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How the Global Credit Meltdown Has Changed the World of Private Equity - For The Better

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At The Peak

- 2007 commitments to new funds increased by 64% from 2000 and 2,250% from 1990
- 75 funds of $5 billion or more were raised from 2003-2007
- 58 deals of $5 billion or more were completed from 2003-2007 (up 5,700% from 1996 – 2000 period)
- 2003-2007 13,000 deals were completed (up 140% from 1996 – 2000 period)
- Senior loan volume for sponsored transactions reached $485 billion in 2005-2007 (up 386% from 1999 – 2001 period)
- Debt / EBITDA multiples increased by 50% from 2001 (4.1x Debt / EBITDA average) to 2007 (6.2x EBITDA average)
- Purchase price / EBITDA multiples increased 62% from 2001 (6.0x average) to 2007 (9.7x average)
- Top 20 public pension funds' allocations to private equity exceeded $100 billion from 2000 to 2007

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Source: Thomson Venture Economics, data as of 12/31/08; Capital IQ; Dealogic, data for sponsor-entry transactions; S&P LCD; Private Equity Council, Primer 2007.

Now

- Global deal value declined from $738 billion in 2007 to $212 billion in 2008
- Commitments to new funds declined from $152 billion committed in first quarter of 2008 compared to $49 billion committed in last quarter of 2008
- Distributions decreased from 3Q07 to 4Q08 by 78%

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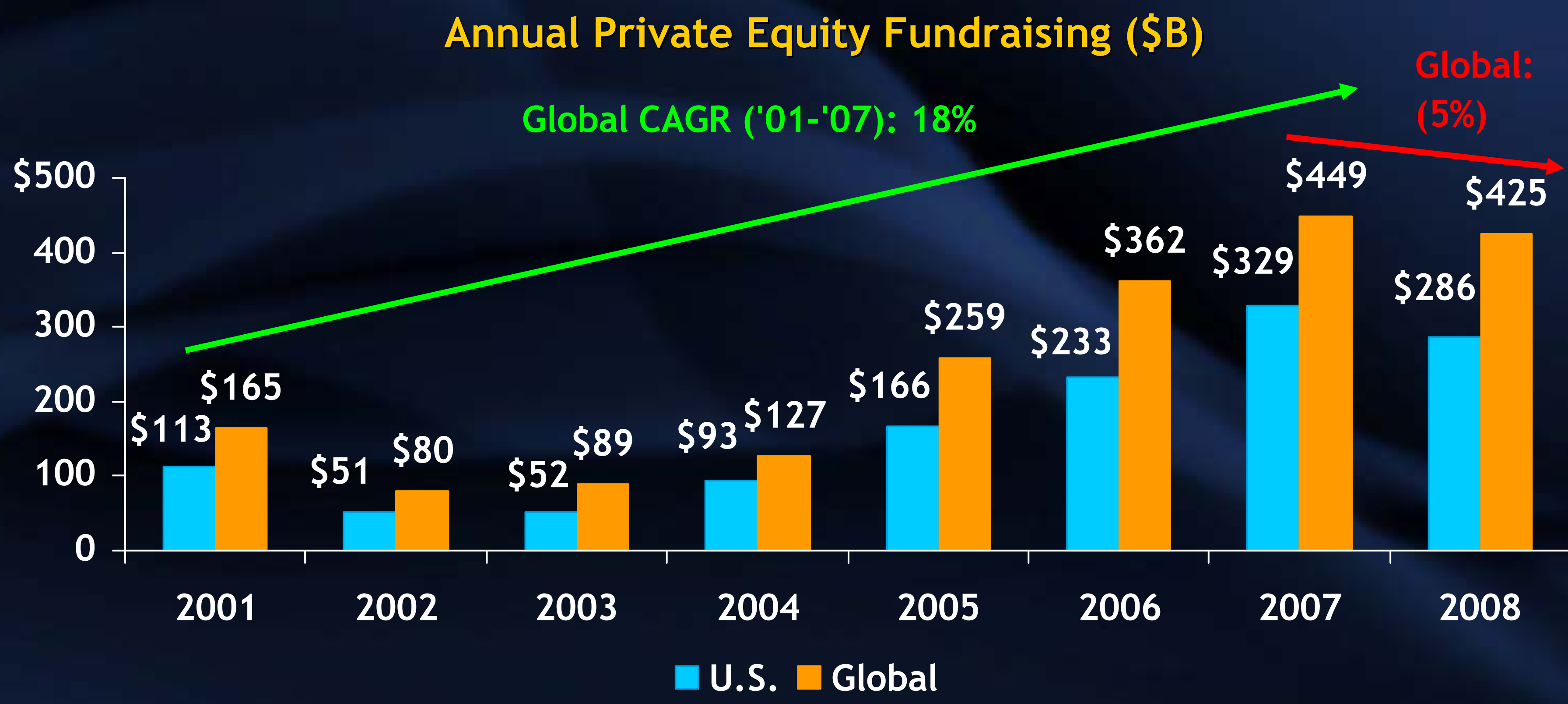
Source: Thomson Venture Economics, data as of 12/31/08; Capital IQ; Dealogic, data for sponsor-entry transactions; S&P LCD; Private Equity Council, Primer 2007.

Fundraising Has Slowed



Source: Thomson Venture Economics, data as of 12/31/08.

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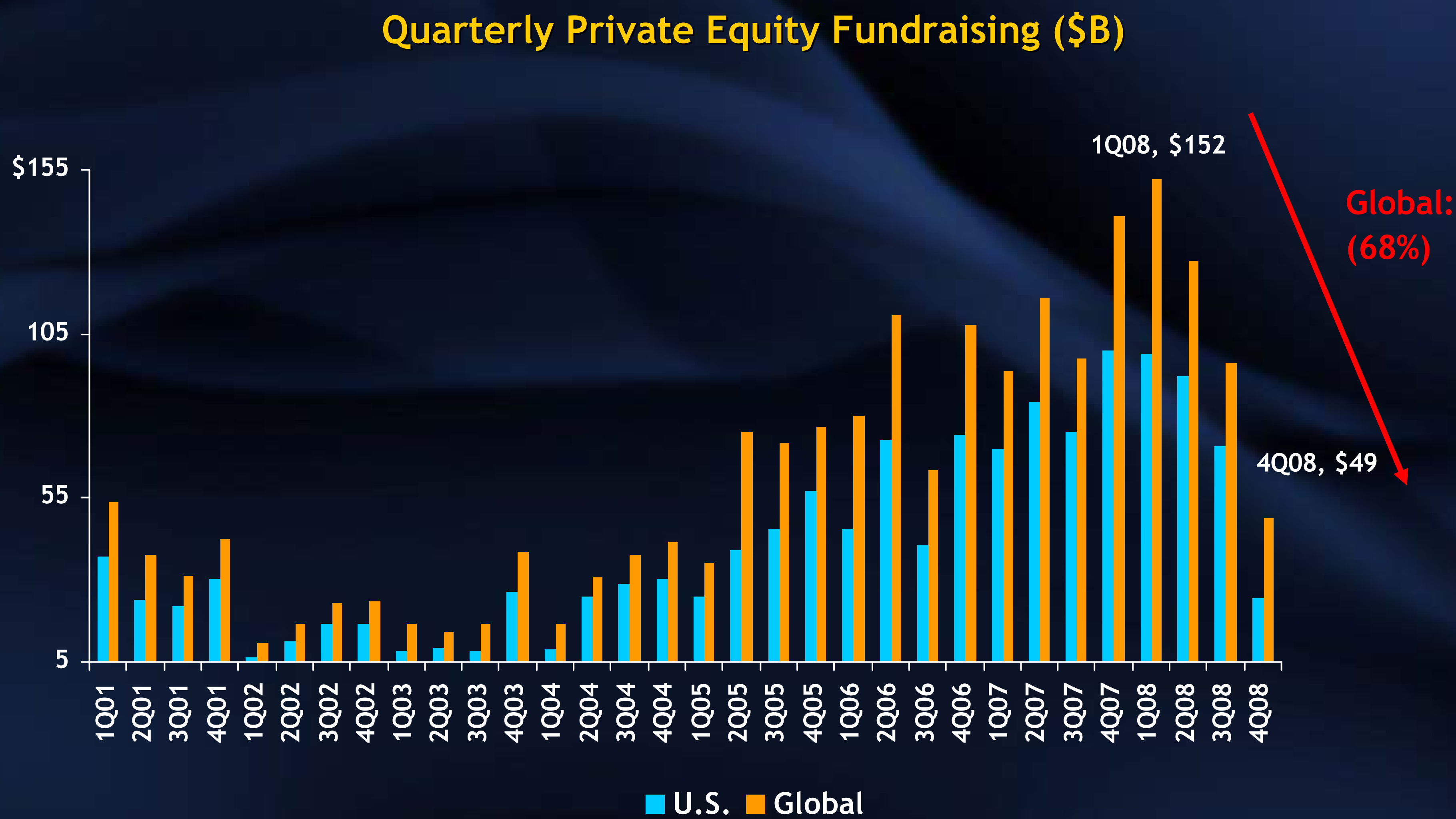
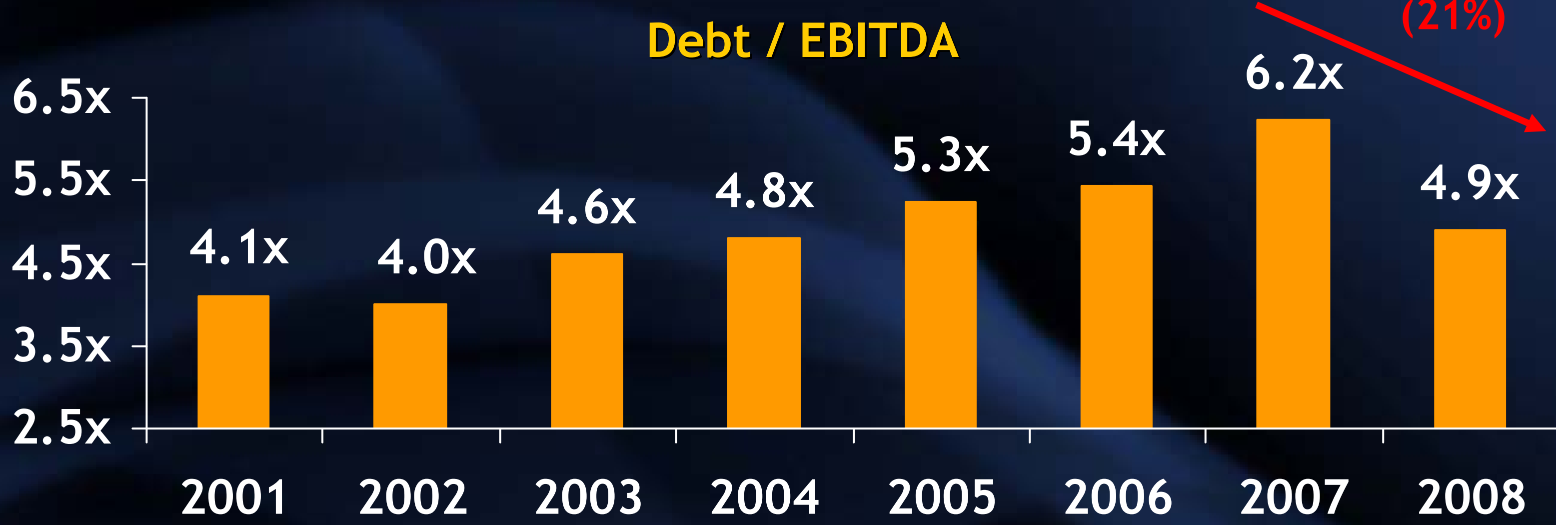
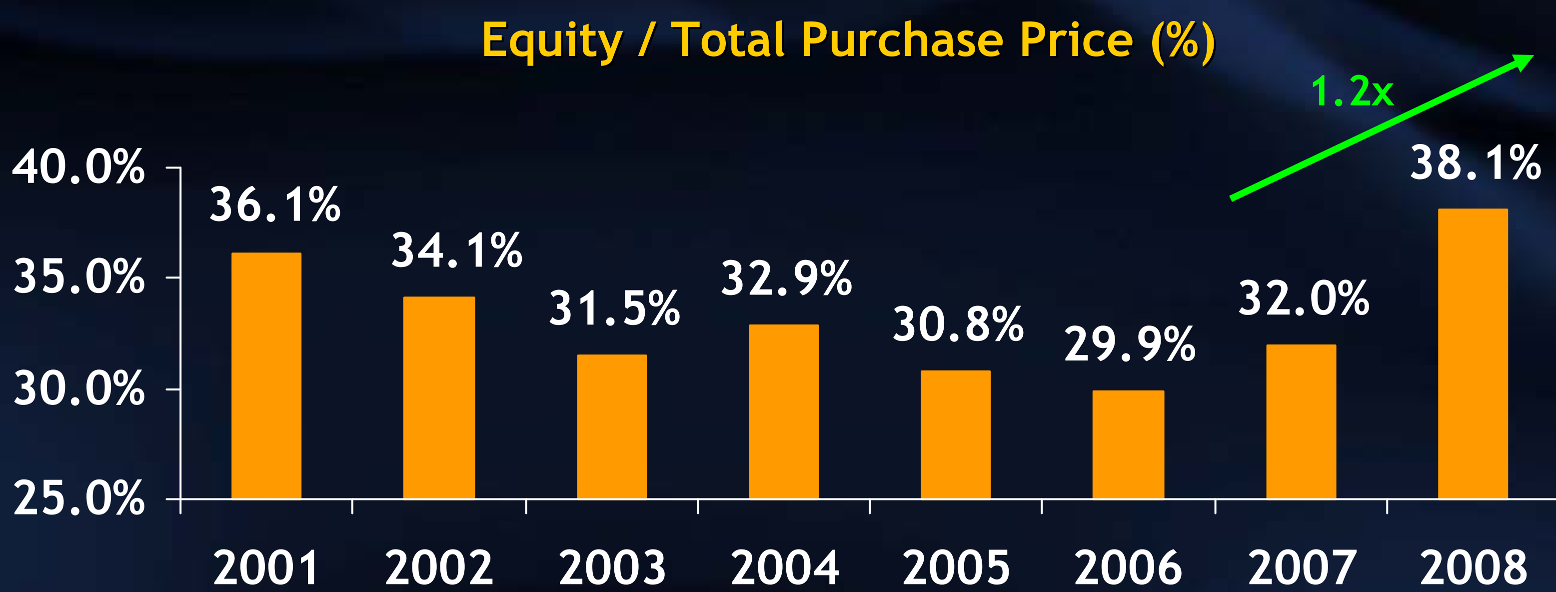


Source: Thomson Venture Economics, data as of 12/31/08.

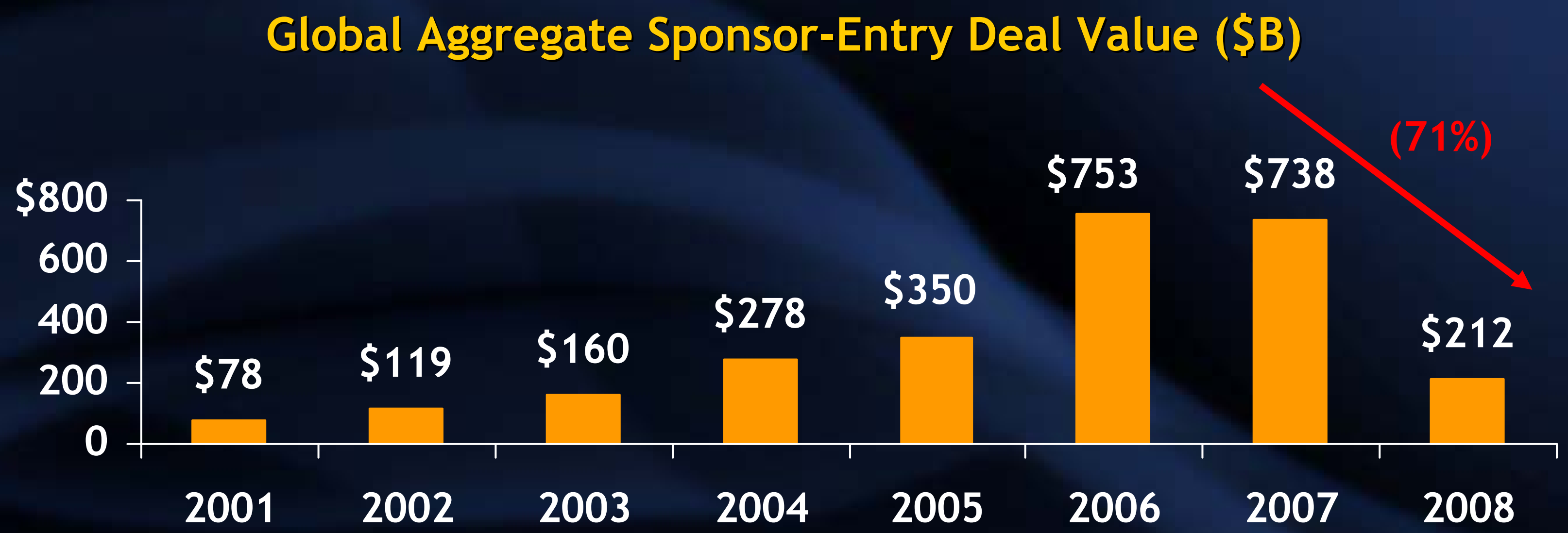
Leverage Has Declined, Requiring More Equity





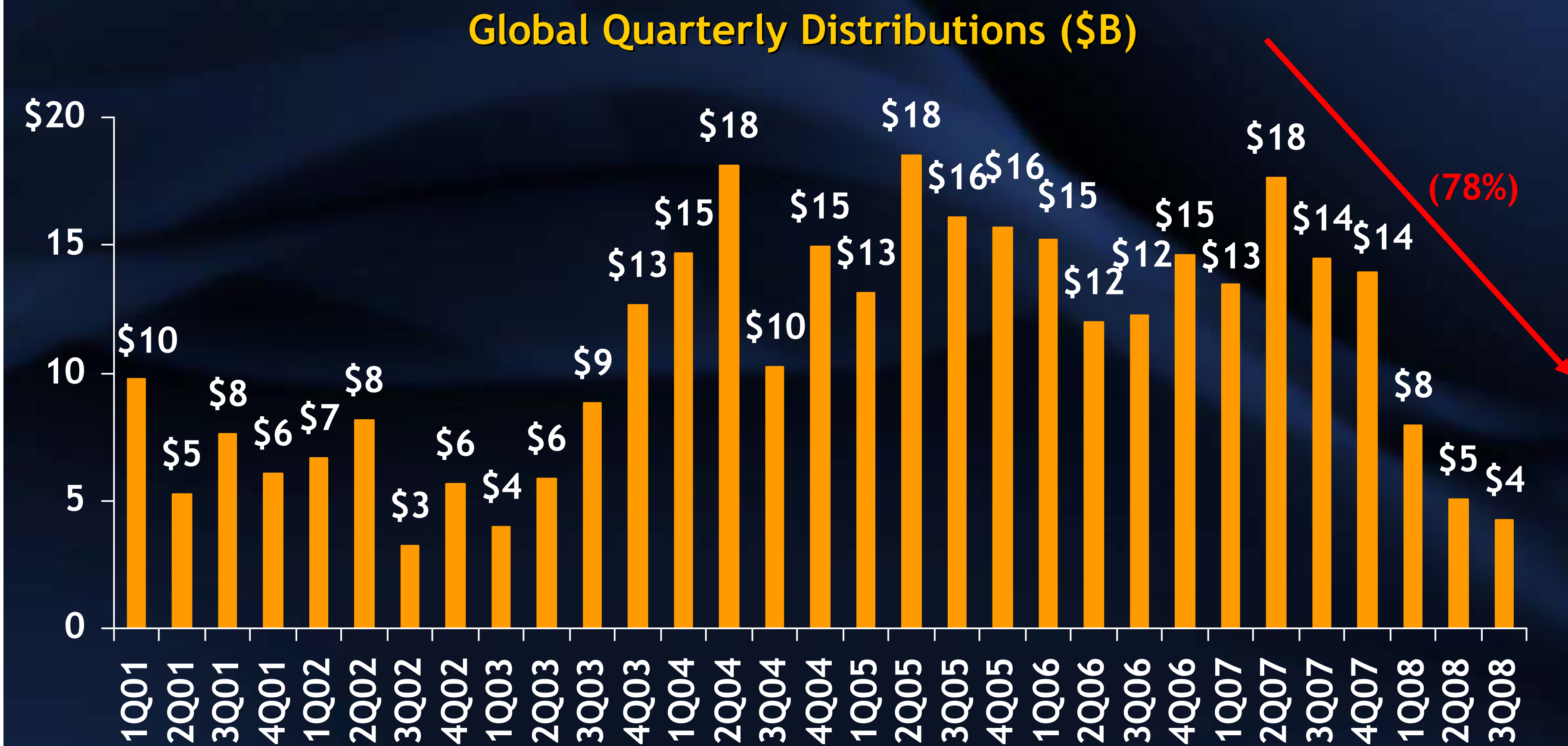
Source: S&P LCD, leverage data for U.S. large corporate LBOs (issuer w/EBITDA >$50M), equity data for all U.S. LBOs with total sources > $1 billion.

Deal Value and Average Size Declining



Source: Dealogic, data for global sponsor-entry transactions, includes pending.

Distributions Have Declined



Source: Thomson Venture Economics, data as of 9/30/08

How The Private Equity World Has Changed

1. Confidence in the Future Has Been Diminished
   - From 2002-2007, confidence in private equity's ability to achieve superior returns was at highest levels ever
   - Now: some have concerns (a) whether private equity can yield attractive returns on investments made in 2005-2008 period; (b) whether private equity can ever again reach the returns achieved by private equity at its peak

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How The Private Equity World Has Changed

2. PE Has Ceased Being the Visible Face of Economic Change and Activity
   - From 2005-2007, private equity was so active in its buying new companies that it essentially became the symbol of capital activity
   - Now: public focus has been on systemic risk from commercial and investment banks, insurance companies, and hedge funds

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How The Private Equity World Has Changed

3. PE's Main Focus Is Now to Preserve Value of Its Existing Holdings
   - PE firms have been spending most of their time on their portfolio companies--cutting costs, preserving cash, and surviving until the economy and investment world returns

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How The Private Equity World Has Changed

4. PE Firms Have Sought to Do With Their Firms What They are Telling their Portfolio Companies to Do
   - PE firms have been cutting the size of their staffs, reducing other costs, preserving their cash, and refocusing their efforts on their core businesses

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How The Private Equity World Has Changed

5. PE Firms are Focusing on Preserving Strength of their Funds
   - Firms are in more regular dialogue with their investors about current investment needs and opportunities

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How The Private Equity World Has Changed

6. <u>PE firms Have Recognized the Enormous Difficulty of Raising New Funds for the Foreseeable Future</u>
   - Even strongest and best known will find fundraising hardest in decades; PE firms without well known brands or long track records realize they may not be able to raise new capital at all for quite awhile

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How The Private Equity World Has Changed

7. New Investments Will Be Far Different in Nature, Shape, Size and Structure Than in the 2003-2007 Period
   - Now: investments are few in number; tend to be less than $3 billion in size; have stringent debt terms (where there is debt); have traditional EBITDA multiples; require about 45-50% equity (where a control position is being purchased); and are increasingly minority stake positions

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How The Private Equity World Has Changed

8. Opportunities for Exit Have Been Reduced, Resulting In Lower Returns and Fewer Distributions
   - PE firms will have to hold onto their companies longer or take prices far below their once anticipated exit levels; and provide less frequent distributions than once projected

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How The Private Equity World Has Changed

9. <u>More than a Few of the Best Known and Largest Investments completed in the 2005-2007 Period Will Have to Be Recapitalized in Order to be Preserved</u>

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How The Private Equity World Has Changed

10. Increased government regulation of banks and other lending organizations could constrain credit availability beyond normal market constraints

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What 2009 Will Bring to the World of Private Equity

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1. Relatively few U.S. buyouts will be completed; buyout firms will be focused on their existing portfolios; sellers will not like the available sale prices; and banks will not return to lending for all but the safest transactions. Buyouts completed in this environment will likely yield high returns in several years
2. Private equity firms will complete, proportionately, a higher percentage of non-control investments than ever; many of these will be outside the U.S. and Europe, in emerging markets
3. Exits on existing investments will be relatively few, with strategic buyers providing the only available exit route

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What 2009 Will Bring to the World of Private Equity

4. Few new funds will be raised at the sizes truly desired by private equity firms; funds which are raised will be raised by the best brand name firms or firms with specialized expertise in attractive niches
5. Some investors will continue selling their stakes in private equity funds; the sales will yield larger than normal discounts to NAV
6. Other investors will increase their private equity stakes; and some investors not yet in private equity will enter the private equity world

What 2009 Will Bring to the World of Private Equity

7. More than a few well-known investments will likely not survive
8. New private equity funds (for new organizations) will have a difficult time getting any funding
9. Private equity firms will reduce the size of their organizations and will narrow their focus
10. The appeal of PE to new MBA's and financial professionals will be reduced, as compensation and activity are reduced

Why Might All Of This Be For The Better?

1. Need for private equity capital is greater than ever
2. Reduced prices will likely yield very high returns for private equity capital invested now and over the next 2-3 years
3. Many private equity transactions now available do not need new debt, or any debt
4. A return to normal patterns is always welcome--less frenzy, uneconomic activity, more time to improve companies
5. Pressure on banks to lend will result in enhanced credit availability for deals needing leverage--likely by mid--2009
6. Co-investment opportunities will be far greater than before

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Why Might All Of This Be For The Better?

7. Debt will be on terms which ensure more discipline in the investment decision and process
8. Pressure to invest funds quickly will be reduced
9. Less disciplined buyers will be largely removed from the market
10. Governments and others will increasingly see private equity as a solution to problems
11. Enhanced recognition that private equity was not a cause of systemic risk--not a cause of the economic decline
12. Expectations of what private equity can do to fix companies, achieve returns, solve society's problems will return to more normal (and realistic) levels
13. Private equity will stabilize; better firms will stay in business and grow

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Why Might All Of This Be For The Better?

14. Image of private equity will have a chance of improving as more normal investment patterns and performance returns
15. Private equity will emerge as the clearly preferred form of alternative investing

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Challenges For The Industry

1. Recognize that the world of finance--and private equity--has dramatically changed over the past year (this is not your father's private equity world), and the private equity firms need to adapt their investment approaches and business model to accommodate these changes--if they want to continue to be active in the private equity world
   - The Theory of Evolution applies to private equity as well as to animal species

Challenges For The Industry

2. Realize that governmental actions can play a larger role in the private equity world, and be prepared therefore to better explain to government officials--and the general public--precisely how private equity adds value to an economy and therefore deserves to be treated as an important and valued partner in economic growth and recovery plans
   - It is up to the industry to ensure that governments understand and value private equity

Challenges For The Industry

3. Work to strengthen limited partner relationships and trust by understanding limited partner concerns and needs and aligning interests as closely as possible over a reasonable period
   - The economic and structural relationships of the industry are not written in stone; they may need to be updated to reflect the new world of private equity

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Challenges For The Industry

4. Recognize that the current public image of the industry is not a positive one, and continued efforts (by GP's and LP's) to improve this image (and ensure there is reality behind this image) will be needed if the industry is to be seen as additive to society rather than negative for society
    - The public needs to be treated as a partner if the industry is going to survive and prosper; and partners need to be informed about what is actually occurring on a timely basis

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Challenges For The Industry

5. Preserving as much equity and as many jobs as possible during the economic downtown
    - What happens in the private equity world will not stay in the private equity world; what is done in this period will be remembered far more than what is done in good economic times

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