Private Equity – After the Golden Age

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September 2008

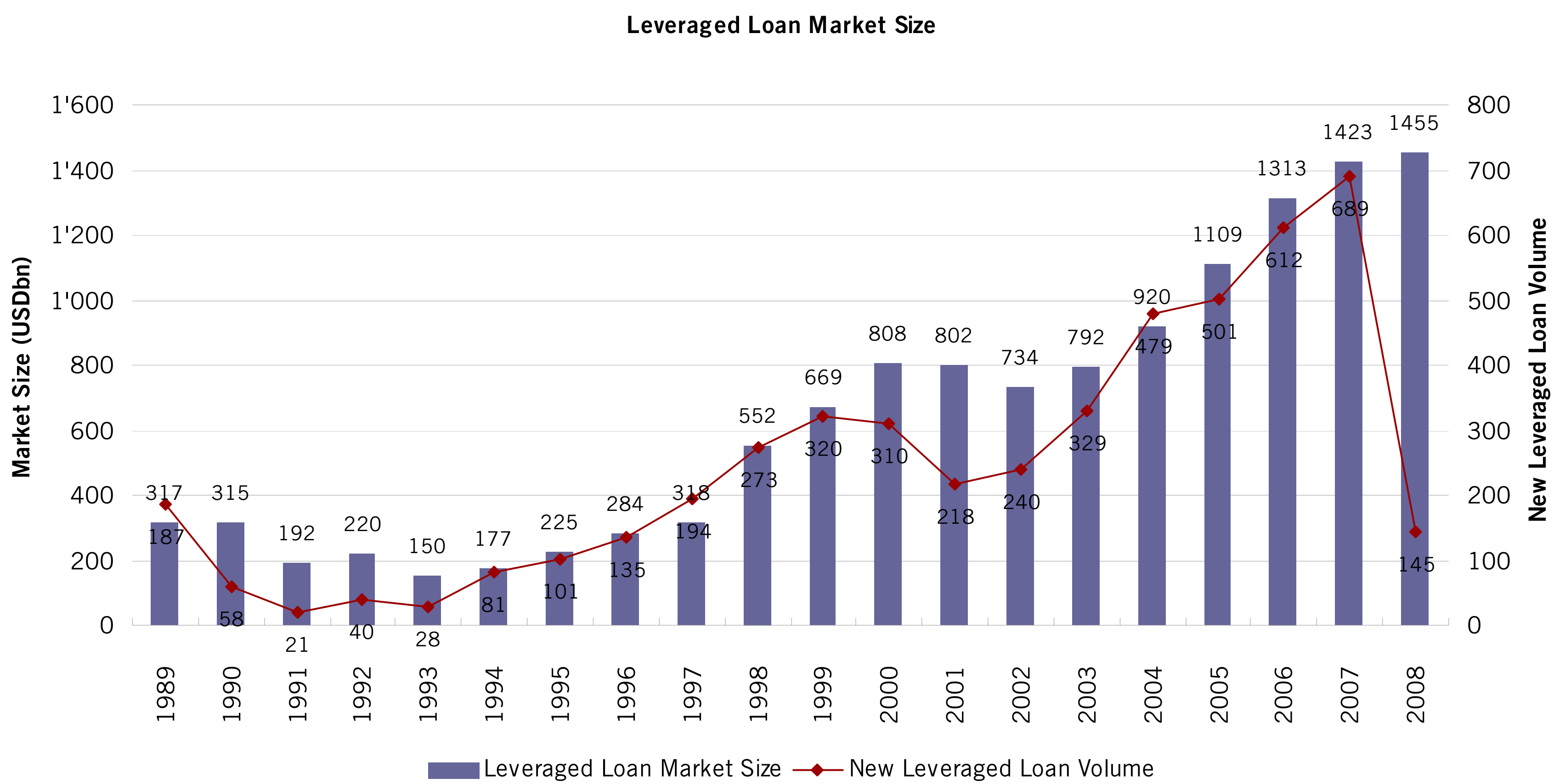
"We're, right now, the Golden Age [of private equity.]"

Henry Kravis, April 2007

"Remember that there is nothing stable in human affairs; therefore avoid undue elation in prosperity, or undue depression in adversity."

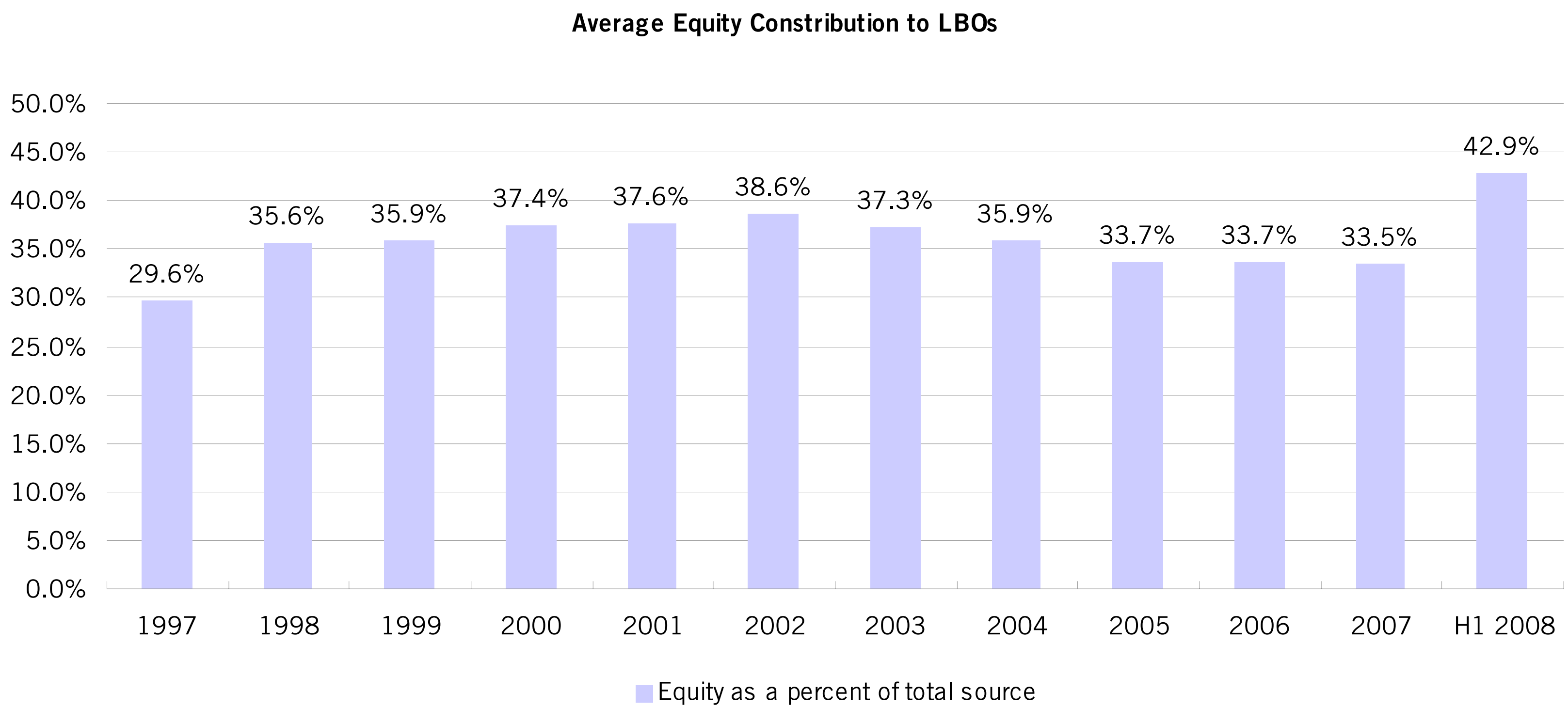
Socrates (469 BC – 399 BC)

Collapse in Leverage Capacity



Source: Credit Suisse, LPC
Notes:
As of 30.06.2008
Includes USD denominated non investment grade bank debt (revolvers, pro-rata and institutional term loans)

Increased Reliance on Equity



Source: S&P LCD

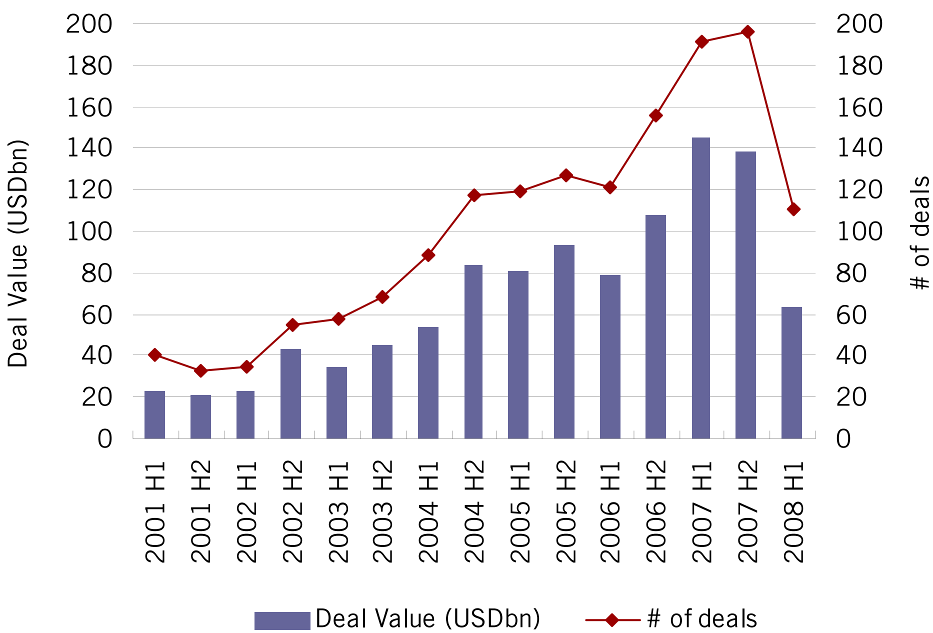
Note: Shareholder loans, common equity and preferred stock down streamed to the operating company as common equity as well as vendor note proceeds

Solid Overall Deal Activity

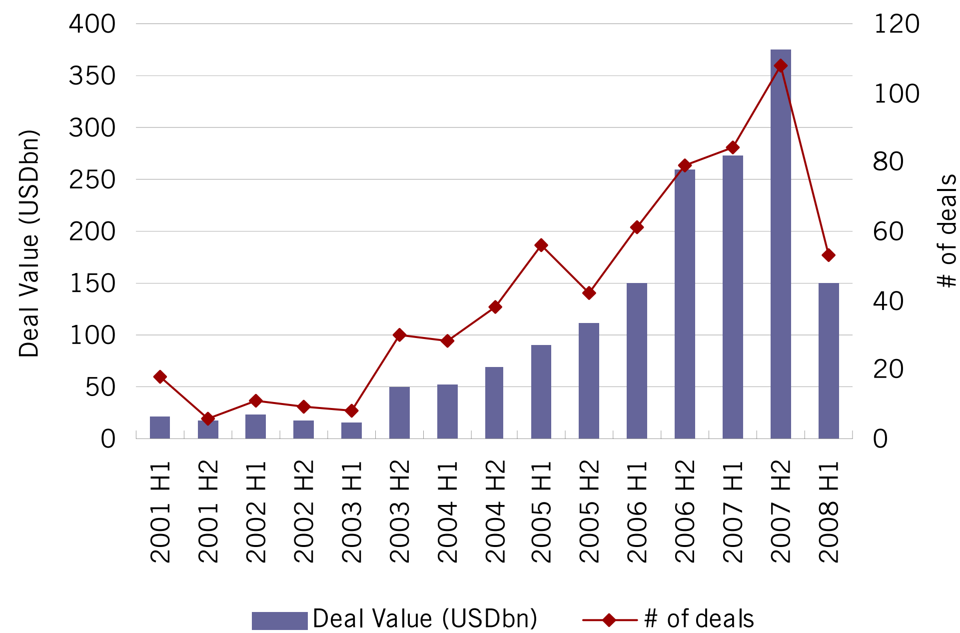
Source: S&P LCD

Financial Sponsors Deal Activity

Middle-Market (USD 500m-2'000m)



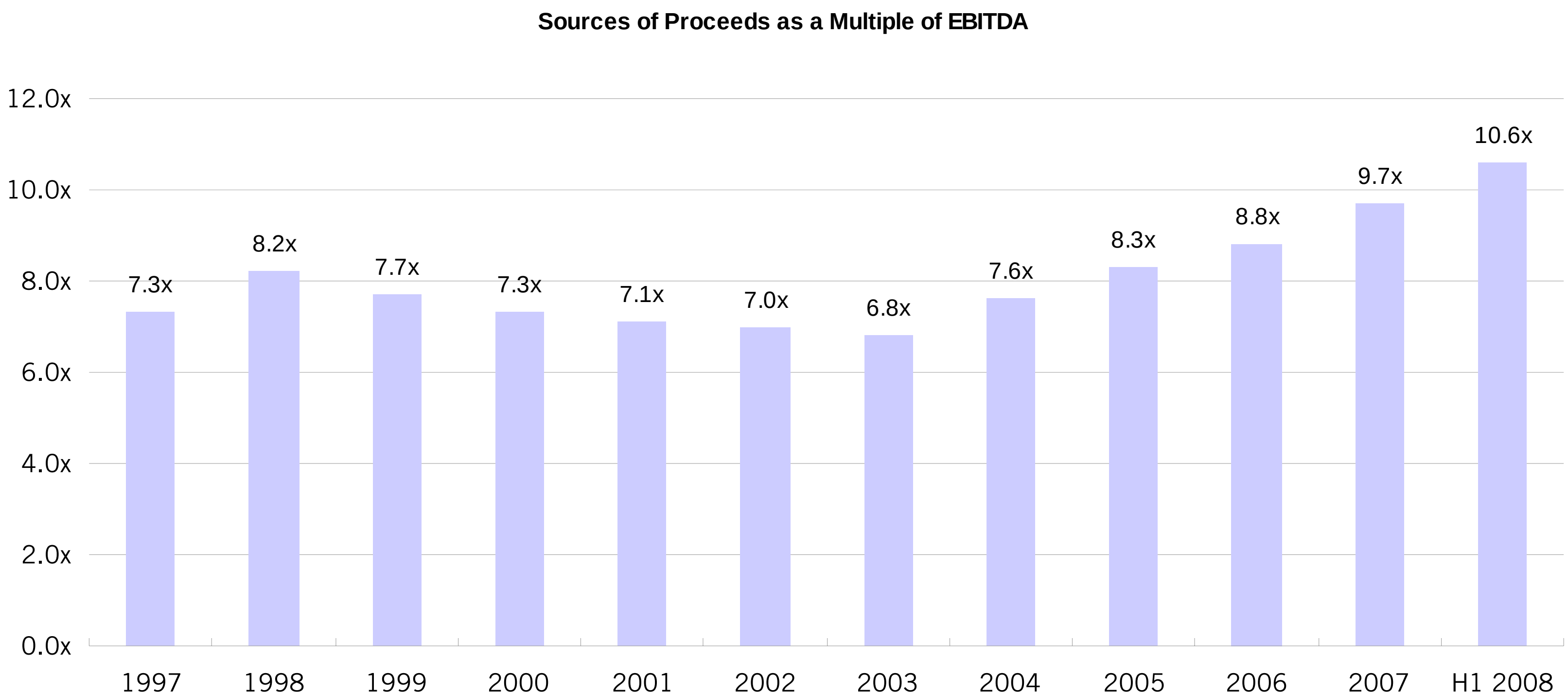
Large Corps (>USD 2'000m)



- H1 2008 shows substantially lower deal activity compared to H1 2007
- Since H2 2007, deal activity has dropped 48% for middle market transactions and 54% for large cap transactions

Source: Dealogic

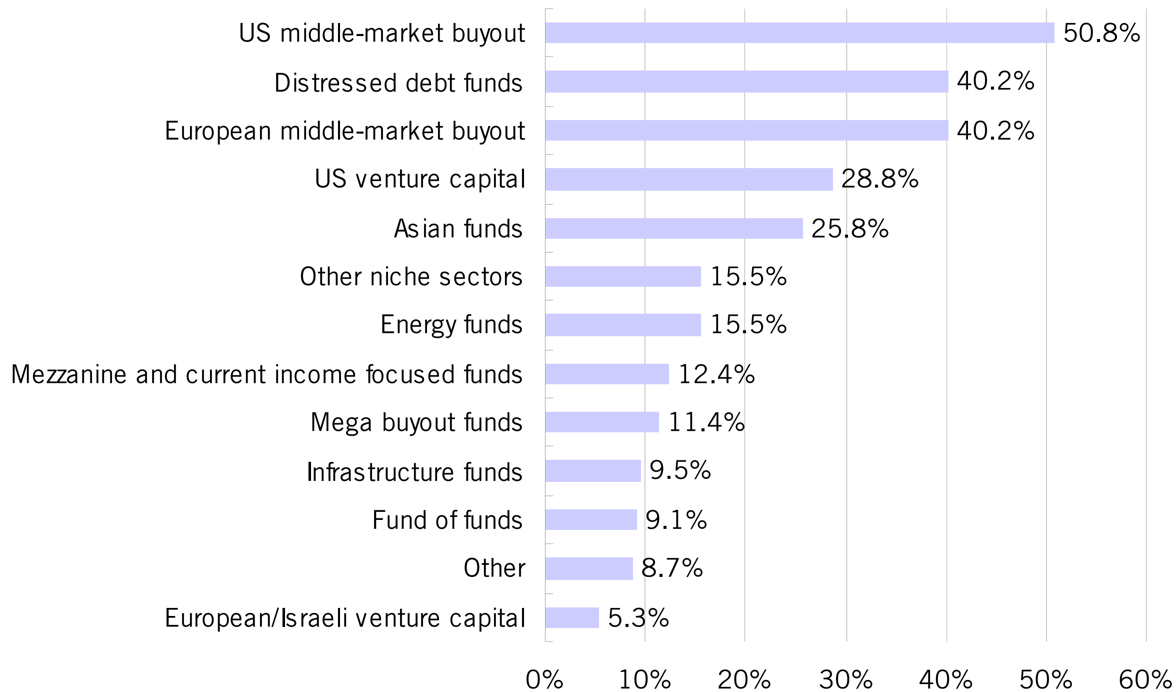
Stubbornly High Prices



Source: S&P LCD

Allocations Are Shifting

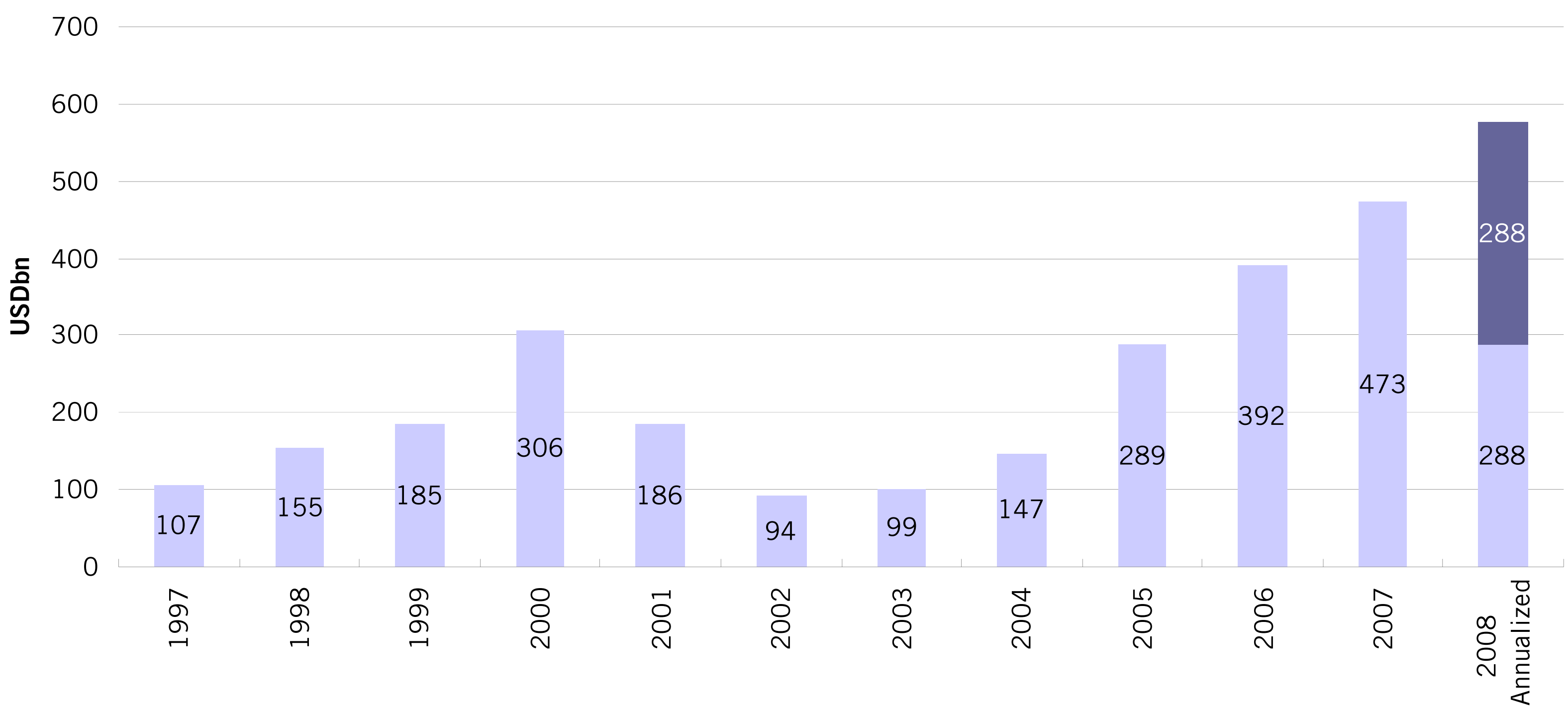
- Sectors LPs plan to focus most of their attention on investing during 2008



Source: Probitas Partners

Record Fund Raising

Global Private Equity Funds Raised (USDbn)



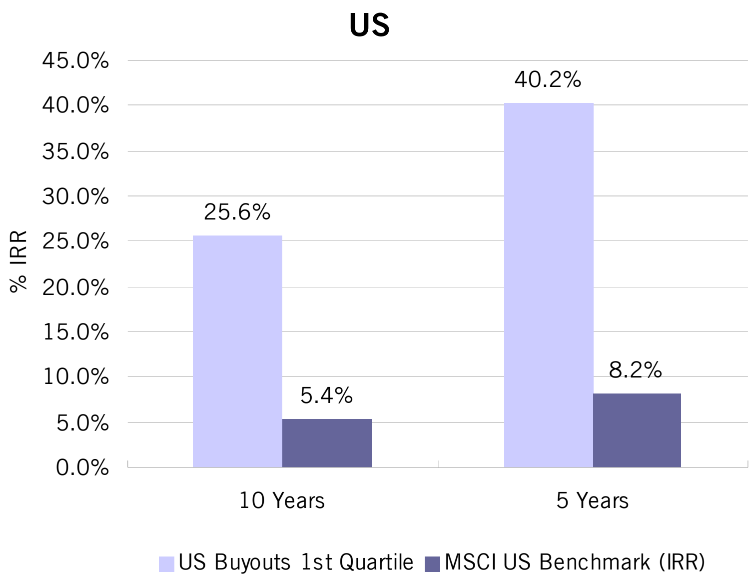
Source: Thomson Venture Economics

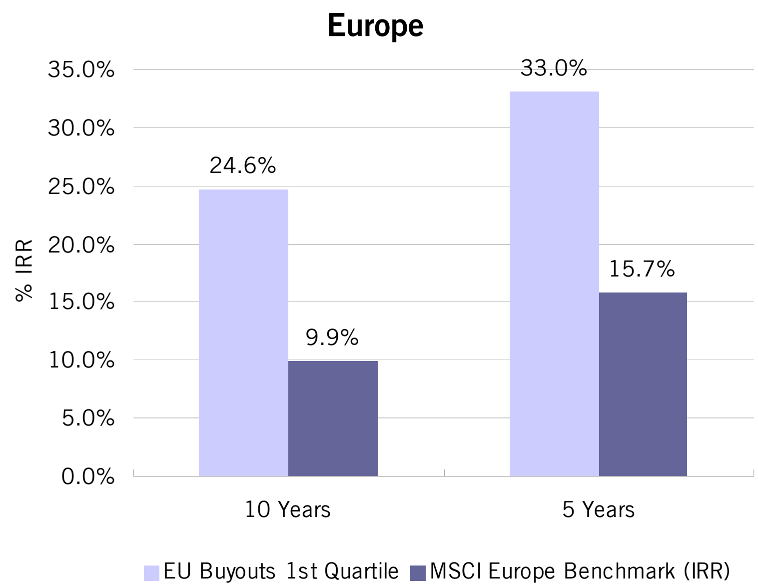
1) Private Equity Has Delivered

Public Market Equivalent

US	US Buyouts 1stQ (IRR)[1]	MSCI US Benchmark (IRR)[2]	US Buyouts Pooled (IRR)[3]	MSCI US Benchmark (IRR)[4]	MSCI US (TWR)[5]
1998 - Q1 2008	25.6%	5.4%	9.7%	3.7%	5.2%
2003 - Q1 2008	40.2%	8.2%	15.8%	4.4%	12.1%

Europe	EU Buyouts 1stQ (IRR)[1]	MSCI Europe Benchmark (IRR)[2]	EU Buyouts Pooled (IRR)[3]	MSCI Europe Benchmark (IRR)[4]	MSCI Europe (TWR)[5]
1998 - 2007	24.6%	9.9%	15.1%	8.0%	7.1%
2003 - 2007	33.0%	15.7%	13.2%	13.4%	19.2%





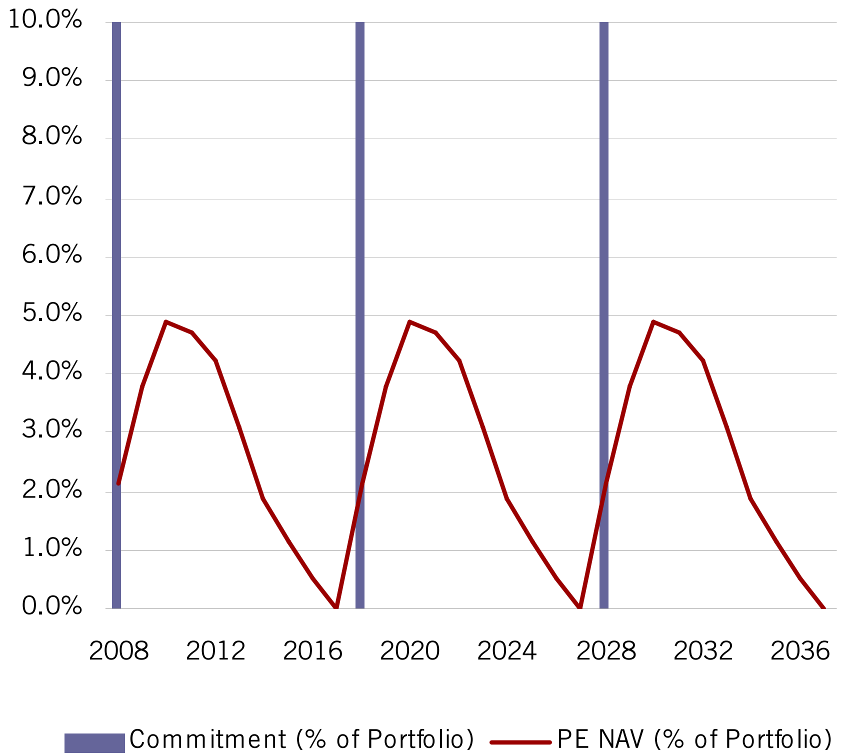
Sources: DataStream, Thomson Venture Economics

Notes:

1 Benchmark derived from cash flows from funds in the top quartile position relative to their vintage (only vintages of the relevant period are included in the sample)
2 MSCI benchmark IRR determined by replicating cash flows from 1st quartile funds in sample on MSCI total return index (Public Market Equivalent Method – PME+)
3 Pooled benchmarks are calculated by pooling together all cash flows from all funds in sample
4 MSCI benchmark IRR determined by replicating pooled cash flows from all funds in sample on MSCI total return index (Public Market Equivalent Method – PME+)
5 Time Weighted Return (annualized monthly log-returns for the index over the relevant period)

2) Commitment Is Not Exposure

Relative PE exposure (%)

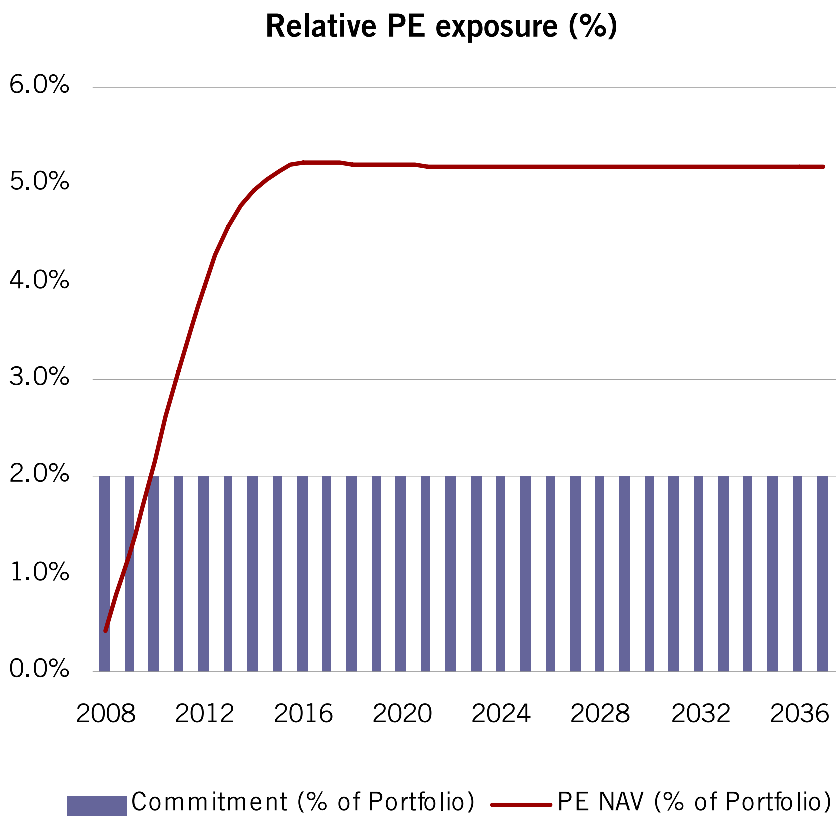


- **Commitments** to private equity funds do no result in the amount of the commitment being called
- **Calls**: Cash is called as needed for investments typically over a six year period
- **Distributions**: Cash is distributed as investments are realized resulting in a decline in exposure to private equity
- **Overlap**: Investment and divestiture periods overlap resulting limiting the peak level of exposure (i.e. distributions occur before the commitments are fully called)

Notes:
Commitment equal to 10% of portfolio
Average cashflow behavior of 800 funds applied
Portfolio returns 7.0% p.a. for non PE assets
PE investments return 1.7x or 17.6% IRR

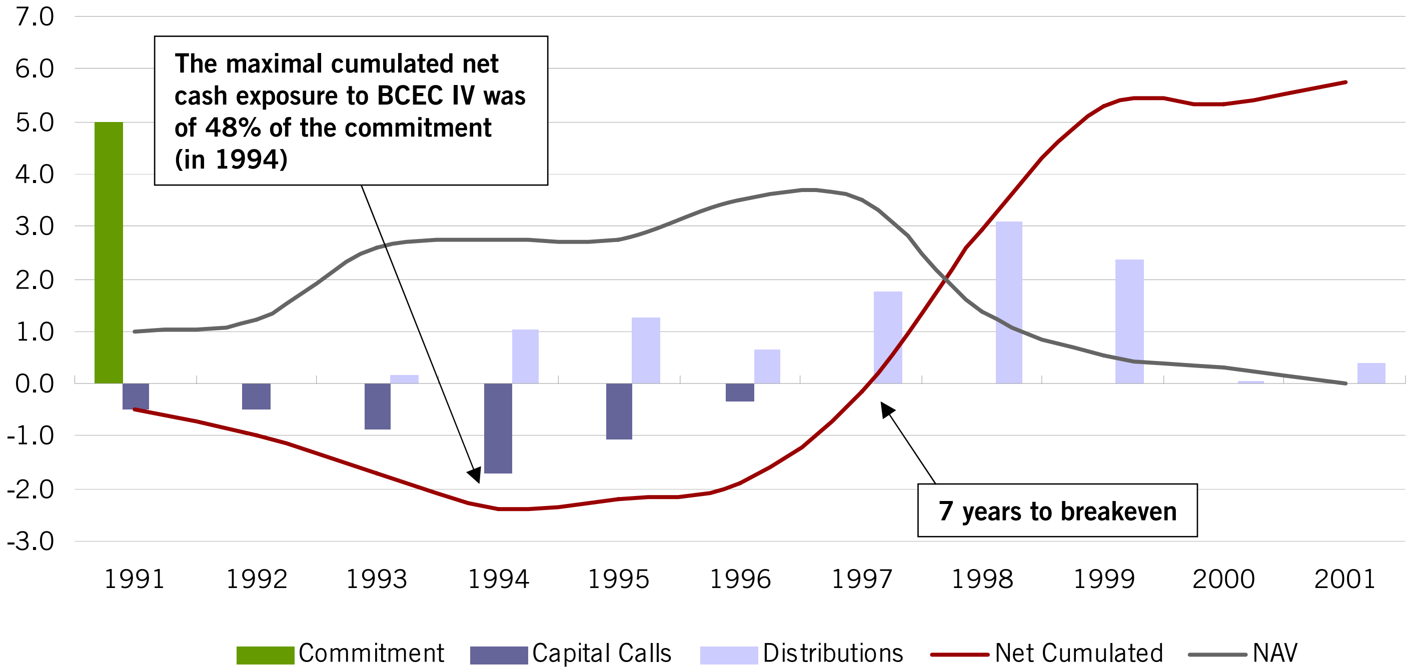
3) Overcommitment Required

- Given the structural characteristic of private equity exposure to decrease with the progression of the life of funds, continuous investments are required to maintain exposure
- For example, our standard model shows that an annual allocation equaling 2% of the portfolio leads to a constant PE exposure of 5%



Notes:
Portfolio returns 7.0% p.a. for non PE assets
PE investments return 1.7x at liquidation or 17.6% IRR

BCEC IV – A Case Study



- **BC European Capital IV is a 1990 vintage Fund of EUR 144m total commitments**
  - The Fund had a realized net multiple of 2.1x with a 24.1% net IRR
- **Early distributions offset capital drawdowns**
  - Net cumulated cash exposure rarely reaches 100% of the commitment
- **Net Asset Value (NAV) reaches 0 as the Fund is liquidated**

Conclusion

- **Leverage** is dramatically down
- **Deal levels** are significantly down from 2007 highs, but surprisingly robust compared to historical levels
- Sub-asset class **allocations shifting** to mid-market, distressed and emerging markets – reallocations should be expected to be a normal ongoing process
- **Valuations** are stubbornly high
- **Fundraising** is remarkably strong…why?
  - Private equity has delivered in terms of
    - Premium returns over public markets
    - Limited volatility of reported valuations
  - Commitments do not equal exposure
    - Cash is called as needed over six years and distributions occur prior to commitments being fully called and ultimately lead to an exposure of zero

"More than any other time in history, mankind faces a crossroads. One path leads to despair and utter hopelessness. The other, to total extinction. Let us pray we have the wisdom to choose correctly."

Woody Allen (1935 -)
My Speech to the Graduates
US movie actor, comedian, & director

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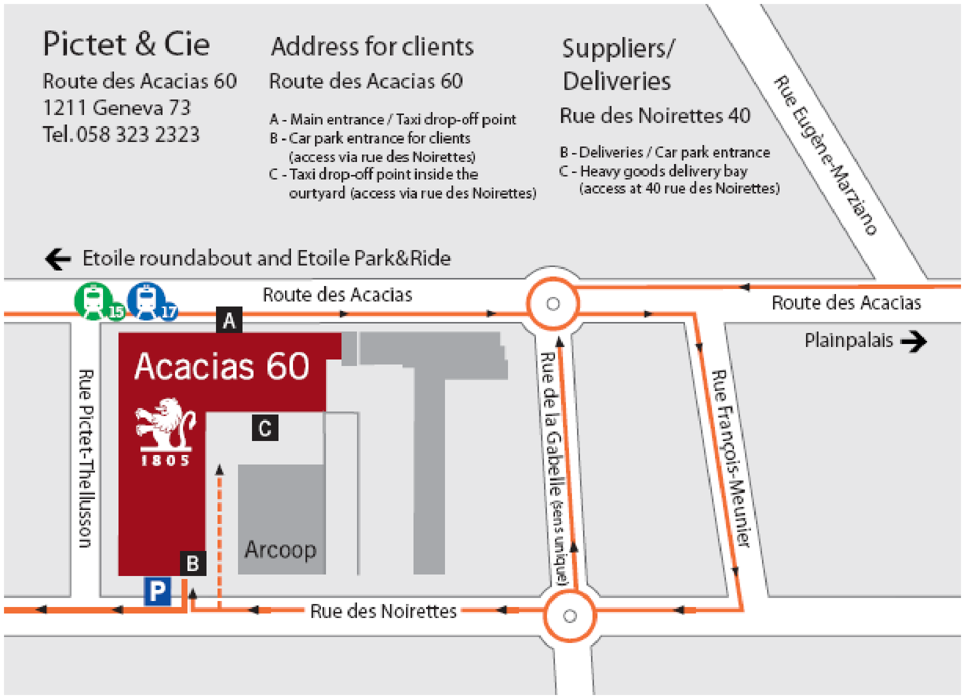
Contacts



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