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PRIVATE EQUITY PARTNERS | MARKET UPDATE

May 2006

Mega Buyout Firms Going Public?

Recently, Kohlberg Kravis & Roberts ("KKR") filed an IPO to raise a $1.5 billion private equity vehicle, KKR Private Equity Investors LP. It is structured as an offshore limited partnership and will be traded on the Euronext exchange in Amsterdam, where the disclosure requirements are not as strict as U.S. exchanges. Investor demand was so high that KKR more than tripled the offering to $5 billion. Proceeds from the IPO will be invested in KKR-sponsored private equity investments (75%) and "opportunistic investments" (25%), including publicly traded equity and debt. We believe this was the first time that public-market investors have been able to invest in a blind pool of buyouts. We wondered whether this marks a sea change in the way mega buyout firms raise capital or is this merely a passing fad similar to the flurry of Business Development Corporation ("BDC") filings in 2004.

Other non-traditional public offerings in the past two years include:

- Apollo Management listed a mezzanine focused BDC in 2004 (NASDAQ: AINV). Blackstone, KKR and Evercore began, but did not complete, the registration process for similar vehicles due to market conditions.
- Charlemagne Capital and Absolute Capital, two hedge funds, raised capital on London's Alternative Investment Market, a global market for small, high-growth companies with relatively simple listing requirements.
- Ripplewood Holdings LLC recently listed some of its existing Japanese and European investments on a European exchange.
- Macquarie Bank, Australia's largest investment bank, recently filed an IPO in Europe for its first publicly traded investment fund. Approximately 60% of the capital will be invested in existing infrastructure investments, with the remainder reserved for new infrastructure investments.

There are compelling reasons for big buyout funds to raise publicly traded investment vehicles: (1) GP-friendly terms, (2) a relatively short fundraising process that imposes less wear and tear on senior partners and (3) perpetual vehicles that are not beholden to investors' three-five year exit expectations regarding each portfolio company as in a typical buyout fund.

Primary terms for the KKR offering were as follows:

- Annual management fee, based on net asset value (at market value), of 1.25% on the first $3 billion raised and 1% on the excess. All future realized and unrealized value from underlying investments, net of tax distributions, will be available for reinvestment. Management fee revenue would increase over time (perhaps substantially so) if NAV rises.
- Vehicle has a perpetual life so KKR can hold onto portfolio companies as long as they choose. This could be a positive factor because it removes the GP's sometimes artificial sense of urgency to return capital as soon as possible under a normal buyout fund structure.
- 20% carried interest fee on realized gains from private equity investments (after the 5% underwriting fee of $250 million is recouped). 20% carried interest on quarterly NAV of "opportunistic investments" using a high water mark methodology.
- Shares are non-voting. A majority of the board will be independent but two-thirds approval is required for most actions, so KKR effectively should have substantial control at the board level.

Not surprisingly, several other large private equity firms such as Blackstone, 3i, Carlyle and Texas Pacific Group are reportedly planning similar public vehicles. We had predicted Apollo would be close

PRIVATE EQUITY PARTNERS

INVESTMENT PROFESSIONALS

Scott Barrington
612 303-1110
scott.l.barrington@pjc.com

Dan Donoghue
312 920-2132
daniel.j.donoghue@pjc.com

Danny Zouber
612 303-0410
danny.a.zouber@pjc.com

Seth Trier
612 303-6674
seth.r.trier@pjc.com

Andrew Wissler
612 303-5690
andrew.j.wissler@pjc.com

FUND ADMINISTRATION

Gretchen Postula
Investor Relations
612 303-6331
gretchen.s.postula@pjc.com

Susan Swift
CFO
312 920-2153
susan.e.swift@pjc.com

Amber Preston
612 303-6588
amber.d.preston@pjc.com

PRIVATE CAPITAL GROUP

800 Nicollet Mall
MS: J09N03
Minneapolis, MN 55402

Hyatt Center, 24th Floor
71 South Wacker Drive
Chicago, IL 60606-4616

Find us on the web at
piperjaffray.com/fundoffunds

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behind KKR and, as we were writing this piece, Apollo in fact filed an IPO for a vehicle that is very similar to the KKR vehicle. Law firm Cleary Gottlieb reported that eight private equity firms have retained them to explore the possibility of a KKR-like vehicle.

Conclusion

While we expect other large, brand name buyout firms will launch similar vehicles this year, we don't think this represents a sea change in the way buyout funds raise capital. Fees, control issues and other factors may also limit the appeal of such vehicles. In particular, we think it is highly unlikely that smaller buyout funds will be able to follow suit anytime soon due to brand name recognition, marketability and economies of scale issues. Publicly traded vehicles probably will supplement but not supplant the fundraising process for big firms in the future. If true, large public pension plans can breathe a sigh of relief that they will still hold sway with the mega funds and will still have vehicles in which to invest their large sums of capital.

Fundraising Update

We recently began marketing **Private Equity Partners III** ("PEP III"), our third diversified fund of funds. PEP III will be similar to PEP II, with commitments to 10-15 venture capital funds and 10 buyout funds. We have begun to warehouse commitments to oversubscribed funds, including Madison Dearborn V, Alta Partners VIII and Oak XII. Several others are pending, particularly VC funds that are in high demand.

In addition, we are nearing the completion of raising and investing a "cleantech" fund of funds for certain of our family office and foundation clients. **Piper Jaffray CleanTech Ventures** will invest in solar, wind, biomass, fuel cell, advanced materials and water companies. We are the only U.S. fund of funds dedicating resources to this increasingly important sector, which accounted for 10% of all VC investments in Q4 of 2005. This fund will close to new investors in approximately 30 days.

If you would like additional information on either of these funds, please contact Gretchen Postula.

Piper Jaffray was established in 1895 and has grown to become a nationally and internationally recognized firm serving growth companies and growth company investors. We have a significant commitment to alternative assets through our series of fund of funds, ***Private Equity Partners.***