CAMBRIDGE ASSOCIATES LLC

Cambridge Associates LLC Private Equity and Venture Capital Market Commentary for Quarter Ending September 30, 2009

Overview

During the third quarter, private equity and venture capital continued to recover from losses incurred in 2008 and early 2009, as indicated by the Cambridge Associates LLC benchmark indices of the two alternative asset classes. For the second consecutive quarter, the positive returns for private equity and venture capital were lower than those earned by public equity indices but over the long term both asset classes have outperformed the public markets.

The quarter ending September 30th was the best since the second quarter of 2007 for the **Cambridge Associates LLC U.S. Private Equity Index®** and the best since the end of 2007 for the **Cambridge Associates LLC U.S. Venture Capital Index®**. Private equity outperformed venture capital, and both indices moved directionally with the public markets, but the investment environment continued to present challenges for investors. Leverage was still hard to obtain for buyout managers and exit opportunities remained limited.

The Cambridge Associates LLC U.S. Private Equity Index® is derived from performance data compiled for institutional quality funds that represent nearly two-thirds of the capital raised by private equity partnerships between 1986 and 2009. Based on that data, private equity's returns versus indices tracking large- and small-capitalization public equities – the Dow Jones Industrial Average, the Russell 2000 Composite, and the S&P 500 – are shown below:

U.S. Private Equity Index Returns (%) for the Periods ending September 30, 2009

For the periods ending	Qtr.	Nine Months	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
September 30, 2009	6.2	7.4	-8.9	2.3	11.1	8.3	11.6	11.8
Other indices at September 30, 2009								
DJIA	15.8	13.5	-7.4	-3.3	1.8	1.6	8.7	9.2
Russell 2000 Composite	19.3	22.4	-9.5	-4.6	2.4	4.9	7.3	7.9
S&P 500	15.6	19.3	-6.9	-5.4	1.0	-0.2	7.6	8.0

Source: Cambridge Associates LLC

The Cambridge Associates LLC U.S. Venture Capital Index® is derived from performance data compiled for institutional quality funds that represent more than three-fourths of the capital raised by venture capital partnerships between 1981 and 2009. Based on that data, venture capital's returns versus indices tracking large- and small-capitalization public equities – the NASDAQ Composite, the Russell 2000 Composite, and the S&P 500 – are shown below:

U.S. Venture Capital Index Returns (%) for the Periods ending September 30, 2009

For the periods ending	Qtr.	Nine Months	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
September 30, 2009	2.3	-0.3	-12.4	1.3	4.9	8.4	36.6	23.1
Other indices at September 30, 2009								
NASDAQ Composite	15.7	34.6	1.5	-2.0	2.3	-2.5	7.0	7.8
Russell 2000 Composite	19.3	22.4	-9.5	-4.6	2.4	4.9	7.3	7.9
S&P 500	15.6	19.3	-6.9	-5.4	1.0	-0.2	7.6	8.0

Source: Cambridge Associates LLC
Note: Because the U.S. Private Equity and Venture Capital indices are capital weighted, the largest vintage years mainly drive the indices' performance.

In the sections below we provide details regarding the indices' performance. Highlights of the third quarter are:

- Despite their recent underperformance of the public equity markets, private equity and venture capital returns are still dominant over the long term.
- Over the ten-years ending September 30, 2009, private equity and venture capital have earned virtually identical returns.
- Private equity and venture funds invested slightly more in the third quarter than they had in the previous two quarters, and contributions continued to outpace distributions.
- For the second quarter in a row, the private equity funds raised in 2007 earned the best return among the five vintage years that represented at least 10% of the index. A few of the smaller vintage years, such as 2001 and 2003, had better quarters but due to their size they had less influence on the index.
- All industries in the private equity index produced positive results for the quarter, but none matched the performance of their public market counterparts.
- Energy and consumer-related businesses were the leading recipients of capital from the fund managers in the private equity index.
- Venture funds raised in 2004 outperformed all vintage years from 1998 to the present in the third quarter. Two earlier vintage years earned higher returns than 2004, but together they represented less than 1% of the index.
- Healthcare, IT, and software companies, the top three industries by size in the venture index, all earned positive returns in the third quarter.
- Based on market values at September 30, 2009, public companies accounted for about 12% of the private equity index and a bit more than 10% of the venture one.

Private Equity Performance Insights

During the third quarter, amid continued concerns about the economy, public equity indices worldwide rose, with many enjoying double-digit increases. At the same time, the Cambridge Associates LLC U.S. Private Equity Index earned its best quarterly return in more than two years, rising 6.2%. The benchmark's performance resulted largely from improved valuations for funds raised from 2000 to 2007; all but one vintage year in the period saw their assets increase in value by $1.0 billion or more. Private company valuations, particularly in the retail, healthcare, and financial services sectors, increased significantly, due in part to the use of market-based valuation methodologies amid rising public markets.

The index's performance in the second quarter was driven largely by its top five vintage years by size, 2006, 2005, 2004, 2000, and 2007, together 76% of the index's value. Quarterly returns for the top five vintages ranged from the 2000 funds' gain of 4.8% to the 2007 funds' rise of 7.0%. Increased valuations for retail, media, and healthcare investments drove the largest vintage year, 2006, to a quarterly return of 6.4%. The 2005 funds' gain of 5.9% was due to written-up values for financial services, consumer, and healthcare companies. The 2004 funds differentiated themselves by having six different industries positively contribute to their return of 5.6%; transportation and technology were among them. In contrast, the 2000 vintage's return of 4.8% was mostly driven by one industry, healthcare. The 2007 funds, the smallest of the top five vintages, benefited from realizations from and higher values for their energy, retail, financial services, and healthcare investments.

All Eight Prominent Sectors in the PE Index Earned Positive Returns for the Quarter

Each of the eight sectors that together represented 90% of the index's value earned positive returns in the third quarter. The top three industries by size—consumer, energy, and healthcare—rose between 2.8% and 8.5%; healthcare performed best and energy the worst. Combined, the top three sectors accounted for a little more than half of the benchmark's value. Healthcare, financial services, and consumer companies collectively contributed more than half of the index's return. In the quarter, electronics gained the most and industrials, for the third quarter in a row, lost the most. Neither industry represented more than 2% of the index's value.

Capital Calls and Distributions Increased over the Prior Quarter

In the third quarter, private equity managers called roughly $9.0 billion from investors and returned almost $4.6 billion. Compared with the previous quarter, contributions increased by about $1.4 billion, or 15%, and distributions rose by $2.1 billion, or 46%. Investors in funds raised from 2006 through 2008 contributed 78% of the total capital fund managers called – the 2006 and 2007 vintages called nearly $3.0 billion each. Collectively, five vintage years, 1999, 2000, and 2003 through 2005 distributed about $3.6 billion or 78% of the total for the quarter. The funds raised in 2000 returned slightly more than $1.0 billion to investors, the most during the quarter. After a slow first half of the year, the private equity investment pace began to pick up in the third quarter with the bulk of the capital going into energy, retail, financial services, and media companies.

With Limited Exits and High Equity Deals, Capital Contributions Still Outpaced Distributions

Macroeconomic factors remained a challenge for businesses in the third quarter, particularly those that were levered or highly sensitive to consumer spending. In the first three quarters of 2009, the economic environment forced private equity funds to focus more on supporting and restructuring existing portfolio companies than on identifying new investments. In addition, given the shortage of easily available credit, new investments demanded more equity than deals completed in the previous years. Further, because exits continued to be hard to come by, capital calls once again outnumbered distributions.

Positive Impact from Public Market Valuation Methodology – Some Companies, Especially Large Non-U.S. Healthcare Businesses, Benefited from Weak U.S. Dollar

Because public equities continued to rally during the third quarter, the private equity index again benefited from the “mark-to-market” valuation methodology. Since the methodology was adopted, the private equity index has moved directionally with the public markets but with less volatility. For example, when the S&P 500 fell 30.5% from October 2008 through March 2009, the private equity index also dropped, but only by 21.0%; and when the S&P jumped 34.0% between April and September 2009, the private equity benchmark rose only 10.5%. Similarly, during the third quarter, when the public companies in most of the large sectors in the private equity index rose in the double digits, valuation increases for private companies were generally more modest. There were exceptions, however, because some funds in the private equity index invest outside of the U.S. Those companies benefited not only from strong public markets but also from a weakened U.S. dollar, which results in higher values for dollar-denominated investments. The healthcare component of the index was one of the larger beneficiaries of the currency effect.

Cambridge Associates derives its U.S. private equity benchmark from the financial information contained in its proprietary database of private equity funds. As of September 30, 2009, the database comprised 800 U.S. buyouts, private equity energy, growth equity, and mezzanine funds formed from 1986 to 2009, with a value of roughly $337 billion. Ten years ago, as of September 30, 1999, the index included 313 funds whose value was nearly $85 billion.

Venture Capital Performance Insights

As 2009 progressed, the amounts of capital being called and distributed slowly increased but, as of the third quarter, both were close to the levels not seen since in over a decade. There were signs of life in the exit markets but results were mixed. On one hand, one of the quarter’s initial public offerings (IPOs) was the largest venture-backed IPO exit in more than two years. In addition, by the end of September, 2009 had already produced more IPOs than all of 2008. On the other hand, while there was a slight increase in the number of mergers and acquisitions (M&A) in the third quarter, based on deals with disclosed values, the average transaction size dropped significantly from the previous period.

According to the National Venture Capital Association (NVCA), there were 3 IPOs and 68 M&A in the third quarter; 2 of the IPOs and 51 of the M&A involved information technology companies. The third quarter’s 22 deals with announced values were worth $1.3 billion, less than half the value of the 13 deals in the quarter before, which, as reported to the public, were worth $2.6 billion.

VC Index Has Best Quarter Since the End of 2007; Funds Raised in 2004 Outpaced All Others

With its return of 2.3% in the quarter ending September 30, 2009, the Cambridge Associates LLC U.S. Venture Capital Index enjoyed its best quarter since the end of 2007. Six vintage years, 1999 through 2001, and 2004 through 2006, accounted for nearly 80% of the index; all had positive returns in the third quarter with the funds raised in 2004 performing best, 4.2%, and the 2006 funds the worst, 0.6%. Higher values for technology companies boosted the 2004 vintage's return, while healthcare was the highlight for the quarter for the 2006 funds. The largest vintage year in the index, 2000, earned 2.0% for the quarter, due to realizations from and increased valuations for technology investments and rising values for healthcare companies. The funds from the remaining top six vintage years, 2005, 1999, and 2001, returned 2.8%, 3.4%, and 2.0%, respectively. Gains in technology, healthcare, and software propelled the 2005 and 1999 funds performance, while increased valuations for healthcare, electronics, and hardware portfolio companies drove the return for the 2001 funds.

As in previous periods, healthcare, information technology, and software represented nearly 75% of the venture index's value. All three had positive quarters, technology, up about 5.0%, fared the best, followed by healthcare and then IT. Electronics is the only other sector that represented more than 5% of the index. Only three industries, manufacturing, energy, and media had negative returns during the quarter. Among the index's smaller sectors, hardware earned the best return and manufacturing the worst.

Capital Calls and Distributions Increased Slightly over the Prior Quarter but the Year is Still on Pace to Reach Levels Not Seen in More Than a Decade

In the third quarter, the venture capital fund managers in the index called nearly $3.0 billion from investors and returned about $1.1 billion, which represented an 8% increase in capital calls and a 19% increase in distributions from the previous quarter. As a group, the funds from vintage years 2004 through 2008 called $2.5 billion, or 85% of the capital called during the quarter. The 1999 and 2000 vintage year funds combined to return $682.9 million, or 60% of the quarter's distributions. The distributions largely resulted from technology, healthcare, and software company investments.

Venture-Backed Company Valuations Increased in the Third Quarter, but there Remained a Shortage of Profitable Exit Opportunities

Valuations for venture-backed companies appeared to benefit more from the public market rally in the third quarter than they did in the second. Technology and healthcare companies were the main beneficiaries while technology companies continued to lead all others as IPO candidates and targets for M&A transactions. The news for venture capitalists though was not all good; in at least half of the M&A deals with announced values, the price paid for the company was less than the amount of money that had been invested. The industry has also entered a period of time when its medium-term performance will significantly trail its long-term return. For example, the venture index's ten-year result of 8.4% as of September 2009 (as shown in the table above) marks a decline of nearly 32% from the ten-year period ending September 2008. By and large, the short- and medium-term results have been driven by the outsized vintage years of 1999 and 2000, which have struggled.

Cambridge Associates derives its U.S. venture capital benchmark from the financial information contained in its proprietary database of venture capital funds. As of September 30, 2009, the database comprised 1,287 venture funds formed from 1981 through 2009 with a value of approximately $94 billion. Ten years ago, as of September 30, 1999, the index included 646 funds whose collective value was slightly more than $70 billion.

About Cambridge Associates and the Indices

Founded in 1973, Cambridge Associates delivers investment consulting, independent research, and performance monitoring services to over 825 institutional investors and private clients worldwide.

Cambridge Associates LLC's proprietary databases provide independent statistics to the institutional investment industry and the National Venture Capital Association (NVCA). The Cambridge Associates LLC U.S. Venture Capital Index® is based on returns data compiled for more than three-fourths of institutional quality venture capital assets formed between 1981 and 2009. Similarly, the Cambridge Associates LLC U.S. Private Equity Index® is based on returns data compiled for nearly two-thirds of leveraged buyouts, subordinated debt, and special situations partnerships formed between 1986 and 2009. The pooled means represent the net end-to-end rates of return calculated on the aggregate of all cash flows and market values as reported to Cambridge Associates by the funds' general partners in their quarterly and annual audited financial reports. These returns are net of management fees, expenses, and performance fees that take the form of a carried interest.

Both the Cambridge Associates LLC U.S. Venture Capital Index® and the Cambridge Associates LLC U.S. Private Equity Index® are reported each week in *Barron's* Market Laboratory section. In addition, complete historical data can be found on Standard & Poor's Micropal products and on our website, www.cambridgeassociates.com.

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