PRIVATE EQUITY SPOTLIGHT

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July 2006 Volume 2 Issue 7

Welcome to the latest edition of ***Private Equity Spotlight***, the monthly newsletter from Private Equity Intelligence, providing insights into private equity performance, investors and fund raising. Private Equity Spotlight combines information from our online products Performance Analyst, Investor Intelligence and Funds in Market.

No. of Funds on Road	US	Europe	ROW	Total
Venture	140	50	72	**262**
Buyout	107	49	35	**191**
Fund of Funds	65	38	8	**111**
Other	67	15	16	**98**
Total	**452**	**180**	**153**	**785**

SUBSCRIPTIONS

If you would like to receive Private Equity Spotlight each month please email spotlight@preqin.com.

Subscribers to Performance Analyst and Investor Intelligence receive additional information not available in the free version. If you would like further details please email sales@preqin.com.

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Feature Article: The Governance Problem

Active investors are one of the most effective and little appreciated forces in improving corporate governance - both directly in the companies they acquire, and indirectly through their ability to influence public companies to adopt their financial and operational practices. It is not a coincidence that they also create significant value.

Active investors are a diverse group that includes financial entrepreneurs; the merchant banking arms of Wall Street houses; hedge funds; and, most important of all, buyout firms. Unlike typical institutional investors who generally have a broad portfolio with small stakes in many companies, active investors use their own capital and that of their investors to take substantial positions in a small number of companies.

In 1989, Michael Jensen, then a Harvard Business School Professor, predicted that large public corporations in many sectors would be "eclipsed" by active investors. The reason: they resolved the inherent conflict between owners and managers over the control of a public corporation's resources. According to Jensen, neither the board of directors nor institutional investors can be expected to align the interests of owners with managers. Neither group has the incentive or time to keep a close eye on management.

> "As demonstrated by its spread across industries and countries, private equity investment is a critical catalyst for restructuring corporate assets and creating value."

The wave of high-profile public-company governance disasters can to some extent be traced to this system's reliance on passive governance. The U.S. government response has been the introduction of comprehensive and costly new securities legislation to verify internal controls and accountability procedures, and new listing standards to increase director independence.

Hence, it's a good time to look at how active investors resolve the conflict between owners and managers, especially given that their track record in generating stellar returns is marked by few instances of fraud or dishonest dealings.

The Mechanics of Good Governance

Active investors resolve the divergence in owner-manager interests in a number of ways. One of the most effective is to concentrate equity ownership of a firm into fewer hands - involving going private through a leveraged buyout or leveraged recapitalization in the public market. When managers and directors become owners, the conflicts and monitoring costs are minimized, solving a big part of the governance problem.

Ownership at the board level matters too. Robert Gertner and Steve Kaplan at the University of Chicago found that the biggest difference between the boards of buyouts that go public and those of comparison company boards was that the former control larger equity stakes. They also discovered that compared to their peers, buyout firms put a premium on finding board members with industry knowledge.

Besides promoting governance through strong ownership incentives, debt also provides a powerful check on the tendency of managers to fund value destroying investments. Contractual obligations to pay down debt help management achieve strategic clarity by keeping them focused on the core business and motivated to cut costs.

The partnership structure is another key feature. Limited partners commit funds for up to 5 years, or longer, while general partners (GPs), are obligated to return this money plus a profit, and generally do not receive their carry until they do so. As principals, GPs invest side-by-side with limited partners - another big incentive-alignment plus.

There is no equivalent discipline in public corporations to the partnership's obligation to distribute cash to investors. On the contrary, excess cash can give rise to significant "agency costs" - the monitoring, contracting, and governance costs to ensure the interests of owners and managers are aligned.

Private equity's multiple year fund life means that its investment horizon is much longer than the quarterly focus of many public companies. Enron, WorldCom and other governance failures demonstrated that the short-term game of managing quarterly earnings results can encourage managers to over-step the law to "hit their numbers," and lead to massive destruction of shareholder value.

The partnership structure, limited fund life, and reliance on ownership incentives enable private equity firms to operate with lean, decentralized staffs. Fewer organizational layers make the job of governance easier by increasing transparency and strengthening accountability.

In sharp contrast with large public companies with multiple divisions, each portfolio company of a buyout firm is operated as a separate stand-alone entity. This limits opportunities to cross-subsidize businesses, engage in financial fraud, and waste free cash flow.

Buyout groups generally insist on separating the chairman and CEO positions and installing an "active" chairman. According to Don Gogle, President and CEO of Clayton, Dubilier and Rice, buyout companies are "fanatics about control", with active chairmen typically spending 80% of his or her time with the company building the business plan.

Lead deal partners on an investment tend to become key board members, serving the role that "lead director" serves on public boards. This provides continuity while the GP's ownership interest ensures focus on value creation and on sound internal controls such as strong independent audit and compensation committees.

Results That Matter

As demonstrated by its spread across industries and countries, private equity investment is a critical catalyst for restructuring corporate assets and creating value. At the heart of this process is its success at directly and systematically resolving the owner-management conflict and thus minimizing opportunities for corporate mischief and fraud.

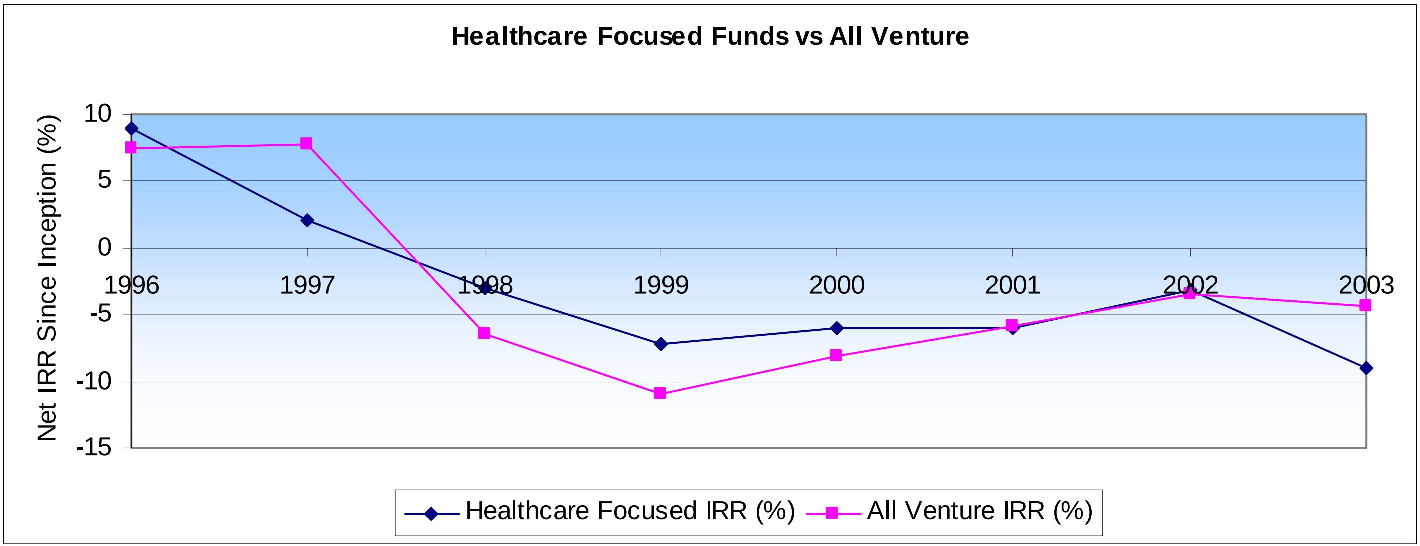
Good governance comes from addressing each firm's unique organizational, financial, and operational challenges, and doing so in a way that raises corporate performance. Private equity partnerships offer lessons in how good governance and performance go hand-in-hand.

David Haarmeyer is a consultant and writer on corporate governance and active investing. This is a condensed version of an article that originally appeared in the June 2006 issue of Directors Monthly. To read the original please visit National Association of Corporate Directors website at www.nacdonline.org

PERFORMANCE SPOTLIGHT

Performance Spotlight is your monthly update on Private Equity Performance. Each month we look at the performance for a particular type of fund and give you information on some of the top performing funds.

PERFORMANCE OF HEALTHCARE FOCUSED VENTURE FUNDS



Figures show median IRR from inception to latest date now available for funds by vintage year. IRRs are fund IRRs calculated on a net basis to LPs, i.e. after management fees and GP carry.

PERFORMANCE COMMENTARY

Thanks to the recent updates of Performance Analyst, this month Spotlight looks at the performance of Healthcare focused venture funds. Out of the 1,193 venture funds with performance on Performance Analyst, 555 or 47% express an interest in investing in Healthcare, and 111 are focused exclusively on the sector.

The graph above compares the performance of Healthcare focused funds against the general venture benchmark for the period 1996 to 2003. The funds selected for the benchmark are funds focusing solely on Healthcare, including sub-categories such as life science, biotechnology, medical devices or pharmaceutical. Funds with a broader focus, even though they may include these above sectors, were excluded. The sample includes 111 Healthcare focused funds.

The chart indicates that industry specialisation does have a certain influence on fund performance. During the vintages 1998-2000, some of the most difficult years for the venture industry, Healthcare focused funds seemed to have performed slightly better than the rest of the industry. 2001-2002 saw similar performances for both focused and general funds.

LPs and GPs should monitor the performance of venture funds by taking the industry focus into account, a factor that evidently has an impact on fund performance figures. The new industry search function on Performance Analyst is an convenient solution to find, track and benchmark funds investing in specific industries.

The table below summarizes the net performance of some of the best Healthcare focused venture funds proving that industry focused funds can generate strong results.

Fund	Vintage	Fund Size (Mn)	Called (%)	Distr. (%)	Value (%)	IRR (%)	Multiple	Date
Sanderling IV Biomedical	1997	20 USD	100	108.4	38.9	11.6	1.47	31/12/2005
NeoMed II	1998	14 USD	100	114	63	16.4	1.77	31/12/2005
Caduceus Private Investments II	2002	300 USD	53.3	15.1	108.3	18.5	1.23	31/12/2005
HealthPointCapital I	2003	160 USD	65	0	184	98.4	1.84	31/12/2005
Thomas Weisel Healthcare Ventures	2003	122 USD	50.1	12.5	111.7	21.4	1.24	31/12/2005

Product Spotlight: Performance Analyst

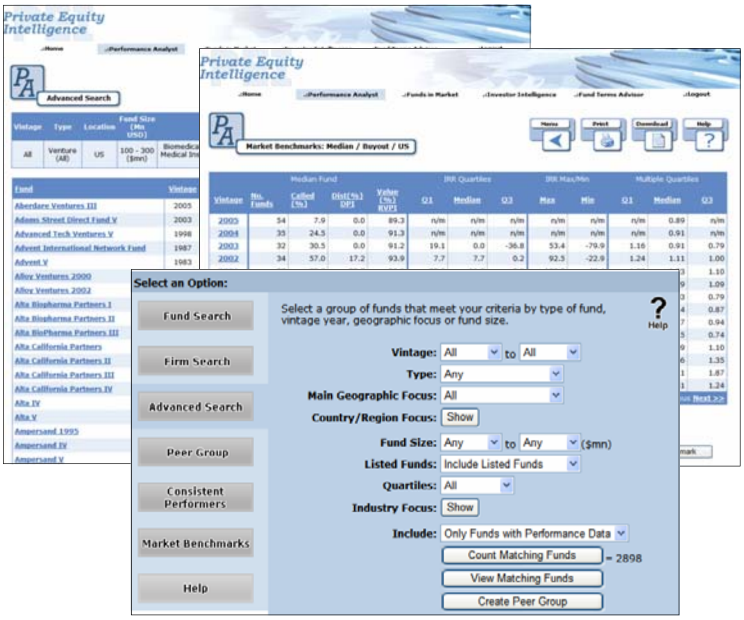
Each month Spotlight takes a closer look at one of the many products and services provided by Private Equity Intelligence, exploring the features offered; how it can help you in your job; who uses it and how you can get it.

This month: Performance Analyst and its recent major updates

WHAT IS PERFORMANCE ANALYST?

Performance Analyst is a powerful and flexible analytical online database service allowing private equity professionals to:

- View performance data for 2,900 private equity funds
- Compare funds of all types including venture, buyout, mezzanine, real estate and more
- View and assess key performance data for each fund, such as size, vintage, type, % called, % distributed (DPI), % unrealised value (RVPI), multiple and IRR
- Get access to the latest data through monthly updates
- Select, compare and analyse funds by type, size, vintage year and more
- Keep an eye on each firm's long-term track record through quartile analysis
- Download data to spreadsheets for further analysis



HOW CAN I GET IT?

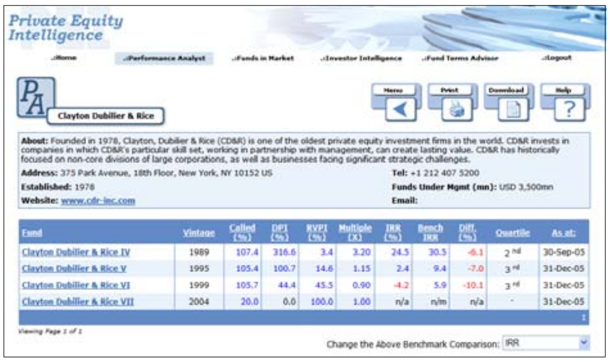
Performance Analyst is available through a 12-months subscription for £995 / $1,950 / €1,495. In addition, some customers come to us for one-off data downloads. For more information and to order please visit

www.preqin.com

RECENT PRODUCT UPDATE:

The new service has many enhancements, including the following:

- Industry Focus for each fund, so that you can see not only which industries each fund invests in, but you can also search to find funds investing in specific industries;
- An improved Advanced Search so that you can search and select funds by a combination of criteria – fund type / vintage / location / countries and industries invested in / fund size / top quartile funds only;
- An enhanced Peer Group feature to help you choose specific peer groups for comparison;
- A new Consistent Performers search: see which firms have been the most consistent performers across selected fund types; and
- An improved Benchmarks section, with money-weighted and median benchmarks and new benchmarks for Mezzanine and Early Stage funds.



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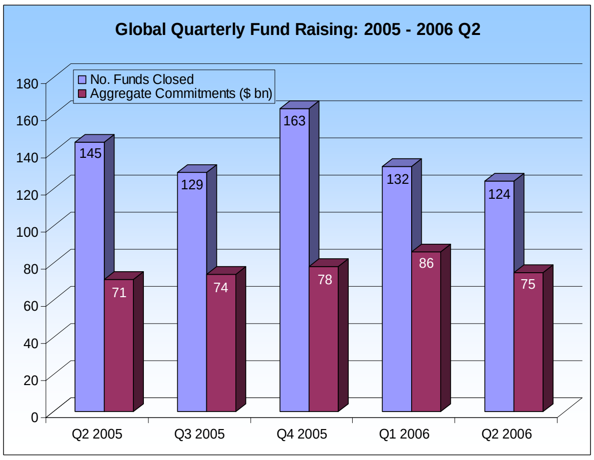
Global Fund Raising Update - Q2 2006

2006 - A Record Breaking Year in the Making?

2005 was a record breaking year for private equity in terms of fundraising, with the industry gathering $283 billion in aggregate commitments. With funds continuing to close at a steady rate, and with an excellent stock of funds on the road, all the signs are pointing towards 2006 not only matching the levels of 2005, but going on to exceed them to become the second record breaking year in a row.

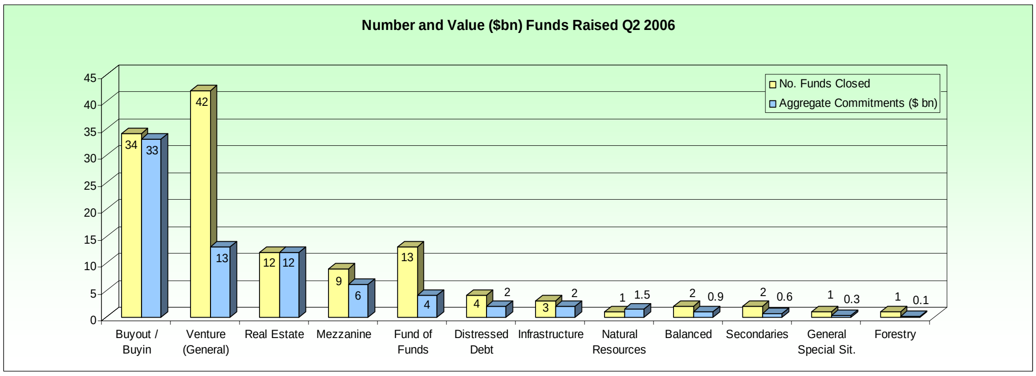


$75 billion raised in Q2 2006

124 Funds closed during Q2 2006, raising an aggregate $75 billion. This represents an increase of 6% on the $71 billion raised during Q2 2005. It is interesting to note that although the amount of capital being raised remains stable, there is evidence of a slight decline in the number of funds being closed. The aggregate total of 124 closed funds is lower than that of any quarter during 2005 and Q1 2006.

There has been a slight decline in aggregate capital raised in comparison to Q1 2006, with the total raised during Q2 2006 being 13% less than commitments garnered in the early part of the year. Although this might suggest a slowing in the fundraising market, when the stock of funds due to close is examined a more positive scenario emerges. With a number of mega buyout funds from firms such as Blackstone, KKR, Permira and Texas Pacific close to wrapping up their fundraising efforts, Q3 2006 is shaping up to be an exceptional quarter for fundraising.

Q2 2006 Fund Raising by Type



- 34 Buyout funds raised an aggregate $33 billion, with $18 billion coming from US focused funds and over $11 billion coming from Europe focused funds.

- 42 Venture funds raised an aggregate $13 billion, with over $8 billion coming from US focused funds alone.

- 12 Real estate funds raised an aggregate of $ 12 billion. Over 41% of this total comes from Blackstone Real Estate Partners V alone, a $5 billion fund focusing on property investments on a global scale.

- 13 Fund of funds raised a total of $ 4 billion. Morgan Stanley Private Markets Fund III contributed around a third of total commitments gathered during the period.

- A total of $6 billion was garnered by 9 mezzanine funds that closed during Q2 2006, a slight increase on the $5 billion raised during Q1.

Funds on the Road

- The number of funds on the road seeking capital continues to grow as 2006 progresses. There are currently 787 private equity funds on the road, seeking an aggregate $342 billion; a 12% increase in the aggregate target at the close of Q1, and a significant 55% more than funds were seeking at the start of 2006.

- Of the 787 funds on the road 33% are venture funds and 24% buyout. The bulk of the $342 billion aggregate target comprises buyout funds, which account for 48% of all capital currently being raised within the industry as a whole.

The data presented here is taken from the Global Fund Raising Update – Q2 2006.
The full report is available for online subscribers.

Contact us for more information – info@preqin.com

INVESTOR SPOTLIGHT

Investor Spotlight is your monthly update on investors in Private Equity. See how key investors are changing their allocations and which new investors are coming into the market. This month's Investor Spotlight is the Executive Summary of our recently published 2006 Limited Partner Universe.

The private equity industry is experiencing tremendous growth, as LPs increase their allocations to the asset class, fund-raising records are toppled on a regular basis, and ever-larger assets are acquired by financial sponsors. Some commentators think that we are near to the peak, while others believe that we are still writing the first chapter of the private equity story.

Our research strongly supports the latter view, as the growth in investors' interest in private equity is broadly-based and fundamental. More and more investors are entering the asset class from all around the world, while existing and new LPs alike are increasing their target allocations for sound portfolio considerations. Any setbacks in the returns being enjoyed by private equity funds – which will surely happen from time to time – are more likely to be cause for a breathing space in the growth rate of the industry, rather than a change of direction.

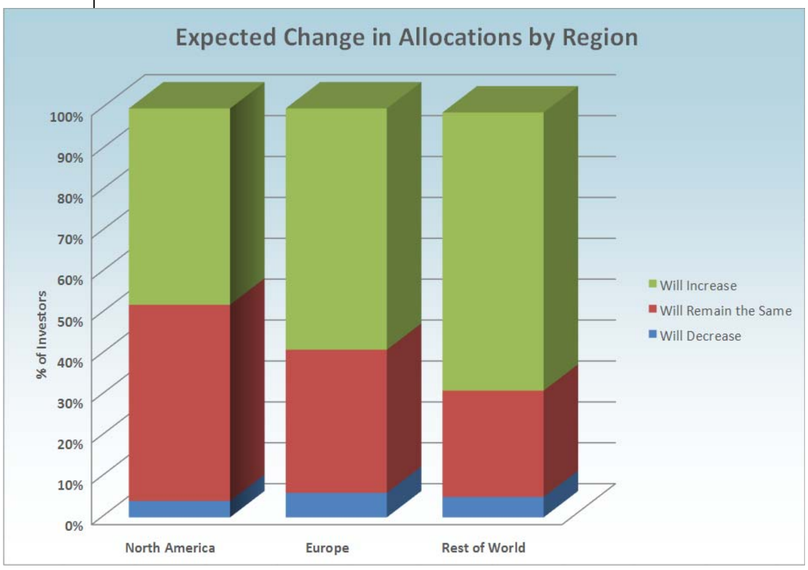
Along with the growth of the industry comes change in investors' attitudes and behaviour. The 2006 Limited Partner Universe is based upon a detailed analysis of the private equity programs of over 3,000 LPs worldwide, including specially commissioned surveys of the views of over 600 of the largest investors in the asset class. Its objective is to further the understanding of LPs and their requirements, and so help GPs and their advisors in their fund raising and investor relations tasks. Six key trends are shaping the market:

- **Strong, Widespread Growth**: LPs' allocations to private equity currently stand at approximately $1.3 trillion, and are growing strongly. Based upon our survey of 657 LPs on their future intentions, no fewer than 54% plan to increase their allocations to the asset class, with only 5% expecting to decrease them (41% will remain at their current levels for the time being.) Growth will be strongest in Europe, Asia, Middle East and Australia. However, it is notable how broadly-based the growth is: all geographic regions and most types of LPs will see continued growth in private equity allocations. Many new LPs are entering the asset class for the first time, and some of these new entrants are set to become major investors.

- **Global Investment Plans**: a growing proportion of LPs (57% of those with programs above $1 billion) are interested in investing globally, rather than just in their home country or region. As a result, GPs are gathering commitments for their funds from further afield than they used to. This is especially true for all but the smallest funds, and most funds of $250 million and above are raising their funds from an international investor base.

- **Centres of LP Activity**: the 3,195 LPs on the Investor Intelligence database are located in 575 cities around the world. However, no less than 48% of the entire global allocation to private equity is controlled by LPs in the top 10 LP cities. New York alone accounts for 22% of the US total, while London is second worldwide and largest in Europe. Philadelphia, Zurich, Boston, Los Angeles, Amsterdam, Paris, Sacramento and San Francisco complete the global top 10 cities.

- **Huge Interest in Emerging Markets**: LP interest in emerging markets has rarely been stronger, and this is reflected in GPs' fund raising success: 2005 was 300%



up on 2004, and the pace is increasing further in 2006. LPs of all sizes are interested in emerging markets, but this is especially true for the largest LPs, with a clear majority of those with programs of $1 billion or more now expressing an active interest in investing in emerging markets. European LPs are in the forefront, with the US close behind.

- **Strong Support for Emerging Managers**: raising a first-time fund is always challenging, and will clearly remain so. However, the environment for first-time funds is currently very good, and a growing proportion of LPs are prepared to invest with emerging managers. There are clear patterns of where the support for first-time funds is strongest, and where it is relatively weaker. Broadly speaking, US and 'Rest of World' LPs are more supportive than Europeans; larger LPs are more supportive than smaller ones; and fund of funds and public pension plans are more active than corporate pension plans, family offices and others. Emerging managers would do well to consider these factors when targeting potential LPs for their new funds – knowing which LPs will support emerging managers can be vital to fund raising success.

- **Concentration and Fragmentation**: these two opposing trends will shape the fund-raising challenge for GPs in coming years. On the one hand, more and more new LPs are entering the asset class, so that GPs have opportunities to establish relationships with these new investors. On the other hand, many large LPs are moving to focus their programs on fewer, larger relationships with what they consider to be their core GPs. As a result, there will continue to be significant churn in the LP Universe, and GPs need to plan and execute their investor relations strategies with care.

RECENTLY UPDATED PROFILES

The investor profiles on the Investor Intelligence database are updated and reviewed on a regular basis. Private Equity Intelligence contacts investors regularly to make sure the profiles hold correct and up-to-date information.

Over the last few months we have reviewed and updated 1,250 profiles for the most significant LPs which are included within **The 2006 Limited Partner Universe**.

2006 Limited Partner Universe

The world's most comprehensive printed guide to private equity limited partners

- See profiles for 1,250 global LP investors.
- Complete with assets under management, investment plans, previous partnerships, contact details and more.
- Detailed analysis of the LP universe to help you identify the best target for your fund.
- League tables: largest LP investors by type and location, target allocation and more

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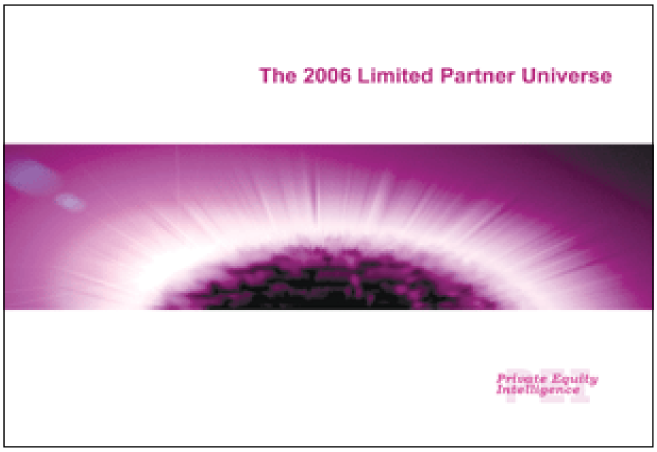

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INVESTOR NEWS

AMB Generali Asset Managers has launched a EUR 2.7 billion fund of funds, Generali Global Private Equity. The fund has so far received EUR 175 million in commitments from the Generali group and will be marketed to external investors once the vehicle has built up a good track record. The fund plans to invest 50% in European Funds and 50% in the US.

The USD 52.1 billion **Pennsylvania Public School Employees' Retirement System (PSERS)** has made commitments totalling USD 975 million to five funds, including two USD 300 million commitments to the KKR Fund 2006 and Avenue Asia Special Situations Fund IV. This follows a change in the investment decision process in April 2006; the old process, with no less than 15 conditions imposed by the fund, was producing too few investment opportunities. PSERS currently has a target allocation to the private equity asset class of USD 5.7 billion and for the one year period ending 31st December 2005, its alternative assets portfolio has a return of 27.3%.

The second biggest investor in private equity in the world, **AlpInvest Partners**, was one of the lead investors in Catterton Partners VI, which focuses on consumer goods and services. The fund was raised in ten weeks with other investors including the Employees' Retirement System of Rhode Island as well as the Pennsylvania Public School Employees' Retirement System. AlpInvest Partners currently has EUR 30 billion allocated to private equity and manages the private equity investments of ABP and PGGM.

The USD 14.9 billion **San Francisco Employee's Retirement System (SFERS)** has increased its allocation to the private equity asset class, reports the PE Insider. SFERS' target has now been raised to between USD 425 million and USD 475 million. To date, 60% of the investment portfolio has been committed to buyouts, with 10% to special situations and 30% to venture funds. 75% of its investments are US-based and the remaining 25% is spilt between Europe and the Pacific Rim, with the emphasis on the latter. It does not invest in emerging markets but will consider any industry.

The private investment arm of the World Bank, the **International Finance Corporation (IFC**), has decided to increase its allocation to venture funds, reports the PE Insider. It is likely to look for opportunities outside India and China, with Mexico and Brazil being likely targets. One-third of IFC fund investments are in Asia, with the remaining two-thirds spread evenly across the rest of the developing world. Although it has no set targets, the IFC is expected to invest USD 200 million to USD 300 million in 10 to 15 funds in the next 12 months.

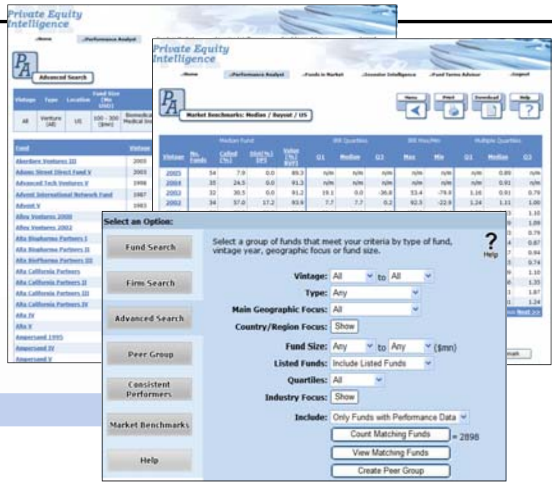
The USD 74 billion **New Jersey State Investment Council** has made its maiden investment in the secondary market. Furthermore, it has exceeded its June 2006 target allocation to private equity by USD 450 million. In May 2006, it made commitments to Lexington Capital Partners VI and Partners Group Secondary 2006, both secondary funds. It has exceeded its target allocation to secondaries by at least USD 25 million; to distressed-debt funds, by at least USD 75 million; to mezzanine funds by USD 100 million; and to buyouts by USD 250 million. In contrast, venture and co-investment funds failed to meet their target allocations, reports the PE Insider. Currently, the New Jersey State Investment Council aims to commit up to USD 4.9 billion to private equity over the next few years.

In the spotlight: Private Equity Intelligence

Private Equity Intelligence is a financial information business focused on the private equity industry. We provide private equity and venture capital firms, fund-of-funds, investors and advisors with products and services within four main areas: **Fund Performance, Investors, Fund Raising and Research & Consulting.**

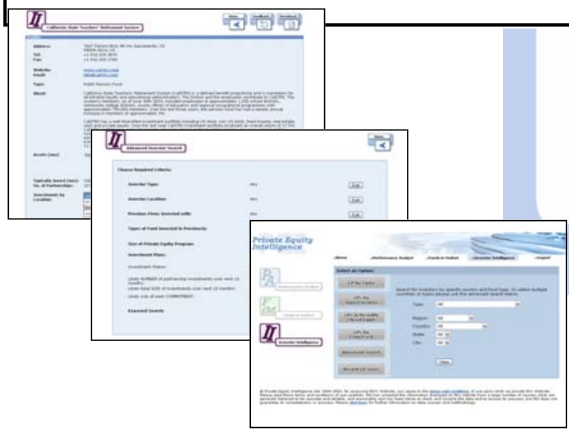
FUND PERFORMANCE:

We provide performance data for 2,900 private equity funds worldwide. For each individual fund you see the amount called, distributed, unrealised value, value multiple and net IRR. Performance is measured on a net-to-LP basis. Fund performance is available through our online database **"Performance Analyst"** and our publication **"The 2006 Private Equity Performance Monitor"**.



INVESTORS:

View profiles for 3,000 global LPs complete with information on background, contact details including key people, program size, investment plans, investment preferences, current portfolio and funds previously invested with. This information is available through our online database **"Investor Intelligence"** and our publication **"The 2006 Limited Partner Universe"**.



FUND RAISING:

See information on over 700 private equity funds worldwide who are currently raising capital. Get details of funds likely to be raising in the near future and view funds closed over the last year including sample investors. This information is available through our online database **"Funds in Market"** and our annual publication **"The Global Fund Raising Review"**.

Value of Funds being Raised ($bn)	US	Europe	ROW	Total
Venture	25	9	7	42
Buyout	84	52	5	140
Fund of Funds	12	9	1	22
Other	8	1	3	13
Total	**130**	**71**	**16**	**216**

Number of Funds being Raised	US	Europe	ROW	Total
Venture	158	69	61	288
Buyout	113	58	22	193
Fund of Funds	44	32	5	81
Other	33	11	11	55
Total	**348**	**170**	**99**	**617**

Average Size of Fund being Raised ($mn)	US	Europe	ROW	Average
Venture	160	135	119	145
Buyout	741	890	212	725
Fund of Funds	284	270	145	270
Other	250	105	262	232
Average	**373**	**416**	**162**	**351**

RESEARCH AND CONSULTING SERVICES:

Do you need a target list of investors for your new fund? And to test their appetite for your fund? Maybe you need to review publicly listed private equity vehicles? Do you want to project likely cashflows for your model portfolio?

Whatever your requirements, PEI's proprietary databases, research skills and contacts can be an effective and economic solution for you. For more information on how we can help you to meet your goals