



CAMBRIDGE ASSOCIATES LLC

Cambridge Associates Private Equity and Venture Capital Market Commentary for Quarter Ending September 20, 2006

During the quarter ending the Cambridge Associates LLC U.S. Venture Capital Index[®] rose 2.2%, more than double its increase of the previous quarter and brought the benchmark's return for the year-to-date to 7.5%. Because they represented nearly 70% of the index's value during the period, the funds formed between 1999 and 2001 dominated its return for the quarter. Of this group, the year 2000 funds were the most active during the quarter, investing more than \$800 million in new and existing portfolio companies while distributing close to \$700 million to investors from exits through initial public offerings (IPOs) and mergers and acquisitions (M&A). The largest exits involved health care and software companies.

The modest third quarter increase resulted from investments in a range of investment industries, regions, and development stages. The benchmark's three largest industries—communications, health care, and software—all had positive returns, with software leading the pack. Energy companies did the best overall, but the energy sector, despite the venture industry's growing interest in clean energy technology, does not represent a large part of the index's value. The index earned positive returns in all regions of the United States, and in the less well-represented areas of China, the United Kingdom, and India. By stage of development, the private, early- to late-stage companies were up during the quarter, but the public companies in the venture capital index were down.

As shown in the table below, over the longer term, the venture capital index has produced double-digit returns in all but one of the time periods ending September 30, 2006. The lone negative return, -1.7 for the five-year period, reflects the record amount of money invested in 1999 and 2000 in early-stage technology and telecommunications companies that did not survive the bursting of the technology bubble. In today's market, venture capital investment is generally more diversified by industry, investment stage, and geographic region than it was during the late 1990s. The one exception, however, is the large amount of capital pouring into companies considered to be the next generation of Web technology, or Web 2.0, which uses that platform to share data, distribute media, and connect socially. Inflows into this sector sparked concerns for some that a new investment bubble was in the making.

Cambridge Associates derives its venture capital benchmarks from the financial information contained in its proprietary database of venture capital funds; as of September 30, 2006, the database comprised 1,132 venture funds started between 1981 and 2006, and 26,966 transactions with a value of roughly \$69 billion. By way of comparison, in September 1996 the benchmark index had 431 funds and 8,751 transactions whose value was nearly \$24 billion.

U.S. Venture Capital Index Returns (%)							
As of September 30, 2006							
Periods Ending September 30, 2006							
	3rd Qtr.		1	3	5	10	15
	<u>2006</u>	<u>9 Months</u>	<u>Year</u>	<u>Years</u>	<u>Years</u>	<u>Years</u>	<u>Years</u>
U.S. Venture Capital	2.2	7.5	10.0	10.9	-1.7	37.0	29.9

Source: Cambridge Associates LLC U.S. Venture Capital Index[®]

During the quarter ending September 30, 2006, the Cambridge Associates LLC U.S. Private Equity Index[®] gained 4.0%, equaling its previous quarter's return, and bringing year-to-date performance to 13.2%. The funds formed between 1997 and 2005 constitute the vast majority of the index's value, the year 2000 funds represent the largest portion at 28%, while the other years make up at least 5% each. The funds started in 2002 and 2003 earned the best returns in the third quarter due to strong performance by the energy and middle-market buyout funds. By sector, communications is the largest, accounting for roughly 20% of the underlying investments, but their return trailed those produced by the energy, manufacturing, retail, and financial services companies that dominate the mid-market funds.

As noted in the table below, the index returned roughly 23% and 26%, for the one- and three-year periods ending September 30, 2006, respectively. Both are considerably higher than the index's longer-term performance, driven mostly by strong credit markets, frenzied M&A activity worldwide, and volatile commodity prices, especially energy, which is the only one of the three that has begun to wane. Given the amount of money available to private equity funds, companies of all types and sizes are being considered for investment, including distressed companies or those in difficult industries or markets.

Throughout 2006, fund-raising remained strong for all buyout funds, including large and mega sized funds, industry specialists and diversified groups, and now, distressed specialists, which have begun to gear up for the next buying cycle. Private equity firms are competing with industry leaders, referred to as strategic buyers, for controlling stakes in companies in virtually all industries, and recruiting executives away from large public companies to obtain expertise in specific industries, which could help the firms find investment opportunities and the help to improve the and increase their value. This strategy has most recently been employed by private equity investors interested in companies in the automotive and technology industries

Cambridge Associates derives its private equity benchmarks from the financial information contained in its proprietary database of private equity funds; as of September 30, 2006, the database comprised 617 buyout, expansion, restructuring, special situation, sector specialized, and mezzanine funds. Among them there were 8,197 transactions with a value of roughly \$196 billion; ten years ago, the index contained 184 private equity funds and 1,466 transactions whose value was \$22 billion.

U.S. Private Equity Index Returns (%)							
As of September 30, 2006							
Periods Ending September 30, 2006							
	3rd Qtr.		1	3	5	10	15
	<u>2006</u>	<u>9 Months</u>	<u>Year</u>	<u>Years</u>	<u>Years</u>	<u>Years</u>	<u>Years</u>
U.S. Private Equity	4.0	13.2	22.6	26.1	15.2	13.2	14.5

Source: Cambridge Associates LLC U.S. Private Equity Index[®]

Cambridge Associates LLC's proprietary databases provide independent statistics to the institutional investment industry. The Cambridge Associates LLC U.S. Private Equity Index[®] is based on returns data compiled on funds representing over 70% of the total dollars raised by U.S. leveraged buyout, subordinated debt, and special situation partnerships formed between 1986 and 2006. 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 by the funds' general partners to Cambridge Associates LLC 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 at http://online.barrons.com/mktlab?mod=9_0002_markettools. 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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