THE TRIAGO QUARTERLY

June 2010

Dear Reader,

For over 18 years, Triago has helped general partners and limited partners with their global fundraising and private equity portfolio management activities. As an active participant in the primary and secondary markets, Triago has built a privileged position as an agent working with investors across the globe. As always, we gather a wealth of information on many aspects of what has now become a very large asset class.

This is the first issue of a quarterly where we share our insights with market participants like you, highlighting key elements from our fundraising activities and analyzing the data produced by our secondary transactions. Naturally, we welcome your comments and suggestions, and we hope the exercise is worthwhile for all of our industry's stakeholders.

I look forward to hearing back from you.

Sincerely,

Antoine Dréan
Triago Founder and Chief Executive
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INSIDE

Analysis: A Mixed Picture
Net asset values rise but investors do without cash

AIFM Roundtable
The European Union takes aim at private equity with discriminatory rules

Private Equity Blog
Dry powder, overallocation, debt wall, emerging markets, new secondary buyers

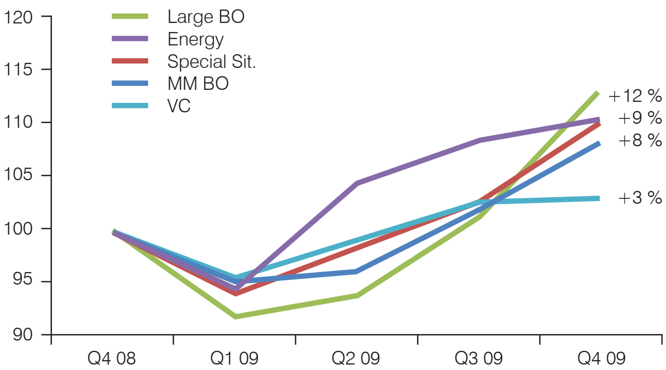
SNAPSHOT

WITH INCREASINGLY STRONG MARK-UPS…

2009 NAV Evolution

STRATEGY	Q1 09	Q2 09	Q3 09	Q4 09
Large BO	-7.4 %	+2.0 %	+7.3 %	+10.4 %
MM BO	-4.3 %	+1.1 %	+5.2 %	+5.7 %
VC	-3.9 %	+3.3 %	+3.1 %	+0.6 %
Special Sit.	-5.3 %	+3.9 %	+4.1 %	+6.7 %
Energy	-4.8 %	+9.6 %	+3.5 %	+1.6 %

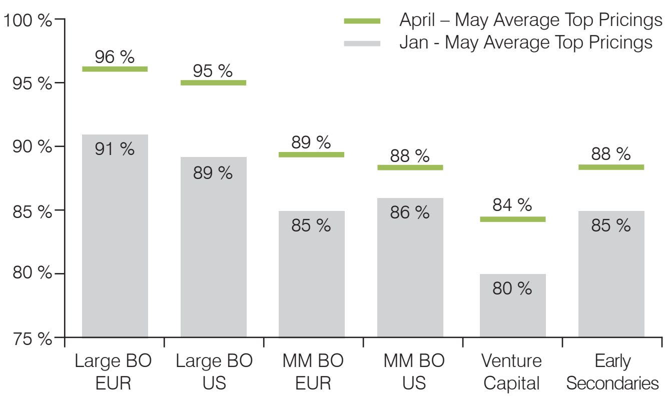
…LARGE BUYOUTS NOW LEAD RECOVERY…



…BUT DISTRIBUTIONS AND CALLS REMAIN WEAK…

PERIOD	2009	Q4 09
NAV evolution	+9.3 %	+6.6 %
Calls as % of Total Commitment	5.3 %	2.1 %
Distributions as % of Total Commitment	2.0 %	0.9 %

…AS SECONDARY PRICES CLIMB.



Source: Triago's proprietary data.

Market Snapshot Analysis: A Mixed Picture

Net asset values and secondary prices rise; anemic distributions give limited partners little money to re-invest; low call levels underline the struggle to do deals.

Continuing a three-quarter long recovery, net asset values rose 6.6 percent in the last three months of 2009, led by large buyout portfolios. Net asset value mark-ups at large buyout funds sharply outpaced other categories – increasing 10.4 percent in the quarter versus gains of 6.7 percent, 5.7 percent, 1.6 percent and 0.6 percent respectively for special situations, middle market buyout, energy and venture capital categories. Large buyout funds, written down more than any other category as stock prices and earnings plunged in the seven months following Lehman Brothers' collapse in September 2008, were helped the most in the fourth quarter by sales and EBITDA figures that for many portfolio companies exceeded targets as global economic recovery gathered steam.

The positive fourth quarter for large buyout mark-ups allowed the category to post the best recovery for asset values of any fund type in 2009. Up 12 percent over the course of the year, large buyout mark-ups outperformed increasing net asset values for energy and special situations by a third, mid-market buyout mark-ups by 50 percent and venture capital - for which there are fewer stock market comparables than for other categories - by 300 percent.

With the exception of venture capital funds, which tend to use only equity to fund purchases, private equity net asset values were helped to some extent in the fourth quarter by a significant expansion in leveraged buyout multiples, as bank debt became available for the first time in a year. LBO purchase multiples, which averaged 4 to 5 times EBITDA from the first to the third quarter of 2009, jumped to 7.6 times EBITDA in the final quarter, with banks willing to loan as much as 5.5 times EBITDA, according to Standard & Poor's.

The September decision by the International Private Equity Valuation Board to eliminate a marketability discount from its valuation guidelines and its adoption of a slightly more liberal regime on comparable pricing benchmarks also provided a minor boost to NAV mark-ups in the fourth quarter.

Distributions of 0.9 percent of total commitments in the fourth quarter amounted to just under half of all distributions made in 2009, in line with recovering deal flow, but sharply below levels of previous years. Until deal activity leads to a major increase in distributions, many traditional private equity investors who have reached or exceeded allocation targets – including the challenged categories of pension funds and endowments – are unlikely to earmark significant new funds for the asset class, pointing to a difficult fund raising environment.

Calls on the record $1.1 trillion in private equity dry powder also remained low in the fourth quarter – coming in at just 2.1 percent for Triago's fund universe. This is an indication that deal activity – although rising – remained exceptionally subdued. If little headway is made cutting deals, general partners face the prospect of returning a large chunk of their dry powder to investors over the next several years.

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Despite fear this spring of a global sovereign debt crisis, the past nine months through May 2010 have seen prices for private equity stakes sold on the secondary market steadily increase. Average top prices range from 84 percent of net asset value for venture capital portfolios, to 96 percent of net asset value for large European buyout funds, with some funds selling at par or small premiums. That is up from respectively 45 percent and 60 percent of net asset value for venture capital and large buyout at the market bottom in the second half of 2009 – a period when few deals were concluded, with sellers rejecting discounts offered at these levels or lower.

With a record overhang of more than $40 billion in dry powder that must be deployed by secondary funds, and many new buyers entering the market, the elements are in place for secondary volume to rise to a record $20 billion-plus this year, up from $15 billion in 2008 and $7.5 billion in 2009.

Roundtable

Public Rules for Private Equity
Has too little been done too late to avoid restrictive European proposals?

Through an unwieldly legislative process that has involved little industry consultation, the European Union is lurching towards transformation of how private equity is marketed and regulated. The repercussions could negatively impact private equity's ability to attract investors and invest, not just in Europe, but globally.

Drafts of the Alternative Investment Fund Managers Directive have been drawn up in the European Council of Ministers and in the European Parliament. The aim is to reach one text via negotiation this summer, when a final legislative vote is intended to make the directive law. AIFM will apply to both private equity and hedge funds and could impose minimum capital requirements, caps on leverage, and new third-party audits on funds, plus onerous disclosure on portfolio company finances and strategy.

Triago invited Javier Echarri, the secretary general of the European Venture Capital Association, the main industry trade group lobbying against the directive, Anthony McWhirter, a Debevoise & Plimpton partner and leading U.K. fund industry lawyer, and Klaus Bjorn Ruhne, partner at investor ATP Private Equity Partners – manager of €6 billion on behalf of ATP, Denmark's largest pension fund - to discuss the directive's pitfalls and the tough road to reasonable compromise.

TRIAGO: What aspects of the proposed AIFM Directive should worry the private equity community the most?

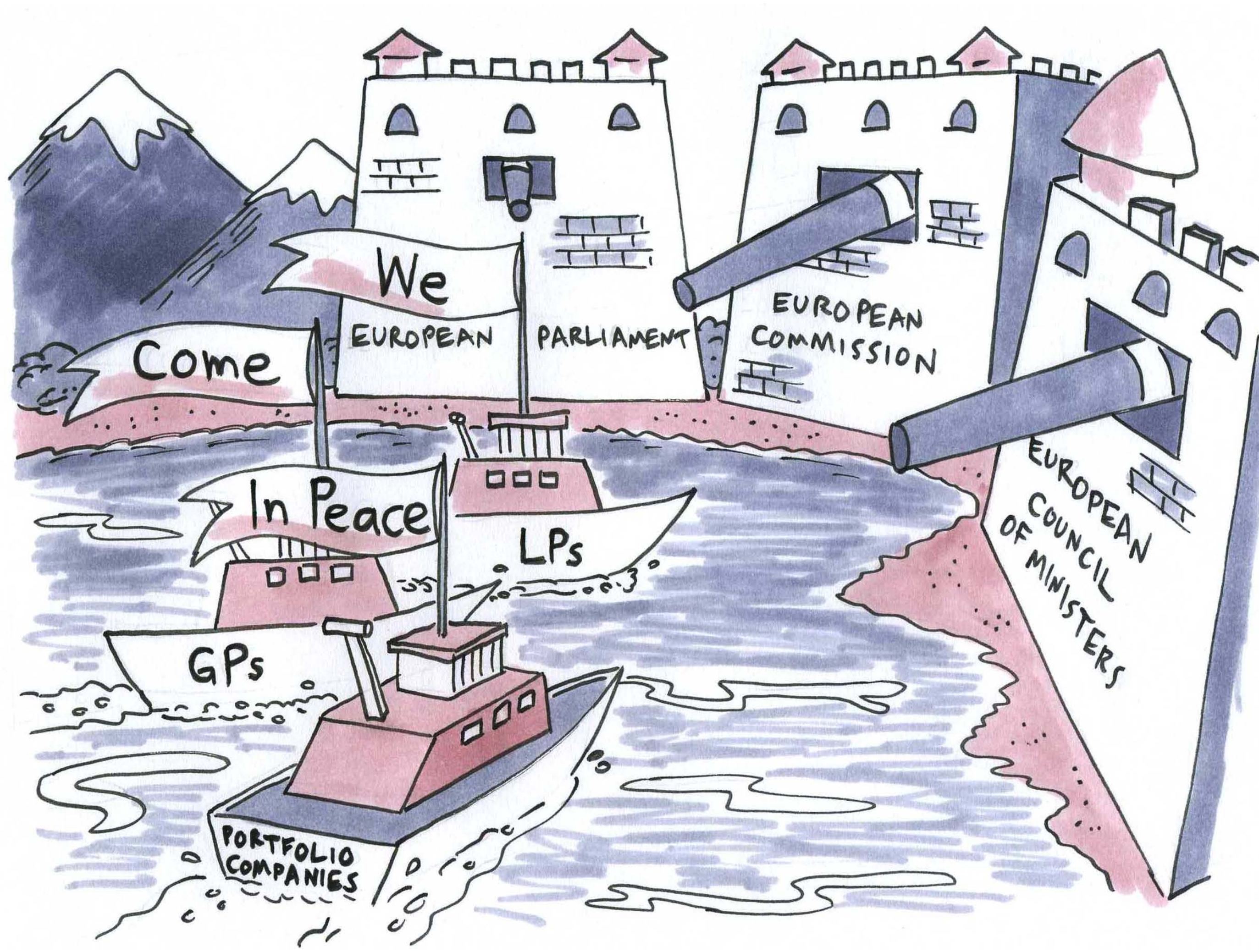
Anthony McWhirter: First of all, third-country issues and the level playing field. Some of the proposals will make it very difficult for private equity funds outside of the European Union to access investors inside the EU. For EU-based funds, the cost and red tape of proposals as they stand could make returns less good than they've been and lower than equivalent non-EU regulated private equity funds. Other investors – for example, sovereign wealth funds - will also be unfairly advantaged versus private equity when they compete for investments. They simply won't be saddled with the range of compliance costs contained in the various versions of the directive.

Javier Echarri: There is discrimination, not just against European private equity funds in current proposals, but also against portfolio companies. A technology company with a private equity shareholder will have to disclose research and development projects, current financial details and prospects. PE-backed firms will quickly be competitively dead. Changing rules for corporate competition is the most risky thing in the directive for private equity and for the European economy.

Klaus Bjorn Ruhne: I wouldn't take issue with the dangers as outlined by Anthony and Javier. To understand how this happened, context is needed - the rhetoric around these issues has been a disaster for years, with many vilifying private equity, and the industry never doing enough to explain its role as a catalyst for positive change. If the industry's focus were on pushing for a global equivalency regime, rather than the outright defeat of AIFM, I think many of the most absurd proposals might drop by the wayside as we compared regulation in Europe with the state of regulation in the U.S. and elsewhere. Such an effort would focus on coming up with harmonized regimes based on everyone pulling in the same direction, and broad goals for regional and national rules, rather than their literal or identical agreement.

TRIAGO: Javier and Anthony, what do you think of the value of pushing for an equivalency regime?

JE: Klaus is right that a lot of what we are dealing with now is fallout from the industry not realizing its weight in the economy and not communicating more openly about the business model. Pushing for a workable equivalency regime based on broad goals as a means of diffusing some of AIFM's more discriminatory proposals makes a lot of sense, in theory. But equivalency is not that easy in practice. Although there have been efforts for 25 years, the US and Europe have never worked out mutually acceptable regulatory regimes for mutual funds. So, what is the likelihood for private equity? Instead of pushing equivalency, we have made it our priority to make sure that existing national rules in Europe, that don't restrict



Marc Tyler Nobleman

fund access or discriminate against portfolio companies, remain in place, even after an AIFM directive provides a European passport to market private equity funds.

AM: I agree equivalency should not be the main focus. Many non-EU funds actually only want to market in one country, or to a select group of countries in Europe, which makes it all the more important that each state has the freedom to set the marketing rules for "non-equivalent" funds that they deem fit. There is a danger that the AIFM Directive will end any national ability to regulate and that must be guarded against.

TRIAGO: Are the parliamentary versions, or the European Council version of the directive more friendly to fund managers and investors?

JE: The Council version is better when it comes to portfolio company treatment and it is worse when it comes to non-EU funds and their ability to market in Europe. The parliament versions are incredibly negative on the treatment of portfolio companies and slightly better on the treatment of non EU funds. But the bottom line is that none of them, as they stand, would be good.

AM: Rather than agreeing on a good text, the priority has been speed, and it shows in the poor quality of all the versions. Ideally, this whole process should go slowly. That is a view, however, that does not take account of the political pressures that are being applied.

KBR: Certainly the EU is moving much too fast for a sensible directive.

TRIAGO: Do you think it is now more or less likely we will see a vote on a final text by the July deadline?

JE: There is tremendous political pressure for fast action. I'm not sure about July, but something will almost certainly be passed by the fall. The directive is part of a broader political battle that goes far beyond alternative investments. The essential question at the heart of the debate is "do we like shareholder capitalism and if we do, which model do we like most."Some in Europe clearly favor more interventionist models. What is very frustrating is that most people have a very poor understanding of how these concerns affect specific industries including private equity and the impact negative consequences can have on the broader economy.

AM: The other thing to bear in mind about fast approval is that once the directive is passed it will not be the end of the story. The EU is only likely to get close to hitting the July deadline by deferring some of the most difficult decisions to the next stage. There will be a lot of substantial issues to go through, and it will probably take a good 18 months more to reach a complete framework for the directive. Until then, many of the issues we are talking about are likely to remain the subject of heated political debate.

KBR: Concerning the lack of broad understanding when it comes to many directive proposals, it's worth pointing out that the portfolio company discrimination issue has the ability to really turn the debate around. If other stakeholders are made aware of the broad implications of AIFM rules, you will see Europe's chambers of commerce, its unions and pension funds all opposing the more absurd rules.

JE: That support is being mobilized as we speak and we expect it to be particularly potent.

TRIAGO: What needs to be changed in the directive to prevent European LPs from cutting allocations to private equity?

KBR: To avoid seeing funds available for investment getting cut either partially or altogether, all discriminatory practices must be eliminated from the directive. In addition to excessive disclosure for both funds and portfolio companies, this clearly includes insuring that there are no caps on leverage, and no minimum capitalization requirements, particularly for smaller funds.

JE: Caps on leverage would put a minimum and standard cost of capital on companies whether industrial, service, high tech, low tech, profitable, unprofitable, good or bad. Leverage caps would clearly reduce the appeal of private equity as an asset class. As for lock-in periods of three years, can you imagine backing innovative, potentially high-return companies in rapidly evolving industries if you did not have the ability to sell your investment at the time you judged right? Lock-in periods of three years, as some extremist parliamentarians are proposing, would make venture financing impossible.

AM: The minimum capital requirement will be another big problem for small venture firms. They won't be able to operate if they have to start life by setting aside a significant amount of cash. The parliamentary versions call for €125,000.00 of minimum capital and 0.02 percent of assets under management in excess of €250 million, but subject to a cap of €10 million. It doesn't sound like a lot, but the 0.02 percent requirement also becomes a significant amount in the case of large funds and groups of funds.

TRIAGO: Could the directive lead to an exodus of European GPs? Many say hedge fund managers, the other group affected by AIFM, are already leaving.

JE: Unlike hedge fund managers, good private equity managers don't take a passive view on investment trends. That means private equity managers have no possibility to leave Europe for less burdensome regulatory districts. You can talk about complex holding structures that might allow you to be both inside and outside the EU, but the bottom line is that this business is about investing actively in companies, and to do that successfully, you need proximity.

KBR: As an LP I would underline that I don't want to invest in a GP separated by thousands of miles and a few time zones from his portfolio companies.

TRIAGO: Klaus, one of AIFM's key proposals is for independent evaluation of private equity portfolios to insure investor protection and transparency. If implemented, this will clearly increase costs for GPs. Would this proposal help investors?

KBR: We already have auditors. This is definitely not where LPs require greater transparency. In fact, now that you have a sophisticated secondary market, you've already got checks and balances when it comes to GP valuations. By placing a discount or premium on assets, secondary market investors already give you an independent assessment of the accuracy of GP valuations.

TRIAGO: Are GPs and LPs doing enough to combat the negative aspects of the directive?

JE: We have successfully got the whole industry aligned, pushing for proposal reform. We have permitted funds-of-funds to have a specific voice, small venture to have a specific voice, as well as the industry's other players, including portfolio companies and LPs, while nevertheless coordinating the big picture and sending the same overall message. Enough is never enough, but we are doing pretty much all we can. I'm very satisfied with the reaction of the industry.

AM: There has been a lot of getting together behind the scenes to try to present a united front and mount a successful lobbying effort. As you say, Javier, you never have enough, but I think we are doing quite well considering the disparate universe of European GPs and LPs.

KBR: Much has been done. But I think that until recently many GPs were keeping their heads buried in the sand and hoping that stakeholders' more negative views of private equity would just go away. Unreasonable AIFM proposals are a good example of why private equity should have started explaining its social utility a long time ago.

> *«To avoid seeing funds available for investment getting cut either partially or altogether, all discriminatory practices must be eliminated from the directive.»*

Private Equity Blog

A round-up of market opportunities and issues for limited partners.

DRY POWDER

The predictions have ranged from 18 months to 15 years, but Bain & Company's calculations – among the more detailed and credible - estimate that if deal activity returns to the fairly robust levels achieved in 2005 and 2006 it will take four years for buyout firms to deploy their current record dry powder overhang of $508 billion. That would beat the previous record: 3.4 years to spend the $149 billion in dry powder that accumulated by the time the internet bubble burst in 2000. Whatever calculation you go by, competition for assets is likely to be intense for an extended period, keeping average multiples high and putting a premium on general partners who know their industries inside and out.

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OVERALLOCATION

Slightly more than half of all limited partners remain at or above target allocations, with endowments and private pension funds the most overexposed. Overall, limited partners – even those that are over-target – continue to make investments. But the trend is towards lower allocations to fewer managers. This will pressure even the best funds to tap new geographies, notably Asia, Australia and the Middle East, as well as new types of investors like sovereign wealth funds. Opportunities for limited partners in these less traditional markets will be greater than ever going forward.

DEBT

Mostly by pushing maturities out, borrowers decreased leveraged loans due in 2010 and 2011 by nearly half to less than $50 billion, according to Bank of America Merrill Lynch. But borrowers, most of whom are PE portfolio companies, still have to refinance or pay off $460 billion of leveraged loans between 2012 and 2014. Using refinancing windows like the equity and bond markets - when they are open and attractively priced - or buying back loans when benchmark prices are low, might be the smartest way to avoid being drowned in a wave of debt. Limited partners should closely monitor general partner debt management at the portfolio company level and when appropriate, push for refinancing.

EMERGING MARKETS

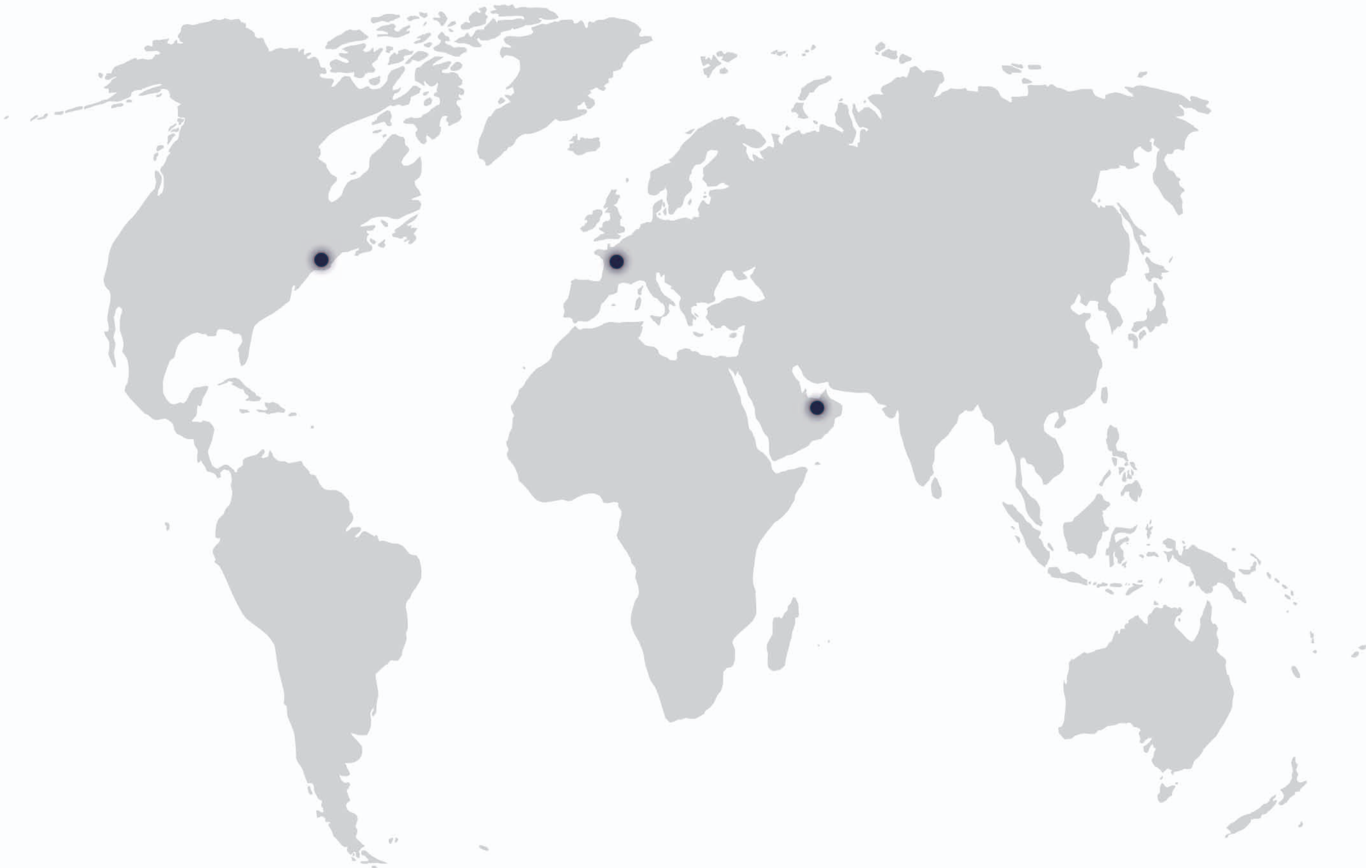
For much of the month of May - even after the announcement of a €750 billion debt stabilization package for the European Union - the cost of a five-year Saudi Arabian credit default swap was lower than a French or British CDS of similar maturity; Egyptian CDS prices remained below those of Portugal, Spain and Italy, and the Middle East's most indebted state, Dubai was cheaper to insure against non-payment than Greece. It goes against stereotypes, but the Middle East's low and improving risk profile is real, giving the region considerable appeal as an underpenetrated market for private equity.

The Middle East's best private equity teams have internal rates of return of 30 percent or more, achieved after only two or three years investment, largely without leverage. And unlike Asia, a region where it is difficult to accommodate the large numbers of limited partners looking to invest, access to top teams remains relatively easy in the Middle East, while potential comes cheaper, as measured by price-earnings-to-estimated-growth ratios.

THE SECONDARY MARKET

New buyers turned to the secondary market in recent months after being frustrated by a primary market characterized by little fundraising. In contrast to the relative dearth of opportunity in the primary market, secondaries are providing investors access to coveted general partners, often at a discount, and without the J-curve effect (whereby new fund expenses are not offset by investment income). Particularly good news for secondary market sellers: the new buyers - including every type of institutional investor, from pension funds to family offices – are often able to pay higher prices than traditional specialists like secondary funds and funds-of-funds. The latter are frequently interested in fund maturity and discounts, while the new buyers want access to specific funds and managers – with the possibility to participate in future fundraisings a major draw. An increasingly competitive market with more motivated buyers is clearly a positive sign for long-term prices.

Contact



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