



## CAMBRIDGE ASSOCIATES LLC

### **Cambridge Associates Private Equity and Venture Capital Market Commentary for Quarter Ending September 30, 2008**

During the quarter ending September 30, 2008, the Cambridge Associates LLC U.S. Venture Capital Index<sup>®</sup> fell 2.8%, bringing its year-to-date return to -4.3%. All vintage years from 1996 through 2008 were down in the quarter, with the 1999 funds declining the most, 4.3%, followed by the 2000 funds' fall of 3.9%. Venture capital fundraising peaked in 2000, and funds raised that year still represented 30% of the benchmark's value and its largest vintage year. The 1999 and 2000 funds' returns resulted from losses in information technology, electronics, and software. The funds started more recently, from 2003 through 2006, suffered losses in those sectors too, but they were also hurt by media and energy investments. Health care was the one bright spot for the quarter, helping to offset losses in other sectors in 1999, 2001, 2003, and 2005 vintage year funds.

From a sector standpoint, information technology, health care, and software represented most of the venture index's value in the third quarter. Returns among these industries were mixed: technology was down 3.7%, software fell 2.6%, and health care was up 0.5%. Across the index, manufacturing companies performed the best and electronics the worst.

In the third quarter, venture capital fund managers called \$3.6 billion from investors and returned \$1.5 billion, as both contributions and distributions were down from the previous quarter. Vintage year funds in the midst of their investment periods, such as the 2005 to 2007 groups, each called at least \$700 million in the quarter, while the mature funds from 2000 called more than \$230 million. Investors in funds started in 1997, 1999, 2000, and 2002, received a little more than \$1 billion of distributions, largely as a result of realized investments in health care and technology companies.

Due to the increasingly difficult economic environment, venture capital fund managers spent more time in the third quarter shoring up their existing portfolio companies than they did looking for new ones. Most of the capital invested in the third quarter went into North America-based clean-technology energy, health care, and software companies. There was one venture-backed initial public offering during the third quarter, and 78 investment exits via mergers and acquisitions (M&A). M&A activity was nearly the same as that of the quarter before, and most of it was again in the technology sector. Of the quarter's 78 M&A transactions, there were 29 deals whose values were released to the public. Those 29 deals were worth \$3.7 billion, compared with the 22 deals, based on public information, worth \$4.2 billion in the quarter before.

Venture capital investments have suffered in the economic turmoil in 2008 but the industry's long-term results are still positive, as shown in the table below. The industry's most dramatic decline, which occurred in 2001 and 2002 following the bursting of the technology investment bubble, accounts for the more than 38% drop in returns from the 10-year to the 7-year period.

Cambridge Associates derives its venture capital benchmarks from the financial information contained in its proprietary database of venture capital funds. As of September 30, 2008, the database included 1,238 venture funds formed from 1981 to 2008 with a value of approximately \$91.9 billion. By way of comparison, on September 30, 1998, the benchmark index included 565 funds whose value was slightly more than \$26.8 billion.

<b>U.S. Venture Capital Index Returns (%)</b>								
<b>As of September 30, 2008</b>								
<b>Periods Ending September 30, 2008</b>								
	<b>3<sup>rd</sup> Qtr.</b>	<b>9 Months</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>7 Years</b>	<b>10 Years</b>	<b>15 Years</b>
<b>U.S Venture Capital</b>	-2.8	-4.3	-0.9	10.2	10.7	1.8	40.2	33.3

Sources: Cambridge Associates LLC and the National Venture Capital Association

During the quarter ending September 30, 2008, the Cambridge Associates LLC U.S. Private Equity Index<sup>®</sup> fell 8.0%, bringing its year-to-date return to -8.9%. Beginning with 1995, all vintage years were down at least 3% for the quarter. The largest vintage year in the benchmark, 2006, produced the quarter's worst return, -12.7%, due mostly to declines in consumer, energy, and media investments. The next three top vintage years by size, 2005, 2004, and 2000, all dropped at least 4.9% for the quarter, as the value of their energy, consumer, financial services, and media companies fell. The funds launched in 2000, 2004, 2005, and 2006 comprised 70% of the index's value in the third quarter.

The private equity benchmark's third quarter performance reflected the worsening economy, with no sector earning a positive return. Five of the benchmark's top six industries by value—consumer, energy, financial services, manufacturing, and media—all dropped at least 6.0%. Health care fared well in comparison, falling only about 1.5%. But it was investments in retail companies, which accounted for nearly 25% of the index's value and dropped 6.5% in the quarter, that hurt the benchmark's return the most. The index's formerly high flying energy companies lost about 10.0% in the third quarter as oil and gas prices dropped, taking energy company valuations down with them. Among the index's smaller industries, electronics performed worst while software performed best.

In the third quarter, private equity managers called \$23 billion from investors and returned about \$8 billion, as both contributions and distributions outpaced the prior quarter's activity. Investors in funds raised in 2004 through 2007 contributed 94% of the total capital fund managers called for during the quarter. On the other hand, investors in funds launched from 1999 through 2005 received roughly 75% of the money funds distributed.

Private equity fund managers invested mostly in North American companies during the third quarter, spreading the capital among companies in the consumer, energy, financial services, technology, and health care sectors.

Despite a negative quarter and year-to-date performance, the private equity index's long-term returns have been positive, as shown in the table below. The benchmark's recent decline is rooted in the global economic downturn that began with the credit crunch in 2007.

Cambridge Associates derives its U.S Private Equity benchmarks from the financial information contained in its proprietary database of private equity funds. As of September 30, 2008, the database included 748 U.S buyouts, private equity energy, growth equity, and mezzanine funds formed from 1986 to 2008, values at roughly \$322.6 billion. By way of comparison, at September 30, 1998, the benchmark index included 268 funds whose value was nearly \$54.4 billion.

<b>U.S. Private Equity Index Returns (%)</b>								
<b>As of September 30, 2008</b>								
<b>Periods Ending September 30, 2008</b>								
	<b>3<sup>rd</sup> Qtr.</b>	<b>9 Months</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>7 Years</b>	<b>10 Years</b>	<b>15 Years</b>
<b>U.S Private Equity</b>	-8.0	-8.9	-5.6	13.3	19.0	13.6	11.8	14.0

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<sup>®</sup> is based on returns data compiled on funds representing over 80% of the total dollars raised by U.S. venture capital partnerships formed between 1981 and 2008. Similarly, the Cambridge Associates LLC U.S. Private Equity Index<sup>®</sup> is based on returns data compiled on funds representing over 70% of the total dollars raised by U.S buyouts, private equity, energy, growth equity, and mezzanine funds 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<sup>®</sup> and the Cambridge Associates LLC U.S. Private Equity Index<sup>®</sup> 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).

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