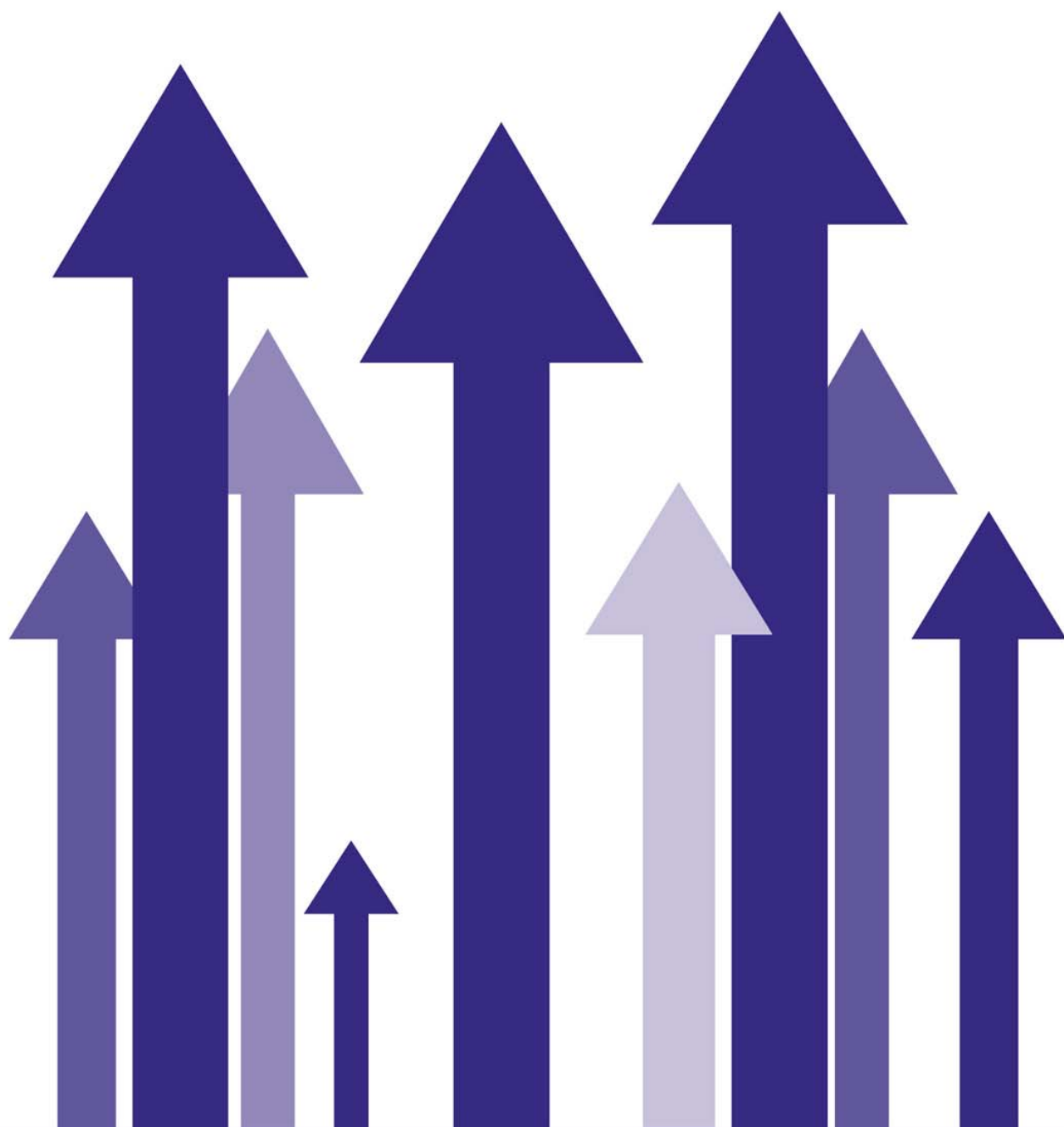


A business confidence survey amongst
3i-backed companies across Europe
Number 26, Quarter 4 2005



The European economy has been faced by a number of challenges in 2005, such as the impact of the escalating price of oil, coupled with further uncertainty around the European Constitution and the strengthening of the USD to the Euro. However in Q4, European countries are showing remarkable resilience and signs of possible recovery. After GDP dropped to a low of 1.2%, it is predicted to rise to 1.5% in Q4. Sources suggest that increased exports and lower interest rates will help to sustain the recovery into 2006 and possibly 2007.

Executive Summary

The downturn in economic confidence during Q3 2005 as reported by the 3i European Enterprise Barometer now shows signs of stabilising, however many 3i-backed companies see a mixed picture ahead.

- **Initial signs of resurgent levels of optimism in Europe**
- **The environment for starting new business in Europe is perceived to be improving**
- **3i-backed companies are innovators**

The European Enterprise barometer provides a quarterly measure of business confidence among 3i-backed companies in the UK, France, Germany, Italy, Spain and the Nordic Region. Since its conception in 1988, the Index produced from the Barometer has tended to follow a similar pattern to the GDP growth rate of the European Union and provides a useful insight into the political and economic climate in each market. It also shows the outlook for turnover, investment and profitability among 3i-backed companies in the months ahead. For this quarter we ran a special section on product innovation, results from 3i-backed companies show a high level of innovation driving their business.

The downturn in economic optimism exhibited in Q3 2005 has been confirmed in Q4. However, the latest quarters European Enterprise Barometer shows that the current economic circumstances are slightly more favourable than they were in the previous quarter, perhaps an initial sign of recovery.

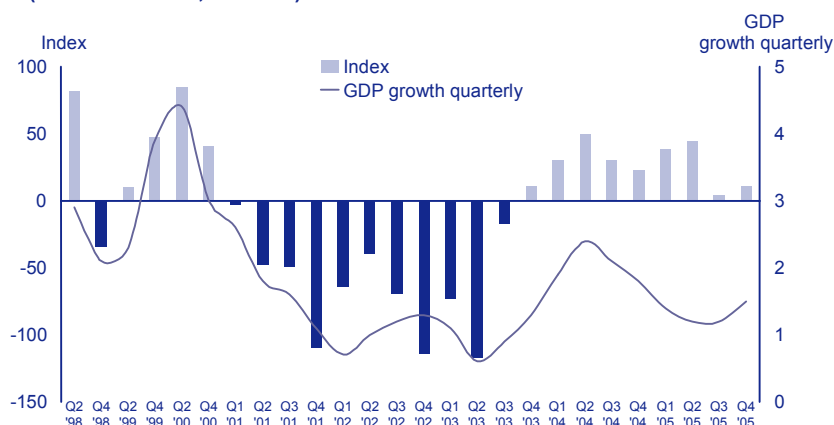
The current Q4 2005 European Index score is +11, this is considerably down on the same period last year (Q4 2004 achieved an Index score of +23). However the current Q4 2005 climate compares favourably with Q3 European Enterprise Barometer Index score (+4). This upturn in economic confidence is reflected in the improving levels of quarterly GDP growth in the Europe. (see Chart 1)

"A more positive climate, after a bad start to the first half of the year"

3i-backed company, France

These sentiments of revival are reinforced by La Caixa: latest indicators suggest that in the April-June period the euro area economy may have hit bottom while beginning a slight upward move in the third quarter.

Chart 1: 3i European Barometer Index*, historical series (weighted by GDP) compared with EU15 real GDP annual growth rate for equivalent quarter (source: Eurostat, La Caixa)



The Nordic countries (+62) and Germany (+61) still hold the highest Index scores, furthermore both show substantial increases in levels of confidence in the latest survey. Italy (-45) and the UK (-29) have the lowest Index scores of all the countries in the survey, however both countries show a considerable improvement from Q3. Spain and France are the only countries to exhibit a downturn in optimism, Spain's Index scores fell from +28 in Q3 to +12 in Q4, with France falling from +16 to +10. (see Chart 2).

"The increased use of raw materials, mainly energy and especially natural gas, through the increases of the price of crude have affected business development, mainly to the level of production for 2006."

3i-backed company, Spain

The climate for growth by acquisition is perceived to be less favourable, however pessimism regarding the establishment of new business has lessened.

3i-backed companies across Europe, are less pessimistic about starting up a new business. On balance, Barometer respondents gave starting new business a -14 score, however this is a considerable improvement from last quarter (-21). At the European level, the balance scores for expanding existing activities and growth by acquisition are consistent with the last quarter (see Chart 3).

"Our situation has been greatly improved through some highly skilled individuals making a real difference, rather than through an upturn in the market. We are very upbeat about the future."

3i-backed company, UK

Overall, 3i-backed companies maintain a positive outlook regarding their own position, however expectations regarding levels of profitability, turnover, investment and employment continue to decline.

The climate for investment is perceived to have deteriorated towards the end of 2005 to the current level of +3, the lowest result since Q1 2004.

Last quarter suffered a downturn in companies expecting to increase their labour force and turnover, this has fallen further amongst 3i-backed companies in the last quarter, now down to one in three (see Chart 4).

Chart 2: 3i European Barometer Index, by country

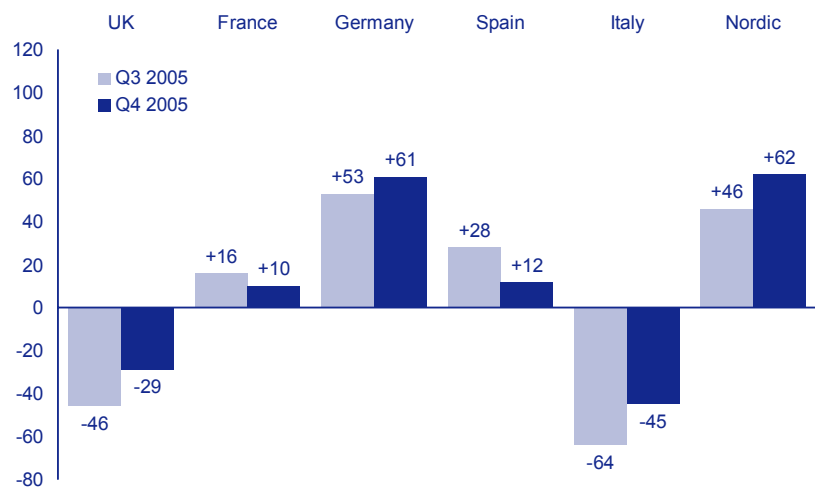


Chart 3: Components of Barometer Index – balance of all European respondents (weighted by GDP) considering business and political climate more favourable to:

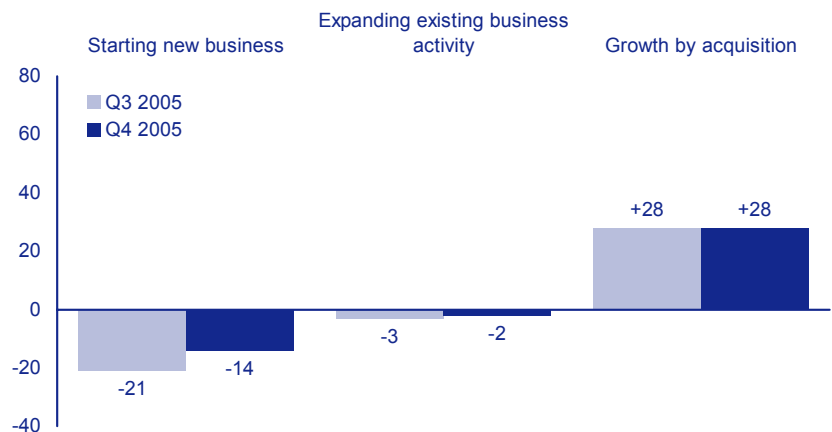
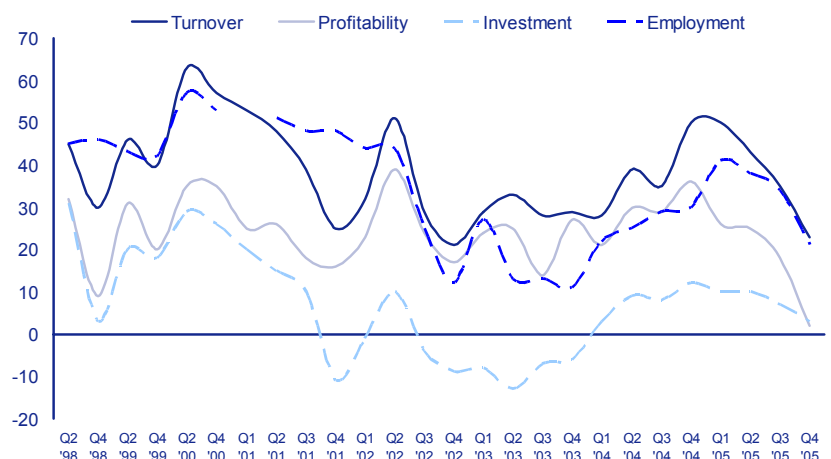


Chart 4: Balance of all European respondents (weighted by GDP) expecting an increase over current quarter in:



The results of our questions on innovation this quarter suggest that companies are seeking to maximise their opportunities to improve their position through product and service improvements.

Any type of product improvement is likely to attract a premium and more than half the 3i backed companies who participated in this quarter's research tell us they have been able to charge premiums of at least 10% following the launch of new ideas. Product development can also result in an organisation gaining a position as market leader...

"This product field meets the current need framework...and within a short period of time we had a gained a leading position in the world wide market"

Germany, 3i backed company

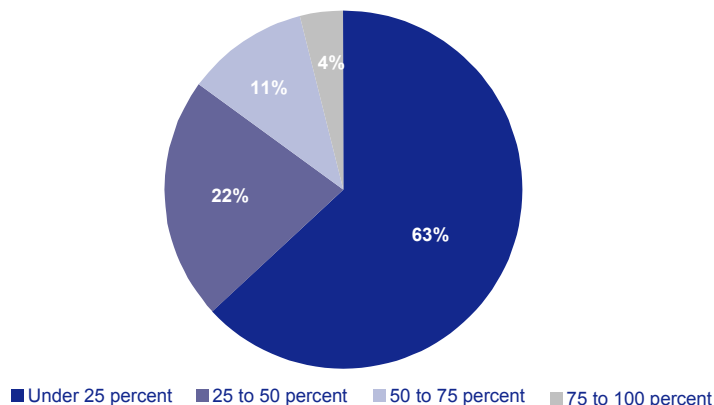
Innovation is largely driven from within 3i backed companies, as opposed to customers or suppliers although this does vary from country to country. France has the highest level of internal product innovation (76%), whilst in Spain 3i companies are more strongly influenced by their customers (40% of Spanish companies say customers are driving improvements).

Given that the majority of firms estimate that at least 25% of current sales are driven by new or improved product offerings, staying one step ahead of the competition, anticipating customer needs and driving change clearly brings dividends!

"The introduction of a new women's range...it was highly profitable the first year of introduction and has maintained high growth. It is already 20% of our total turnover."

Nordic, 3i backed company

Chart 5: Proportion of current sales that are driven by new oimproved product offerings



United Kingdom

Business confidence in the UK remains fragile; concerns about fuel prices continue to dampen optimism.

The Index in the UK and business confidence reached a high point in the early part of 2004. However, this recovery was fairly short lived, at the end of 2004 confidence fell dramatically and in Q3 2005 it reached a low point not seen for two years (-46 Index score). Quarter 4 shows slight signs of a recovery in the UK market, with improving levels of optimism (Index score -29). (See Chart 5).

“Climate very uncertain due to oil price increases and the roll on impact on input prices. Difficulty in recovering cost increases due to competitive nature of our sector.”

3i-backed company, UK

Latest results from the 3i European Enterprise Barometer shows on balance, an increasing optimism amongst UK based 3i-backed companies about the general business and political climate for growth by acquisition. The outlook has risen from +1 in Q3 2005 to the current level of +16. That said, the UK does achieve the lowest score on this measure amongst the countries surveyed. Furthermore, compared to their European counterparts, respondents in the UK are one of the most pessimistic regarding the climate for starting a new business, only exceeded by Italy. On balance the UK has shown a small improvement in favourability for expansion of the existing business but the balance outlook remains pessimistic (see Chart 6).

Expectations regarding profitability and investment have improved from Q3, the lowest point in the UK since the survey began in 1988. Furthermore, latest results show that the balance of 3i-backed companies expecting an increase in turnover over the coming quarter has also risen (up to +28). This improved outlook extends to expectations regarding employment over the coming year, also up on last quarter (+14 vs +10). (See Chart 7).

“Tough-recession in place, we need an interest rate reduction to stimulate economy.”

3i-backed company, UK

Chart 6: UK Barometer Index



Chart 7: Components of Barometer Index – balance of all UK respondents (weighted by GDP) considering business and political climate more favourable to:

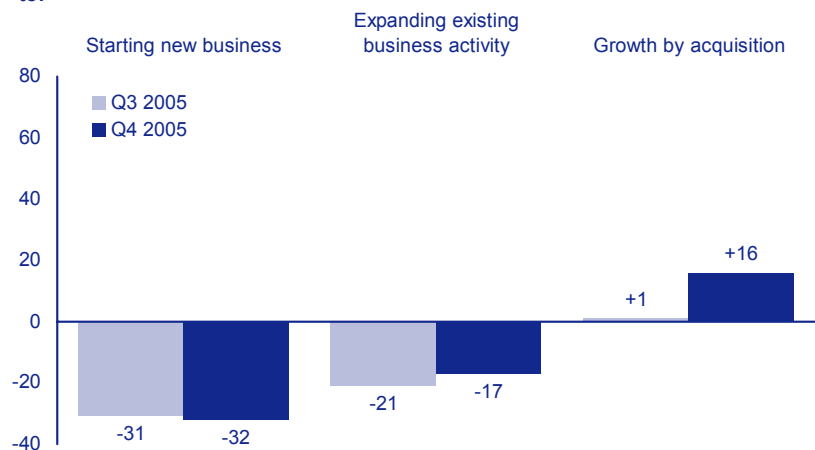
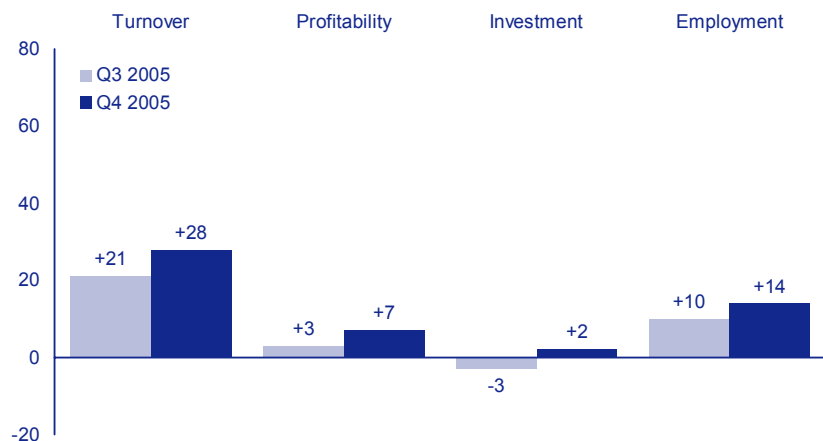


Chart 8: Balance of all UK respondents (weighted by GDP) expecting an increase over current quarter in:



Germany

3i-backed companies in Germany are some of the most optimistic in Europe regarding their economic confidence.

The Die Weltwirtschaft predicts a cyclical recovery period in Germany: "Production growth is likely to accelerate somewhat at the end of the year. Impulses will mainly come from exports. Especially exports to the rest of the euro area will accelerate markedly. Domestic demand, in contrast, is likely to contract. In particular, we expect private consumption growth to be dampened by the sharp rise in world market prices for oil and oil products."

Although the German index is down from Q1 this year, confidence is showing signs of recovery after the slump in Q3 this year. The outlook amongst 3i-backed companies in Germany is the second most positive in Europe. The levels of optimism are primarily driven by high on balance scores for expanding existing business activities (+29) and growth by acquisition (+29). Optimism regarding the business and political climate for starting new business has also improved, now up to +11. (see Chart 9).

Despite the overall positive outlook regarding the local economy, 3i-backed companies, on balance, remain cautious about their own fortunes this quarter. German companies in Q4 predict on balance, the second lowest level of turnover and profitability in the history of the European Enterprise Barometer. In comparison, 3i-backed companies in Germany are relatively positive about employment levels and opportunities for investment over the coming year. (see Chart 10).

"With strong foreign business (export), the domestic market will easily improve, however still facing further price sensitivity. However, certain markets will need a clear stimulation."

3i-backed company, Germany

Chart 9: Germany Barometer Index

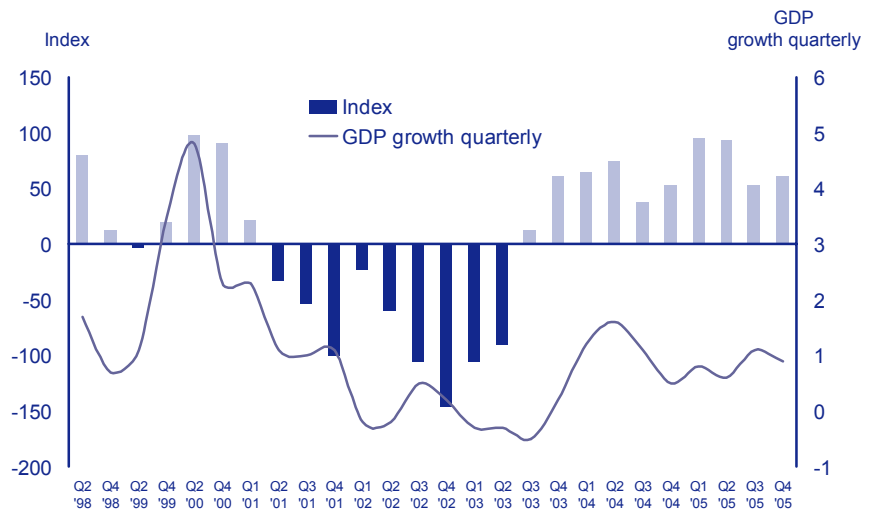


Chart 10: Components of Barometer Index – balance of all German respondents (weighted by GDP) considering business and political climate more favourable to:

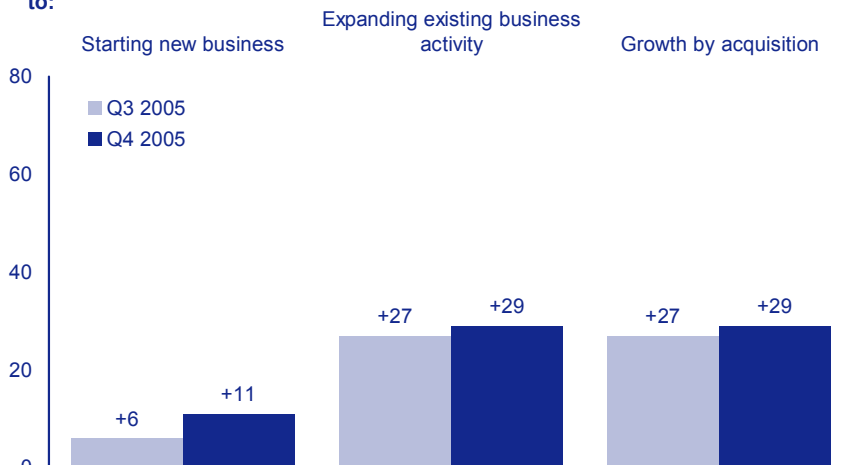
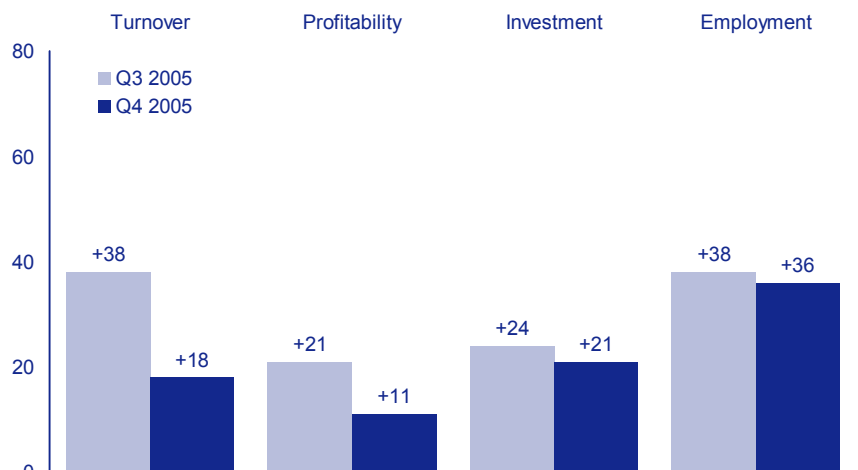


Chart 11: Balance of all German respondents (weighted by GDP) expecting an increase over current quarter in:



Nordic Region

Growing levels of economic confidence amongst 3i-backed companies in the Nordic region, the most optimistic in Europe

Despite escalating fuel prices companies in the Nordic region remain positive, Nordea Economic Outlook: "After this spring's array of bad news and uncertainty about economic trends, the outlook in Sweden has brightened."

3i-backed companies in the Nordic region show an increased confidence regarding the business and political climate, and are currently the most optimistic in Europe with a score of +62 (see Appendix: Barometer Index).

The latest results from Q4 suggest that on balance the Nordic market remains ready for growth by acquisition and has greater opportunities for starting up of new business (the highest in Europe). However, the outlook for expanding existing business activities, although still positive, is less promising than in the last quarter (down from +42 to +28) (see Chart 12).

The Nordic countries are the most optimistic in Europe regarding predicted levels of turnover. Expectations for investment growth, although still comparatively high, are on balance down from the Q3 level. Confidence is growing regarding future profitability and employment levels. (see Chart 13).

The downturn in the climate for investment as identified in the European Enterprise Barometer is confirmed by the Research Institute of the Finnish Economy: "Machinery and equipment, including transport equipment, investment plunged by 14 percent in the first quarter of this year." The Research Institute also confirms that the Barometer's indications of growing confidence and improving economic conditions in the Nordic region: "Both net exports and domestic demand will contribute positively to growth."

Chart 12: Nordic Barometer Index



Chart 13: Components of Barometer Index – balance of all Nordic respondents (weighted by GDP) considering business and political climate more favourable to:

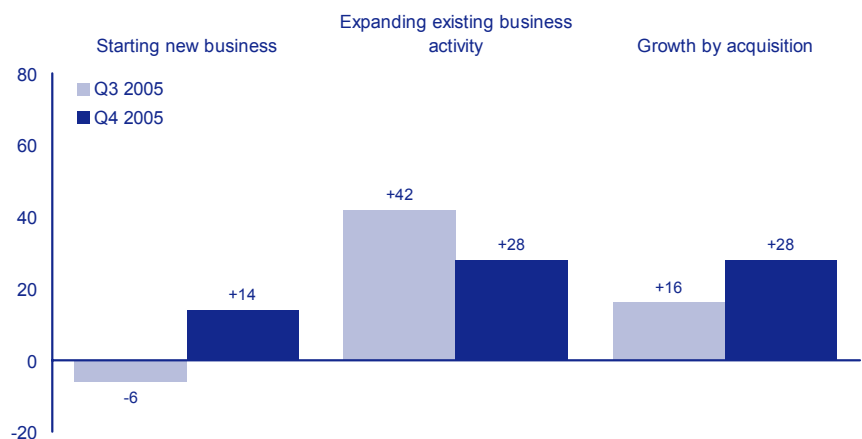
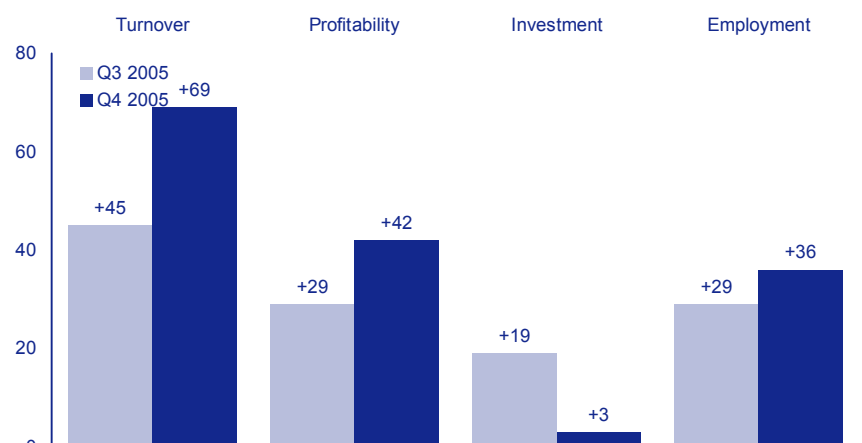


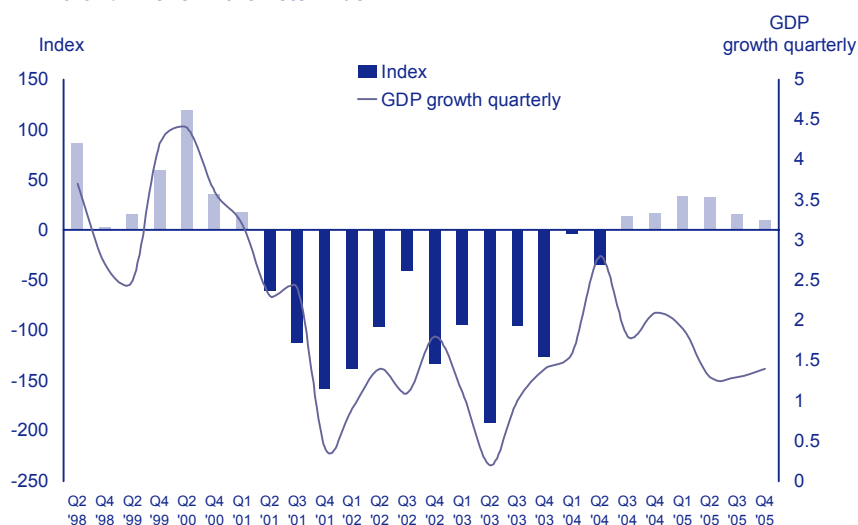
Chart 14: Balance of all Nordic respondents (weighted by GDP) expecting an increase over current quarter in:



France, Spain and Italy

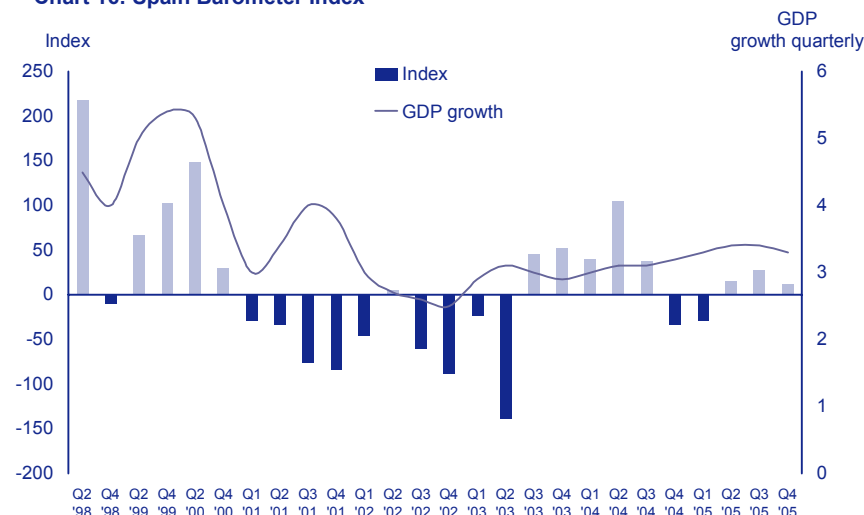
The downturn in French economic confidence reported by the European Enterprise Barometer since Q2 2005 has continued into Q4. This growing pessimism tracks the trend for GDP. Although the political and business environment remains favourable for growth by acquisition in France, a decline in optimism for this area (down from +64 last quarter to +45), has been the main driver for the national downturn in confidence. Compared to other European countries, 3i-backed companies in France have the most pessimistic outlook for future levels of turnover, profitability and investment. Furthermore, employee levels although on balance positive (+11) are the second lowest in Europe behind Italy (see Chart 14).

Chart 15: French Barometer Index



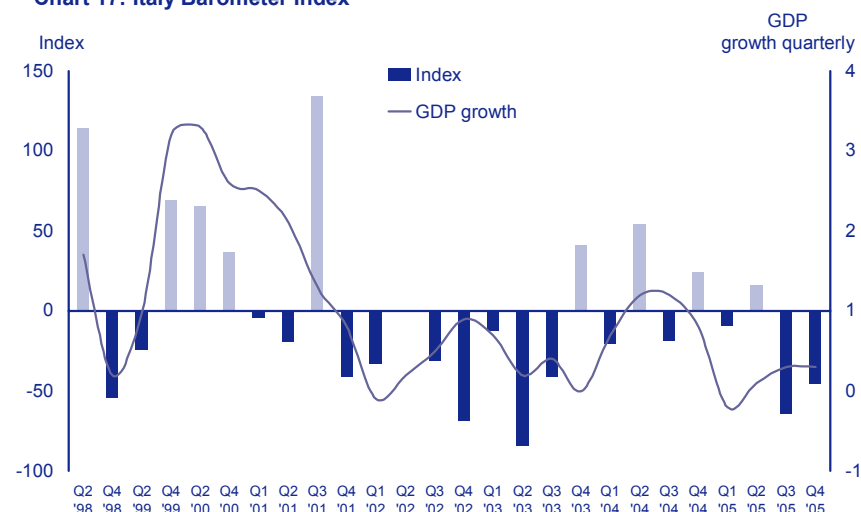
The increase we saw in the Q3 2005 level of economic confidence has not been sustained amongst Spanish 3i-backed companies during Q4. There has been a small downturn in outlook regarding the climate for starting new businesses, expanding existing activities and growth by acquisition. However, on balance, Spanish companies compared to their European counterparts have the most optimistic outlook for their own future profitability, investment and employment levels. Furthermore expectations for turnover levels are the second highest in Europe (+64) (see Chart 15).

Chart 16: Spain Barometer Index



Economic confidence in Italy has become increasingly pessimistic towards the end of 2005. The latest results indicate that the outlook in Italy (-45) is now the most pessimistic in Europe. On balance, the business and political climate for starting a new business or expanding existing holdings is considered to be the least favourable in Europe. However, similar to other European countries covered in the scope of European Enterprise Barometer, the outlook for 'growth by acquisition' is the area where businesses are more optimistic. The Q4 index sees greater optimism for predicted turnover (+20), however Italy has the lowest level of optimism for future employment levels in Europe (-11) (see Chart 16).

Chart 17: Italy Barometer Index



Innovation and changes to product offering

A considerable majority of the companies surveyed in the European Economic Barometer attribute a quarter of their sales to new products (63%). This proportion is highest in the UK and France (69% and 67% respectively) and lowest in Germany 48% (see Chart 17).

Most (over half of 3i-backed companies) charge a premium of between 10% and 20% on their new products. Spain and Italy are the most likely to charge this level of premium on new products (around 70% of companies surveyed), whilst in the UK, over two in five businesses surveyed can only charge a premium of up to 10% (see Chart 18).

Results from the latest quarter show that 3i-backed companies are the driving force behind innovation. Two thirds of product innovation originates from within their own company. France has the highest level of internal product innovation (76%), whilst Spain has the highest proportion of customer innovation (40%) (see Chart 18).

Respondents to the Barometer reported a wide range of innovation:

“Development of a new range using digital technology giving a reduction in manufactured cost of 70% against the previous design. The major customer benefits are: better data quality, much smaller, lighter and easier to deploy, thereby reducing equipment mobilisation costs and greater flexibility in the use of the equipment.”

3i-backed company, UK

“New generation of coating allowing a reduction in the temperature for coating from 130°C to 80°C.... Launching 4th quarter 2005, potential +30% improvement on disc activity against competitors.”

3i-backed company, France

Chart 18: Proportion of current sales that are driven by new or improved product offerings

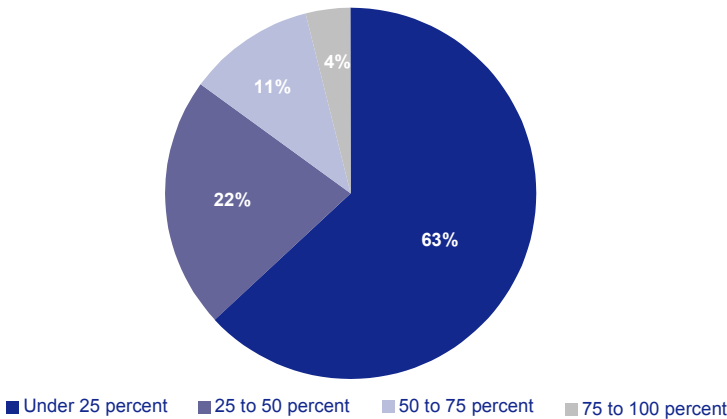


Chart 19: Percentage extra charge through new product offering

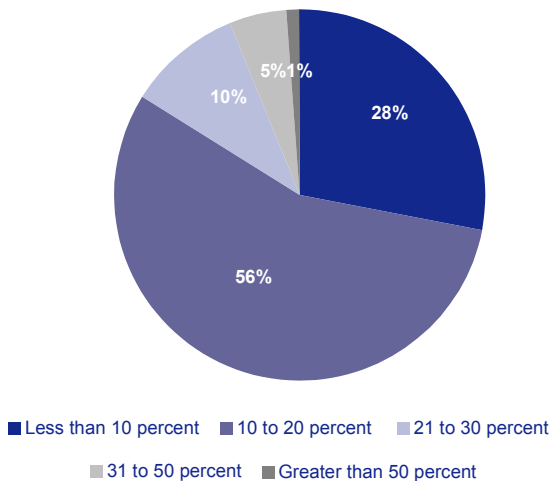
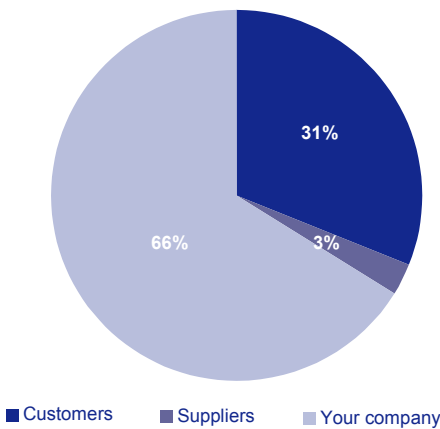


Chart 20: Drivers of product innovation



Appendix

3i offices in the UK, France, Germany, Italy, Denmark and Sweden supplied lists of names of contacts, generally managing directors, in companies in which they had made investments.

Questionnaires were e-mailed in the relevant languages from 30th September 2005. By 20th October 239 completed questionnaires had been returned.

A summary statistic, the 'balance' is used to report the answers to most questions. For a question where the options are 'up', 'same' and 'down', the balance is the percentage reporting 'up', minus the percentage reporting 'down'.

Overall figures have been weighted by national CDP in each of the countries (responses from Denmark, Finland and Sweden are grouped together and treated as a 'Nordic' region).

3i-backed companies in Europe taking part are split fairly evenly between those with under and those with over 100 employees. More 3i-backed companies in Germany than elsewhere have fewer than 100 employees. More of those in Spain than elsewhere employ over 250 people.

The small sample sizes for some aspects of the analysis, particularly the country results for Italy and France, should be borne in mind when assessing the results.

Barometer Index

	Weighted	UK	France	Germany	Spain	Italy	Nordic
Q2 98	81	-6	86	79	218	114	
Q4 98	-34	-133	3	12	-10	-54	
Q2 99	10	26	16	-3	67	-24	
Q4 99	47	38	59	19	102	69	
Q2 00	84	25	120	98	148	65	
Q4 00	40	-17	35	91	30	37	
Q1 01	-3	-41	18	21	-29	-4	
Q2 01	-48	-86	-60	-33	-34	-19	
Q3 01	-49	-113	-112	-53	-76	134	
Q4 01	-109	-139	-158	-100	-83	-41	
Q1 02	-64	-82	-138	-23	-46	-33	
Q2 02	-39	-7	-96	-60	6		
Q3 02	-69	-81	-40	-108	-60	-31	
Q4 02	-114	-102	-133	-146	-88	-69	
Q1 03	-73	-107	-94	-105	-24	-12	7
Q2 03	-117	-128	-192	-91	-139	-84	-37
Q3 03	-17	-14	-95	12	46	-41	45
Q4 03	11	8	-126	61	52	41	74
Q1 04	30	32	-3	64	40	-20	86
Q2 04	49	53	-35	74	105	54	95
Q3 04	30	44	13	38	38	-18	100
Q4 04	23	-10	17	52	-34	24	95
Q1 05	38	6	34	95	-28	-9	110
Q2 05	44	2	33	93	16	16	101
Q3 05	4	-46	16	53	28	-64	46
Q4 05	11	-29	10	61	12	-45	62

Response Rates

	All (unweighted)	UK	France	Germany	Spain	Italy	Nordic
Despatched	1069	764	51	122	53	21	58
Returned	239	125	18	28	22	10	36
Response rate	22%	16%	35%	23%	42%	48%	62%

Chart 21: UK Barometer Index, historical series

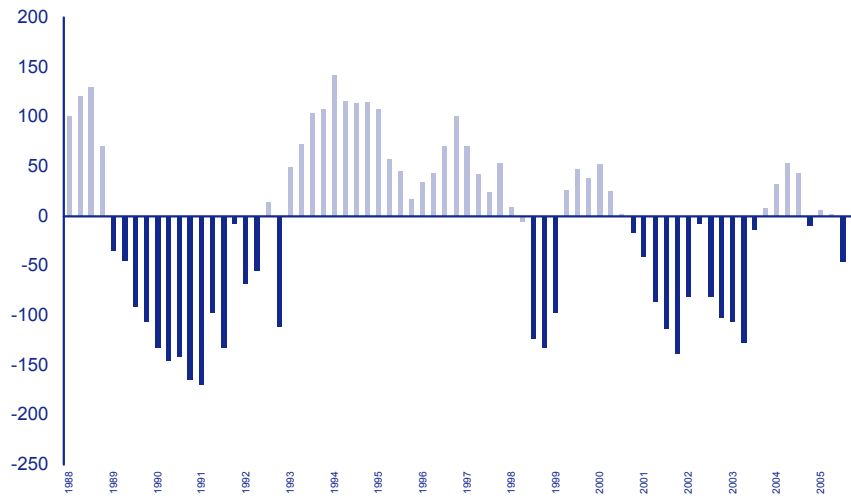


Chart 22: UK Barometer Index, by sector

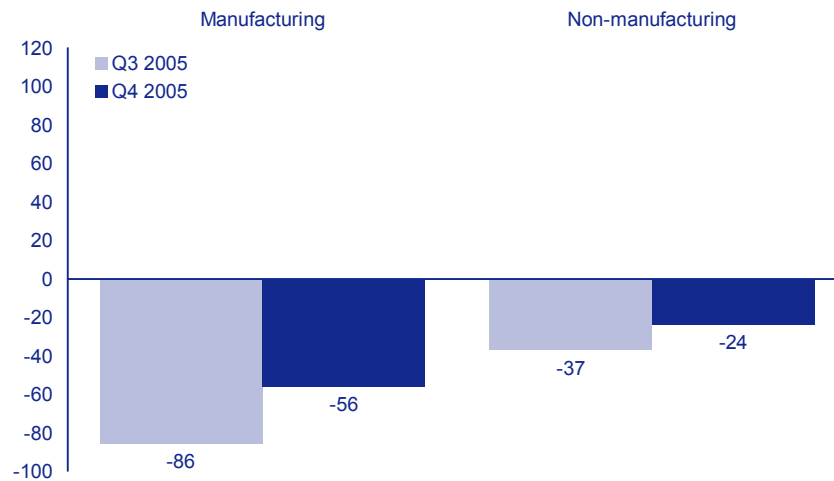


Chart 23: UK Barometer Index, by region

