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CAMBRIDGE ASSOCIATES LLC

EUROPEAN PRIVATE EQUITY INVESTING

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ABSTRACT

1. Market conditions are favorable for investors in European private equity, despite the global contraction and equity bear market, because European companies will continue to be pressured to rationalize in order to compete effectively in the global market, while European governments will continue to deregulate their economies in an effort to improve productivity and create jobs. Progress along these lines will be sporadic, however, since such changes remain deeply unpopular among many politically powerful constituencies and politicians are responsive to this opposition, particularly during election years. Nevertheless, the European Union is gradually evolving into a single market that rivals the United States in terms of population and economic output. Meanwhile, European capital markets developed strongly in the 1990s, with initial public equity offerings growing at a compound annual rate of 30% through 2000, aided by the introduction of multiple new junior stock exchanges across the region, before subsiding in 2001. Including high-yield issues, the corporate bond market, while less than one-third the size of the U.S. market at €125 billion, has been growing 2.5 times faster in recent years. European mergers and acquisitions (M&A), the source of many investments and exits for European private equity investors, grew at a compound annual rate of 49% during the boom years of the late 1990s, reaching €1.3 trillion in 2000, before settling back down to €550 billion in 2001—still a respectable level. Although small-company markets, like Germany's Neuer Markt, have been decimated by the inevitable ebbing of the tech and telecom mania (IPOs have dried up and M&A volumes have contracted sharply), the general outlook for private equity investors remains positive because European restructuring will continue and private equity capital plays an important role in this process.

2. Europe lacks sufficient private equity capital to address the market potential. Although €29 billion was raised in 2000 (0.38% of GDP) and a total of €74 billion in the period 1996-2000 (growing at 45% per year), this is significantly less than in the United States where €67 billion was raised in 2000 (0.68% of GDP). The United Kingdom, Germany, and France are currently the most prolific sources of private equity transactions and over 75% of all European private equity capital is invested in these three countries, which serve as the headquarters for many pan-European and global corporations. With a well-established local private equity market, the United Kingdom is also home to most of Europe's leading and longstanding private equity fund managers, particularly those targeting larger transactions. France and Sweden have several longstanding resident fund managers that are migrating to larger transactions and broadening their geographic focus beyond their borders. In our view, Italy and the Benelux also have promising private equity market potential.

3. European acquisitions seem reasonably priced, but have recently increased, especially for larger transactions. The average EBIT purchase multiple for European private equity was 8.5 in 1999 and 8.4 in 2000, compared to a long-term average of 7.7 and the typical market range of 6 to 8. While purchase multiples are at the high end of the historical range, they are comparable to U.S. multiples of 8.3 in 1999 and 7.9 in 2000. In addition, the increase in multiples has been commensurate with fund managers' migration to larger transactions. For example, investments between €20 million and €50 million registered a multiple of 8.8, and investments over €50 million in size were purchased at 11.0. While the premia required to acquire large, successful European companies may be higher, given their success in overcoming commercial, legal, and cultural differences to address the broader European market, the relatively high average EBIT purchase multiples for 1999 and 2000 may indicate a broader trend that could negatively impact returns for these vintage years.

4. European private equity performance is competitive with that of U.S. private equity. The pooled net IRR to Limited Partners from funds formed in 1986 through 1996 was 23.5%, compared to 20.2% for U.S. private equity funds over the same period. On a vintage year basis, European private equity funds outperformed their U.S. counterparts in five of those years: 1987, 1990, 1994, 1995, and 1996. Comparing the United Kingdom, the most advanced European private equity market, to the United States, the results are similar: 20.9% vs. 20.2%, respectively. Europe recovered from its early 1990s recession earlier than the United States and this subsequent recovery, combined with continued market inefficiencies, may have contributed to the strong performance registered from 1994 through 1996.

5. As noted above, we are cautiously optimistic that private equity fund managers will continue to find attractive opportunities, even if public equity markets prove more challenging than during the recent bull market. However, these difficult public market conditions, combined with increased capital flowing into this asset class increases the importance of identifying quality fund managers in building and maintaining a successful program. Fund investors should diversify by market segment (middle-market fund, large buyout fund, etc.), geographic focus (country-specific fund, pan-European fund, etc.), and vintage year. With over 500 European private equity funds managers and a bevy of U.S. fund managers expanding overseas, a disciplined investor can readily build a program that mitigates the risks inherent in individual funds and specific strategies. The available population of European private equity fund managers is ever changing. As private equity markets continue to mature across Europe, more quality fund managers are expected to emerge at the middle-market level and the number of spin-off funds comprised of teams wanting to focus on a particular sector, region, or transaction type is expected to increase.

SUMMARY

Growth and Development of the European Private Equity Market

During the great U.S. and European equity bull market of the late 1990s, private equity and venture capital funding grew at an annual rate of 41%,[1] with over €230 billion raised worldwide in the year 2000. Of that, however, €167 billion, or 72%, went to U.S.-based funds, while European funds came in a distant second, with €44 billion, or 19% of the total, followed by Asia and Israel (see Exhibit 1). Of the €181 billion invested in both private equity and venture capital in 2000, 75% was invested in the United States, 18% in Europe, and the rest in Asia, Israel, and Latin America (see Exhibit 2). Although the United States dominates, the broader market is sizable and growing, led at present by Europe, which has six countries in the top ten in terms of private equity and venture capital investment growth.

The emergence of Europe as a major private equity market is to be expected. With a total population of around 373 million and a GDP of €9.5 trillion as compared to a U.S. population of 275 million with a GDP of €10.4 trillion,[2] the amount of private equity activity in this region appears to be well under its potential. With Europe comprising 20% of world GDP and the United States comprising 22%, the disparity between their private equity markets must be addressed eventually (see Exhibit 3). Using a common indicator of utilization, private equity as a percentage of GDP, Europe's private equity market has been growing at an accelerating rate and is expected to eventually reach the same level of utilization as the United States. Private equity as a percentage of GDP increased from 0.13% in 1997 to 0.38% in 2000 (Exhibit 4), compared to 0.41% and 0.63%, respectively, for the United States. In addition, on a country basis Sweden and the United Kingdom are already playing at the same level as the United States.

Divided We Differ

Europe's private equity market consists of two tiers: individual countries or subregions and the European Union (EU) as a whole. The current viability of private equity on a country-by-country basis varies widely across Europe due to differences in size, wealth, tax, legal, financial, and industrial environments:

- Corporate taxes range from 10% (Ireland) to 40.3% (Italy);
- Strong employment policies can discourage investors from pursuing an investment in a specific country (e.g., France);
- Corporate governance, which outlines the rights and roles of shareholders and Board directors, can be vastly different depending on the country of jurisdiction; and
- Local capital markets may not be robust enough to support significant private equity investment or may only support one specific industry sector.

Of course, language differences can immediately indicate friend or foe to a potential investee company. There are also more subtle and not-so-subtle differences that split Europe apart geographically for private equity investors. Value can be created in each country but investors lacking in local knowledge may run into difficulties when they try to extract that value efficiently. In our view, the three countries that offer the best market conditions for private equity transactions

[1] Global Private Equity 2001, PriceWaterhouseCoopers.

[2] OECD.

in the long run are the United Kingdom, Germany, and France, followed by Sweden, Italy, and the Benelux, with current market conditions favoring the United Kingdom, Scandinavia, and France. (See Table A on the following page.)

United We Coalesce

Since its formation in 1993, when it replaced the European Common Market, the 15 member EU has steadily moved the region towards a single market by extending EU citizenship to all citizens of member states, creating the European Central Bank, prodding national governments to privatize state-owned enterprises and to deregulate the commercial environment, and introducing a common currency, the euro (see Exhibit 5). Among the major EU initiatives affecting private equity investors are:

European Monetary Union/Eurozone. The introduction of a single European currency, the euro (which only Denmark, Sweden, and the United Kingdom have so far resisted), makes it easier to compare businesses across the region. In addition, the diminished importance of national central banks is expected to increase the need for alternative funding sources, including private equity managers.

European Capital Markets Development. In recent years, there has been a proliferation of junior stock markets across Europe, including the Neuer Markt (Germany), Nouveau Marché (France), Swiss New Market (Switzerland), Nuovo Mercato (Italy), Nuevo Mercado (Spain), TechMARK (U.K.) and Easdaq (European affiliate of Nasdaq). These new exchanges were established within the last couple of years, concurrent with the Internet boom, and target emerging high-growth European companies. Their initial success provided an additional boost to the nascent equity culture in many of these countries by providing high-profile public market exits for venture capital investments. While the dot-com crash has decimated their growth, the development of these exchanges reflects a more enduring shift in European commercial culture in favor of entrepreneurship and capital market (rather than bank) financing. In general, the increased acceptance and development of an equity culture is expected to generate a new class of corporate managers that are willing to work for upside, resulting in a greater source of qualified managers for private equity and venture capital portfolio companies. In addition, the decline of technology companies on these junior exchanges may encourage investors to take another look at profitable growing companies in other, less glamorous sectors, providing another source of exit to middle-market fund managers.

Overall, increased capital markets development has improved the flow of information from companies to stockholders, resulting in more immediate indications of approval of corporate strategy and revealing opportunities for consolidation/divestiture, which should benefit private equity fund managers in sourcing transactions.

Increased Intra-European Commerce. The EU continues to work towards a single market, breaking down barriers to protected national markets, providing citizenship across its member countries and introducing a single common currency. The results of these efforts should be reflected in the actions and performance of European corporations. In order to remain competitive in this new arena, many companies are expected to review lines of business to determine where their competitive strengths lie and to refocus their efforts accordingly. This activity should result in increased spin-offs, consolidation, and expansion efforts on a pan-European basis, all of which create private equity investment opportunities.

Table A

SURVEY OF EUROPEAN PRIVATE EQUITY MARKET CONDITIONS

	United Kingdom	Germany	France	Sweden	Netherlands	Italy	Switzerland	Ireland	Belgium	Spain	Portugal
Economic/Regulatory											
Corporate Governance	Strong	Weak	Wanting	Strong	Promising	Promising	Wanting	Strong	Wanting	Weak	Weak
Corporate Tax Rates	Promising	Wanting	Promising	Strong	Promising	Weak	Strong	Strong	Weak	Promising	Promising
Employment Rate	Promising	Wanting	Weak	Promising	Strong	Weak	Strong	Promising	Weak	Weak	Weak
Labor Market	Strong	Wanting	Weak	Promising	Promising	Weak	Strong	Strong	Wanting	Weak	Weak
Euro 2002	Weak	Strong	Strong	Weak	Strong	Strong	Weak	Strong	Strong	Strong	Strong
Availability/Accessibility											
Private Equity Capital	Strong	Strong	Strong	Promising	Promising	Promising	Wanting	Wanting	Wanting	Promising	Wanting
IPO Market	Strong	Strong	Strong	Promising	Promising	Promising	Promising	Wanting	Wanting	Wanting	Wanting
M&A Market	Strong	Promising	Strong	Strong	Strong	Promising	Wanting	Weak	Weak	Wanting	Weak
Overall Buyout Prospects	Strong	Strong	Strong	Promising	Promising	Promising	Wanting	Wanting	Wanting	Wanting	Wanting

Strong **Promising** **Wanting** **Weak**

Sources: *The Economist*, European Commision, Heidrick & Struggles 1999 Survey "Is Your Board Fit for the Global Challenge? Corporate Governance in Europe," KPMG 2001 Corporate Tax Rates Survey, and Merrill Lynch & Company 2001 Report "OECD Labor Market Scorecard."

Central and Eastern Europe Market Development. Ten Central and Eastern European countries are currently applying for EU membership (Hungary, Poland, Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia, the Czech Republic, and Slovenia) and their accession is projected to occur between 2004 and 2006. In addition to accepting and demonstrating certain political and social precepts, these countries must demonstrate well-functioning market economies that can cope with the market forces and competitive pressures of the EU's single market. To meet these conditions, including a reduction in central bank involvement in the local economy, many countries are expected to shed state-owned assets and improve fiscal and legislative policies to encourage investment. While these countries are still acquiring the right attributes for EU admission, privatization investment opportunities, among others, are expected to attract more fund managers to these regions.

In short, the massive secular changes in European corporate development triggered by the evolution of the EU have all the characteristics of a market in transition, seeking new routes to higher growth, both at the individual country level and at the EU level, which generate a tailwind for private equity investors. Maturing quickly in the United Kingdom, private equity investing has already blossomed in Europe, through a combination of U.K. manager expansion and local manager startups. Today there are over 500 European private equity managers,[3] ranging from small country-focused funds to pan-European funds competing with global corporations for investment opportunities.

Sources of European Private Equity Capital

With commitments to European private equity funds at an estimated €29 billion for 2000, twice the €14 billion raised in 1999, the European private equity market continued to grow at a rapid pace (see Exhibit 6) even as the bear market in public equities started to unfold. In 2001 the final tally is expected to be in the range of €30 billion to €50 billion, either slightly besting 2000 or at least settling into the pace of expansion set in earlier years. Private equity fund raising in 2001 was significantly bolstered by large fund closings, including CVC III, the third Cinven fund, and PAI Europe III, among others. With most of the larger buyout managers closing new funds in the last couple of years, 2002 is expected to be fairly quiet, with only a handful of funds, including Charterhouse, Industri Kapital, and Terra Firma, coming to market with €1 billion-plus funds.

Commitments to European private equity funds are sourced primarily from European pension funds and banks, which typically take up over 45% of the funds on offer in any given year (see Exhibit 7), although non-European investors, at 27%, also represent a significant source of capital. European pension funds increased their percentage participation in 2000 to 24.2%, up significantly from 18.7% in 1999, but in line with historical levels of 24% to 25%. European banks appear to have lost some of their appetite for buyout investing, with their percentage declining to 21.7% in 2000 from a four-year high of 29.1% in 1999. In recent years, funds-of-funds have increased their role from a *de minimus* percentage in 1997 to 11.4% of total European private equity capital raised in 2000. This is due in part to the increased fund sizes raised by fund-of-funds managers, including HarbourVest and Pantheon, and to the increased number of fund-of-funds managers in recent years.

[3] *European Venture Capital Association 2001 Yearbook.*

Uses of European Private Equity Capital

European private equity investment has been growing in step with commitments, prospering in countries with more established markets and resulting in step-ups in investment sizes as the market absorbs larger and larger deals and greater diversity in industries represented. The European buyout market had been increasing at a compound annual rate of 44.1% from 1996-2000, culminating in €62.8 billion in total value in 2000 (see Exhibit 8). Although much of the expansion of the late 1990s was driven by conditions that are unlikely to recur anytime soon, we would expect growth to resume as the global economy recovers, because the pace of mergers and acquisitions (M&A), divestitures, and middle-market sales is likely to pick up again.

Overwhelming Majority of Invested Capital in the United Kingdom, Germany, and France

At 77.5% of the total market, the United Kingdom, Germany, and France are clearly the lead countries by enterprise value for European private equity. Of these, Germany grew the fastest from 1996 to 2000, at 76.4% per year, followed by France at 55.8%, and then the United Kingdom at 40.2%. With firmly established private equity markets and many pan-European and global corporation headquarters, these three countries are expected to maintain their roles as leaders in European private equity-although it is worth noting that the fund managers completing deals in these countries are typically pan-European firms with U.K. headquarters, such as Apax, BC Partners, Candover, Cinven, and Schroders, among others.

Overall Transaction Sizes Increasing

The average transaction size for European private equity has increased in step with the growth of the overall market. At €134.8 million in 2000, the average transaction size had grown at a 47.2% rate over the last four years, to almost five times the 1996 average of €28.7 million (see Exhibit 9). Factors driving this increase include larger fund sizes, increased comfort in private equity investing and managing larger businesses by capital providers, and the continued economic growth of the region overall. Although telecommunication services with an average transaction size of €1,269.6 million obviously pushed up the overall average, even excluding this sector, transactions averaged €127.5 million in 2000.

Increasing Industry Sector Diversity

The industries favored by European private equity fund managers varied somewhat as investment trends unfolded in the late 1990s, but in general their aggregate portfolios became more diversified. In 1996, the top five industry sectors represented 63% of European buyouts, with general industrials/engineering dominating at 27.8% and the fifth and sixth sectors, general retailers and transport, each representing just 4.8% (see Exhibit 10). In contrast, the top five sectors aggregated just over 50% of the region's buyouts in 2000, a marked reduction. General industrials/engineering was still a leading sector, but with just 14.9% of the market, and the fifth category, telecommunication services, represented only 6.1% of that year's total.

Despite perennial sector leaders such as general industrials/engineering and basic industries/chemicals jointly and consistently representing between 25% and 35% of all European buyouts by sector, certain industries make a flash in the pan from time to time. For example, health care-related buyouts represented 8% of the market in 1997 only to decline to 0.8% the following year, recovering to 4.5% in 2000. Media and photography increased from 2.9% of the market in 1996 to 13% in 1998 before declining to 3.1% in 2000. And in 2000, telecommunications services was the hottest sector, at 6.1% of the market, which had averaged a mere 0.5% for each of the previous four years. Due to business failures, depressed valuations, and overcapitalization, telecommunications services is expected to yield some attractively priced turnaround and consolidation opportunities in the short- to medium-term.

Valuations Similar to the United States

With a long-term average EBIT multiple of 7.7, private equity investors have paid about the same amount for European companies as they have for U.S. companies, whose EBIT has averaged 7.3 (see Exhibit 11). However, as in the United States, there has been considerable variability around this average: from 7.6 in 1998, up to 8.5 in 1999, and then slightly down to 8.4 in 2000.

Ticking Upwards?

Over the last few years, as several European fund managers successfully raised multi-billion euro funds and the average buyout transaction size increased from €57.6 million in 1998 to €134.8 in 2000, the average EBIT purchase multiple increased commensurately, as larger companies appear to command higher prices (see Exhibit 12). For example, European buyout managers paid on average an 8.8 EBIT multiple when investing between €20 million and €50 million in equity, but the multiple rose to 11.0 when the investment was greater than €50 million, while for investments below €5 million, the average was only 7.2. This may be attributable to a large-company premium effect, but may also be related to differentiation among sectors—larger companies are more likely to be in those sectors, like publishing and retail, which have commanded higher multiples, than in sectors like general industrial where multiples have been lower.

Improving Exit Environment

Private equity investments are realized either via trade sale or IPO. When neither is available, but exit interest is high, a leveraged recapitalization can be effected, in which a company is refinanced with more leverage, creating cash that can then be paid out to investors. As Europe's public capital markets continue to grow and develop, fueling IPOs, M&A, and public debt issuance, the exit environment for European private equity should also broaden and deepen.

Trade Sale Exit Route Open

Trade sales are the dominant exit route for European private equity investments, constituting 33% of all exits by value[4] (€3 billion) in 2000. Yet trade sales constitute less than 1% of European M&A activity, which totaled €1.3 trillion in 2000 and has been growing at a rapid rate in recent years (see Exhibits 17 through 20). M&A slowed along with the overall market in 2001, declining to €550 billion, but still consistent with the pace set in previous years. M&A would therefore seem to offer greater opportunities for trade sales in the future, especially as the restructuring of the European corporate sector shows no signs of abating.

[4] *European Venture Capital Association 2001 Yearbook.*

Increased sales to financial buyers are also expected, as the larger private equity funds begin to look to smaller private equity funds for deal flow. For example, 12% of all exits in 2000 were to other fund managers.[5] Smaller private equity funds provide larger funds with prequalified companies with management teams that are already accustomed to working with leverage and reporting to a financial owner. As larger funds continue to break away from the rest of the European private equity market in terms of target transaction size, this trend of buying from smaller funds is expected to continue.

IPO Market Better or Worse?

The launching of multiple stock exchanges over the last several years has increased awareness and availability of the public markets as a viable exit option, while recently setting the bar higher for would-be public companies. The Internet bubble led to the emergence of more than ten new stock exchanges in Europe, including the Neuer Markt in Germany and the Nouveau Marché in France, among others, all established in 1997 or later, materially increasing access to the public markets as an exit mechanism, particularly for high-growth companies. The bursting of the Internet bubble and the subsequent decline of technology as an investment sector of interest has resulted in renewed focus on cash flow-based businesses as attractive investments. However, there is also increased scrutiny on profitability and growth, with the typical threshold for a successful IPO at approximately €1 billion in market capitalization. Thus, companies may feel as if they are surrounded by water but cannot manage even a sip when it comes to the public equity markets.

Nevertheless, although the IPO window is currently shut, European companies have increasingly come to think in terms of public stock offerings as a means of financing, and capital raised in this way increased from €5.8 billion in 1991 to €94 billion in 2000, at the peak of the bull market (a ten-year growth rate of 30%) (see Exhibits 13 through 16). While the IPO market subsided in 2001, with only €33 billion in capital raised from IPOs, the knowledge base of the European public equity market is deeper than ever and better positioned to capitalize on any upturn in the future.

The Use of Leverage

The use of leverage in European private equity has always been moderate, with equity representing 35% to 40% of the capital structure. European fund managers and banks never fully embraced the highly leveraged buyout, in which equity constituted only 10%, which was in favor in the United States for several years. As a result, European fund managers have consistently focused on creating value through a combination of operational growth and leverage. Hindsight may prove them right: a McKinsey study found that two-thirds of the value in a leveraged buyout (LBO) comes from operating improvements and only one-third from leverage.[6] Despite this relative conservatism in the use of leverage, European private equity investors have not always found debt financing easy to come by. Assuming a company is purchased at an EBIT multiple of 7, financial institutions typically lend to achieve a total debt to EBIT ratio of 4.5 or thereabouts, resulting in approximately 60% leverage. A funding gap can occur when overall purchase multiples increase, which has been the case over the last couple of years. This gap can be filled with more debt, mezzanine financing, or more equity. As more equity would materially dilute the typical target gross return of 30%, and mezzanine funds also typically require equity in the form of warrant positions to hit a similar return target, more debt is often the focus of managers seeking to fill a funding gap.

[5] Ibid.

[6] "The Alchemy of LBOs," The McKinsey Quarterly, 2001 Number 2.

Currently in Europe, bank debt tends to be more readily available to larger companies. The European syndicated loan market, which also encompasses high-yield securities, was €125 billion in 2000, 30% the size of the U.S. market for the same period (see Exhibit 21). Further, the average size of a European syndicated loan package was €444 million versus the U.S. average of €256 million in 2000, or 1.7 times greater. However, the syndicated loan market is just one indicator of bank lending practices to European companies: the smaller the company, the more likely one bank will provide 100% of the debt required to effect a transaction as the sum total will be too small to syndicate.

In an effort to eliminate additional costs associated with sourcing debt financing to fill a funding gap, European private equity managers and other financial services institutions have been introducing collateralized debt obligation (CDO) funds or similar vehicles to the market. A CDO is a portfolio pool of debt instruments, such as senior LBO debt, that is then sold to investors seeking a competitive current fixed income return, or further leveraged. The sale or leverage generates more capital for additional investment in senior LBO debt, creating a new source of debt financing. Duke Street Capital and AIG are both raising funds that would employ some form of collateralization of debt, potentially providing capital for their own buyout transactions. While captive or semi-captive funds are expected to have particularly strong proprietary deal flow, they would be riddled with conflicts of interest if both the mezzanine and the private equity funds were investors in the same company at different levels in the capital structure.

Market Segments

The European private equity market has two major segments: *middle-market buyouts* concentrated on investments within a single region or country and *large buyouts* focused primarily on pan-European or global companies. While there is a significant overlap in the skills required to execute transactions in both segments, fund managers are also developing strategies to specifically address each one.

Middle Market

The European middle market attracted more than 60% of all European private equity transactions in 2000, and over 35% of the €62.8 billion in private equity investment.[7] While the definition of the middle market is fluid, it currently consists of transactions with enterprise values ranging from €50 million to €500 million. Beyond enterprise value, a middle-market company is typically a well-established, local company with few lines of business, often family-owned with some professional managers on board, and a fairly quiet profile beyond its sales footprint. As owners face generational change and want to monetize their investment or management wants to expand the business further, they may seek private equity investors. European private equity has its roots in providing growth capital to small, middle-market companies such as these.

There are many regional private equity markets in Europe, situated around primary and secondary cities, where opportunities are sourced locally through relationships with the legal and accounting firms that serve middle-market companies. Auctions are rare and there are few advisory firms marketing investment opportunities; instead, companies ask their accounting or legal advisor whom they might recommend for private equity funding. Fund managers with strong local ties and a local presence are therefore best situated to capitalize on emerging middle-market investment opportunities.

[7] Initiative Europe Ltd.

In certain markets, such as the United Kingdom, however, the middle market is increasingly efficient, with more savvy companies now seeking out fund managers focused on their particular industry or local market. In fact, 50% of the entire European middle-market value is concentrated in the United Kingdom alone. To address the greater level of sophistication in the United Kingdom, many U.K. middle-market fund managers have staffed and reorganized themselves by industry sector, and market directly to the corresponding companies to demonstrate their potential added value as an investor. Middle-market private equity funds range in size up to €1.4 billion (e.g., Bridgepoint Capital), with a typical fund size between €200 million and €500 million.

As the use of leverage is generally more conservative in Europe, middle-market fund managers targeting traditional 30% IRR returns would focus on growth through combinations of organic expansion or acquisition. At the middle-market level, professional management is patchy and often requires replacement or augmentation. For example, a chief financial officer at a middle-market company is typically a controller with little or no corporate finance experience. Consequently, many middle-market fund managers function as an outsourced corporate finance department for their portfolio companies, arranging bank financing and negotiating transactions for debt, acquisitions or sales, and advising on the finances of the business. Fund managers are obviously involved also in the exit process, which is (as noted above) typically via trade sale or occasionally, more recently, to a larger private equity fund manager.

Large Buyout Market

While the European buyout market as a whole grew at a healthy 44.5% annually from 1996-2000, the large buyout market grew at a staggering 92.6% annual rate during this period with deals worth €39.9 billion (average size, €1.3 billion) transacted in 2000 (see Exhibit 22). Based on corporate headquarters location, over 44% of European large buyouts originate in the United Kingdom (which is consistent with the overall buyout market), followed by Germany at 15.9%, with Pan-European companies comprising just over 10% of large buyouts (see Exhibit 23). From a manager standpoint, the vast majority of fund managers participating in large buyouts are U.K.-based, almost all with European offices, such as Charterhouse, Cinven, and BC Partners including some U.S. firms such as KKR.

Several factors have contributed to the rapid growth of the large buyout market:

- First, the continued development of the capital markets in Europe has increased transparency and public scrutiny of major companies, encouraging and even rewarding divestitures of non-core or underperforming lines of business;
- Second, Europe continues to have pockets of privatization activity, providing opportunities to buyout managers to own and operate sizable national businesses with significant assets;
- Third, the European high-yield and investment-grade bond markets have been growing and maturing, providing a reliable source of debt financing for private equity fund managers;
- Fourth, until fairly recently fund managers had been constrained by a both smaller fund sizes and portfolio diversification guidelines from pursuing larger deals—but in the last couple of years over ten European funds have been raised with commitments over the €1 billion mark; and
- Fifth and finally, larger companies are more attractive to private equity fund managers due to their market position, professional management teams, and maturity, among other attributes. As fund managers raised more capital it became easier to pursue these companies.

Is the Deep End of the Market Shallow? There is some concern that the European large buyout market is shallow, yielding few opportunities that are heavily marketed and bid up to high multiples by the larger fund managers to win the lead equity role. The lead then forms a consortium typically comprised of other bidders, and completes the transaction at the inflated price. Despite some grains of truth here, the following premises are flawed:

- **There is an *over*supply of private equity for buyouts.** The European buyout market as a whole is vastly *under*served by private equity investment, especially taking into consideration the similarity in size to the United States. At just 0.38% of GDP, Europe's private equity utilization significantly trails that of the United States at 0.63%.
- **There is an *under*supply of large buyouts for available private equity.** European M&A topped €1.3 trillion in 2000 and €553 billion in 2001, compared to €1.8 trillion and €1.2 trillion for the United States in those two years. In 2000, European buyouts comprised just 2.8% of the M&A market. Employing 65% leverage, over €650 billion in equity capital (22 times the record amount raised in 2000) would be required to address the last two years' worth of M&A opportunities solely with private equity.
- **Fund managers do *not* constitute a viable alternative to trade sales.** Fund managers may actually prove to be a superior alternative to trade sales, as large corporations divesting a significant line of business may be reluctant to sell to a competitor. As fund managers have demonstrated their ability to invest and manage large buyouts successfully, private equity is gaining credibility as a viable buyer.

Fund managers pursuing large buyouts typically have a pan-European footprint, with offices located in a combination of London, Paris, Frankfurt, Stockholm, and Milan, among other major European cities. The pace of large buyout investing is slower than that of middle-market investing. Large deals are often generated as the result of a corporate divestiture program or other high-profile effort, always requiring the involvement of a financial advisor and a formal bidding process. Most fund managers have marketing programs that create and maintain relationships with large corporations in their target sectors or geographic markets in an effort to create an edge should an investment opportunity arise. Post investment, many fund managers focus on recruiting appropriate senior management teams, adding value on the corporate finance side, and pursuing cross-border acquisitions and consolidations. At this level, both trade sale and IPO are viable exit options.

Watch for Style Drift

The appeal of completing a headlining deal and setting the market top can distract fund managers from maintaining their traditional investment strategy. Fund managers that have built their track record and reputation on being the lead and sole investor in a transaction, holding the lion's share of the equity (80%), are suddenly teaming up with peers to co-invest in transactions that exceed their portfolio diversification guidelines. The emergence of consortia at the large buyout level should not be considered highly unusual, as syndicates have always been a component of European private equity investing for the purpose of diversifying exposure to risk. However, syndicates at this large buyout level occur because no one-fund manager has enough private equity capital to complete the deal themselves. The company-specific risk in this segment of the market is relatively low because large buyout candidate companies are generally well established and often have a market leadership position and a pan-European, if not global, footprint. The migration of middle-market fund managers into the larger deals, where they may lack experience is disconcerting, but can be monitored through an analysis of investment track records.

U.S./European Cross-Border Private Equity Expected to Follow M&A Trends

At the large buyout level, we expect fund managers to develop increasingly geographically diversified portfolios as corporations continue to go global. As companies seek to expand and build new markets, their financiers will follow and provide private equity capital, among other sources of funding, to effect acquisitions. Indeed, cross-border deals represent an increasing proportion of the total value of all deals done across the world—41% in 2000 compared to 24% in 1996.[8] At an average value of €340 million, cross-border deals are also 54% larger than their domestic counterparts at €222 million. Cross-border M&A activity should be more familiar to European-based companies than to U.S.-based companies, given the smaller size of Europe's local markets and experience in expanding across multiple countries to become pan-European. In 2000, cross-border M&A purchasers hailed from the United Kingdom, France, the United States, Germany, and the Netherlands, in that order. U.K.-based companies led with approximately €362 billion in total value acquired, compared to an estimated €149 billion acquired by French- and U.S.-based companies. Targets were located in Germany, the United States, the United Kingdom, Canada, and France, in that order, with Germany representing €256 billion in value, the United States approximately €240 billion in value, and the United Kingdom €213 billion in total value. Greater U.S.-Europe cross-border activity is expected in private equity, particularly at the large buyout level.

Here Come the Yanks —U.S. Entrants in European Private Equity

Recognizing the market potential, many U.S.-based private equity managers are establishing offices in Europe to participate in the European private equity market. Among others, Bain Capital, Blackstone, Carlyle, Hicks Muse Tate & Furst, KKR, and Providence Equity Partners have all launched European funds or allocated significant capital from recent domestic funds to European private equity investing. To U.S.-based fund managers used to competing for deals in a region that has raised over €200 billion in private equity capital in recent years, the undercapitalized and underfunded European market must look appealing.

Private Equity Market Comparison

Characteristics	Europe	United States
Market	Growing, U.K. most mature market	Mature
LBO Structure Acceptance	Depends on Country	Fully Embraced
Leverage	Modest	High
Pricing	Under Control	Under Control
Supply of Capital	Undercapitalized-Large Buyout In Balance-Middle Market	Oversupply
Deal Structuring Skills	High	High
Opportunity for Added Value	High-Large Buyout High-Middle Market	Medium-Large Buyout High-Middle Market
Quality of Local Management	High-Large Buyout Variable-Middle Market	High-Large Buyout High-Middle Market
Exits	Trade Sale, then IPO	IPO, then Trade Sale

Source: Cambridge Associates LLC.

[8] KPMG Corporate Finance, Computasoft Research Limited/Commscan.

Many U.S. private equity fund managers now pursue large buyout investment opportunities in Europe to mixed results. As every deal in this segment is auctioned, the playing field is perceived to be relatively level, with little advantage accruing to local private equity firms. Not so. The European fund managers investing at this level often have far longer history in the private equity marketplace (15 to 20 years), established reputations, and European staff with European educational and professional backgrounds. In addition, they have probably co-invested with each other in the past and are familiar with what each fund manager can bring to a transaction in the event a consortium is needed. While European corporations selling businesses take price into consideration, they may also consider a European buyer to keep management and management style local and familiar, and to protect employment. U.S. managers, with lots of capital but only a few years on the ground, may not appear optimal under these conditions. With the home field advantage and increasing fund sizes, European fund managers have significantly more leverage in European auction situations. Nevertheless, U.S. fund managers that make a long-term commitment to the region, hire European nationals, and relocate one or more senior partners to Europe to transfer knowledge and culture, should eventually benefit from the effort. U.S. managers are finding that to succeed in Europe *il faut hurler avec les loups* (i.e., when in Rome, do as the Romans do).

Central and Eastern European Private Equity

With over €800 million in commitments raised by Central and Eastern European fund managers in 2000, and just over €375 million invested in the same year,[9] investor interest appears to be cautious on both sides of the equation. These countries are known for their state-owned assets and state-influenced capital markets not for their robust private sector. Most are currently focusing on meeting the convergence requirements for admission into the EU, which include an independent central bank and strong capital markets. Several Central European (e.g., Poland, Hungary, Slovakia, Slovenia, Czech Republic) and Eastern European countries (e.g., Bulgaria, Estonia, Latvia, Lithuania, and Romania) are slated for EU admission within the next five years. For private equity investors, the most significant opportunities are from the privatization of state-owned enterprises, and several North American and Western European private equity fund managers are actively considering such opportunities, which are concentrated in telecommunications, financial services, utilities, transportation, and leisure companies. Private equity investors also have to contend with a lack of equity culture in these countries, making it difficult to source and motivate high-quality management teams without importing them.

Fund managers investing in this region are typically local firms with native speakers and networks, or London-based firms with investment professionals assigned to generate and manage investments from the region. Another approach taken is the joint venture, which would typically consist of a Western European fund manager and a Central or Eastern European bank, financial services company or small private equity manager. The local venture partner might contribute a network of contacts and language skills, the non-local partner might contribute professional private equity expertise. While risk is higher for private equity investors in this region of the world, actual returns have so far proved disappointing. Until the equity culture, governance, legal, and tax systems improve, this private equity market will be slow to develop.

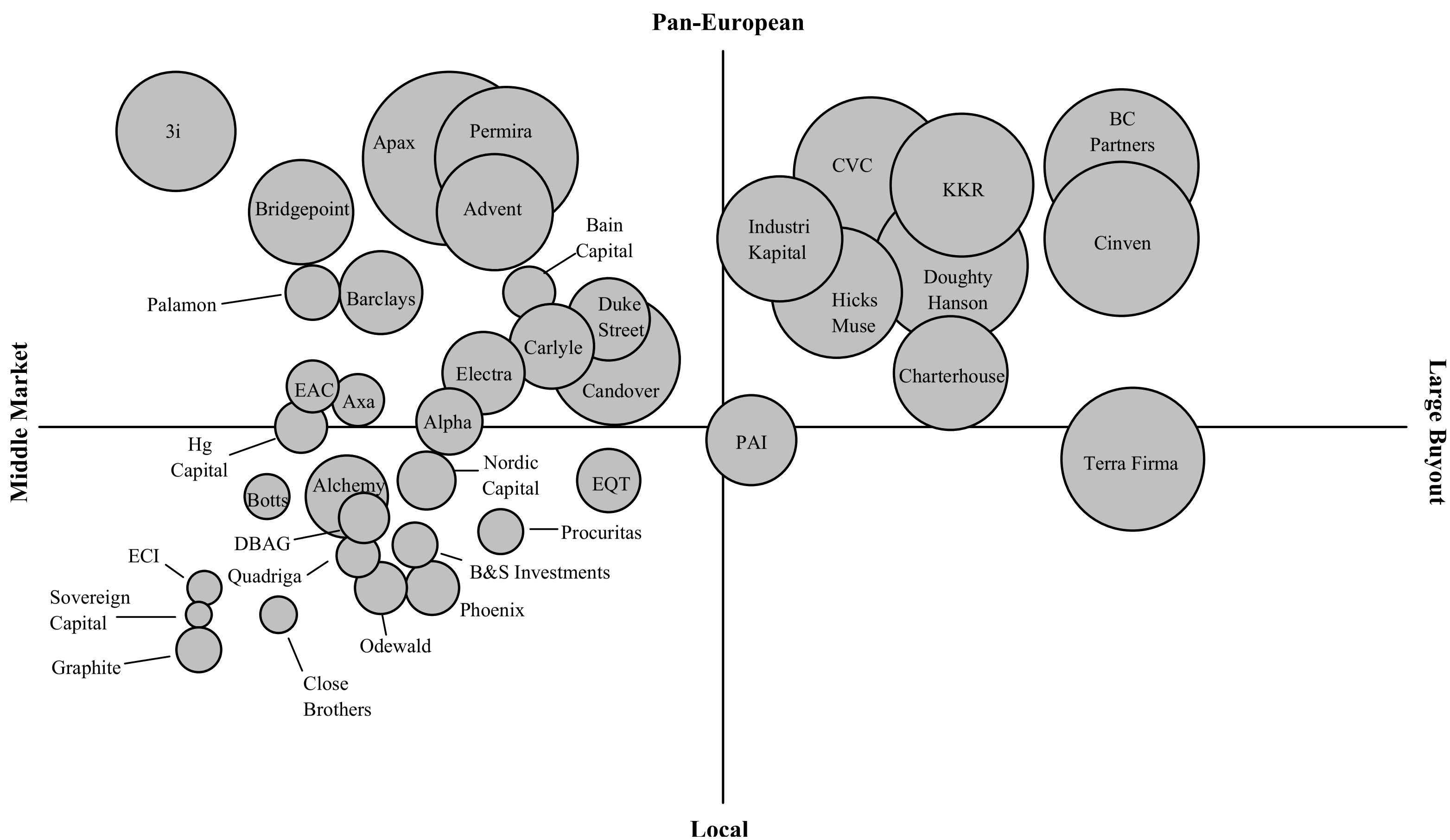
[9] *European Venture Capital Association 2001 Yearbook.*

European Private Equity Fund Managers

European private equity fund managers are constantly evolving their investment strategies with each new fund raised. Many fund managers begin life as small- to middle-market private equity investors, raising a €100 million to €250 million fund, working out of one office, and building a small, close-knit team. The resulting portfolio is often small and relatively concentrated by industry expertise held by the staff. Close Brothers and ECI represented in the bottom left quadrant of Table B (on the following page) are classic examples of this type of manager. With subsequent funds, managers can decide to take on more capital and either continue investing in small to middle-market companies or take the focus up a notch to the middle market or even the large buyout market, if the fund is sizable enough. More money usually requires more people to manage it and perhaps more than one office, maybe even an office in another country. Portfolios at this stage can be diversified by number of investments, countries represented, and industries invested, in any combination. The Phoenix Fund, shown in the bottom left quadrant of Table B, is an example of a manager that has raised a larger fund, but has maintained a local, middle-market investment strategy. Alpha, shown on the border between the lower left quadrant and the upper left quadrant, is an example of a manager that has maintained a middle-market investment strategy but has two offices, one in Paris and one in Frankfurt, further diversifying the investment portfolio. Managers raising subsequent funds often need to determine whether or not to stay within the middle-market investment strategy or migrate fully to the large buyout market. Bridgepoint, located in the upper left quadrant of Table B, recently raised a €1.4 billion-plus fund, but remains a dedicated middle-market investor with ten offices and a current portfolio of over 160 companies. Large-market buyout managers in a way have come full circle. While they have large funds and usually several offices, they tend to do fewer deals and the resulting portfolio is small in number of companies and in industries represented. For example, Cinven, a U.K.-based fund manager with additional offices in Munich and Paris, recently closed a €3.5 billion fund, and has approximately 22 employees and 22 portfolio companies. Cinven began as a small- to middle-market private equity investor with one London office. Private equity fund managers can and do migrate across the spectrum of investment strategy and investors should note atypical moves, for they could impact the evolution of future funds. Table B presents a landscape of selected European private equity fund managers.

Table B

EUROPEAN PRIVATE EQUITY MANAGER LANDSCAPE



Source: Cambridge Associates LLC.

Note: The size of the "bubble" corresponds to the size of the most recent fund raised by that manager (i.e., the larger the fund, the larger the bubble and vice versa).

Assessing Performance

European Funds Surpassed U.S. Counterparts

Return expectations for European private equity funds should be equivalent to or better than those expected from U.S. private equity funds. Managers in both regions invest to achieve target IRR returns of 30% on each investment, and as fee structures and carry distribution structures are the same for both regions, returns should be somewhat similar, despite market differences. North American investors tend to expect higher returns in exchange for committing capital to European private equity, viewing the market as less developed and, therefore, riskier. However, given that most European private equity managers have target returns similar to those of their U.S. counterparts, and most investors in these funds share these return expectations, North American investors' expectations of higher returns may be unrealistic.

According to Cambridge Associates data, European private equity funds averaged a 23.5% pooled net IRR to Limited Partners from funds formed 1986 through 1996, compared to 20.2% for U.S. funds during the same period.[10] In addition, on a vintage year basis, European private equity funds outperformed their U.S. counterparts in five of these years: 1987, 1990, 1994, 1995, and 1996 (see Exhibit 24). The analysis further indicates the two markets perform similarly with a correlation of over 60%, due in part to the consistency in approach to private equity investing across the two regions. Europe experienced its 1990s recession slightly later than the United States and its subsequent recovery, combined with continued market inefficiencies, may have contributed to the strong relative performance registered from 1994 through 1996.

Distribution Metrics Comparable Across Markets

Employing another metric of comparison, distributions as a multiple of paid in capital, European and U.S. fund managers are comparable, with European managers averaging 1.8 times from 1986-96 and U.S. managers averaging slightly less, at 1.6 times over the same period (see Exhibit 25). On a vintage year basis, distribution multiples mirror the IRR horizon analysis described above. Taking into account the net asset value of the fund as a multiple of paid in capital, U.S. and European managers both average 2.0 times over the ten-year period. Given the historical game of cat and mouse played by these two private equity markets over the course of the last decade, investors seeking exposure to both markets should be sure to diversify by vintage year, among other attributes.

Broader European Focus Benefits Investors

Private equity funds targeting the United Kingdom and Europe, which averaged a 19.9% pooled net IRR from funds formed 1987 through 1996, fared better than their U.K.-focused counterparts, which registered a 19.2% pooled net IRR for funds formed in the same period (see Exhibit 26). The advanced stage of development of the U.K. private equity market, relative to that of other European countries, has resulted in a more efficient market, which could have impacted returns for U.K.-only funds.

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[10] European return information is sourced from the Cambridge Associates LLC Non-Marketable Alternative Assets Database unless otherwise noted.

Partnership Terms

European private equity partnership terms are fairly straightforward and comparable to U.S. private equity partnership terms, with one exception: investment vehicles. Many European private equity funds are structured as multiple Limited Partnerships to provide tax-efficient structures for both local and international investors. While many offer a Delaware Limited Partnership as an option for North American investors, it is also common for these funds to offer another comparable partnership vehicle, such as:

- **English:** English Limited Partnership, often in a series with at least one structure to be suitable for ERISA. Currently, legal restrictions limit the number of partners in one partnership to 20 giving rise to the creation of parallel partnerships. This legal restriction is being reviewed.
- **French:** Fonds Commun de Placement à Risques (FCPR), a collective investment fund that is tax transparent.
- **Channel Islands/Offshore:** Jersey or Guernsey Limited Partnership. These Channel Islands are part of the British Isles but are not part of the United Kingdom. They are self-governing dependencies of the English Crown and serve as tax havens.
- **Offshore:** Cayman Islands Limited Partnership.

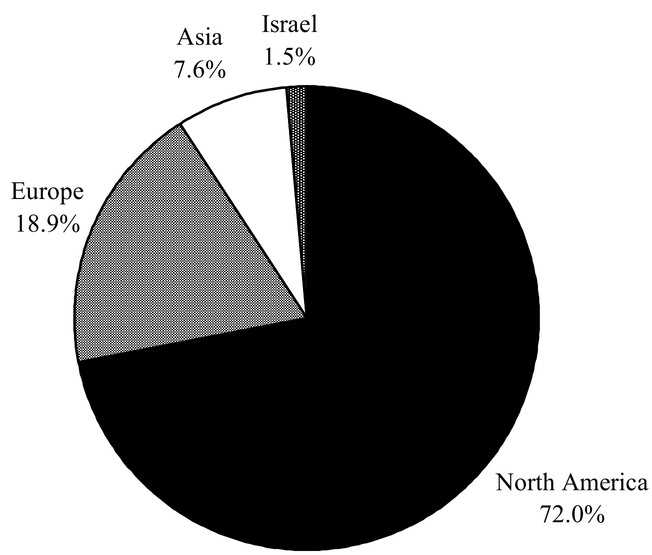
EXHIBITS

Exhibit 1

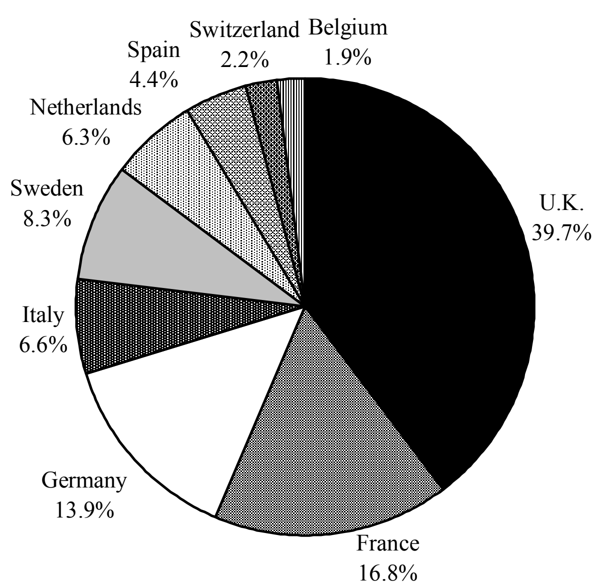
GLOBAL PRIVATE EQUITY COMMITMENTS

2000

Private Equity Raised by Region = €231.9 Billion



European Private Equity Commitments = €43.8 Billion



Sources: European Venture Capital Association and PriceWaterhouseCoopers.

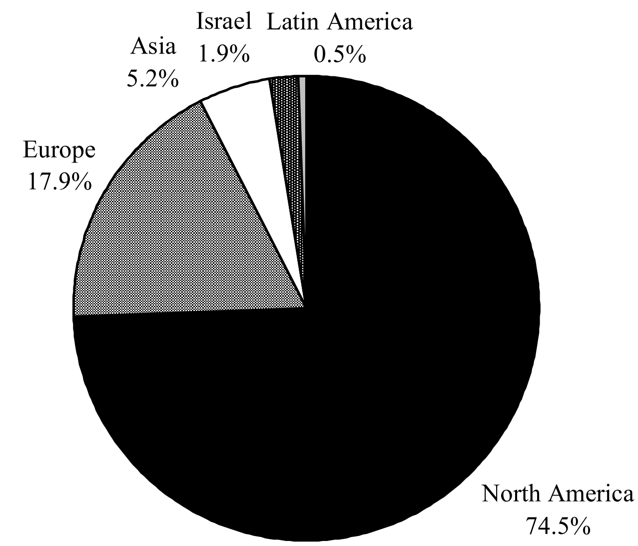
Note: Numbers may not total due to rounding.

Exhibit 2

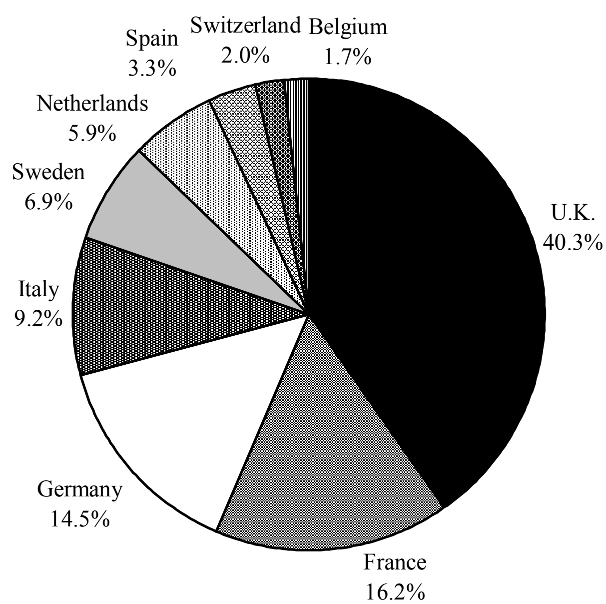
GLOBAL PRIVATE EQUITY INVESTED

2000

Private Equity Invested by Region = €180.6 Billion



Private Equity Invested in Europe = €32.3 Billion



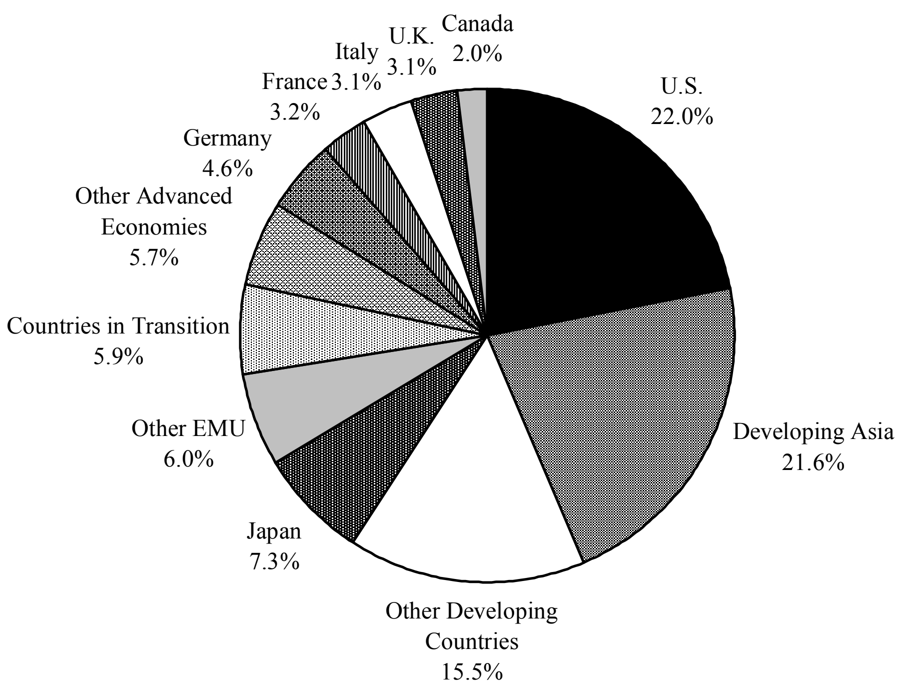
Sources: European Venture Capital Association and PriceWaterhouseCoopers.

Note: Numbers may not total due to rounding.

Exhibit 3

WORLD GDP

2000



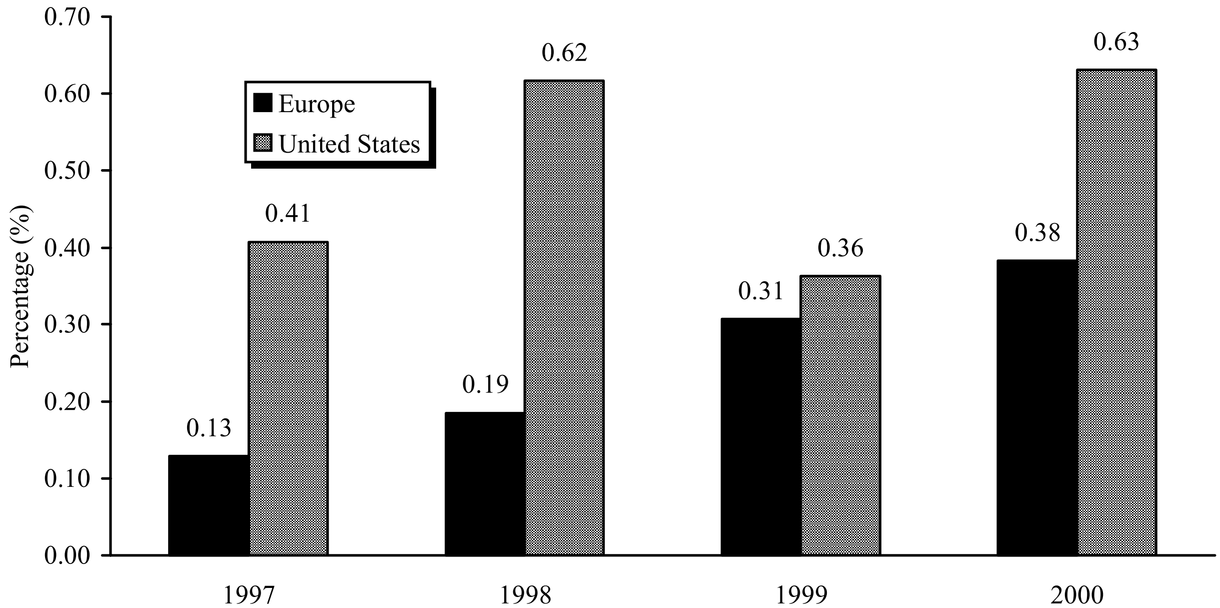
Other Advanced Economies	**Developing Asia**	**Other Developing Countries**	**Countries in Transition**
Hong Kong	China (11.6%)	Africa (3.2%)	Central and Eastern Europe (2.3%)
Korea	India (4.6%)	Middle East, Malta, Turkey (3.9%)	Commonwealth of Independent States and Mongolia (3.6%)
Singapore	Other Developing Asia (5.4%)	Western Hemisphere (8.4%)	
Taiwan			
Australia			
Cyprus			
Iceland			
Israel			
New Zealand			
Norway			
Switzerland			

Source: International Monetary Fund.

Notes: Numbers may not total due to rounding. GDP shares are based on the purchasing-power-parity valuation of country GDPs.

Exhibit 4

**EUROPEAN AND U.S. PRIVATE EQUITY
AS A PERCENTAGE OF GDP BY COUNTRY**



	Percentage (%)			
	1997	1998	1999	2000
Sweden	0.17	0.10	0.58	0.92
United Kingdom	0.39	0.59	0.87	0.86
Netherlands	0.24	0.31	0.48	0.48
France	0.10	0.14	0.21	0.38
Finland	0.11	0.17	0.21	0.29
Italy	0.06	0.09	0.18	0.26
Germany	0.07	0.10	0.16	0.23
Ireland	0.06	0.09	0.14	0.22
Spain	0.06	0.08	0.13	0.19
Norway	0.12	0.13	0.19	0.18
Denmark	0.02	0.03	0.07	0.17
Europe	0.13	0.19	0.31	0.38
United States*	0.41	0.62	0.36	0.63

Sources: *Buyouts* , Datastream International, and *European Venture Capital Association Yearbook* .

* Commitments to buyout funds.

Exhibit 5

EUROPEAN UNION TIMELINE

- **1946** Winston Churchill calls for a "kind of United States in Europe" to be established.
- **1950** French foreign minister Robert Schuman proposes formation of the European Coal & Steel Community (ECSC).
- **1951** The ECSC is formed by "The Six" (France, West Germany, the Netherlands, Belguim, Italy, Luxembourg) in the Treaty of Paris.
- **1957** The Six establish the European Economic Community (EEC) & European Atomic Energy Community (Euratom) in the Treaties of Rome.
- **1962** The EEC Launches a Common Agricultural Policy (CAP) establishing a single market for agricultural goods.
- **1967** ECSC, Euratom and EEC merge to form the European Communities (EC), whose name is later changed to the European Community.
- **1972** The Six form the "snake," a monetary arrangement that limits fluctuations between their currencies.
- **1973** Denmark, Ireland & the U.K. join the EC, bringing its membership to nine countries.
- **1979** The European Monetary System goes into operation to promote monetary and exchange rate stability.
- **1981** Greece becomes the tenth member of the EC.
- **1986** Spain & Portugal join the EC, bringing its membership to 12 countries; the Single European Act is approved, opening the door for the formation of a single internal market.
- **1989** The Berlin Wall collapses.
- **1990** Germany is reunified.
- **1992** The Treaty on the European Union, also known as the Maastricht Treaty, is approved, establishing the European Union (EU), extending EU citizenship to all citizens of member states, providing for the introduction of a common central bank and currency, and committing the EU to the implementation of a common defense and foreign policy.
- **1993** The Single European Market enters into force; the Maastricht Treaty, ratified through referendums in all member countries, enters into force; the union's name is changed to the European Union (EU); the EU officially commits itself to admitting the nations of Central and Eastern Europe as soon as they fulfill the requisite conditions.
- **1993** Hungary and Poland formally apply for EU membership.
- **1995** Austria, Finland, and Sweden join the EU, bringing its membership to 15 nations; Bulgaria, Estonia, Latvia, Lithuania, Romania and Slovakia formally apply for EU membership.
- **1996** Czech Republic and Slovenia formally apply for EU membership.
- **1998** European Commission endorses convergence and recommends that 11 out of the 15 EU members adopt euro; European Central Bank is established.
- **1999** Euro is officially launched, with Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain adopting it.
- **2000** Treaty of Nice is approved, establishing a new voting system for the Council of Ministers.
- **2001** Greece becomes 12th member of the eurozone.
- **2002** Euro notes and coins scheduled to go into circulation, officially replacing the national currencies of eurozone members.

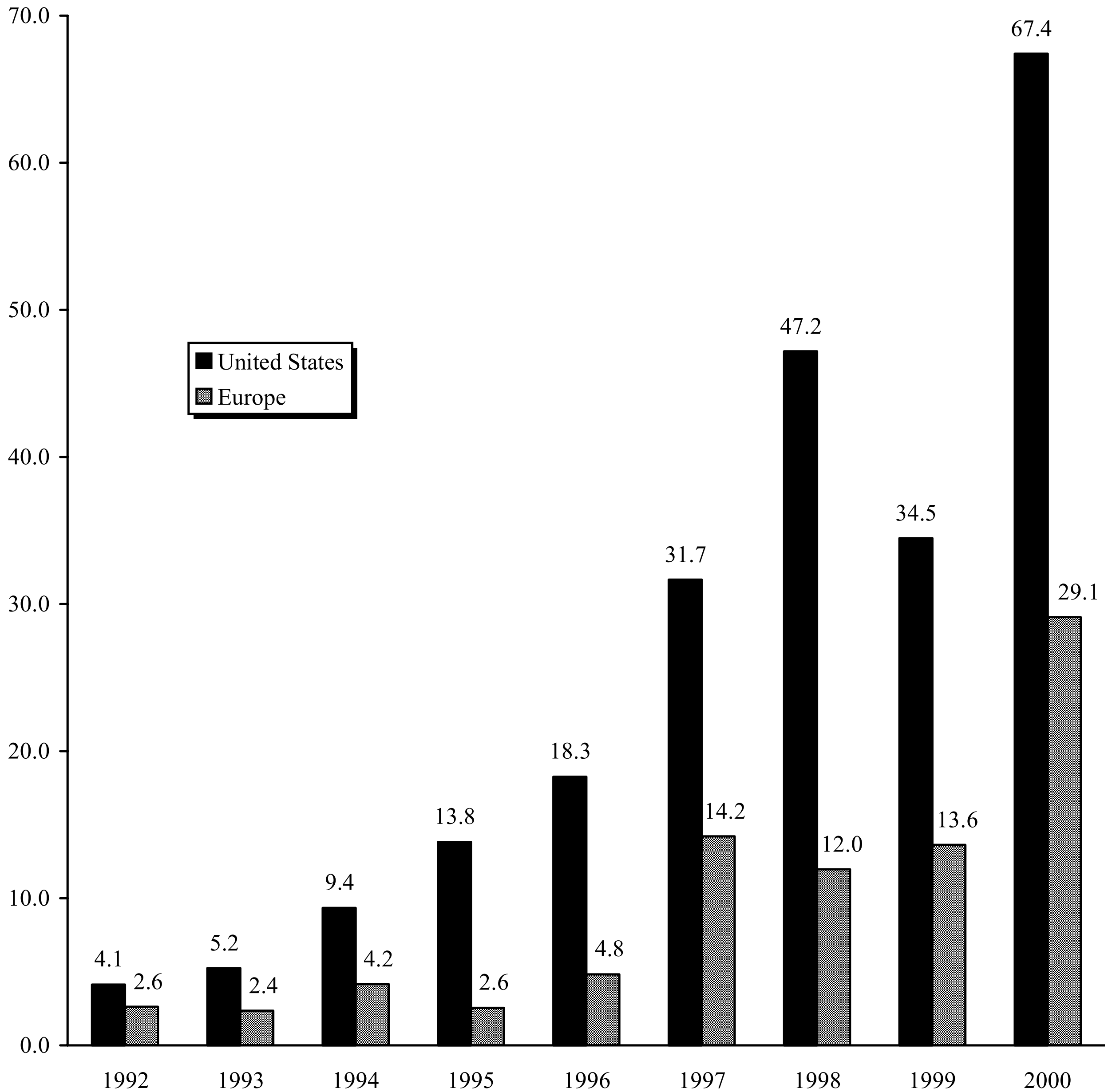
Sources: AIB Govett and European Union.

Exhibit 6

CAPITAL COMMITMENTS TO PRIVATE EQUITY

1992-2000

Billions (€)

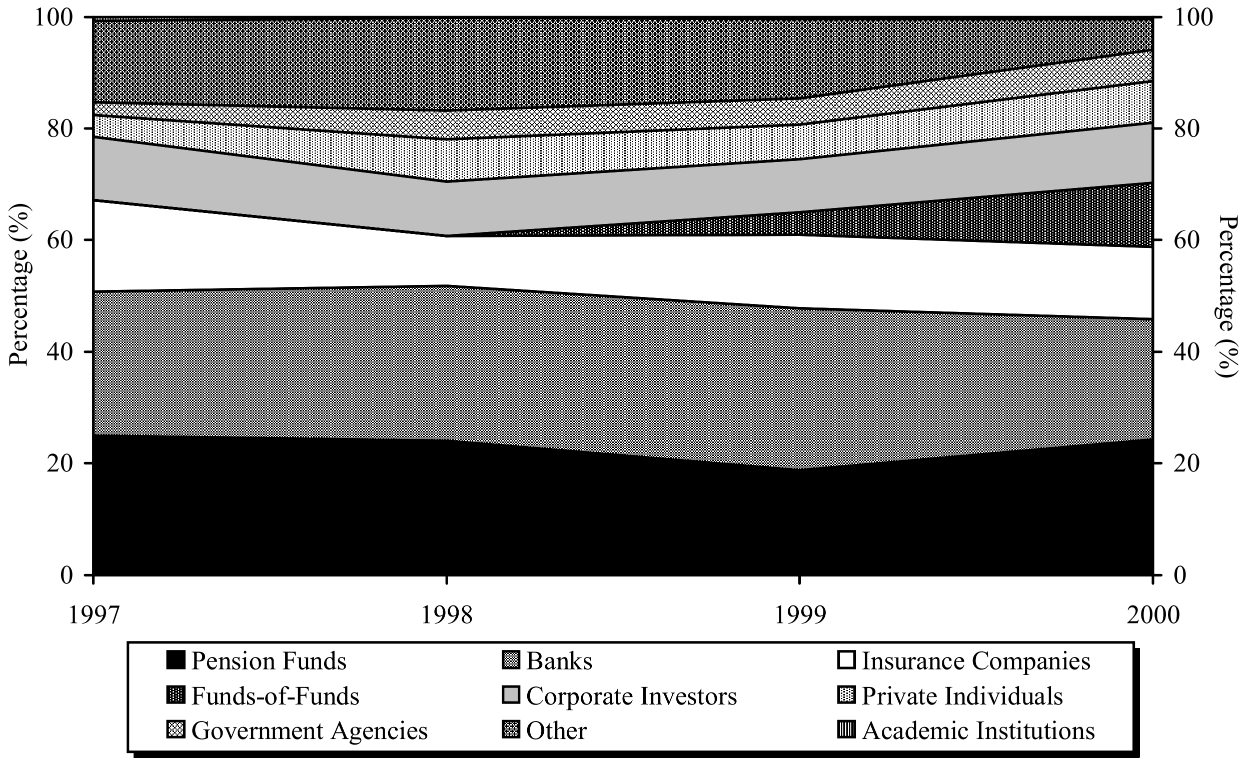


Sources: *Buyouts* and *European Venture Capital Association Yearbook.*

Exhibit 7

SOURCES OF EUROPEAN PRIVATE EQUITY CAPITAL

1997-2000



	Percentage (%)			
	1997	1998	1999	2000
Pension Funds	25.0	24.0	18.7	24.2
Banks	25.8	27.8	29.1	21.7
Insurance Companies	16.4	8.9	13.2	12.9
Funds-of-Funds	0.0	0.0	4.0	11.4
Corporate Investors	11.3	9.8	9.5	10.9
Private Individuals	4.0	7.6	6.2	7.4
Government Agencies	2.2	5.1	4.7	5.6
Other	14.6	16.7	14.2	5.5
Academic Institutions	0.7	0.1	0.4	0.4
Total	100.0	100.0	100.0	100.0

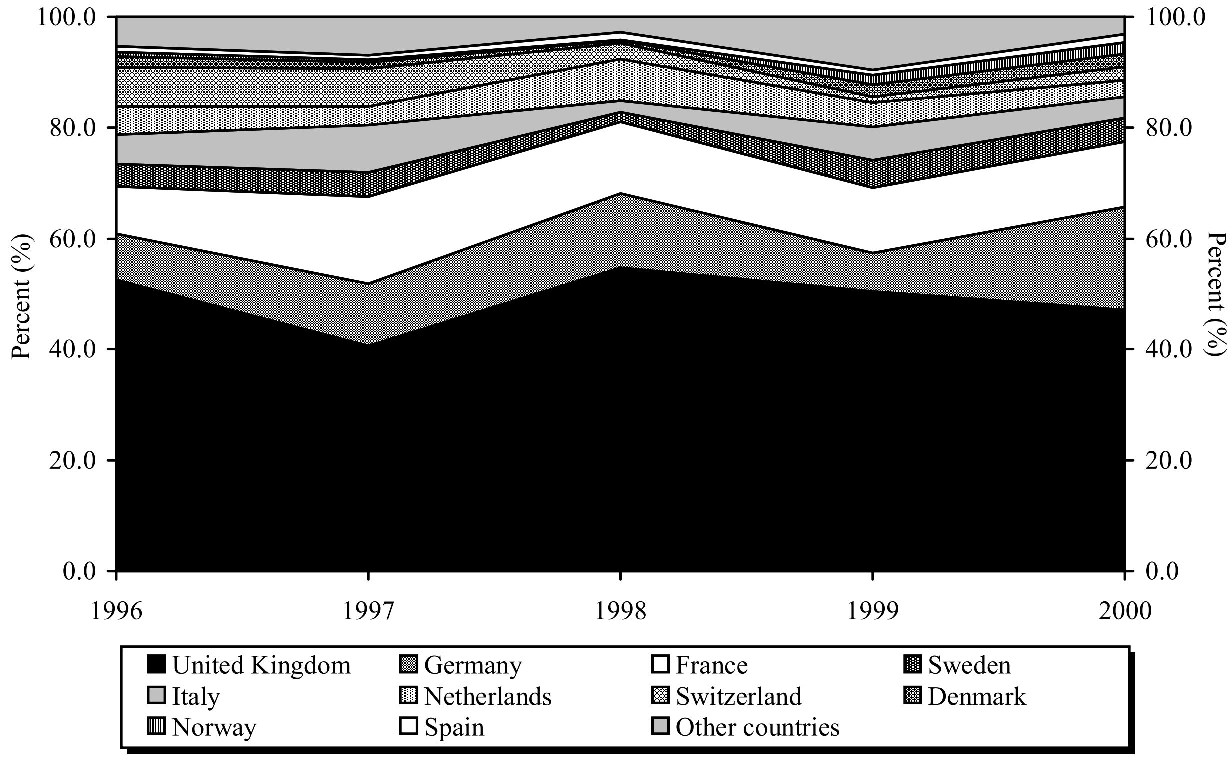
Source: *European Venture Capital Association Yearbook*.

Note: Numbers may not total due to rounding.

Exhibit 8

TOTAL VALUE OF PRIVATE EQUITY-BACKED BUYOUTS BY COUNTRY

1996-2000



Value of Private Equity-backed Buyouts (Millions €)

	1996	1997	1998	1999	2000	Compound Annual Growth Rate (%)
United Kingdom	7,650.3	12,169.5	18,417.9	25,398.9	29,580.0	40.2
Germany	1,208.0	3,324.0	4,494.3	3,489.1	11,685.9	76.4
France	1,257.0	4,716.8	4,368.5	5,920.7	7,397.3	55.8
Sweden	575.7	1,301.7	575.8	2,506.5	2,702.0	47.2
Italy	779.9	2,574.2	696.5	3,043.2	2,336.5	31.6
Netherlands	729.2	992.0	2,521.9	2,207.9	1,909.0	27.2
Switzerland	1,030.6	2,023.2	955.9	500.2	1,546.4	10.7
Denmark	283.1	354.4	173.6	1,121.6	1,427.7	49.9
Norway	124.4	139.4	12.7	880.8	1,305.5	80.0
Spain	149.9	257.3	488.4	451.2	952.5	58.8
Other Countries	775.0	2,063.8	929.1	4,826.5	1,950.8	26.0
Total	14,563.1	29,916.3	33,634.6	50,346.6	62,793.6	44.1

Source: Initiative Europe Ltd.

Note: Other Countries includes Austria, Belgium, Finland, Ireland, Luxembourg, and Portugal.

Exhibit 9

AVERAGE VALUE OF EUROPEAN PRIVATE EQUITY-BACKED BUYOUTS BY SECTOR

1996-2000

Millions (€)

	1996	1997	1998	1999	2000
Telecommunication Services	0.0	132.6	29.7	66.8	1,269.6
Packaging	12.2	21.9	132.2	142.5	302.8
Food Producers and Processors	17.4	57.2	33.1	141.9	285.2
Personal Care and Household Products	18.7	102.1	86.5	17.3	280.8
Leisure, Entertainment, and Hotels	51.5	158.5	132.8	178.4	264.9
Automobiles	51.2	28.8	75.6	126.4	236.8
Information Technology and Hardware	41.8	42.3	58.3	34.9	215.2
Health	47.2	184.8	36.9	92.5	167.2
General Industrials/Engineering	36.5	52.2	39.0	77.0	153.0
Restaurants, Pubs, and Breweries	143.7	185.0	26.7	197.5	150.8
Transport	32.0	65.6	50.4	103.7	128.3
Financials	42.4	89.3	203.6	209.5	124.6
Household Goods and Textiles	39.9	41.3	28.8	50.0	116.5
Basic Industries/Chemicals	21.5	27.5	72.9	142.7	108.6
Beverages	0.0	10.3	90.5	192.7	98.8
Media and Photography	20.4	82.9	108.9	123.0	88.1
Distributors	12.5	21.5	36.9	52.0	85.7
General Retailers	46.4	70.2	100.5	88.9	77.3
Oil/Gas/Mining	30.9	16.1	59.0	198.5	46.6
Software and Computer Services	9.3	22.9	16.1	56.3	41.2
Food and Drug Retailers	0.0	19.8	0.0	9.7	37.1
Support Services	33.7	46.6	19.3	50.9	34.0
Unclassified	2.1	19.3	39.1	7.6	24.0
Pharmaceuticals	30.6	48.3	656.0	35.3	13.7
Utilities	111.6	0.0	90.4	0.0	0.0
Annual Average	28.7	52.9	57.6	92.0	134.8

Source: Initiative Europe Ltd.

Note: Figures are based on institutional buyouts held as of 9/3/2001 and include estimated values.

Exhibit 10

TOTAL VALUE OF EUROPEAN PRIVATE EQUITY-BACKED BUYOUTS BY SECTOR

1996-2000

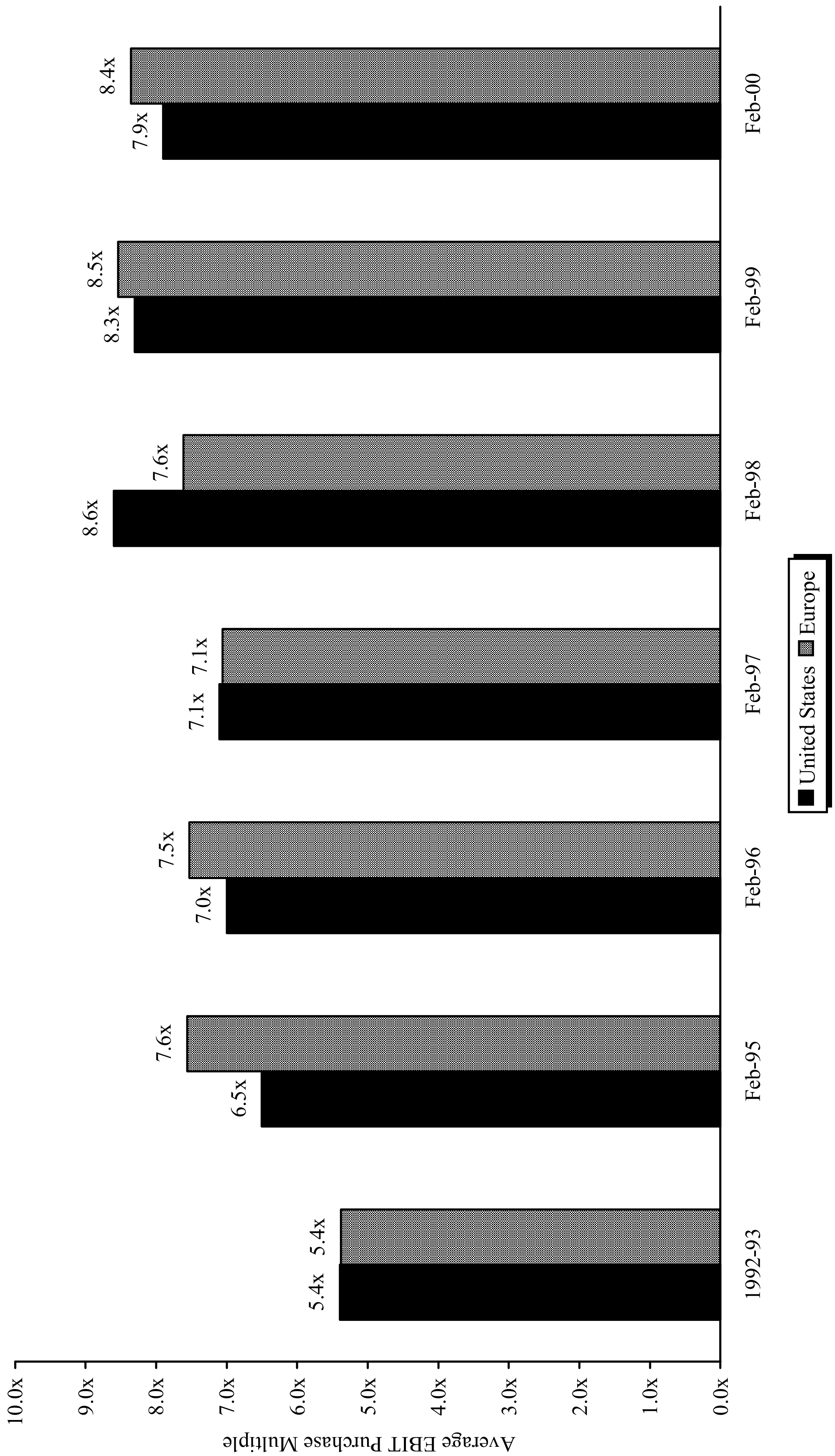
	Percent (%)				
	1996	1997	1998	1999	2000
General Industrials/Engineering	27.8	21.3	16.4	16.4	14.9
Food Producers and Processors	3.2	6.3	3.0	4.5	11.3
Basic Industries/Chemicals	7.8	7.4	11.9	17.9	11.2
Leisure, Entertainment & Hotels	2.8	5.8	7.5	6.0	7.2
Telecommunication Services	0.0	1.3	0.2	0.5	6.1
Information Technology and Hardware	2.6	3.1	3.1	1.6	5.8
Automobiles	1.1	0.4	2.5	2.3	5.7
Household Goods & Textiles	12.0	6.8	4.7	4.5	4.6
Health	4.2	8.0	0.8	1.7	4.5
Distributors	3.8	2.7	4.7	3.7	4.2
Packaging	0.9	1.5	6.3	4.3	3.9
Media & Photography	2.9	9.1	13.0	6.6	3.1
Transport	4.8	2.8	1.6	2.3	2.7
General Retailers	4.8	4.9	7.8	2.7	2.5
Support Services	10.6	7.3	2.9	5.7	2.4
Restaurants, Pubs & Breweries	2.0	5.6	0.3	3.9	2.4
Software & Computer Services	0.9	1.0	1.1	4.9	2.3
Financials	3.5	1.2	4.8	5.8	2.2
Personal Care & Household Products	0.1	1.0	0.3	0.1	1.8
Oil/Gas/Mining	1.5	0.3	1.1	1.2	0.6
Beverages	0.0	0.2	0.5	2.7	0.3
Unclassified	0.6	0.5	1.4	0.0	0.2
Pharmaceuticals	0.4	1.3	3.9	0.6	0.1
Food & Drug Retailers	0.0	0.1	0.0	0.0	0.1
Utilities	1.5	0.0	0.3	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0
Total Value (Millions €)	14,563.2	29,916.2	33,634.6	50,207.0	62,826.1

Source: Initiative Europe Ltd.

Note: Figures are based on institutional buyouts held as of 9/3/2001 and include estimated values.

Exhibit 11

AVERAGE EBIT PURCHASE MULTIPLES: THE UNITED STATES AND EUROPE

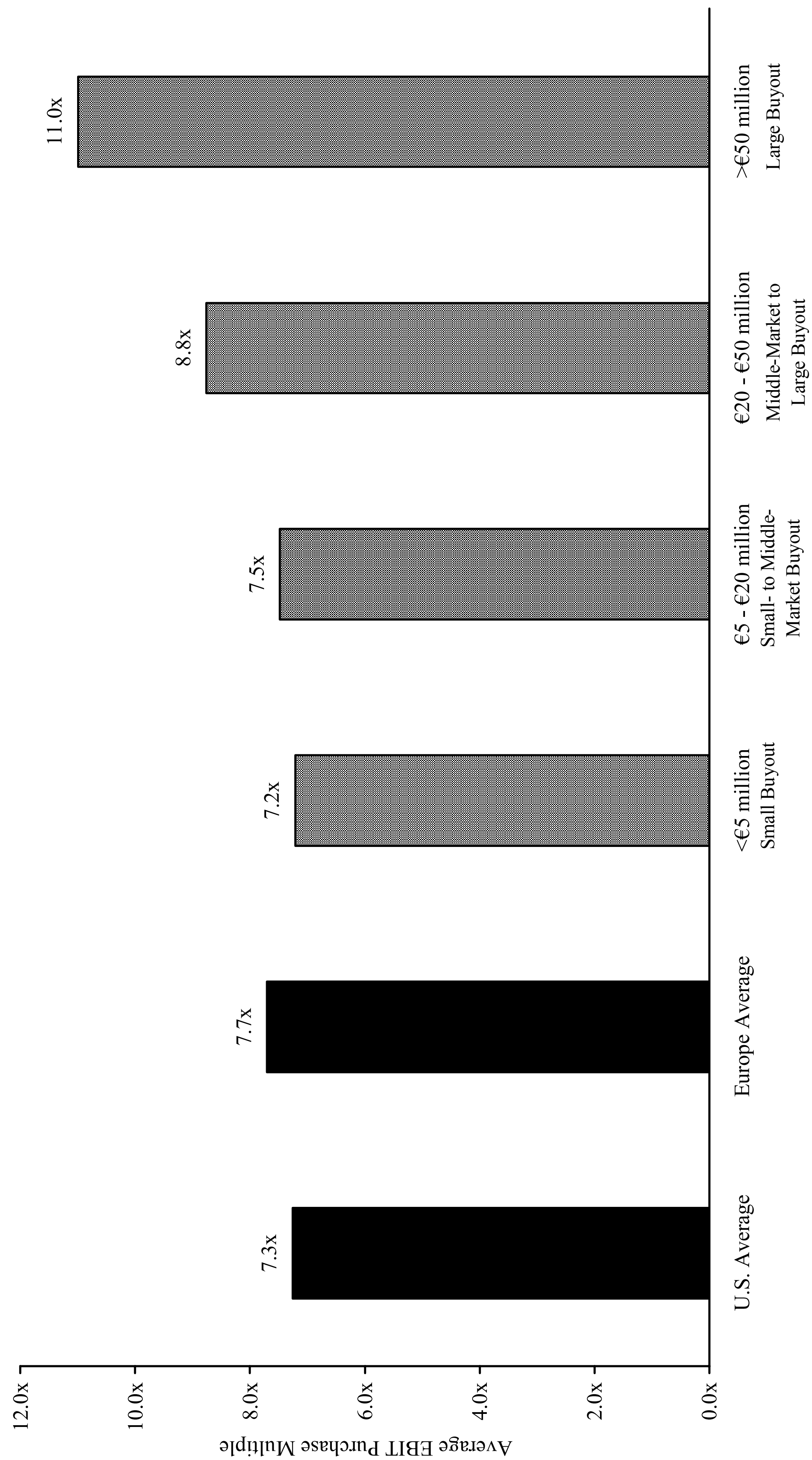


Sources: *Buyouts* and Cambridge Associates LLC.

Exhibit 12

EUROPEAN EBIT PURCHASE MULTIPLES BY EQUITY INVESTMENT SIZE

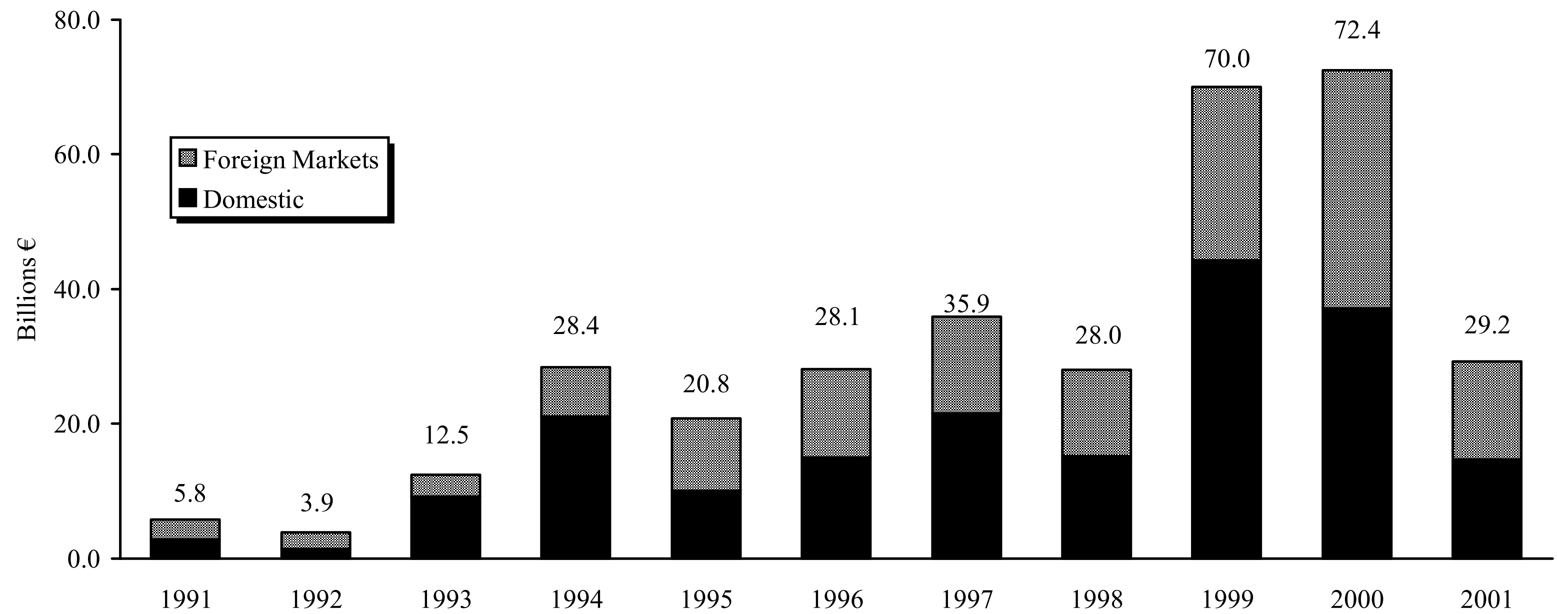
1992-2000



Sources: *Buyouts* and Cambridge Associates LLC.

Exhibit 13

INITIAL PUBLIC OFFERINGS: WESTERN EUROPE



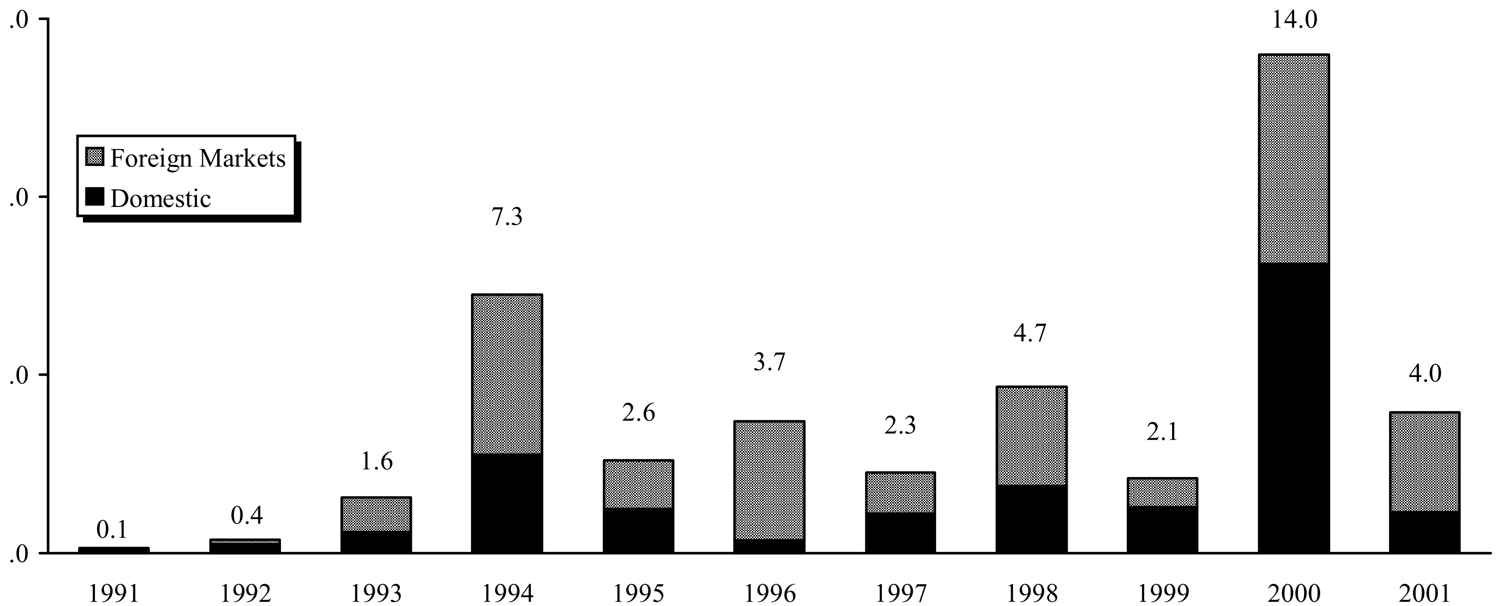
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Foreign Markets											
Amount (Billions €)	2.9	2.4	3.2	7.3	10.7	13.1	14.3	12.8	25.7	35.3	14.5
Number of IPOs	23	24	34	53	81	103	134	133	227	253	65
Domestic IPOs											
Amount (Billions €)	2.9	1.5	9.3	21.1	10.1	15.0	21.6	15.2	44.2	37.1	14.7
Number of IPOs	26	27	47	180	112	234	289	341	466	748	286

Source: Securities Data Company, Inc.

Notes: Initial public offerings data exclude mutual fund share offerings. Western Europe includes Andorra, Belgium, France, Germany, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Portugal, Spain, Switzerland, and the United Kingdom.

Exhibit 14

INITIAL PUBLIC OFFERINGS: NORTHERN EUROPE



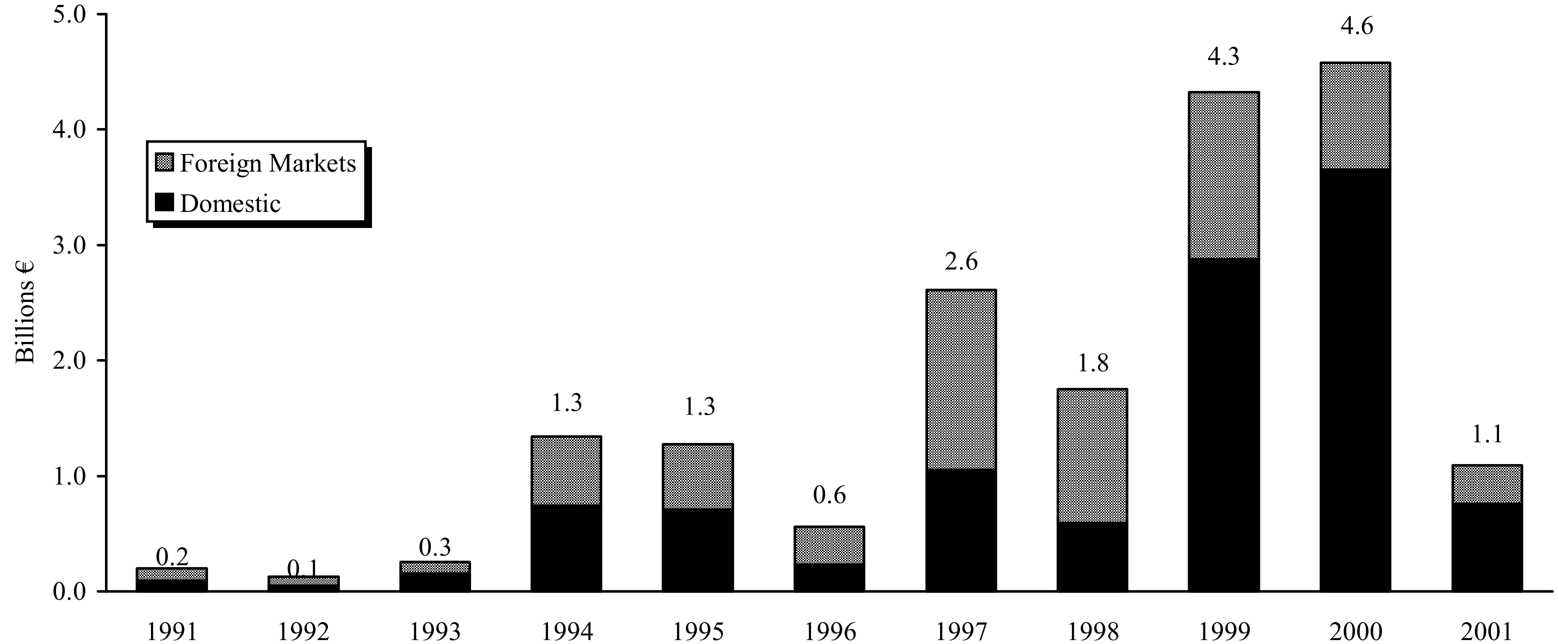
0.1	0.1	1.0	4.5	1.4	3.3	1.2	2.8	0.8	5.9	2.8
2	2	12	24	24	29	25	18	23	37	13
0.1	0.2	0.6	2.8	1.2	0.4	1.1	1.9	1.3	8.1	1.2
6	9	19	39	37	24	57	43	61	73	28

ı Company, Inc.

ferings data exclude mutual fund share offerings. Northern Europe includes Denmark, Faroe Islands, Finland, Greenland, Iceland,

Exhibit 15

INITIAL PUBLIC OFFERINGS: CENTRAL EUROPE



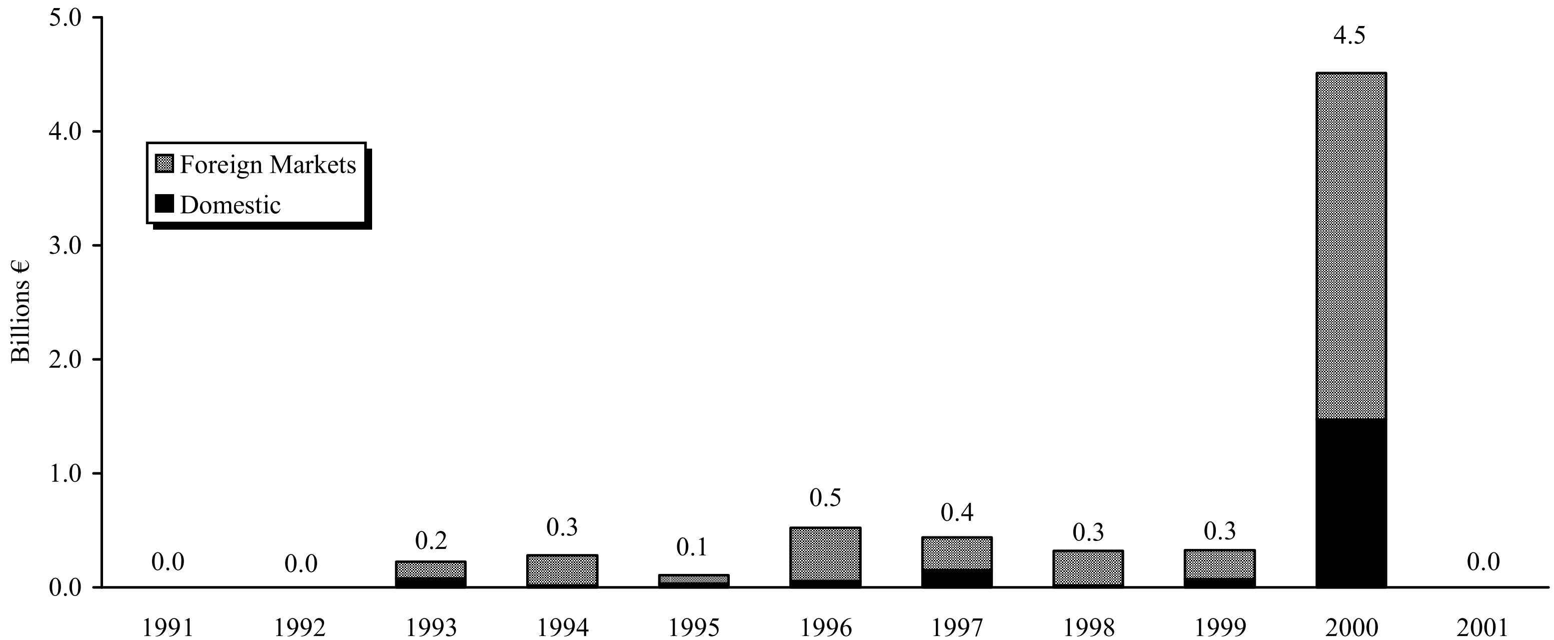
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Foreign Markets											
Amount (Billions €)	0.1	0.1	0.1	0.6	0.6	0.3	1.6	1.2	1.4	0.9	0.3
Number of IPOs	4	4	6	13	11	5	14	13	18	7	4
Domestic IPOs											
Amount (Billions €)	0.1	0.0	0.2	0.7	0.7	0.2	1.1	0.6	2.9	3.7	0.8
Number of IPOs	8	6	11	13	19	8	18	25	58	66	36

Source: Securities Data Company, Inc.

Notes: Initial public offerings data exclude mutual fund share offerings. Central Europe includes Albania, Austria, Czech Republic, Cyprus, Greece, Hungary, Slovenia, Macedonia, Poland, Slovak Republic, and Yugoslavia.

Exhibit 16

INITIAL PUBLIC OFFERINGS: EASTERN EUROPE



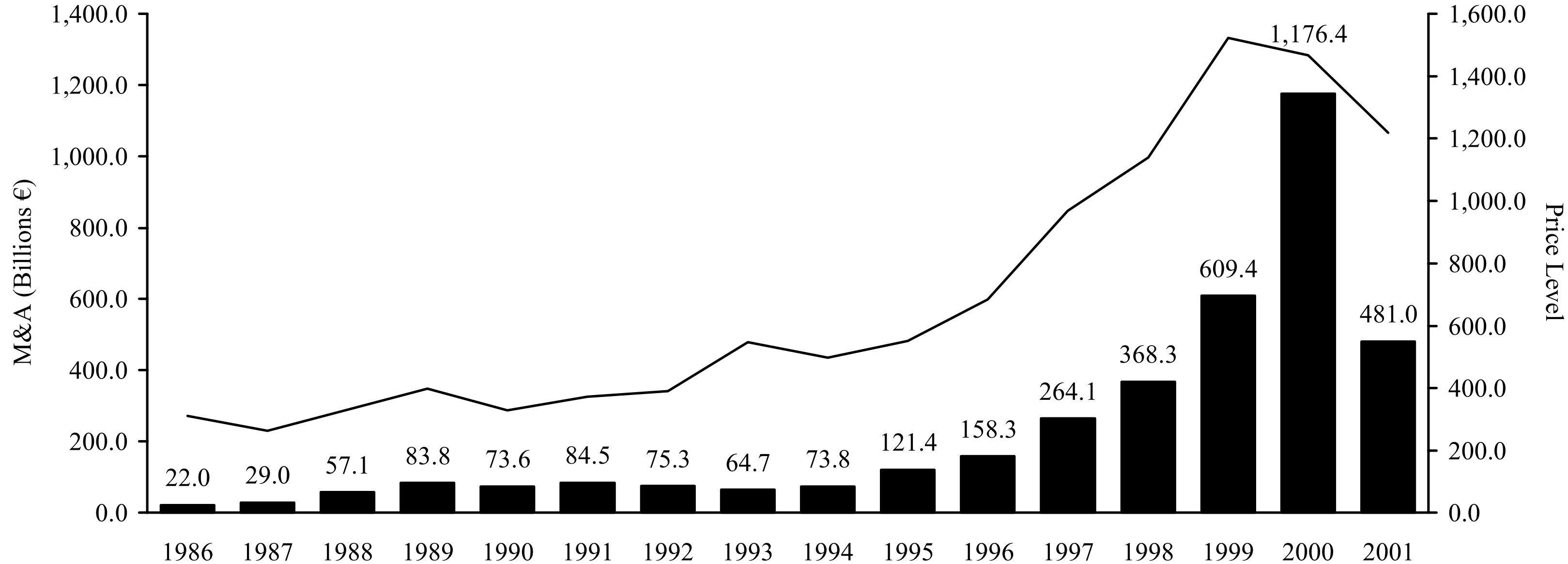
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Foreign Markets											
Amount (Billions €)	0.0	0.0	0.1	0.3	0.1	0.5	0.3	0.3	0.3	3.0	0.0
Number of IPOs	0	0	2	2	4	5	9	6	3	10	0
Domestic IPOs											
Amount (Billions €)	0.0	0.0	0.1	0.0	0.0	0.1	0.2	0.0	0.1	1.5	0.0
Number of IPOs	0	1	1	5	3	2	8	3	3	12	0

Source: Securities Data Company, Inc.

Notes: Initial public offerings data exclude mutual fund share offerings. Eastern Europe includes Azerbaijan, Bosnia, Bulgaria, Belarus, Croatia, Estonia, Georgia, Kyrgyzstan, Kazakhstan, Latvia, Lithuania, Moldova, Romania, Russia, Tajikistan, Turkey, Turkmenistan, Ukraine, and Uzbekistan.

Exhibit 17

COMPLETED MERGERS AND ACQUISITIONS: WESTERN EUROPE



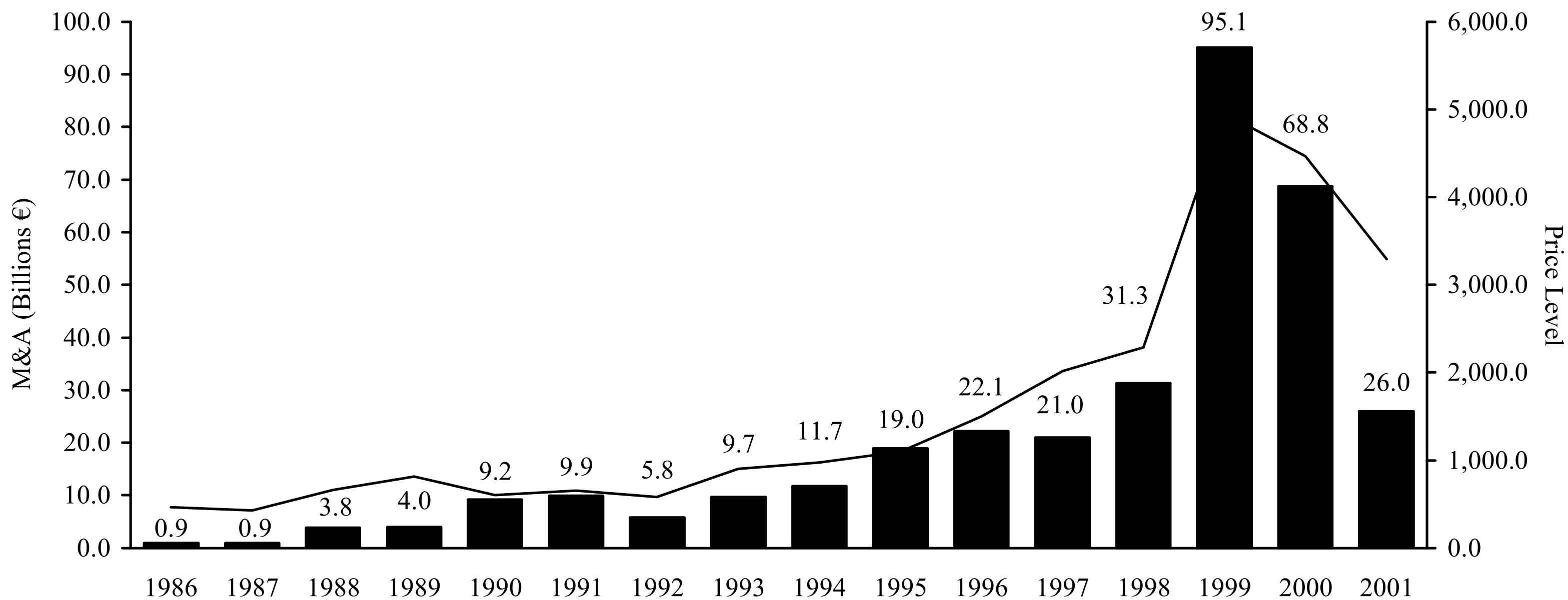
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total Number of Transactions	434	928	1,870	2,204	2,404	4,160	4,064	3,560	4,262	5,225	4,935	5,723	6,216	6,975	7,633	5,667
Number of Disclosed Values	232	550	1,192	1,311	1,259	1,304	1,359	1,323	1,562	1,687	1,799	2,307	2,797	2,797	2,806	2,152
Average Disclosed Price (Millions €)	94.8	52.6	47.9	63.9	58.5	64.8	55.4	48.9	47.2	71.9	88.0	114.5	131.7	217.9	419.2	223.5

Sources: Datastream International and Securities Data Company, Inc. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Notes: Western Europe includes Andorra, Belgium, France, Germany, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Portugal, Spain, Switzerland, and the United Kingdom. Price level is represented by MSCI Europe.

Exhibit 18

COMPLETED MERGERS AND ACQUISITIONS: NORTHERN EUROPE



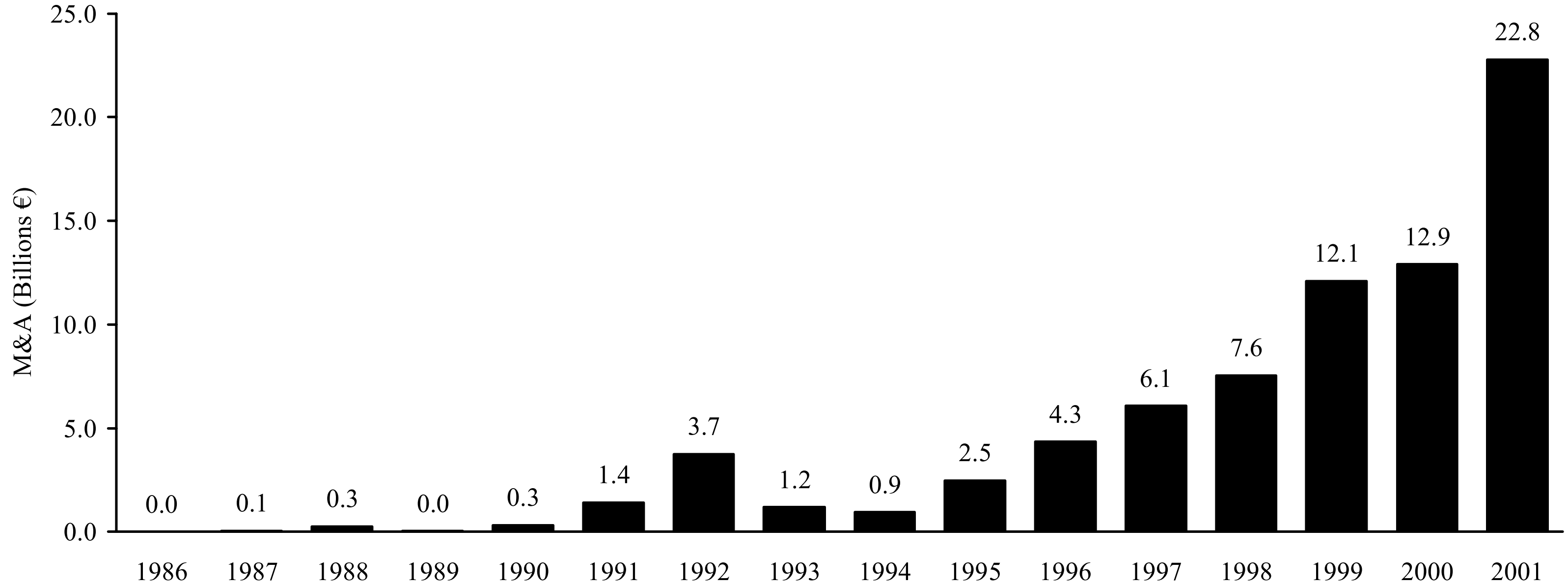
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total Number of Transactions	25	31	71	163	173	1,004	908	638	689	662	545	537	685	978	1,043	868
Number of Disclosed Values	8	13	39	67	69	247	180	155	194	169	161	200	214	320	342	253
Average Disclosed Price (Millions €)	112.5	72.0	98.5	59.1	133.3	40.2	32.4	62.6	60.3	112.2	137.6	105.0	146.4	297.1	201.1	102.9

Sources: Datastream International and Securities Data Company, Inc. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Notes: Northern Europe includes Denmark, Faroe Islands, Finland, Greenland, Iceland, Norway, and Sweden. Price level is represented by MSCI Nordic Countries.

Exhibit 19

COMPLETED MERGERS AND ACQUISITIONS: CENTRAL EUROPE



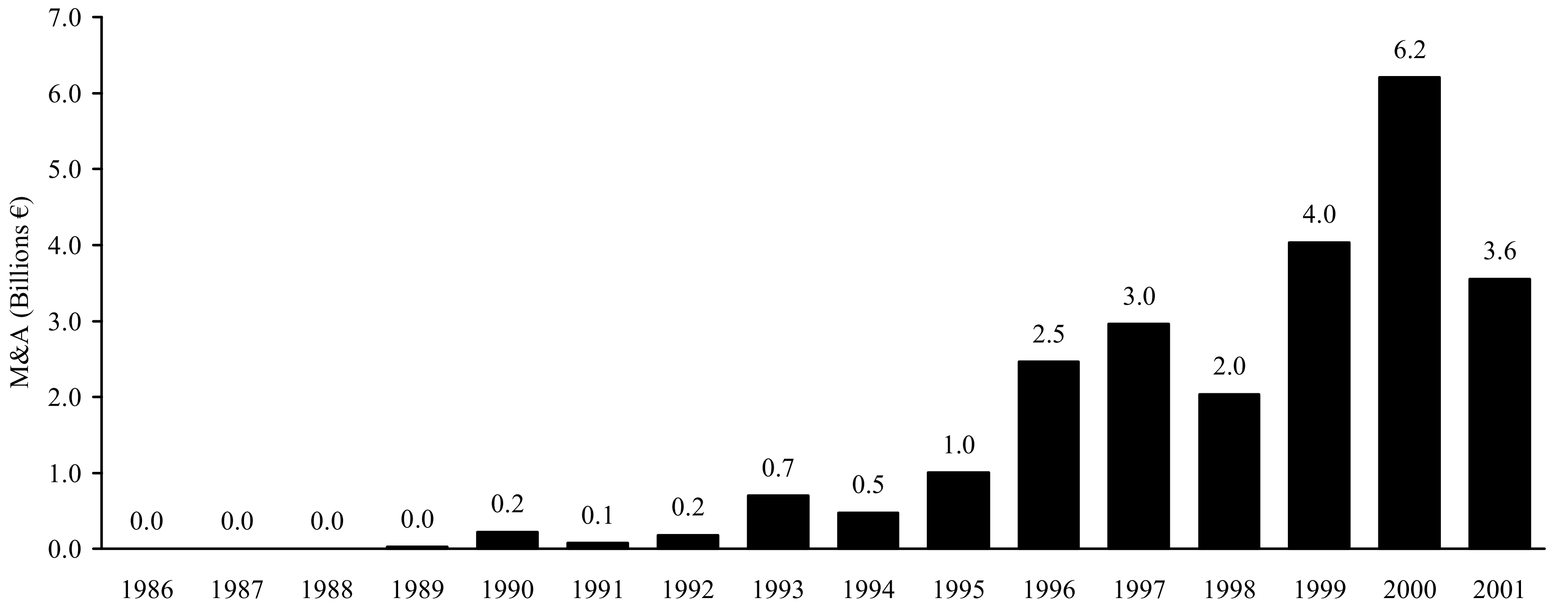
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total Number of Transactions	2	5	10	20	33	106	203	244	219	361	338	306	337	688	725	690
Number of Disclosed Values	0	3	5	6	9	35	67	72	58	129	113	98	105	162	185	232
Average Disclosed Price (Millions €)	0.0	17.6	52.4	5.8	35.7	40.3	55.9	16.5	16.1	19.2	38.4	62.0	72.0	74.6	69.7	98.2

Source: Securities Data Company, Inc.

Note: Central Europe includes Albania, Austria, Czech Republic, Cyprus, Greece, Hungary, Slovenia, Macedonia, Poland, Slovak Republic, and Yugoslavia.

Exhibit 20

COMPLETED MERGERS AND ACQUISITIONS: EASTERN EUROPE



	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total Number of Transactions	0	0	2	12	12	18	25	51	60	126	121	145	169	391	444	394
Number of Disclosed Values	0	0	0	3	6	1	10	23	26	52	61	83	81	180	178	111
Average Disclosed Price (Millions €)	0.0	0.0	0.0	8.0	37.5	74.4	18.0	30.4	18.4	19.3	40.4	35.7	25.2	22.4	34.9	32.0

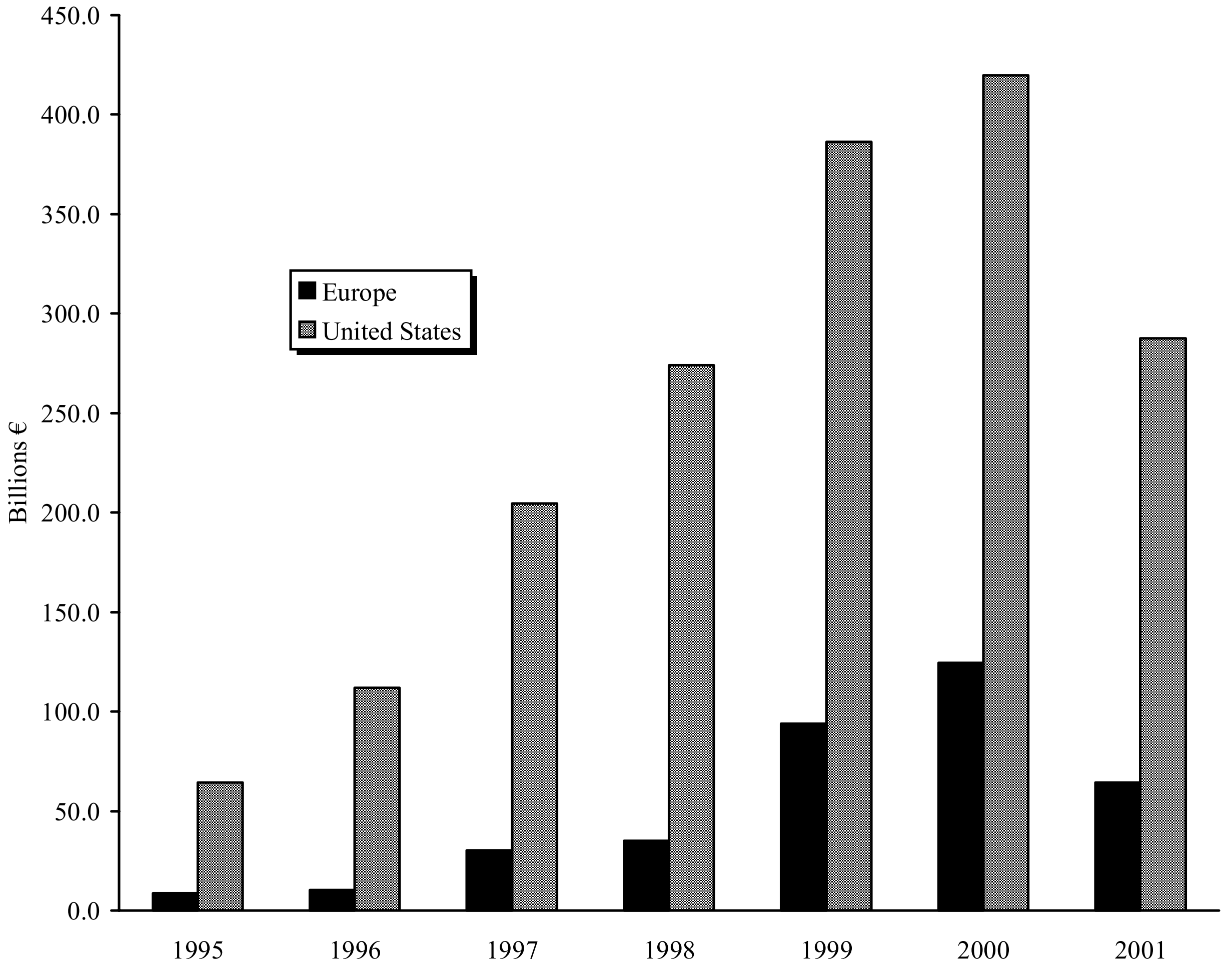
Source: Securities Data Company, Inc.

Note: Eastern Europe includes Azerbaijan, Bosnia, Bulgaria, Belarus, Croatia, Estonia, Georgia, Kyrgyzstan, Kazakhstan, Latvia, Lithuania, Moldova, Romania, Russia, Tajikistan, Turkey, Turkmenistan, Ukraine, and Uzbekistan.

Exhibit 21

SYNDICATED LOANS

January 1, 1995 - September 30, 2001



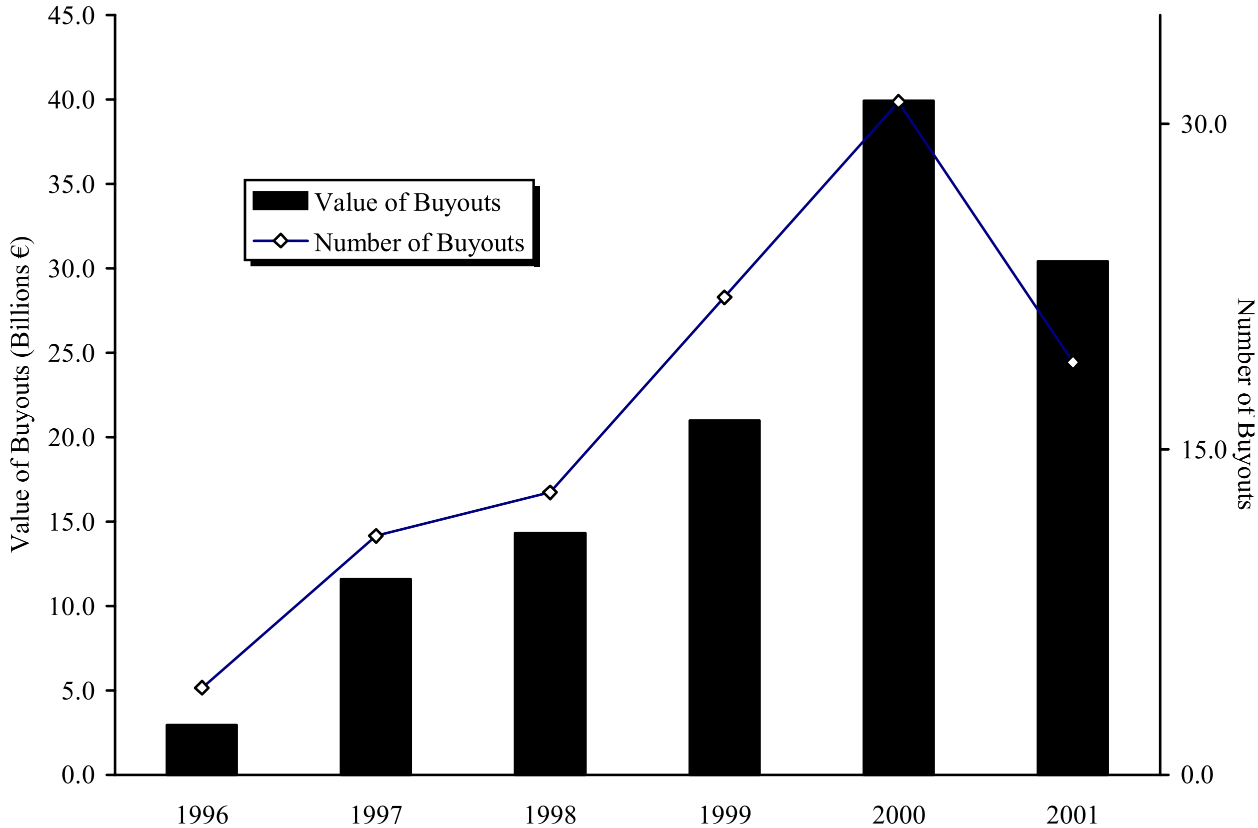
European Loans	1995	1996	1997	1998	1999	2000	2001
Total (Billions €)	8.9	10.5	30.4	35.3	94.0	124.7	64.4
Number of Packages	57	65	117	131	220	281	135
Average Package (Millions €)	155.7	161.1	259.7	269.3	427.1	443.6	477.3
U.S. Loans							
Total (Billions €)	64.5	112.1	204.7	274.3	386.3	419.7	287.5
Number of Packages	401	625	1,106	1,482	1,648	1,643	1,025
Average Package (Millions €)	160.9	179.3	185.1	185.1	234.4	255.5	280.5

Source: Securities Data Company, Inc.

Exhibit 22

EUROPEAN LARGE BUYOUT MARKET

1996-2001



Year	Number	Total Value (Billions €)	Average Buyout Size (Millions €)
1996	4	2.9	730.3
1997	11	11.6	1,053.7
1998	13	14.3	1,099.3
1999	22	21.0	954.2
2000	31	39.9	1,287.7
2001	19	30.4	1,601.2
	100	120.1	1,201.3

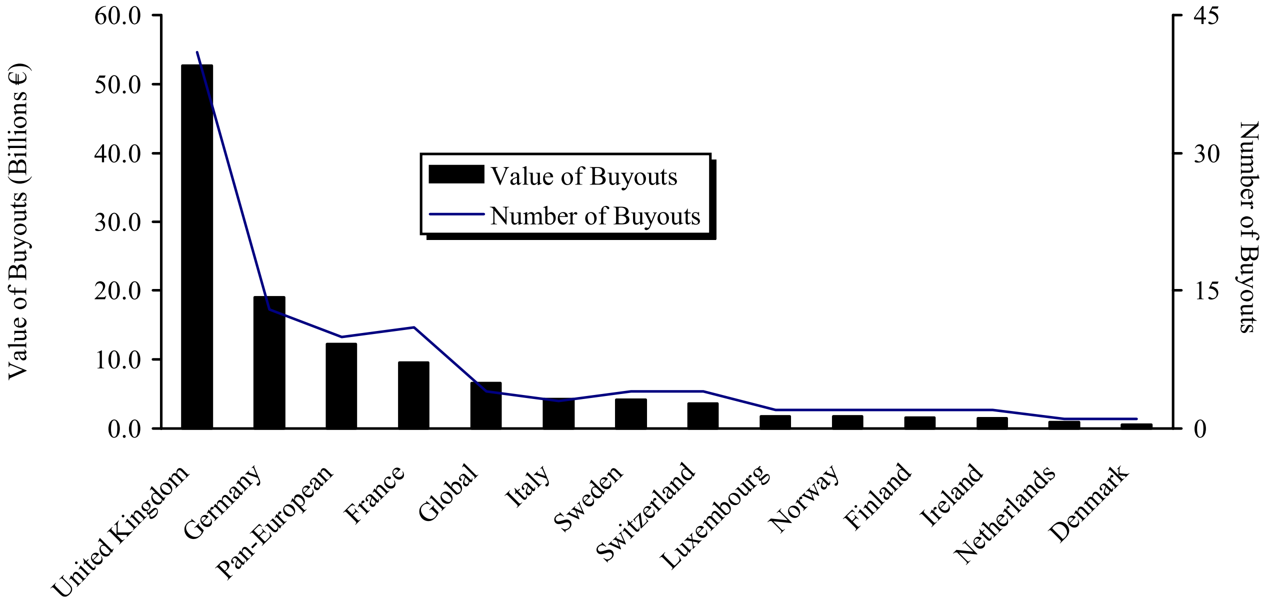
Source: PriceWaterhouseCoopers.

Note: Data for 2001 are through June 30.

Exhibit 23

EUROPEAN LARGE BUYOUT MARKET BY COUNTRY

1996-2001



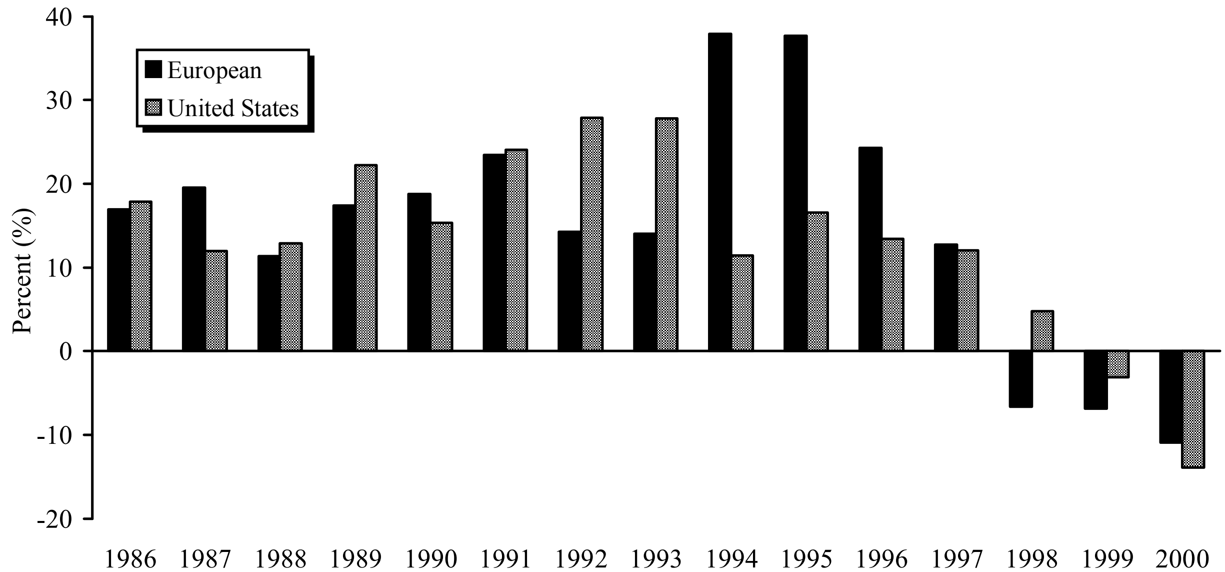
Country	Total Value of Buyouts (Billions €)	Percent of Total Value (%)	Number of Buyouts	Average Size per Country/Region (Millions €)
United Kingdom	52.7	43.8	41	1,284.4
Germany	19.0	15.9	13	1,465.1
Pan-European	12.2	10.2	10	1,224.1
France	9.6	8.0	11	868.7
Global	6.6	5.5	4	1,641.6
Italy	4.2	3.5	3	1,410.6
Sweden	4.2	3.5	4	1,041.8
Switzerland	3.6	3.0	4	901.3
Luxembourg	1.8	1.5	2	895.1
Norway	1.8	1.5	2	882.6
Finland	1.6	1.3	2	785.2
Ireland	1.5	1.2	2	741.2
Netherlands	0.9	0.8	1	908.0
Denmark	0.5	0.5	1	546.9
	120.1	100.0	100	1,201.3

Source: PriceWaterhouseCoopers.

Note: Data for 2001 are through June 30.

Exhibit 24

COMPARISON OF EUROPEAN AND U.S. PRIVATE EQUITY RETURNS



Vintage Year	European Private Equity[1] Pooled Mean Net to Limited Partners[3] (%)	U.S. Private Equity[2] Pooled Mean Net to Limited Partners[3] (%)
1986	16.9	17.9
1987	19.6	12.0
1988	11.4	12.9
1989	17.4	22.2
1990	18.8	15.4
1991	23.4	24.0
1992	14.3	27.9
1993	14.0	27.8
1994	37.9	11.5
1995	37.7	16.6
1996	24.3	13.5
1997[4]	12.7	12.0
1998[4]	-6.6	4.8
1999[4]	-6.9	-3.1
2000[4]	-10.9	-13.9

Source: Cambridge Associates LLC Non-Marketable Alternative Assets Database.

[1] Based on data compiled from 74 European private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 2000.

[2] Based on data compiled from 364 U.S. private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 2000.

[3] Net of fees, expenses, and carried interest.

[4] Most of these funds are too young to have produced meaningful returns. Analysis and comparison of partnership returns may be irrelevant.

Exhibit 25

COMPARISON OF EUROPEAN AND U.S. PRIVATE EQUITY DISTRIBUTIONS TO LIMITED PARTNERS

	LP Distributions/Paid In Capital [1]		Total LP Value/Paid In Capital [2]	
Year	European [3]	U.S. [4]	European [3]	U.S. [4]
1986	2.5	3.1	2.5	3.2
1987	2.4	1.6	2.4	2.0
1988	1.7	1.6	1.7	1.7
1989	2.0	2.2	2.1	2.3
1990	2.0	1.5	2.1	1.8
1991	1.9	2.6	2.0	2.7
1992	1.3	1.9	1.6	2.2
1993	1.3	1.7	1.6	2.2
1994	2.2	0.6	2.7	1.4
1995	1.7	0.8	2.0	1.5
1996	1.1	0.5	1.9	1.4
1997 [5]	0.4	0.2	1.2	1.2
1998 [5]	0.1	0.1	0.9	1.1
1999 [5]	0.1	0.1	0.9	1.0
2000 [5]	0.0	0.0	0.9	0.9

Source: Cambridge Associates LLC Non-Marketable Alternative Assets Database.

[1] LP Distributions/Paid In Capital presents the multiple of actual distributions to LPs over the capital called from the LPs to date for the entire fund.

[2] Total LP Value/Paid In Capital presents the multiple of actual distributions plus the valuation of the unrealized portfolio as it pertains to the LPs over the capital called from the LPs to date for the entire fund.

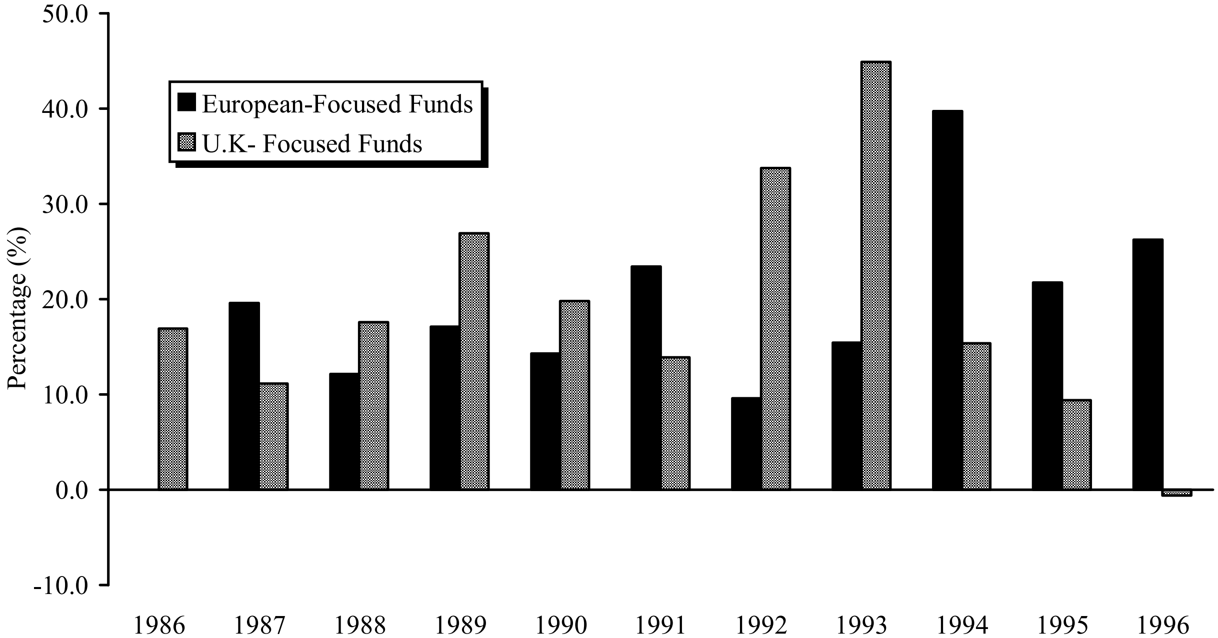
[3] Based on data compiled from 74 European private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 2000.

[4] Based on data compiled from 364 U.S. private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 2000.

[5] Most of these funds are too young to have produced meaningful data. Analysis and comparison of these statistics may be irrelevant.

Exhibit 26

COMPARISON OF U.K. AND EUROPEAN PRIVATE EQUITY RETURNS



Vintage Year	U.K.-Focused Funds [1] Pooled Mean Net to Limited Partners [3]	European-Focused Funds [2] Pooled Mean Net to Limited Partners [3]
1986	16.9	---
1987	11.1	19.6
1988	17.6	12.1
1989	26.9	17.1
1990	19.8	14.3
1991	13.9	23.4
1992	33.8	9.6
1993	45.0	15.4
1994	15.4	39.8
1995	9.4	21.7
1996	-0.6	26.2

Source: Cambridge Associates LLC Non-Marketable Alternative Assets Database.

[1] Based on data compiled from 36 U.K.-focused private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 1996.

[2] Based on data compiled from 38 European-focused private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1987 and 1996.

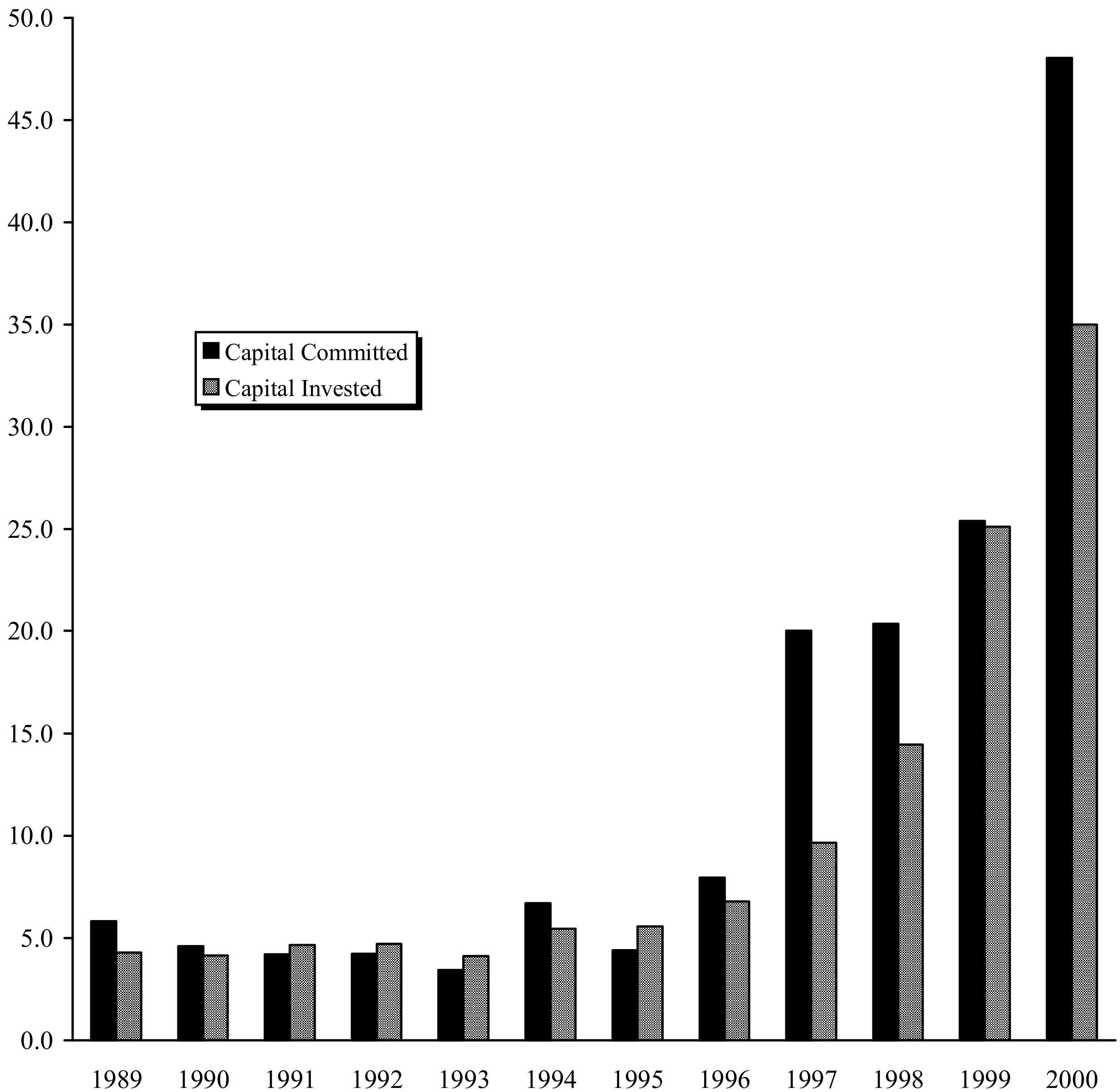
[3] Net of fees, expenses, and carried interest.

Exhibit 27

ANNUAL EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL COMMITTED AND INVESTED

1989-2000

Billions (€)



Source: European Venture Capital Association.

Exhibit 28

EUROPEAN AND U.S. PRIVATE EQUITY TIME-WEIGHTED RETURNS NET TO LIMITED PARTNERS COMPARED TO THE S&P 500

July 1, 1985 - June 30, 2000

Years Ended June 30	European Private Equity Funds[1,3] (%)	U.S. Private Equity Funds[2,3] (%)	S&P 500 (%)
1986	16.2	---	35.6
1987	16.2	6.0	25.1
1988	16.3	4.9	-7.0
1989	16.7	13.3	20.5
1990	16.6	8.9	16.5
1991	17.7	3.7	7.4
1992	18.3	8.1	13.4
1993	20.8	22.2	13.6
1994	19.0	17.1	1.4
1995	19.0	16.0	26.1
1996	19.3	27.9	26.0
1997	17.7	25.0	34.7
1998	14.0	36.7	30.2
1999	11.0	16.7	22.8
2000	-7.6	29.2	7.2
Average Annual Compound Return (7/1/86-6/30/00)	15.1	16.4	16.4
14-Year Median (7/1/86-6/30/00)	17.2	16.3	18.5
10-Year Median (7/1/90-6/30/00)	18.0	19.6	18.2
5-Year Median (7/1/95-6/30/00)	14.0	27.9	26.0

Sources: Cambridge Associates LLC Non-Marketable Alternative Assets Database and Standard & Poor's.

[1] Based on data compiled from 74 European private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 2000.

[2] Based on data compiled from 364 U.S. private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1987 and 2000.

[3] Net of fees, expenses, and carried interest.

Exhibit 29

U.S. PRIVATE EQUITY PERFORMANCE STATISTICS

As of June 30, 2001

Vintage Year	Pooled Mean Net to Limited Partners[1] (%)	Median Net to Limited Partners[1] (%)	Equal-Weighted Mean Net to Limited Partners[1] (%)	Number of Funds (%)
1986	17.9	10.9	12.6	11
1987	12.0	11.5	14.6	13
1988	12.9	12.3	11.8	15
1989	22.2	18.1	21.9	18
1990	15.4	14.9	15.7	9
1991	24.0	24.5	24.4	9
1992	27.9	16.9	21.6	18
1993	27.8	24.9	27.3	27
1994	11.5	15.0	14.6	19
1995	16.6	10.9	15.9	28
1996	13.5	9.3	15.9	32
1997[2]	12.0	0.8	10.6	40
1998[2]	4.8	2.3	5.9	49
1999[2]	-3.1	-2.7	-2.0	31
2000[2]	-13.9	-16.4	-18.8	45[3]

Source: Cambridge Associates LLC Non-Marketable Alternative Assets Database.

Note: Based on data compiled from 364 U.S. private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 2000.

[1] Net of fees, expenses and carried interest.

[2] Most of these funds are too young to have produced meaningful returns. Analysis and comparison of partnership returns to benchmark statistics may be irrelevant.

[3] Represents only those funds formed in 2000 that began investing by June 30, 2001.

Exhibit 30

EUROPEAN PRIVATE EQUITY PERFORMANCE STATISTICS

As of June 30, 2001

Vintage Year	Pooled Mean Net to Limited Partners[1] (%)	Equal-Weighted Mean Net to Limited Partners[1] (%)	Number of Funds
1986	16.9	16.9	1
1987	19.6	19.6	1
1988	11.4	9.8	4
1989	17.4	17.9	3
1990	18.8	19.9	7
1991	23.4	23.4	1
1992	14.3	11.1	4
1993	14.0	18.7	4
1994	37.9	24.3	9
1995	37.7	46.0	6
1996	24.3	19.2	4
1997[2]	12.7	23.7	14
1998[2]	-6.6	-5.4	5
1999[2]	-6.9	-10.6	8
2000[2]	-10.9	-38.2	3[3]

Source: Cambridge Associates LLC Non-Marketable Alternative Assets Database.

Note: Based on data compiled from 74 European private equity funds (subordinated debt, leveraged buyout, and special situation funds), including fully liquidated partnerships, formed between 1986 and 2000.

[1] Net of fees, expenses, and carried interest.

[2] Most of these funds are too young to have produced meaningful returns. Analysis and comparison of partnership returns to benchmark statistics may be irrelevant.

[3] Represents only those funds formed in 2000 that began investing by June 30, 2001.

APPENDIXES

Appendix A

REGIONAL PRIVATE EQUITY MARKET ANALYSIS

European Private Equity—Local Market Characteristics

Country/Region	Summary
United Kingdom	-Mature, highly competitive market. -Headquarters for most pan-European funds. -Reasonable quality data and investment valuations.
Germany and Austria	-Lots of promise. Performance thus far does not corroborate potential. -Local tax issues negatively impact funds and investors. -Nascent but growing equity culture. -Crowded middle market with many new entrants.
France	-Signs of growth and significant potential as the buyout concept catches on. -Many local fund managers are captive. -Local fund teams of pan-European funds growing in experience. -Governance/accounting standards possibly becoming more international, less French. -Stringent local employment laws favor growth-oriented investing. -Local FCPR investment vehicle is tax transparent.
Scandinavia	-Mature market. -Experienced managers. -Small local economies lead to strong international perspective and M&A skills.
Benelux	-Mature market, but small in size. -Experienced local middle-market managers.
Italy	-Small market, characterized by a few headlining deals. -Selected high-quality managers. -Crowded small/middle market. -Legal and regulatory issues hinder growth. -High potential as buyout concept and equity culture gain acceptance.
Switzerland	-Small market with limited opportunities. -Equity culture hindered by unfavorable local tax treatment.
Iberia	-Small economy. -Crowded market with large funds raised by inexperienced local managers leading to competitive deals. -Latin America axis negatively impacted by current political and economic climate.
Ireland	-Despite high GDP growth, few investment opportunities. -Technology orientation of economy favors venture capital over private equity.
Central Europe	-Immature market and economies with limited deals. -Few managers with any experience. -High risk, returns to date not commensurate.

Source: Cambridge Associates LLC.

United Kingdom

At 47% of all European buyouts, the U.K. market is by far the largest private equity market in Europe, with €29.6 billion in transaction value for 2000. This level of domination is not new to the United Kingdom—the region has historically commanded a majority share of European buyout activity. The majority of Europe's leading private equity funds and investment professionals have their roots in this market, beginning with the establishment of 3i over 50 years ago. In addition, the position of London as one of the key financial centers for Europe has enabled the U.K. private equity market to advance its financing capabilities farther and faster than its continental European counterparts, creating a more efficient market. Current market trends in the U.K. private equity market include:

- Clearer bifurcation of managers focusing on either large buyouts or middle-market investments;
- Fund managers targeting specific industry sectors to further differentiate themselves to potential target companies;
- Fund managers establishing internal consulting groups, separate and distinct from deal teams, to work with portfolio companies on executing business plans;
- Fund managers launching CDO funds to provide debt financing for transactions in the event the bank or public high-yield markets suddenly retrench; and
- Secondary buyouts, or exiting via a sale to another fund manager. This typically occurs from a middle-market manager to a large buyout manager. This trend is increasing on a pan-European basis, but initially gaining momentum in the United Kingdom.

Because of the level of efficiency and level of competition in U.K. private equity, many U.K.-based fund managers are beginning to expand more aggressively into Europe, particularly Germany, seeking more favorable markets.

Germany and Austria

According to *Initiative Europe*, of the €62.8 billion in European buyouts completed in 2000, 19% or €12.1 billion were completed in Germany and Austria, second only to the United Kingdom in value. Indeed, this private equity market has been growing at a compound annual rate of 78%, far ahead of the U.K.'s 40%. While the numbers of private equity-backed buyouts has stayed fairly constant, the average value has risen consistently over the past five years from €36.6 million in 1996 to €343.7 million in 2000. This shift in size may indicate a growing acceptance among German corporates of buyouts as an acceptable exit for non-core divisions and affiliated companies.

This growing acceptance may be driven in part by German tax reforms, which became fully effective in January 2002, providing for the elimination of capital gains taxes for corporate shareholders and the reduction by 50% of taxes for individuals selling corporate shares, thus encouraging asset transfers. These reforms are expected to encourage efforts by larger companies to divest non-core divisions and subsidiaries that would qualify as middle-market companies and therefore generate potential private equity investor interest.

In addition, as the EU continues to strive towards one market and one currency, there is a new focus on competitive market positioning and many local and regional companies are seeking capital and guidance for competitive positioning in the broader market. This need for capital and guidance was not found within the German banking system, which was characterized by stringent lending requirements and little value add, rather private equity firms seeking a foothold in the largest economy in the EU are seeking to fill the void. Private equity firms have been flocking to Germany in advance of the tax reforms to set up a local shop and stand ready for the onslaught of spin-offs and divestitures that are expected to occur as firms begin rationalizing and paring down. These firms offer pan-European networks and market information and are seeking to capitalize on the relatively untapped private equity market in Germany. While this market is not expected to suddenly emerge, the level of promise embedded in the German economy should eventually provide for a sufficient supply of buyout opportunities over the medium to long term.

France

The French buyout market, currently estimated to be €7.4 billion in size, comprises 12% of the European private equity market, typically vying for second or third place with Germany behind the United Kingdom. According to *Initiative Europe*, France was second to the United Kingdom in terms of volume and second to Germany in terms of compound annual growth rate (CAGR), registering a 56% CAGR from 1996 through 2000.

While there has been a trend across Europe towards larger and fewer buyouts, the French market is still characterized by volume rather than value, with almost three times more buyouts than the rest of the countries in continental Europe. A large portion of this volume is derived from families seeking to monetize all or some of their wholly-owned businesses. Despite the political and social problems often encountered by French companies, including employment laws, the global trend towards restructuring is impacting the French market and creating more spin-off investment opportunities for fund managers. Buyouts from local parent companies have comprised 30% of all buyouts since the early 1990s. Public-to-privates are not as common in France, with a handful accomplished each year, due to the high level of shareholder acceptance (95%) required to force a squeeze out of minority shareholders, among other issues. Overall, the French market continues to grow at a steady pace, yielding multiple investment opportunities.

Scandinavia

Scandinavia has developed a sizable private equity market. At €5.4 billion in total value for 2000, Scandinavia represents 9% of the European private equity market and is the third fastest growing region behind Germany and France, at a 53% CAGR.

One dominant feature of the Scandinavian private equity market has been the restructuring of large corporations refocusing on core business lines. Even the region's traditional industries of shipping and natural resources are paring down to compete globally. The resulting spin-offs have provided fund managers with a healthy supply of opportunities, which are reflected in the region's growth and size. Financial buyers are becoming regarded as a viable option by sellers and there is an increasing number of local debt financiers willing to provide acquisition financing, as well as a growing circle of pan-European advisors. The Scandinavian private equity market continues to mature, with fund managers targeting specific opportunities by stage of investment and industry focus, including increasing investment in earlier stages.

Benelux

While Scandinavia has recently leapfrogged the Benelux private equity market in terms of total value for 2000, the Benelux countries have provided a constant source of buyout activity for European fund managers, generating an average of €2.9 billion a year in total value over the last four years and comprising 5% of the overall market. The Dutch market was one of the first to develop in Europe, supported by government programs and a strong financial environment. Recently the focus has shifted somewhat more towards venture capital, but the experience and track records of indigenous private equity managers such as ABN Amro and NIB Capital were established providing expansion and buyout capital to local companies. The Benelux is expected to continue to yield private equity opportunities in a favorable investment climate.

Italy

The Italian private equity market, at €2.3 billion in total value for 2000, is typically characterized by a small number of very large deals, which alone represent a large part of the country's annual deal value. At just 4% of the overall European market, Italy remains a small private equity market despite a large number of successful industrial companies.

From a legal and fiscal point of view, Italy is undergoing a period of reorganization after regulatory reforms introduced over recent years have encouraged a wider range of organizations, both domestic and international, to operate in the market. However, two recent court cases in Italy may negatively impact local buyout activity. One case challenges the use of *newco* structures, arguing that the *newco* structure can be used by larger companies to avoid stringent antitrust regulations. The second case was brought against the Milan office of an international private equity manager. This case argued that the recent receivership of a company was the direct result of a leveraged buyout transacted by this manager several years ago. Despite having already exited the company, the manager was found liable for receivership costs. It is the success of cases such as this that currently hinder Italy's growth in private equity.

Switzerland

At €1.5 billion, Switzerland comprised 2% of the European private equity market in 2000, growing at a mere 11% CAGR since 1996. Switzerland is a small market, and the number of domestic investment opportunities is limited.

Despite its favorable tax treatment of capital gains for individuals, Switzerland is not an attractive location for private equity managers due to several tax-related regulations. Currently, the only Swiss legal entity available for private equity funds, a holding company, is subject to double taxation. Distributions to individual investors from Swiss holding companies are taxed as dividends, not capital gains. Consequently, Swiss private equity fund managers continue to domicile their funds offshore, particularly in the Channel Islands. In addition, stock options are currently taxable at the date of grant based on their value, including time value, as determined using an option pricing model such as Black-Scholes. The resulting taxable values may be prohibitive. In December 2000, the cantonal tax authorities rejected a government proposal intended to reduce taxation of stock options granted by companies less than five years old. While Swiss private equity managers and industry groups continue to seek productive changes to encourage private equity investment, until some of these fundamental changes are made, the Swiss market is not expected to grow significantly.

Iberia

Iberia's private equity market registered almost €1 billion in total value for 2000, demonstrating a five-year CAGR of 42%, making the region the fourth fastest in terms of growth. While development capital transactions continue to represent the focus of local private equity investments, the buyout sector has been growing steadily since 1996. However, this region's contribution to the overall European market has held steady at 2% of total value over the last five years and is expected to continue to remain at this level over the short term.

Iberia has proven difficult to invest in and even more difficult with respect to exits. Privately owned firms, which offer the greatest investment opportunity to fund managers, are wary of financial acquirers and often fail to see the value in hiring outside managers to professionalize their business. However, efforts by banks and private equity investors, who continue to educate and market to potential investors and vendors, combined with increased awareness of the development of the broader European private equity market, are building a level of trust that should lead to increased activity.

In addition, the continued development of the Latin axis, supporting efforts by Spanish companies to expand via acquisition or organic growth to Latin America, is expected to yield private equity investment opportunities on both sides of the Atlantic. For the time being, however, political and economic crises in Latin America have negatively impacted the development of this particular investment strategy.

Ireland

The Irish private equity market was just €37.8 million in 2000, less than 0.1% of the overall market. Private equity prospects in Ireland tend to tend to be rare and mostly middle-market in nature, with the recent €3 billion takeover of Eircom an exception. Despite a population of just 3.6 million people and GDP of €101 billion, owing to a number of initiatives taken by the Irish Government since the late 1980s, Ireland has become the fastest growing economy in Europe. Over the period 1993 to 2000, GDP increased at an annual average rate of 9%, well above the EU annual average rate of 2.4%. Also in 2000, GDP rose by 10% and GNP by just under 10%. However, the global slowdown in IT and the crisis in the airline and tourism sectors in the wake of the attacks on the United States, have had a devastating impact on Dublin and other centers of the Irish economy. Ireland's dependence on the U.S. technology sector has been exposed in sharp relief by the current downturn. The country's private equity market is expected to remain a small portion of Europe's overall private equity activity.

Appendix B

DESCRIPTION OF CAMBRIDGE ASSOCIATES LLC PERFORMANCE MEASUREMENT METHODOLOGY

Cambridge Associates LLC has established a database to monitor the investments made by alternative asset partnerships. Users of the analysis may find the following description of the data sources, our classification process, and the calculation techniques helpful to their interpretation of information presented in the report:

- Partnership financial statements and narratives are the primary sources for information concerning partnership cash flows, portfolio company investments, and investor transactions.
- The performance calculation solves for the discount rate or internal rate of return that makes the net present value of an investment equal to zero. The calculation is based on cash-on-cash returns over equal periods, modified for the residual value of the partnership's equity or portfolio company's net asset value. The residual value attributed to each respective group being measured is incorporated at its ending value. The database accounts for transactions on a quarterly basis, but adopts annualized values for reporting purposes.
- Recognizing the venture capital community's sensitivity to the distribution of information pertaining to individual fund investment, as a matter of policy, Cambridge Associates only releases aggregated figures in its benchmark report.
- Vintage year is defined as the legal inception date as noted in a fund's financial statement.

Definitions

- The **pooled mean** aggregates or "pools" all cash flows and ending net asset values to calculate a dollar-weighted return.
- The **arithmetic mean** is the average of the discrete returns of each fund for a particular vintage year.
- The **median** is the middle fund return of the group of funds included in a vintage year.

The realization ratios described below are measures of return or contribution capital. Ratios are based on actual dollar values and not averages.

- **Distribution to paid-in capital** measures the cumulative investment returned relative to contributed capital.
- **Residual value to paid-in capital** measures the amount of contributed capital still tied up in the equity of the fund.
- **Total value to paid-in capital** measures the residual value and distributions received to date relative to contributed capital.