



CAMBRIDGE ASSOCIATES LLC

Cambridge Associates Venture Capital and Private Equity Market Commentary for Quarter Ending March 31, 2009

Overview

The first quarter of 2009 showed the continuing strain of a very difficult economy on both venture capital and private equity, as determined by the Cambridge Associates benchmark indices of these alternative asset classes. However, despite their lackluster performance, venture capital and private equity continued, virtually without exception, to outperform other major market indices across all time horizons over a 20-year investment period.

March 31st brought to a close the third consecutive negative quarter for the **Cambridge Associates LLC U.S. Venture Capital Index[®]**; it also marked the fourth negative quarterly performance out of the five quarters since January 1, 2008, for the **Cambridge Associates LLC U.S. Private Equity Index[®]**. Among the many factors impacting valuations since the beginning of 2008 – a number of which are discussed below – is a lack of viable exits from these investments. When liquidity returns to the broader market place, exits should reappear and create liquidity in both asset classes. The million dollar (at least) question, of course, is when that will occur.

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 funds formed between 1981 and 2008. Based on that data, venture capital's performance against three major indices tracking traditional equities – the Dow Jones Industrial Average, NASDAQ Composite, and S&P 500 – is shown below:

US Venture Capital Index Returns (%) for the Periods ending 3/31/2009

For the periods ending	1 st Qtr.	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
Mar. 31, 2009	-2.9	-17.5	1.3	5.8	26.2	34.2	22.5
Other indices at March 31, 2009							
DJIA	-12.5	-35.9	-9.5	-3.6	-0.4	7.4	8.8
NASDAQ Composite	-3.1	-32.9	-13.2	-5.2	-4.7	4.9	6.8
S&P 500	-11.0	-38.1	-13.1	-4.8	-3.0	5.9	7.4

Source: Cambridge Associates LLC

Note: Because the US Venture Capital index is capital weighted, the largest vintage years mainly drive the index's performance.

For the quarter ended March 31, 2009, venture capital outperformed the comparative indices across all listed time horizons.

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 2008.

As the following table shows, private equity, like venture capital, outperformed (or, at worst, essentially equaled) the comparative indices across all time horizons.

US Private Equity Index Returns (%) for the Periods ending 3/31/2009

For the periods ending	1st Qtr.	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
Mar. 31, 2009	-3.2	-24.2	0.3	9.7	7.9	10.9	11.3
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Source: Cambridge Associates LLC

In the sections below we provide additional details and color on the performance of The Cambridge Associates’ venture capital and private equity indices. But some key takeaways from the first quarter are:

- As noted above, both asset classes performed admirably when compared to liquid equity investments.
- For venture and private equity, a lack of viable exit opportunities coupled with the need for capital to make new investments has kept contributions higher than distributions.
- Venture funds raised in 2000, the largest vintage year on record, outperformed all vintage years, beginning with 1998, in the first quarter. (The much smaller 1997 vintage outperformed 2000, but it represented less than 1% of the index.)
- Healthcare, IT, and software companies continue to dominate the performance of the venture index, comprising three-quarters of its total value.
- The private equity index’s top three industries by value—consumer, healthcare, and energy—produced minimal losses compared with the declines of the previous quarter.
- Private equity funds raised in 2006, the largest vintage in size, fell primarily from losses in energy and consumer investments.
- Energy, financial services, and consumer companies attracted most of the capital invested by private equity fund managers.

Venture Capital Performance Insights

A drop in capital calls compared with prior quarters indicated a slower investment pace compared with prior quarters – a situation no doubt exacerbated by challenging conditions in the broader economy. For the second quarter in a row, exit opportunities were limited to mergers and acquisitions due to a lack of initial public offerings (IPO); this shortage of exits will require some funds to hold investments perhaps beyond their preferred time periods, thereby lowering these funds’ internal rates of return.

According to the National Venture Capital Association, there were 62 mergers and acquisitions in the first quarter, the same number as in the prior quarter; again, most involved technology companies. The 14 deals in the first quarter whose values were released to the public were worth \$657 million. This compared with the fourth quarter’s 17 deals that were worth \$2.4 billion, as reported to the public. The low figure for the first quarter is another indication of a very difficult exit environment.

Venture Funds Raised in the 2000— the Index's Largest Vintage Year in Terms Of Capital — Fall, But Still Outperform All Other Vintages over the Last 11 Years, Starting with 1998; 2002 Vintage Hardest Hit. Healthcare, IT, and Software Industries Continue to Dominate the Index, Reflecting Three-Quarters of Its Total Value.

The Cambridge Associates LLC U.S. Venture Capital Index's 2.9% drop in the quarter ended March 31, 2009, was far better than its performance in the previous quarter. In the first quarter, funds raised in 2000 lost the least, 1.9%, while the 2002 funds lost the most, 7.2%. [Both were hit hardest by healthcare investments, though the 2002 funds more so because they were more heavily invested in that sector than the 2000 funds. The 2000 funds remained the largest vintage year by size in the index, followed by the 2004 and 2005 vintages. The 2004 funds fell 2.1% and the 2005 group lost 3.5%, due mostly to technology company losses. Negative returns for the next three vintage years by size, 1999, 2006, and 2001, resulted mostly from reduced valuations for their energy, healthcare, technology, and media portfolio companies.

As in previous periods, healthcare, information technology, and software represented nearly 75% of the venture index's value. Software, with a virtually flat return for the quarter, fared the best of the three, while healthcare and technology both dropped nearly 2.0%. The smaller sectors in the index were also down in the quarter: financial services lost the least, and hardware the most.

Venture fund contributions and distributions down sharply from previous quarter.

In the first quarter, the benchmark's venture capital fund managers called \$2.6 billion from investors and returned about \$707 million, a sharp decrease in contributions and distributions from the previous quarter. Young funds from vintage years 2005 through 2008 called \$1.8 billion, while mature funds from 2000, 2003, and 2004 called about \$560 million. The 1999, 2000, and 2004 funds distributed nearly \$450 million to investors, resulting largely from healthcare, technology, and software company investments.

Healthcare Losses Hit Hard in Index's First-Quarter Decline. Current Lack of Exit Opportunities Could Hurt Future Returns while Mark-To-Market Accounting Threatens Private Company Valuations.

The venture benchmark's first quarter return reflected public market declines, particularly in healthcare, the difficult economic environment, and the absence of IPOs. Recent negative returns coupled with the technology bust at the beginning of the decade have severely impacted the index's performance since 2000. The two recessionary periods account for the large, roughly 31 percentage point difference in returns for the nine- and ten-year periods shown in the table below. Long-term performance, however, remained strong. Because of the shortage of exit opportunities, venture fund managers will need to either own companies longer or potentially sell at reduced values. Either could hurt future returns. Longer holding periods could also affect interim private company valuations due to the adoption of the Financial Accounting Standards Board (FASB) market-based valuation methodology. Previously, private company valuations were based on the price of the most recent financing, but with FASB's methodology, interim valuations will be adjusted to reflect movements in the public markets.

Cambridge Associates derives its U.S. venture capital benchmarks from the financial information contained in its proprietary database of venture capital funds. As of March 31, 2009, the database comprised 1,271 venture funds formed from 1981 through 2009 with a value of approximately \$82.5 billion. Ten years ago, as of March 31, 1999, the index included 607 funds whose value was slightly more than \$34.0 billion.

U.S. Venture Capital Index Returns (%)								
Periods Ending March 31, 2009								
	1 st Qtr.	1 Year	3 Years	5 Years	9 Years	10 Years	15 Years	20 Years
U.S. Venture Capital	-2.9	-17.5	1.3	5.8	-4.9	26.2	34.2	22.5

Source: Cambridge Associates LLC

Private Equity Performance Insights

The recession that started in 2007 hurt all sectors of the economy, particularly those relying on consumer demand, such as retail and manufacturing. The Cambridge Associates LLC U.S. Private Equity Index reflected public market declines in the first quarter, especially for energy, manufacturing, healthcare, and media companies, falling 3.2%. The adoption of the FASB market-based valuation methodology likely will result in a continuation of the private equity index's quarterly returns fluctuating with those of the public markets.

Every sector except one of the smallest, electronics, recorded negative returns in the first quarter. The index's top three industries by value—consumer, healthcare, and energy—fell between 1.1% and about 3.5%, minimal losses compared with the declines of the previous quarter. Collectively, retail, healthcare, and energy represented slightly more than half of the benchmark's value; retail performed the best and energy the worst. Energy and mid-sized industries, such as manufacturing, media, and financial services, contributed most to the index's return. Among all sectors, industrials, which represent only a small percentage of the index's value, lost the most during the quarter.

First Quarter Losses Modest Compared to Previous Quarter, with Funds Raised in 2006, the Index's Largest Vintage, Falling Primarily from Losses in Energy and Consumer Investments.

Compared with the double-digit declines in the fourth quarter, first quarter losses across the vintage years were modest. The top five vintage years by size, 2006, 2005, 2004, 2000, and 2007, represented 76% of the index's value and largely drove the index's return. They lost between 2.2% and 4.8% for the quarter. The dominant 2006 funds suffered losses mainly in energy and consumer investments. Valuation declines in the 2005 funds were widely spread among consumer, healthcare, manufacturing, energy, and technology companies. Vintage years 2004, 2000, and 2007 were down due to investments in manufacturing, industrials, media, and energy companies.

Investment Rate Slows over Prior Quarter; Even So, Fund Contributions Outstrip Distributions by Almost 2 ½ Times.

In the first quarter, private equity managers called down 2.48 times more capital than they distributed – taking roughly \$6.2 billion from investors and returning about \$2.5 billion, in both cases less than half the activity of the prior quarter. Investors in funds raised in 2005 and 2007 contributed almost 75% of the total capital fund managers called during the quarter. On the other hand, investors in funds launched in 2000, 2005, 2006, and 2007 received slightly more than 70% of the capital distributed. Private equity fund managers invested at a much slower rate in the first quarter than in the prior period. Energy, financial services, and consumer companies attracted most of the capital invested.

A string of negative returns caused the index's 3-, 5-, and 10-year returns to dip below 10%, as shown in the table below.

Cambridge Associates derives its U.S private equity benchmarks from the financial information contained in its proprietary database of private equity funds. As of March 31, 2009, the database comprised 769 U.S buyouts, private equity, energy, growth equity, and mezzanine funds formed from 1986 to 2009, with a value of about \$276.2 billion. Ten years ago, as of March 31, 1999, the benchmark index included 289 funds whose value was nearly \$63.6 billion.

U.S. Private Equity Index Returns (%)								
Periods Ending March 31, 2009								
	1 st Qtr.	1 Year	3 Years	5 Years	9 Years	10 Years	15 Years	20 Years
U.S. Private Equity	-3.2	-24.2	0.3	9.7	5.1	7.9	10.9	11.3

Source: Cambridge Associates LLC

About Cambridge Associates and the Indices

Founded in 1973, Cambridge Associates delivers investment consulting, independent research, and performance monitoring services to approximately 850 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 2008. 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 2008. 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.

Inquiries about these indexes should be addressed to Rik Nuenighoff at Cambridge Associates LLC, 100 Summer Street, Boston, MA 02110-2122; 617.457.7500; (fax) 617.457.7501; email rnuenighoff@cambridgeassociates.com.