



CAMBRIDGE ASSOCIATES LLC

Cambridge Associates Private Equity and Venture Capital Market Commentary for Quarter Ending December 31, 2008

During the quarter ending December 31, 2008, the Cambridge Associates LLC U.S. Venture Capital Index[®] dropped 12.5%, its worst decline since the first quarter of 2001. For all of 2008, the index lost 16.5%, its worst annual performance since 2002. Venture capital funds raised in vintage years 1996 through 2004 suffered double-digit declines. The 1999 funds lost the most, 14.6%, followed by the 2000 and 2003 funds, which dropped 14.5% each. Because these three vintage years represented nearly half of the index's value, they largely drove the benchmark's performance. Negative returns for the 1999, 2000, and 2003 funds were due mostly to decreased values for privately-held information technology companies, mirroring the downturn in the public markets.

As in previous periods, health care, information technology, and software represented nearly 75% of the venture index's value in the fourth quarter. Technology had the worst quarter of the three, falling 15.0%, software dropped 13.3%, and health care declined 9.5%. All sectors in the index fell in the quarter; financial services companies lost the least and hardware the most.

In the fourth quarter, the venture capital fund managers in the benchmark called \$3.8 billion from investors and returned \$1.5 billion, about the same amount of contributions and distributions as in the previous quarter. Young funds with vintage years 2005 through 2007 collectively called \$2.3 billion, while mature funds from 2000 and 2001 together called about \$400 million. The 1999 through 2001 funds distributed nearly \$1 billion to investors, with most of that coming from technology company investments.

The relatively small amount of venture capital that was invested during the quarter went mostly to seed- and early-stage businesses; the clean technology sector was still attractive to many venture investors. As for exiting investments, there were no initial public offerings (IPO) so venture capital fund managers were again forced to rely on mergers and acquisitions (M&A). There were 61 M&As in the fourth quarter, fewer than in the prior quarter, and again most involved technology companies. The 17 deals whose values were released to the public were worth \$2.4 billion. This compares to the third quarter's 32 deals that were worth \$3.1 billion, as reported to the public. Only six IPOs occurred in 2008 overall, the worst year for IPOs since 1977.

The venture benchmark's fourth quarter return was a product of declining values for venture-backed companies and venture firms' inability to exit their investments in the difficult economic environment. The index's poor quarterly performance did not materially change its long-term returns, as shown in the table below. But short- and medium-term returns were severely affected. The benchmark last declined more than 10% in a quarter at the beginning of the decade when fund managers were quick to write off companies that were not expected to be viable following the bursting of the technology bubble. In contrast, the companies written down at the end of 2008 were largely long supported by venture capital funds, believed to be viable but unable to be sold in the current market. The timing of the write downs coincided with the adoption of the Financial Accounting Standards Board (FASB) market-based valuation methodology. Previously, private company valuations were held at the price of the most recent financing but with FASB's methodology, values will be adjusted to reflect movements in the

public markets. As a result, we expect an increase in quarterly valuation adjustments and volatility of the venture capital benchmark's quarterly returns.

Cambridge Associates derives its U.S. venture capital benchmarks from the financial information contained in its proprietary database of venture capital funds. As of December 31, 2008, the database comprised 1,261 venture funds formed from 1981 through 2008 with a value of approximately \$83.1 billion. This compares to the year ending December 31, 1998, when the benchmark index included 593 funds whose value was slightly more than \$29.8 billion.

U.S. Venture Capital Index Returns (%)							
Periods Ending December 31, 2008							
	4th	1	3	5	8	10	15
	Qtr.	Year	Years	Years	Years	Years	Years
U.S. Venture Capital	-12.5	-16.5	4.1	7.1	-4.5	35.0	33.7

Sources: Cambridge Associates LLC and the National Venture Capital Association

During the quarter ending December 31, 2008, the Cambridge Associates LLC U.S. Private Equity Index[®] fell 16.0%, its worst quarter since the benchmark's inception in 1986. For all of 2008, the index returned -24.2%. All vintage years beginning with 1994 declined at least 10% in the quarter. The 2006 vintage year funds, the largest in the benchmark, fell 17.0%, due mainly to losses in consumer, energy, and media investments. Each of the next three top vintage years by size, 2005, 2004, and 2000, lost at least 13.6% for the quarter. While retail holdings were a common problem among funds of these three vintage years, the 2005 and 2004 funds were also hit hard by declines in financial services, energy, and manufacturing investments. The 2000 vintage returns also suffered from media and software company write downs. The funds launched in 2000, 2004, 2005, and 2006 comprised nearly 70% of the index's value in the fourth quarter and drove its performance.

As in the previous quarter, all sectors had negative returns. The index's top six industries by value—consumer, health care, energy, financial services, manufacturing, and media—fell between 6.0% and nearly 20.0%, doubling the declines of the previous quarter. Health care fell the least of the six, media fell the most. Together retail and financial services investments cost the benchmark more in returns than any other industries. Retail represented nearly 25% of the benchmark's value and dropped about 15.0%; financial services, at nearly 9.5% of the index's value, fell roughly 19.5%. Among the index's smaller sectors, industrials lost the least and electronics the most.

In the fourth quarter, private equity managers called approximately \$14.9 billion from investors and returned about \$5.5 billion, as both contributions and distributions slowed, compared with the prior quarter. Investors in funds raised from 2004 through 2008 contributed almost 90% of the total capital fund managers called during the quarter. On the other hand, investors in funds launched in 1999, 2000, 2004, 2005, and 2006 received slightly more than 70% of the capital distributed. While investing at a slower rate in the fourth quarter than during the rest of the year, private equity fund managers allocated most of their capital to consumer, energy, financial services, and health care companies.

The private equity benchmark's negative returns for fourth quarter and all of 2008 reduced the index's short-, medium- and long-term results. The 3-, 5-, and 10-year returns dipped below 10%, as shown in the table below. The index's fourth-quarter performance was mainly caused by the continuing deterioration of the economy, which led to less consumer spending and more bankruptcies in the retail

sector. The credit crisis that began in 2007 continued to hurt borrowers and financial services companies. Company valuations across sectors were written down to reflect public market declines as private equity fund managers adopted the FASB market-based valuation methodology. We expect the FASB valuation methodology to lead to more frequent valuation adjustments and volatility of the private equity benchmark's quarterly returns.

Cambridge Associates derives its U.S private equity benchmarks from the financial information contained in its proprietary database of private equity funds. As of December 31, 2008, the database comprised 758 U.S buyouts, private equity, energy, growth equity, and mezzanine funds formed from 1986 to 2008, with a value of roughly \$281.7 billion. By way of comparison, at December 31, 1998, the benchmark index included 277 funds whose value was nearly \$59.6 billion.

U.S. Private Equity Index Returns (%)							
Periods Ending December 31, 2008							
	4 th	1	3	5	8	10	15
	Qtr.	Year	Years	Years	Years	Years	Years
U.S. Private Equity	-16.0	-24.2	2.6	11.0	7.2	8.6	11.4

Source: Cambridge Associates LLC

Cambridge Associates LLC's proprietary databases provide independent statistics to the institutional investment industry. 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.

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