



EVCA Barometer

EVCA Barometer May 2006

Investing in European venture capital

Euro Zone GDP growth forecast remains unchanged for 2006 and 2007

Inflation forecast rises to 2.4% in April 2006

4,098 European M&A transactions adding up to €276bn in 2006 so far

Industry Snapshot:

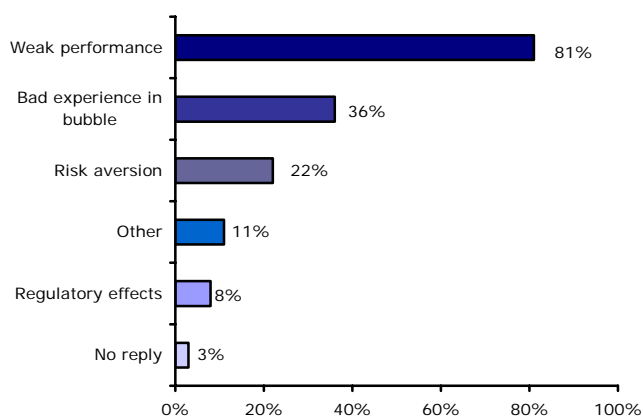
Since the technology hype of 2000 and the bursting of the stock market bubble in early 2001, the European Venture Capital sector has suffered disproportionately from a retreat by investors. Many limited partners have shifted their investment focus to the later stage, especially buyouts, where strong performances have rewarded and encouraged further moves in that direction. The key drivers behind this have been not only the higher risk profile of investments in the earlier stages, but more importantly the low overall performance that the venture sector has achieved in Europe. Although short-term performance data for 2005 indicates a positive change, average European venture performance has generally been below the average performance measured for US venture capital players, despite the fact that top quartile performance in both regions is very similar.

Understanding the reasons for the average performance difference and shedding some light on the current state of the European venture capital market is the aim of a new project that EVCA will launch over the coming months and from which results will be available in 2007. To obtain initial insights into the discussion from its members, EVCA has asked those investing in venture capital for their view on the current venture capital markets situation.

Performance and experience from the bubble years at the origin

Asking respondents about the key reason why limited partners shy away from investing in European venture capital, 81% of respondents referred to weak performance as the main reason. This is often related to a lack of a long-enough track record for European venture capital funds, proving the funds ability to generate returns for its investors. In second place came bad experiences from the bubble years, stated by 36% of respondents. 22% of respondents noted a general risk aversion by limited partners as the reason for their low interest in European venture capital. Regulatory aspects were least important, referred to by 8% of respondents.

What do you think is the main reason that limited partners shy away from European venture capital?



Multiple answers possible
Source: EVCA

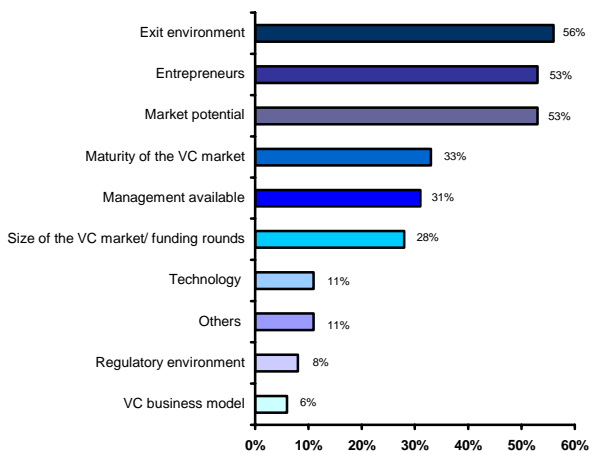


European Private Equity &
Venture Capital
Association

Weak exit environment, entrepreneurs and market potential as key source for performance difference

Asking respondents about three reasons for the performance difference with the US venture capital market, the exit environment came up top of the list, at 56%. Entrepreneurs and the market potential came second, both equally mentioned by 53% of the respondents. Third came the maturity of the venture capital market referred to by 33% of respondents. The management availability and the size of the venture capital market and funding rounds were stated by 31% and 28% of respondents respectively. Weak technology and other reasons were cited by 11% of respondents and 8% referred to the regulatory environment. The venture capital business model was cited by 6% of respondents only.

What do you think are the **three** main reasons for the overall performance difference between European venture capital funds and those in the US?



Multiple answers possible
Source: EVCA

Why to invest in European venture capital?

Asking respondents about the three main arguments they use in convincing limited partners to invest in European venture capital, the excellence of European businesses and their technology came up on top of the list, together with the quality of the management teams available in the portfolio companies. Second came the low levels of competition among European venture capital funds, which lead to very attractive valuation of deals.

Moreover, Europe has a large pool of potential deals looking for financing, of which many are in an attractive development stage. A third strong argument is the maturity of the venture capital market itself. European funds have more experienced teams than a few years ago and have established a strong network of contacts. Market consolidation has taken place: funds with little experience have left, leaving a smaller and stronger group behind. At the same time, the improved exit environment now allows funds to show a healthier track record than just a few years ago.

One side effect of this consolidation is that players and funding rounds are getting bigger, which increases the funding for the best companies. Many of the particularly larger deals today are syndicated, with venture capitalists sharing knowledge and resources.

Limited partners' interest and the right timing

Recently, some limited partners, both in Europe and the US, have publicly expressed a growing interest in European venture capital. In this respect, we asked members, as to whether they could confirm this from their own experience. Close to half of the respondents confirmed that limited partner interest in European venture capital is currently picking up. However, some respondents recall that this is from a very low level and that not all limited partners are returning. A few respondents fear that already too much money has been raised for European venture capital.

Possible reasons mentioned for the rising interest by limited partners are that the market is expected to enter a new cycle, and performance is anticipated to increase in the near future, given a number of successful exits realized recently. Respondents see venture interest as also being driven by rising concerns about debt levels and the high inflow of capital in the buyout market, questioning the sustainability of returns achieved over the past years. As a result, limited partners are expected to diversify themselves more across the private equity asset class.

At the same time, investors from abroad, particularly the US are taking a closer look

at the European venture capital market, due to rising information availability and the lower perceived risk of increasing economic integration.

Some of the respondents expect a wider return to venture capital by limited partners only in the coming year or two, as a number of investors are not ready yet to return to the market.

Significant performance improvement and an open exit environment

When asking respondents about what needs to happen to improve the reputation of European venture capital and to re-attract limited partners to the market, a significant and sustainable improvement in performance, coupled with a positive exit route via IPO and trade sale was mentioned first. The creation of more success stories and a better communication of those was further cited, which would have a positive effect in encouraging entrepreneurs across Europe.

Many of the changes required to achieve this have already occurred over the last year. At the same time, the industry and investment teams have become more mature and are now able to prove a long enough track record when fundraising. Funds that have survived the post bubble area have developed a more sustainable investment and business concept for their funds, which is now profiting from low competition, a positive exit environments and globalization of markets and businesses.

A further requirement vital for establishing a venture capital market is significant size and hence more courage is expected by respondents on the part of limited partners to invest. At the same time, rising awareness of the asset class and the discussions over the venture capital market over the past years have increased the understanding by limited partners for venture capital investing.

More serial entrepreneurs and a better framework for the seed and early stage

Asking respondents about what should change to encourage in particular the seed and start-up stages in Europe, the need for more serial entrepreneurs and a better

framework were most often mentioned. Entrepreneurs and especially serial entrepreneurs should be encouraged to start a new business after having created one successfully, or even after an unsuccessful attempt to do so. Administrative infrastructure needs to become more entrepreneur-friendly, with less bureaucracy and more flexibility with respect to company creation, employment contracts and the taxation of stock options. Here, European governments have a crucial role to play in supporting the industry.

Furthermore, school education should encourage entrepreneurship at an early stage. Academia and scientists need to become more entrepreneurial and business minded. Given that high-quality management with a strong understanding of markets is vital to portfolio companies success, creating and shaping those managers and encouraging them to stay in Europe is essential.

At the same time, there should be more partnering between leading academic institutions and venture capital funds, as well as joint private and the public sector activities, particularly when it comes to the funding of projects. Encouraging the availability of soft money, particularly for projects in the very early stage, was furthermore recommended by respondents. More collaboration between different venture capital funds would also encourage the availability of follow-on funding.

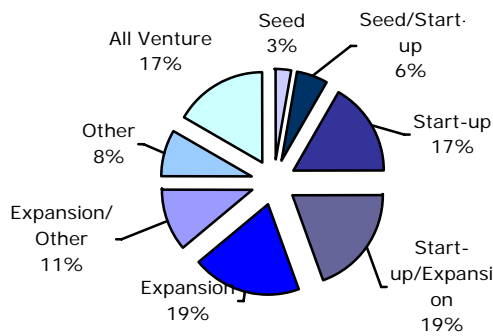
However, it is also crucial that the IPO market stays open over the longer term. Exit by IPO is a main feature for a successful and liquid venture capital market and a key motivator for entrepreneurs and venture capitalists alike.

Sample

Overall, responses from 36 EVCA full members investing in venture capital were received, which is around 9% of the universe contacted for the survey.

The sample was split relatively evenly across early and expansion stage funds with both representing around one third of respondents.

What is your investment focus?



Source: EVCA

Much has already been discussed about the revival of the European venture capital market last year, and 2006 is expected to show a materialization of that uptake on a broader scale. Key drivers behind this are the better exit environment, particularly with respect to IPOs, which is still the linchpin of a well functioning venture capital market, and the possibility to generate the necessary performance and track record for funds. However, IPOs are not only crucial to satisfy limited partners and to establish a track record, but also as an example to entrepreneurs. Certainly, the European market still has a large potential to create, encourage and recycle entrepreneurs in a better and faster manner.

Although a number of larger and prominent venture capital funds were already raised successfully in 2005, many European venture capital funds are coming back to the market throughout 2006. Whether the year 2006 will finally be the turning point for the European venture capital market will be seen over the coming 7 months.

Latest news on emerging technologies for the Information Society

Below you will find a summary of news from the European Commission's IST Results service, featuring innovations and results from the €3.6bn Information Society Technologies research programme.

SCAMPI trawls the internet

Network traffic management is becoming increasingly important as computer

networks grow larger and more complicated. A EU project has developed a combination of hardware and software to create new, open tools for high-speed network monitoring, addressing a costly bottleneck for companies wanting to extract the full potential of their bandwidths. [Read more...](#)

Online cost-engineering service to help SMEs build business

Cost estimates are fundamental to business decisions. Indeed, some believe that, "cost has become a business driver." Which is why a prototype set of online cost-engineering services that could help engineers understand and benefit from best estimating practice in key industry sectors has been developed. [Read more...](#)

Online portal helps build IST partnerships

Navigating Europe's maze of research organisations to find the right partner is no easy task. A new portal aims to lower the barriers to collaboration by raising the visibility of organisations, researchers and projects to facilitate community partnership building. [Read more...](#)

Artificial vision technology proves a sight for sore eyes

Becoming Europe's leading designer of powerful chips for artificial vision systems sits squarely in the sights of young Spanish high-growth company, AnaFocus. AnaFocus specialises in the design of innovative and high-performance vision systems-on-a-chip and mixed-signal (analogue and digital) integrated circuits. The company's vision systems-on-a-chip technology, called Eye-RIS, was inspired by the workings of the human eye. [Read more...](#)

IST Results can be visited at www.cordis.lu/ist/results/. IST is funded by DG Information Society of the European Commission.

Euro Zone GDP growth forecast remains unchanged for 2006 and 2007

The economic outlook for 2007 has remained relatively stable for both the Euro Zone and the US in comparison to last month, according to *The Economist's* monthly GDP growth estimates.

The GDP growth estimate for the Euro Zone still foresees 1.7% of GDP growth in 2007. Forecasts for Denmark and Sweden have also remained unchanged, predicting 2.2% and 2.8% of GDP growth respectively. Expectations for the UK have increased by 0.1 percentage point, now anticipating 2.5% of GDP growth in 2007. For the US economy, a growth rate of 2.8% is anticipated for 2007, the same as last month.

For the current year 2006, the GDP growth expectations for the Euro Zone have remained constant, expecting 2.1% of GDP growth. Similarly, the estimate for Denmark has not changed, predicting 2.8% of GDP growth. At the same time, the economic outlook for the UK, Sweden and the US have improved since last month's publication, now anticipating 2.4%, 3.4% and 3.4% of GDP growth in 2006 respectively (up 0.1 percentage point).

In view of the publication of the European Commission's quarterly Euro Area GDP growth projection in June, part of the GDP growth forecast is not covered in this month's issue of the Barometer.

However, the actual GDP growth for the first quarter of 2006 has been published, indicating a quarterly growth rate of 0.6%, which is in the middle of the range previously estimated for the quarter.

Upward trend in LIBOR continues, surpassing the 3.3% at the end of April

LIBOR continued its upward trend into the second quarter of 2006, surpassing 3.3% at the end of April for the first time since January 2004. In spite of a temporary dip between the second and fourth week of April, the LIBOR rate closed the month at 3.32%.

The average LIBOR rate for April 2006 was 3.22%, which is 96 basis points above the April 2005 average of 2.26%.

Inflation and Exchange Rates

After three consecutive months of decreasing Euro Zone inflation rates, the April forecast for the annual inflation rate increased to 2.4%. This signifies a strong

increase compared to last month's inflation of 2.2%.

After a temporary downswing in February, the US\$/€ exchange rate continued its upward trend into the month of April. At the end of the month, the Euro was traded at US\$ 1.2537.

Upward trend came to a halt

After an optimistic start into the year and increasing stock market indices over the first four months of 2006, the upwards trend came to a halt in mid May 2006. Since then, all stock markets presented have fallen back, closing at the cut-off date (17 May 2006) below their April opening value.

The AIM increased throughout April and early May, only to fall back afterwards closing with a negative balance of -2% between early April and the cut-off date (17 May 2006). Similarly the Technology All Share, after first increasing in April, dropped likewise as of the second May week, falling by 5% over the same period of time.

The FTSE Eurotop 300 fell by a similar 5% and the Nasdaq decreased by 6% between the beginning of April and the cut-off date (17 May 2006).

IPO Activity

According to data provided by *Thomson Financial*, IPO activity by European and US companies continued to be strong in the second quarter of 2006.

In April 2006, 36 European companies went public on international stock markets, generating total proceeds of €6bn. This is the second strongest month in terms of number of IPOs and revenue generated. In May to date (cut-off date: 17 May 2006) 20 additional European companies were launched on international stock markets, with revenues amounting to €6.4bn.

In total 138 IPOs by European companies were counted in 2006 so far (cut-off date: 17 May 2006) generating €20bn in revenues. This translates to 31 European IPOs, generating €4.5bn in returns on average per month in 2006.

Looking at the first quarter of 2006, European IPO activity has been 46% above last year's quarter one activity level in terms of number of deals. Further, the second quarter 2006 has already almost reached the volume of last year's second quarter in terms of value of deals, despite the fact that half of the quarter is still missing.

Moreover, another 23 European company IPOs are in the pipeline and expected to be realised in the second quarter of 2006, of which 8 are venture and 2 are buyout backed.

The largest transaction by a European company this year to date was the May IPO of the Italian oil refiner *SARAS*, which raised total proceeds of €2.1bn. Second, also in May, was the listing of private equity backed and UK based *Debenhams PLC*, with total revenues of €1.5bn, followed by the April IPO of the German chemical company *Wacker Chemie AG*, which raised €1.1bn.

In comparison to Europe, US IPO activity has been less strong in the first quarter and in the beginning of the second quarter of 2006. The first quarter saw 42 US companies going public, generating total proceeds of €5.9bn. Although being quite below the European IPO activity level, there is not much of a difference with last year's IPO level. In the first quarter of 2005, 44 US IPOs took place, with revenues totalling €7.9bn.

Both in April and May 13 US companies quoted on internal stock markets, with proceeds summing to €2.1bn and €5.5bn respectively. In all, this year to date has seen 68 IPOs by US companies, generating €13.4bn in revenues (cut-off date: 17 May 2006). The average monthly deal volume is 15, with on average €3bn in proceeds.

KKR Private Equity Investors is the largest IPO of a US company so far in 2006 (€5bn in proceeds). Second and third are the IPOs of the US oilfield service provider *Complete Production Services* (€718m) and the US energy company *Exco Resources Inc.* (€697m).

4,098 European M&A transactions adding up to €276bn in 2006 so far

According to data from *Dealogic*, a total of 4,098 M&A deals, valued at €276bn, have taken place in Europe in 2006 so far (cut-off date: 17 May 2006). This marks an increase in deal volume of 30% compared to the April data, counting 912 M&A transactions more. This year to date (cut-off date: 17 May 2006), an average of 911 European M&A transactions have taken place per month, which is slightly above the average deal volume in 2005, counting 902 M&A transactions per month. Average deal volume in 2006 is with €61bn so far however slightly lower than the average deal value of €62bn measured in 2005.

The most active sectors in 2006 so far in terms of number of deals were *Industrial Manufacturing* (508 transactions) and *Media, Information & Software* (459 transactions), with each over 100 more than last month. The leading sector in value terms in 2006 so far (cut-off date: 17 May 2006) is *Telecommunications*, with a total M&A value of €60bn.

Overall, 2006 M&A activity has reached 46% of last year's total activity level in terms of number of deals and 51% of last year's deal volume.

Appendix

Annual GDP Growth Forecasts in %

	May 2006 forecast		April 2006 forecast		Difference between the two forecasts	
	2006	2007	2006	2007	2006	2007
Euro Zone	2.1	1.7	2.1	1.7		
UK	2.4	2.5	2.3	2.4	+0.1	+0.1
Denmark	2.8	2.2	2.8	2.2		
Sweden	3.4	2.8	3.3	2.8	+0.1	
USA	3.4	2.8	3.3	2.8	+0.1	

Source: The Economist

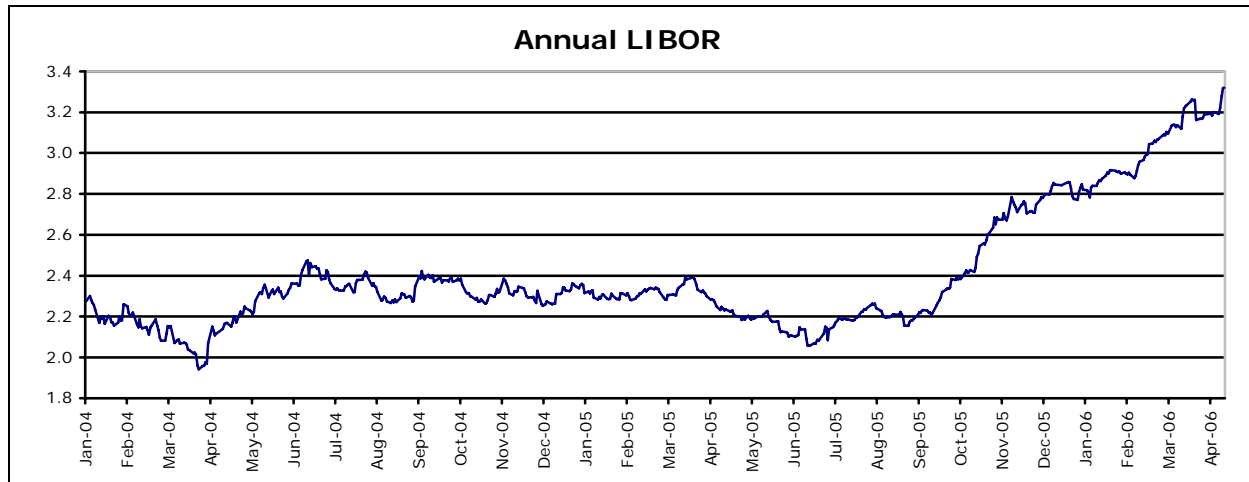
Quarterly GDP Growth Forecasts for the Euro Zone in %

	May 2006 forecast	April 2006 forecast	Difference between the two rates/forecasts
3 rd Quarter 2005	0.7	0.7	
4 th Quarter 2005	0.3	0.3	
1 st Quarter 2006	0.6	0.4-0.8%	
2 nd Quarter 2006	Not yet published	0.3-0.8%	
3 rd Quarter 2006	Not yet published	0.2-0.8%	

* Refers to the actual quarterly growth rates, which are revised monthly to take account of new information.

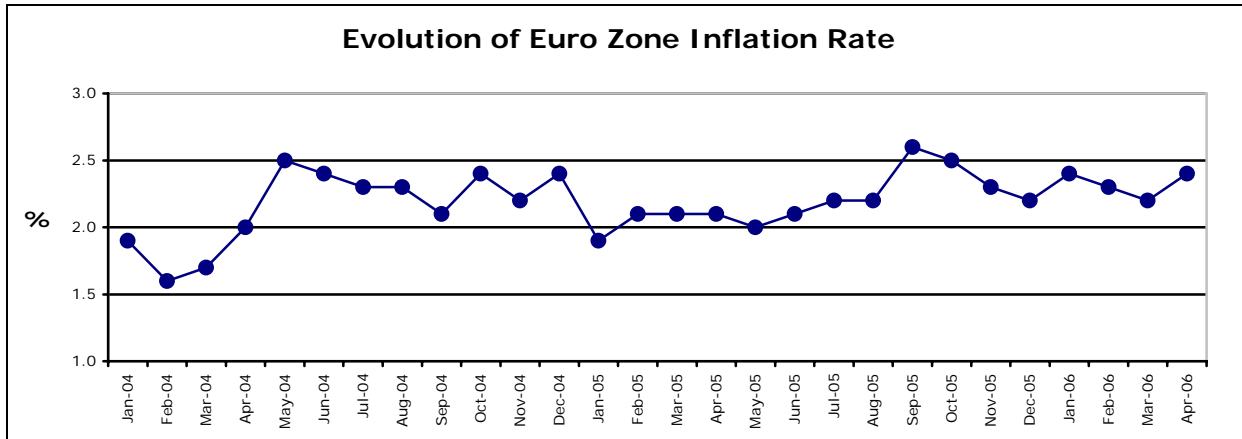
Source: ECFIN – EU Commission Directorate General for Economic and Financial Affairs

Annual LIBOR



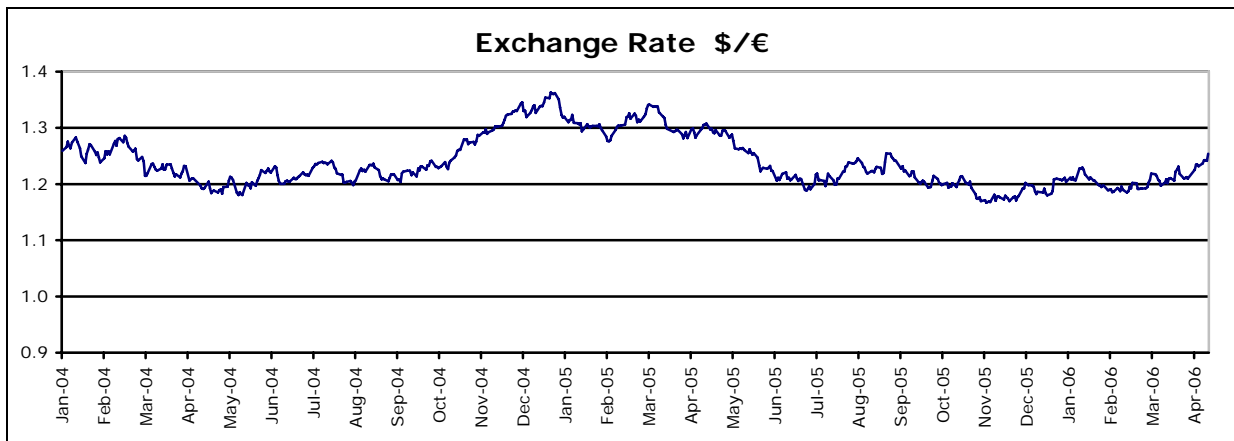
Source: British Bankers Association (BBA)

Annual Inflation for the Euro Zone



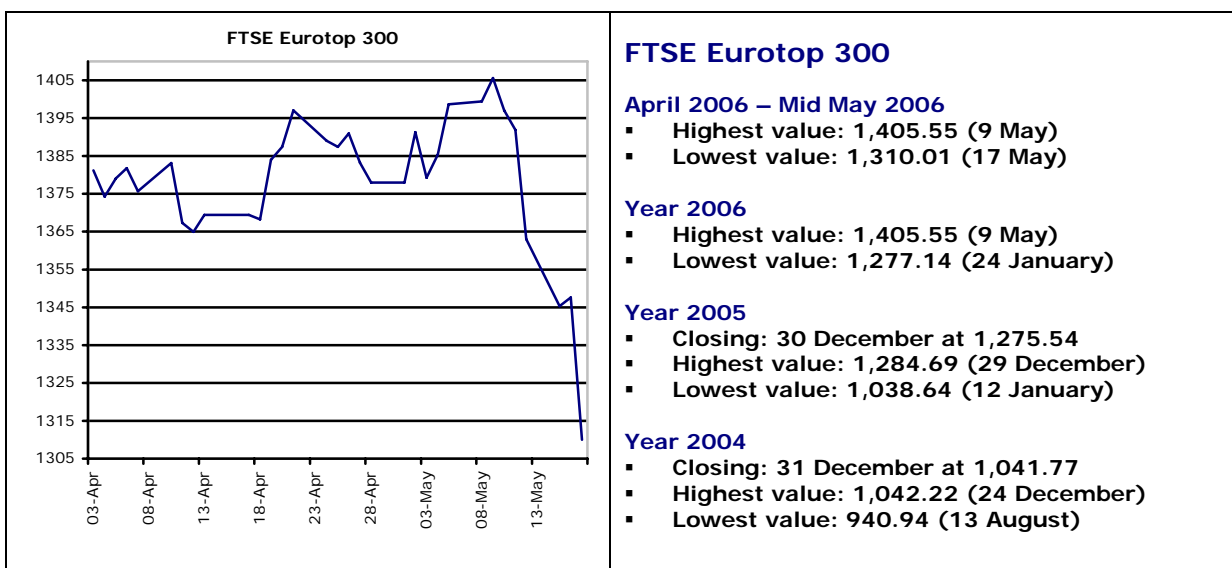
Source: Eurostat - Inflation rate for consumer price

Exchange rate



Source: European Central Bank (ECB)

Stock markets



FTSE Eurotop 300

April 2006 – Mid May 2006

- Highest value: 1,405.55 (9 May)
- Lowest value: 1,310.01 (17 May)

Year 2006

- Highest value: 1,405.55 (9 May)
- Lowest value: 1,277.14 (24 January)

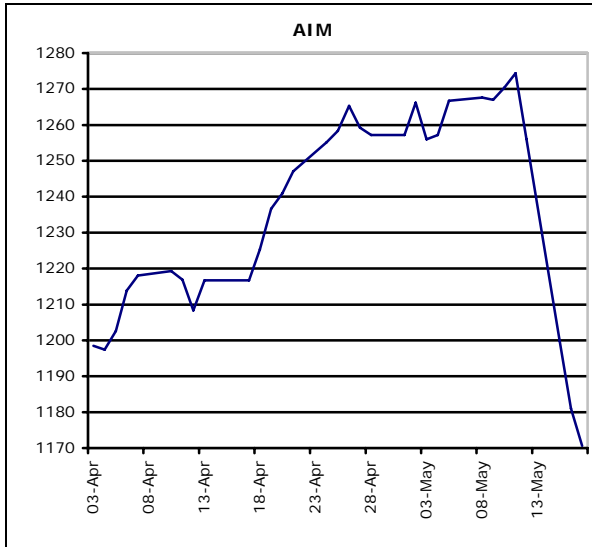
Year 2005

- Closing: 30 December at 1,275.54
- Highest value: 1,284.69 (29 December)
- Lowest value: 1,038.64 (12 January)

Year 2004

- Closing: 31 December at 1,041.77
- Highest value: 1,042.22 (24 December)
- Lowest value: 940.94 (13 August)

Source: London Stock Exchange



AIM

April 2006 – Mid May 2006

- Highest value: 1,274.4 (11 May)
- Lowest value: 1,170.6 (17 May)

Year 2006

- Highest value: 1,274.4 (11 May)
- Lowest value: 1,046.1 (2 January)

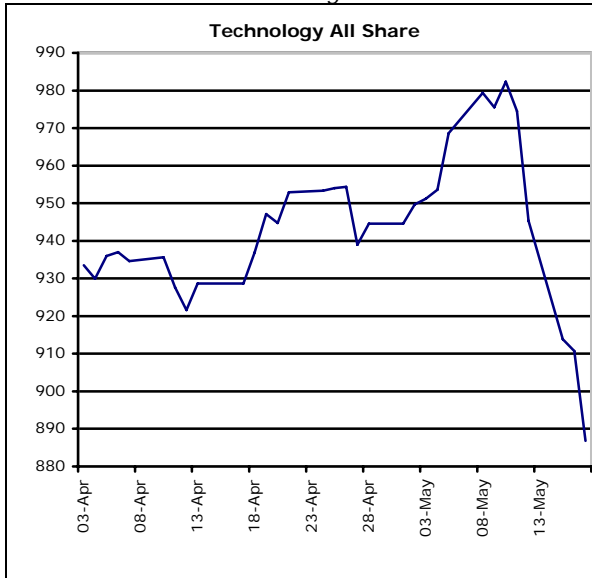
Year 2005

- Closing: 30 December at 1,046.1
- Highest value: 1,166.80 (7 March)
- Lowest value: 944.50 (18 May)

Year 2004

- Closing: 31 December at 1,005.6
- Highest value: 1,005.6 (31 December)
- Lowest value: 837.30 (2 January)

Source: London Stock Exchange



Technology All Share

April 2006 – Mid May 2006

- Highest value: 982.34 (10 May)
- Lowest value: 886.82 (17 May)

Year 2006

- Highest value: 982.34 (10 May)
- Lowest value: 770.58 (2 January)

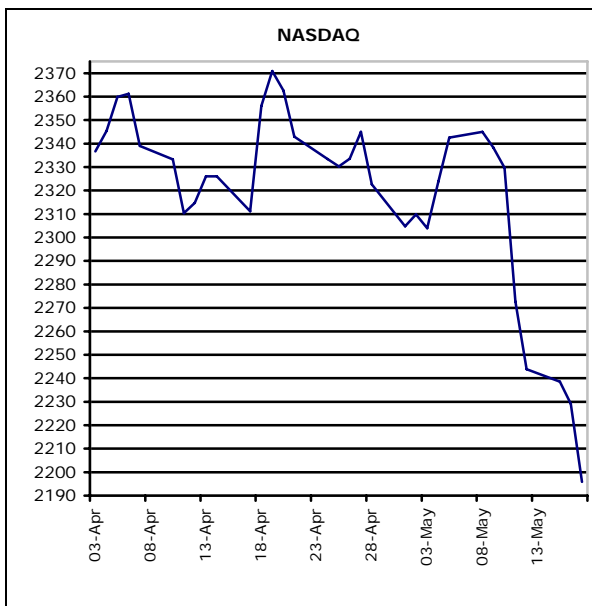
Year 2005

- Closing: 30 December at 765.62
- Highest value: 797.53 (4 October)
- Lowest value: 633.81 (29 April)

Year 2004

- Closing: 31 December at 647.96
- Highest value: 777.06 (8 March)
- Lowest value: 542.23 (12 August)

Source: Deutsche Börse



NASDAQ

April 2006 – Mid May 2006

- Highest value: 2,370.88 (19 April)
- Lowest value: 2,195.8 (17 May)

Year 2006

- Highest value: 2,370.88 (19 April)
- Lowest value: 2,195.8 (17 May)

Year 2005

- Closing: 30 December at 2,205.32
- Highest value: 2,273.37 (2 December)
- Lowest value: 1,904.18 (28 April)

Year 2004

- Closing: 31 December at 2,175.44
- Highest value: 2,178.34 (30 December)
- Lowest value: 1,752.49 (12 August)

Source: NASDAQ

IPO activity

	USA						Europe					
	2004		2005		2006*		2004		2005		2006*	
	Proceeds €m	No. Issues	Proceeds €m	No. Issues	Proceeds €m	No. Issues	Proceeds €m	No. Issues	Proceeds €m	No. Issues	Proceeds €m	No. Issues
Quarter 1	5,572	41	7,896	44	5,875	42	7,042	56	5,483	56	7,776	82
January			1,702	11	1,807	13			93	5	651	13
February			5,214	27	3,367	21			1,925	21	3,461	24
March			980	6	701	8			3,464	30	3,665	45
Quarter 2	8,387	54	6,685	48	7,564	26	10,147	86	12,400	105	12,377	56
April			631	9	2,057	13			3,108	25	6,003	36
May			2,143	12	5,507	13			2,837	26	6,373	20
Quarter 3	10,754	66	8,272	73			4,742	78	9,792	51		
Quarter 4	11,374	79	7,110	55			7,935	98	21,906	96		
Total	36,087	240	29,963	220	13,439	68	29,866	318	49,581	308	20,153	138

* Cut-off date: 17 May 2006

IPO activity is classified by the domicile nation of the issuer's headquarters

Data is continuously updated and is therefore subject to change

Source: Thomson Financial

M&A activity in Europe

	2002		2003		2004		2005		2006*	
	Amt. €bn	No. of deals	Amt. €bn	No. of deals	Amt. €bn	No. of deals	Amt. €bn	No. of deals	Amt. €bn	No. of deals
Telecommunications	35	524	96	470	25	386	101	498	60	183
Finance & Insurance	99	1,053	89	1,003	78	820	111	972	36	359
Industrial Manufacturing	71	1,294	43	1,162	64	1,103	83	1,352	14	508
Chemicals & Pharmaceuticals	39	521	27	464	86	509	44	520	7	201
Utilities	99	297	40	249	24	231	66	273	11	105
Mining	15	164	24	204	24	171	43	293	8	128
Media, Information & Software	31	1,336	22	974	27	1,091	31	1,278	6	459
Food, Textiles & Furniture	34	744	18	767	18	554	37	668	10	283
Leisure & Lodging	20	538	22	450	19	416	29	533	15	185
Real Estate	37	345	35	399	77	588	76	801	30	274
Computers & Electronics	13	373	8	320	10	370	14	386	4	155
Transportation & Logistics	30	376	31	319	17	324	25	408	13	156
Retail Trade	23	445	10	380	27	388	26	455	4	162
Wholesale Trade	10	499	11	413	12	405	16	542	2	165
Construction	8	283	22	211	6	207	6	283	45	138
Professional Services	8	981	10	723	12	893	16	1,074	4	428
Health Care	4	89	2	91	5	113	7	130	2	51
Other	12	351	10	288	12	276	16	361	5	158
Total	587	10,213	522	8,887	542	8,845	749	10,827	276	4,098

* Cut-off date: 17 May 2006

Data is continuously updated and is therefore subject to change

Note: the data methodology has changed as of January 2005 and is presented excluding company carveouts.

Source: Dealogic

Methodology

1. Latest news on emerging technologies for the Information Society

Source: IST Results at www.cordis.lu/ist/results/

2. GDP:

i) **EU Commission**, Directorate General for Economic and Financial Affairs (ECFIN):

Source: http://europa.eu.int/comm/dgs/economy_finance/index_en.htm

The growth rates presented refer to the quarterly percentage change in real GDP. The numbers given in ranges are the GDP growth forecasts estimated for two quarters in advance of the actual figures. The ranges indicate the lowest expected growth rate compared to the highest. The single numbers are the actual growth figures, for the respective quarters, which are again recalculated as new data becomes available. The area referred to is the Euro Zone (EU 12).

ii) **The Economist**: *The Economist poll forecast*

Source: www.economist.com

The Economist poll forecast is a monthly estimate for the GDP growth rate in the Euro Zone for the coming year. To obtain this forecast, 17 banks and financial institutions are questioned on their current growth projections. For the final figure, the arithmetic average of individual projections is calculated.

3. LIBOR:

Source: British Bankers Association (BBA), Home Page: www.bba.org.uk

The data presented is the 12 month Euro LIBOR, measured at spot value.

4. Inflation:

Source: Eurostat

The numbers displayed are the annual consumer price inflation rates published by Eurostat on a monthly basis. The most recent value is an estimate, which is published at the end of the month and incorporates all information available at the time. This figure is restated in the middle of the following month. The data presented measures price changes in the Euro Zone between the current month and the same month in the previous year.

5. Exchange rate:

Source: European Central Bank (ECB)

Bilateral Euro/ US Dollar exchange rate.

6. Stock Markets:

a) FTSE Eurotop 300

Source: www.londonstockexchange.com

b) AIM:

Source: www.londonstockexchange.com

c) Technology All Share:

Source: <http://deutsche-boerse.com>

d) NASDAQ:

Source: www.nasdaq.com

7. IPO activity

Source: Thomson Financial at <http://www.thomson.com/>

IPO data includes the first public offering of a company's common stock. Secondary listings or re-listings on other markets are not considered IPOs. The data is attributed geographically by the domicile nation of the issuer's headquarters, regardless of the target market. European data comprises IPOs of companies domiciled in Europe, including Central and Eastern Europe. All amounts are given in Euros and represent total proceeds raised to the issuing company, including overallotments sold.

8. M&A activity in Europe:

Source: Dealogic at www.dealogic.com

The M&A data accounts for completed deals between January 1999 and the time of publication. Deals that are pending, withdrawn or in which shares have been bought back are excluded. Europe refers to both Western and Eastern Europe. Please note that the Volume data refers to M&As of quoted and unquoted companies. Please also note that the data methodology has changed as of January 2005 and that M&A data is presented excluding company carveouts.

Disclaimer:

The data provided in this Barometer has been collected from different sources. EVCA has taken steps to ensure the reliability of the information presented. However, EVCA cannot guarantee the ultimate accuracy of the data and therefore EVCA does not accept responsibility for any decision made or action taken based on the information provided.

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