

PRIVATE EQUITY PARTNERS | MARKET UPDATE

August – September 2007

Credit Market Update

Recent events in the subprime market have rippled through all U.S. credit markets resulting in a widespread repricing of risk. Demand for high-yield bonds seemingly evaporated overnight as hedge funds and other non-traditional investors exited the market. Similarly, banks with significant exposure to subprime loans raised their lending standards across the board, which resulted in higher rates, lower leverage multiples and more covenants for new buyout deals.

We expect the consequences of this repricing of risk to be three-fold: **(1) Valuations must decline.** Buyers can no longer price deals to perfection as so many of them had been doing, given the new (higher) interest rates and stricter loan covenants. **(2) The pace of buyouts will slow.** Recent events have created a significant disconnect with respect to the price expectations of buyers and sellers. While buyers have quickly recognized they are no longer able to pay top dollar, sellers are reluctant to concede that their companies are no longer worth what they were a short time ago. We expect buyers and sellers to reach a new equilibrium over the next six months, at which time funds with ready capital will be positioned to make new acquisitions. **(3) Distressed investors are about to become "pigs in mud."** High-yield spreads have markedly increased, leading us to believe default rates will increase. Default rates have been at historical lows, so even modest increases in the number of defaults will provide ample opportunities for distressed funds.

Venture Capital and Leveraged Buyout Statistics

Below is our semi-annual update on fundraising, valuations and exits.

- **VC-backed IPO activity is on pace to reach its highest level since 2000** in terms of capital raised. Following an extended period of economic growth and market gains, investors have a renewed appetite for growth-oriented companies. Strong demand resulted in over 70% of VC-backed IPOs in 2007 pricing at or above the expected range in 1H 2007. Somewhat surprisingly, LBO-backed IPO activity declined substantially after three years of remarkable volume. We believe this is a temporary anomaly as our capital markets desk reports that investor demand in such deals remains strong and the IPO backlog is currently above 100, its highest point in 12 months.
- **VC-backed M&A volume dropped slightly, but average deal size increased to the highest level since 2000.** Meanwhile, domestic M&A volume and average deal size for all reported deals were on pace to reach 10-year highs. We expect this strong M&A activity to continue, especially in healthcare. With patents on key drugs set to expire and few blockbuster drugs in the pipeline, we anticipate significant demand for promising biopharmaceutical companies by Big Pharma in the near term.
- **Fundraising volume was down in the first half of the year but remains healthy.** VC fundraising volume was down from 2005 and 2006 levels, but remains well ahead of the sluggish fundraising pace of 2002-4. LBO fundraising also slowed in 1H 2007, although the average fund size reached record levels as fundraising continued to be dominated by mega LBO funds.
- **Insignificant changes in VC pre-money valuations.** VCs have enjoyed a stable pricing environment since 2004. During 1H 2007, pre-money valuations remained relatively flat compared to 2006 levels. A close reading of the mid-year data shows early stage pre-money valuations increased compared to 2006, while late stage valuations somewhat decreased. Given the proliferation of late stage funds, we do not believe this is indicative of a trend.
- **LBO purchase price multiples reached their highest levels in more than a decade.** Borrowers were again able to raise relatively cheap debt with few covenants in 1H 2007, enabling target companies to support greater debt loads. However, this ended in Q3 after trouble in the subprime market caused many investors to exit the high yield market, temporarily delaying many deals and stopping others altogether. Consequently, we expect purchase price multiples to decrease in 2H 2007.

PRIVATE CAPITAL

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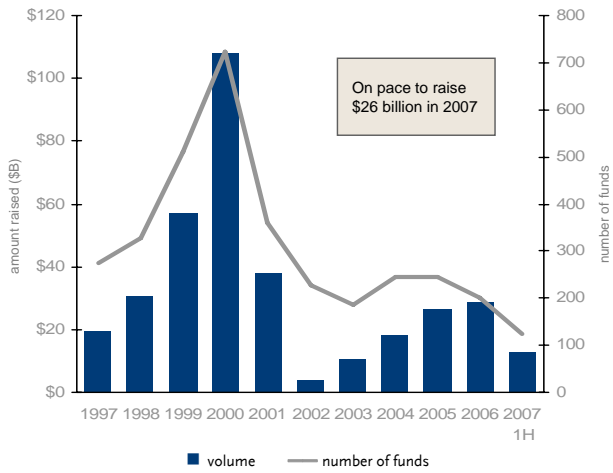
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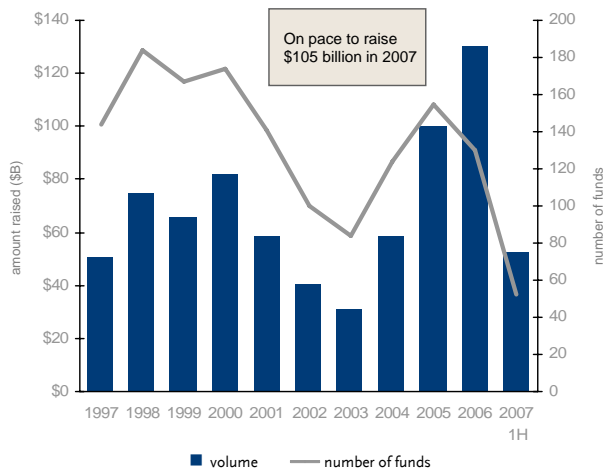
Find us on the web at
piperjaffray.com/fundoffunds

Fundraising

Venture Capital (1997 – 1H 2007)



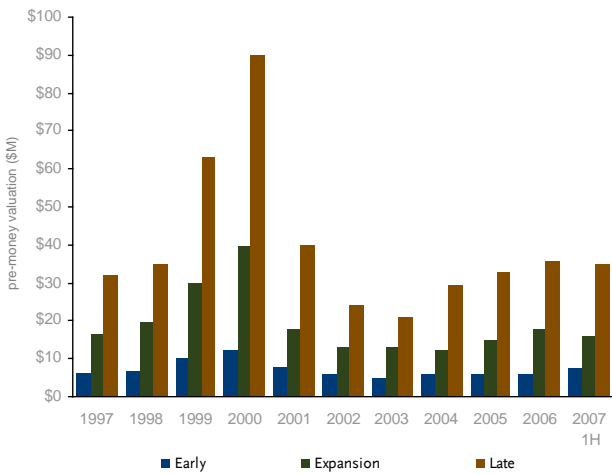
LBO* (1997 – 1H 2007)



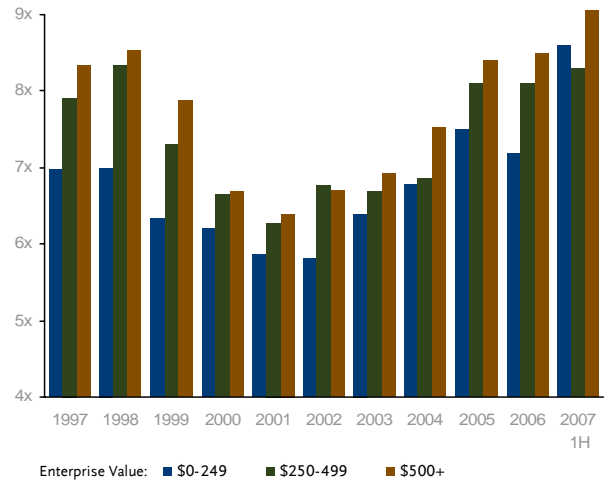
* This category includes LBO, Mezzanine, Turnaround and Recapitalization-focused funds.

Valuations

VC Median Pre-Money Valuations (1997 – 1H 2007)

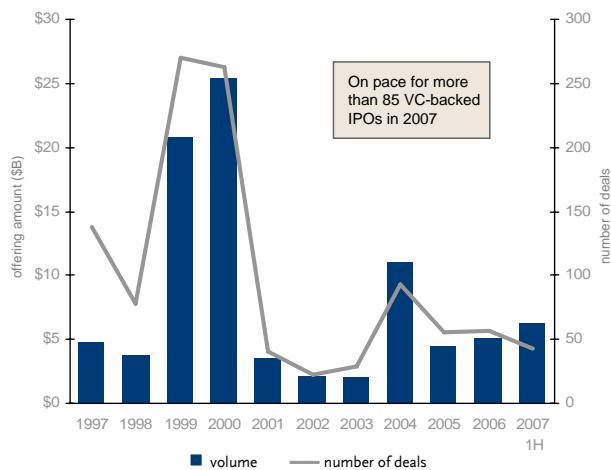


Avg. LBO Purchase Price (Multiple of EBITDA) (1997 – 1H 2007)

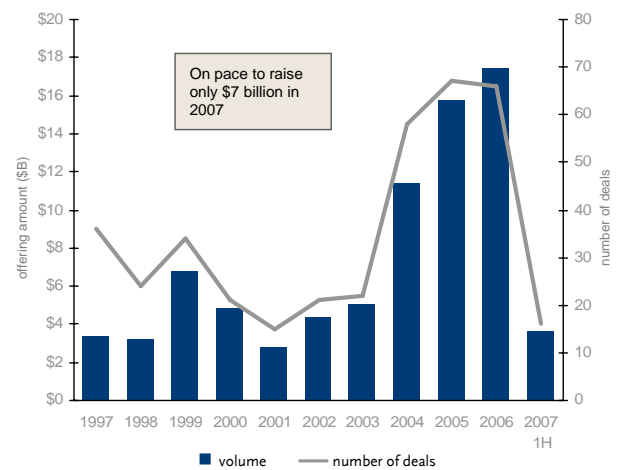


Exits

VC-backed IPO Market (1997 – 1H 2007)

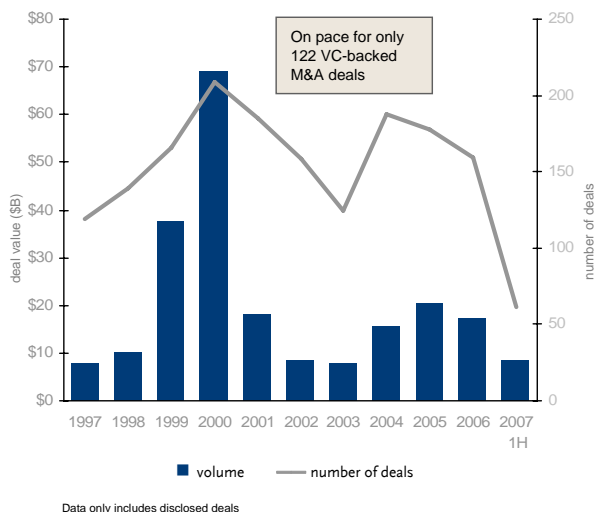


LBO-backed IPO Market (1997 – 1H 2007)

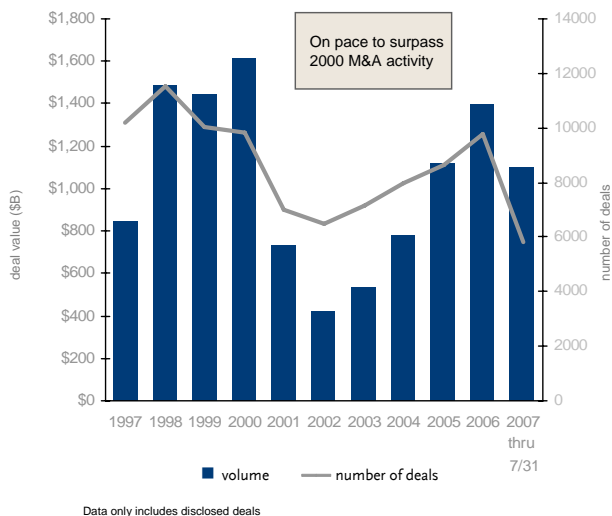


Exits (cont.)

VC-backed M&A Market (1997 – 1H 2007)



Domestic M&A Market (1997 – YTD 2007)



Sources: Thompson Venture Economics, National Venture Capital Association, Securities Data Company and Standard & Poor's Q4 Leveraged Buyout Review. All data as of 6/30/07, except as noted, and run as of 9/27/07.

In the News

The Private Capital group continues to maintain its leadership position in clean technology. Follow this link to read an excerpt of Scott Barrington's recent interview with Navigant Consulting, which was featured on page 4 of the wrapper on Fortune Magazine in August.

<http://www.navigantconsulting.com/fortune/fortune0607.pdf>

At over \$2.9 billion in investments, Cleantech ranked as the 3rd largest VC investment category in 2006, which placed it ahead of telecom and medical devices. Fueled by technological breakthroughs, high energy prices, national security concerns and other factors, the demand for cleantech innovation and investment is expected to significantly increase. We are well-positioned to help our investors benefit from this emerging area of innovation.

Upcoming Events

We are regular speakers and attendees at key industry conferences. We hope to see you at one of the upcoming conferences:

- **October 10-11:** Minnesota Venture Finance Conference in Minneapolis www.mnvca.org
- **October 14-17:** Scott Barrington will be speaking about private equity investing at the National Conference on Public Employee Retirement Systems (NCPERS) in Palm Springs www.ncpers.org
- **October 24-26:** CleanTech Network's CleanTech Forum XIV in Toronto www.cleantechnetwork.com
- **November 3-6:** 18th Annual SRI in the Rockies Conference at the Hyatt Regency Tamaya Resort near Albuquerque, New Mexico www.sriintherockies.com
- **November 8:** Scott Barrington will be moderating a panel of institutional investors regarding cleantech investing at the Pacific Northwest Conference in Seattle www.stoel.com

Fundraising Timing

PEP III Closes on October 31: PEP III will hold its final closing on October 31st. If you have not yet submitted your subscription agreement, please make arrangements with Gretchen Postula at 612 303-6331 or gretchen.s.postula@pjc.com.

PEP IV Launches on November 1: PEP IV will offer four investment options – VC, LBO, CleanTech and Co-investment.