



## CAMBRIDGE ASSOCIATES LLC

### Cambridge Associates LLC Private Equity and Venture Capital Market Commentary for the Quarter Ending December 31, 2010

#### Overview

U.S. private equity and venture capital funds ended 2010 strongly and extended their streak of consecutive positive quarters to seven, as indicated by the Cambridge Associates LLC benchmark indices of the two alternative asset classes. Despite underperforming venture capital and the public markets in the most recent quarter, private equity maintained its lead on both asset classes over the last ten years.

Fourth quarter returns for the Cambridge Associates LLC U.S. Private Equity Index® and Cambridge Associates LLC U.S. Venture Capital Index® reached levels unseen since before the recession. Once again, strong public markets and other macroeconomic factors, such as rising commodity prices, helped bolster company performance. The investment environment has improved gradually due to the return of available leverage and the heightened activity for mergers and acquisitions (M&A) and initial public offerings (IPOs).

The Cambridge Associates LLC U.S. Private Equity Index® is derived from performance data compiled for funds that represent the majority of the institutional capital raised by private equity partnerships between 1986 and 2010. 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 Periods ending December 31, 2010

For the periods ending December 31, 2010	Qtr.	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
<b>USPE</b>	7.6	19.9	2.8	9.5	9.7	12.2	13.1
<b>Other Indices</b>							
<b>DJIA</b>	8.0	14.1	-1.6	4.3	3.1	7.9	10.3
<b>Russell 2000 Composite</b>	16.3	26.9	2.2	4.5	6.3	7.6	10.8
<b>S&amp;P 500</b>	10.8	15.1	-2.9	2.3	1.4	6.8	9.1

Sources: Cambridge Associates LLC, Dow Jones & Company, Inc., Frank Russell Company, Standard and Poor's, and Thomson Datastream.

The Cambridge Associates LLC U.S. Venture Capital Index® is based on returns data compiled for funds that represent the majority of the institutional capital raised by venture capital partnerships between 1981 and 2010. Based on that data, venture capital's performance against indices tracking large- and small-capitalization public equities – the NASDAQ Composite, the Russell 2000 Composite, and the S&P 500 – is shown below:

## U.S. Venture Capital Index Returns (%) for Periods ending December 31, 2010

For the periods ending December 31, 2010	Qtr.	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
<b>USVC</b>	8.4	13.5	-0.3	5.7	-2.0	34.7	26.3
<b>Other Indices</b>							
<b>NASDAQ Composite</b>	12.0	16.9	0.0	3.8	0.7	6.4	10.3
<b>Russell 2000 Composite</b>	16.3	26.9	2.2	4.5	6.3	7.6	10.8
<b>S&amp;P 500</b>	10.8	15.1	-2.9	2.3	1.4	6.8	9.1

Sources: Cambridge Associates LLC, Dow Jones & Company, Inc., Frank Russell Company, Standard and Poor's, and Thomson Datastream.

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 fourth quarter and year are:

- With the exception of the most recent quarter, the private equity benchmark outperformed large public companies in all of the time periods ending December 31, 2010 listed in the table above. Small public companies, tracked by the Russell 2000 Composite, have produced better results than the private equity index over the past three years. Over the past ten years, the venture capital index's record against the public markets has been mixed but over the long term, venture has significantly outperformed the public markets.
- The 2003 private equity and 2004 venture capital funds were the best performing among the top-sized vintages for the quarter in their respective indices. Because of its size, the 2006 vintage year in private equity had the largest impact on the index.
- The spread between the private equity and venture capital ten-year returns shrank in the fourth quarter, moving to 11.7% from 12.7% as of the third quarter.
- Private equity funds called less capital and distributed more in the fourth quarter than they did in the third; LP contributions decreased by roughly \$890 million and fund distributions increased by about \$11.1 billion. For venture funds, capitals calls and distributions increased significantly on a percentage basis; LP contributions were up more than 42% while distributions jumped nearly 138%.
- Fund managers in the private equity index distributed more capital in 2010 than they did in the two previous years (2008 and 2009) combined.
- For the second consecutive quarter, all sectors that represented at least 5% of the private equity index produced positive results; information technology (IT) was the best among the large sectors but electronics led all.
- Six sectors – energy, healthcare, consumer, IT, manufacturing, and financial services – dominated private equity fund investments during the fourth quarter. Energy companies attracted the most capital, about 21% or roughly 6% more than the long-term average for the sector.
- While still negative, the ten-year return for the venture capital index improved in the quarter ending December 31, 2010, rising 2.6% from where it was as of September 30, 2010.
- Two of the top three sectors by size in the venture index – IT and software – earned double-digit returns during the quarter. With a 21.9% quarterly return, IT bested all other sectors.
- As of December 31, 2010, public companies accounted for about 12.6% of the private equity index, a near 1% jump from the third quarter. Conversely, public company representation in the venture

capital index fell about 1% since the third quarter to 9.4%. Non-U.S. company exposure in both indices increased roughly half of a percent during the quarter.

## Private Equity Performance Insights

In the final quarter of 2010, U.S. public equity indices rose on average by more than 10% - the fourth quarter this has happened in the seven quarters since April 2009. While the Cambridge Associates LLC U.S. Private Equity Index® did not match each of the public market's double-digit increases, it produced positive returns in all seven quarters. During the fourth quarter of 2010, the private equity index returned 7.6%, bringing its performance for 2010 to 19.9%, its best year since 2006. Portfolio company valuations increased across all vintage years from 2000 to 2009; funds launched in the seven vintages that represented at least 5% of the index saw asset values improve by at least \$1.5 billion. In dollar terms, company valuations grew most for energy, consumer, and financial services businesses; among the large sectors in the index, IT valuations increased by the largest amount in percentage terms.

Seven vintage years, 2006, 2005, 2007, 2004, 2000, 2008, and 2003, represented nearly 90% of the private equity index's value in the fourth quarter. Returns among the seven vintages were better in the fourth quarter than they were in the third, ranging from 5.9% for the 2005 funds to 10.5% for the 2003 funds. Amidst an active M&A environment, results were driven by realizations as well as by unrealized valuation increases. In funds from the largest vintage year, 2006, consumer, energy, manufacturing, IT, and healthcare drove valuation increases and realizations. Energy sector portfolio companies in the 2005 and 2007 funds jumped the most in value, while realizations for both vintages were more widespread. For the 2004 funds, the biggest contributors to the higher valuations were financial services, manufacturing, media, IT, and consumer companies while realizations were dominated by consumer, manufacturing, IT, and software. For the second quarter in a row, the 2003 funds earned the best return, thanks to growth in values for financial services, consumer, electronics, and energy businesses and realizations within energy, retail, manufacturing, and software.

Vintage Year <sup>1</sup>	4 <sup>th</sup> Qtr Return	Avg. Weight In Index
2000	7.7%	7.7%
2003	10.5%	5.1%
2004	8.4%	12.2%
2005	5.9%	17.5%
2006	6.8%	24.9%
2007	9.0%	16.7%
2008	7.0%	5.1%

*All Eight Key Sectors in the PE Index Earned Positive Returns for the Quarter, with IT Edging Out Financial Services for the Best Performance Among Sectors*

For the second quarter in a row, all eight sectors that represented at least 5% ("meaningfully sized") of the index produced a positive return during the fourth quarter of 2010. Similar to the vintage years, sector results were better in the fourth quarter than they were in the third. The three largest sectors – consumer, healthcare, and energy – comprised nearly half of the index's total value and returned between 5.8% and 10.8%. Energy performed the best followed by consumer and healthcare which produced nearly equal returns. On a dollar-weighted basis, the three earned a gross return of 7.3%, underperforming the total benchmark gross performance by 1.5%. Among the eight meaningfully-sized sectors, IT posted the highest return, 11.0%, which was driven by funds raised in 2004 and 2008. Funds raised in 2004

Sector <sup>2</sup>	4 <sup>th</sup> Qtr. Return	Avg. Weight In Index
Consumer	5.8%	21.3%
Energy	10.8%	15.1%
Financial Services	11.0%	10.1%
Healthcare	5.8%	13.4%
IT	11.3%	7.5%
Manufacturing	10.6%	9.1%
Media	8.9%	6.7%
Software	5.4%	5.5%

<sup>1</sup> Vintage year fund-level returns are net of fees, expenses, and carried interest.

<sup>2</sup> Industry- and geographic region-specific gross company-level returns are before fees, expenses, and carried interest.

and 2008 accounted for over 23% of IT's market value. Software produced the lowest return, 5.4%. During the quarter, fund managers allocated roughly 40% of the capital invested to healthcare and energy companies – 15% more than their historical average.

For the year, the three largest sectors underperformed the benchmark's total gross return by 2.7% and underperformed all other industries by 5.5%. Out of the meaningfully-sized sectors, manufacturing produced the highest return of 40.0%, and healthcare produced the lowest return of 19.1% during 2010.

#### *Capital Calls Decline and Distributions Rise*

In the fourth quarter, managers in the U.S. private equity index called nearly \$19.2 billion from limited partners and returned slightly more than \$27.9 billion; these represent a 4.4% decrease in contributions and a 66% increase in distributions from last quarter. The reduction of almost \$900 million in capital calls from the prior quarter marked the first time in 2010 that contributions did not experience a quarter over quarter increase. With the increase of roughly \$11.1 billion from the third quarter, distributions hit their highest level since the second quarter of 2007. Further, fourth quarter distributions represent the second largest quarterly distribution amount in the 25 years since Cambridge Associates began tracking the industry.

Investors in funds launched in 2005 through 2008 contributed \$17.6 billion, or 91% of the total capital called during the quarter, the 2007 funds alone represented \$8.2 billion, or 43% of the capital called. Conversely, investors in funds launched in 2000 and 2004 through 2006 received approximately \$17.0 billion or 61% of the capital distributed.

During 2010, managers in the U.S. private equity index called \$69.1 billion from limited partners, 75% more than they called in 2009 and the fourth most called in one year since the index's inception in 1986. Annual contributions for 2010 were outpaced only by contributions in 2006, 2007, and 2008; the difference in percentage terms from 2010 was 2.1%, 36.5% and 19.7% respectively. Total distributions during 2010 returned to the levels experienced during 2006 and 2007 as managers returned nearly \$66.5 billion to limited partners – the third largest annual amount since the index's inception. Distributions in 2010 increased by 220.4% from 2009 and were only 1.9% and 15.6% less than the pre-recession years of 2006 and 2007 respectively. The spread between annual contributions and distributions narrowed to its lowest amount since 2005. Annual distributions have only outpaced annual contributions in four years 1995, 1996, 2004, and 2005.

#### *Distributions Outpace Contributions in the Quarter for the First Time in more than Three Years*

For the first time since the second quarter of 2007, distributions were higher than contributions during the fourth quarter. The gap between contributions and distributions in 2010, roughly \$2.6 billion, was the smallest it had been in six years (2005), and over that span, private equity fund managers in the index called 1.3 times as much capital as they distributed. Investment activity was steady in the fourth quarter with readily available credit and declining equity contributions, both of which were creeping towards pre-recession levels. Private equity fund managers also took advantage of the friendly exit environment by selling companies through IPOs and M&A transactions.

Cambridge Associates derives its U.S. private equity benchmark from the financial information contained in its proprietary database of private equity funds. As of December 31, 2010, the database comprised 883 U.S. buyouts, private equity energy, growth equity, and mezzanine funds formed from 1986 to 2010, with a value of roughly \$463 billion. Ten years ago, as of December 31, 2000, the index included 418 funds whose value was slightly more than \$126 billion.

## Venture Capital Performance Insights

Venture capital performance and most industry fundamentals reached their best levels in years during the fourth quarter of 2010. It was the sixth quarter in a row that valuations for venture-backed companies rose. The IPO market had its best quarter since 2000 and another strong quarter for M&A led to a record year for transactions. Offering prices for IPOs were higher than those in the quarter before and while the total number of M&A transactions fell slightly, the number of deals with disclosed values increased as did the average deal size. Capital calls and distributions both rose during the quarter and 2010 marked the first year since 2007 that LP contributions and distributions were nearly equal; in the other years, contributions were higher.

According to the National Venture Capital Association (NVCA) and Thomson Reuters, during the fourth quarter, 32 venture-backed companies went public and the IPOs were worth more than \$3.5 billion; both figures represented significant increases over the third quarter, when 14 IPOs raised less than \$1.3 billion. M&A decreased, from 113 in the third quarter to 97 in the fourth. The values of 41 deals were disclosed to the public in the fourth quarter, up from 30 in the previous quarter. Based on the publicly available values, the average size of transactions rose from \$134 million to \$146 million.

### *VC Index Had Its Best Quarter in Four Years; Funds Raised in 2004 Performed Best*

The Cambridge Associates LLC U.S. Venture Capital Index® enjoyed its best quarter since the final one in 2006, rising 8.4% in the fourth quarter of 2010; its performance for 2010 was 13.5%, the best year since 2007. In the fourth quarter nine vintage years combined to represent nearly 93% of the index and all nine had positive quarters. The largest vintage, 2000, represented less than 19%, a decrease of more than 5% from a year earlier. The top four vintage years by size continued to be 2000, 2006, 2005, and 2004, accounting for 56.5% of the benchmark. With an 18.3% quarterly return, the funds raised in 2004 earned by far the best return for the quarter. A multi-billion dollar increase in IT valuations plus realizations from the sector drove the 2004 group's results. IT and software company realizations plus written up values for multiple sectors, including software, IT, financial services, and hardware were the main contributors to the 2000 vintage year funds' return, which was the lowest among the nine large vintages. Write-ups in the healthcare and IT sectors led to a strong return for the 2006 funds, while IT mostly drove the valuation increase for the 2005 vintage.

Vintage Year <sup>3</sup>	4 <sup>th</sup> Qtr Return	Avg. Weight In Index
1999	7.2%	7.5%
2000	3.9%	18.5%
2001	5.0%	7.6%
2003	5.5%	5.8%
2004	18.3%	12.1%
2005	9.1%	12.5%
2006	8.1%	13.3%
2007	11.5%	8.8%
2008	12.1%	6.5%

<sup>3</sup> Vintage year fund-level returns are net of fees, expenses, and carried interest.

### *IT Outperforms Again*

For the second quarter in a row, all meaningfully-sized sectors produced positive returns in the fourth quarter of 2010. The venture capital index remained concentrated by sector, with the top three – IT, healthcare, and software – comprising nearly 75% of the index’s value. Fourth quarter returns for the three sectors ranged from healthcare’s 4.7% to IT’s 21.9%. On a dollar-weighted basis, IT, healthcare, and software companies earned a combined gross return of 12.5%, outperforming the benchmark’s company-level return of 11.3%. Again, IT led all meaningfully-sized sectors; results were helped by funds raised in 2004, which boosted the sector’s return by nearly 6.5%.

<b>Sector<sup>4</sup></b>	<b>4<sup>th</sup> Qtr. Return</b>	<b>Avg. Weight In Index</b>
Electronics	1.3%	5.7%
Energy	3.9%	4.2%
Healthcare	4.7%	28.5%
IT	21.9%	30.3%
Media/Comm.	15.0%	4.5%
Software	10.0%	16.0%

Internet-related companies are included in the IT sector, which also helped performance in the quarter. Electronics, despite producing a positive return, performed the worst out of the large sectors. Electronics low return was not overly influenced by any specific vintage year.

For the year, the three largest industries returned 24.5%, which outperformed the annual company-level returns by nearly 3.0%. Within the three largest sectors, healthcare performed relatively poorly as it returned 6.5% compared to IT and software’s returns of 45.5% and 24.7%, respectively. IT alone helped improve the index’s gross return by 8.7%.

### *VC Calls and Distributions Rise from Prior Quarter Levels*

In the fourth quarter, managers in the U.S. venture capital index called just over \$3.9 billion, an increase of \$1.2 billion or 42.4% from the previous quarter. Contributions in the fourth quarter marked their highest level since the second quarter of 2008. Managers distributed \$5.6 billion to their investors, an increase of \$3.3 billion or 137.5% over the third quarter. Distributions hit their highest quarterly amount since the first quarter of 2001 and were only about \$200 million shy of the total distributions for all of 2009.

Managers of funds raised between 2005 and 2008 called roughly \$2.7 billion or 69.8% of the total capital called. The 2008 vintage year funds called \$922.4 million, which represented 23.6% of the total called during the quarter. On the other hand, investors in vintage years 1999 and 2000 received approximately \$2.9 billion in distributions or 50.7% of the total distributed.

During 2010, managers in the U.S. venture capital index called \$13.2 billion, a 13.8% increase over 2009 total contributions; however, 2010 contributions remain 18.9% and 23.0% below the totals for 2008 and 2007, respectively. Distributions during 2010 made a comeback as managers returned roughly \$13.1 billion to their LP’s marking a 125.5% and 65.2% increase over 2009 and 2008, respectively. Although distributions have increased over the last two years, they remain well below totals from the bubble years of 1999 and 2000, as well as from 2007.

### *More than Half of the U.S. IPOs were China-Based Companies; IT Still Dominated M&A*

Of the 32 IPOs in the fourth quarter, 17 were Chinese companies listing on U.S. exchanges. IT and healthcare companies represented only half of the total IPOs. The quarter’s largest IPO was a credit card processing company. By number, IT companies accounted for about 82% of the M&A in the

---

<sup>4</sup> Industry- and geographic region-specific gross company-level returns are before fees, expenses, and carried interest.

quarter, with the majority involving either Internet or software companies. The largest transaction with a reported value involved a healthcare services company. With 431 deals for the year, M&A hit a record level.

Cambridge Associates derives its U.S. venture capital benchmark from the financial information contained in its proprietary database of venture capital funds. As of December 31, 2010, the database comprised 1,298 U.S. venture capital funds formed from 1982 to 2010, with a value of roughly \$110 billion. Ten years ago, as of December 31, 2000, the index included 840 funds whose value was about \$94 billion.

## **About Cambridge Associates and the Indices**

Founded in 1973, **Cambridge Associates** delivers investment consulting, independent research, performance reporting services, and outsourced portfolio solutions to over 900 institutional investors and private clients worldwide. Cambridge Associates has advised its clients on alternative assets since the 1970s and today serves its clients with more than 180 professionals dedicated to consulting, research, operational due diligence, and performance reporting on these asset classes. The firm compiles the performance results for more than 4,400 private partnerships and their more than 61,000 portfolio company investments to publish its proprietary private investments benchmarks, of which the *Cambridge Associates U.S. Venture Capital Index*® and *Cambridge Associates U.S. Private Equity Index*® are widely considered to be the industry-standard benchmark statistics for these asset classes. The firm also compiles benchmark statistics for global private equity and venture capital, real estate, natural resources, distressed securities, and funds of funds and secondaries. Cambridge Associates has over 1,000 employees serving its client base globally and maintains offices in Arlington, VA; Boston, MA; Dallas, TX; Menlo Park, CA; London, England; Singapore, and Sydney, Australia. Cambridge Associates is recognized as a thought leader, innovator and advocate for institutional investors. For more information about Cambridge Associates, please visit [www.cambridgeassociates.com](http://www.cambridgeassociates.com).

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 performance data compiled for funds that represent the majority of the institutional capital raised by venture capital partnerships from 1981 through 2010. Similarly, the Cambridge Associates LLC U.S. Private Equity Index® is based on returns data compiled for leveraged buyouts, subordinated debt, and special situations funds that represent the majority of institutional capital raised by private equity partnerships formed from 1986 through 2010. 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](http://www.cambridgeassociates.com).

Inquiries about these indices should be addressed to: Itay Engelman at Sommerfield Communications, 156 Fifth Avenue Suite 1219, New York, NY 10010; 212.255.8386; (fax) 212.255.8459; email [itay@sommerfield.com](mailto:itay@sommerfield.com).