

The Outlook for Private Equity: First Quarter 2009

May 2009

Table of Contents:

Overview.....	1
Prospects for the Global Economy.....	1
Advantages of Private Equity.....	3
Investor Fears and Concerns: Evidence from the Market.....	4
Concluding Remarks	11
Private Equity Trends At a Glance	12

Overview

The global recession has led to record-setting corporate losses, hurting private equity firms, which have not been immune to the current global downturn and seizure in financial markets. All asset classes and all regions of the world have been impacted by this synchronized downturn, with correlations across diverse assets and geographies nearing one. The recessionary environment and collapse in underlying corporate profitability have hurt profits of firms held in private equity portfolios, effectively closing exit markets, prolonging the life of funds, and lowering returns on recent-year vintage funds.

In this report, following an update of the prospects for the global economy, we focus on factors that render private equity different from other asset classes. A recovery in the global economy should determine the likely trajectory for profit growth across private equity firms. The economic overview is followed by a brief look at market conditions surrounding private equity firms. We conclude this report with an assessment of private equity investor fears and concerns given the current macroeconomic environment.

Prospects for the Global Economy

Worst Recession in the Post-War Era

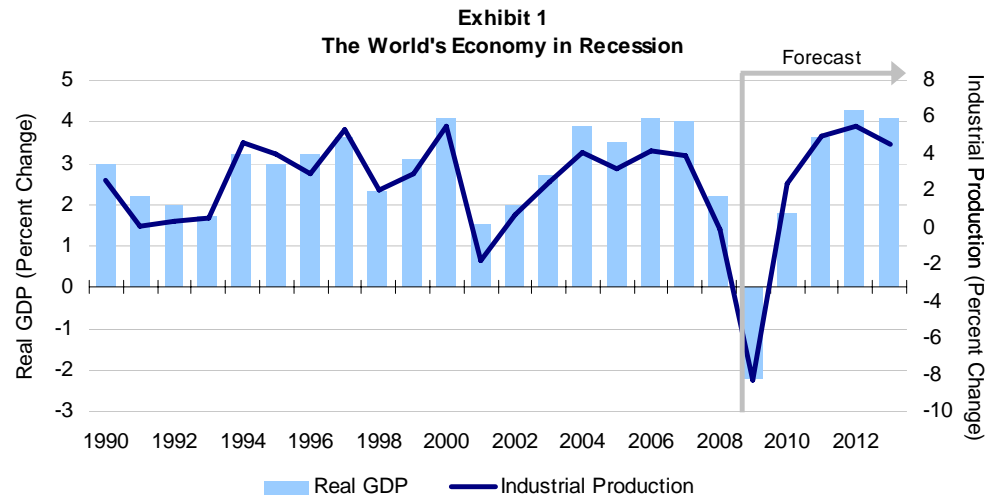
The current global recession is on track to be among the longest, broadest, and deepest of the post-war period. With the collapse of Lehman Brothers and the ensuing seizure in world financial markets, the global economy has fallen into a highly synchronized and deepening recession marked by contracting trade volumes, rising unemployment, falling asset values, collapsing corporate profitability, and busting commodity markets.

Over the past several months, economists have rushed to downwardly revise their already downbeat assessments of the global macroeconomy. Consumer spending, business investment and trade have plummeted in almost every region. We expect world GDP to contract by 2.2% in 2009, its first decline since World War II. Given the depth and breadth of the current global downturn, the policy response by governments worldwide has been quite forceful. The downward economic spiral should continue through much of 2009, but unprecedented fiscal and monetary policy should help stabilize world output growth by 2010. The industrialized markets should see some modest recovery next year while the emerging countries should experience stronger growth.

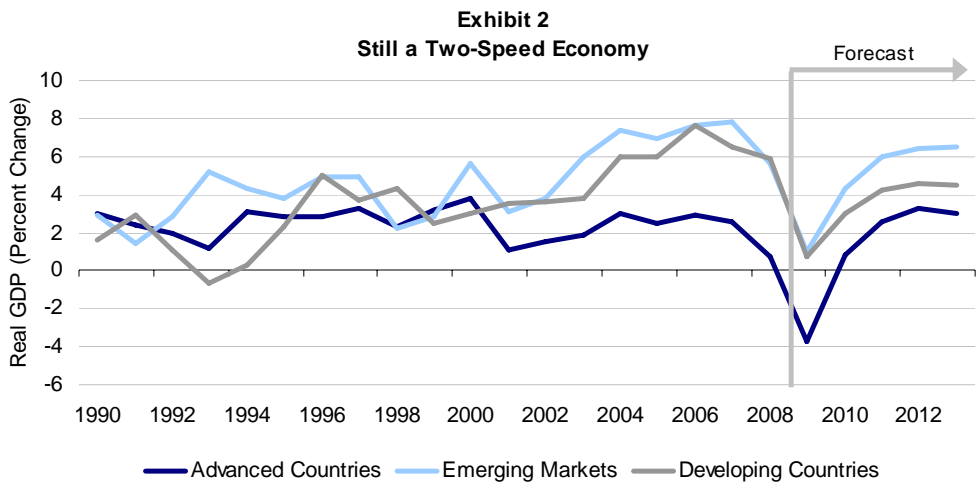
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Industrial markets have been the most impacted by the global recession and should experience a slight recovery in 2010. Hurt by popping housing bubbles and financial systems highly exposed to toxic assets, the industrialized markets face a tougher road to recovery. By contrast, the emerging economies should experience a stronger recovery in 2010, as fiscal stimulus policies effectively boost domestic consumption.



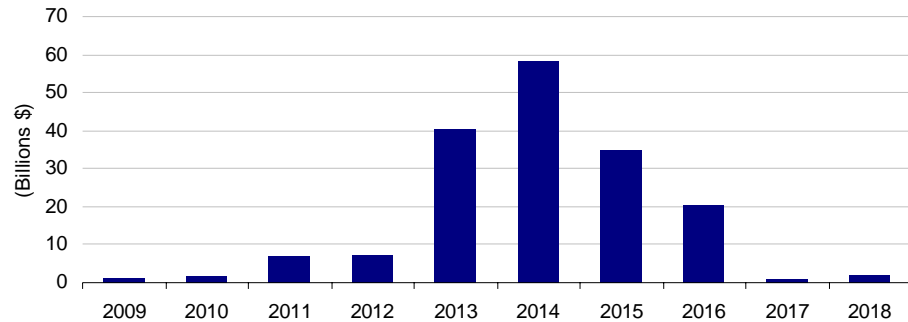
Despite the inordinate amount of economic gloom, we do believe that global growth is at an inflection point. The pace of economic deterioration is slowing, especially in the US and China, the two nations that have implemented the largest fiscal stimulus packages to date. Industrial production and global trade, which had been in a freefall since late 2008, have stabilized in recent weeks. A large number of other leading economic indicators are sending mixed signals, indicating that we may have reached an economic bottom. Equity markets rallied significantly in March and April, with emerging markets leading the bull run. Financial institutions are reporting better than expected results for first quarter 2009, as a steeply-sloped yield curve is helping top-line revenue. Purchasing managers' indices across the US and China have recovered from the lows achieved last autumn. Commodity prices have also firmed up recently, but still remain about 60% below their mid-2008 peak. Swift cuts in factory output have successfully cleared excess inventories, even though we still expect some production cuts throughout this year. Housing markets and bank lending behavior across the US and China have also made us more sanguine about the outlook in 2010.

Yet risks remain in this uncertain environment. The still fragile condition of many banks in the US and Western Europe is a continuing concern. We do not expect a significant or sustainable economic recovery until bank balance sheets are cleared of impaired assets, allowing the free-flow of credit through the world economic system.

Advantages of Private Equity

Amid the current crisis, one of the advantages of private equity portfolio investments is a superior capital structure with favorable debt terms and debt with longer term maturities. Private equity firms benefit from a strong expertise in debt restructuring which has been a great asset in helping them navigate through current capital market conditions. Standard & Poor's examined a sample of private equity deals totaling \$173 billion of investments made during 2006 and 2007. As shown in Exhibit 3, these leveraged deals have maturity distribution dates that range from 2009 to 2018, with an average maturity date of 2014. Such longer-dated maturities of the underlying debt have rendered us relatively more sanguine about the outlook for the private equity industry. The hope is that by 2014, there will be a major thaw in the financial environment, with credit flowing once again to better-managed firms.

Exhibit 3
Syndicated Bank Loan and Debt Distribution for Private Equity Deals
 (Maturing 2009-2018)

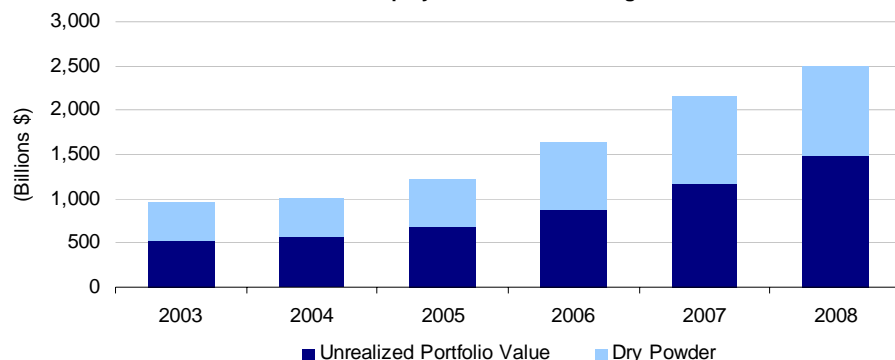


Note: Data includes the aggregate outstanding loan and debt for a sample of private equity deals made in 2006 and 2007.
 Source: Standard & Poor's and RREEF Research

A number of private equity firms also have the opportunity to re-size the existing debt on their investments since the debt is trading at significant discounts. For private equity firms that have uncommitted capital, buying back their portfolio companies' debt at a discount is a profitable opportunity.

Exhibit 4 displays overall assets under management of private equity firms, including the amount of dry powder they still possess. According to Preqin, private equity fund managers have more than \$1 trillion in dry powder as of year-end 2008. This can lead to very profitable 2009-vintage funds as more opportunities arise over coming months.

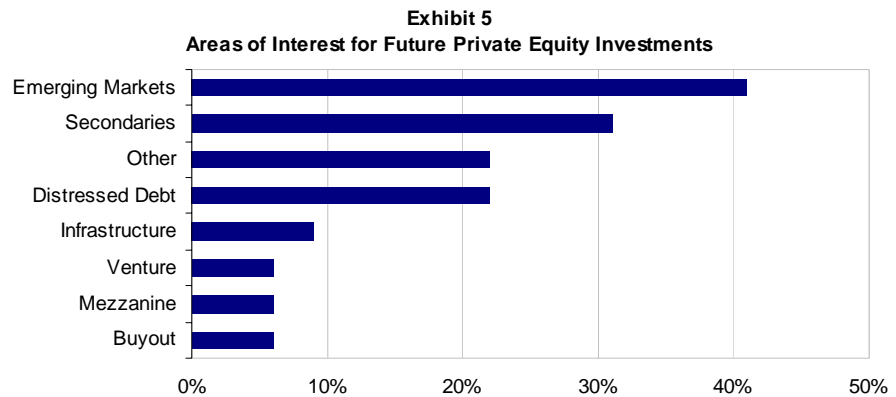
Exhibit 4
Private Equity Assets Under Management



Source: 2009 Preqin Global Private Equity Review

In the current capital-starved environment, many private equity firms are eyeing a variety of distressed plays as opportunities range from impaired bond or mortgage assets to acquiring bankrupt or near-bankrupt firms. Other opportunities may be in partnering with the US Treasury in acquiring legacy loans or securities off of bank balance sheets in the recently announced Public-Private Investment Program (PPIP). PPIP targets legacy (formerly known as toxic) bank assets, seeking to attract capital from private investors such as private equity firms, matched with Treasury capital and non-recourse lending facilities that would lever the returns to the equity investors. PPIP consists of two major components, one targeting legacy loans and the other targeting legacy securities.

Despite the opportunities that may arise on the distressed front, a recent Prequin survey ranked distressed debt as only the fourth area of interest by private equity firms. Exhibit 5 ranks emerging markets, followed by secondaries and other, as the top three strategies of interest among investors. What is interesting to note about secondaries is that they are now in a position to capitalize on the element of distress in the market while at the same time benefiting from their intrinsic qualities of liquidity and transparency. This is similar to conditions in the public equity market, however, secondaries have the advantage of private equity's governance ability and proper alignment of incentives.



Source: 2009 Prequin Global Private Equity Review

Investor Fears and Concerns: Evidence from the Market

Despite the advantages of private equity, investors have been raising some concerns as well. In its 2009 annual 'Private Equity Market Review and Institutional Investor Survey', Probitas Partners has summarized the most prevalent fears and concerns facing private equity investors in the current market environment. Unlike previous years when the overall survey was tinged with widespread optimism for the asset class, the results from this year's survey are more apprehensive. Moreover, the consistently top fears for investors in the 2005, 2006, and 2007 surveys—management fee levels and transaction fees on large funds are destroying alignment of interest between fund managers and investors; the amount of leverage in the buyout market is unsustainable; and there is too much money available in the large buyout market that will dramatically impact future returns—have come to fruition. This does not bode well for the state of the future private equity market.

Amongst the top fears that limited partners (LPs) have are lower return expectations, obstacles inhibiting the performance of portfolio companies, and a misalignment of general partner (GP) interests and LP expectations. Given this scenario, investors seem to be favoring counter-cyclical investment strategies that capitalize on market turmoil such as distressed debt/restructuring funds and secondaries.

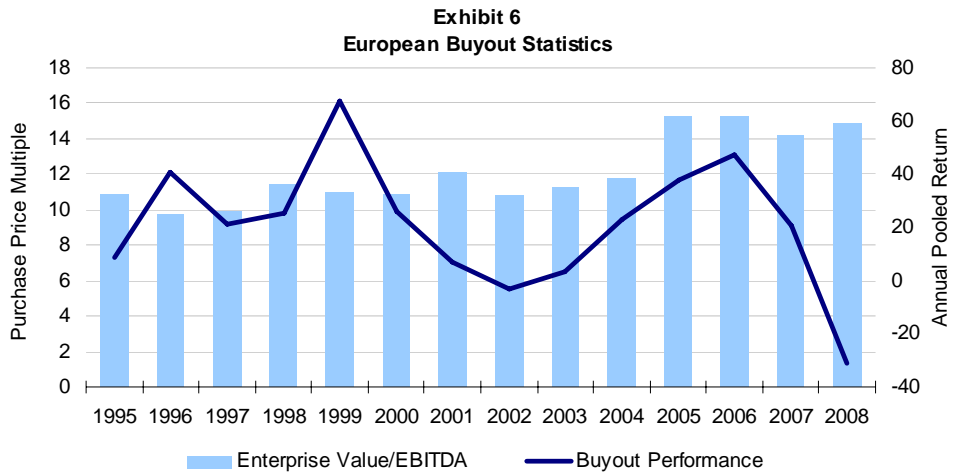
Probitas' survey is a sound barometer of market sentiment and it is with their findings that we will juxtapose our views and insights on the outlook for private equity. The following are the top

five fears regarding the private equity market. As you will see, some of the fears are well-founded while others are not as imminent or justified as investors believe.

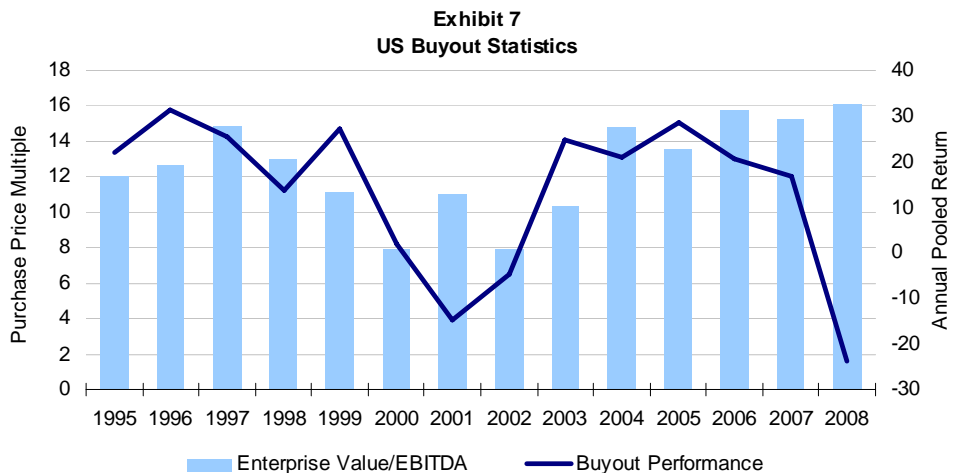
High purchase price multiples paid for buyout portfolio companies in 2005 through 2007 will dramatically impact returns.

The combination of strong capital flows into the buyout sector just prior to the credit crisis, coupled with copious amounts of leverage available, inflated purchase price multiples (enterprise value/EBITDA) to levels unseen in decades on a global aggregate basis. In particular, in North America deals achieved an average multiple of 15.8x in 2008. In Europe, the purchase price multiple peaked at 15.3x in 2006 while in Asia, the highest average multiple was 14.7x in 2007. Between 1995 and 2004, global purchase price multiples averaged 11.4x so paying a multiple greater than 15x is easily a 35% premium.

Does paying a high purchase price automatically mean returns will take a hit? According to evidence we have on the US and European markets (Exhibits 6 and 7), there is a slightly positive (in the case of the US) to slightly negative (in the case of Europe) correlation between price multiples and returns. In the US, the previous peak in purchase multiples was in 1997 but returns didn't really come down significantly until 2001 and that is chiefly due to exogenous market events. In Europe, purchase price multiples appear to have had no effect on the movement of returns between 1995 and 2004; however, the past four years when pricing levels were at their highest seem to coincide with a drop in performance.



Source: Dealogic, Thomson VentureXpert



Source: Dealogic, Thomson VentureXpert

Aside from high purchase price multiples, the downward pressure currently facing buyout returns can be attributed to a combination of over-leverage, economic uncertainty and mark-to-market accounting rules. True, the intoxicated buying spree has left many firms with a huge hangover that they now have to nurse. But more significantly, the credit crunch and economic recession have meant that many firms are behind on their growth plans for portfolio companies and cannot hit the return hurdles they anticipated when they were willing to pay the high prices they did. Furthering the image problem buyouts have, new mark-to-market rules are exacerbating write-downs to portfolio valuations. That is probably inducing the most fear when investors review their quarterly reports—the view of current valuations for a portfolio company vis-à-vis the initial purchase price. Hopefully as the economy begins to improve in 2010, so will the outlook for returns.

Increasing economic difficulties will have widespread impact on all alternative investment returns.

The foremost concerns facing investors are not relegated to private equity returns alone, but to their entire alternative investment portfolio. These types of investments, including private equity, real estate and infrastructure, share similar characteristics in that they are typically illiquid, have a longer capital lockup period and investment horizon, and are less transparent and subject to less regulation. As such, factors negatively influencing one alternative asset class are likely to affect other alternative asset classes as well.

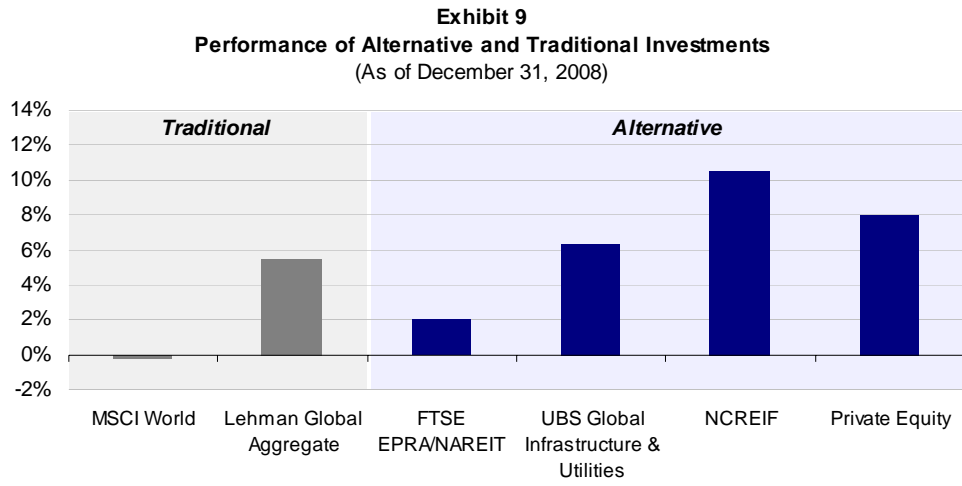
Based on the current performance data we have, we find that poor investment performance has been widespread over the past year but that most alternative investments have been outperforming traditional investments, even on a risk-adjusted basis. Over the past year, almost all asset classes posted negative returns except for bonds which produced a 4.8% return. US private real estate along with US and European private equity had returns of -6.5%, -23.6% and -30.6%, respectively. The results for private equity performance are indeed harsh, but, to some degree, expected. The global stock market produced a one-year return of -40.3% while the global public real estate and infrastructure markets posted returns of -50.2% and -37.9%, respectively. The dismal returns of real estate and infrastructure are due, in part, to lower confidence, as well as contagion from the broader equity market. A snapshot of investment returns is provided in Exhibit 8.

Exhibit 8
Performance Characteristics
(As of December 31, 2008)

	1 Year	3 Year	5 Year	10 Year	10 Year Sharpe Ratio
Stocks					
MSCI World	(40.3%)	(7.6%)	0.0%	(0.2%)	(0.05)
Bonds					
Lehman Global Aggregate	4.8%	7.0%	5.0%	5.2%	0.16
Real Estate					
NCREIF (US Private)	(6.5%)	8.1%	11.7%	10.5%	0.88
NAREIT (US Public)	(37.7%)	(10.8%)	0.9%	7.4%	0.16
FTSE EPRA/NAREIT (Global Public)	(50.2%)	(14.9%)	(2.1%)	2.0%	0.02
Infrastructure					
UBS Global Infrastructure & Utilities (Public)	(30.1%)	5.0%	11.5%	6.3%	0.13
US Global Infrastructure (Public)	(37.9%)	2.0%	10.6%	6.2%	0.13
Private Equity					
Thomson VentureXpert (US)	(23.6%)	3.4%	7.9%	7.9%	0.24
Thomson VentureXpert (Europe)	(30.6%)	2.6%	8.1%	8.0%	0.36

Source: MSCI Barra, Barclays Capital Research, NCREIF, Bloomberg, Thomson VentureXpert

2008 was a difficult year by almost all economic and financial accounts, so much so that most gains experienced by investors over the past few years have been negated. Looking at a longer time horizon though, alternative investments have still done better than the traditional market. Annualized 10-year returns for stocks and bonds are -0.2% and 5.2%, respectively. In contrast, annualized 10-year returns for global infrastructure, US private real estate and US private equity are 6.3%, 10.5% and 7.9%, respectively. Similarly, European private equity has yielded a 10-year return of 8.0%. The only alternatives sector we track that has performed below bonds over the past decade has been global public real estate. The EPRA/NAREIT index took such a severe beating in 2008 that it could only muster a 10-year annualized return of 2.0%. Exhibit 9 outlines the performance of traditional and alternative assets classes over the past decade.



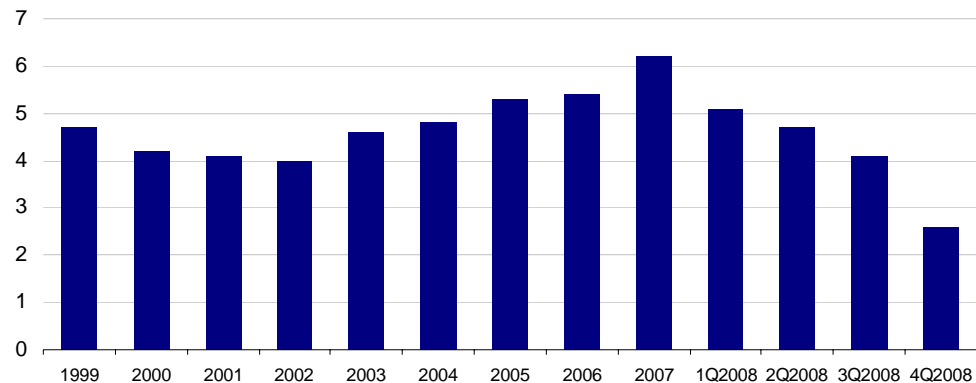
Source: MSCI Barra, Lehman Brothers, NCREIF, FTSE, UBS, Thomson VentureXpert, Bloomberg

Decreased leverage availability in the market will hurt companies needing working capital or re-financing.

Despite all of the global efforts to bring back adequate levels and pricing of financing into the private equity markets, the landscape will never be the same as it was prior to the credit crisis when leverage was cheap and plentiful. As previously stated, we expect financing conditions to improve in the next five years but, in the meantime, the short-term implications of the credit crunch are three-fold. First, firms will need to be more prudent when undertaking leverage. The market viewed leverage levels to be unsustainably high in the past so the pendulum is likely to swing in the opposite direction as a counter-measure. Second, firms will have to pursue more creative strategies in procuring capital to take the place of traditional debt. Cash-strapped and debt-laden firms in particular will have to find other workarounds to the financing problem than simply putting more equity into the pot. Third, firms will have to work quickly and demonstrate flexibility in preventing shortages of capital lest their portfolio companies suffer any further. Exhibit 10 shows the fluctuations in LBO debt multiples since 1999.

A number of new financial workarounds are being considered to mitigate shortages in working capital. One is to unload non-core assets to free up cash. Another approach is to infuse new capital from fundraising into portfolio companies rather than making investments in new ventures. This ‘doubling down’ on investments can help reduce leverage risk but makes firms more vulnerable to product risk, market risk and execution risk.

Exhibit 10
Average LBO Debt Multiple (Debt/EBITDA)



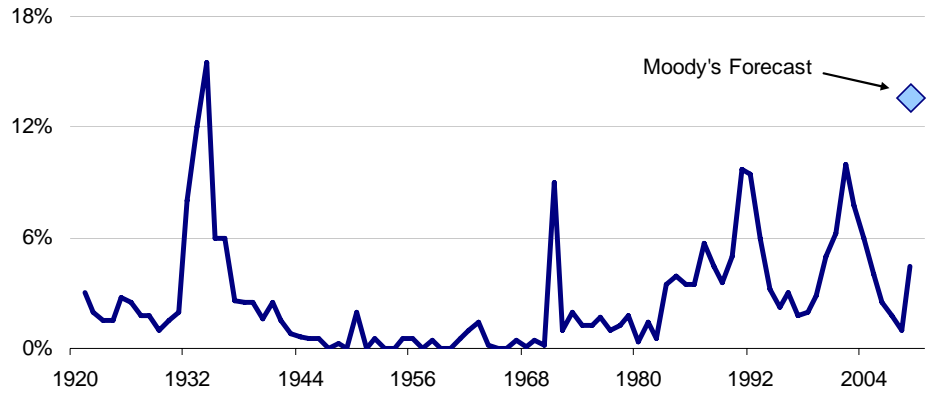
Source: UBS

In terms of re-financing options, there have been indications that controversial payment-in-kind (PIK) loans and notes are starting to resurface. These instruments were widely exploited during the period before the credit crisis but these days they are becoming more of a lifeline to firms struggling with increasing debt burdens and dwindling cash flows. Another option has been for buyout firms to do away with leverage all together and undertake equity buyouts (EBOs). Since target companies are trading well below their historic average multiples, EBOs are more feasible in the current environment than in the past from a pricing perspective. Nevertheless, the downside is a greater concentration of risk and the loss of tax benefits associated with assuming debt for the transaction. The market for EBOs has yet to take off in a big way but the foundation is there.

Increasing defaults in 2009 will dramatically impact returns on buyout funds in my portfolio.

The prediction of increasing bond defaults and portfolio company bankruptcies has been persistent for the past 18 months but the up-tick hasn't been realized until recently. Defaults in leveraged finance are expected to rise due to high debt multiples, a faltering economy and an increase in risk premiums—the same factors affecting other parts of the private equity return equation. According to S&P LCD, loan default rates spiked to 5.6% in the first quarter, a 180 basis point increase from December last year and a 460 basis point increase from the year-end 2007. By comparison, the historical average default rate is 3%. S&P doesn't forecast future rates but Moody's is predicting the default rate to soar to 14% in the US and 21% in Europe by the close of 2009 (Exhibit 11). Some industry analysts are actually hoping for defaults to hit sooner rather than later so as put the ugliness behind them and not cause continuous market disruptions.

Exhibit 11
The Default Rate is Expected to Rise to Over 13% by Year-End
(As of February, 2009)



Source: UBS, Moody's

Overall, portfolio companies are also experiencing bankruptcies at an increasing rate. Thomson Reuters' PEhub counts 24 LBO-backed bankruptcies in first quarter 2009 (Exhibit 12), compared to 49 for all of 2008 and only 2 in 2007. Furthermore, a recent study by Boston Consulting Group predicts more than half of private-equity backed companies will default in the coming years. Exhibit 12 highlights the most notable bankruptcies year-to-date.

**Exhibit 12
LBO-Backed Companies That Filed For Bankruptcy Protection In 2009 (as of March 31, 2009)**

Company	Date Filed	Sponsor(s)	Year of Purchase/ Deal Value	Equity Invested	Sector	Reasons Cited	Updates
Interlake Material	1/10/00	Wynchurch Capital Ltd.	2006/\$48 million	Unavailable	Industrial Machinery and Equipment	Hurt by weak sales and cash flow.	Approved for 363 sale to Macalux Inc.
Blue Tulip Corp.	1/6/09	Highland Capital Partners	2006-2008/Unavailable	44% stake/- \$12.21 million	Gift Retailer	Economic downturn hurt performance.	Plans to liquidate 24 stores, hired Hilco Merchant Resources.
Merisant Worldwide Inc.	1/10/09	Pegasus Capital Advisors and consortium of co-investors	2000/\$570 million	\$51.3 million	Food Products	Beat down by competition and too much debt.	The company has won access to its \$20 million DIP loan from Wayzata Investment Partners and is approved for a sale to Macalux.
American Restaurant Star Tribune Co.	1/15/09	Versa Capital Management Inc.	2008/Unavailable	\$14.64 million	Restaurant	Sales hurt by recessionary economic conditions.	DIP Lending Approved.
	1/15/09	Avista Capital Partners	2007/\$530 million	\$100 million	Media	Hurt by drop in advertising sales and by economy.	The company has won use of cash and will meet with its creditors on 3/30.
Wall Homes Inc.	1/17/09	Warburg Pincus and Jen Partners	2005/\$50 million	Warburg Pincus owns 73.11% of Wall Home's outstanding common stock and 81.56% of its outstanding preferred stock	Homebuilding	Housing market conditions.	The business has obtained court permission to tap its cash collateral and continue business.
Von Weise (Specialty Motors Holding Corp.)	1/21/09	Sun Capital Partners	2007/\$10 million	Unavailable	Auto Parts	Slump in sales.	The company will liquidate.
Edscha	2/2/09	Carlyle Group	2003/\$247.6 million	\$180 million	Automotive Supplier	Slump in car sales.	Bi-Lo, an affiliate, has provided DIP financing.
Bruno's Supermarkets	2/5/09	Lone Star Funds	2004/\$660 million for Bruno's and Bi-Lo, which filed for Ch. 11 on 3/23 2008/\$80 million	Unavailable	Supermarket Operator	Drop in consumer spending.	Wells Fargo and UBS are leading an \$80 million DIP loan; liquidation in process.
Fortunoff	2/5/09	NRDC Equity Group	2007/Unavailable	\$10 million	Jewelry Retailer	Disappointing sales for holiday 2008, economic pressures on sales.	Sun Capital will provide up to \$12 million in DIP financing.
Fluid Routing Solutions Inc.	2/6/09	Sun Capital Partners	2007/Unavailable	Unavailable	Automotive Supplier	Movement away from SUVs and trucks, and high raw material costs hurt sales volume.	The company won the use of its DIP loan.
Pilant Corp.	2/12/09	CCMP Capital Advisors LLC	2000/Unavailable	Unavailable	Chemicals, Packaging & Environmental Svcs.	Heavy debt load and high commodity costs.	The company won court approval to use \$20 million in cash collateral.
Muzak Partners LLC	2/10/09	ABRY Partners LLC	1998/ \$250 million	Unavailable	Music Programming	Heavy debt load and failure to merge with competitor.	The company has won more than \$1 billion in DIP after arguments between creditors over the terms.
Aleris International Inc.	2/13/09	TPG	2006/\$1.7 billion, plus the assuming of \$1.6 billion in debt	Unavailable	Aerospace Supplier	Deteriorating demand, earnings and liquidity caused by the recession.	The company has won approval to use DIP financing from prospective buyer Premier Exteriors.
Naillie International Inc.	2/17/09	Graham Partners, Argosy Partners	2003/Unavailable	Unavailable	Building Products Manufacturer	Hurt by slump in the housing market.	The company has won court approval for \$4MM in DIP financing. [Corrected from previous version, which incorrectly stated the company would liquidate.]
Forward Foods LLC	2/17/09	Emigrant Capital Corp.	2006/Unavailable	\$12.72 million	Food Products	Salmonella outbreak at its supplier damaged demand for its products.	The company has won court approval to access its DIP financing and sell itself, possibly to stalking horse bidder, D.B. Zwirn.
Everything But Water	2/27/09	Bear Growth Capital Partners	2006/Unavailable	Unavailable	Apparel Retailer	Hurt by economic conditions.	JedDirect will sell itself to a new entity.
Regal Jet LLC (a unit of JetDirect)	2/27/09	ABS Capital Partners, AIG Global Investment Group, Argosy Partners, Brantley Partners, CD Ventures LLC, HSBC Pte Equity (Asia)	2006-7/Unavailable	AIG and HSBC committed \$50 million in 2006. ABS Capital committed \$60 million in 2007	Aviation Services	Unavailable	The company plans to sell itself within 30 days of 3/11.
G.L. Joe's Inc.	3/4/09	Gyphon Investors, Inc.	2007/Unavailable	Unavailable	Sporting Goods Retailer	Hurt by economic conditions that is curtailing consumer spending.	The company won the interim use of its cash collateral on 3/19.
Masonite International Inc.	3/16/09	Kohlberg Kravis Roberts & Co.	2005/\$2.7 billion	\$551.5 million	Residential Door Manufacturer	Hurt by slide in the housing and construction markets, and by loss of one of its largest customers in 2007.	The company plans to sell 32 of its stores to Walgreen Co.
Drug Far Group Inc.	3/18/09	Sun Capital Partners	6/27/05	Unavailable	Pharmacy Chain	Hurt by downturn in the economy.	The company awaits restructuring approval on its DIP loans and hopes to emerge from bankruptcy as a stand-alone entity.
Bi-Lo LLC	3/23/09	Lone Star Funds	2004/\$660 million for Bi-Lo and Bruno's, which filed for Ch. 11 on 2/5	Unavailable	Supermarket Operator	To address \$360 million in two loans due 3/26/09.	The firm was awarded the use of cash collateral.
Indalex Aluminum Solutions	3/20/09	Sun Capital Partners Inc.	2006/\$425 million	Unavailable	Metals, Mining & Steel	Saw a 35% decline in demand for its products since 2006.	Seeking approval for \$20 million in DIP funding.
MIMC Precision Holdings	3/22/09	Brazos Private Equity Partners LLC	2006/Unavailable	80% stake for \$60 million in equity	Metals, Mining & Steel	The recession caused a 30% drop in sales, combined with tight credit markets.	
Robbins Bros. Corp.	3/3/09	Weston Presidio, Dorset Capital Management LLC	2004	The firms purchased a 49% stake	Engagement Ring Retailer	The recession has caused a decline in demand for the company's discretionary high-end items.	The company has selected Weston Presidio and Spence Diamonds as lead bidders.
Milacron Inc.	3/11/09	Bayside Capital	2007	Bayside owns 57.5% of the company's 6% Series B convertible preferred stock	Plastics Processing	Credit crisis and deteriorating global economy forced filing.	The company awaits court approval on \$60 million in DIP financing and purchase from Avenue Capital and DDJ Capital Management.
Fleetwood Enterprises Inc.	3/10/09	Tennenbaum Capital Partners, Marathon Asset Management	Unavailable	Unavailable	Prefabricated Homes and RV Manufacturing Retailer	Hurt by fuel prices and economic recession.	The company has closed 23 locations.
Sportsman's Cheater	3/21/09	Seidler Equity Partners	2008	Seidler Equity owns 25% of the company	Cable Operator	Hurt by drop in sales that reflects economic slowdown.	Pre-packaged bankruptcy plan, if approved, would sell assets and repay all trade creditors. Apollo Management will have a majority stake through its debt-for-equity swap.
	3/29/09	Kelso & Co., Oak Hill Advisors LLC	Unavailable	Unavailable		Massive debt load from financing roll-up strategy.	

Source: pehUB.com and Buyouts Research

Naturally, increasing defaults will adversely impact returns of buyout funds. However, the situation will be a boon to distressed debt investment strategies that are gaining favor in the marketplace. Investors who fear that the private equity market is overexposed to defaulting companies and who want to improve their risk/return profile can turn to distressed debt and restructuring funds as a way to hedge their bets and take advantage of the economic and financial down cycle.

Management fee levels and transaction fees on large funds are destroying alignment of interest between fund managers and investors.

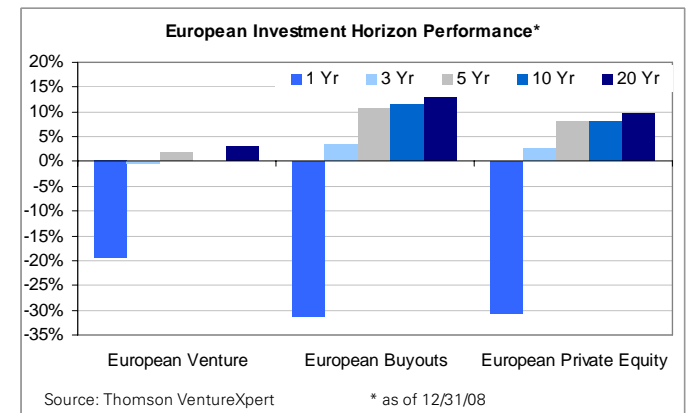
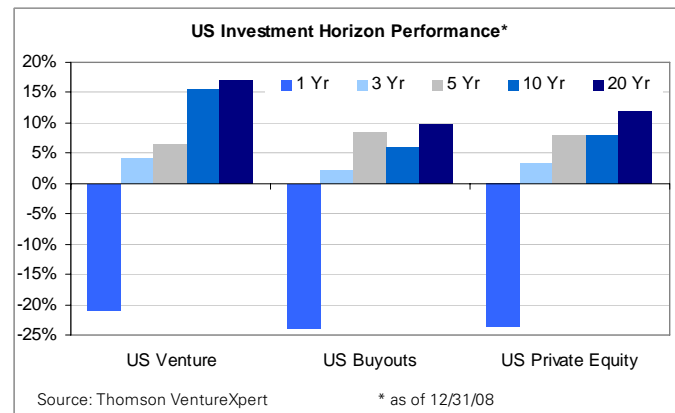
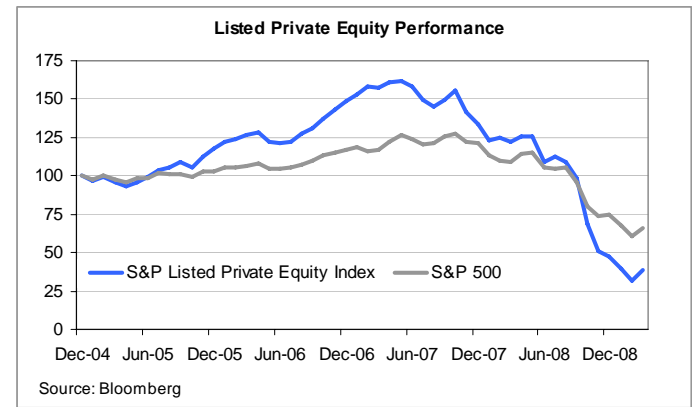
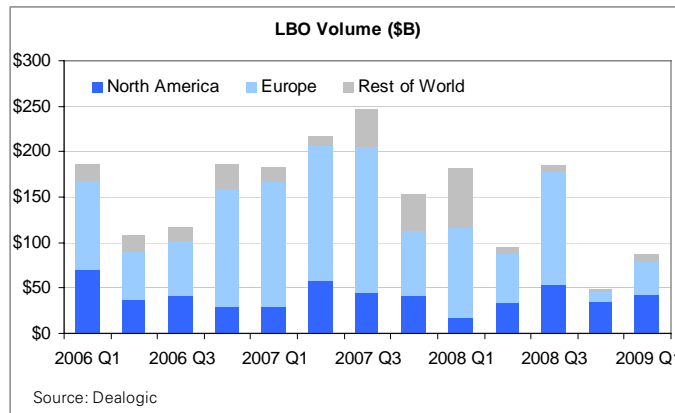
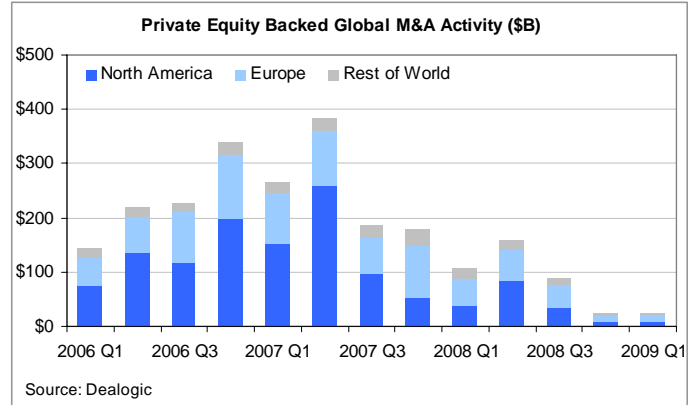
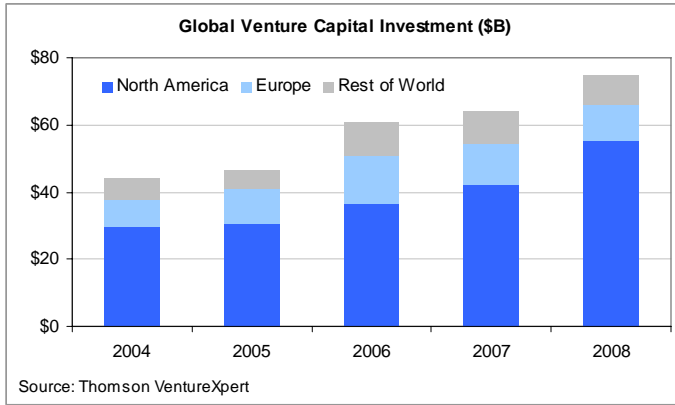
Most of the current fears and concerns circling the private equity market are beyond anyone's control – GPs and LPs. However, the one area in which there has been some cooperative measure to change the status quo is in regards to fee structure. Once used as a tool to align the interests of fund managers and investors, management and transaction fees have recently diverged from covering operational expenses (rent, salaries, travel, etc.) to becoming a source of unearned profit. Concerned by this, investors have begun calling for a remuneration arrangement that reflects the current economic and investment environment. An environment where a 2% fee for large funds is deemed excessive given that GPs are idly sitting on ample dry powder and deal flow continues to be moribund. Now, more than ever, LPs have considerable bargaining power with GPs and fee structures are an area in which they are exercising their clout. Investors feel that managers are unjustified in earning income to essentially baby-sit their money and are calling for more accountability and transparency to the situation.

Some managers have responded by renegotiating lower fees and, in some cases, waiving management fees temporarily until normal business conditions resume. In order to raise fresh capital in the future, GPs realize they will need to reassess their fee structure in order to attract investors. They also concede that to improve the industry's image and sustainability, they will need to make concessions which has led to an overall improvement in the outlook for fees.

Concluding Remarks

Private equity benefits from a number of factors, including a superior capital structure, as compared to other alternative asset classes. Despite these benefits, investors have raised alarm bells relating to some of the same inherent features of the private equity industry, given current market dynamics. The industry still has miles to go before it fully rebounds, however, 2009 will be an important milestone in its path to recovery.

Private Equity Trends At a Glance



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I-011466-1.2