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Editorial – “2001 Vintage Private Equity Investing – Genius or Insanity?”

There are plenty of reasons for uncertainty in today's world. In light of tough conditions on the world's stock markets, a faltering US economy, slashed corporate IT budgets, and a problematic environment for attracting follow-on funding in portfolio companies, not to mention the recent terrorist attacks, things can seem bleak for any investment manager, regardless of asset class. For investors in European private equity the questions are endless, but the focus on one main issue: Timing.

Timing the reopening of exit markets and an improvement in conditions is an imprecise science. Many prefer to wait, focusing on the downgraded valuations of portfolios and unwilling to make further commitments before there is more visibility on prospects and a stabilisation in the economy. However those brave souls who continue to make commitments through 2001 will see their bravery rewarded with exceptional returns. There are three main reasons for this: **Valuations; Quality; and Timing.**

Valuations in the venture capital market have reached ground zero, where the main question is not whether investors can negotiate attractive terms, but whether there is sufficient incentive and upside for entrepreneurs to build sustainable businesses against the background of a soft economy. In venture capital, even if the stock market falls further, it is hard to see how valuations in the private market could follow.

Quality is at a premium. Anyone who is considering setting up a business now is either insane or knows exactly what they are doing. The companies that emerge from this downturn will be the Ciscos and Microsofts of tomorrow, more so than any company launched in the pampered years of 1999 and 2000.

Timing, on a medium term view, could not be better. Entrepreneurs and venture capitalists have probably a couple of years to build lean, robust businesses for eventual exit in more benign times.

So when companies are cheap, of excellent calibre and raised in the toughest conditions our view is that investors should be looking to gain exposure. For limited partners wishing to exploit this market environment we believe first that the opportunities exist to establish relationships with fund management groups that would have been closed, or invitation only, during the heady days of the boom. This is especially true of the US market. Funds that do not have a legacy of 1999 and 2000 investments are also exceptionally well placed. The excesses of those years cannot begin to work themselves out of the market until exit markets reopen, or a significant volume of portfolio businesses fail. In the meantime managers with substantial 1999 and 2000 vintage portfolios will continue to suffer from the gout caused by over-investment.

We believe that 2001 will be remembered as an excellent vintage by those brave few who buck the trend and make commitments. It's not easy to go against the herd, but it's where exceptional returns lie.

Recent European Fund Closures

Fund Name	Manager	Region	Stage	Sector	Target (Emill)	Close (Emill)
BAEPE II	BAEPE	Europe	Growth, Expansion, LBO, Recap	Diverse	590	590
21 invest Industry Fund	21 Invest	Southern Europe	Mid-Market Buyout	Generalist	275	323
Index Ventures II	Index Ventures	Europe	Early Stage VC	Technology, Biotech	326	326
E-Millennium 1	E-Millennium	Europe	Expansion, Later-Stage, Pre-IPO VC	TMT	200	210

News and Developments from European Fundraisers Active in the Market

Fund Name	Manager	Region	Stage	Sector	Target (Em/bn)	Status	Close (Em/bn)
JVPIV	Jerusalem Venture Partners	Israel	Early Stage	TechVC	na	1st	326
MVM International Life Sciences II	MVM Limited	UK, US, Scandi	Early Stage	Life Science VC	118	FA	0
Avlar BioVentures Fund II	Avlar BioVentures	UK	Early Stage	Life Science VC	118	1st	60
NBG Tech Fund	NBG Capital	Greece	Early Stage	TMT VC	80	FA	60
European Digital Infrastructure Fund I	Digital Networks	Europe	Early Stage	TMT VC	75	1st	48
Pall Mall Technology Fund	Pall Mall Partners	UK	Early Stage	Technology VC	50	FA	0
NVM	Northern 3 VCT				39.5	FA	0
STAR 1	Star Capital Partners	UK	Mid-Market	Diverse Buyout	500	1st	272
COREplus Private Equity Partners	WestAM	US, Europe, Asia	General	Fund of Funds	543	1st	196

Status Key: FA - Fund Announced; 1st - 1st Close; 2nd - 2nd Close; 3rd - 3rd Close; Fin - Final Close; P - Pulled

Target Key: na - not available; ns - not set, Includes funds with a target size over E25m

Source: Somerset Capital