February 2002

EUROPEAN BUYOUT MARKET: HISTORY, CURRENT SITUATION AND PERFORMANCE

Summary-Conclusion

An easily explainable boom

The buyout market, which only started to boom in the 1990s, is a relatively recent activity in Europe and now accounts for half of the European private equity market.

From the point of view of corporates, this boom is quite easy to explain : albeit a financial transaction, the management buyout is also a way for salaried employees to become entrepreneurs. This boom is one of the signs that European economies, following the United States, have rediscovered the collective usefulness of the shareholder's function. Furthermore in the 1990s in Europe, the management buyout sector spawned numerous types of jobs including entrepreneurs, fund managers, lenders, lawyers and consultants. Today the management buyout market in Europe accounts for annual investments of about €25 billion, 2,000 employees working in specialised fund management teams and a growing share of mergers and acquisitions activity. The growth potential for the forthcoming decade is still high, founded on the upswing in the continental European market.

538 transactions on our database

The behavioural observation of a sample of 583 management buyout transactions that were executed and exited between 1986 and 1996 and which are held on an in-house database, has led CPR Private Equity to analyse the performance of management buyout and the different components that it is made up of. CPR Private Equity has measured both the overall performance of this theoretical portfolio and the performance of series of annual transactions according to the year in which they were entered into.

34% per year

The gross returns for the year on year transactions series outperform by 18 points on average the returns for investments in listed shares undertaken at the same point in time and over the same period. The overall IRR comes out at 34% per year. The rotation of capital is quick (2.8 year period). The risk impact is limited (9% of invested capital is lost). Multiples for performing transactions range from 1 to 32.

Performance (IRR, multiple, "duration") of a sample of 583 European management buyout transactions executed and exited between 1986 and 1996 out of CPR Private Equity data base aggregated by vintage years

Vintage	IRR	Multiple	"Duration" (in years)
1986	24.5%	1.6	2.1
1987	50.5%	2.1	1.9
1988	49.9%	2.5	2.3
1989	-0.2%	1.0	3.7
1990	22.3%	2.1	3.8
1991	40.4%	3.0	3.2
1992	33.5%	2.8	3.5
1993	53.5%	2.5	2.2
1994	41.3%	2.4	2.5
1995	22.1%	2.0	3.6
1996	35.2%	2.0	2.2
1986/1996	**34.1%**	**2.3**	**2.8**

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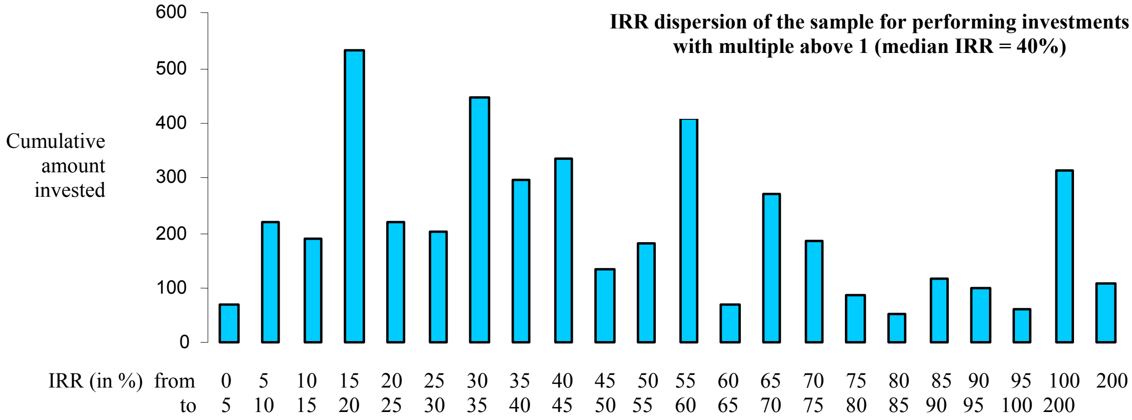
Large variation in the multiples and durations

An examination of the performance criteria (IRR, "duration" and multiples) illuminates the great dispersion within transactions. One transaction in four does not perform (generating a multiple of less than 1). The buyout market is in fact fundamentally inefficient. Only a small number of management teams, who respect the profession's best practices, are able to able to successfully exploit this inefficiency by achieving on some of their transactions the aim of maximising investment multiples, an aim that is common to the whole profession.



A question of talent

The performance of the buyout market will continue to depend on the collective talent of the management teams, tending to transcend the ups and downs in the economic cycle. However an exceptionally upswing can have a positive impact on performance when a speeding up in the growth rate following an investment year has a favourable effect in reducing the period or lifetime of the transactions.

Assertion of private equity as an alternative asset class

From an asset manager's point of view, the European management buyout market, like the venture capital market, has allowed private equity to assert its position as an alternative asset class that is likely to improve the overall efficiency of a portfolio. In terms of returns, volatility and dispersion, the management buyout market contains the original characteristics of private equity : high returns, a decorrelation with listed stock indices, low volatility, and strong dispersion of results between different managers. The management buyout market owes all of this to its track-record, to the volume that it has reached and to the definition of professional industry-specific best practices. In this context the process undertaken by the fund selector aims to reduce the risks that arise out of the variation in returns between different managers which come about because of the dispersion of transactions.