recovery since their introduction in mid-2009. Many advanced economies have started the transition from fiscal stimulus to austerity, in the face of rising debt. The gamble they are taking is that consumer confidence will be boosted by prudent economic management, and that private consumption will step in to compensate for reduced public spending. However, this strategy has yet to bear fruit, as the private sector does not appear to be fully convinced of the commitment of some countries to fiscal consolidation. Furthermore, weak labour and housing markets and the process of balance-sheet adjustment[6] in various sectors are all holding back private sector spending.

Policymakers have by now used most of the tools at their disposal. Monetary policy has seen interest rates reduced to a minimum, quantitative easing has been introduced, and fiscal policy has been used to the extent possible without causing confidence crises. This in part explains the current global trend towards currency interventions: in the face of weak domestic demand, countries are attempting to increase their GDP by developing their export markets. Recently the dollar fell after the Federal Reserve made it clear it was prepared to act to counter excessively low inflation. Japan undertook its first intervention in six years in mid-September, in order to address the fact that the yen was at its highest nominal rate against the dollar since 1995. Switzerland's foreign reserves have quadrupled over the past two years. And it is well known that China has built up huge reserves to keep the yuan stable against the dollar. This has caused the euro to strengthen in relative terms, making it harder for European exporters to compete.

The loss of the exchange rate as a policy tool is proving particularly challenging for certain peripheral euro-zone countries that are suffering an acute lack of competitiveness. Their problems are a hangover from the introduction of the euro, when the drop in real interest rates – particularly in Ireland, Greece and Spain – caused a consumer boom, pushing up unit wage costs, reducing competitiveness and giving rise to large current account deficits. The problem is clearly demonstrated by comparing the real effective exchange rates[7] of the countries of the Eurozone as shown in figure 2.

In the absence of the devaluation option, improving competitiveness requires either wage cuts or increases in productivity. The former is difficult to implement in conjunction with fiscal austerity. Ultimately the weaker countries need to undertake structural reforms to improve their competitiveness.

Figure 2: Real effective exchange rates, Q2 2010



Source: BIS Statistical Database, www.bis.org

There is still no consensus among the members of the Eurozone as to whether countries with a trade surplus, such as Germany, should do more to address the Eurozone's problems by encouraging domestic consumption. Therefore the economic outlook remains particularly uncertain. A double-dip recession remains a distinct possibility, although most economists believe a sluggish recovery in the medium term to be a more likely outcome.

[6] Balance-sheet adjustment in this instance refers to changes in private sector debt and saving levels.

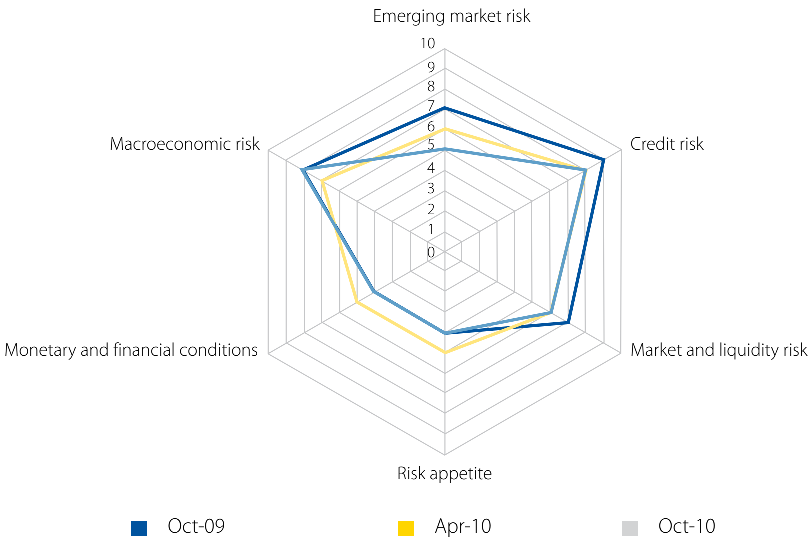
[7] The real effective exchange rate is the weighted average of a country's currency relative to an index or basket of other major currencies adjusted for the effects of inflation; the weightings are determined based on relative trade balances. It is used as a measure of the country's external competitiveness.

Table 1: Real GDP growth (in %)

	2009	2010(f)	2011(f)	2012(f)	2013(f)	2014(f)
Global	-0.7	4.4	3.6	4.0	4.1	4.2
US	-2.6	2.3	1.5	1.9	2.3	2.4
EU 27	-4.2	0.9	1.0	1.5	1.8	1.9
EU 15	-4.2	1.4	1.0	1.3	1.5	1.7
LATAM	-2.1	5.2	3.6	4.1	4.2	4.4

Souce: EIU, Country Forecast, September 2010

Figure 3: IMF Global Financial Stability Map[9]



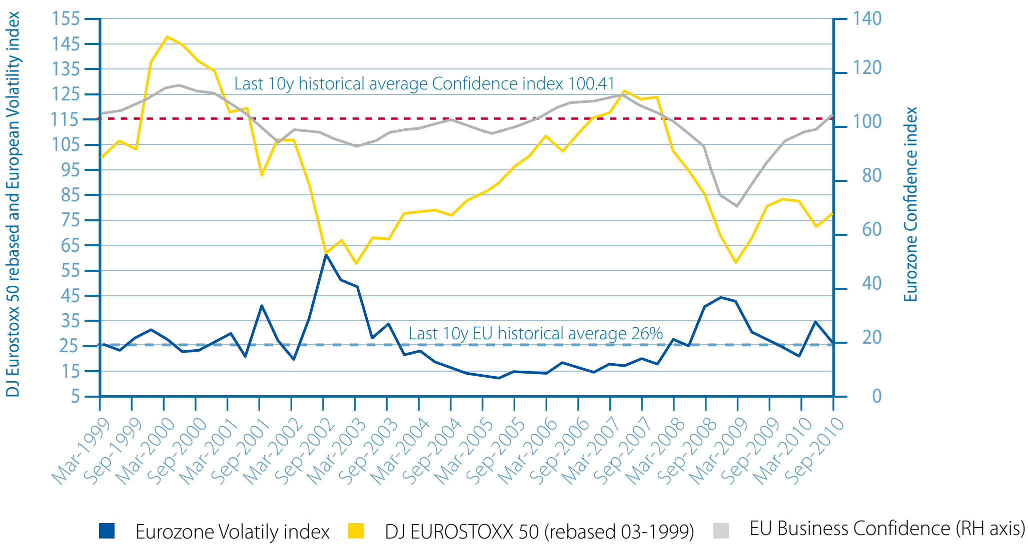
Source: IMF, Global Financial Stability Report, October 2010

The IMF Global Financial Stability Map[8] illustrates the stability of global financial markets as of October 2010, and their evolution since October 2009 (see figure 3). Stability is assessed by estimating the key financial risks (macroeconomic risk, emerging market risk, credit risk, market and liquidity risk) and the two dimensions that assess general market conditions (monetary and financial conditions, and risk appetite).

According to the IMF, progress towards global financial stability has stuttered over the past six months. The turmoil in sovereign debt markets has exposed the vulnerability of bank and sovereign balance sheets, and the outlook is insecure despite interventions by European policymakers. Macroeconomic risks have heightened and, as discussed earlier, the recovery has begun to lose steam, as uncertainty has begun to take its toll on consumer confidence and other leading indicators have started to retract. Economic uncertainty, continuing deleveraging and sovereign spillovers mean that core banking systems remain vulnerable to confidence shocks and remain reliant on government support. As a result, the improvement in credit risks that had been seen earlier in the year appears to have paused. Although the European policy response discussed earlier was successful in addressing the rise in market and liquidity risks of April and May, the banking sector still has sizeable refinancing needs. These, along with the steps taken by central banks to start unwinding support measures introduced in response to the global credit crisis, have caused a tightening of monetary and financial conditions. Finally, the limited extent of spillovers from the European sovereign debt turmoil have meant that emerging markets have been somewhat protected, causing emerging market risk to decline.

[8] IMF (2010b).
[9] Closer to the centre signifies lower risk, tighter monetary and financial conditions or reduced risk appetite.

Figure 4: DJ Eurostoxx 50 and Eurozone volatility index vs. EU confidence index

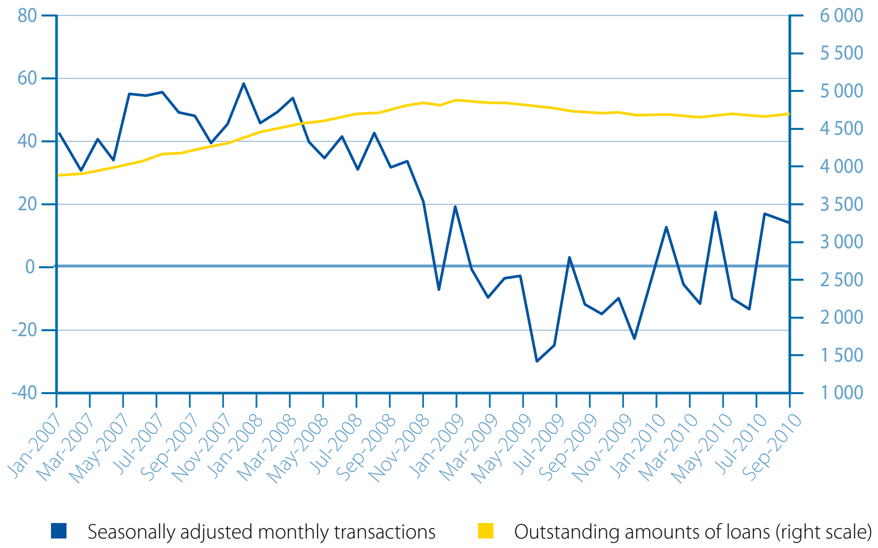


Source: Bloomberg

Stock markets have continued to recover from 2008 losses and volatilities and confidence indices are back to their historical averages (see figure 4). However, the outlook in the short term is still uncertain and it is difficult to draw conclusions on the future trend of the market.

Seasonally adjusted monthly bank lending to non-financial firms (see figure 5) continues to be volatile, indicating ongoing challenges faced by firms seeking to raise funds.

Figure 5: Bank lending to non-financial firms in the euro area, in EUR bn



Source: ECB

2. European private equity market outlook

> "A vibrant VC market has a sizeable effect on macroeconomic performance… An increase in VC investments of 0.1% of GDP is statistically associated with an increase in real GDP growth of 0.3pp. Early-stage investments have an even bigger impact of 0.96pp."
>
> *Thomas Meyer, Deutsche Bank*

2.1 Activity trends

Overview

One of the biggest issues faced by the industry has been the challenging **fundraising** environment. In 2009, following a decrease in fund valuations, investors suffered a loss of confidence and reduced the level of new commitments. The problem was exacerbated by the denominator effect and Limited Partners' (LPs) liquidity constraints as distributions dried up.

Nevertheless, most LPs seem to remain committed to PE in the long term, continuing to trust the industry's ability to deliver competitive returns. A survey conducted by Preqin in June 2010[10], which observed a large and varied sample of institutional investors, revealed that 87%[11] of the respondents intend to increase (39%) or maintain (48%) the number of relationships they have with general partners (GPs).

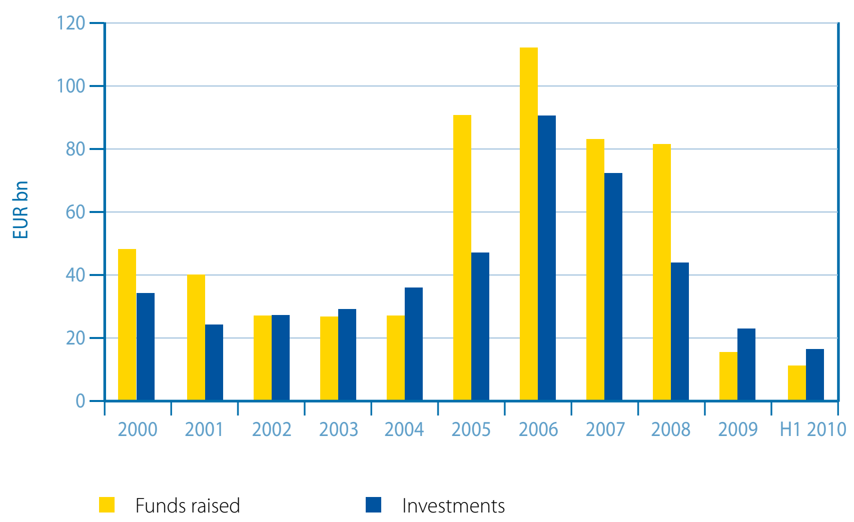
Fundraising will most likely remain challenging beyond the end of 2010 and start picking up more substantially in late 2011. But in the long term, 36% of the respondent LPs expect an increase in their allocation to the asset class while only 2% intend to decrease it.

Investment activity bottomed out in 2009 due to macroeconomic uncertainty, reduced availability of leverage and mismatching views on pricing between sellers and buyers. However, investment levels started picking up in H1 2010, with Q2 2010 achieving the highest quarterly amount invested since Q3 2008. EVCA activity data for 2009 and H1 2010 reveal a striking amount of capital directed to existing portfolio companies. PE firms concentrated on their existing portfolios, helping them through the crisis via additional equity support, internal diligence and carefully managed restructurings. Coupled with the fact that the number of investments made by the industry declined only marginally compared with recent years, this demonstrates PE firms' support for European businesses at a time when other funding options almost disappeared.[12] What's more, the vast majority of companies receiving PE backing were small and medium-sized enterprises (SMEs) – the backbone of European economic growth.

As fundraising was most impacted by the crisis, the total investment amount surpassed fundraising in 2009, the first year this has happened since 2004. In H1 2010, while the fundraising market saw only a modest recovery, investments showed a more dynamic upswing.

With closed exit markets and an overall asset repricing triggered by the financial and economic crisis, **divestments** were also inevitably affected by the recession. However, exits had picked up by Q4 2009, mainly driven by buyout divestments. H1 2010 showed higher amounts at cost divested compared with the corresponding period during the previous year. Yet trade sales did not manage to pick up as expected and the IPOs of many companies did not go through.

Figure 6: Yearly evolution of European PE activity by amount



Note: Investments aggregated as industry statistics
Source: EVCA/PEREP_Analytics.

[10] Preqin (2010a).
[11] This excluded survey participants that did not anticipate making any new commitments to PE funds over the next two years.
[12] See EVCA (2009).

Fundraising – *the hardest challenge*

As valuations stabilised, fundraising activity showed a modest recovery in H1 2010 (with EUR 11.0bn raised in H1 2010 compared with EUR 16.1bn raised in the full-year 2009). However, this uptick needs to be viewed with caution, as the growth was driven mainly by three EUR 1bn+ funds. On the other hand, this development shows that some confidence in the upper (EUR 1bn+) end of the market is coming back. Quarterly VC fundraising figures increased in Q1 2010 (by about one-fifth, to EUR 1.1bn) but fell back again in Q2 2010 (by more than 60%, to EUR 376m) reaching close to the Q3 2009 level, the lowest quarterly VC fundraising in 2009.

By number of funds reaching final closing, H1 2010 – at 51 funds – is well on track to exceed the 2009 final closings (66 funds) by year-end.

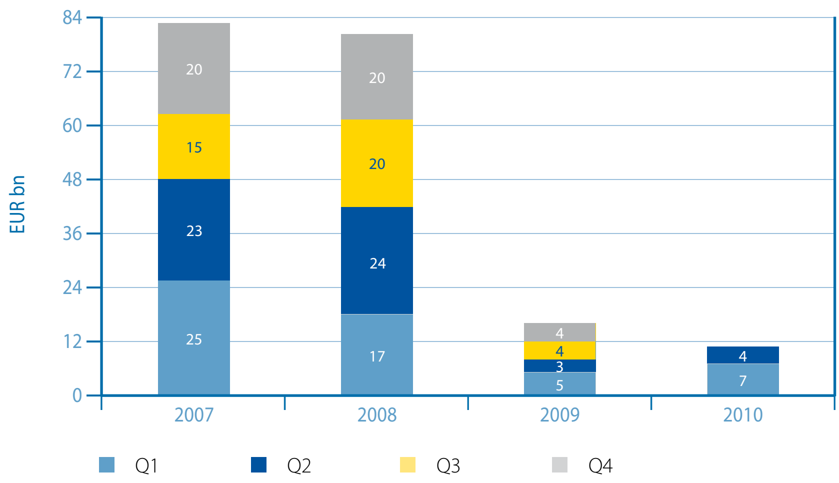
In H1 2010, most of the funds reaching final closings were VC funds (23 venture funds out of a total of 51 funds with final closings), similar to 2009 fundraising which was also dominated by VC funds, with 34 final closings. VC's share of final closings in 2007 and 2008 had been about a third.

When looking at the upper end of the market, only five EUR 1bn+ funds were raised from the beginning of 2009 until the end of H1 2010, compared with 15 such funds raised in 2008, and 12 in 2007. As for the mid-market activity, the funds that reached final closings in H1 2010 were similar to those of 2009 – the main differences being a slightly lower concentration in the EUR 50m–EUR 149m space and a shift away from EUR 250m–EUR 499m funds into the EUR 500m–EUR 999m range.

Preliminary figures for H1 2010 seem to confirm some shifts in the investor base for European PE funds, namely pension funds losing their lead role in capital commitments, to the benefit of banks and sovereign wealth funds. According to Peter Cornelius of AlpInvest, this is driven by the considerable funding challenges that pension funds face amid record low interest rates. Sovereign wealth funds picked up the pace during H1 2010. Banks were the only major capital contributor to European fundraising in both 2009 and 2010.

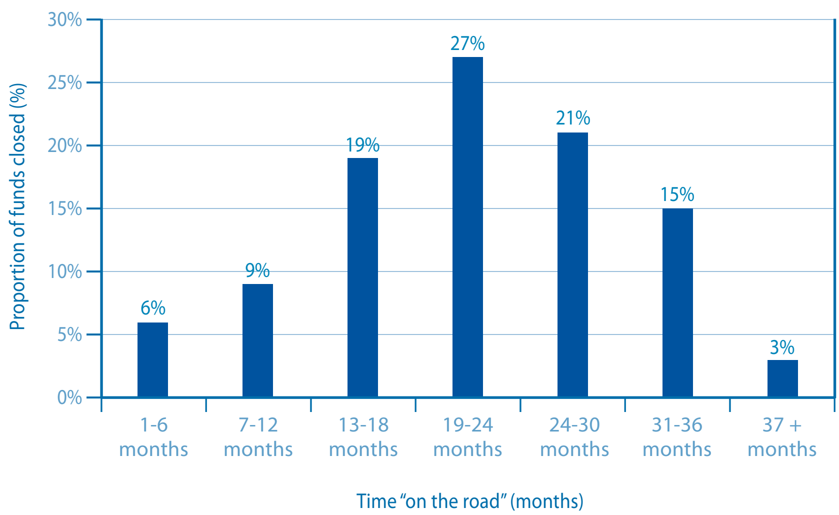
The longer average time spent "on the road" in the fundraising effort shows the difficult market conditions faced by fund managers for H1 2010 (figure 8).

Figure 7: Quarterly fundraising evolution: 2007 – Q2 2010



Source: EVCA/PEREP_Analytics

Figure 8: Time spent fundraising for funds closed in Q3 2010



Source: Preqin, Q3 2010 Fundraising Overview (global data)

> "Several major factors were responsible for suppressed fundraising levels in 2009. First, the denominator effect meant that many LPs were unable to commit to new funds. Additionally lower distributions exacerbated the LPs' general liquidity constraints. Second, private equity firms' portfolios needed attention due to the severity of the downturn, which also meant that GPs were spending a considerable amount of time focusing on their existing portfolio companies, rather than searching for new deals. Third, as leverage became more difficult to come by, deal activity declined in 2009, with potential sellers of businesses unwilling to sell at depressed valuations. There was a clear mismatch between seller and buyer price expectations, which resulted in few deals being closed in 2009, particularly as there was uncertainty about sales and profit forecasts."
>
> *Helen Steers, Pantheon Ventures*

Figure 9: Average time taken for funds to achieve a final close

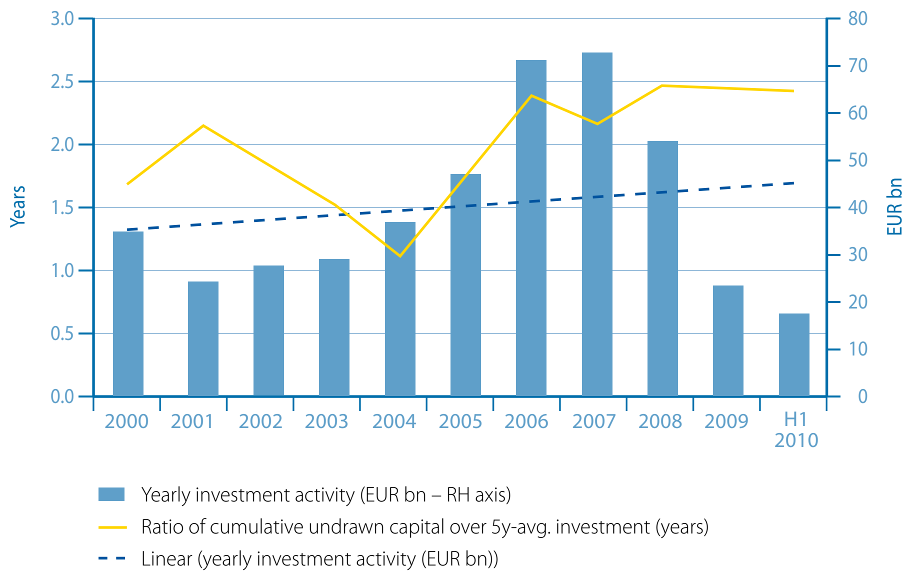
Source: Preqin (global data)

The time on the road increased steadily since 2007 (figure 9). The biggest leap was in 2008 (from an average of 12 months for funds closed in 2007 to 15 months in 2008), and 2009 (to an average of 18.6 months). 2010 funds spent one more month on the road than 2009 funds.

The depressed market conditions led to a further decrease of the total amount raised by PE funds in 2009, driven by the reduction of fund target sizes by GPs and the adoption by LPs of revised strategies using smaller average ticket sizes and reduced portfolios.

Overall, taking into account the cyclical nature of fundraising – and the very high levels of funds committed to European PE between 2006 and 2008 – a large part of the industry still had considerable capital to invest. Nevertheless, this would represent about two years of investment activity (see figure 10). Therefore, we might expect that the need to come back to the market will increase in 2011.

Figure 10: Ratio of cumulative undrawn capital to five-year-average investment activity – Europe

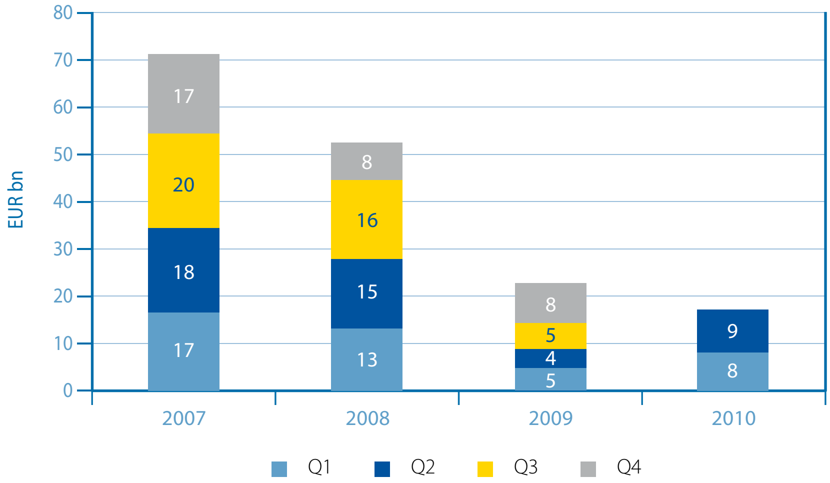


Source: EIF on EVCA activity data

Investments – *private equity rebounded in 2010*

With many fund managers having a large stockpile of committed but as yet uncalled capital available, in particular funds approaching the end of their investment periods, there was increased pressure to put capital to good use. With financing conditions improving and the modest rebound in economic growth, we started to see a significant increase in activity in H1 2010, driven by bigger deal sizes. A total of EUR 17.2bn was invested in European companies in this period, just 24% below the full-year 2009 level, showing a significant recovery from the crisis (see figure 11).

Figure 11: Quarterly investment evolution: 2007–Q2 2010



Source: EVCA/PEREP_Analytics

The buyout segment was most affected in 2009 but is recovering faster in 2010

The investment environment was most affected in 2009, with the buyout market suffering the most due to substantially lower activity at the larger end of the market. Buyout investment in H1 2010, despite being at only 20% of 2007 activity, was almost equal to full-year 2009 value at EUR 11.1bn. However the number of companies financed was half (around 300 companies) of the full-year 2009 number. While close to half of the amount invested in buyouts in H1 2010 went to mid-market transactions, the vast majority of targets were small buyouts (four out of five companies). At the other end of the scale, due to the still-scarce availability of leverage, there were only three mega deals (EUR 1bn+ transaction value) in H1 2010, compared with 53 in 2007. However, this is still an improvement on 2009, when there were just three mega-deals for the full year. For large buyouts (EUR 500m-EUR 1bn transaction value), the improvement on 2009 was more considerable, with six companies financed in H1 2010 compared with just four for 2009.

As of 2009, the number of companies receiving growth capital far exceeded the number of companies subject to buyout. Buyout activity reached its peak in 2007, while 2008 was the record year of growth capital investment.

After a dip in 2009, growth capital rebounded in 2010 (to EUR 2.7bn). At around 400 companies financed, it is even likely to exceed the 2008 level (~600 companies) by year-end. Altogether, comparing H1 2010 to 2007, it seems that growth capital gained at the expense of buyout activity.

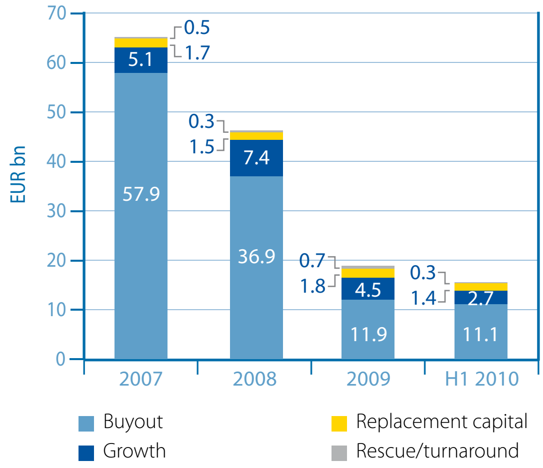
Based on H1 2010 figures (EUR 1.4bn), replacement capital activity was also on track to surpass the full-year 2009 level (EUR 1.8bn).

> **"Improved financing conditions have allowed the refinancing of existing portfolio companies to address the maturing wall of debt falling due over the next few years. Such conditions include the fall in high-yield corporate bond spreads to a level close to their long-term average and the increase in institutional investors' demand for leveraged loans."**
>
> *Peter Cornelius, Alpinvest*

> **"In terms of industries, buyouts have been broad-based, with more cyclical industries accounting for around half the transaction volume. Purchase multiples have been relatively high, reflecting strong competition including cash-rich strategic buyers."**
>
> *Peter Cornelius, Alpinvest*

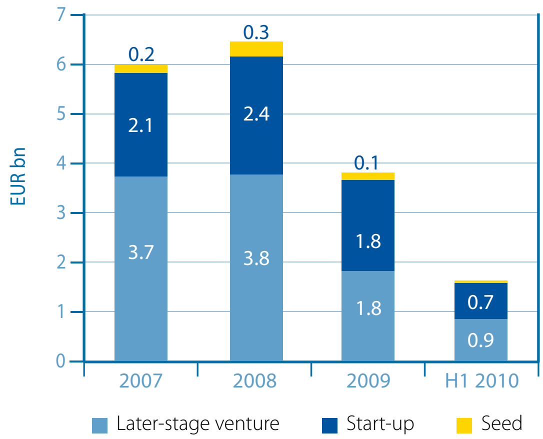
By sectoral focus, consumer goods & retail was the most targeted buyout sector in H1 2010, attracting nearly a quarter of the buyout amount invested and accounting for 16% of the companies financed by buyouts. This was also the most invested sector by amount in 2009, and among the top three invested sectors during 2007 and 2008. Business & industrial products – the sector most favoured by buyouts in 2007 and 2008 – attracted less than 8% of the amount invested in H1 2010 as a result of modest average deal sizes (15% of the buyout-backed companies financed). By contrast, an increase in the average deal size made life sciences – at 17% – the second most invested buyout sector by amount (10% of buyout-backed companies financed).

Figure 12A: Buyout activity evolution



Note: Bank debt excluded for buyouts

Figure 12B: Venture activity evolution



Source: EVCA/PEREP_Analytics

> **"In contrast to leveraged buyouts, venture capital transactions have remained subdued. Although the substantial decline in investment activity in this market segment appears to have bottomed out, there have been few signs of a sustained recovery yet."**
>
> *Peter Cornelius, Alpinvest*

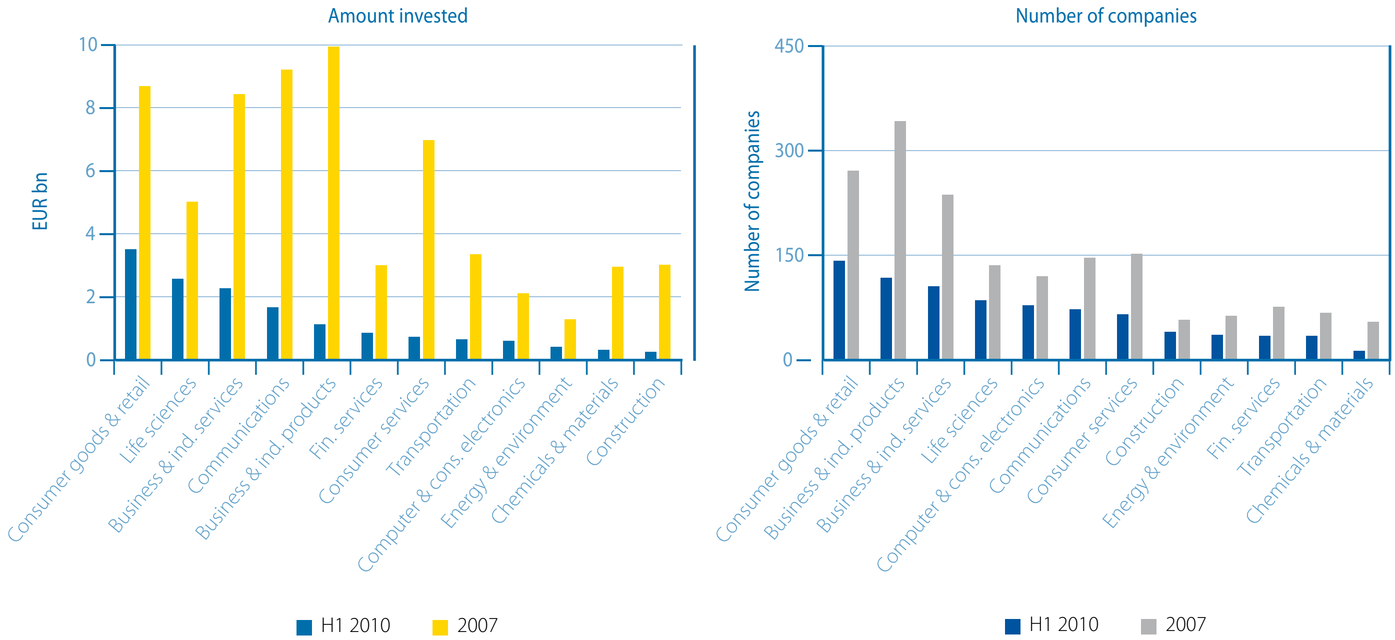
Venture capital is still subdued in 2010

At EUR 1.6bn in around 1,500 companies, VC investment in H1 2010 narrowly failed to exceed the levels of the corresponding period in 2009 (the gap was approximately EUR 240m and 200 companies).

While in 2007 and 2008 the amount invested in later-stage investment exceeded early-stage by more than EUR 1bn, this segment contracted more during the recession, and in 2009 and 2010 was about the same as early-stage investment. A similar process was observed by number of companies invested.

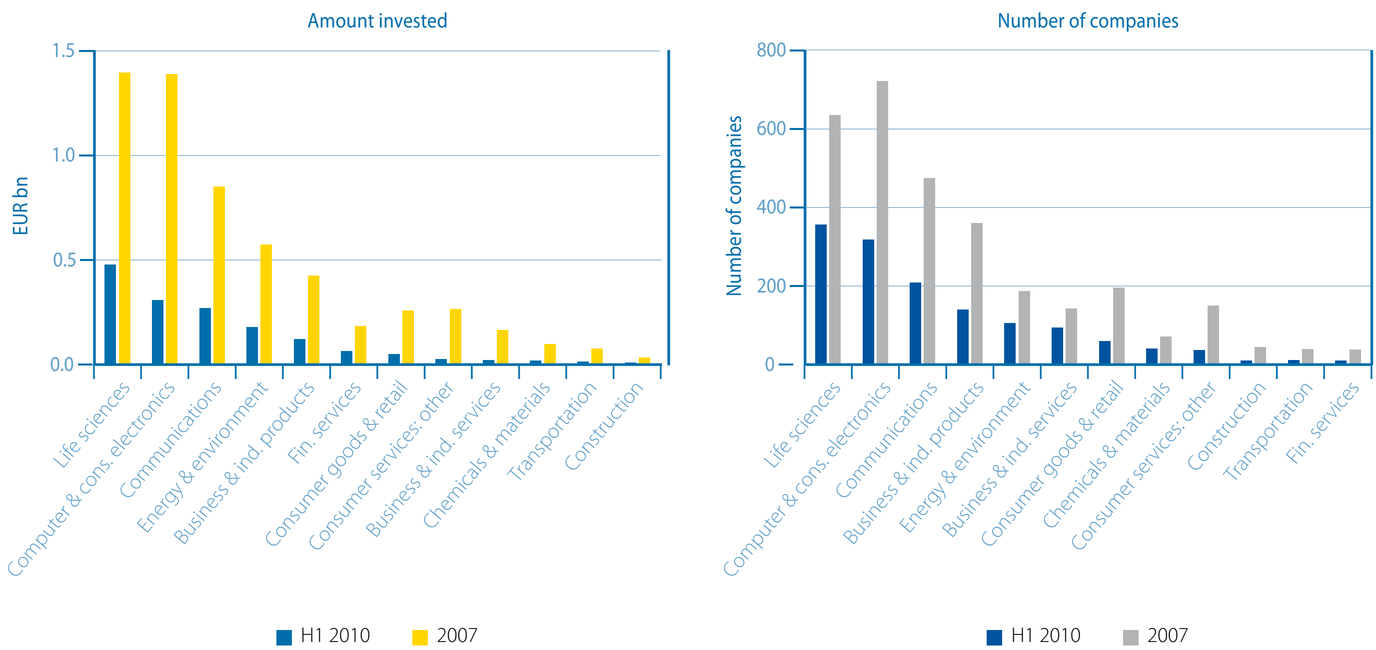
The most targeted sectors on the VC side in H1 2010 remained unchanged from 2007: life sciences, computer & consumer electronics, and communications, altogether representing 65% by amount invested and 61% by deal volumes.

Figure 13: Buyout investment by sector – H1 2010 versus 2007



Note: Bank debt excluded
Source: EVCA/PEREP_Analytics

Figure 14: Venture investment by sector – H1 2010 versus 2007



Source: EVCA/PEREP_Analytics

Divestments – Exits increased as of Q3 2009

After an extremely difficult exit environment in 2008 and 2009 – characterised by a virtually closed IPO market and an almost complete absence of trade buyers – some signals of a gradual revival in the exit market appeared towards the end of 2009. This revival continued into 2010.

Divestment at cost (excluding write-offs) reached EUR 5.7bn in H1 2010, just 20% below the full-year 2009 level. In line with the general economic environment and as a result of the economic crisis, the level of write-offs intensified in 2009 and H1 2010. However, the number of companies written off during H1 2010 was still only 1.3% (on an annualised basis) of the aggregate number of companies invested in over the previous five years.[13]

Buyout exits at cost (when excluding write-offs), at EUR 4.8bn in H1 2010, were already at a level close to the one of full-year 2009, with the recovery gathering pace since the last quarter of 2009. VC exits at cost (EUR 843m, when excluding write-offs) grew more slowly and are set to hit the 2009 level by year-end. As expected, given the nature of their business models, more venture-backed companies were written off (70% of the total number of companies written-off in H1 2010) than buyout-backed companies.

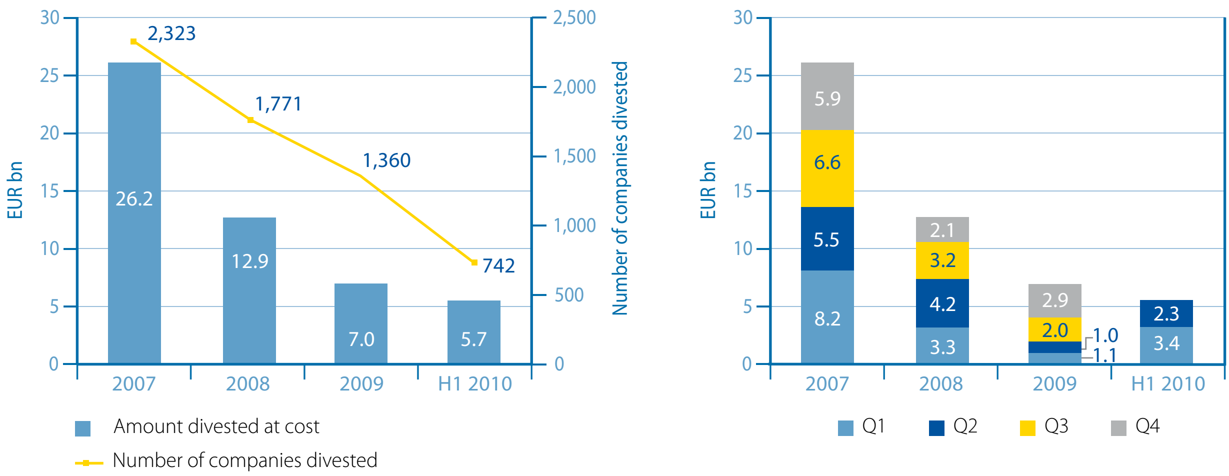
Write-offs aside, in H1 2010 sales to other PE players drove the buyout exit market by amount (EUR 1.7bn or 35% of the total). Trade sales – despite being the second most favourable exit method in H1 2010 at EUR 1.4bn – did not pick up as expected during this period. At EUR 0.8bn, IPOs reached a level similar to 2007.

By number of companies, the top two exit methods in the buyout segment were repayment of principal loans & silent partnerships and trade sales.

Trade sales was the favoured exit method in the VC segment, accounting for more than a third of the amount at cost of venture divestments, excluding write-offs (EUR 303m). Sales

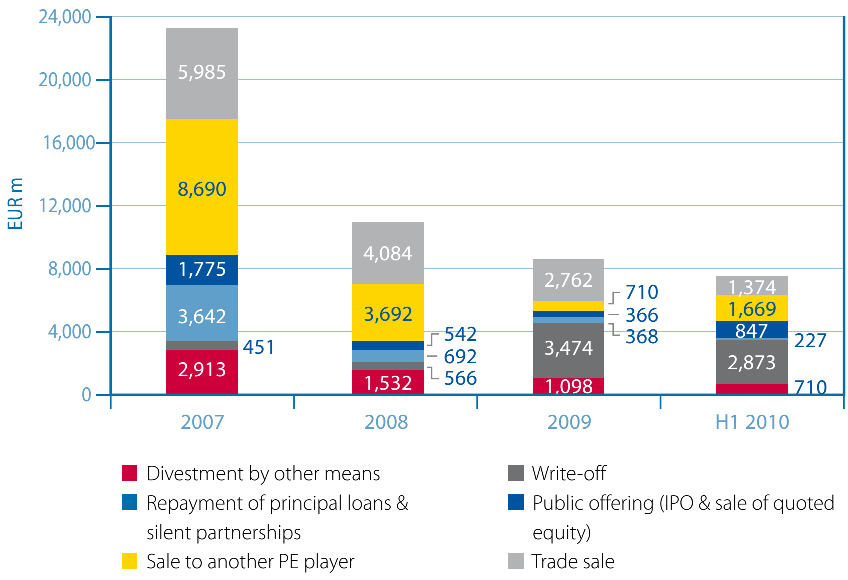
[13] This is the approach used to estimate the number of portfolio companies held by private equity firms.

Figure 15: Divestment evolution by amount at cost divested (write-offs excluded)



Source: EVCA/PEREP_Analytics

Figure 16: Buyout divestment evolution by exit route (amount at cost divested)



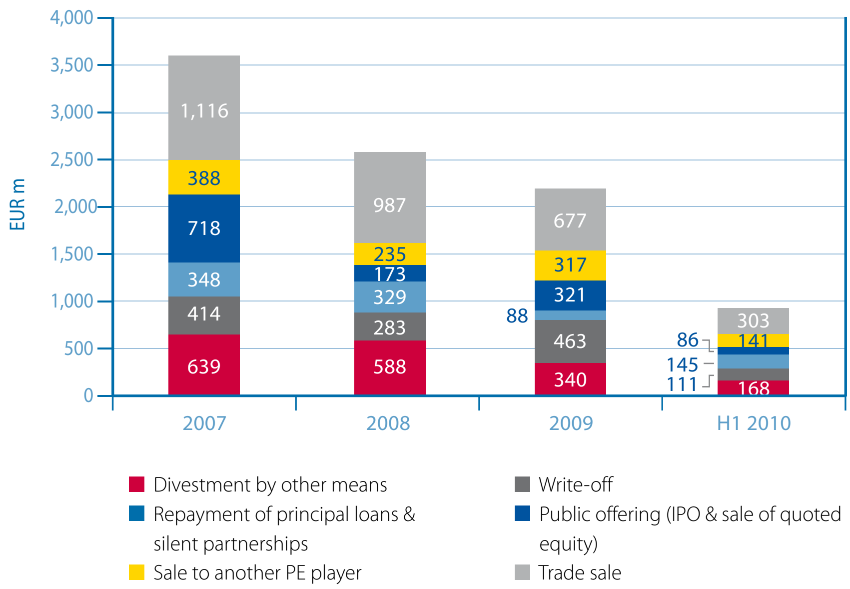
Source: EVCA/PEREP_Analytics

> **"While secondary transactions have provided an important exit route, private equity fund managers have also taken advantage of improved conditions in the M&A and IPO markets, which have permitted them to increase distributions to their limited partners."**
>
> *Peter Cornelius, Alpinvest*

to another PE firm and repayment of principal loans & silent partnerships followed some way behind, each with 17% of the total. There were few IPOs for SMEs in the VC arena. By number of companies divested, the top-ranking exit methods (excluding write-offs) on the VC side were similar to those of buyouts: repayment of principal loans & silent partnerships and trade sales.

The PE activity for H1 2010 is a two-sided story. While deal flow clearly picked up, fundraising showed no major improvement in the number of funds reaching final closing, and while there was an increase in exits, it was below expectations. Moreover, it is not yet possible to determine if even this modest increase in divestments is driven by ˝exit-ready˝ companies that were earlier kept in portfolios because of the exit market conditions, or by a general pick-up in the market itself. 2011 will determine whether PE activity will show a definitive market rebound.

Figure 17: Venture divestment evolution by exit route (amount at cost divested)



Source: EVCA/PEREP_Analytics

2.2 Performance trends

In 2008, one-year net PE horizon returns were severely affected by the downturn (see figure 18). However, after a dismal 2008, net short-term IRRs returned to positive territory with 1-year horizon IRRs as of December 2009 at 5.6% and a further upward trend noticed to June 2010. This partial recovery had mostly been driven by improved valuations rather than actual distributions: the short term PE returns' historical volatility is relatively high, although on the same level as public equity market returns' volatility.

During the crisis, VC funds were less affected than buyout ones when looking at short-term variations (figure 18).

But the latter have managed to bounce back more rapidly. Nevertheless, it is important to bear in mind that PE is by definition an illiquid asset class, designed to be held until maturity, and intermediate short-term returns are not systematically indicative of the final fund performance.

Figure 18: PE performance – net one-year rolling IRR (in %)

Note: Intra-year performance figures (as of June 2010) are based on only a limited sample of funds
Source: Thomson Reuters/EVCA

Table 2: Investment benchmarks: PE performance – net horizon IRRs (in %)

	10-year		20-year	
Stage	Dec-09	Jun-10	Dec-09	Jun-10
Early Stage	-4.1	-3.7	-0.8	-1.1
Later Stage	-3.7	-4.4	2.1	2.0
Balanced	-0.9	-1.4	2.5	2.1
All Venture	-3.1	-3.2	0.5	0.2
Small Buyouts	7.9	7.2	12.7	12.8
Medium Buyouts	7.1	7.4	12.0	12.0
Large Buyouts	7.7	9.4	19.9	20.2
Mega Buyouts	9.9	8.7	9.8	9.0
All Buyouts	9.0	8.4	12.1	11.9
Generalist	2.6	5.0	10.0	10.0
All Private Equity	5.4	5.5	9.4	9.3

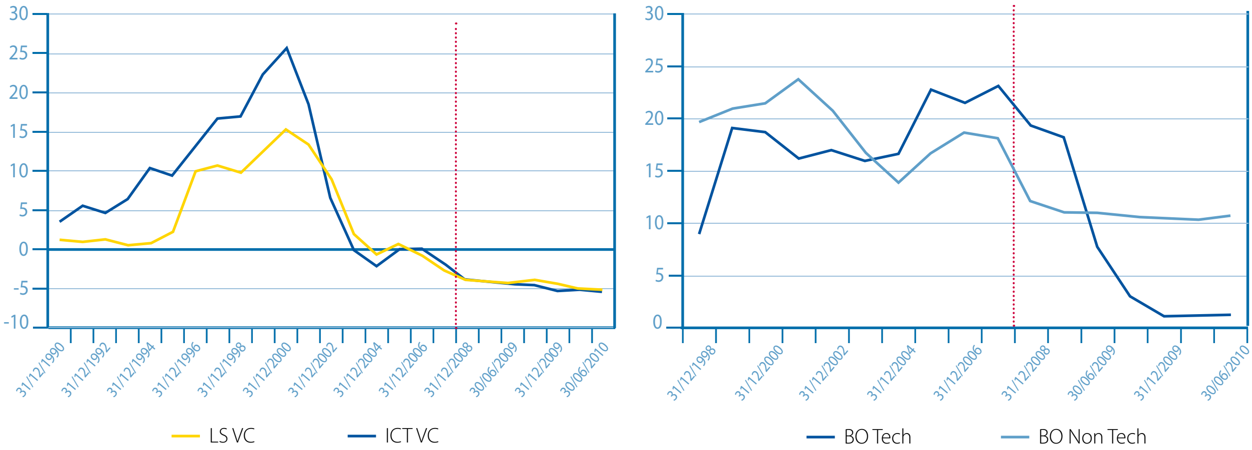
Source: Thomson Reuters/EVCA[14]

As of June 2010, long-term PE returns remained steady, with 10-year and 20-year horizon IRRs of 5.4% and 9.4% respectively. Buyout funds registered the highest returns over these periods, with 9.0% and 12.1%. This represented an increase of 0.6pp and 0.2pp over the 10- and 20-year returns recorded by the end of 2009. VC performance remained weaker, registering a 10-year IRR of -3.1% as of June 2010, the latter affected by the dotcom burst of 2000 (see table 2).

[14] Data are continuously updated and might therefore be subject to change.

An analysis of performance figures over the long term (10-year IRR investment horizon returns) split by sectors (figure 19) illustrates how the performance of VC tech sectors – life sciences and ICT – has been following the same downward trend after the peak of the dotcom bubble in 2001. On the other hand, buyout returns remained more stable in the long term. However, the impact of the recent crisis affected buyout tech and non-tech (generalist) funds differently, with the former suffering the most.

Figure 19: Sectoral performance by market segment – 10-year net horizon IRR (in %) [15]



Source: Thomson Reuters/EVCA

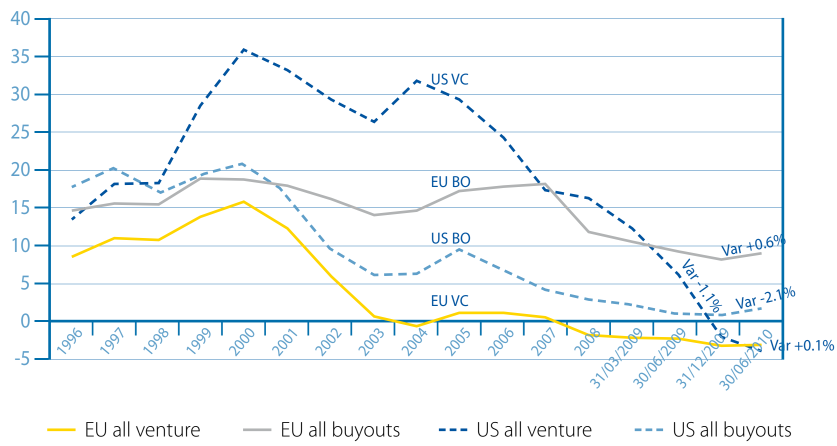
US and EU comparison

The US VC market has not been immune to the effects of the crisis, as the plunge of US VC returns shows (see figure 20), for which the 10-year IRR fell from 1.9% as of December 2009 to -4.1% by June 2010. This decline is significantly steeper than the corresponding +0.1% variation in the EU VC market from December 2009 to June 2010. The EU continues to outperform the US market in the buyout segment, although with a reduced gap of +1.7% (vs. +3.4% at the end of 2009).

2.3 EIF D-Indices

The performance trends described in the previous section are confirmed by the EIF D-Indices – return indices based on the underlying portfolio companies in the EIF portfolio[16] (see Annex 2). Note that EIF returns are calculated gross before all fund management and incentive fees, so they are not directly comparable to the net fund performance figures published by Thomson Reuters presented in the previous section. Moreover, while Thomson Reuters' figures represent pooled IRRs, the EIF's figures are calculated as time-weighted returns.

Figure 20: US and European PE performance – 10-year net horizon IRRs (in %)



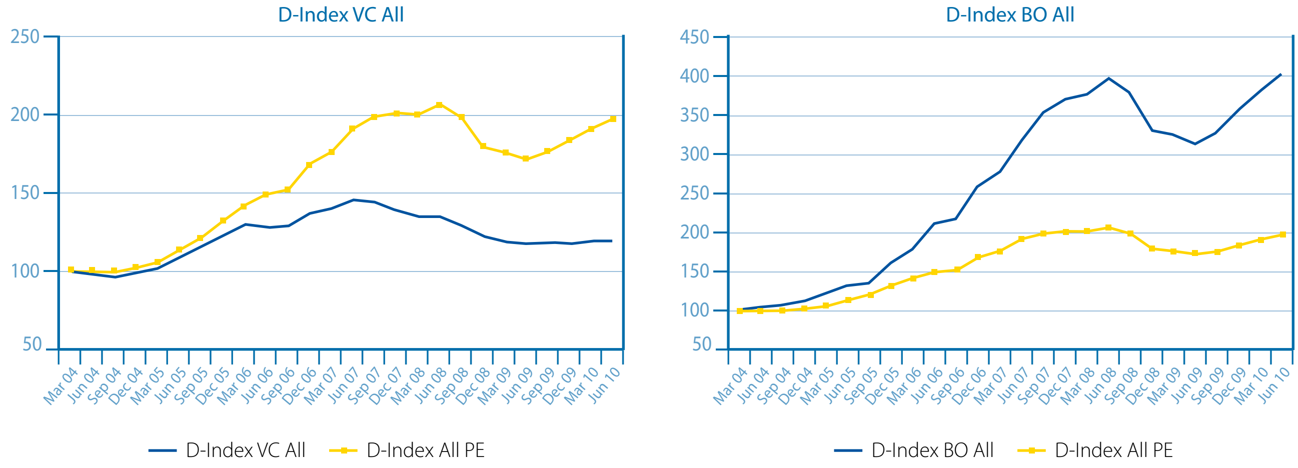
Source: Thomson Reuters/EVCA

The figures below (figures 21-23) show the quarterly return evolution of EIF portfolio companies since 2004. To highlight the impact of the crisis, particular attention is paid to the variation between the peak of the summer of 2008 vs. the bottom reached in the summer of 2009 and the recovery since then.

[15] VC LS and ICT include biotechnology, medical/health, communications and media, computer hardware, computer software and services, internet specific, semiconductors/other electrical. BO tech includes communications and media, computer hardware, computer software and services, internet specific, semiconductors/other electrical and biotechnology. BO non-tech (generalist) includes medical/health, consumer related, industrial/energy and other products.

[16] The indices are calculated based on the evolution of the valuations of portfolio companies in the EIF's portfolio of 330 funds. Companies in portfolio are active at the beginning of the return calculation period, which implies that exits are taken into account. For additional details on the methodology of EIF D-indices see Annex 2.

Figure 21: Quarterly D-index evolution – VC vs. BO (base 100, March 2004)

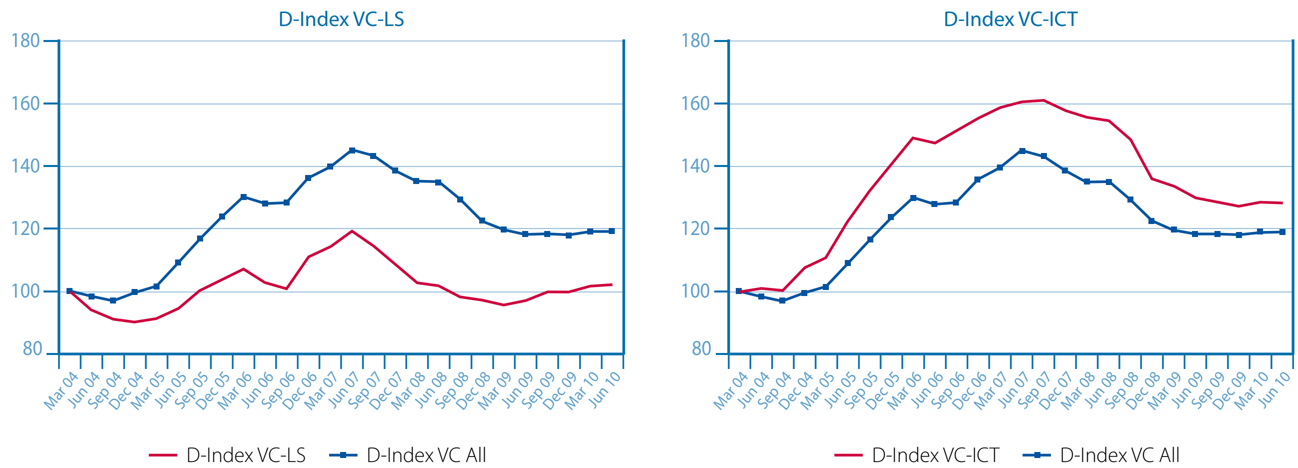


Source: EIF internal data

Buyout investments historically outperformed VC investments (see figure 21). However, a closer look at the data reveals that the buyout sector was hit harder by the crisis than the VC. At the same time, the ability to recover from the crisis quickly and steadily appears to be stronger in the buyout sector than in VC (see table 3). These results confirm what is observed in the market at fund level (see section 2.2).

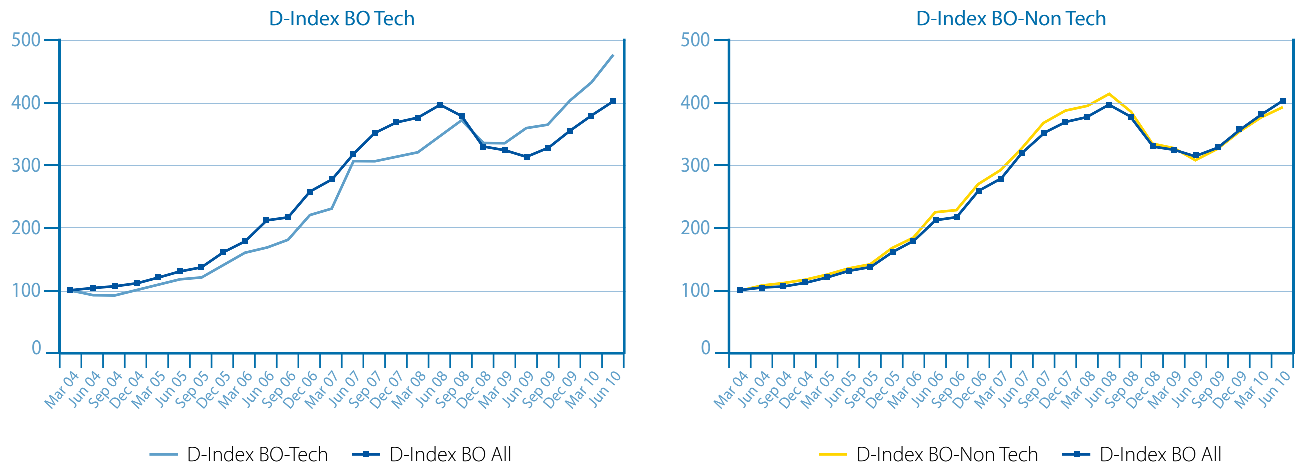
An analysis of VC data by industry sector reveals that the life sciences sector has consistently underperformed in the overall VC portfolio, in contrast with the VC ICT sector. This result differs from the net fund performance by industry sector presented in the previous section, where life sciences and ICT funds performed very similarly throughout the years. However, VC life sciences investments

Figure 22: Quarterly D-index evolution – VC LS vs. VC ICT (base 100, March 2004)



Source: EIF internal data

Figure 23: Quarterly D-index evolution – BO tech vs. BO non-tech (generalist, base 100, March 2004)



Source: EIF internal data

Table 3: EIF D-Indices statistics (from March 2004 to June 2010)

D-Index	CAGR annual (%)	STD DEV (%)	Jun 08-09	Jun 09-10
VC LS	0.3	8.0	-4.6	5.1
VC ICT	4.0	8.0	-16.1	-1.2
VC ALL	3.0	7.0	-12.3	0.8
BO Tech	28.0	17.0	4.4	32.2
BO Non Tech	25.0	15.0	-25.6	27.8
BO ALL	25.0	14.0	-21.0	28.6
PE ALL	12.0	9.0	-16.6	14.9

Source: EIF internal data

performed somewhat better over the past few quarters (+5.1% from June 2009 till June 2010) compared with the ICT sector (see figure 22), which registered a –1.2% decrease in value from June 2009 till June 2010.

An analysis of buyout data by industry sector shows that both tech and non-tech (generalist) investments have performed very similarly since March 2004 (see figure 23). However, non-tech investments were more severely impacted during the recent crisis, while tech ones were more resilient.

3. Concluding remarks

After a challenging 2009, H1 2010 showed a moderate recovery in PE activity. Will PE activity pick up more substantially in 2011? Many industry practitioners, who shared their views with us, expect a further gradual improvement in PE activity with the pace of the recovery depending on the strength of the economic revival. Given the still considerable macroeconomic uncertainties, coupled with regulatory concerns, the market environment is expected to remain challenging in the short term with investors remaining cautious.

According to Peter Cornelius, economic growth is likely to have moderated in the second half of the year. "The near- to medium-term outlook remains clouded with exceptional uncertainty," he says. "The base case foresees a further gradual improvement in private equity activity, as yield-chasing investors are expected to show robust demand for high-yield debt. Historically, fundraising has followed investments, suggesting that under such conditions commitments should start to recover soon, albeit at a relatively modest pace. However, economic risks remain clearly tilted to the downside and could push a still fragile recovery in private equity off track".

Industry practitioners such as Katita Palamar from Cogent Partners foresee a decrease in new investment activity, as managers are concerned about a double dip, with debt financing becoming less available.

Turning to fundraising, Peter Cornelius says market conditions will remain difficult in the short term, due to a number of different factors. "Key among them are: the funding challenges of pension funds and the regulatory uncertainty pertaining, for example, to the treatment of private equity under Solvency II, and the potential investment restrictions and costs under the new Alternative Investment Fund Managers Directive (AIFMD)".

Helen Steers concludes that, for now, both GPs and LPs will need to quantify and understand the macroeconomic risks associated with investing in various sectors and countries: "This situation is expected to increase uncertainty in the medium term, and drive capital to areas that are considered more promising," she says. "However, a well-diversified European portfolio, invested with high-quality managers, should continue to deliver superior returns for investors, even in the current economic climate".

Annex 1: Acronyms

- AIFMD: Alternative Investment Fund Managers Directive
- BO: Buyout
- EIB: European Investment Bank
- EIF: European Investment Fund
- EIU: Economist Intelligence Unit
- EU: European Union
- EVCA: European Private Equity and Venture Capital Association
- GP: General partner
- ICT: Information and Communications Technologies
- IMF: International Monetary Fund
- IRR: Internal rate of return
- LP: Limited partner
- LS: Life Sciences
- PE: Private equity
- SMEs: Small and medium-sized enterprises
- VC: Venture capital

Annex 2: Methodology and Definitions

I. Market activity section - methodology

Fundraising

The funds included in the statistics are:
- private equity funds making direct private equity investments
- mezzanine private equity funds
- co-investment funds
- rescue/turnaround funds

The following funds are excluded from the statistics:
- infrastructure funds
- real estate funds
- distressed debt funds
- primary funds of funds
- secondary funds of funds

Fundraising is captured by two methods:
- by incremental amount raised in a year – if a fund has an intermediary closing of €200m in 2010 and the cumulative amount raised for this fund stands at €500m, €200m only is captured in the 2010 fundraising

- by final closings – captures the total cumulative amount raised at final closing.

Investments

Unless stated otherwise (see figure 6. Industry statistics – by location of private equity firm), the approach taken in this report is a market approach (i.e. investments and divestments are represented by location of the portfolio company).

At European level, this means investments in European companies or divestments from European companies, regardless of the location of the private equity firm.

Buyout split

Buyout investments are split into four classes: small, mid-market, large, and mega. In this report, the classification is based on the transaction value of the buyout deals (see table below). If two syndication partners invest equity values of €100m and €200m respectively for a total transaction value of €600m, the deal will be classified under large deals with an equity value of €300m and transaction value of €600m.

Divestments

Divestments are measured by cost of investment, not proceeds. This is done in order to be able to compare divestments with investments on an equivalent basis.

Data updates

PEREP_Analytics offers to the players the potential to submit surveys and validate previously populated data captured from public information sources at a later stage. Moreover, if a player submits a divestment at a later stage, and the corresponding investment has never been reported or captured, the PEREP_Analyst will create the investment so that no portfolio company is reflected with negative capital flow in the database. Moreover, some information is disclosed on the website of the private equity players at a later stage, after the cut-off for producing our activity reports, and thus is processed in the database at a later moment. For all the above reasons, figures may be updated year on year to reflect the latest available statistics for previously released years starting with 2007.

Buyout deals	Equity value (€m)	Transaction value (€m)
Small	<15	<50
Mid-market	15 ≤ X <150	50 ≤ X <500
Large	150 ≤ X <300	500 ≤ X <1,000
Mega	≥ 300	≥ 1,000

II. EIF D-Indices - methodology

Source of data

The indices were calculated using data from 330 VC and buyout funds that have the EIF as an investor (see table below). All funds target primarily European-based SMEs. The indices are therefore not representative of the performance of large and mega buyout deals.

Data set size description

	PE ALL	BO ALL	BO Non Tech	BO Tech	VC LS	VC ICT	VC ALL
Max	2 339	426	338	88	569	844	1 600
Min	1 727	165	120	45	391	752	1 248
Average	2 064	287	223	64	494	803	1 453

Calculation

The index is designed to track the performance of a portfolio of investments in privately held companies (private equity investments, or PEIs). Periodic returns (R) for the index are calculated as:

$$R_{t=1} = \frac{(FV_{t=1} - CF_{t=1}) - FV_{t=0}}{FV_{t=0}}$$

Where:

FV_t = Σ of fair market value of PEI at time t

CF_t = Σ of new PEIs completed during period $(t, t-1)$ – Σ of distributions received during period $(t, t-1)$

Frequency

R is calculated on a quarterly basis, in line with the reporting frequency of the vast majority of funds analysed. The calculation assumes that all CF take place at the end of the quarter.

Definition of fair market value

FV is calculated on the basis of International Private Equity Valuation (IPEV) guidelines. (http://www.privateequityvaluation.com/).

Cash

Cash held by the funds analysed is not included in the calculation of periodic returns. The index simulates the performance of a portfolio of PEIs that is always fully invested.

Fees

Returns are calculated gross of all management and incentive fees charged by the funds analysed.

Universe

PEIs in more than 3,500 small and medium-sized enterprises (SMEs) has been used for the creation of the indices. These have been grouped into sub-universes according to the sector in which the SME operates (ICT, life sciences or generalist) and according to the stage of development of the SME (VC or BO). See "EIF D-Indices Definition" below.

II. EIF D-Indices Definitions

Sector membership and stage membership definitions can be found in the table below:

Index Name	Sector	Stage
D-Index VC-ICT	ICT	VC
D-Index VC-LS	LS	VC
D-Index VC	ICT+LS+Generalist	VC
D-Index BO-Tech	ICT+LS	BO
D-Index BO-Non Tech	Generalist	BO
D-Index BO	ICT+LS+Generalist	BO
D-Index All PE	ICT+LS+Generalist	BO+VC

The conversion from EVCA's sector classification to EIF D-Indices sector classification can be found below:

EVCA Sector Investee Company	Sector of the index
*Generalist	Generalist
Agriculture	Generalist
Biotechnology	Life Science
Chemicals and Materials	Generalist
Communications	ICT
Computer Related	ICT
Construction	Generalist
Consumer Related	Generalist
Energy	Generalist
Financial Services	Generalist
Industrial Automation	Generalist
Industrial Prod. and Services	Generalist
Medical/Health Related	Life Science
Not Allocated	Generalist
Other	Generalist
Other Electronic Related	ICT
Other Manufacturing	Generalist
Other Services	Generalist
Transportation	Generalist

The conversion from EVCA's stage classification to EIF D-Indices stage classification can be found below:

EVCA Stage Investee Company	Stage Focus Fund	Stage of the index
*Generalist	"Mid-Market PE" or "Small Cap PE" or "Growth / Replacement Capital" or "Balanced PE"	BO
*Generalist	"Seed Capital" or "Start-up / Early Stage" or "Balanced VC" or "Expansion VC" or "Technology Transfer Accelerator"	VC
Buyout	No Filter	BO
Expansion	"Mid-Market PE" or "Small Cap PE" or "Growth / Replacement Capital" or "Balanced PE"	BO
Expansion	"Seed Capital" or "Start-up / Early Stage" or "Balanced VC" or "Expansion VC" or "Technology Transfer Accelerator"	VC
Other early stage	No Filter	VC
Replacement Capital	"Mid-Market PE" or "Small Cap PE" or "Growth / Replacement Capital" or "Balanced PE"	BO
Replacement Capital	"Seed Capital" or "Start-up / Early Stage" or "Balanced VC" or "Expansion VC" or "Technology Transfer Accelerator"	VC
Seed	No Filter	VC
Start-Up	No Filter	VC

III. Definitions

Activity section

Private equity: Private equity provides equity capital to enterprises not quoted on a stock market. Private equity includes the following investment stages: venture capital, growth capital, replacement capital, rescue/turnaround and buyouts. **Private equity funds** are pools of capital managed in general as closed-end, fixed-life funds making primarily equity capital investments into enterprises (i.e. direct private equity funds as opposed to primary or secondary private equity funds of funds) not quoted on a stock market.

Venture capital: Venture capital is, strictly speaking, a subset of private equity and refers to equity investments made for the launch, early development, or expansion of a business.

Fund stage focus

Early-stage fund: A venture capital fund focused on investing in companies in the early stages of their lives.

Later-stage fund: A venture capital fund focused on investing in later-stage companies in need of expansion capital, usually providing a third or fourth (or subsequent) round of venture investment.

Balanced fund: A venture capital fund focused on both early-stage and development, with no particular concentration on either.

Growth fund: Funds whose strategy is to invest in or acquire relatively mature companies that are looking for capital to expand or restructure operations; they often provide the first private equity investment in a company.

Buyout fund: A fund whose strategy is to acquire other businesses.

Mezzanine fund: A fund that provides (generally subordinated) debt to facilitate the financing of buyouts, frequently alongside a right to some of the equity upside.

Generalist fund: A fund with either a stated focus of investing in all stages of private equity investment, or with a broad area of investment activity.

Stage definitions

Several financing stages can be identified in relation to the stages of development of a private-equity-backed company. These are described as follows:

Seed: Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase.

Start-up: Financing provided to companies for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but have not sold their product commercially.

Other early-stage: Financing to companies that have completed the product development stage and require further funds to initiate commercial manufacturing and sales. They will not yet be generating a profit.

Later-stage venture: Financing provided for the expansion of an operating company, which may or may not be breaking even or trading profitably. Later-stage venture tends to finance companies already backed by VCs, and are therefore involved in a third or fourth (or subsequent) round of financing.

Growth: A type of private equity investment – most often a minority investment but not necessarily – in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a significant acquisition without a change of control of the business. Growth capital tends to be a company's first private equity financing. Additionally, most investments made by buyout funds into venture stages would be defined as growth capital.

Bridge financing: Financing made available to a company for the period of transition between being privately owned and publicly quoted.

Rescue/turnaround: Financing made available to an existing business, which has experienced trading difficulties, with a view to re-establishing prosperity.

Secondary purchase/replacement capital: The purchase of a minority stake of existing shares in a company from another private equity firm or from another shareholder or shareholders.

Refinancing bank debt: An injection of capital to reduce a company's level of gearing.

Management buyout: Financing provided to enable current operating management and investors to acquire existing product lines or businesses.

Management buy-in: Financing provided to enable a manager or group of managers from outside the company to buy in to the company with the support of private equity investors.

Public-to-private: A transaction involving an offer for the entire share capital of a listed target company for the purpose of delisting the company. Management may be involved in the offering.

Other PIPE: A private investment in public equity, as a minority or majority stake, without taking the company private.

Other (leveraged) buyout: Financing provided to acquire a company (other than MBI, MBO, public-to-private or other PIPE). It may use a significant amount of borrowed money to meet the cost of acquisition.

Secondary buyout: A secondary buyout is a form of buyout where both buyer and seller are private equity firms or financial sponsors (ie a leveraged buyout of a company that was acquired through a leveraged buyout). Secondary buyouts differ from secondaries or secondary market purchases which typically involve the acquisition of portfolios of private equity assets, including limited partnership stakes and direct investments in corporate securities.

Mapping the above stages into the main five presented in the document leads to the following classification:
Seed: seed
Start-up: start-up, other early stage
Later-stage venture: later-stage venture, bridge financing
Growth: growth
Rescue/turnaround: rescue/turnaround
Replacement capital: secondary purchase/replacement capital, refinancing bank debt
Buyouts: management buyout, management buy-in, public-to-private, other PIPE, leveraged buyout,
Mapping the above stages further into the two main stages presented in the document – venture and buyout & growth - leads to the following classification:

Venture deals: seed, start-up, later-stage venture

Buyout & growth deals: growth, rescue/turnaround, replacement capital, buyouts

Amounts definition

Equity value: Stricto sensu, the amount of capital invested to acquire shares in an enterprise. The equity value includes equity, quasi-equity, mezzanine, unsecured debt and secured debt financing provided by funds raised by private equity firms focused primarily on direct investments (including co-investment funds) or incorporated direct private equity firms investing from the balance sheet (evergreen and direct captive private equity programmes).

Transaction value: The sum of the "equity value" as described above, to which financing coming from the rest of the syndicate is added (LP co-investors, individuals, entrepreneurs, business angels, management, corporates, funds-of-funds, other asset managers and/or financial institutions), together with the leverage (debt provided by banks or other providers). In other words, stricto sensu transaction value is equal to enteprise value multiplied by the percentage ownership by the acquiring syndicate in which at least one financial sponsor (private equity firm) is involved.

Sectoral definitions

For a complete picture of the sectoral classification and its mapping to the NACE standardised sectoral classification of Eurostat (NACE Rev. 2, 2007), go to
www.evca.eu//uploadedFiles/sectoral_classification.pdf

This link above shows the map between the old EVCA sectors, the 67 new sectors used in the online survey by PEREP, their grouping into the 14 sectoral classes used in the sectoral distribution of investments in the EVCA Yearbook, and their further grouping into the seven sectoral clusters used in the fundraising by fund sectoral focus in the EVCA Yearbook.

Divestment methods:

Divestment on flotation (IPO): An initial public offering (IPO) is the sale or distribution of a company's shares to the public for the first time by listing the company on the stock exchange. It is one way a private equity firm can sell its shares and exit an investment.

Repayment of preference shares/loans: If a private equity firm provided loans or bought preference shares in the company at the time of investment, then their repayment according to the amortisation schedule represents a decrease of the financial claim of the firm against the company, and hence a divestment.

Repayment of silent partnership: A silent partnership belongs to the so-called mezzanine financing instruments. It is similar to a long-term bank loan but, in contrast to a loan, a silent partnership is subject to a subordination clause, so that in the event of insolvency all other creditors are paid before the silent partner. The company has to repay the partnership and has to pay interest and possibly a profit-related compensation. The subordination clause gives the capital the status of equity despite its loan character. This financing instrument is frequently used in Germany.

Sale of quoted equity post-flotation: This relates to the sale of quoted shares only if connected to a former private equity investment, such as the sale of quoted shares after a lock-up period.

Sale to another private equity house: See sale to financial institution.

Sale to financial institution: The sale of company shares to banks, insurance companies, pension funds, endowments, foundations and other asset managers other than private equity firms.

Sale to trade buyers: The sale of company shares to industrial investors.

Divestment by write-off: The total or partial write-down of a portfolio company's value to zero or a symbolic amount (sales for a nominal amount) with the consequent exit from the company or reduction of the share owned. The value of the investment is eliminated and the return to investors is equal or close to -100%.

For more information on the methodology of this report, please contact research@evca.eu.

Performance section

The data is taken from Thomson Reuters' application Thomson ONE (www.thomsonone.com). Thomson Reuters' applications contain detailed statistical measurements including distribution and valuation ratios from data based on a sample of 458 buyout and mezzanine funds formed between 1980 and 2009.

IRR Internal Rate of Return

The IRR is the interim net return earned by investors (Limited Partners) from the fund from inception to a stated date. The IRR is calculated as an annualised effective compounded rate of return using monthly cash flows to and from investors, together with the Residual Value as a terminal cash flow to investors. The IRR is therefore net, i.e. after deduction of all fees and carried interest. In cases of captive or semi-captive investment vehicles without fees or carried interest, the IRR is adjusted to create a synthetic net return using assumed fees and carried interest.

Pooled IRR

The IRR obtained by taking cash flows since inception together with the Residual Value for all funds and aggregating them into a pool as if they were a single fund. This is superior to either the average, which can be skewed by large returns on relatively small investments, or the captial-weighted IRR which weights each IRR by the capital committed. This latter measure would be accurate only if all investments were made at once at the beginning of the funds' life.

Horizon IRR

The horizon IRR allows for an indication of performance trends in the industry. It uses the fund's net asset value at the beginning of the period as an initial cash outflow and the Residual Value at the end of the period as the terminal cash flow. The IRR is calculated using those values plus any cash actually received into or paid by the fund from or to investors in the defined time period (i.e. horizon). A three-year horizon looks back from the end of 2009 over three years to the end of 2006 and so on.

Ten-Year Rolling IRR

The ten-year rolling IRR shows the development of the five-year Horizon IRR, measured at the end of each year. By the same token the one-, three- and twenty-year rolling IRRs are produced.

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