THE DANISH MARKET FOR VENTURE CAPITAL AND BUY-OUT (2004)

Vaekstfonden

Vaekstfonden is a state owned financial company. Operating independently in the capital market, we facilitate the supply of venture capital in terms of start-up equity and high-risk loans. Our financing is provided on commercial terms. Furthermore, we invest in private venture funds specialising in specific industry sectors. Our investment strategy extends across a wide range of industries. We invest in companies whose business ventures are innovative with high growth potential. Our vision is to create the best market for innovation finance in Europe.

Our capital base is currently DKK 2,200 million (€ 296 million).

1. INTRODUCTION

Another year has passed in the development of a sustainable Danish environment for venture capital. Even though the investment activity has declined since the peak in 2001 – the Danish market for venture capital has generally been strengthened during the cyclical period from 1998 until today. Danish venture capital investments are thus twice the size in 2003 compared to 1998, while the rest of Europe and USA in 2003 are back at the levels from 1998 after the intervening rise and fall in investment activity caused by the dot-com bubble.

From 2002 to 2003, investment activity by venture capital funds with offices in the Danish market declined from DKK 2.1 billion (€ 272 million) to DKK 1.8 billion (€ 242 million) – a decline of 14%. Investors continued to be hesitant making initial investments in 2003, as more than 2/3 of the total venture capital investments were channelled into existing portfolio companies. Only 31% of this year's investments went to new companies. This also influenced the number of investments. 176 companies got follow-up investments, while only 64 companies received their first round of venture capital in 2003.

The decline in the number of new investments – all other things equal – implies that it has been harder to raise capital for new start-ups in 2003. But a number of the projects, that received capital in 2000 and 2001, did so as a consequence of an exaggerated optimism for the future, while the IT-bobble was at its peak.

Investors are generally more demanding when it comes to business plans and get-to-market strategies than during the dot-com bubble. This means that fewer projects have passed the scrutiny of investors. Correspondingly, the economic downturn has meant that fewer people have taken the jump from being wage earners to starting out on their own as entrepreneurs. For several Venture Capital funds the pipeline of investment projects has thus been reduced. But if tougher demands on the quality of investments means that the survival rate of the companies, who received capital for the first time in 2003, is higher than the corresponding new investments during the bubble it is obviously a step in the right direction.

In this context, it does raise some concern that the size of the average investment declined in 2003 – from DKK 8.0 million (€ 1.08 million) in 2002 to DKK 6.9 million (€ 0.93 million). This implies that companies have a shorter horizon before the next round of funding is needed. And because fundraising is often very time consuming it leaves less effective time for the management to develop the business, when they receive smaller capital infusions at shorter intervals.

On the one hand, the fall in the number of new investments can be an advantage in the longer run as more resources are concentrated on fewer projects, possibly raising the probability of success. On the other hand, it would seem possible, if the likelihood of success were positively correlated with the size of each capital injection. That is also one of the findings in Vaekstfonden's "What creates a success – a profile of high-tech companies" (2004), which finds that successful companies received DKK 9 million (€ 1.21 million), while the companies that went bankrupt received only DKK 0.5 million (€ 0.07 million) at the time of inception.

In 2003, where the total market declined, Life Science companies continued to attract a substantial share of the venture capital invested. Almost 50% of the investments went to companies within biotechnology and medico-health, which was 1 %-point higher than the year before. IT- and telecom companies experienced the opposite development – their share of the investments declining from 38% in 2002 to ¼ in 2003. Technologies which experienced raising market shares were industry and consumer-related services.

While the market for venture capital was characterised by consolidation, 2003 was the year where the Danish buy-out market improved significantly. Despite a smaller market for venture capital in Denmark compared to the leading countries in Europe, Denmark has long had a predominance of venture capital rather than capital for buy-out investments. Measured by investment volumes, venture capital has historically made up ¾ of the total investment volume – while only ¼ was buy-out. In countries like UK, Sweden and Finland the composition of the market is just the opposite with 25-30% venture capital and 70-75% buy-out capital.

The buy-out investors focus on restructuring and development of established companies – often with three-figured million turnover, implies that the demand for capital to single transactions is many times larger compared to venture capital investments. Buy-out investors must thus command greater investment capacity than venture investors. A growth in buy-out investments from DKK 0.7 billion (€ 90 million) in 2002 to DKK 2.7 billion (€ 363 million) in 2003 thus pulls in the direction of creating the same capital distribution between venture capital and buy-out in Denmark as in the leading countries in Europe. But there is still some way to go.

The challenge of raising capital to meet the expected demand for capital is thus still significant for both venture capital and buy-out in Denmark. The investors already have considerable capital resources under management – but the capital demand in the years to come will probably exceed the supply by a good margin. Vaekstfonden's publications "Demand for venture capital in Denmark" and "Business Transfers" (both 2003) forecast that in order to satisfy expected demand up to 2008, the Danish market will need up to DKK 10 billion (€ 1.35 billion) for venture investments and DKK 30 billion (€ 4.03 billion) for buy-out investments.

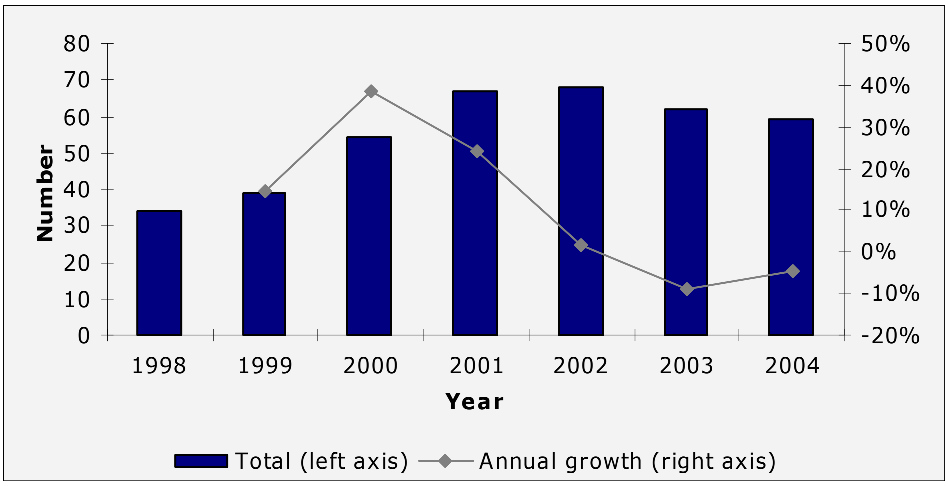
But despite the declining venture capital investments since 2001 and expectations of massive capital demands there is still reason for optimism. In the two first quarters of 2004 the investment activity among venture capital investors has been increasing, see Vaekstfonden's and DVCA's quarterly surveys (www.vf.dk/1551). Moreover, there is widespread optimism among investors indicating they will increase their investments in the coming quarters.

For the optimism to continue and lead to increased capital supply to venture capital and buy-out investors it is however necessary that investors are able to deliver sufficient exits in the years to come in order to realise the levels of returns required to sustain institutional investors interest in allocating funds to venture capital and buy-out investments.

2. The Danish Market for Venture Capital

From 1998 to 2001, the number of active venture capital investors in Denmark more than doubled. In 2002, the number of investors remained steady at 68, but since then the number of investors has declined. By September 2004, the number of investors has declined to 59 (see figure 1). The majority of the investors who left the market in 2003-2004 were CVC-companies.

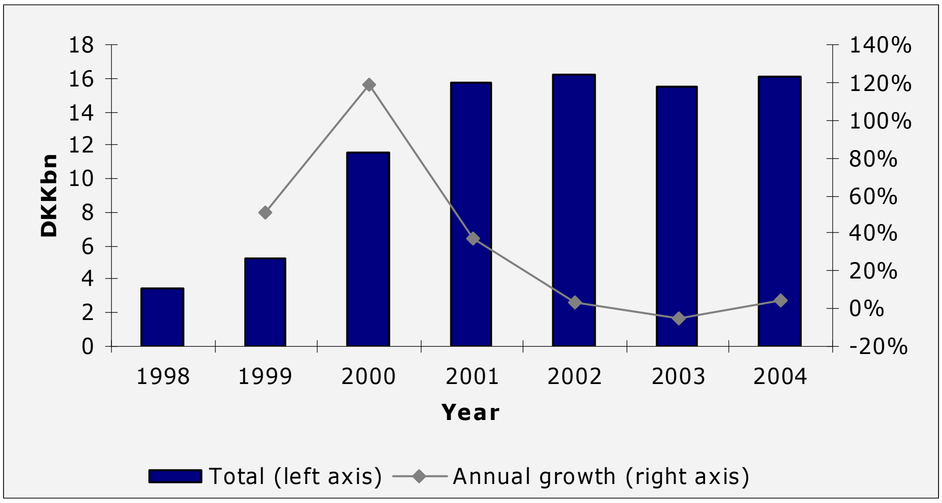
Figure 1. Number of companies in the Danish venture capital market



Source: Vaekstfonden

Despite a decline in the number of investors capital under management has increased from 2003 to 2004. From 1998 to 2002, capital under management more than tripled. In 2003, the amount decreased slightly to DKK 15.4 billion (€ 2.1 billion), whereas in 2004 the capital under management increased to DKK 16.1 billion (€ 2.2 billion), see figure 2.

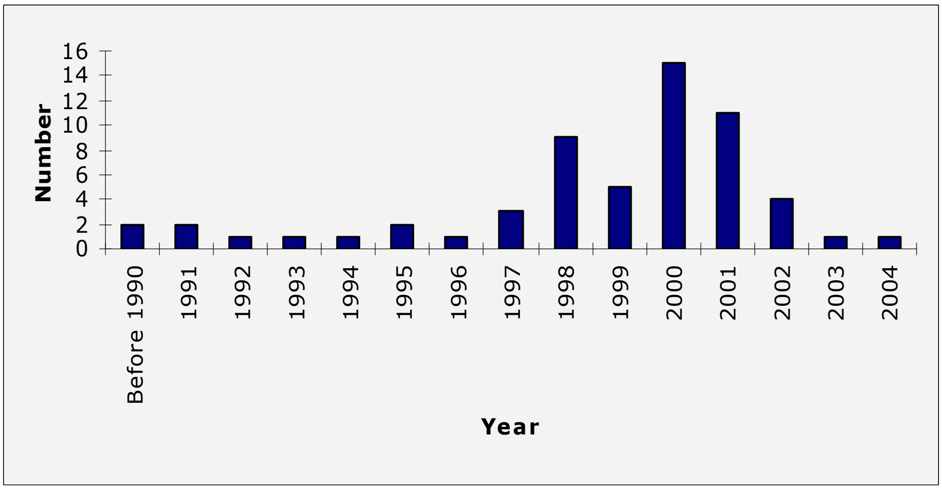
Figure 2. Venture capital under management (DKK billions)



Source: Vaekstfonden

Despite the growing size of the Danish market for venture capital – the market is still fairly young by global standards. Thus more than 50 percent of the investors have been active investors for less than five years (see figure 3).

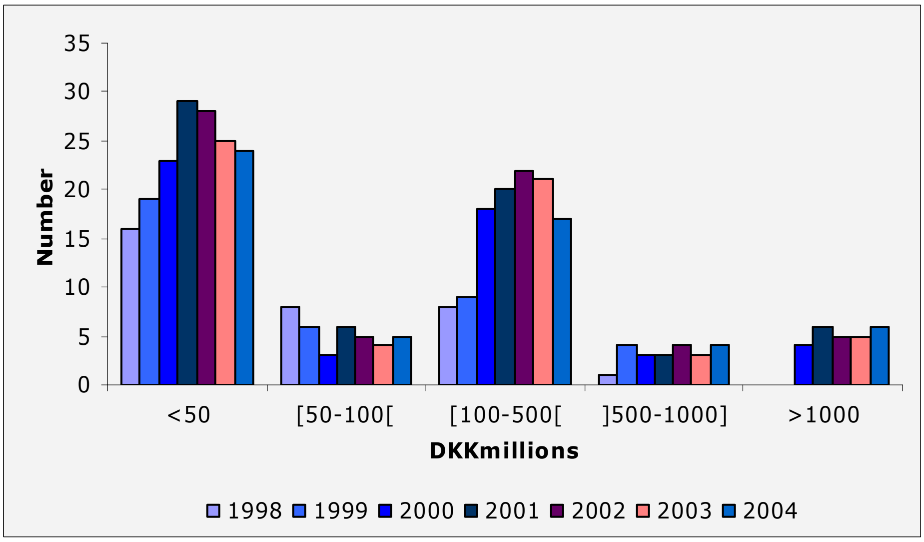
Figure 3. Venture funds by vintage year



Source: Vaekstfonden

The number of smaller funds has declined significantly since 2001. Still, around 40% of the investors have less than DKK 50 million (€ 6.7 million) under management, while only 10 percent have more than DKK 1 billion (€ 134 millions) under management, see figure 4.

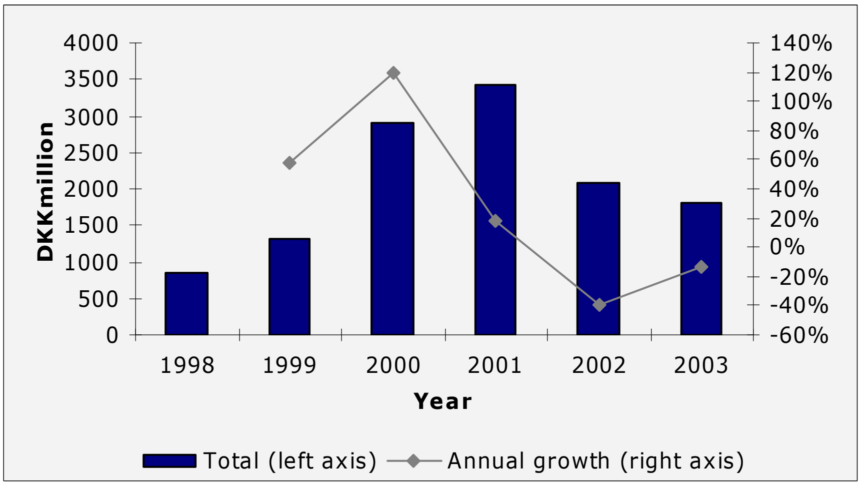
Figure 4. Capital under management per fund



Source: Vaekstfonden

The investment activity continued to decline from 2002 to 2003, partly as a result of the global economic downturn. In 2002 the Danish investors made venture investments totalling DKK 2.1 billion (€ 283 millions), while the corresponding figure was DKK 1.8 billion (€ 242 millions) in 2003 - a decline by only 14%.

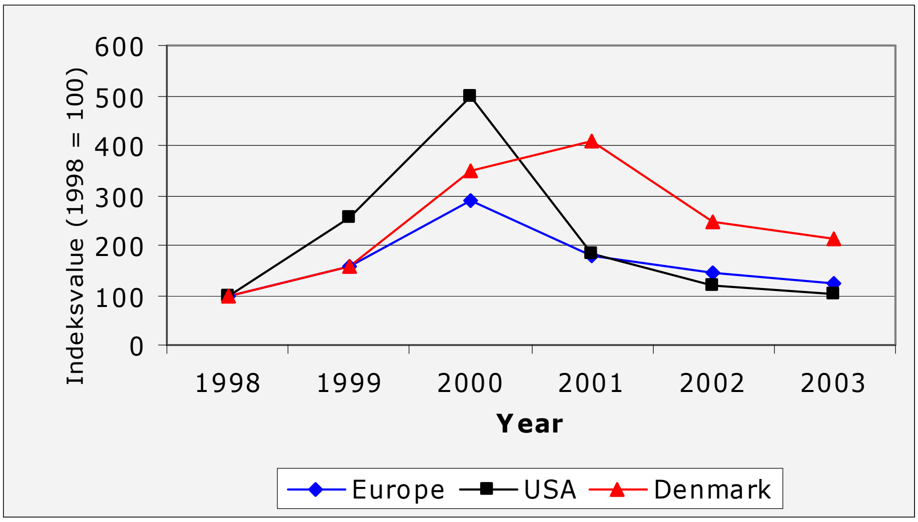
Figure 5. Venture investments (DKK millions)



Source: Vaekstfonden

The market for venture capital in Europe and the USA peaked in 2000, while the Danish venture capital market showed more resilience to the economic downturn from 2000 to 2001 (see figure 6). This was mainly because many new investors had just made their entry into the Danish market.

Figure 6. Venture investments in Denmark, USA and Europe



Source: Vaekstfonden, VentureEconomics, EVCA

In 2002, however Danish investors finally succumbed to the slump in the global economy cutting investments by 40%. From 2002 to 2003 the investment activity continued to decline – by around 15% in both Denmark, the rest of Europe and USA.

Compared to 1998, investments are still up by 150% in Denmark. In Europe, investment volumes have come down 50% from the peak in 2000, while they remain 50% higher than in 1998. In the USA, however, venture capital investments in 2003 had fallen to the same level as in 1998.

Danish investors continued to concentrate on investments already in their portfolio. Therefore, initial investments – as a share of the total investments remained at 31% in 2003 (see table 1).

Table 1. Venture capital investments round (amounts)

	1998	1999	2000	2001	2002	2003
Initial investments	46%	39%	67%	62%	31%	31%
Follow-on investments	54%	61%	33%	38%	69%	69%
Total	100%	100%	100%	100%	100%	100%

Source: Vaekstfonden

This also influenced the number of investments. 176 companies got follow-up investments, while only 64 companies received venture capital for the first time in 2003, see table 2. The number of initial investments has thus decreased significantly since the IT-bubble in 2000-2001 where more than 160 companies annually received venture capital for the first time – a decline by more than 60%.

Table 2. Venture capital investments by round (DKK millions)

	1998	1999	2000	2001	2002	2003
Number						
Initial investments	46	71	163	175	79	64
Follow-on investment	81	105	79	141	159	176
Total	**127**	**176**	**242**	**316**	**238**	**240**
Average amount per investment (DKK millions)						
Initial investments	6,5	6,1	11,6	11,6	6,6	5,8
Follow-on investment	5,6	6,0	10,1	8,2	8,7	7,3
Total	**5,9**	**6,0**	**11,1**	**10,1**	**8,0**	**6,9**

Source: Vaekstfonden

The average size of an investment declined further in 2003 – from DKK 8.0 million (€ 1.08 million) in 2002 to DKK 6.9 million (€ 0.93 million). During the peak in 2000-2001, a company on average received venture capital of DKK 12 million (€ 1.62 million), the first time they received venture finance. In 2003, the amount had declined to DKK 5.8 million (€ 0.78 million) – a decline by 50%.

As a consequence of the decline in the overall investment activity, the amount of capital invested in companies in the seed-stage has decreased from DKK 515 million (€ 69 millions) in 2002 to DKK 349 million (€ 47 millions) in 2003 (see table 3).

Table 3 Venture capital investments by stage (DKK millions)

	1998	1999	2000	2001	2002	2003
Seed	**114**	**114**	**154**	**437**	**515**	**349**
	13,6%	8,6%	5,3%	12,8%	24,7%	19,4%
Start-up	**115**	**142**	**1.121**	**1.395**	**562**	**673**
	13,8%	10,7%	38,6%	40,7%	27,0%	37,4%
Later stages	**608**	**1.067**	**1.632**	**1.593**	**1.006**	**774**
	72,6%	80,7%	56,1%	46,5%	48,3%	43,1%
Venture investments	**837**	**1.322**	**2.906**	**3.425**	**2.083**	**1.796**
	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%

Source: Vaekstfonden

Meanwhile, start-up investments increased by 20%, while expansion capital investments in companies fell by 23% from 2002 to 2003.

In 2003, Life Science companies still attracted close to 50% of investments made by Danish VCs (see table 4). However the share of investments in ICT companies dropped significantly from 38% in 2002 to only 25% in 2003.

Table 4. Venture capital investments by sector (amounts)

Industry Group		1998	1999	2000	2001	2002	2003
Life Sciences	Biotechnology	4%	3%	3%	7%	14%	17%
	Medical/Health related	20%	22%	19%	37%	34%	32%
Life Sciences Total		24%	25%	22%	43%	48%	49%
ICT	Computer Related	24%	20%	45%	22%	24%	12%
	Communications	9%	8%	7%	11%	11%	9%
	Other Electronics Related	9%	5%	2%	4%	3%	4%
Information and Communication Technology - Total		42%	32%	55%	38%	38%	25%
Products and Services	Industrial Products and Services	11%	13%	4%	6%	4%	10%
	Industrial Automation	1%	1%	1%	1%	1%	1%
	Consumer Related	8%	9%	8%	5%	2%	6%
	Other Services	2%	5%	2%	2%	0%	2%
Products and Services - Total		22%	27%	15%	13%	8%	19%
Other	Other Manufactoring	5%	9%	4%	2%	0%	0%
	Agriculture	1%	0%	0%	0%	1%	0%
	Energy	1%	2%	0%	0%	1%	1%
	Other Companies	6%	5%	4%	3%	5%	5%
Other - Total		13%	16%	8%	5%	7%	7%
Total		**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Vaekstfonden

Meanwhile, investments in other industries increased from 7% in 2002 to 26% in 2003 partly driven by a few large investments in companies within the traditional manufacturing industries.

The trend toward greater internationalisation came to a halt in 2002 – and continued in 2003. While 32% of the investments in 2001 were made in foreign companies, the corresponding figure for 2002 and 2003 were 26% and 20% respectively, see table 5.

Table 5. Geographical distribution of venture investments (amounts)

	1998	1999	2000	2001	2002	2003
Foreign	11%	13%	25%	32%	26%	20%
Denmark	89%	87%	75%	68%	74%	80%
Total	100%	100%	100%	100%	100%	100%

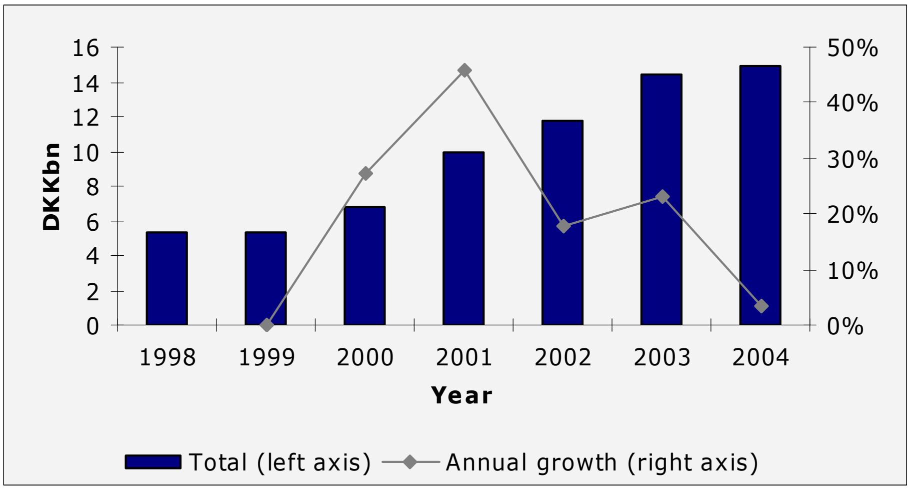
Source: Vaekstfonden

However, the share of capital invested in foreign companies has remained fairly high compared to 1998 and 1999. By co-investing with foreign VC funds, Danish VCs gain valuable access to networks of investors in foreign markets. Moreover, they build up operating experience in foreign markets, which strengthens their capacity to help Danish portfolio companies expand into the same markets.

3. The Danish Market for Buy-out

The market for buy-out investments in Denmark has increased since 1999, but the pace has slowed down. Thus from 2003 to 2004, capital under management increased by less than 5 percent, to around DKK 15 billion (€ 2 billion) (see figure 7).

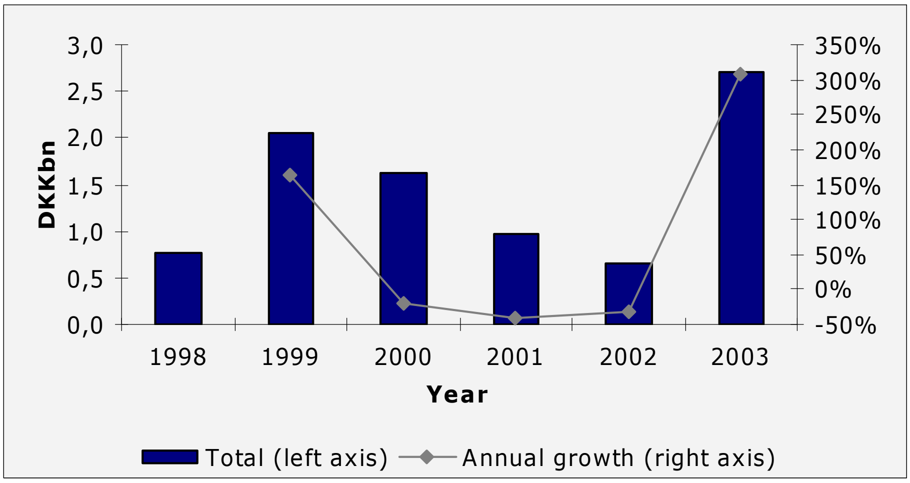
Figure 7. Private Equity under management (DKK billions)



Source: Vaekstfonden

Moreover, the buy-out investment activity has increased significantly from 2002 to 2003 after four years of decline. From 2002 to 2003, the investment activity thus increased from DKK 700 million (€ 95 millions) to DKK 2.7 billion (€ 363 millions) – an increase by more than 300 percent (see figure 8).

Figure 8. Private Equity investments (DKK billions)



Source: Vaekstfonden

The level of buy-out investment in 2003 is thus higher than the corresponding investment volume in 1999.

APPENDIX A – INVESTORS

Venture funds

Evergreen funds

AgroInvest
Dansk Erhvervsinvestering
Dansk Erhvervsudvikling
Dansk Kapitalanlæg Aktieselskab
DICO
Erhvervsinvest Nord
First Investment Partner
GAIA Technologies
Generationsskifte & Vækst
Industri Udvikling
InnoVentures
Invest Miljø
Mezzanin Kapital
Midtjysk Udviklingsselskab
Miljøudvikling
NOVI
Olicom
Storstrøms Regionale Udviklingsselskab
Udviklingsselskabet ARGO
Vækstfonden
Øko-Invest

Limited funds

3i Nordic
BI Bio Venture
BI New Energy Solutions
BI IT Venture
Bridge Venture
Dansk Innovationsinvestering
Incuba Ventures
InnFond
IVS
Nordic Biotech
Nordic Venture Partners
NorthZone
Merlin Biosciences
SLS Venture
Syddansk Kapital
Øresund Healthcare

CVC-companies

Danfoss Innovation
Danisco Venture
Leo Incubator
NOVO A/S
NOVO Nordisk Biotek Fund

Incubators

Private incubators
CAT Seed
Comlex
ComTech Invest
DTU-Invest
Incuba (Tidl. Udviklingsparken)
Oryx
PreVenture
Symbion Capital I

Public incubators
CAT-Symbion Innovation
DTU Innovation
HIH Development
NOVI Innovation
Syddansk Innovation
Teknologisk Innovation
Østjysk Innovation

Buy-out funds

3i Nordic
Axcel Industriinvestor A/S
Capman
CVC Capital Partners Denmark
Dania Capital
Erhvervsinvest
EQT Partners A/S
FIH
ITH Industri Invest A/S
Nordic Capital
Polaris Private Equity A/S
Procuritas Partners

CONTACT INFORMATION

For further information please contact:

DANISH INVESTMENT FUND
STRANDVEJEN 104 A
DK-2900 HELLERUP

Homepage: www.vf.dk

Rolf Kjærgaard

Head of Economic Analysis and Development
TEL DIR: +45 3529 8694
E-mail: rk@vf.dk

Jacob Nordstrøm Borup

Analyst
TEL DIR: +45 3529 8638
E-mail: jbo@vf.dk