PRIVATE EQUITY PERFORMANCE

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A 'Golden Era' for Cash Distributions / 6

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The Cash-Back Golden Era

LPs are getting more money back from their GPs than ever before – so why aren't both sides happier? You'd think that private equity finding itself knee-deep in a new golden era of cash distributions would be cause for giddy celebration.

As you will learn from the experts quoted in this publication, the bounty of cash has not caused irrational exuberance among LPs and has led to some hand-wringing among GPs. On the LP side, the reverse flow of cash is a reminder of the amount of capital that was put to work during an earlier "golden era" of deals done between roughly 2005 and 2007. While private equity is a long term asset class, most investors who answered capital calls in, say, 2005 were hoping for a round trip that lasted less than 12 years. The Great Recession disrupted many dreams, including the one in which PE megadeals quickly delivered value to their backers.

And as capital refills the private equity "buckets" of leading LPs, many GPs have been disappointed to learn that the capital will not be automatically plowed back into new fund commitments. LPs are in the mood to carefully pace and pare back or even eliminate relationships struck in earlier market dispensations.

The good news is that private equity's long term performance still looks good relative to other asset classes, and the recent distributions are furthering cementing an average track record that makes it easy for most LPs to remain committed to the asset class, if not to specific GP names.

Enjoy the report,
David Snow
CEO, Privcap
@SnowsNotes

PRIVATE EQUITY PERFORMANCE

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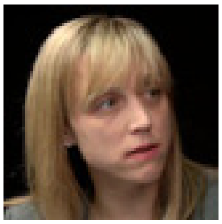
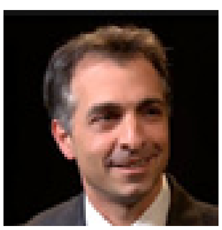


/Andrea Auerbach

Managing Director and Head of U.S. Private Equity Research • Cambridge Associates

Andrea Auerbach is a managing director at Cambridge Associates LLC in the Boston office. She heads the U.S. private equity research team, which performs due diligence on investment opportunities in private equity, mezzanine and distressed markets. Her responsibilities include visiting investment firms and their portfolio companies and tracking the industry. Auerbach and her team also advise the firm's investment consultants on new and existing firms raising and managing funds.

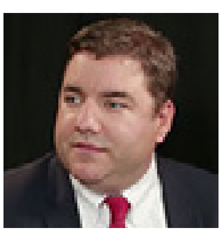
Prior to joining Cambridge Associates in 2001, Andrea was a senior director at Prudential Private Equity. Over the course of her eight years with Prudential in New Jersey, New York and London, Auerbach invested and managed over $1 billion of capital in U.S. buyouts, venture capital, real estate, and European mezzanine and private equity. She also led early efforts to benchmark Prudential's $5 billion buyout portfolio≠, and domestic and European fund investment portfolios. Auerbach was also an equity research associate focused on technology at Harris Nesbitt Gerard.



/Michael Elio

Managing Director, Industry Affairs • ILPA

Michael Elio recently joined the ILPA as its managing director for industry affairs. Prior to joining the ILPA, he was a managing director at LP Capital Advisors and led the firm's Boston office ,where he served as the lead consultant to East Coast and European institutional investors. Mike served as the primary consultant for many of the firm's largest clients, including public and private pension plans. He was also a vice president at State Street Corporation and vice president at Credit Suisse First Boston Private Equity, where he oversaw the Funds Management group.



/Marc Cardillo

Managing Director, Hard Assets Research • Cambridge Associates

Marc Cardillo co-heads the hard assets research team at Cambridge Associates, which covers global private investments in agriculture and natural resources, commodities, energy, infrastructure, real estate and timber. Before joining Cambridge Associates in 2000, Marc was an equity analyst at Gannett Welsh & Kotler. He is a C.F.A. Charterholder and earned a B.A. from the College of the Holy Cross.

Energy Funds Are Powering PE Performance

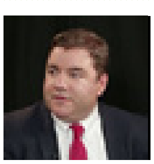
Private equity energy funds have been providing powerful returns. Over the past 15 years they've outperformed almost every other category, with a 15.2% pooled average IRR, versus 11.6% for all other U.S. private equity funds.

For the periods ending December 31, 2012	Qtr.	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years	25 Years
USPE	3.5	13.8	15.2	6.7	14.1	11.6	13.4	13.2
USPE Energy	**3.6**	**6.6**	**12.7**	**8.1**	**17.4**	**15.2**	**15.7**	
				Other Indices				
DJIA	-1.7	10.2	10.9	2.6	7.3	5.8	9.6	10.8
NASDAQ Composite*	-3.1	15.9	10.0	2.6	8.5	4.5	7.8	9.3
Russell 2000 Composite	1.9	16.3	12.2	3.6	9.7	5.9	8.4	9.7
S & P 500	-0.4	16.0	10.9	1.7	7.1	4.5	8.2	9.7

Source: Cambridge Associates

So what's the source of their strength? Some think there's a secular trend consistently propelling energy funds forward. Others think they're just plain lucky. Marc Cardillo, managing director at Cambridge Associates, thinks it's a bit of both.

"Investors need to keep in mind that there has been a pretty good tailwind at the back of these energy funds over the last 15 or 20 years."
Marc Cardillo



"Investors need to keep in mind that there has been a pretty good tailwind at the back of these energy funds over the last 15 or 20 years," Cardillo says. "Oil prices were $25 a barrel in the mid-'90s and then spiked to $80, $90, $100 a barrel—and these groups are benefiting greatly from that."

Still, the energy industry continues to innovate, developing new forms of oil and natural gas extraction (witness the hydrofracturing boom) and pushing ahead with clean-tech applications.

But even the strongest energy funds may eventually falter. "Don't look at past returns and assume that the next 10 years are going to be similar," warns Cardillo. "The transformation related to [natural gas] shales is arguably a one-time event that's captured in these numbers. That may not take place going forward. Also there is a lot more capital in the space now than there was 10 years ago. That obviously has an impact on future returns."

Though energy remains a top priority for many limited partners, they're getting more selective about the firms they choose. For instance, do they go with a pure-play energy fund or do they pick a generalist fund that dabbles in energy?

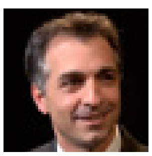
"There are dedicated energy managers that have been at this for 20 years," notes Auerbach. "An interesting question we have for generalist private equity firms with a deal team doing energy is: What advantage do you have versus these longstanding energy-focused funds that are investing in the same space?"

Venture's Lost Decade

Is the beleaguered asset class poised for a comeback?

"We just polled our members about their commitments in the upcoming year. Venture came in fifth of six different categories. It was behind 'other.'"

Mike Elio, ILPA



Not so with venture capital.

Venture capital is often considered the "riskiest" sub-asset class within private capital, and therefore it is expected to deliver outsized returns. And yet over the last 10 years its performance has been anemic—especially compared to buyout funds—with returns hovering in the 6% range, according from data from Cambridge Associates.

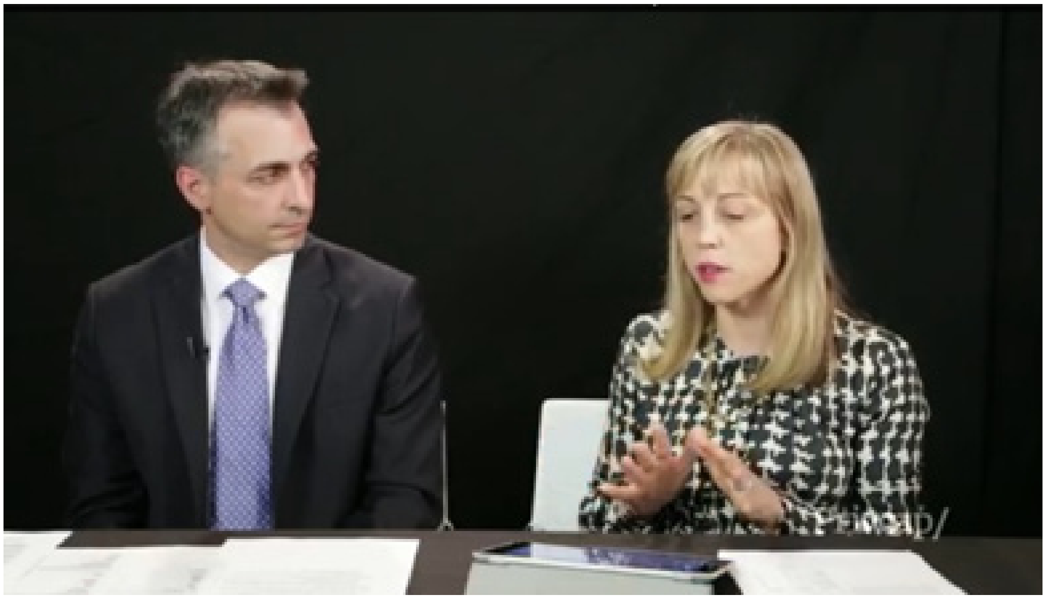
But if you stretch the timeline back 15 or 20 years, venture capital looks more attractive. It's outperforms private equity almost two-to-one, with a 24.7% IRR over a 20-year horizon, compared to private equity's 11.6%.

So what went wrong in the last decade? "Well, there was the tech bubble and then the bust," says Andrea Auerbach of Cambridge Associates, noting that too much capital went into too many venture funds, causing firms to back a lot of subpar companies. "So we're back to the drawing board post the tech bust and we're building a pipeline of investments, some of which we're starting to realize."

For the periods ending December 31, 2012	Qtr.	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years	25 Years
USPE	3.5	13.8	15.2	6.7	14.1	11.6	13.4	13.2
USVC	**1.2**	**7.2**	**11.4**	**4.1**	**6.9**	**24.7**	**28.5**	**19.3**
Other Indices								
DJIA	-1.7	10.2	10.9	2.6	7.3	5.8	9.6	10.8
NASDAQ Composite*	-3.1	15.9	10.0	2.6	8.5	4.5	7.8	9.3
Russell 2000 Composite	1.9	16.3	12.2	3.6	9.7	5.9	8.4	9.7
S & P 500	-0.4	16.0	10.9	1.7	7.1	4.5	8.2	9.7

Source: Cambridge Associates

The bubble years are now a distant memory to many, but LPs are unwilling to forgive and forget. "We just polled our members about their commitments in the upcoming year," says Mike Elio of the Institutional Limited Partners Association. "Venture came in fifth of six different categories. It was behind 'other.'"



(L to R) Michael Elio of the Institutional Limited Partners Association; Andrea Auerbach of Cambridge Associates.

The good news is that venture returns are gradually stabilizing. Over the past three years, for instance, U.S. venture capital returned 11.4% to LPs, according to Cambridge. That still trails the 15.2% returns for private equity.

"You can't set your watch by when venture capital performance will return to the glory days of old and those immense numbers of 25% net," Auerbach says. "You've got a bunch of different cycles that aren't necessarily correlated to each other that need to converge. But it happened once, so can we trap lightning in a bottle twice? Probably. But since we have to go back 15 to 20 years to see it, I'm guessing it's going to be a little while before we see it again in scale. But I have faith that it's out there."

The immediate challenge for LPs is finding the right venture firms to invest in. Of course, there's a handful of well-known funds with a long track record of top 10 performance. But it's often difficult for smaller LPs to access those funds .

"The other half of that top 10 are newer funds that are less proven and less established," Auerbach says. Her message to LPs: Look beyond the funds with the famous names and don't be afraid to make commitments to promising newcomers. Because history shows that they too can deliver large returns.

2012: The Best Year Ever for Distributions

The official numbers show that last year was the best ever for cash distributions to LPs. So where's the party?

$48.6B

Amount distributed to LPs in Q4 2013 – a record

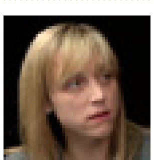
Cambridge Associates' U.S. Private Equity Index rose 13.8% in 2012, easily outpacing venture capital and the public markets. Three quarters in 2012 ranked among in the top 10 quarters for distributions of all time. In particular, investors took in $48.6 billion in the fourth quarter, the highest distribution level in a single quarter in the 27 years that Cambridge Associates has been tracking PE performance (see p. 9 for a complete ranking by quarter/year).

"Roughly $115 billion came in as distributions to LPs," said **Andrea Auerbach**, managing director and head of private industry research at Cambridge Associates. "That's the highest amount we've seen. So absolutely a big year."

Auerbach and **Michael Elio** of the Institutional Limited Partners Association recently sat down with Privcap to talk about private equity performance in 2012—and what the record-breaking year means for the future of private equity.

"If the fourth quarter of 2012 bested the second quarter of '07, which some refer to as the 'golden era' of private equity, does this mean we're heading into another golden era?

Andrea Auerbach



Privcap: Mike, your members include many of the largest participants in the private-capital asset classes. Are they happy about this? Did they also benefit from an influx of cash?

Elio: Who wouldn't be happy getting your money back that you've been waiting years for? They're happy about the return of the money. But when you think about what happened—you had the boom and the bust and the commitment cycle—and we're seeing a lot of the boom commitment money come back. I think LPs are taking it smiling but sticking to their vintage-year allocation and commitment pacing.

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2012: Best Year Ever for Distributions

Auerbach: The largest amount of distributions to LPs was the fourth quarter of 2012. But the next-largest quarter was during the last uptick. The winner of second place, if you will, for U.S. buyouts was the second quarter of 2007, which was really the moment before the moment. So what does this portend? If the fourth quarter of 2012 bested the second quarter of '07, which some refer to as the 'golden era' of private equity, does this mean we're heading into another golden era?

I've talked to quite a few LPs who say, "This is my target pacing for the year," and they don't actually get there."
Micheal Elio

Snow: It looks as if investors are getting lots of cash back but not necessarily turning around and writing large new checks to bolster the fundraising market.

Elio: LPs are being more selective about where they put their money. Getting money back is something they've been waiting for. Now they have it. That doesn't mean they're going to turn around and do what they did in 2007 and start overcommitting just to chase allocation. They're wiser and they're voting with their checkbooks.

Auerbach: But that said, commitments to the asset class have been on the rise year-over-year since 2010. So will 2013 best 2012? If you annualize the four months that we've been able to track so far, it looks like that's a realistic possibility. So even though folks are squirreling away some of that capital and adhering to the discipline that they've been following for several years, you may still see an increase in commitments to the asset class in pursuit of returns.

Elio: Right. The commitment paces are increasing. However, I've talked to quite a few LPs who say, "This is my target pacing for the year," and they don't actually get there."

Snow: It's possible there will be even more distributions coming in next year, even going into 2014, because of the huge inventory of unsold, 'unexited' private equity investments. So this could be just the beginning of the gold era of exits. What would need to go right for the exit fandango to continue? And what could go wrong to end the party?

Elio: We've been through this once before. We pretty much know everything that will go wrong because it all went wrong. For things to go right, it's of course the same thing that went right the last time. I do think, though, that investors are watching a little closer how general partners are adding value in their portfolios... Now, it's hard to show restraint, especially with private equity being the driver of a lot of returns for a lot of investors, but I think it's much more measured this time around.

Auerbach: A lot of these realizations have been held back for economic reasons, recession reasons, or lack of a robust leverage market. That's come roaring back. I think a lot of managers would like to exit their investments and also may need to in order to demonstrate a viable track record to attract capital. I think barring increases in interest rates or the availability of cheap leverage exiting the market rapidly, I would expect we'll see another banner year for exits in 2013.

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Days of Cash and Roses

Below are the top ten quarters by way of cash distributions to LPs, according to Cambridge Associates. The rankings are broken into three sub-strategies – buyouts, growth equity and energy funds.

Asset Class	Period Date	LP Contributions	LP Distributions	LP NAV	Fund Count
US Buyouts	12/31/12	$16.3	$36.7	$384.7	532
	06/30/07	19.5	22.6	231.8	470
	06/30/12	7.8	22.5	377.1	525
	12/31/10	13.8	22.4	352.2	528
	12/31/11	17.6	18.9	373.3	527
	12/31/06	20.6	17.5	204.3	453
	06/30/11	9.8	16.7	374.5	516
	09/30/12	10.9	16.0	391.6	532
	03/31/07	17.0	16.0	217.7	462
	03/31/11	10.0	15.0	364.8	515
US Growth Equity	12/31/12	$2.1	$5.8	$64.9	121
	09/30/00	1.5	4.4	17.7	51
	03/31/00	1.2	4.2	16.8	44
	06/30/11	2.8	4.0	58.7	112
	12/31/05	2.3	2.9	21.5	79
	12/31/10	3.3	2.8	54.9	108
	06/30/07	2.7	2.7	33.4	88
	09/30/05	1.5	2.6	21.6	74
	09/30/12	1.6	2.5	66.7	121
	12/31/99	1.1	2.5	16.6	44
US PE Energy	03/31/11	$2.2	$4.9	$58.0	89
	06/30/12	2.9	4.1	66.2	96
	06/30/07	3.3	4.1	21.0	68
	12/31/12	4.6	4.0	70.9	100
	12/31/11	5.0	3.8	64.5	94
	09/30/10	1.7	2.8	51.5	87
	09/30/08	6.0	2.4	38.0	81
	09/30/12	3.3	2.3	67.8	98
	06/30/11	2.1	2.2	60.3	91
	12/31/06	2.0	2.1	17.7	61

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2012: Best Year Ever for Distributions

Snow: Obviously, it was hard to exit during the financial downturn—and time is the enemy of the IRR. So what's the general sense as far as the performance of some of these exits?

Auerbach: We looked at all the exits for 2012 and, in terms of the average multiple of all the realization events—well over a thousand exit events in 2012—the average multiple that we observed was two times gross to investors. But given the length of time some of these assets have been held—five, six years possibly—that IRR attenuation is very real. But the multiple is holding, which I view as a positive.

Elio: If you look at 2012, interestingly enough it's the distressed base that outperformed all other substrategies. And it was the one that outperformed the S&P itself—all the others didn't. It's interesting to see where these returns are coming from. Folks said 'distressed, we've already run that number.' But we got a little more out of that tank.

Snow: Let's talk about the public markets. Obviously, since the nadir in 2009, the public markets have performed spectacularly well—better than private equity. How might that affect investor decisions?

Elio: A lot comes into play when deciding where to invest your money. Obviously private equity—if you want to be in a certain space you should have committed last year. If you're trying to time yourself to the public markets, shifting back and forth is not recommended. That said, it is hard for a CIO to see that his public market portfolio in the last three years has done about 11% and his private equity has been slightly higher. It would make you want to be a little bit more liquid. CIOs have been through this before. They know that this incredible rise in the public markets is cyclical and over the long term private equity has outperformed. So just stay consistent and true to your pacing.

Auerbach: The other thing that we tend to keep in the back of our heads is that the company size, of course, is going to be different than a public market exposure. And the kinds of sectors that tend to be overweight for private equity do vary even in a classic U.S. index like the S&P 500. So even though maybe the return, the numbers, might be close or the public option is beating the private option, the kind of sector exposure you're getting and company-size exposure is very different and is additive to a portfolio. It's a pretty high correlation between private equity and the public market option but there are differences for a CIO to take into account in balancing a portfolio.