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2010 Private Capital Markets Report (Winter)

John K. Paglia
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PRIVATE CAPITAL MARKETS PROJECT

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SURVEY REPORT VOLUME II – WINTER/SPRING 2010

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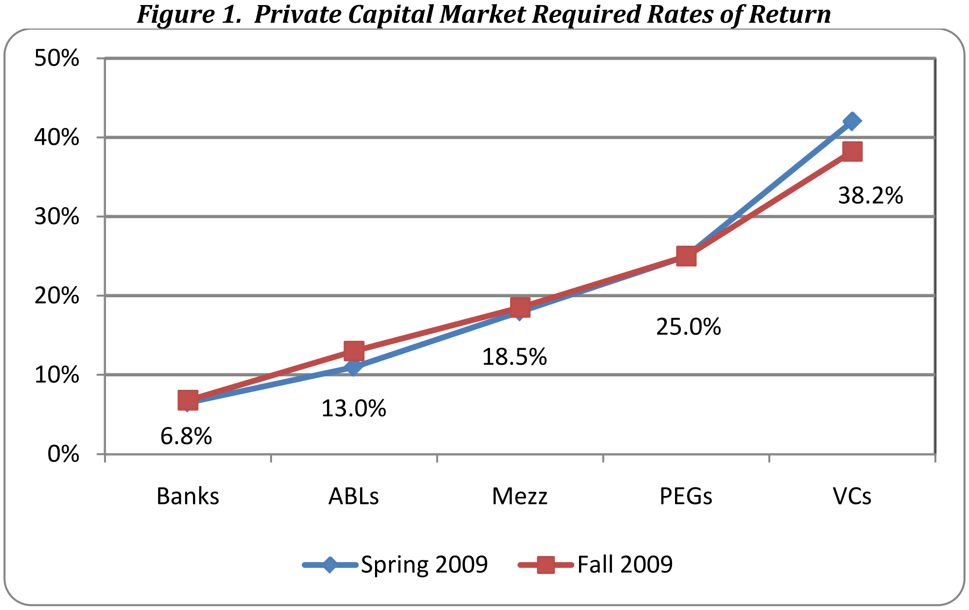
PEPPERDINE PRIVATE CAPITAL MARKETS SURVEY

The Pepperdine private cost of capital survey (PCOC) is the first comprehensive and simultaneous investigation of the behavior of the major private capital market segments. The survey deployed in October/November 2009, specifically examined the behavior of senior lenders, asset-based lenders, mezzanine funds, private equity groups, venture capital firms, and privately-held businesses. The Pepperdine PCOC survey investigated, for each private capital market segment, the important benchmarks that must be met in order to qualify for capital, how much capital is typically accessible, what the required returns are for extending capital in today's economic environment, and outlooks on demand for various capital types, interest rates, and the economy in general.

Our findings indicate that required returns on new investments vary significantly by capital type and risk assumed, with senior lenders requiring 6.8%, asset-based lenders demanding 13%, mezzanine funds expecting 18.5%, private equity groups expecting 25%, and venture capital funds expecting 38.2%. This relationship is depicted in the Pepperdine Private Capital Market Line, which appears below.

Figure 1. Private Capital Market Required Rates of Return



The results from our survey follow by category.

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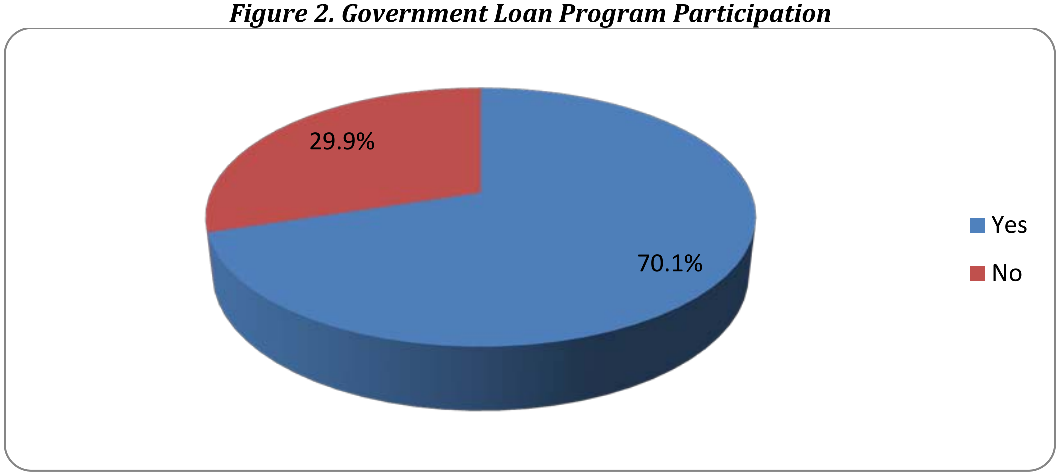
BANK SURVEY INFO

Profile of Respondents

The following responses pertain to the bank survey administered in October/November 2009. Results are based upon 89 responses to this survey. The respondents are geographically dispersed throughout the United States.

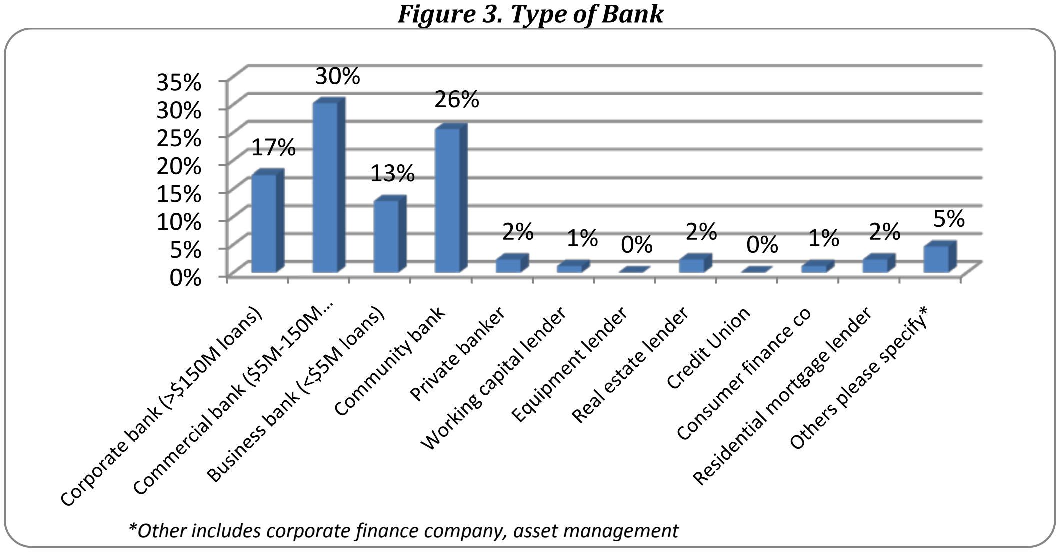
Seventy percent (70%) of these banks said they participate in government loan programs (i.e., SBA).

Figure 2. Government Loan Program Participation



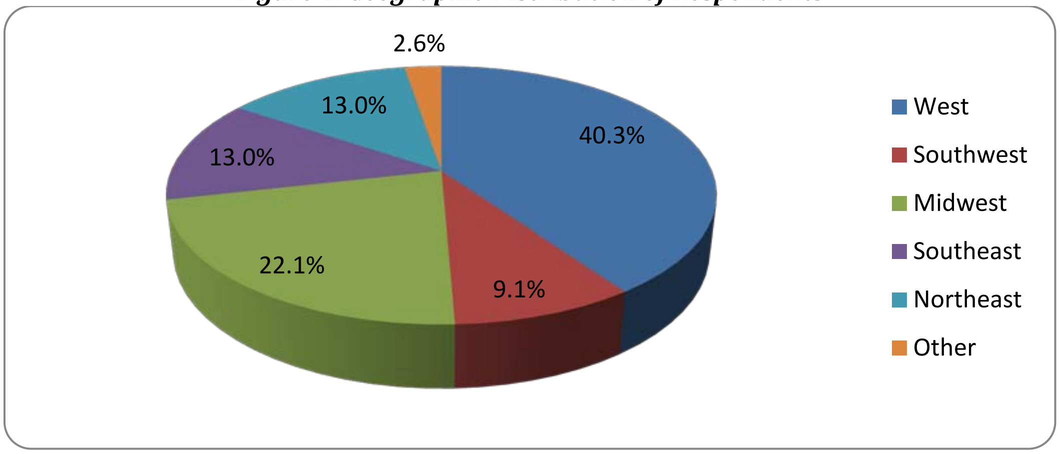
Approximately 30% of respondents report being a commercial bank, 26% report being a community bank, and another 17% identify themselves as a corporate bank.

Figure 3. Type of Bank



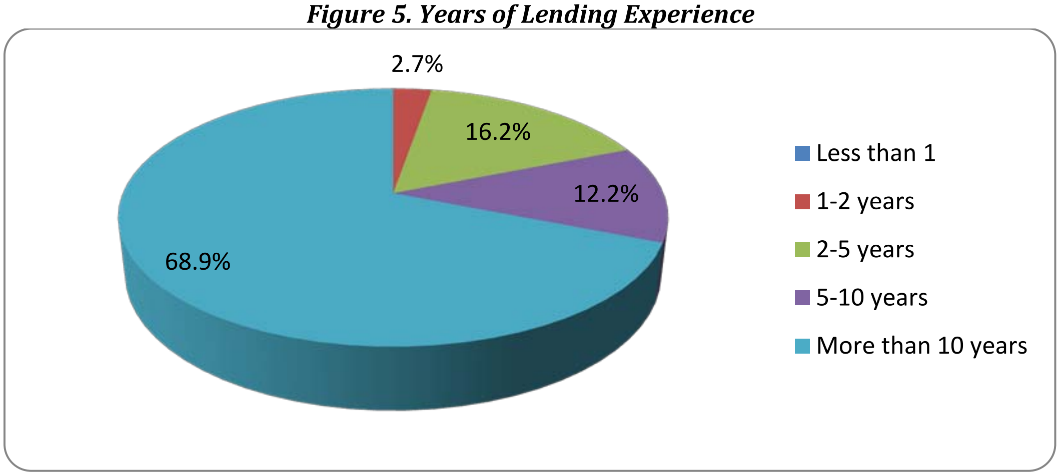
Approximately 40% of respondents identify themselves as being in the western part of the country while 22.1% report being located in the midwest. An even split occurs (13.0% each) between the southeast and northeast.

Figure 4. Geographic Distribution of Respondents



Nearly 69% of respondents report having more than 10 years of experience as a senior lender. Another 16.2% of respondents report having two to five years of experience.

Figure 5. Years of Lending Experience



Operational and Lending Characteristics

We asked respondents to report on various operational and industry items as compared to six months ago. Significant increases were reported in time to process loans, credit quality of borrowers approved for credit, loan delinquency rates, and loan charge-off rates. Significant declines were reported for number of loan applications, credit quality of borrowers applying for credit, number of borrowers approved for credit, percentage of borrowers approved for credit, average loan size, multiple of cash flow lent, standard advance rates, loan maturity (months), size of interest rate spreads, and number of loans being made by competitor banks.

Table 1: General Operational Assessment Today Versus Six Months Ago

	Increased	Decreased	Stayed about the same
Number of loan apps	27%	45%	27%
Time to process loans	64%	18%	18%
Credit quality of borrowers applying for credit	9%	82%	9%
Credit quality of borrowers approved for credit	45%	27%	27%
Number of borrowers approved for credit	18%	64%	18%
Percentage of borrowers approved for credit	9%	82%	9%
Average loan size	18%	45%	36%
Multiple of cash flow lent	9%	64%	27%
Standard advance rates	18%	45%	36%
Loan maturity (months)	9%	36%	55%
Size of interest rate spreads (pricing)	27%	45%	27%
Loan fees	36%	36%	27%
Number of financial covenants (per loan)	27%	27%	45%
Tightness of financial covenants	27%	18%	55%
Percent of loans with personal guarantees	20%	20%	60%
Loan delinquency rates	50%	20%	30%
Loan charge-off rates	50%	20%	30%
Lending capacity of bank (capital ratio impacts)	30%	40%	30%
Number of loans being made by competitor banks	10%	80%	10%

Over the six months prior to the survey, lenders report that 58.6% of all cash flow-based loans offered were ultimately booked. Approximately 60.4% of all collateral-based loans, excluding real estate, were booked, while 75.6% of all real estate-based loans offered were booked.

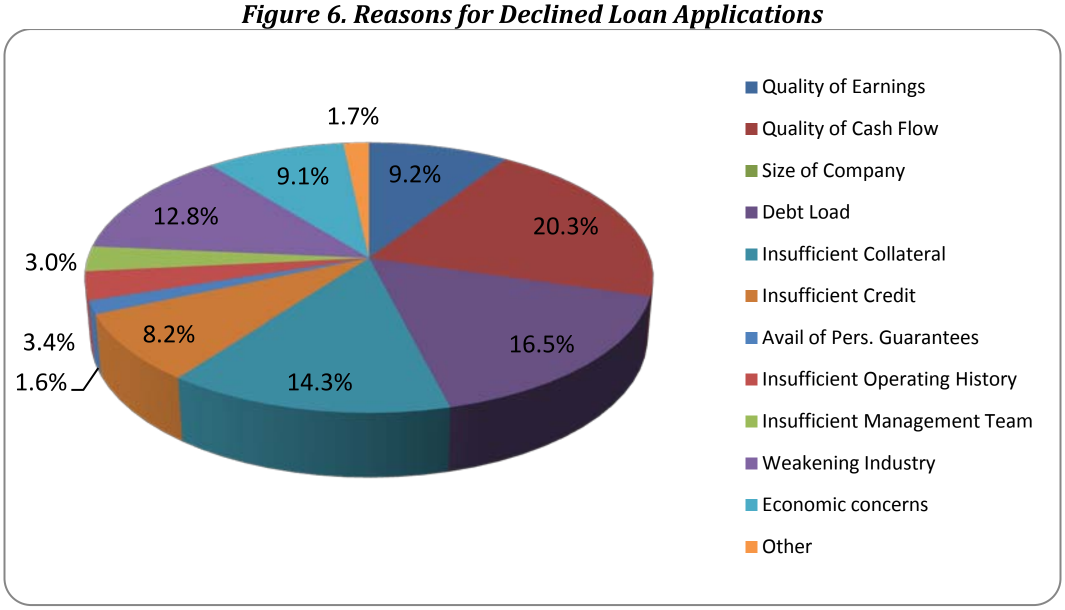
Most applications, however, were declined. Cash flow-based applications were declined most frequently (67.3%) while collateral-based application were declined in 63.3% of cases, and real estate loans were declined in 60.3% of situations.

Table 2. Action Taken on Loans

	Declined %	Offer %	Book to offer %
Cash flow-based	67.3%	31.7%	58.6%
Collateral-based	63.3%	36.7%	60.4%
Real estate-based	60.3%	39.0%	75.6%

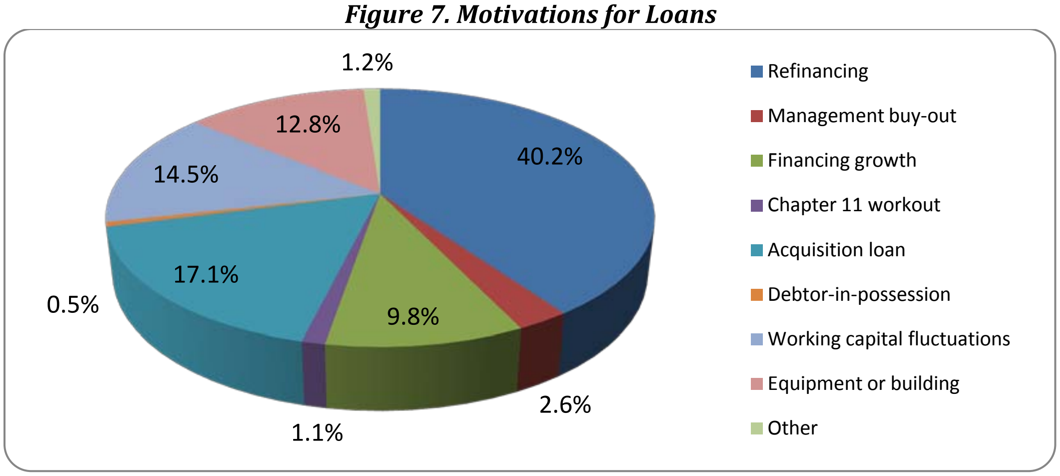
Quality of cash flow was the primary reason loan applications were declined (20.3%) followed by debt load (16.5%) and insufficient collateral (14.3%).

Figure 6. Reasons for Declined Loan Applications



The most common motivation for securing lending was refinancing (40.2%) followed by acquisitions (17.1%). Working capital (14.5%) was also frequently cited as a reason for securing a loan.

Figure 7. Motivations for Loans



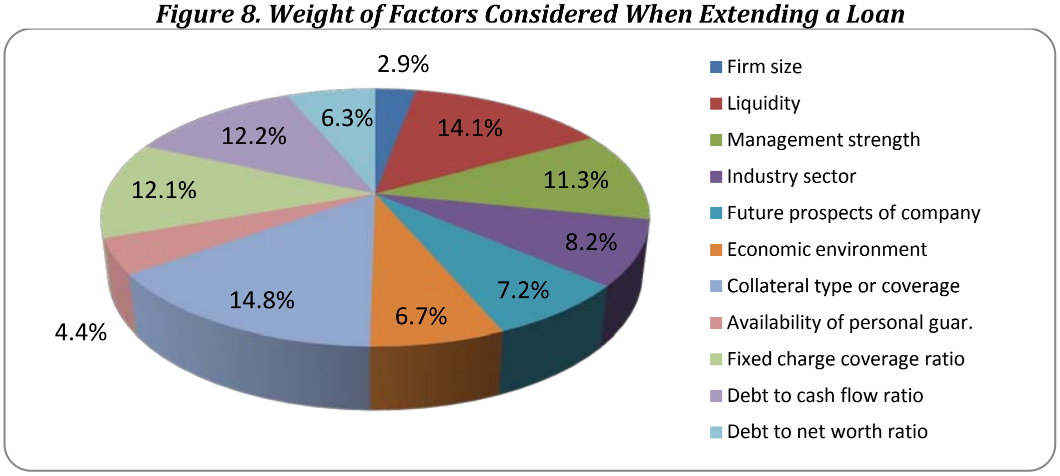
Respondents were asked to assess the following characteristics for loans booked currently versus loans booked just six months ago. Responses generally suggest more restrictive credit conditions.

Table 3: Credit Qualifying Characteristics Today Versus Six Months Ago

	More restrictive today	More lenient today	Approximately the same
Size of firm	30.8%	2.6%	66.7%
Sales growth rate	26.3%	15.8%	57.9%
Fixed charge coverage	72.2%	5.6%	22.2%
Debt service ratio	76.9%	5.1%	17.9%
Funded debt to EBITDA	71.1%	5.3%	23.7%
Total debt to EBITDA	73.7%	5.3%	21.1%
Debt to net worth	67.6%	5.4%	27.0%
Debt to tangible net worth	65.8%	5.3%	28.9%

The most important factors for deciding whether to extend credit or not are the collateral type or coverage (14.8%), liquidity ratios (14.1%), debt to cash flow ratios (12.2%), and fixed-charge coverage ratios (12.1%).

Figure 8. Weight of Factors Considered When Extending a Loan



Banks also report various threshold ratios and benchmarks as being important when determining how much credit to lend. Medians, 1st quartiles, and 3rd quartiles are reported for each below.

Table 4: Critical Ratios When Extending Credit

	Threshold	1st quartile	Median	3rd quartile
Firm revenues ($M)	Typical	3.5	10.0	35.0
Sales growth rate (%)	Typical	0.0	0.5	5.0
Fixed charge coverage	Typical	1.2	1.3	1.3
	Minimum	1.0	1.1	1.2
Debt service ratio	Typical	1.2	1.3	1.5
	Minimum	1.0	1.2	1.3
Funded debt to EBITDA	Typical	2.5	3.0	3.5
	Maximum	3.0	3.5	4.5
Total debt to EBITDA	Typical	3.0	3.5	4.0
	Maximum	3.5	4.3	5.0
Debt to net worth	Typical	2.0	2.8	3.4
	Maximum	3.0	4.0	5.0
Debt to tangible net worth	Typical	2.2	3.0	4.0
	Maximum	3.4	4.0	5.0

Banks report the standard advance rates (or loan-to-value ratio) for each of the following types of assets.

Table 5: Standard Advance Rates

	1st quartile	Median	3rd quartile
Inventory - low quality	22.5%	30.0%	37.5%
Inventory - intermediate quality	20.0%	40.0%	50.0%
Inventory - high quality	35.0%	50.0%	62.5%
Equipment	50.0%	75.0%	80.0%
Real estate	60.0%	70.0%	75.0%
Land	35.0%	50.0%	50.0%
Marketable securities	50.0%	70.0%	80.0%

When lending is based upon assets, fair market value is used most often for real estate and marketable securities when estimating the amount to lend. Face value represents the largest concentration of responses for accounts receivable, while orderly liquidation is the most cited valuation standard for equipment lending

Table 6: Collateral Valuation Standards

	Accounts receivable	Equipment	Real estate	Marketable securities
Purchase price	2.4%	2.4%	0.0%	0.0%
Depreciated value (book)	17.1%	7.3%	2.4%	2.4%
Face value	36.6%	0.0%	0.0%	14.6%
Fair market value	9.8%	14.6%	63.4%	53.7%
Orderly liquidation	12.2%	43.9%	14.6%	14.6%
Forced liquidation	7.3%	19.5%	7.3%	4.9%
Other	4.9%	0.0%	2.4%	0.0%

The median loan terms on booked deals are 60 months for equipment loans, 84 months for real estate, 12 months for working capital, and 36 months for cash flow.

Table 7: Loan Terms

	1st quartile	Median	3rd quartile
Equipment	36	60	60
Real estate	54	84	180
Working capital	12	12	36
Cash flow	15	36	60

Banks also report various financial covenants that are attached to the loans. Medians, 1st quartiles, and 3rd quartiles are reported for each below.

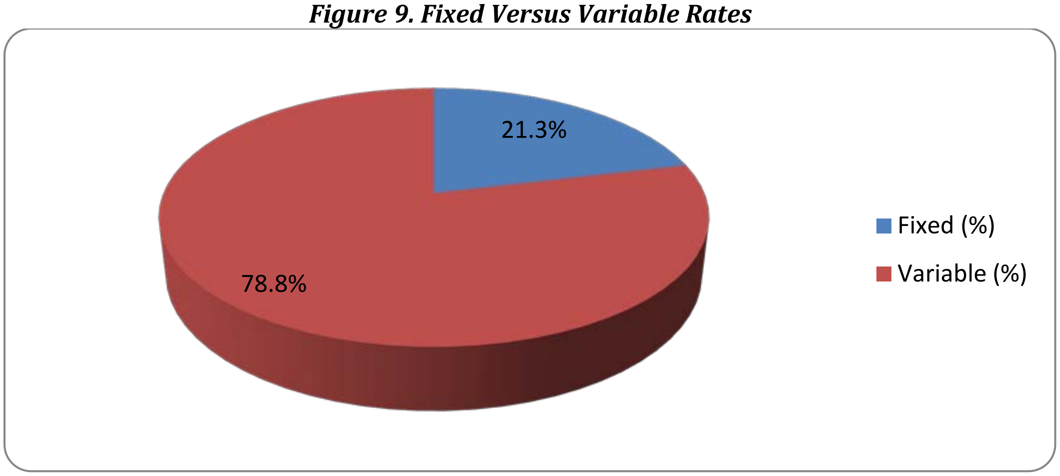
Table 8: Critical Financial Covenants When Extending Credit

	1st quartile	Median	3rd quartile
Current Ratio	1.1	1.3	1.8
Maximum debt / net worth	1.5	2.0	3.0
Max. debt to TNW	2.5	3.0	3.3
Fixed charge coverage	1.2	1.2	1.2
Debt service coverage	1.2	1.3	1.3
Debt/EBITDA	2.5	3.0	3.5

Pricing and Returns

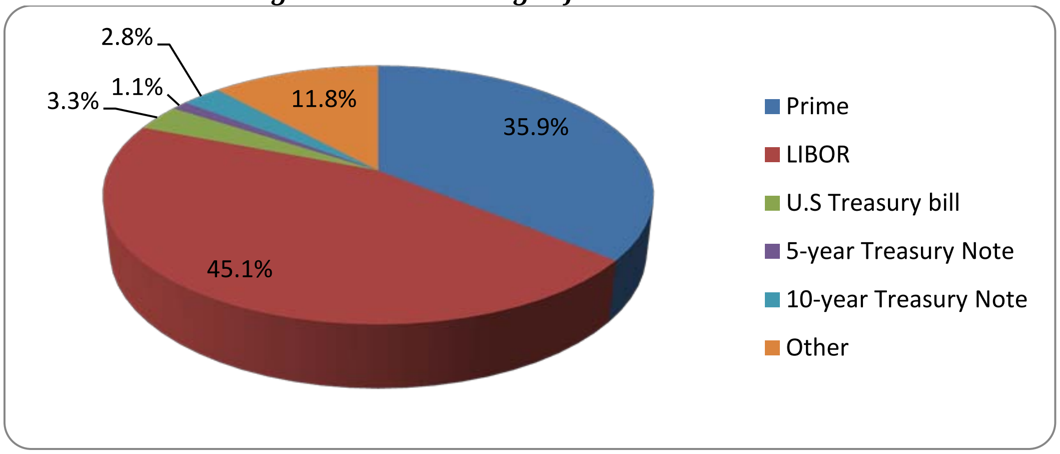
Seventy-eight percent (78.8%) of respondents report using variable rate loans while 21.3% use fixed rates.

Figure 9. Fixed Versus Variable Rates



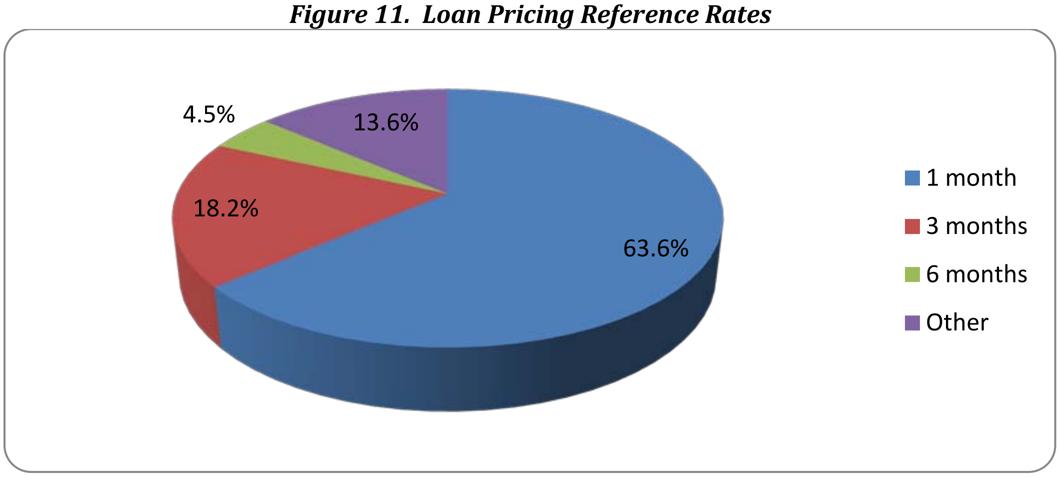
For variable rate loans, 35.9% reference prime while 45.1% reference LIBOR.

Figure 10. Loan Pricing Reference Benchmarks



Of those referencing LIBOR, nearly 64% use a one-month rate as a reference, while 18.2% reference the three-month rate. The other category includes bank cost of funds index, five-year FHLB rate, and swap rates.

Figure 11. Loan Pricing Reference Rates



Banks report a variety of fees that are charged to the borrower. They include the following:

Table 9: Loan Fees

	1st quartile	Median	3rd quartile
Closing fee	1.0%	1.0%	2.1%
Modification fee	0.3%	0.5%	0.5%
Commitment fee	0.5%	1.0%	2.5%
Prepayment penalty (yr 1)	2.8%	3.0%	5.0%
Prepayment penalty (yr 2)	1.0%	2.0%	3.3%
Unused line fee	0.3%	0.4%	0.5%
Audit fee	$2,000	$2,500	$2,500
Attorney's fee	$1,250	$3,500	$6,500

The following table identifies loan rates according to various pricing metrics. The typical loan-based upon variable pricing tied to Prime is 5.3% while variable rate loans tied to LIBOR are 4.8%. For those loans priced on a fixed rate, the typical rate is 6.8%.

Table 10: Loan Rates

		1st quartile	Median	3rd quartile
Prime	Spread (average)	1.0%	1.5%	2.8%
	Total stated rate	4.0%	5.0%	6.3%
	Year 1 fees (exclude prepay)	0.5%	1.0%	1.5%
	Year 1 all-in rate (with fees ex prepay)	4.1%	5.3%	6.1%
	Rate floor (if applicable)	4.6%	5.3%	5.9%
LIBOR	Spread (average)	3.0%	3.4%	4.0%
	Total stated rate	3.4%	4.4%	5.9%
	Year 1 fees (exclude prepay)	0.3%	0.5%	1.5%
	Year 1 all-in rate (with fees ex prepay)	3.8%	4.8%	6.1%
	Rate floor (if applicable)	2.0%	4.0%	4.8%
Fixed	Spread (average)	3.3%	4.0%	6.3%
	Total stated rate	6.1%	6.5%	6.5%
	Year 1 fees (exclude prepay)	0.3%	0.5%	1.0%
	Year 1 all-in rate (with fees ex prepay)	6.3%	6.8%	7.0%
	Rate floor (if applicable)	6.5%	6.5%	6.5%

Industry and Economic Outlook

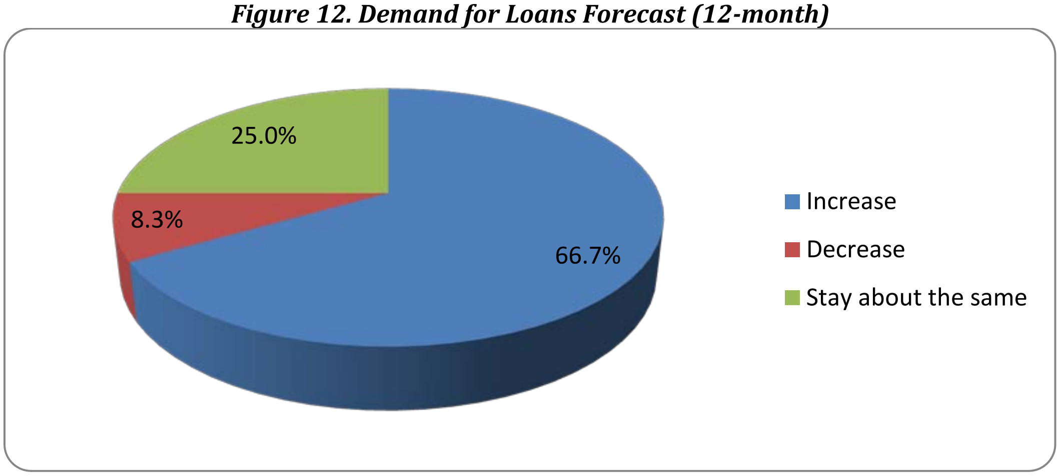
Looking forward to the next 12 months, 75% of those surveyed believe that the prime and LIBOR interest rates will increase, while approximately 17% believe those rates will stay the same.

Table 11: Interest Rate Forecast (12-month)

	Increase	Decrease	Stay about the same
Prime	75.0%	8.3%	16.7%
LIBOR	75.0%	8.3%	16.7%
Credit spreads	33.3%	33.3%	33.3%

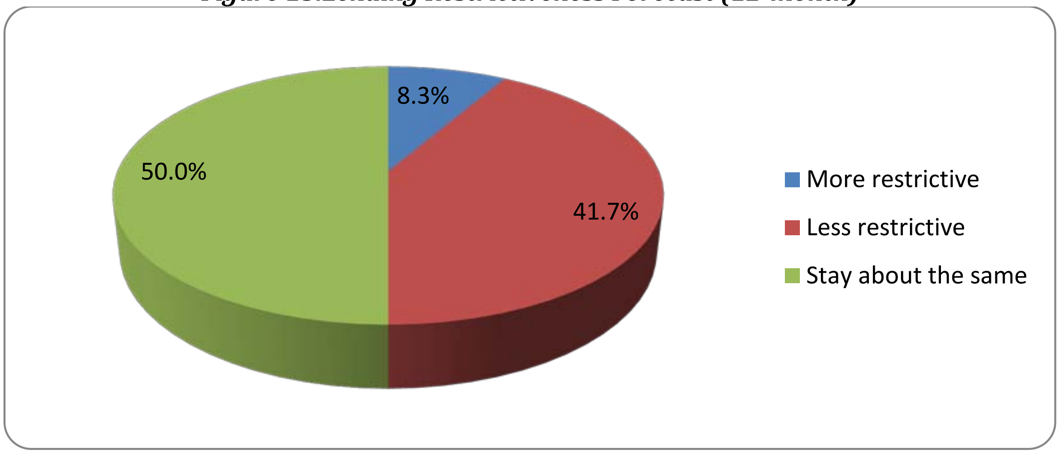
The majority of the banks (66.7%) said that they believe that the demand for loans in general will increase over the next 12 months.

Figure 12. Demand for Loans Forecast (12-month)



Regarding the next 12 months, most lenders believe that lending in general will become more restrictive (41.7%) or stay about the same (50%). Only 8.3% felt that lending will become less restrictive.

Figure 13.Lending Restrictiveness Forecast (12-month)



The majority of banks believe that business conditions will improve slightly over the next 12 months. Approximately 25% of respondents indicated that business conditions would be about the same while 8.3% believe there will be significant improvement.

Table 12: Business Condition Forecast (12-month)

Decline significantly	Decline slightly	Be about the same	Improve slightly	Improve significantly
0.0%	0.0%	25.0%	66.7%	8.3%

Over the next 12 months, bankers believe that overall Gross Domestic Product will increase by 1.7% while the privately-held company GDP equivalent is expected to rise by 1.0%.

Table 13: GDP Forecast (12-month)

	Expected GDP change (%)
Overall GDP	1.7%
Privately-held company equivalent GDP	1.0%

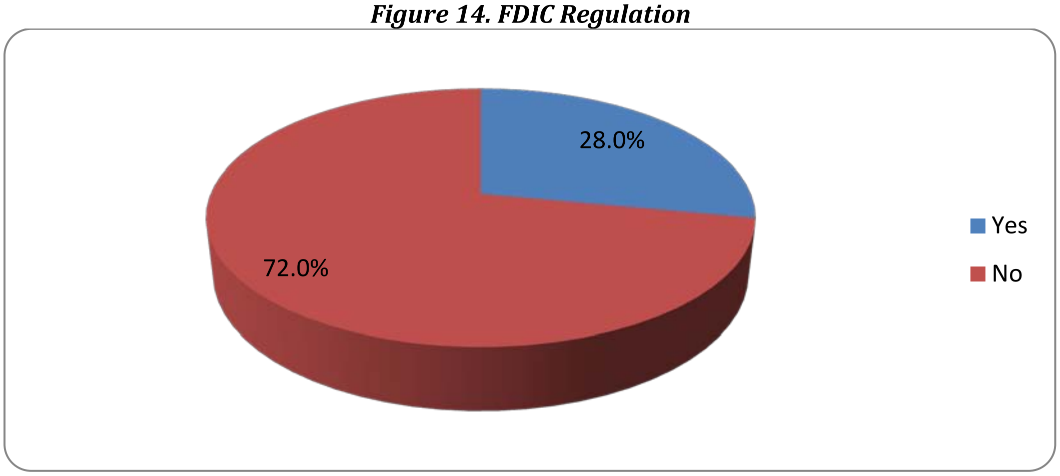
ASSET-BASED LENDER SURVEY INFO

Profile of Respondents

The following responses pertain to the asset-based lender (ABL) survey administered in October/November 2009. Our results are based upon 53 responses to this survey. The respondents are geographically dispersed throughout the United States.

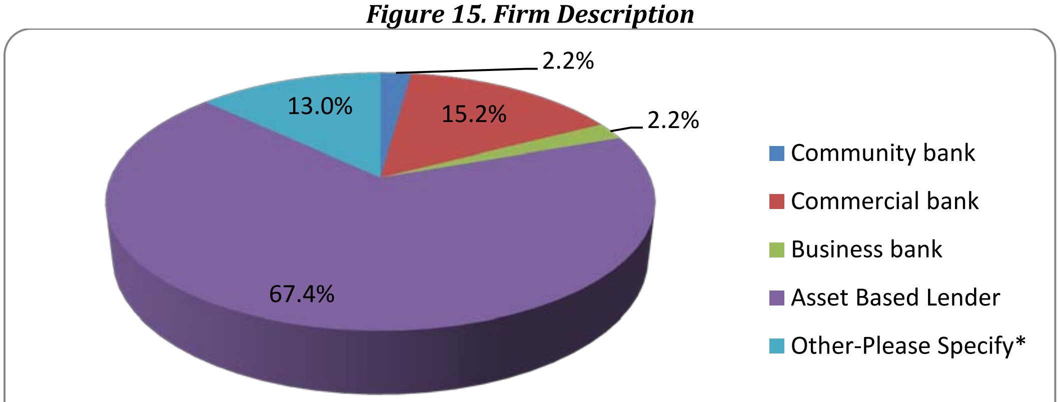
Of those surveyed, only 28% said they were regulated by the Federal Deposit Insurance Corporation (FDIC).

Figure 14. FDIC Regulation



Nearly 67.4% of respondents classified their firm as asset-based lenders while 15.2% indicated this lending function was performed within a commercial bank.

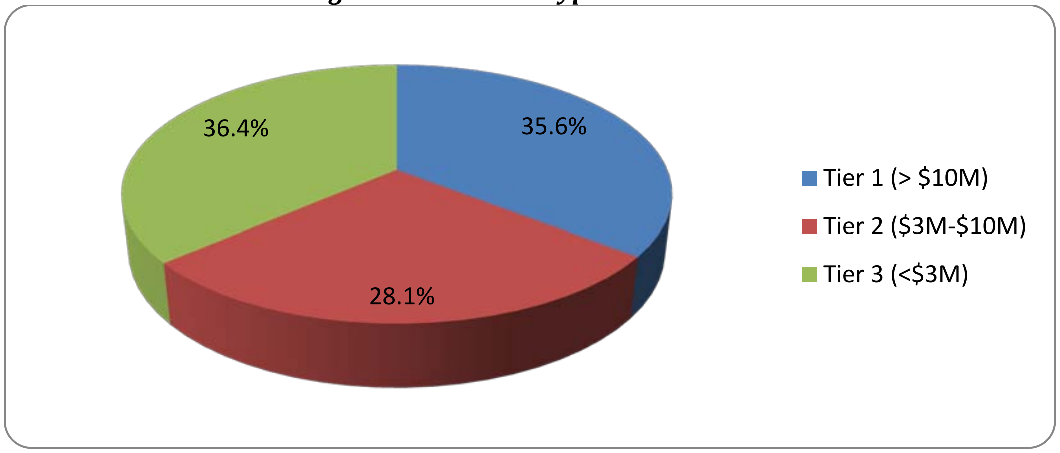
Figure 15. Firm Description



**Other includes factor, venture lender, equipment leasing broker.*

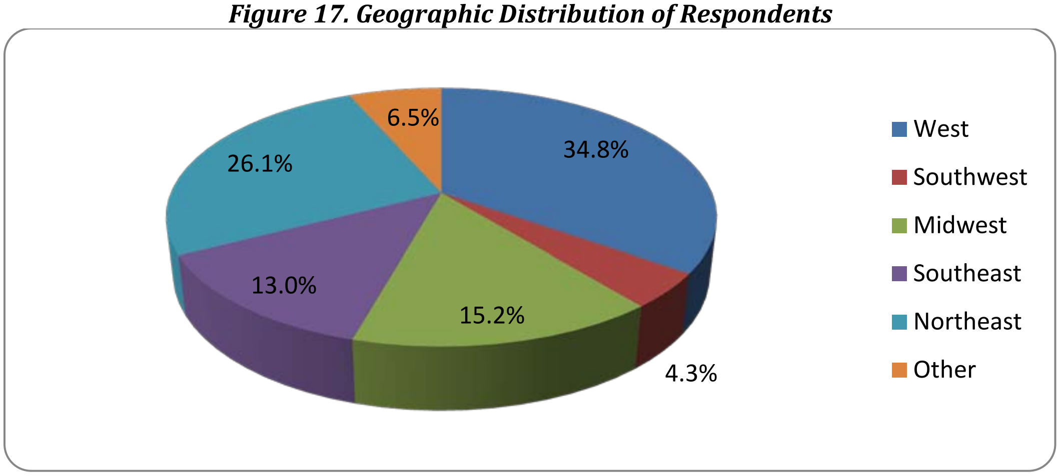
Asset-based lenders generally segment themselves in the various tier types. Approximately 36% of ABL's in the survey are Tier 1, meaning they generally lend amounts greater than $10 million. Approximately 28% classify themselves as Tier 2, as they lend between $3 million and $10 million. The final group (36%) serves the smaller market.

Figure 16. ABL Tier Type Distribution



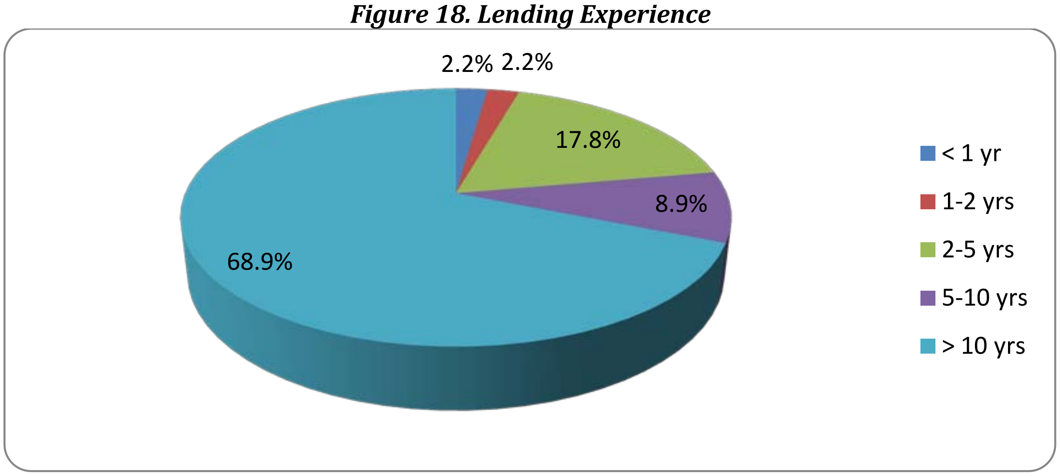
Approximately 34.8% of respondents identified their primary location as being in the western part of the country while 26.1% reported the northeast as being their base.

Figure 17. Geographic Distribution of Respondents



Nearly 69% of respondents report having over 10 years of asset-based lending experience while another 8.9% report between five and 10 years experience.

Figure 18. Lending Experience



Operational and Lending Characteristics

We asked respondents to report on various operational and industry items as compared to six months ago. Significant increases were reported in number of loan applications, loan delinquency rates, loan charge-off rates, and time to process loans. Significant declines were reported for percentage of borrowers approved for credit and loans being made by competitor banks.

Table 14: General Operational Assessment Today Versus Six Months Ago

	Increased	Decreased	Stayed about the same
Number of loan apps	81.8%	18.2%	0.0%
Time to process loans	45.5%	18.2%	36.4%
Credit quality of borrowers applying for credit	36.4%	36.4%	27.3%
Credit quality of borrowers approved for credit	40.0%	30.0%	30.0%
Number of borrowers approved for credit	45.5%	45.5%	9.1%
Percentage of borrowers approved for credit	9.1%	72.7%	18.2%
Average loan size	18.2%	27.3%	54.5%
Standard advance rates	9.1%	18.2%	72.7%
Loan maturity (months)	9.1%	18.2%	72.7%
Size of interest rate spreads (pricing)	36.4%	27.3%	36.4%
Loan fees	27.3%	27.3%	45.5%
Number of financial covenants (per loan)	18.2%	9.1%	72.7%
Tightness of financial covenants	27.3%	9.1%	63.6%
Percent of loans with personal guarantees	18.2%	18.2%	63.6%
Loan delinquency rates	54.5%	18.2%	27.3%
Loan charge-off rates	54.5%	0.0%	45.5%
Lending capacity of bank (capital ratio impacts)	36.4%	27.3%	36.4%
Number of loans being made by competitor banks	18.2%	54.5%	27.3%

Over the six months prior to the survey, asset-based lenders report that 41.9% of all receivables-based loans offered were ultimately booked. Approximately 51% of all inventory-based loans were booked, 54.4% of equipment loans were booked, and 47.3% of real estate loans were booked.

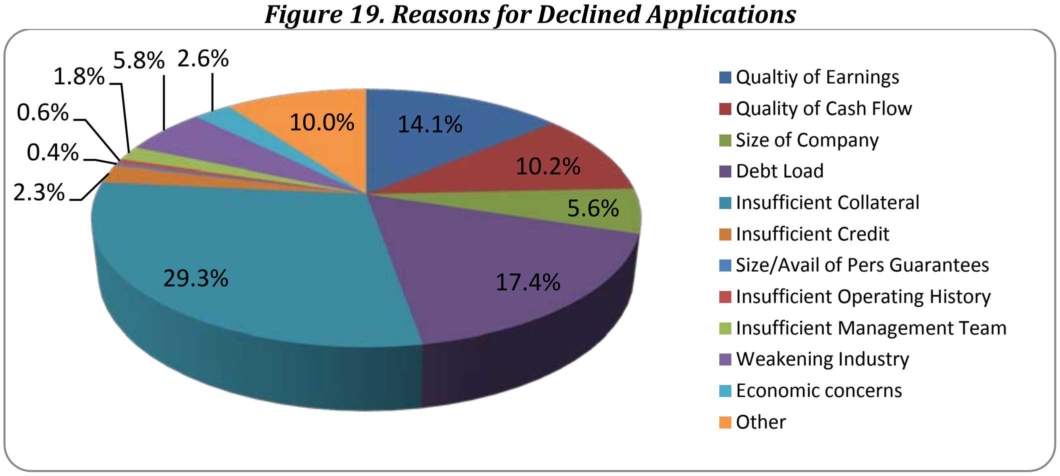
Most applications, however, were declined. Inventory-based applications were declined most frequently (74.5%) while equipment-based applications were declined in 70.7% of cases, and receivables-based loans were declined in 69.4% of situations.

Table 15: Action Taken on Loans

	Declined %	Offer %	Book/offer %
Receivables	69.4%	30.6%	41.9%
Inventory	74.5%	25.5%	50.9%
Equipment	70.7%	29.3%	54.4%
Real estate	68.6%	31.4%	47.3%

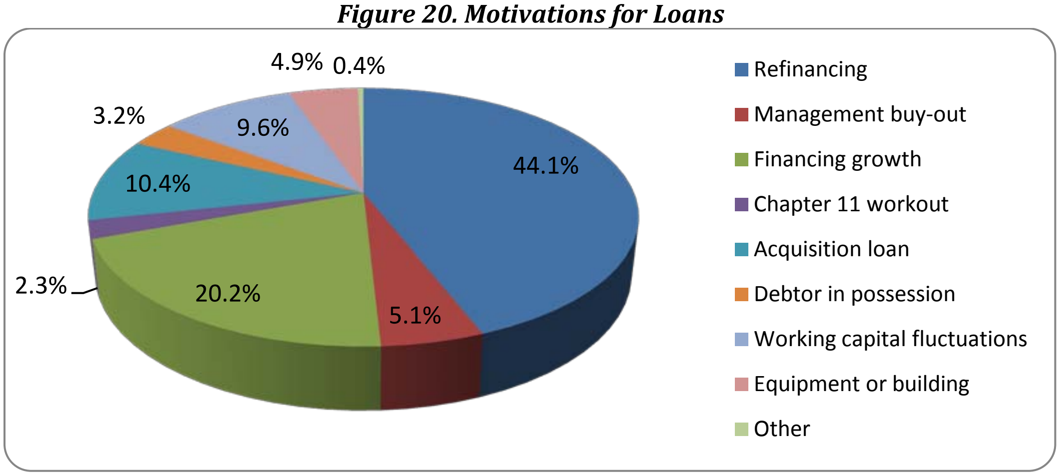
Insufficient collateral was the primary reason loan applications were declined (29.3%) followed by debt load (17.4%) and quality of earnings (14.1%).

Figure 19. Reasons for Declined Applications



The most common motivation for securing lending was refinancing (44.1%) followed by financing growth (20.2%) and acquisitions (10.4%).

Figure 20. Motivations for Loans



Respondents were asked to assess the following characteristics for loans booked currently versus loans booked just six months ago. Responses generally suggest comparable credit conditions.

Table 16: Credit Qualifying Characteristics Today Versus Six Months Ago

	More restrictive today	More lenient today	Approximately the same
Minimum firm revenues ($ million)	10.0%	10.0%	80.0%
Minimum annual sales growth rate (%)	10.0%	30.0%	60.0%
Fixed charge coverage (min ratio)	9.1%	18.2%	72.7%
Debt service ratio (min ratio)	10.0%	20.0%	70.0%
Funded debt to EBITDA (max ratio)	10.0%	20.0%	70.0%
Total debt to EBITDA (max)	10.0%	20.0%	70.0%
Debt to net worth (max ratio)	11.1%	11.1%	77.8%
Debt to tangible net worth (max)	10.0%	20.0%	70.0%

For booked deals, interest rate caps were provided approximately 14.4% of the time, while collars and interest rate locks were provided in 7.4% and 6.8% of the deals, respectively.

Table 17: Caps, Collars, and Locks

	Average
Interest rate cap	14.4%
Interest rate collar	7.4%
Forward rate lock	6.8%

ABLs also report various threshold ratios and benchmarks as being important when determining how much credit to lend. Medians, 1st quartiles, and 3rd quartiles are reported for each below.

Table 18: Critical Ratios When Extending Credit

	1st quartile	Median	3rd quartile
Minimum firm revenues ($ million)	6.3	10.0	27.5
Minimum annual sales growth rate (%)	2.8	5.0	10.0
Fixed charge coverage (min ratio)	1.0	1.1	1.3
Debt service ratio (min ratio)	1.0	1.1	1.3
Total debt to EBITDA (max)	1.0	2.5	2.5
Debt to net worth (max ratio)	1.0	1.0	2.5
Debt to tangible net worth (max)	1.0	2.0	3.0

ABLs report the standard advance rates (or loan-to-value ratio) for each of the following types of assets.

Table 19: Standard Advance Rates

		1st quartile	Median	3rd quartile
Marketable securities	Typical	80.0%	80.0%	90.0%
	Max	90.0%	90.0%	96.3%
Accounts receivable	Typical	80.0%	85.0%	85.0%
	Max	85.0%	90.0%	93.8%
Inventory - low quality	Typical	20.0%	25.0%	30.0%
	Max	25.0%	35.0%	40.0%
Inventory - intermediate quality	Typical	30.0%	40.0%	47.5%
	Max	33.8%	45.0%	50.0%
Inventory - high quality	Typical	40.0%	50.0%	60.0%
	Max	50.0%	60.0%	63.8%
Equipment	Typical	50.0%	50.0%	75.0%
	Max	57.5%	70.0%	81.3%
Real estate	Typical	35.0%	50.0%	60.0%
	Max	50.0%	65.0%	75.0%

When performing an asset-based lending function, the forced liquidation valuation standard is used by 42.9% of respondents when making inventory loans, 66.7% of respondents when making equipment loans and 50% of respondents when making real estate loans. Accounts receivable credits rely on a face value valuation 37.5% of the time and fair market value 25% of the time.

Table 20: Collateral Valuation Standards

	Purchase price	Depreciated value (book)	Face value	Fair market value	Orderly liquidation	Forced liquidation	Other
Accounts Receivable	4.2%	0.0%	37.5%	25.0%	8.3%	12.5%	12.5%
Inventory	0.0%	9.5%	4.8%	4.8%	33.3%	42.9%	4.8%
Equipment	4.8%	9.5%	0.0%	0.0%	19.0%	66.7%	0.0%
Real estate	0.0%	4.5%	0.0%	36.4%	4.5%	50.0%	4.5%

The median loan terms on booked deals are 48 months for equipment loans, 36 months for real estate, and 36 months for working capital.

Table 21: Loan Terms

	Equipment	Real estate	Working capital
1st quartile	36	36	24
Median	48	36	36
3rd quartile	60	60	36

 |

The most common financial covenant is the limit on indebtedness (76.3%), followed by limits on level of distributions (72.2%) and fixed-charge coverage ratio (61.5%).

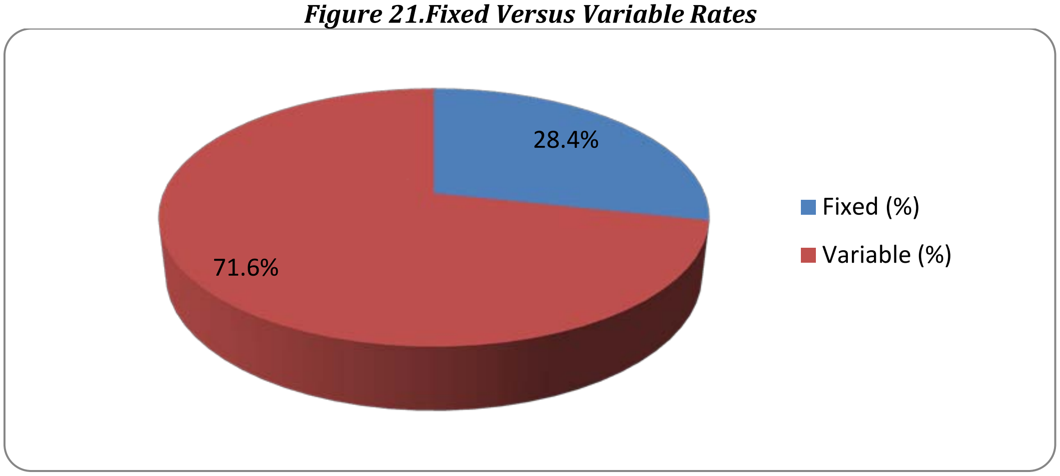
Table 22: Covenant Frequency

	Average
Liquidity	22.5%
Limits on level of indebtedness	76.3%
Limits on distributions	72.2%
Limits on management compensation	55.8%
Positive earnings	19.6%
Fixed-charge coverage	61.5%
Debt service coverage	53.8%
Debt to EBITDA	33.9%
Debt to net worth	25.0%
Debt to tangible net worth	36.4%

Pricing and Returns Data

Approximately 71.6% of respondents report using variable rate loans while 28.4% use fixed rates.

Figure 21.Fixed Versus Variable Rates



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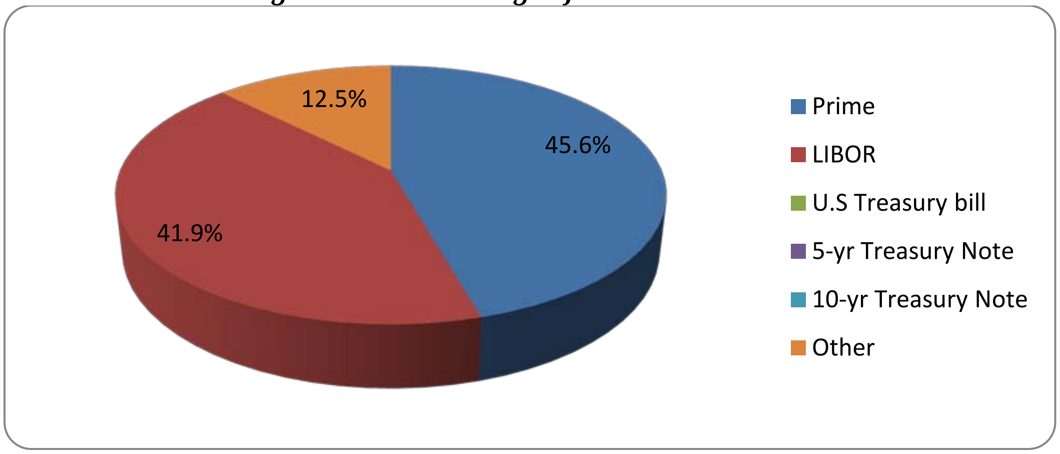
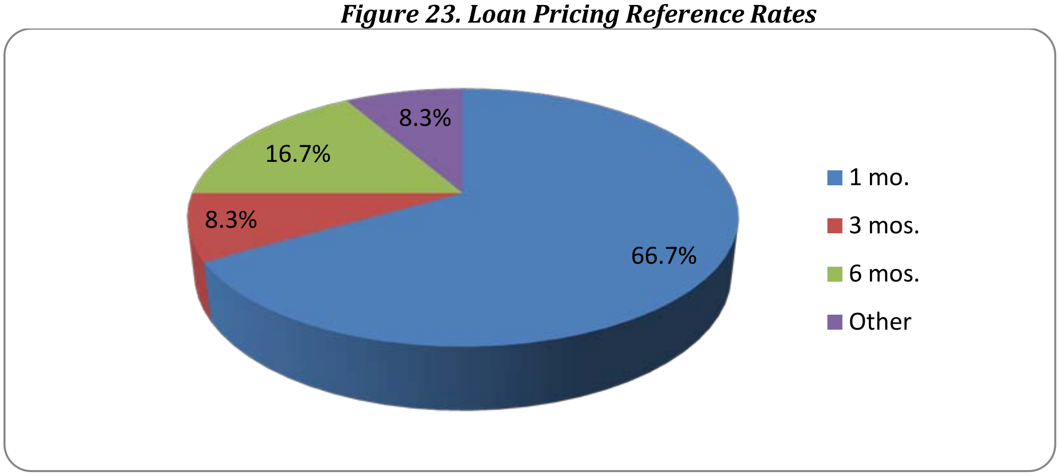
For variable rate loans, 45.6% reference the prime rate while 41.9% reference LIBOR.

Figure 22. Loan Pricing Reference Benchmarks



Of those referencing LIBOR, nearly 66.7% use a one-month rate as a reference, while 8.3% reference the three-month rate, and another 16.7% use the six-month rate.

Figure 23. Loan Pricing Reference Rates



ABLs report a variety of fees that are charged to the borrower. They include the following:

Table 23: Loan Fees

	1st quartile	Median	3rd quartile
Closing fee	0.7%	1.0%	1.0%
Modification fee	0.5%	0.8%	1.3%
Commitment fee	0.5%	1.0%	1.0%
Prepayment penalty (yr 1)	2.0%	3.0%	3.0%
Prepayment penalty (yr 2)	2.0%	2.0%	2.0%
Unused line fee	0.5%	0.5%	0.8%
Audit fee	$1,250	$2,500	$4,500
Attorney's fee	$2,500	$3,000	$10,000
Collateral monitoring fee	$1,000	$1,000	$24,000

The following table identifies loan rates according to various pricing metrics. The typical loan-based upon variable pricing tied to prime is 12.5% while variable rate loans tied to LIBOR are 7.1%.

Table 24: Loan Rates

		1st quartile	Median	3rd quartile
Prime	Spread (average)	2.0%	2.5%	5.0%
	Total stated rate	5.1%	5.5%	9.6%
	Year 1 fees (exclude prepay)	1.4%	2.0%	3.5%
	Year 1 all-in rate (w/fees exclude prepay)	7.9%	12.5%	16.1%
	Rate floor (if applicable)	3.3%	4.0%	7.0%
LIBOR	Spread (average)	3.0%	4.3%	5.0%
	Total stated rate	4.2%	5.0%	9.6%
	Year 1 fees (exclude prepay)	1.0%	2.5%	3.0%
	Year 1 all-in rate (w/fees exclude prepay)	7.0%	7.1%	10.8%
	Rate floor (if applicable)	2.0%	2.0%	3.0%

All-in-rate percentages vary considerably by size of loan. For working capital loans, all-in-rate medians ranged from 7% for loans of approximately $10 million to 17.5% for $500,000 loans.

Table 25: All-in-Rates for Working Capital Loans

	$0.5M	$2.0M	$5.0M	$10.0M
1st quartile	14.8%	13.3%	7.5%	5.0%
Median	17.5%	14.5%	10.5%	7.0%
3rd quartile	20.3%	15.0%	12.8%	12.0%

Industry and Economic Outlook

Over the next 12 months, 40% of those surveyed believe that prime and LIBOR interest rates will increase.

Table 26: Interest Rate Forecast (12-month)

	Increase	Decrease	Stay the same
Prime	40.0%	20.0%	40.0%
LIBOR	40.0%	10.0%	50.0%
Credit spreads	20.0%	20.0%	60.0%

All ABLs (100%) said they believe that the demand for loans in general will increase over the next 12 months.

Table 27: Demand for Loans Forecast (12-month)

Answer	%
Increase	100%
Decrease	0%
Stay the same	0%

Over the next 12 months, ABLs believe that Gross Domestic Product will rise by 1.4% for the whole economy and 1.5% for private companies.

Table 28: GDP Forecast (12-month)

	Expected GDP change (%)
Overall GDP	1.4%
Privately-held company equivalent GDP	1.5%

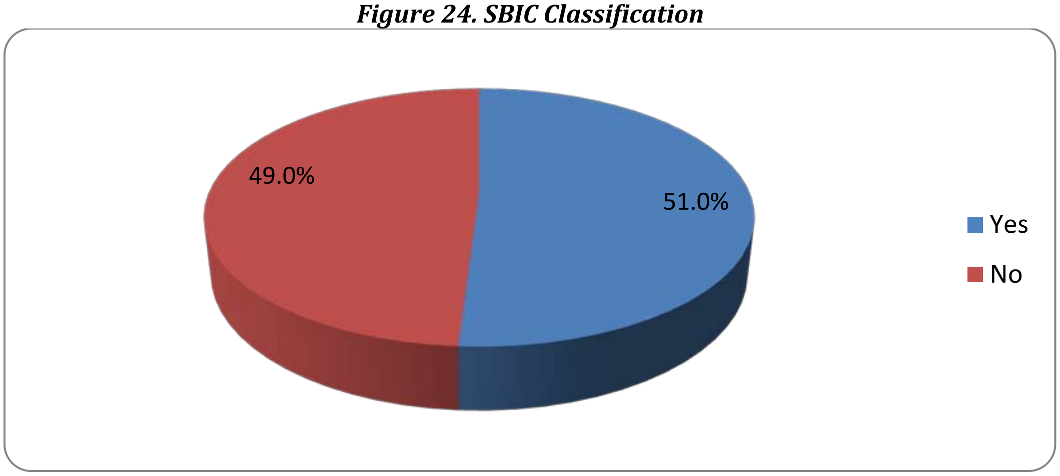
MEZZANINE SURVEY INFO

Profile of Respondents

The following responses pertain to our mezzanine capital survey administered in October/November 2009. Our results are based upon 42 responses to this survey. The respondents are geographically dispersed throughout the United States.

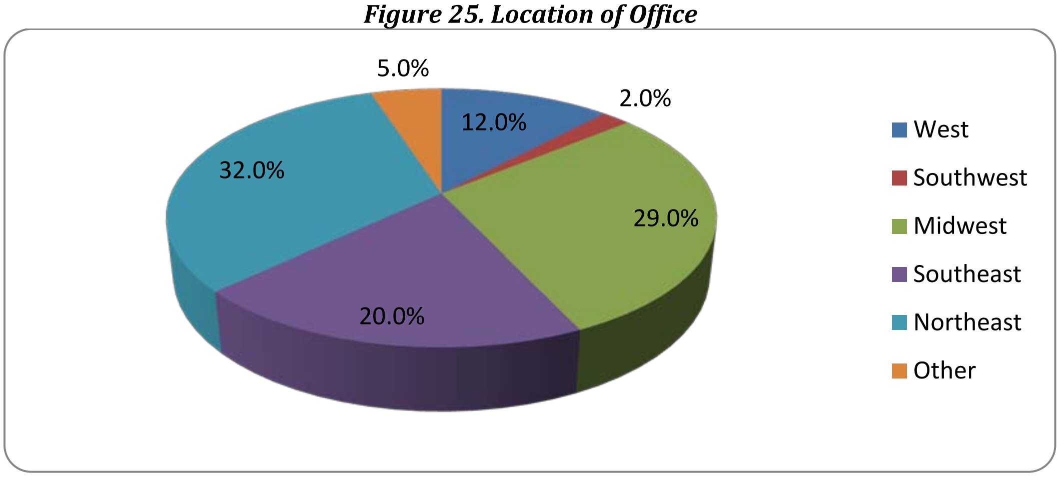
Of those surveyed, 51% identified their firm as a small business investment company (SBIC).

Figure 24. SBIC Classification



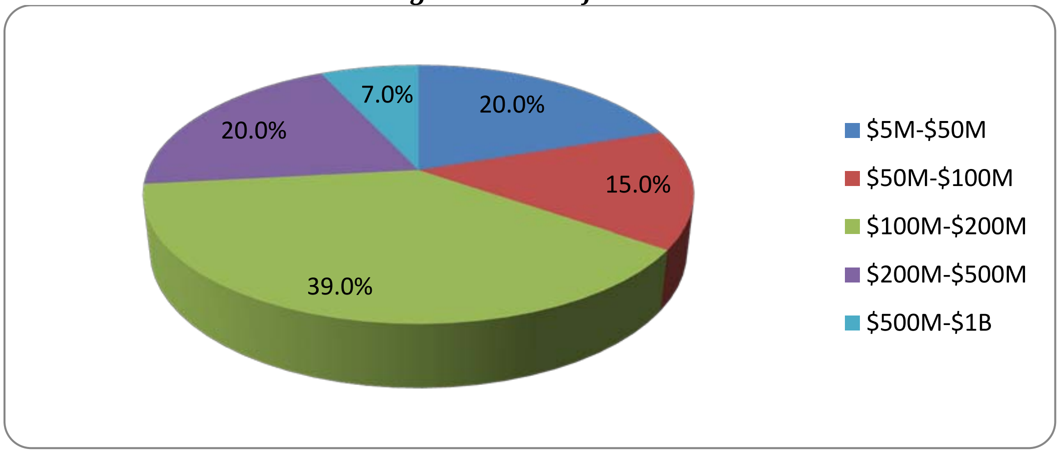
Approximately 32% of mezzanine funds report being located in the northeast area of the country while 29% are located in the midwest, and another 20% are in the southeast.

Figure 25. Location of Office



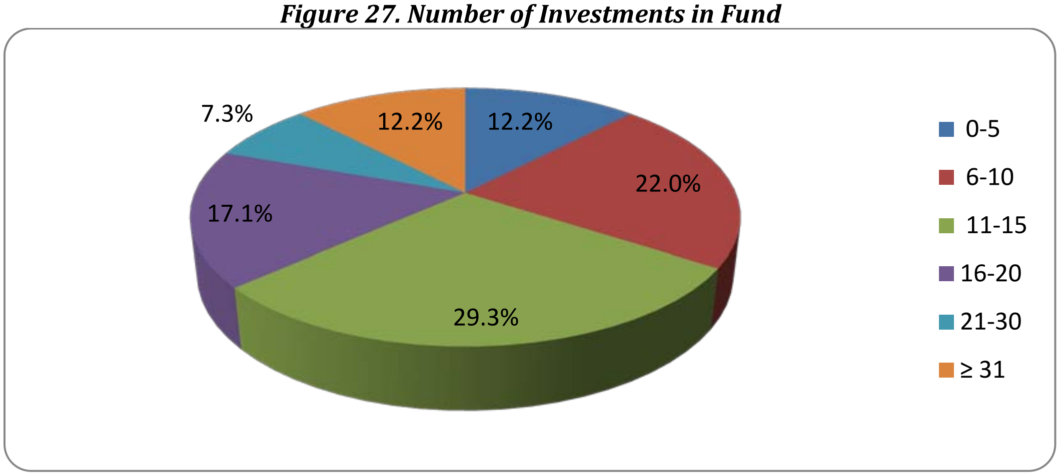
Current fund sizes vary considerably. Thirty-nine percent (39%) report a fund size of between $100 and $200 million while 20% indicate between $200 and $500 million, and another 20% report fund sizes between $5 million and $50 million.

Figure 26. Size of Funds



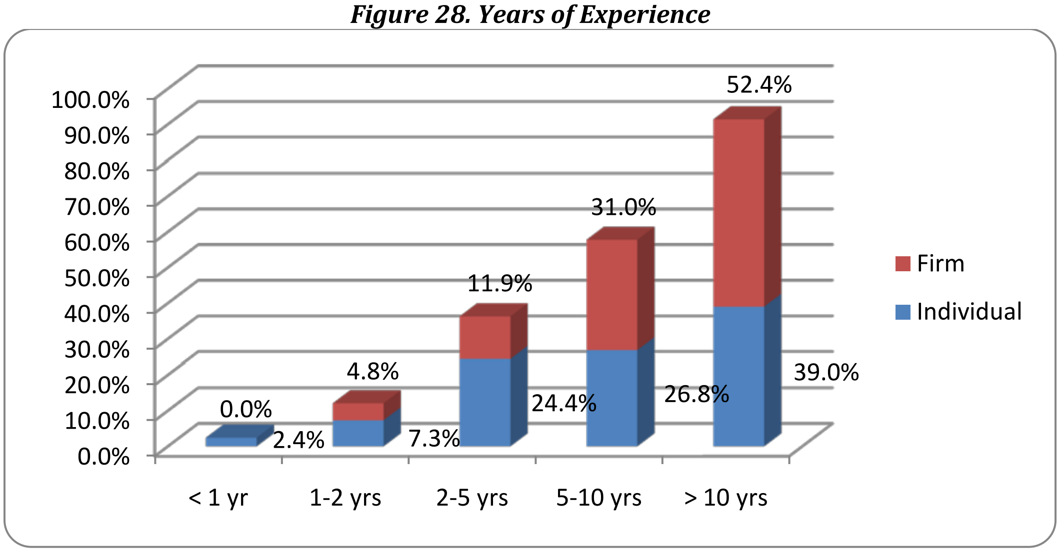
Mezzanine funds report having the following numbers of investments in their current funds.

Figure 27. Number of Investments in Fund



Thirty-nine percent (39%) of individual respondents report having over 10 years of experience in mezzanine investing. Another 26.8% have between five and 10 years experience.

Figure 28. Years of Experience



Operational and Investment Characteristics

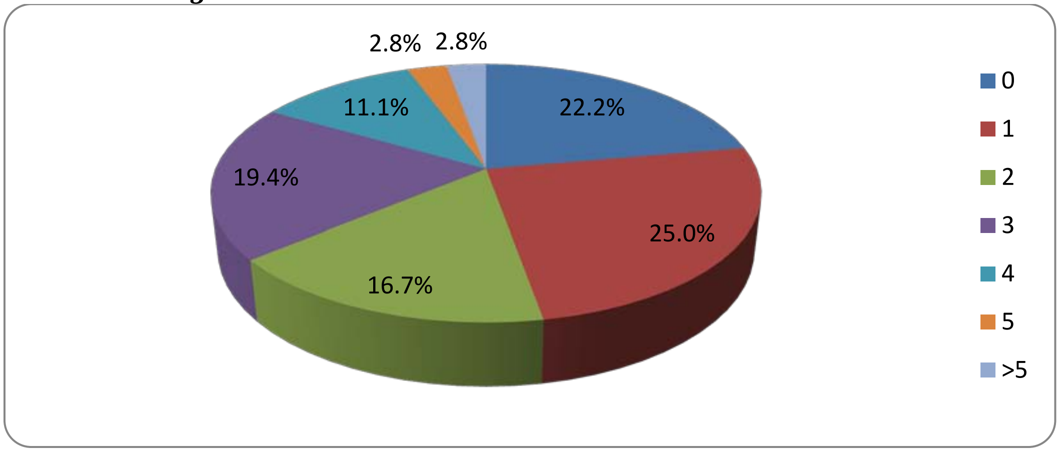
We asked respondents to report on various operational and industry items as compared to six months ago. Significant increases were reported in number of business plans received, size of interest rate spreads, warrant coverage, and size of mezzanine industry. Significant declines were reported for appetite for risk and multiple of cash flow lent.

Table 29: General Operational Assessment Today Versus Six Months Ago

	Increased	Decreased	About the same
No. of business plans rec'd	77.8%	14.8%	7.4%
Credit qual. of borrowers applying for invest.	51.9%	44.4%	3.7%
No. of investments being made	48.1%	33.3%	18.5%
Average investment size	25.9%	22.2%	51.9%
Appetite for risk	22.2%	55.6%	22.2%
Multiple of cash flow lent	18.5%	51.9%	29.6%
Loan maturity (months)	3.7%	7.4%	88.9%
Size of interest rate spreads (pricing)	48.1%	22.2%	29.6%
Loan fees	29.6%	11.1%	59.3%
No. of financial covenants (per loan)	18.5%	0.0%	81.5%
Tightness of financial covenants	25.9%	0.0%	74.1%
Warrant coverage	48.1%	11.1%	40.7%
PIK features	11.1%	7.4%	81.5%
Investment loss rates	11.5%	3.8%	84.6%
Investment capacity of fund	15.4%	30.8%	53.8%
No. of invest. made by competitor funds	29.6%	40.7%	29.6%
Prospects for raising additional funds	33.3%	33.3%	33.3%
Size of mezzanine industry	54.2%	16.7%	29.2%

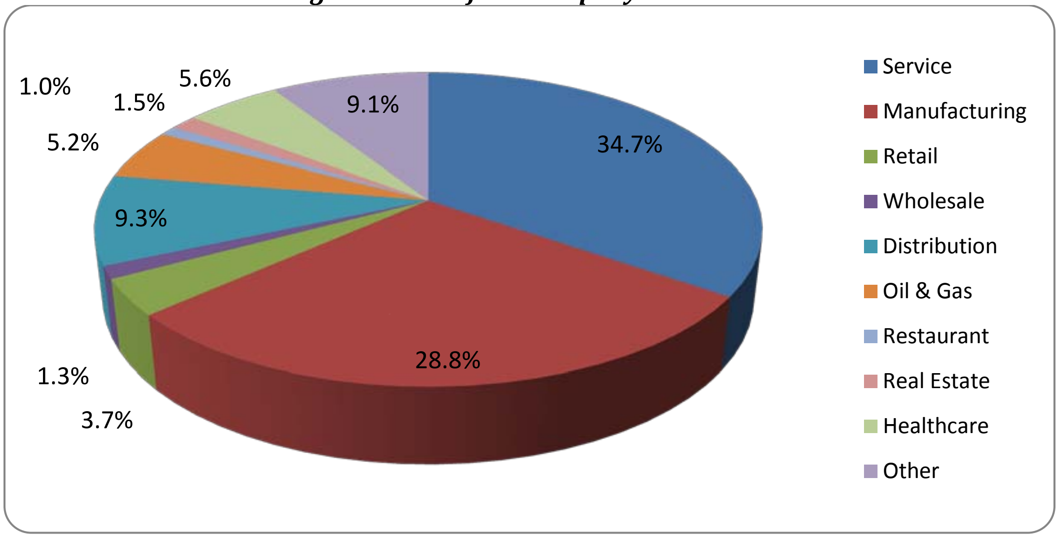
The prior six months yielded a relatively small number of booked deals. Approximately 25% of respondents report having booked just one deal while another 22.2% indicate making no deals at all.

Figure 29. Mezzanine Loans Booked over the Last Six Months



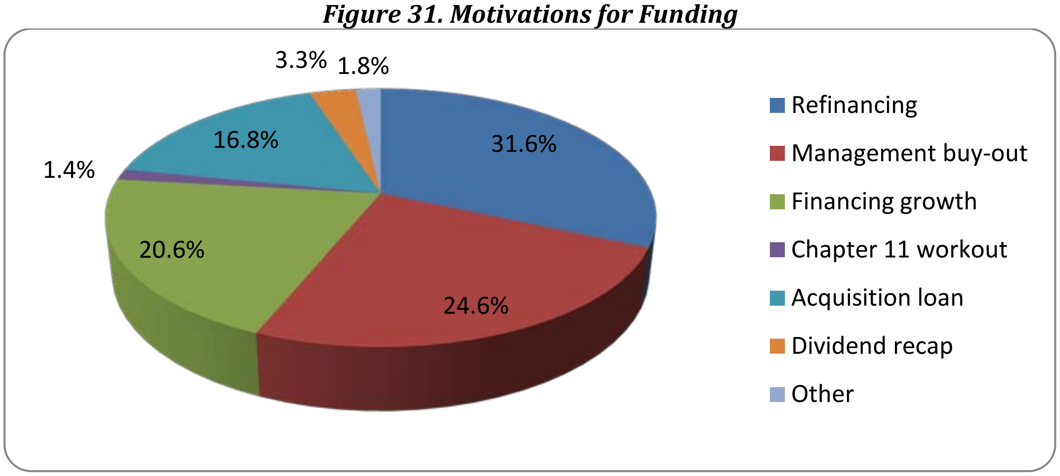
Mezzanine funds report having investments in a variety of industries. The largest concentration is in service (34.7%) followed by manufacturing (28.8%).

Figure 30. Portfolio Company Industries



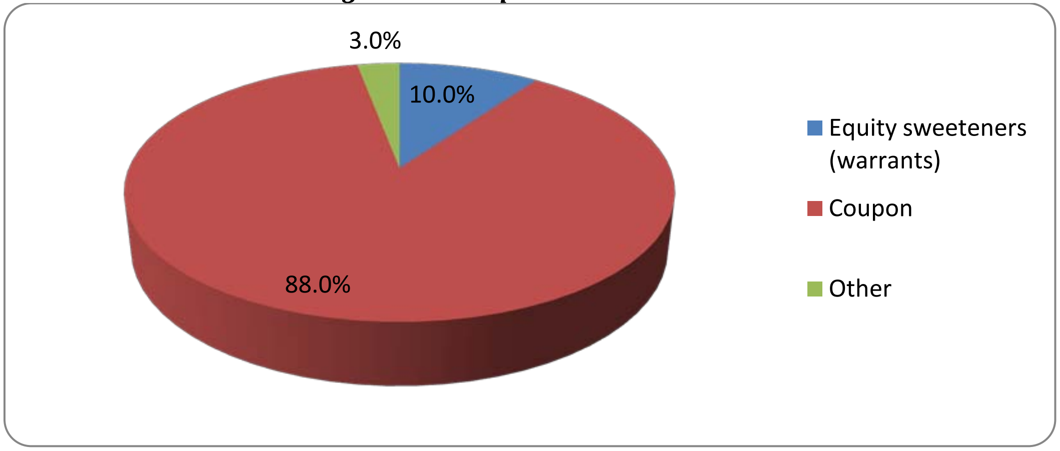
For those making deals, they report motivations for funding as follows: refinancing (31.6%), management buy-out (24.6%), financing growth (20.6%), and others.

Figure 31. Motivations for Funding



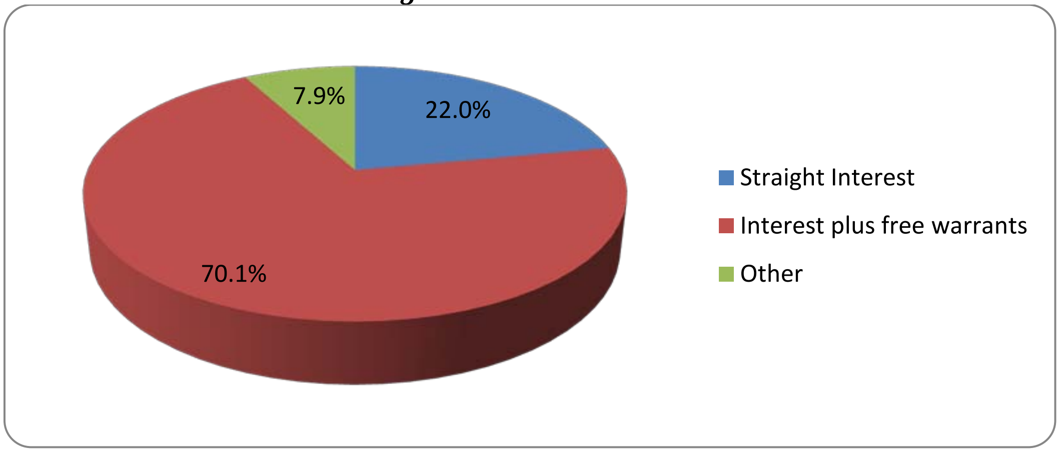
Respondents report receiving approximately 88% of their compensation from coupon payments and 10% from equity sweeteners.

Figure 32. Compensation Structure



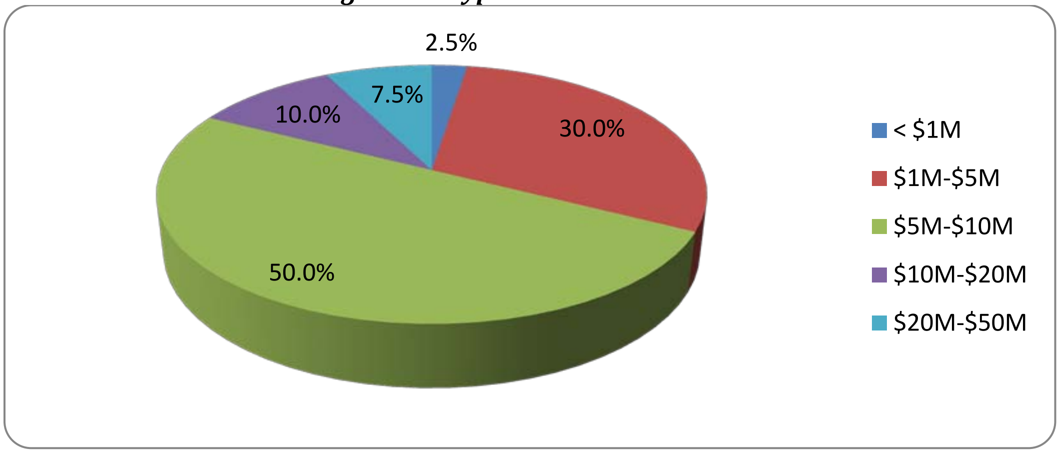
Over the last six months, approximately 70% of deals were structured with a coupon and free warrants. Just 22% of deals were made with coupon payments only.

Figure 33. Deal Structure



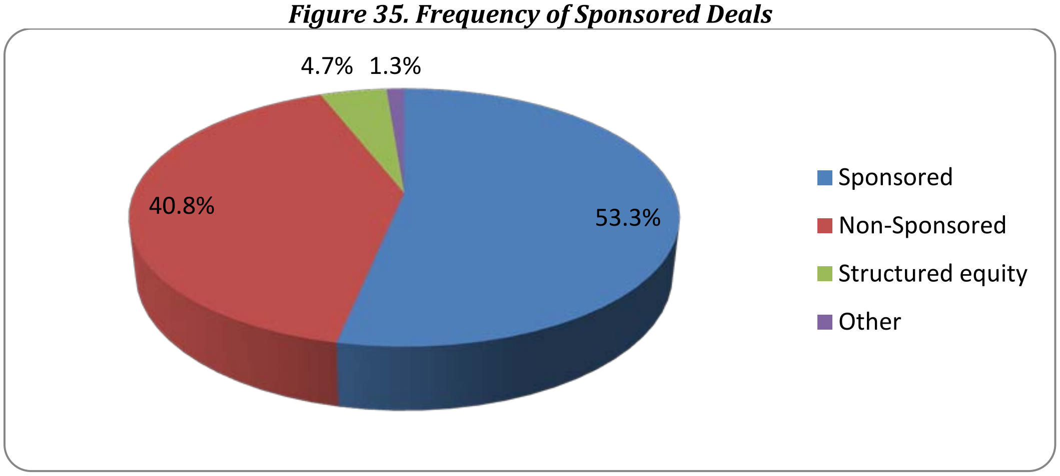
Approximately 50% of current deals are in the \$5 million to \$10 million range according to survey participants. An additional 30% are in the \$1 million to \$5 million range.

Figure 34. Typical Investment Sizes



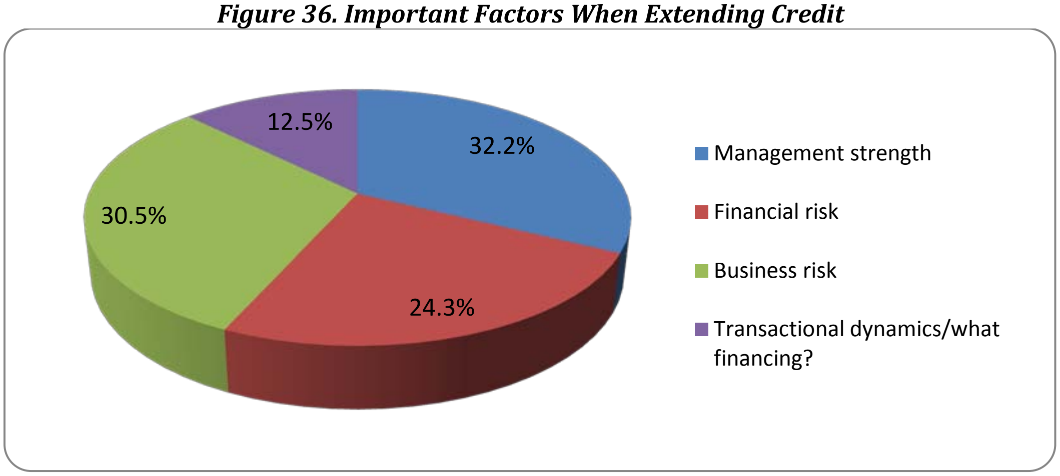
Mezzanine capital providers indicate that 53.3% of their deals are sponsored, which means they join a private equity group in the deal. Approximately 40.8% of deals are non-sponsored.

Figure 35. Frequency of Sponsored Deals



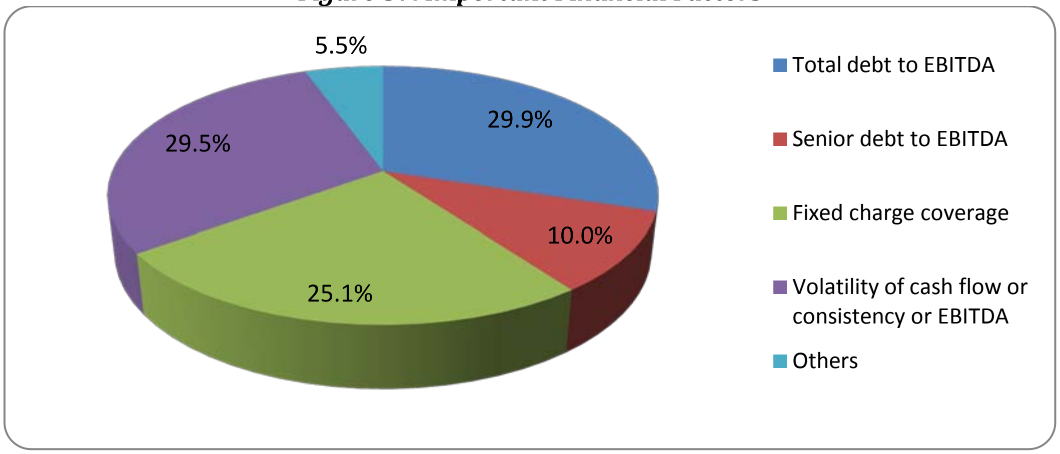
When extending a loan, mezzanine funds report the following factors as being important in order of weight: management strength, business risk, financial risk, and transactional dynamics.

Figure 36. Important Factors When Extending Credit



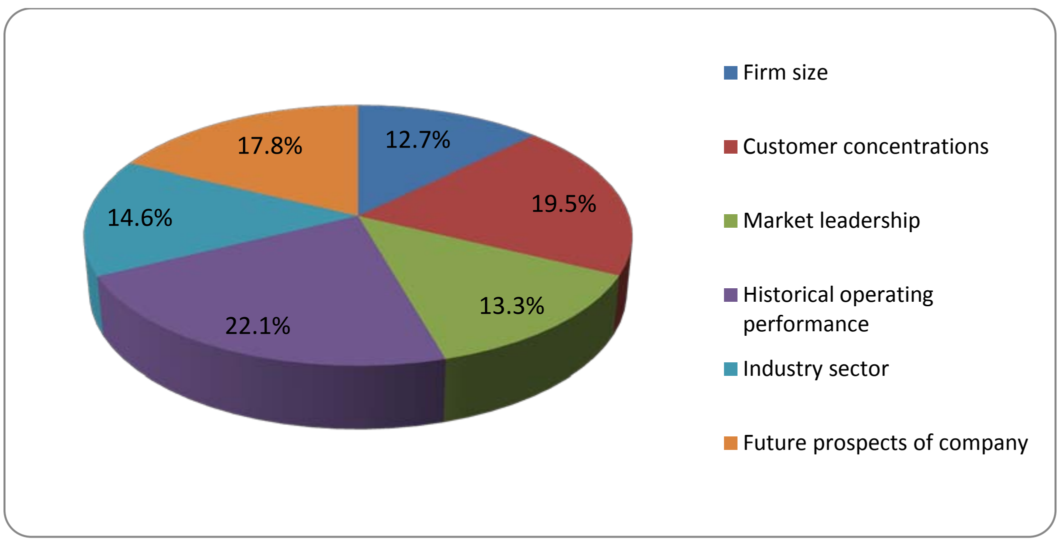
Regarding financial risk, the total debt-to-EBITDA ratio is cited as the most important criterion followed by volatility of cash flow and then fixed-charge coverage.

Figure 37. Important Financial Factors



The highest ranked business risk factor is historical operating performance followed by customer concentrations, future prospects of company, industry sector, market leadership, and firm size.

Figure 38. Business Risk Factors



Mezzanine investors report loan terms to be 60 months in the majority of situations.

Table 30. Average Loan Term on Booked Deals

Months	
60	1st quartile
60	Median
60	3rd quartile

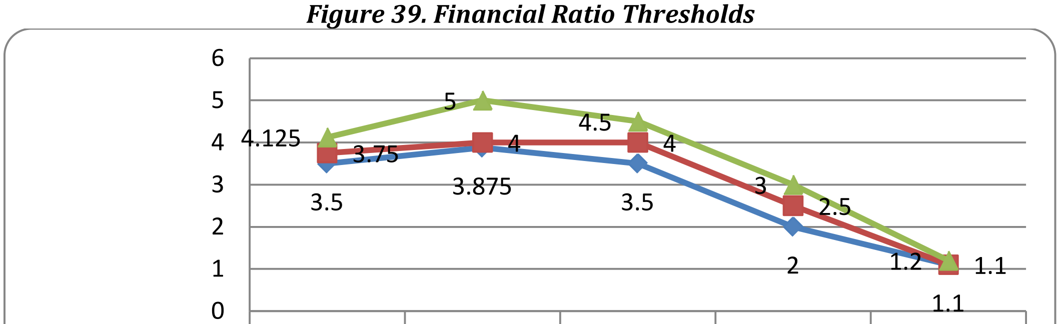
The following thresholds are deemed to be important for qualifying for mezzanine capital. The medians are reported for each criterion.

Table 31 Financial Ratio Thresholds

		Median
Minimum firm revenues ($ million)	Typical borrower data	20.00
	Absolute min to be considered	10.00
Minimum annual sales growth rate (%)	Typical borrower data	5.00
	Absolute min to be considered	0.00
Fixed charge coverage (min ratio)	Typical borrower data (with new loan added)	1.25
	Absolute min to be considered	1.10
Debt service ratio (min ratio)	Typical borrower data (with new loan added)	1.50
	Absolute min to be considered	1.25
Funded debt to EBITDA (max ratio)	Typical borrower data (with new loan added)	3.20
	Absolute max to be considered	4.00
Senior debt to EBITDA (max ratio)	Typical borrower data (with new loan added)	2.00
	Absolute max to be considered	2.50
Total debt to EBITDA (max)	Typical borrower data (with new loan added)	3.50
	Absolute max to be considered	4.00
Debt to net worth (max ratio)	Typical borrower data (with new loan added)	0.60
	Absolute max to be considered	1.00
Debt to tangible net worth (max)	Typical borrower data (with new loan added)	0.60
	Absolute max to be considered	0.73

Mezzanine funds report the following financial ratio thresholds when determining the maximum amount to lend.

Figure 39. Financial Ratio Thresholds



	Maximum multiple of recast EBITDA	Maximum multiple of operating cash flow	Maximum total debt to EBITDA	Maximum senior debt to EBITDA	Minimum fixed charge coverage
1st quartile	3.5	3.875	3.5	2	1.1
median	3.75	4	4	2.5	1.1
3rd quartile	4.125	5	4.5	3	1.2

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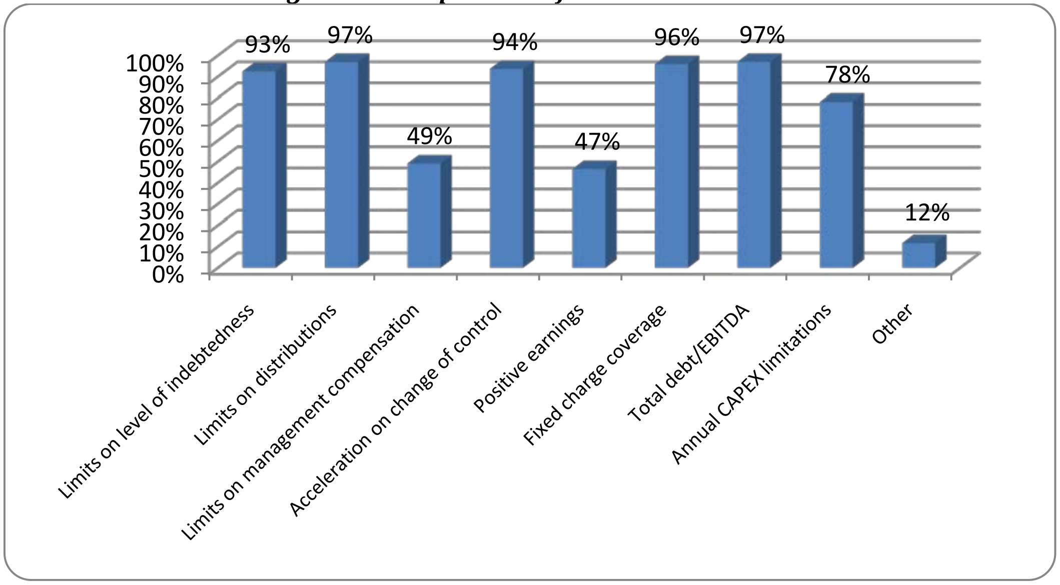
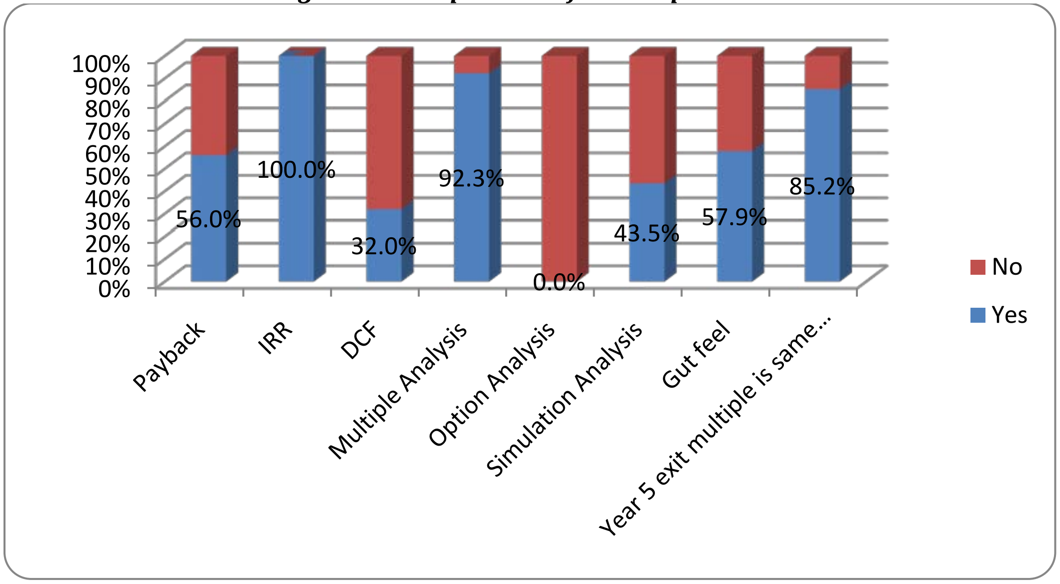
Covenants are used frequently in association with mezzanine financing. Commonly used covenants include limits on levels of indebtedness (93%), limits on distributions (97%), acceleration on change in control (94%), fixed-charge coverage (96%), and total debt/EBITDA (97%).

Figure 40. Frequencies of Various Covenants



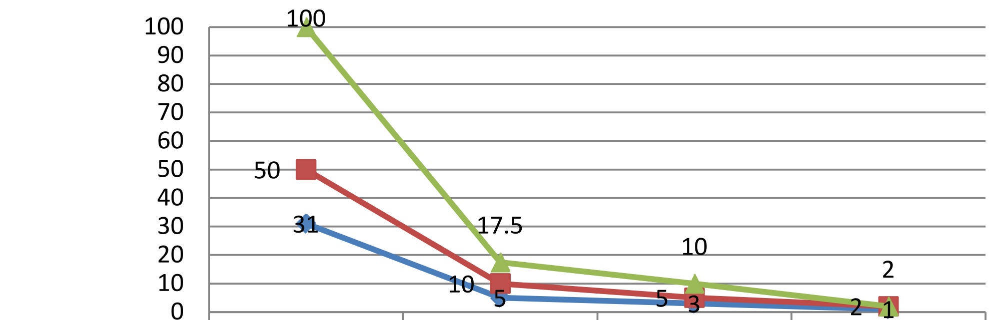
Mezzanine funds use a variety of investment analysis techniques to evaluate potential investments. The most common technique used is IRR (100%) followed by multiple analysis (92.3%). Discounted cash flow techniques are used in just 32% of the cases. Approximately 85.2% of respondents also report that they assume the exit multiple is the same as the entry multiple.

Figure 41. Frequencies of Techniques Used



The median numbers reported for activities to close a deal include the following: 50 business plans reviewed, 10 meetings with principals conducted, five proposal letters issued, and two letters of intent signed.

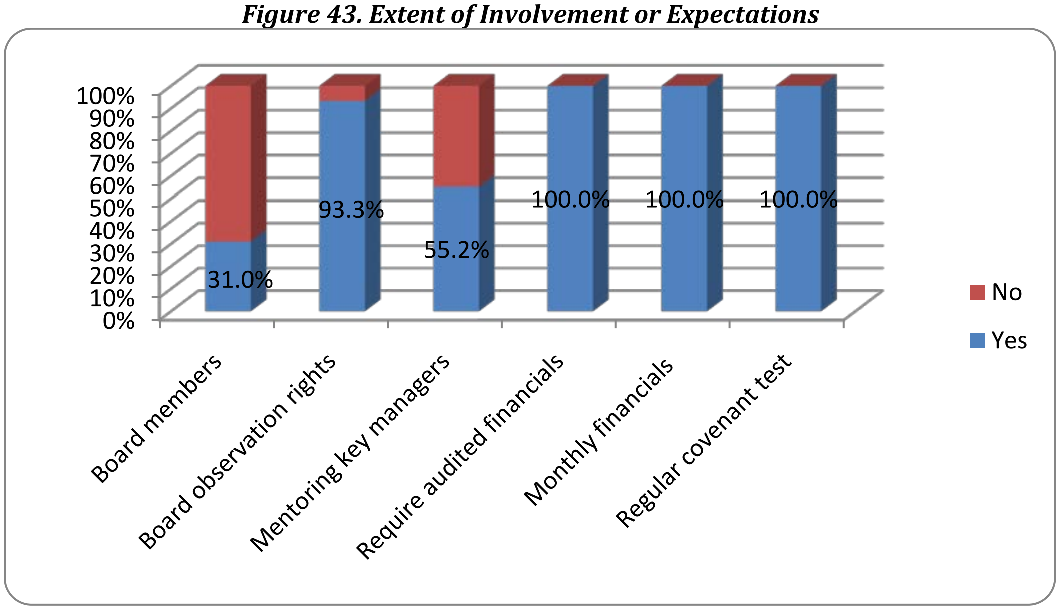
Figure 42. Activities to Close One Deal



	Business plans are reviewed	Meetings with principals are conducted	Proposal letters are issued	Letters of intent are signed
1st quartile	31	5	3	1
median	50	10	5	2
3rd quartile	100	17.5	10	2

Mezzanine funds require regular covenant tests, monthly financials, and audited financials in virtually all cases while demanding board observation rights approximately 93% of the time.

Figure 43. Extent of Involvement or Expectations



Pricing and Terms

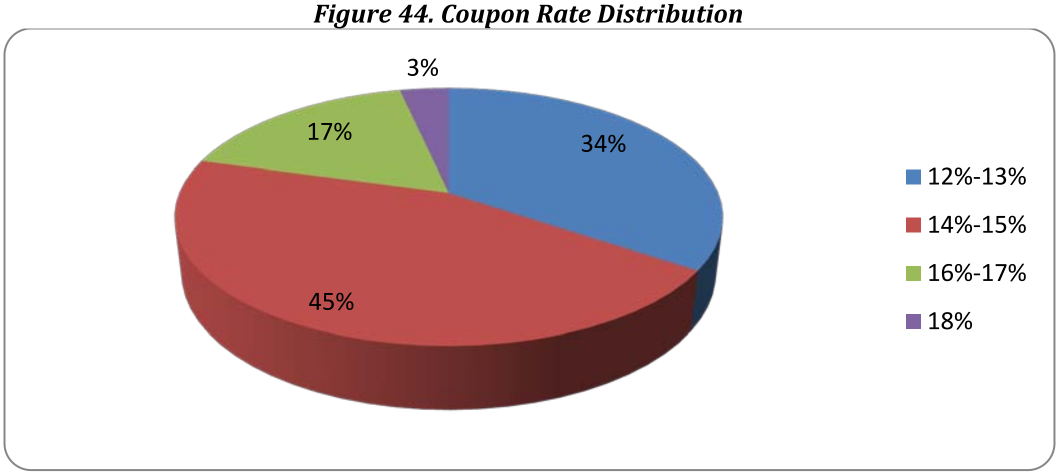
Regarding current deals the median coupon rate is 14%.

Table 32: Coupon Rates

Coupon interest rate	
13.0%	1st quartile
14.0%	Median
15.0%	3rd quartile

The distribution of coupon rates is depicted below.

Figure 44. Coupon Rate Distribution



Mezzanine funds frequently rely on payment in kind provisions. They report that 57.9% of deals contain a PIK provision and approximately 19.6% of the total interest expense is PIK.

Table 33: PIK Provisions

Answer	Average value
Percentage of deals with PIK provisions	57.9%
Ratio of PIK to total (cash interest plus PIK interest) per deal (average)	19.6%

Respondents report that 65% of deals have warrants attached and that warrant coverage as a percentage of fully diluted ownership is 5%. For those deals with warrants, mezzanine investors expect to receive an 8% return for their equity participation.

Table 34: Warrant Details

	1st quartile	Median	3rd quartile
Percentage of deals w/warrants attached	30.0%	65.0%	92.5%
Warrant % of fully diluted ownership of company	4.0%	5.0%	8.0%
Expected % rtn from warrants attached to curr deals	4.5%	8.0%	20.0%
Hist % rtn from warrants attached to deals on last closed fund	4.0%	8.0%	20.5%

Funds regularly charge fees for various activities. These fees are as follows.

Table 35. Fee Types and Amounts

	Closing fee	Modification fee	Commit fee	Prepay fee (yr 1)	Prepay fee (yr 2)	Prepay fee (yr 3)	Prepay fee (yr 4)	Prepay fee (yr 5)
1st quartile	2%	0.25%	0%	3%	3%	2%	0%	0%
Median	2%	1%	0.25%	5%	4%	3%	2%	1%
3rd quartile	2.5%	1%	1%	5%	4%	3%	2%	1%

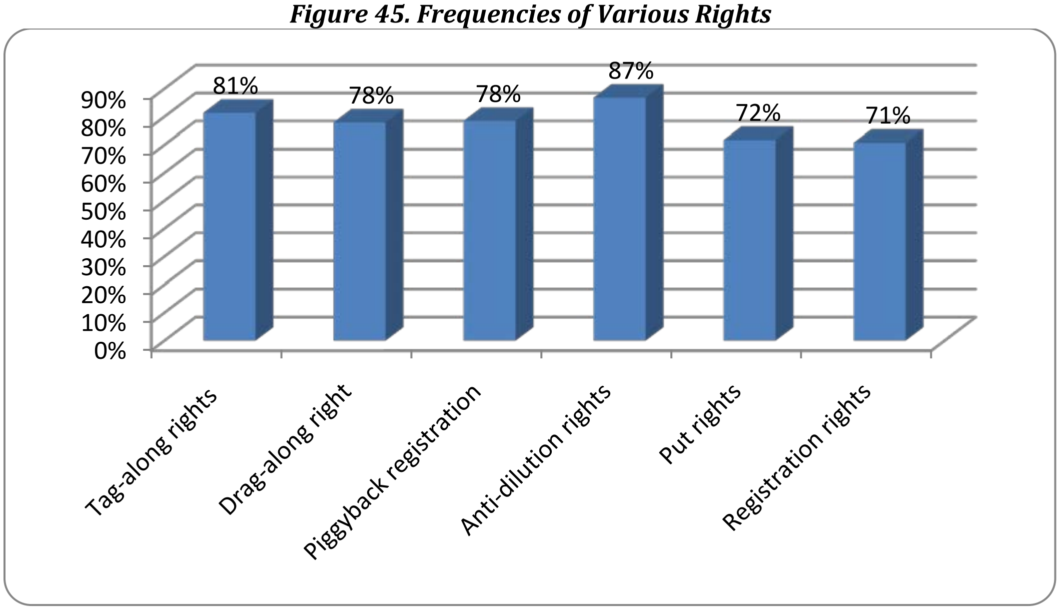
The median time for non-call provisions is two years.

Table 36: Length of Non-Call Provisions

Length of your non-call provision (years)	
1	1st quartile
2	Median
2.25	3rd quartile

Various other rights were attached to the investment contract. These include the following:

Figure 45. Frequencies of Various Rights



Returns

Mezzanine funds report a median of 18% pre-tax returns on booked deals for the prior five years.

Table 37: Five-Year Returns

Annual gross realized returns (pre-tax) on booked deals (IRR %)	
16.5%	1st quartile
18.0%	Median
21.5%	3rd quartile

The median required rate of return (hurdle rate) reported by respondents for mezzanine capital is 18%.

Table 38. Hurdle Rate

Hurdle rate (%)	
17.0%	1st quartile
18.0%	Median
20.0%	3rd quartile

Mezzanine firms expect a median all-in-return rate on new investments of 18.5%.

Table 39. Expected Returns on New Investments

Expected annualized pre-tax gross return on new investment (IRR) (%)	
17.9%	1st quartile
18.5%	Median
20.3%	3rd quartile

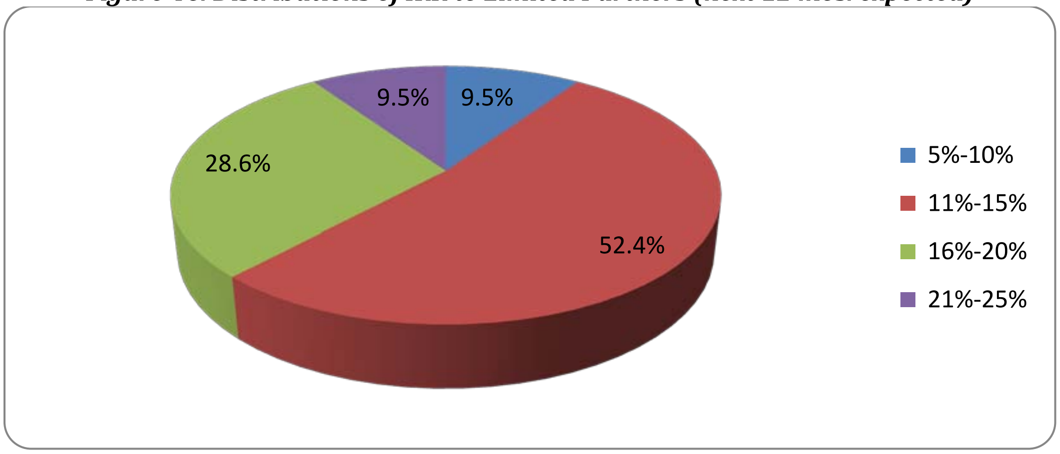
Pre-tax returns to limited partners for the prior 12 months were 14% (median) while 15% returns are expected for the next 12 months.

Table 40. Returns to Limited Partners

	Last 12 mos. (historical)	**Next 12 mos. (expected)**
1st quartile	12.25%	14%
Median	14%	15%
3rd quartile	17%	18%

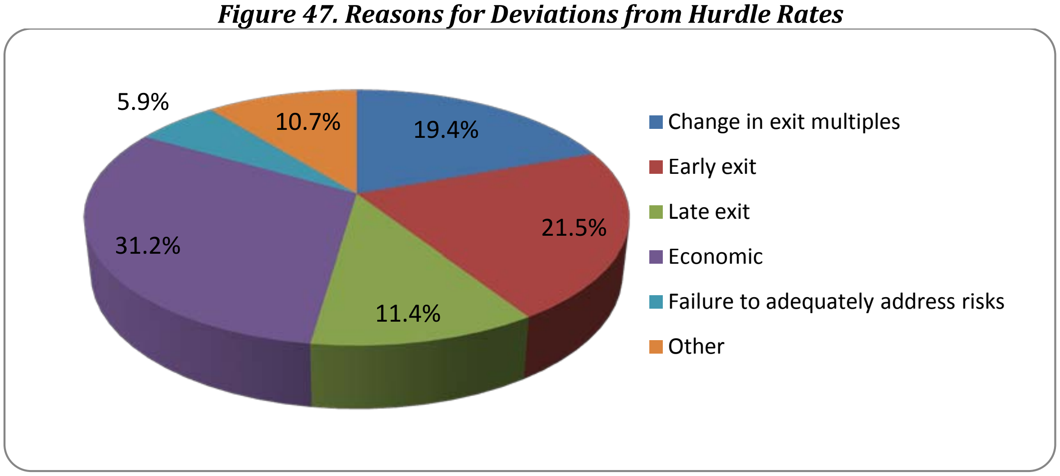
The distribution of expected returns follows below.

Figure 46. Distributions of IRR to Limited Partners (next 12 mos. expected)



For those situations where hurdle rates and realized returns differed, the most commonly cited reason was "economic" while "early exits" and "changes in exit multiples" also were commonly cited.

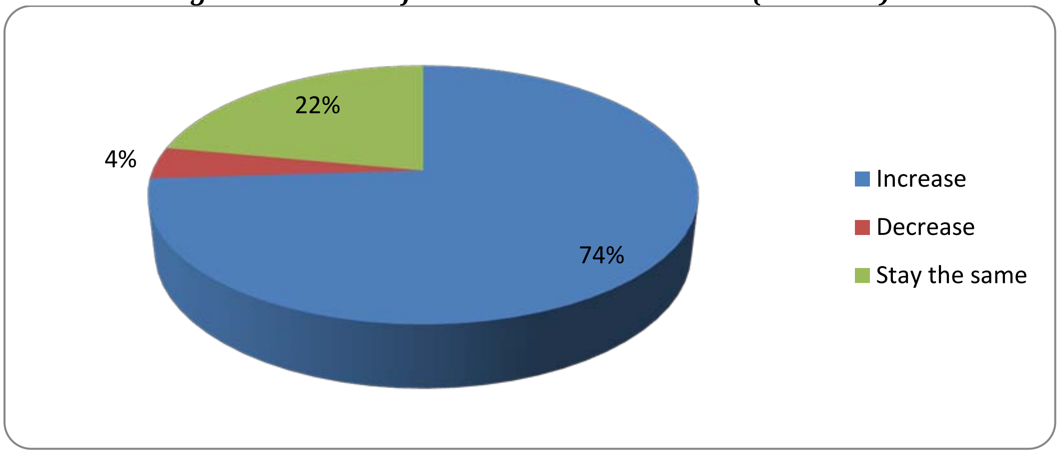
Figure 47. Reasons for Deviations from Hurdle Rates



Industry and Economic Outlook

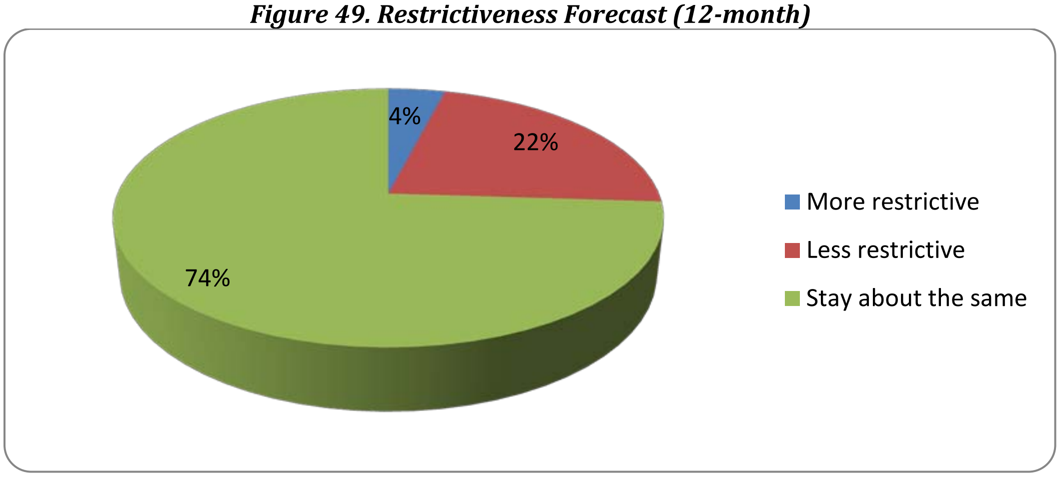
Mezzanine firms largely believe that demand for mezzanine loans will increase over the next year.

Figure 48. Demand for Mezzanine Loan Forecast (12-month)



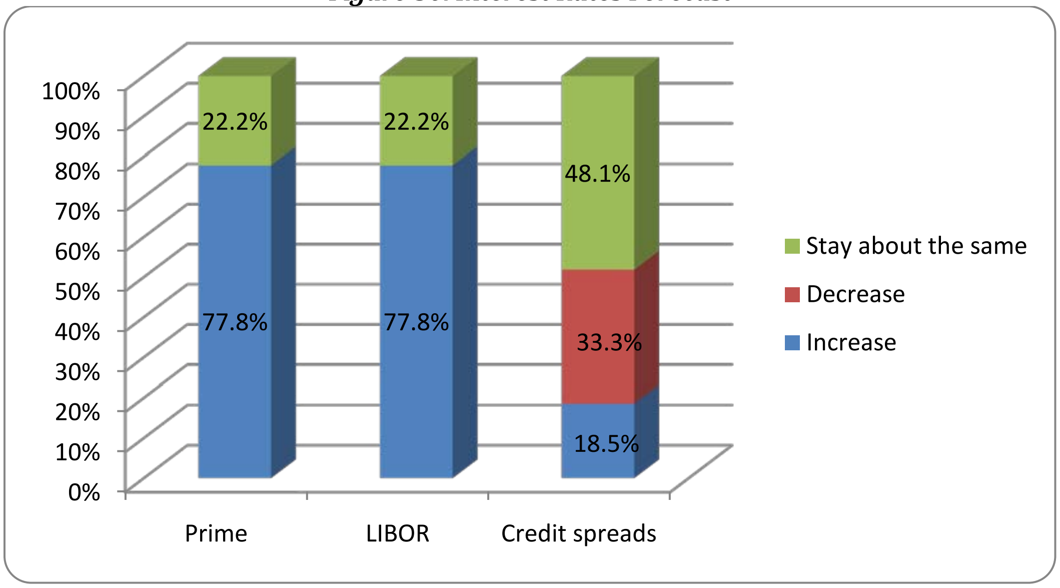
The majority (74%) of mezzanine investors report overall restrictiveness to remain about the same over the next year while 22% believe mezzanine lending will be less restrictive, and another 4% predict tighter lending.

Figure 49. Restrictiveness Forecast (12-month)



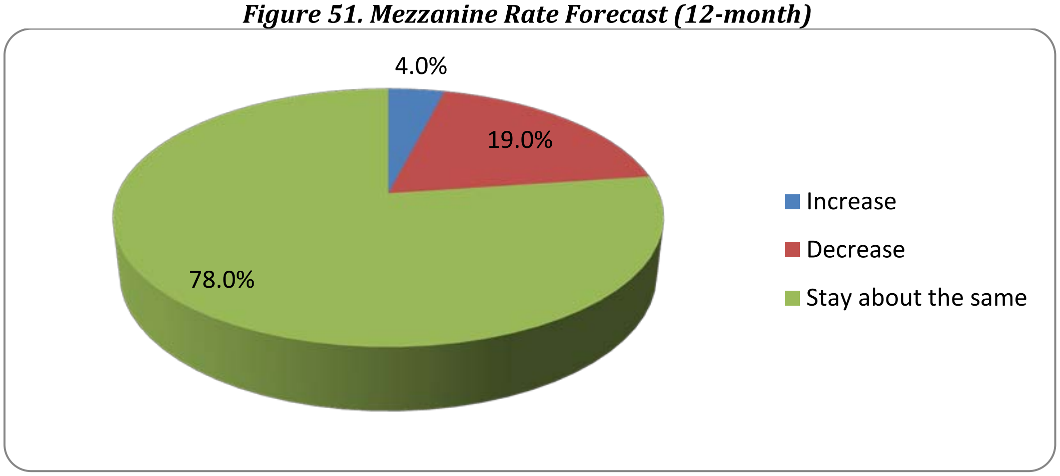
The majority of respondents indicate an expectation for increased prime and LIBOR rates over the next 12 months.

Figure 50. Interest Rates Forecast



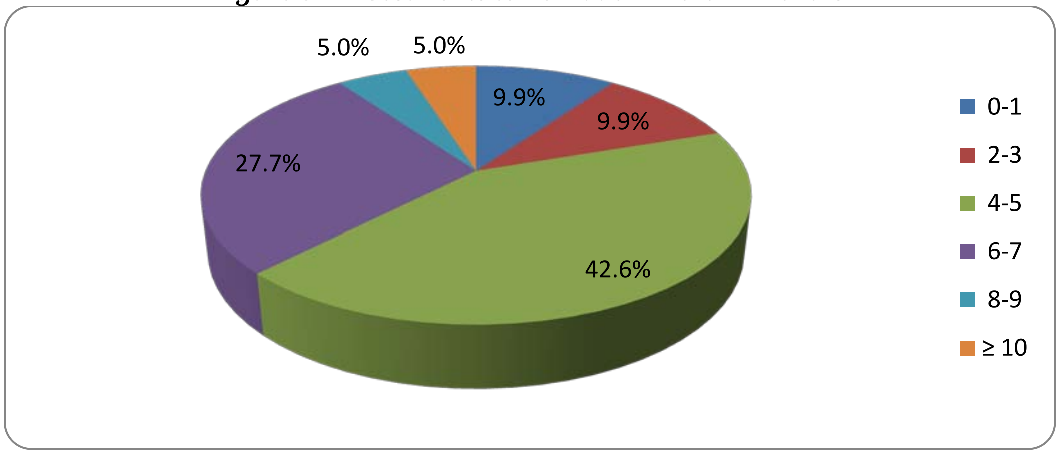
The majority (78%) of mezzanine investors believe all in rates will remain about the same over the next year while just 19% believe rates will decline.

Figure 51. Mezzanine Rate Forecast (12-month)



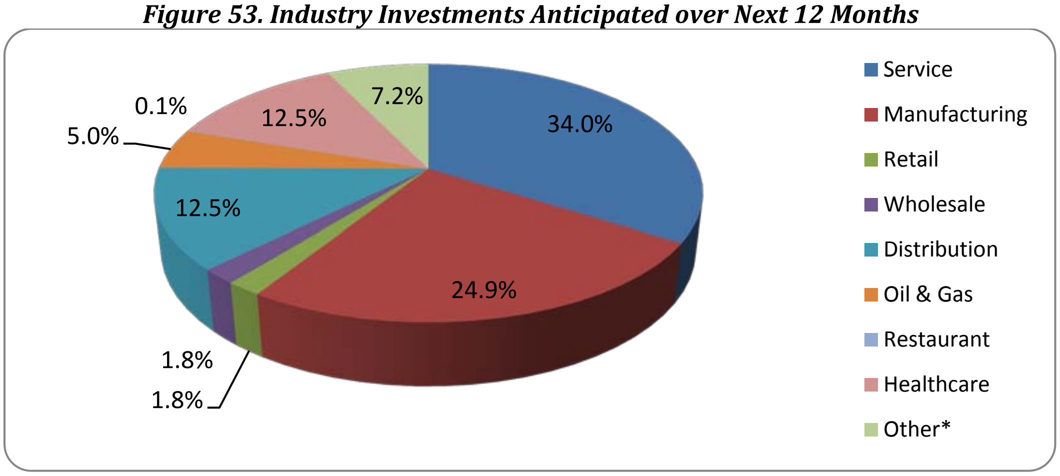
Over the next 12 months, investors anticipate making a number of new investments. The largest category is in the four-to-five range (42.6%) while 27.7% expect to make six-to-seven deals.

Figure 52. Investments to Be Made in Next 12 Months



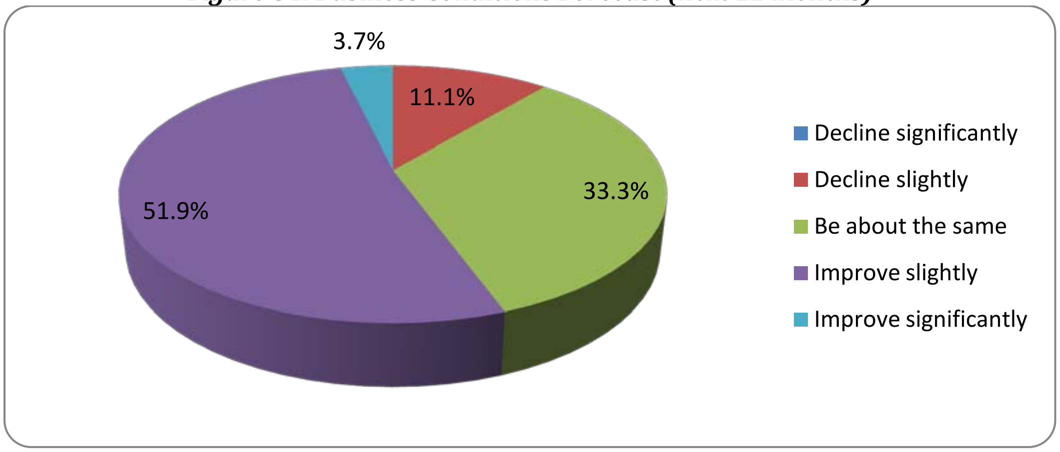
Industries in which respondents expect to make investments over the next 12 months include service (34%), manufacturing (24.9%) and others.

Figure 53. Industry Investments Anticipated over Next 12 Months



Overall, mezzanine investors are optimistic about the prospects for improvement in business conditions. Over half (51.9%) report an expected slight improvement while 33.3% believe conditions will be about the same.

Figure 54. Business Conditions Forecast (next 12 months)



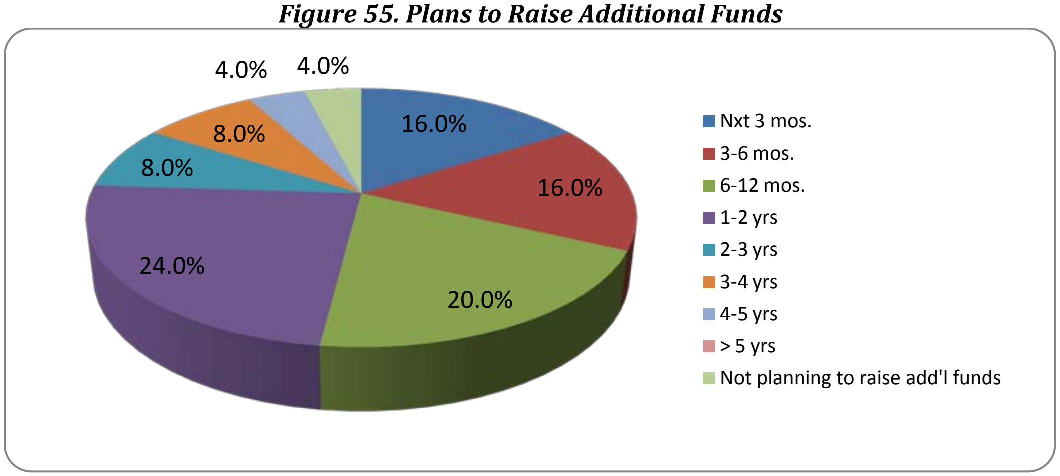
The average GDP growth estimate over the next year is approximately 1.6% while the private company equivalent is approximately 2.0%.

Table 41. GDP Forecast (12-month)

	Expected GDP change (%)
Overall GDP	1.6%
Privately-held company equivalent GDP	2.0%

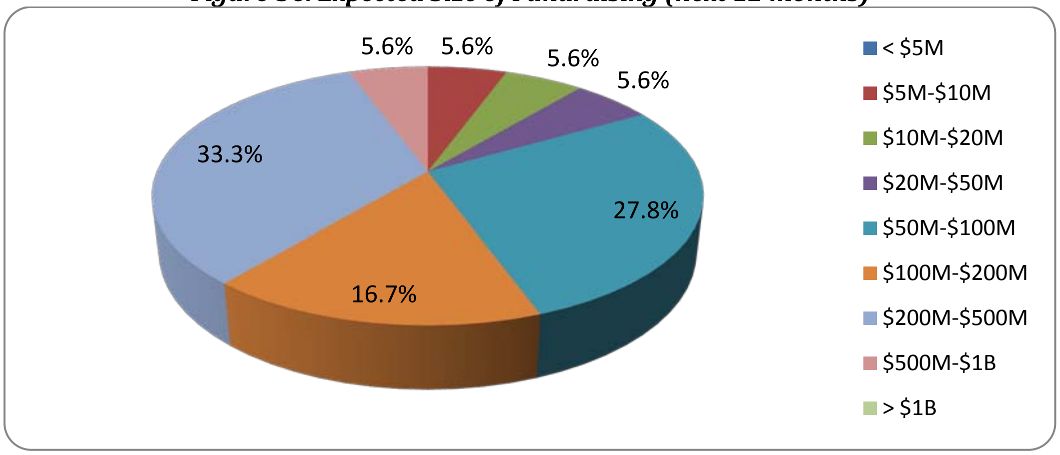
Over half of respondents report an intent to raise additional funds in the next 12 months while 24% are planning for a capital raise in one to two years. Just 4% of funds are not planning to raise additional funds in the foreseeable future.

Figure 55. Plans to Raise Additional Funds



For those respondents who indicated plans to raise funds in the next 12 months, approximately 28% anticipate between $50 million and $100 million while another 33.3% are planning a raise of between $200 and $500 million. Approximately 17% are seeking capital in the range of $100 million to $200 million.

Figure 56. Expected Size of Fundraising (next 12 months)



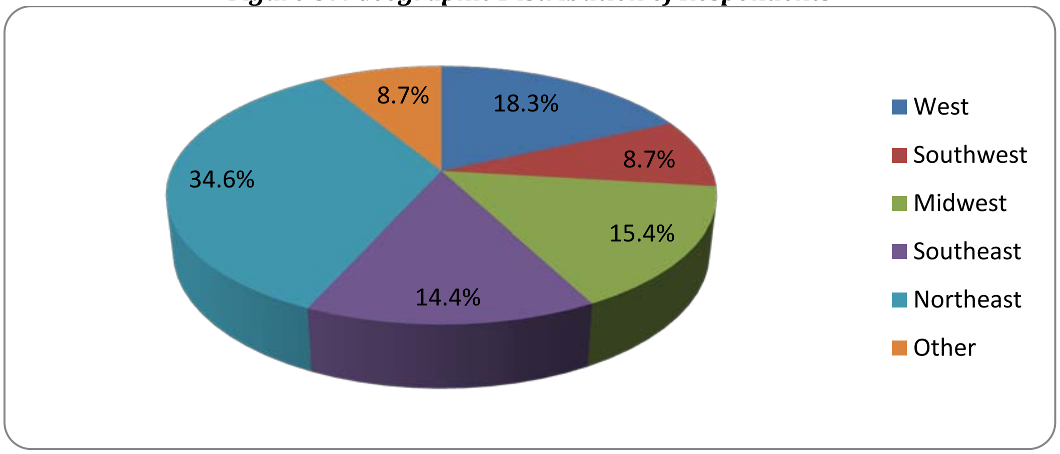
PRIVATE EQUITY SURVEY INFO

Profile of Respondents

The following responses pertain to our private equity survey administered in October/November 2009. Our results are based upon 137 responses to this survey. The respondents are geographically dispersed throughout the United States.

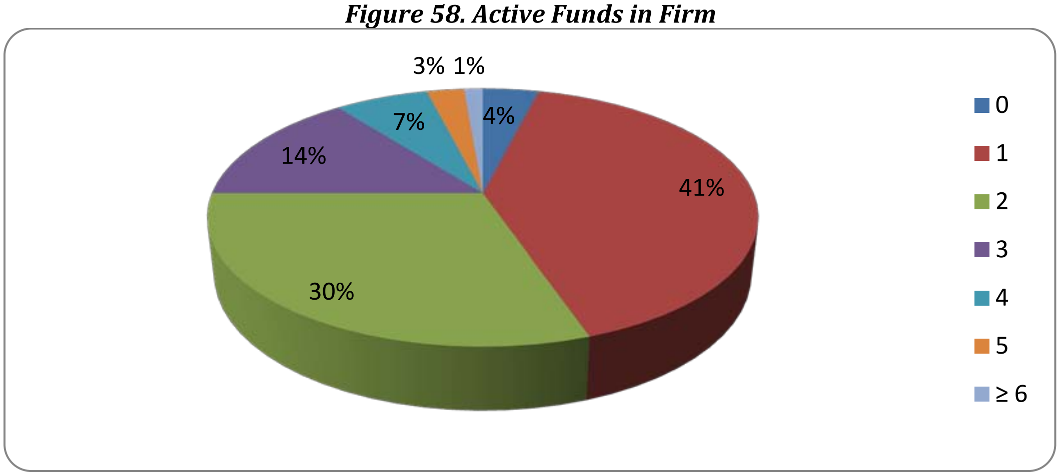
The largest concentration of responses came from the northeast (34.6%) followed by the west (18.3%) and midwest (15.4%).

Figure 57. Geographic Distribution of Respondents



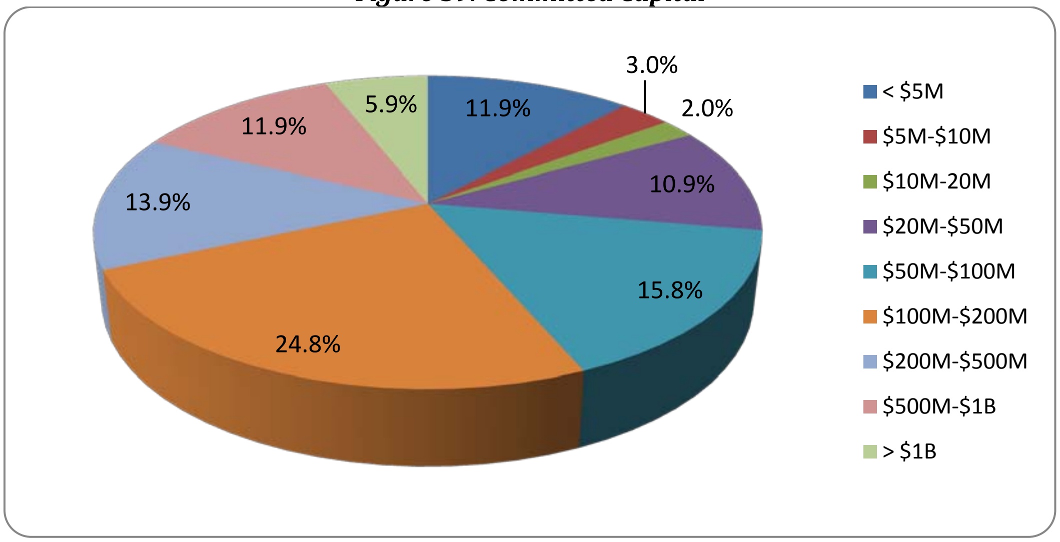
Forty-one percent (41%) of respondents indicate having just one active fund in their firm while another 30% report having two, and 14% indicate three active funds.

Figure 58. Active Funds in Firm



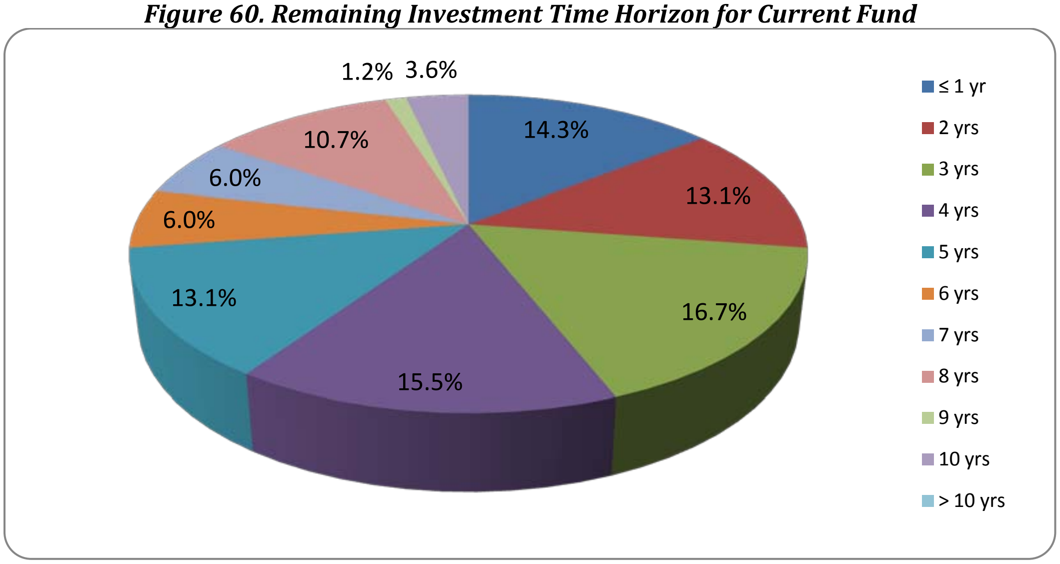
Committed capital for the funds ranged considerably. Approximately 25% reported between $100 million and $200 million while another 15.8% indicate $50 to $100 million, and another 13.9% report $200 to $500 million.

Figure 59. Committed Capital



Remaining time horizons for investment for the current fund were fairly evenly distributed. Approximately 14.3% reported less than one year, 13.1% reported two years, 16.7% reported three years, and 15.5% reported four years.

Figure 60. Remaining Investment Time Horizon for Current Fund



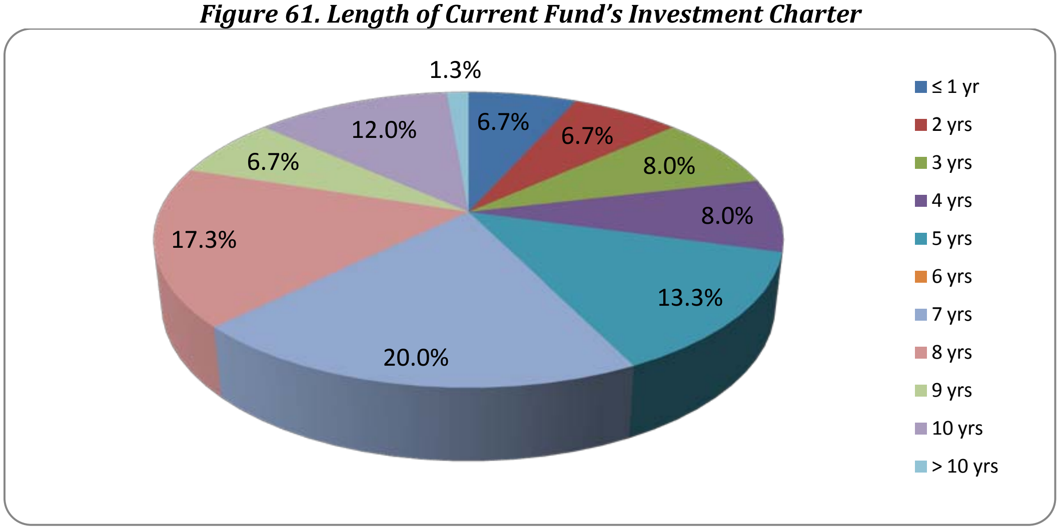
The median amount of capital left to invest from the current fund is approximately $55 million. Firms also report that approximately 50% of their capital is left to deploy.

Table 42. Capital Left for Current Fund

Total capital left ($)	Total capital left (%)	
16.5M	25.0%	1st quartile
55M	50.0%	Median
100M	80.0%	3rd quartile

Approximately 20% of funds report an investment charter length of seven years while another 17.3% reports eight years.

Figure 61. Length of Current Fund's Investment Charter



Individuals taking the survey have varying levels of experience. Nearly 34.3% report greater than 10 years experience while 24.5% report five to 10 years, and another 30.4% indicate two to five years.

Table 43. Years of Experience

	You individually	Your firm
< 1 yr	2.0%	2.0%
1-2 yrs	8.8%	3.0%
2-5 yrs	30.4%	10.1%
5-10 yrs	24.5%	23.2%
> 10 yrs	34.3%	61.6%

Operational and Investment Characteristics

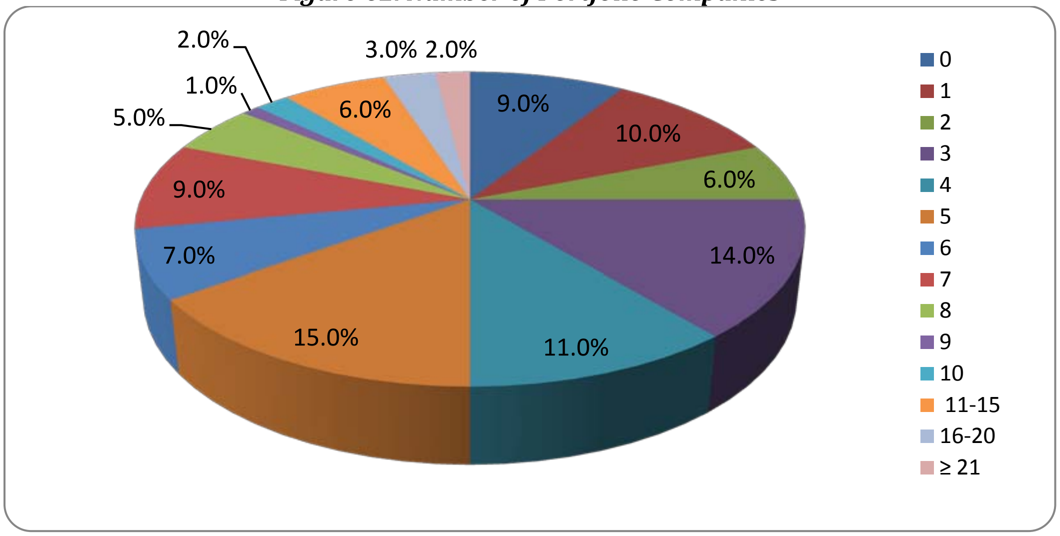
We asked respondents to report on various operational and industry items as compared to six months ago. Significant increases were reported in the time to exit deals. Significant declines were reported for the following categories: deal multiples, size of private equity industry, appetite for risk, investment capacity of fund, number of investments being made by competitor funds, and prospects for raising additional funds.

Table 44. Conditions Now Versus Six Months Ago

	Increased	Decreased	Stayed about the same
Number of business plans submitted	40.3%	33.9%	25.8%
Quality of investee companies	31.7%	41.3%	27.0%
Number of investments being made	23.8%	38.1%	38.1%
Average investment size	17.7%	27.4%	54.8%
Leverage (multiple)	17.7%	53.2%	29.0%
Deal multiples	11.7%	61.7%	26.7%
% of stock option plans to entire capitalization	10.5%	17.5%	71.9%
Time to exit deals	68.3%	1.6%	30.2%
Size of private equity industry	3.2%	69.8%	27.0%
Carried interest	4.8%	17.7%	77.4%
Non-fund investors	23.3%	25.0%	51.7%
Condition of existing portfolio	31.7%	39.7%	28.6%
Appetite for risk	20.6%	44.4%	34.9%
Investment capacity of fund	16.1%	33.9%	50.0%
# of investments being made by competitor funds	16.1%	61.3%	22.6%
Offshore flow of capital	11.7%	28.3%	60.0%
Prospects for raising additional funds	20.6%	46.0%	33.3%

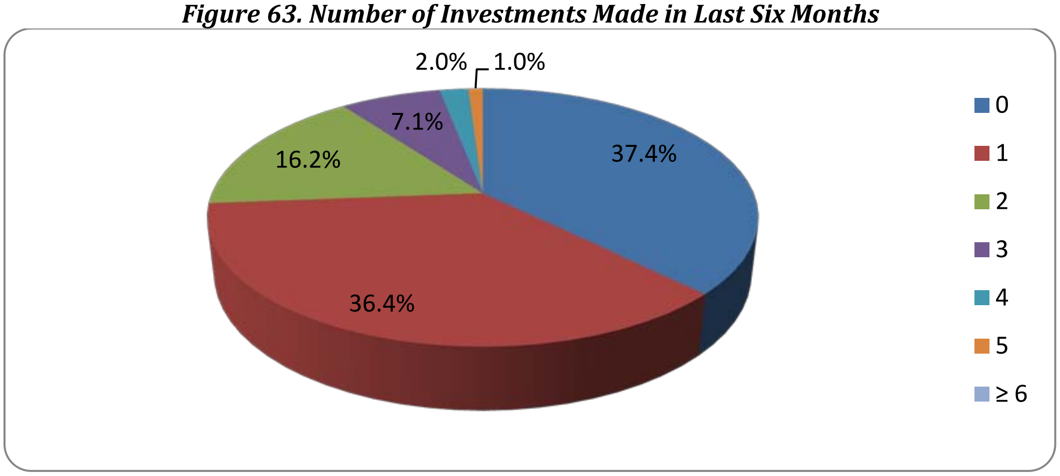
The number of portfolio companies in the current fund varies considerably and ranges from zero to over 21. The largest concentration (15%) was reported for five investments followed by three, four, and one.

Figure 62. Number of Portfolio Companies



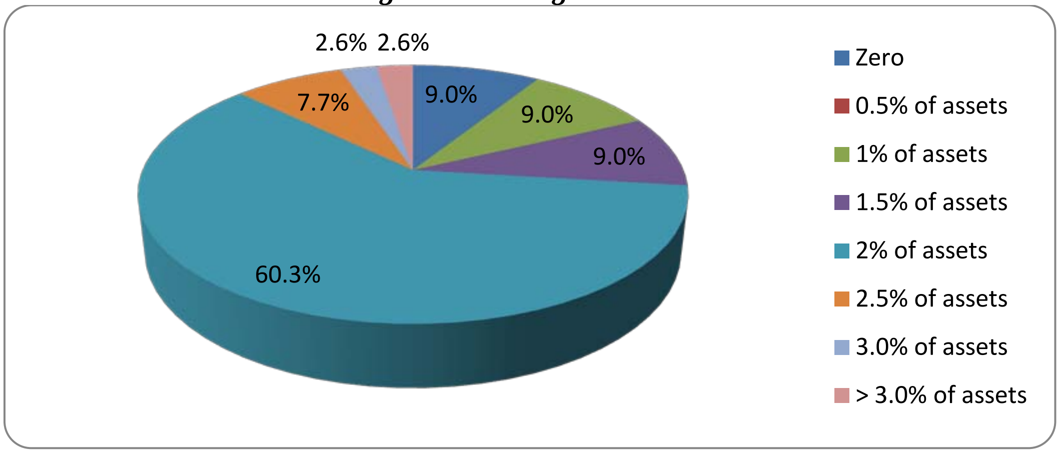
Over the last six months, approximately 37.4% of funds report making no investments while 36.4% made one, and another 16.2% made two.

Figure 63. Number of Investments Made in Last Six Months



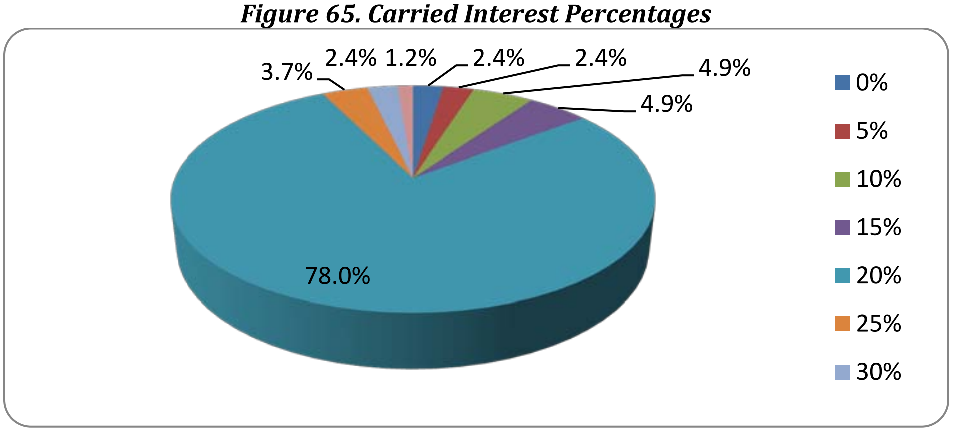
Management fees remain concentrated at 2% of assets. Nearly 60% of respondents report this to be the case while approximately 27% of respondents report an even distribution between 0%, 1%, and 1.5% of assets.

Figure 64. Management Fees



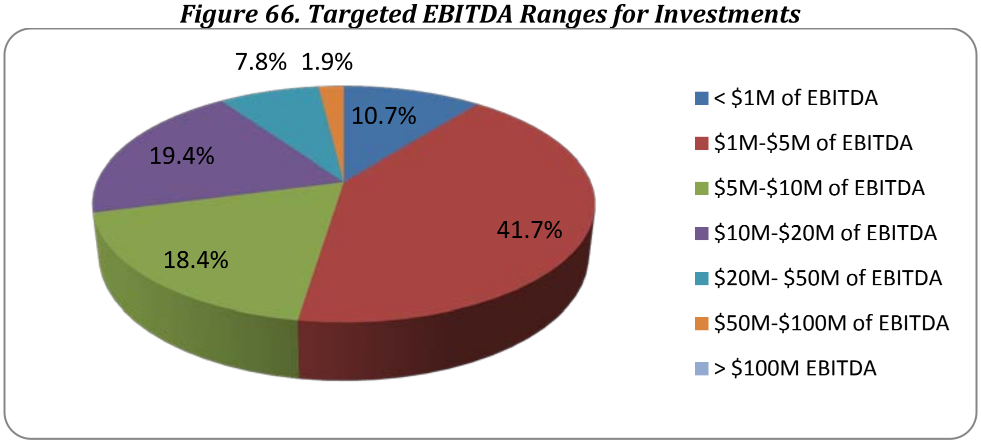
Carried interest percentages are reported to be 20% by approximately 78% of respondents.

Figure 65. Carried Interest Percentages



Approximately 41.7% of respondents indicate targeting companies with \$1 million to \$5 million in EBITDA while 18.4% report \$5 million to 10 million as their preferred range, and another 19.4% seek companies with \$10 million to \$20 million in EBITDA.

Figure 66. Targeted EBITDA Ranges for Investments



A variety of investment analysis techniques are employed to evaluate potential investments. The techniques used most frequently include IRR (96.9%), multiple analysis (94.9%), and payback (73.7%). Gut feel is used by 72.3% of respondents. Also, when evaluating an investment, nearly 84.7% indicate that they assume the exit multiple is the same as the entry multiple.

Table 45. Investment Analysis Techniques Used

	Yes	No
Payback	73.7%	26.3%
Internal rate of return (IRR)	96.9%	3.1%
Discounted cash flow (DCF)	69.0%	31.0%
Multiple analysis	94.9%	5.1%
Option analysis	12.8%	87.2%
Simulation analysis	45.1%	54.9%
Gut feel	72.3%	27.7%
Yr 5 exit multiple same as entry multiple	84.7%	15.3%

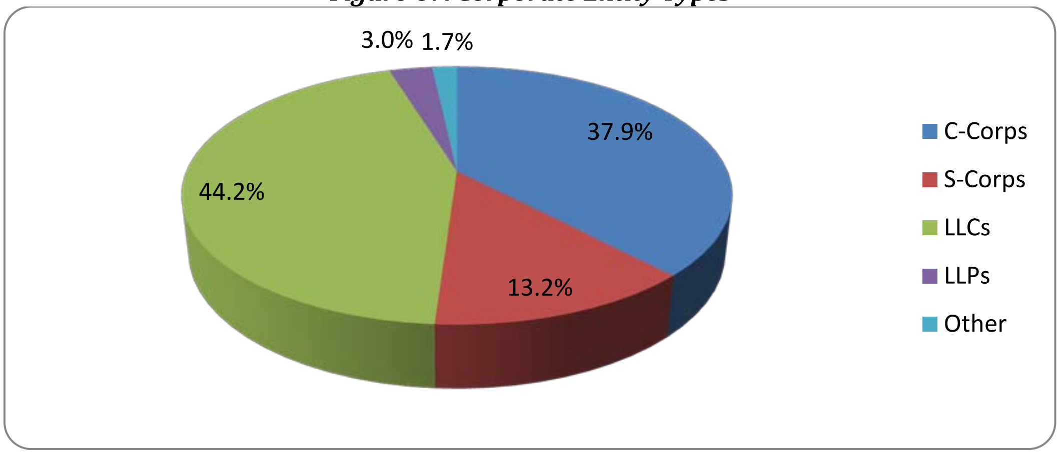
The largest concentration of respondents report preferred investment amounts per deal in the range of $5 million to $10 million followed by $2 million to $5 million.

Table 46. Target Investment Amounts per Deal

	Minimum	Maximum	Preferred
< $1M	20.0%	1.4%	2.5%
$1M-$2M	10.7%	1.4%	7.4%
$2M-$5M	29.3%	9.5%	23.5%
$5M-$10M	21.3%	25.7%	27.2%
$10M-$20M	13.3%	20.3%	14.8%
$20M-$50M	5.3%	17.6%	14.8%
$50M-$100M	0.0%	13.5%	7.4%
> $100M	0.0%	10.8%	2.5%

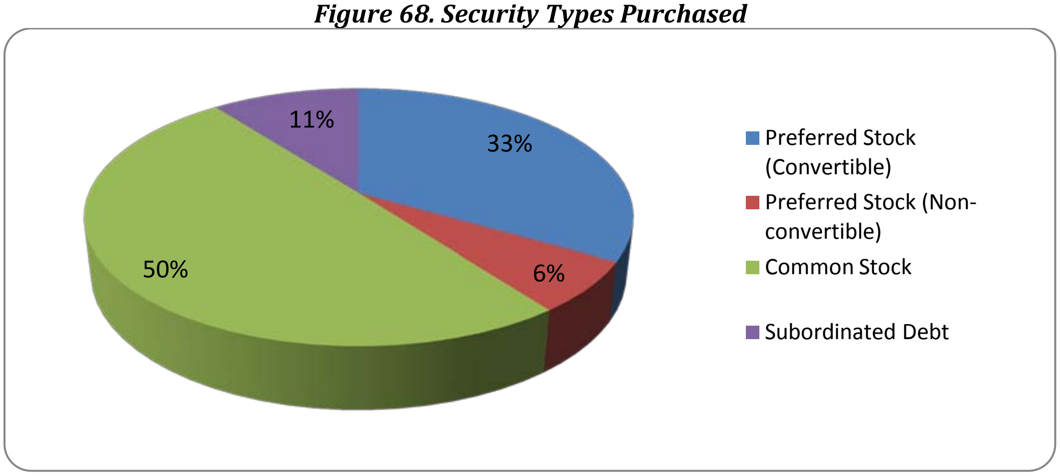
Respondents indicate investing in a variety of legal forms of businesses. The most common was LLCs (44.2%) followed by C-corporations (37.9%).

Figure 67. Corporate Entity Types



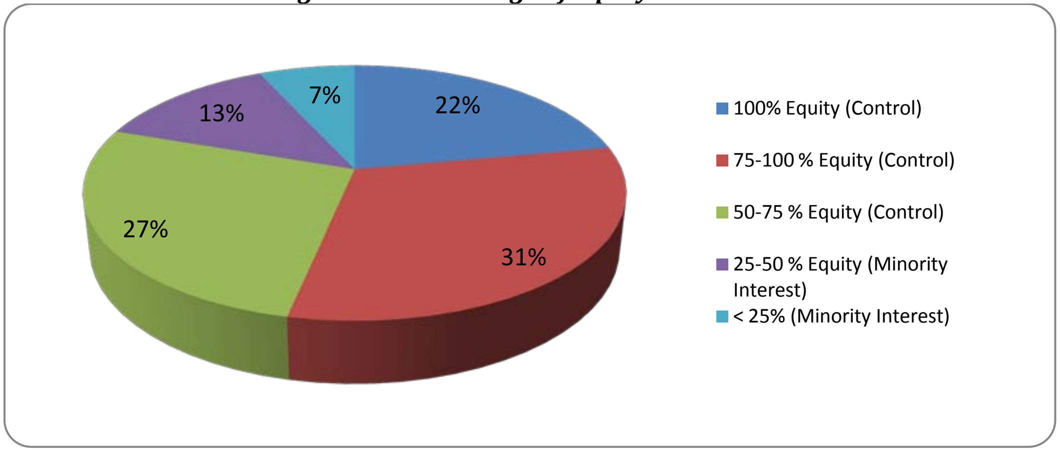
Most commonly, respondents indicate investing in common stock (50%) while another 33% invest in convertible preferred.

Figure 68. Security Types Purchased



Approximately 22% of investments are 100% equity purchases while another 31% are 75-100% equity, and 27% are 50-75% equity purchases. Approximately 20% are non-control or with an ownership stake of less than 50%.

Figure 69. Percentage of Equity Purchased



Respondents were asked whether or not they would invest in a non-control equity interest with and without investor protections (such as shareholder agreements, buy/sell agreements, and employment agreements). Approximately 70.2% reported that they would invest with investor protections but just 5.3% were interested in investing without protections.

Table 47. Minority Interest Investment Receptivity

	Yes	No
With investor protections (shareholder agreement, buy/sell, and employment agreements)	70.2%	29.8%
Without investor protections	5.3%	94.7%

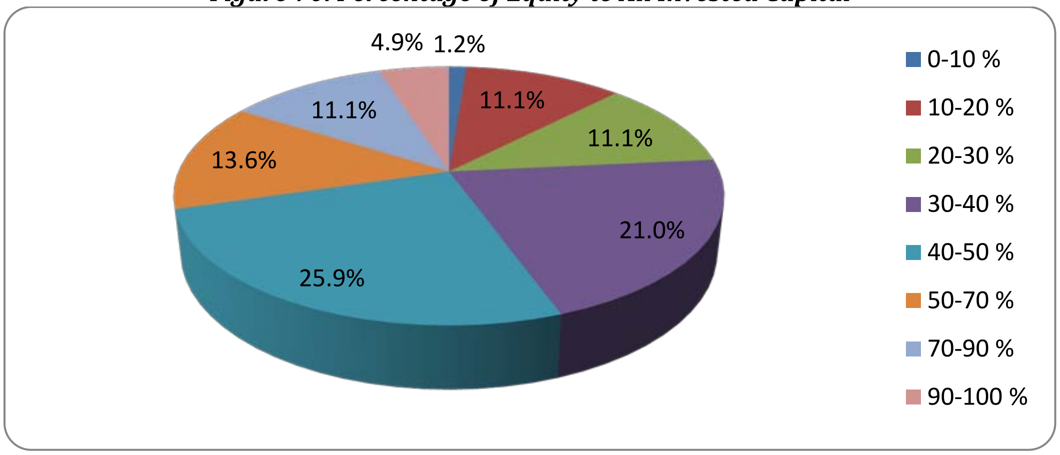
For those who indicated they would invest with investor protections, the median discount from pro rata equity value was 20%.

Table 48. Discount from Pro Rata for Investing in Minority Interests

Size of discount from pro rata (%)	
10.0%	1st quartile
20.0%	Median
25.0%	3rd quartile

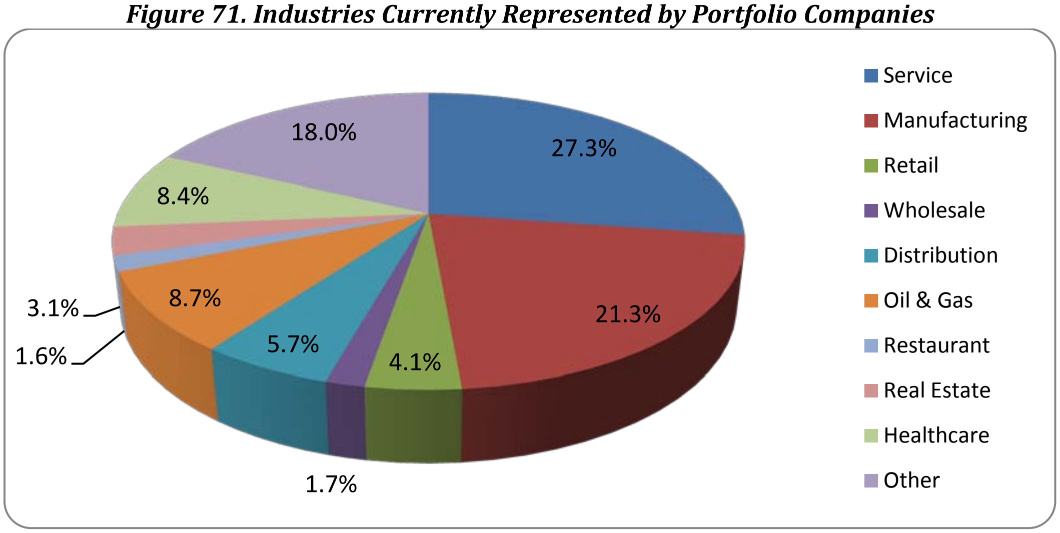
Respondents report varying targets of "equity to all invested capital" percentages in the overall capital structure. Most are indicating a range of between 30% and 70%. Nearly 25.9% report a target of 40-50% while 21% indicate a target of 30-40%.

Figure 70. Percentage of Equity to All Invested Capital



Respondents indicate making investments in a variety of industries. Among them, service (27.3%) and manufacturing (21.3%) have the largest concentrations.

Figure 71. Industries Currently Represented by Portfolio Companies



When considering investing in a company, respondents report expectations for minimum required growth rates for revenues and EBITDA over the next five years. The largest concentrations for both revenues and EBITDA were in the 5-10% range.

Table 49. Minimum Growth Rates for Companies Expected over Next Five Years

	Revenue growth (annual)	**EBITDA growth (annual)**
< 5%	15.9%	7.6%
5-10 %	34.1%	34.2%
10-15 %	20.7%	25.3%
15-20 %	6.1%	8.9%
20-25 %	9.8%	12.7%
25-30%	4.9%	6.3%
30-40%	6.1%	2.5%
40-50 %	2.4%	1.3%
> 50 %	0.0%	1.3%

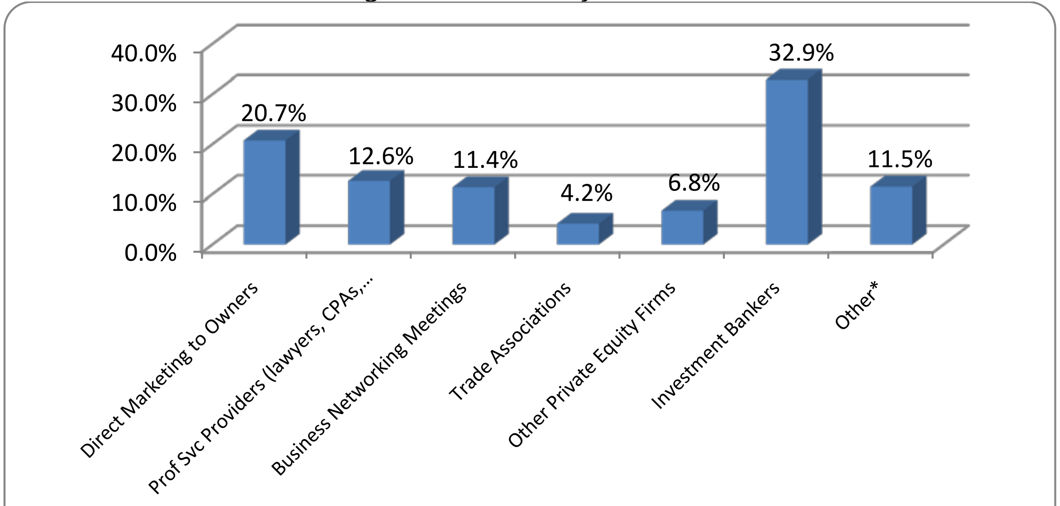
Key executives are frequently replaced when private equity funds acquire a company. Respondents report changing the CFO 30% of the time while the CEO is replaced approximately 25% of the time.

Table 50. Frequencies of Replacing Key Company Executives

CEO	**COO**	**CFO**	
4.0%	0.0%	1.0%	1st quartile
25.0%	10.0%	30.0%	Median
50.0%	33.5%	50.0%	3rd quartile

Respondents report that approximately 32.9% of deal flow comes from investment bankers. Another 20.7% of deals comes from direct marketing to business owners and another 12.6% originates from professional service providers such as lawyers and CPAs.

Figure 72. Sources of Deal Flow



**Other includes brokers, limited partners, websites, personal networks, past management teams*

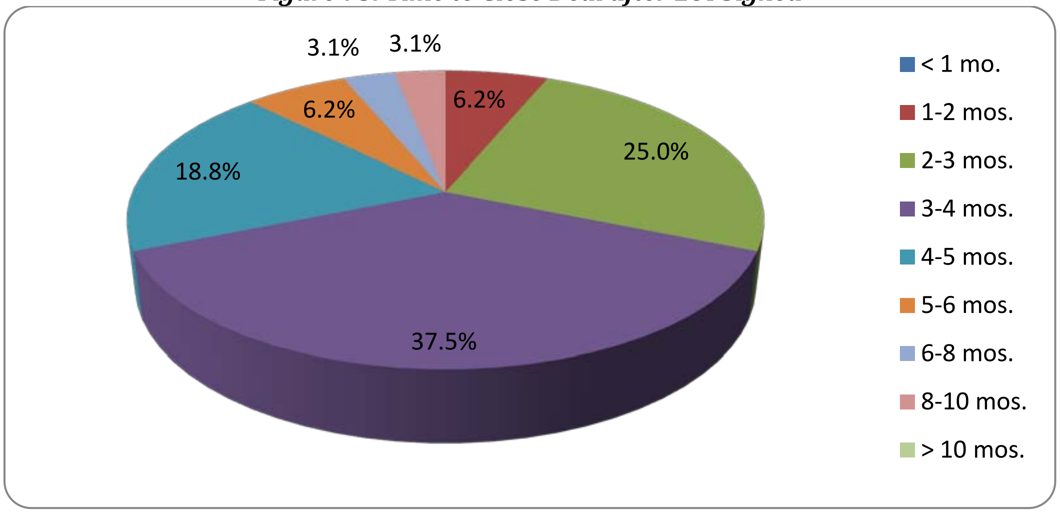
In order to close one deal, the following activities are conducted (medians reported). These include the review of 100 business plans, 15 meetings with principals, five term sheets issued, and two letters of intent signed.

Table 51. Activities to Close One Deal

Business plans or memos are received	Meetings with principals are conducted	Term sheets are issued	Letters of intent are signed	
50	10	3	1	1st quartile
100	15	5	2	Median
200	30	10	3	3rd quartile

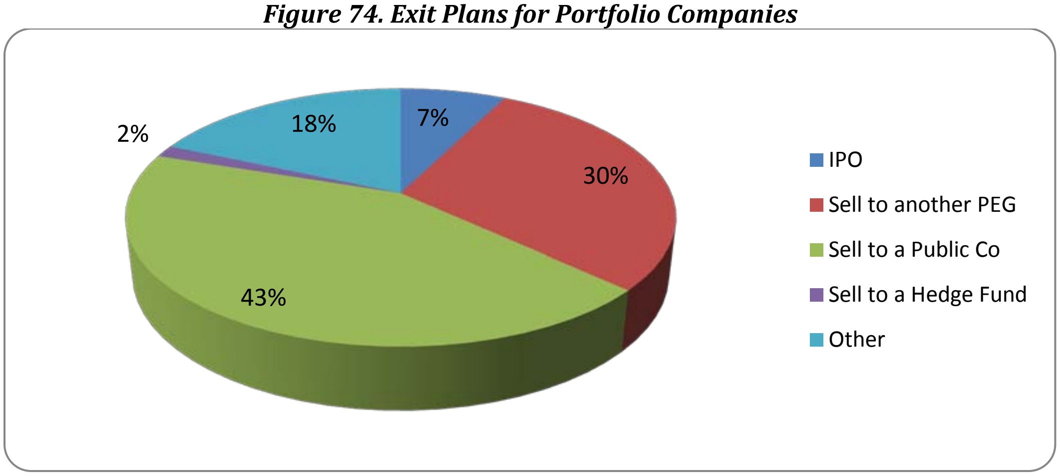
Approximately 37.5% of respondents report an average time of 3-4 months to close a deal after the letter of intent is signed.

Figure 73. Time to Close Deal after LOI Signed



Approximately 43% of portfolio companies are expected to be purchased by public companies while the anticipated buyers of 30% of companies are other private equity groups. Just 7% of portfolio companies are being groomed to go public in an IPO.

Figure 74. Exit Plans for Portfolio Companies



Returns

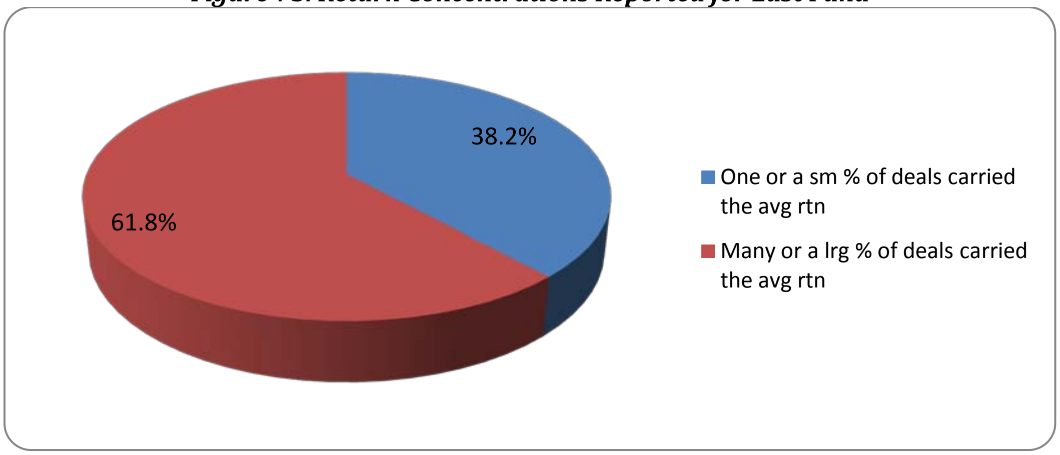
Respondents report that the return for the last closed fund is 28% (median).

Table 52. Last Fund Return

Pre-tax return %	
18.5%	1st quartile
28.0%	Median
37.5%	3rd quartile

Respondents report that, for the last fund, many or a large percentage or deals carried the average return as opposed to having had a small percentage of deals carry the return.

Figure 75. Return Concentrations Reported for Last Fund



Respondents report a median hurdle rate of 25% when evaluating new investments.

Table 53. Hurdle Rates When Evaluating New Investments

Hurdle rate (%)	
18.0%	1st quartile
25.0%	Median
28.0%	3rd quartile

Respondents expect a return of 25% on new investment (median reported).

Table 54. Expected Returns on New Investments

Expected annualized pre-tax gross return on new investment (IRR) (%)	
25.0%	1st quartile
25.0%	Median
30.0%	3rd quartile

Returns in the current fund excluding portfolio company valuations are 17.5% (median).

Table 55. Current Fund Returns Without Portfolio Companies

Pre-tax return (%)	
0.0%	1st quartile
17.5%	Median
25.0%	3rd quartile

Returns in the current fund with portfolio companies valued at fair value are 15.0% (median).

Table 56. Current Fund Returns with Portfolio Companies

Pre-tax Return (%)	
9.3%	1st quartile
15.0%	Median
25.0%	3rd quartile

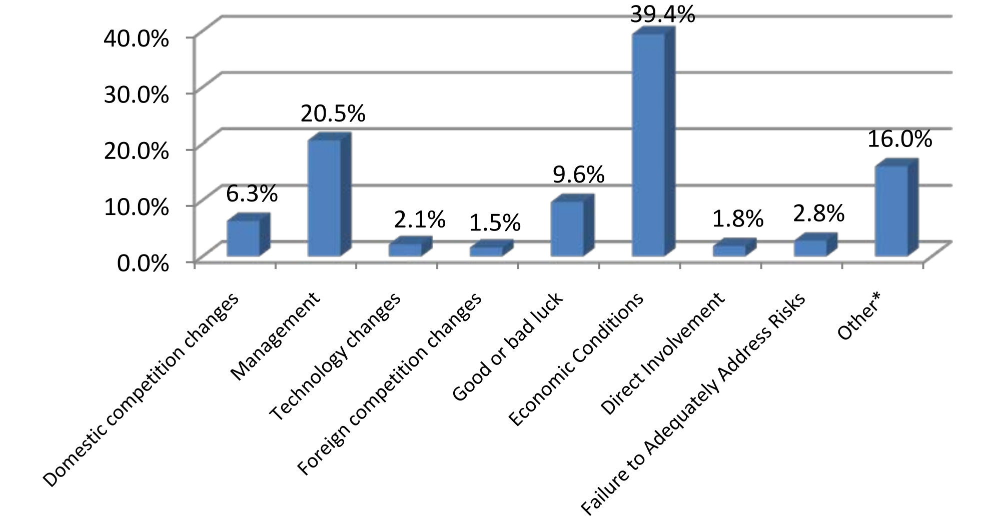
Respondents report historical and expected returns of 20% (median) to limited partners on a pre-tax basis.

Table 57. Returns Realized and Expected for Limited Partners

	Last 12 months (historical)	**Next 12 months (expected)**
1st quartile	0.00%	10.00%
Median	20.00%	20.00%
3rd quartile	25.50%	25.00%

For those firms with deviations between actual returns and hurdle rates, the cause cited with the largest concentration was "economic conditions" followed by "management."

Figure 76. Reasons for Deviations Between Expected and Actual Returns

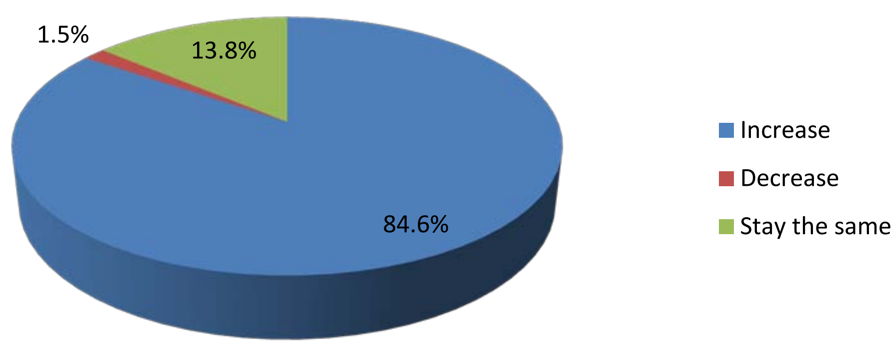


**Other includes no investments yet, timing of fund, government involvement or regulatory issues, fraud*

Industry and Economic Outlook

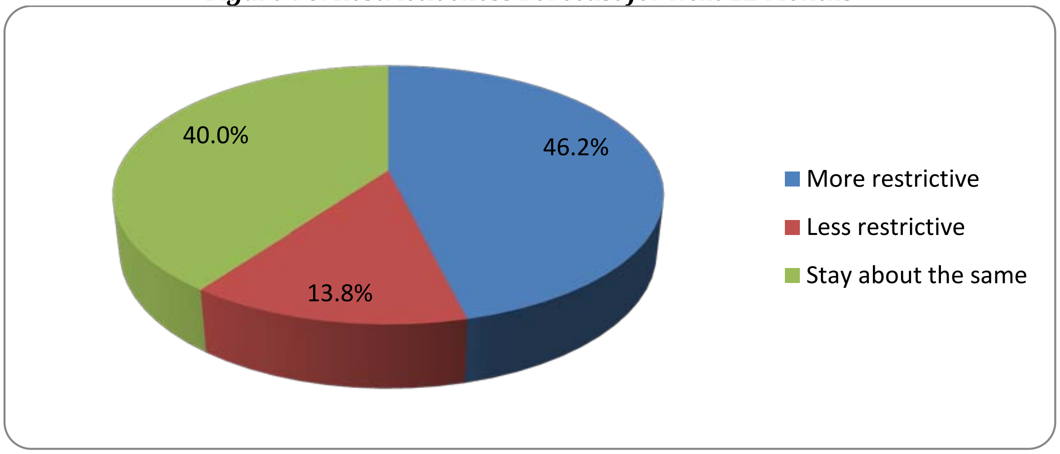
Private equity respondents indicate robust demand for investment. Approximately 85% of respondents report an expected increase in demand for private equity investments over the next year.

Figure 77. Demand for Private Equity Investments for Next 12 Months



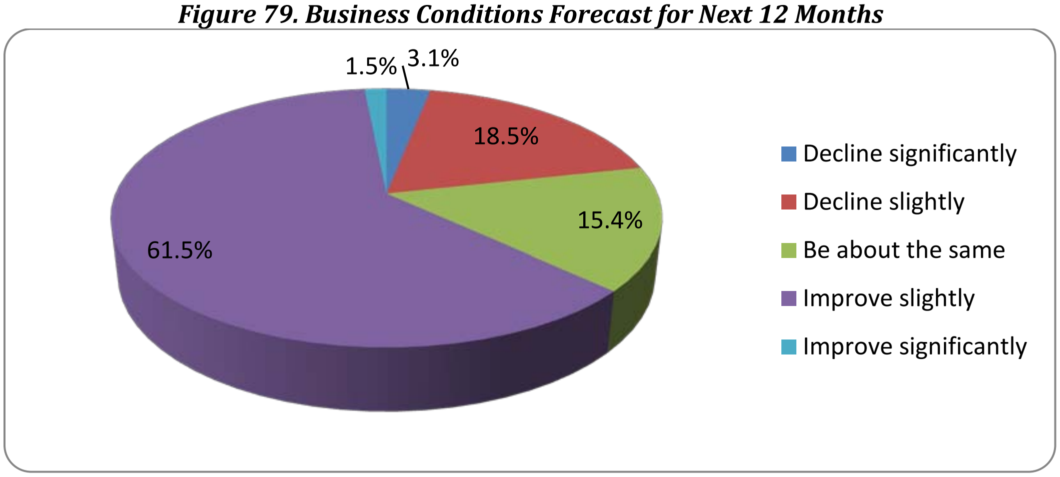
A large number of respondents (46.2%) report an expectation over the next 12 months of more restrictive investment while 40% believe it will be approximately the same. Just 13.8% report that the expectation is for less restrictive investment.

Figure 78. Restrictiveness Forecast for Next 12 Months



Approximately 61.5% of respondents believe business conditions over the next 12 months will improve slightly while 18.5% believe they will decline slightly, and another 15.4% expect similar conditions.

Figure 79. Business Conditions Forecast for Next 12 Months



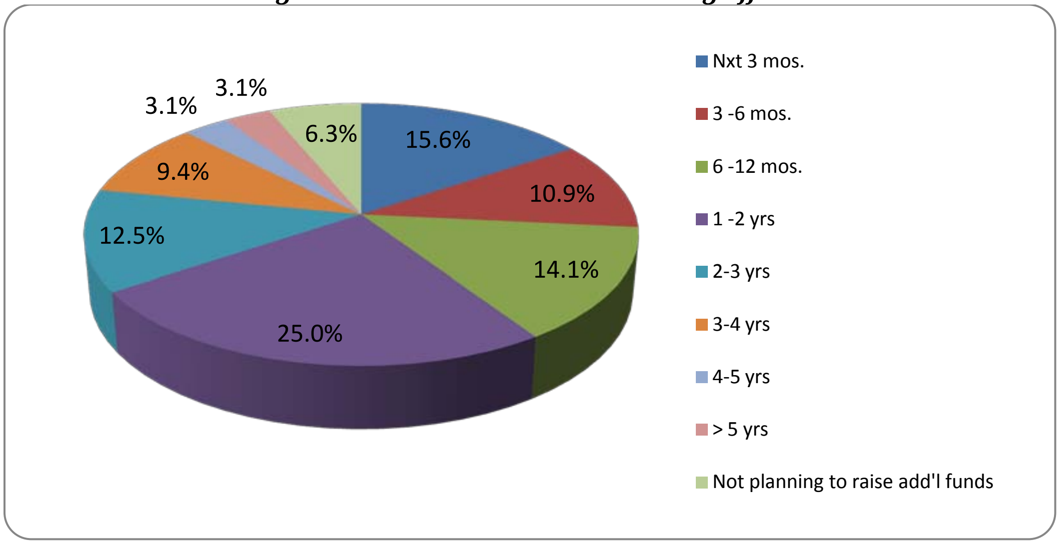
Expectations for overall GDP change average 1.0% for the next 12 months while the private company equivalent is approximately 2.1%.

Table 58. GDP Forecast for Next 12 Months

	Expected GDP change (%)
Overall GDP	1.0%
Privately-held company equivalent GDP	2.1%

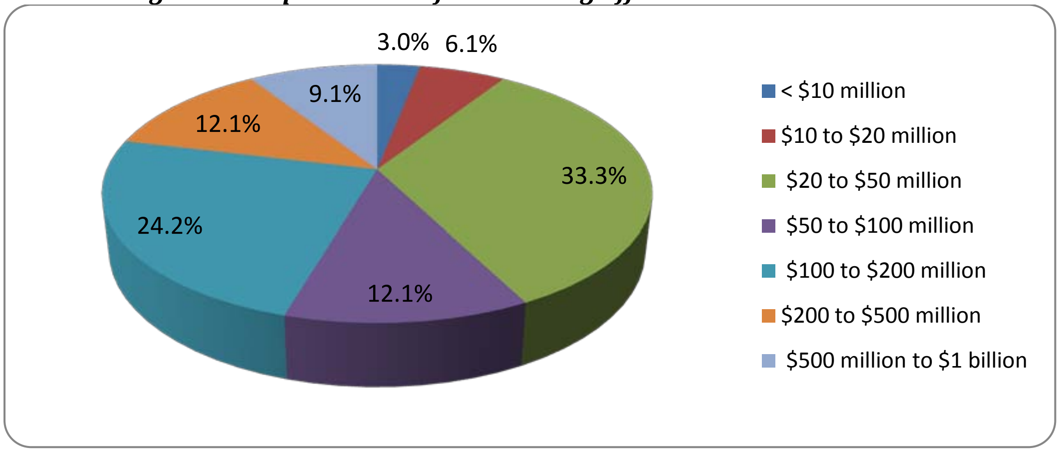
Approximately 6.3% of respondents report no plans to raise additional funds while 15.6% report a fundraising effort in the next three months. Another 10.9% report commencing a fundraising effort in the next 3 to six months and 14.1% indicate an attempt in six to 12 months. Nearly 25% report their intent to launch a fundraising campaign in the next one to two years.

Figure 80. Time Until Next Fundraising Efforts



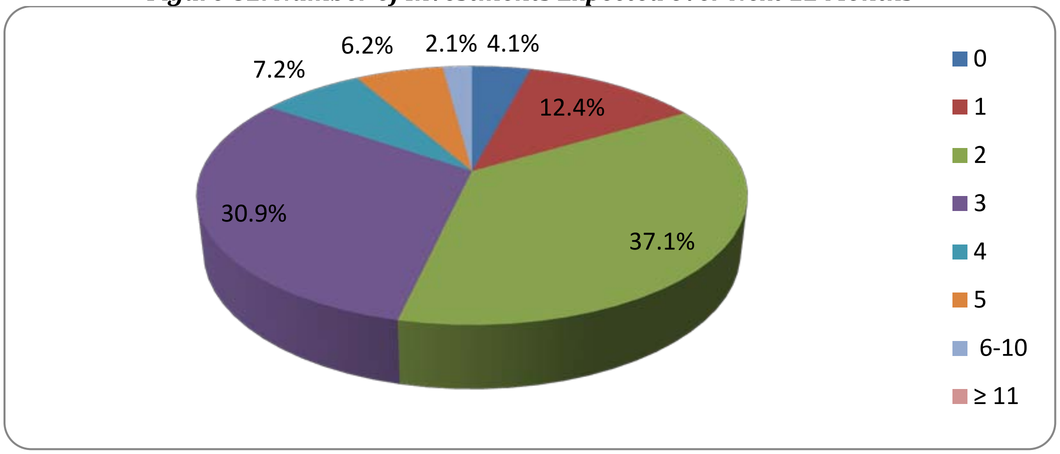
For those respondents who plan to raise funds over the next 12 months, approximately 33% report an intention to raise between $20 million to$50 million while 24.2% report the intent to raise between $100 million and $200 million.

Figure 81. Expected Size of Fundraising Efforts over Next 12 Months



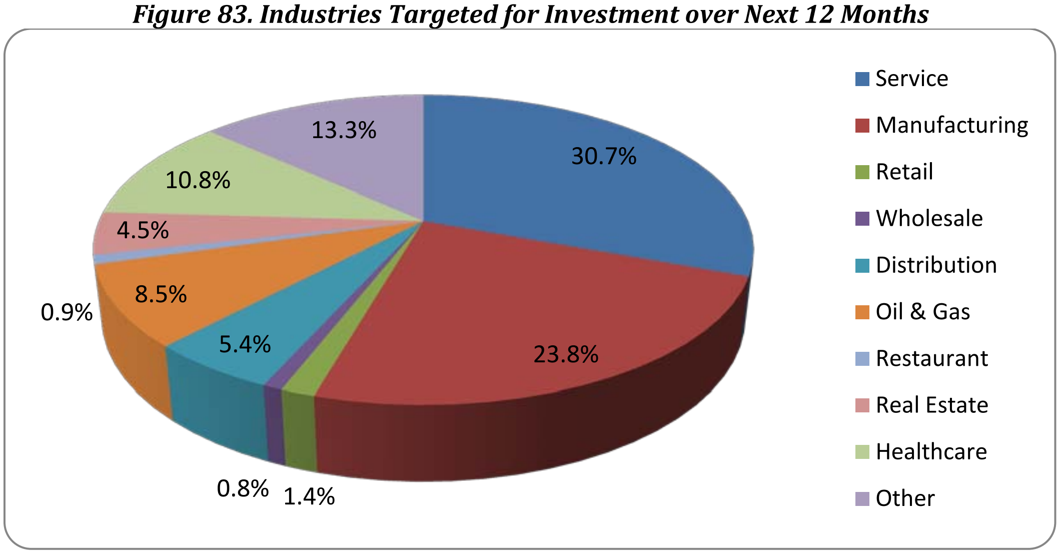
Approximately 12.4% of respondents report an expectation to make one investment over the next 12 months while 37.1% report two, and 30.9% report three investments.

Figure 82. Number of Investments Expected over Next 12 Months



Service and manufacturing companies appear to be the likely targets of private equity firm investment over the next 12 months followed by other, healthcare, and oil and gas.

Figure 83. Industries Targeted for Investment over Next 12 Months



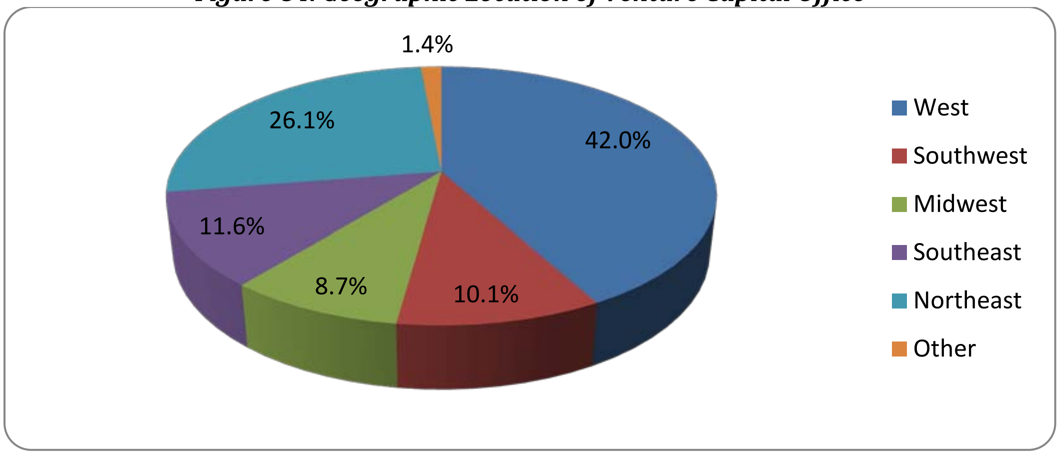
VENTURE CAPITAL SURVEY INFO

Profile of Respondents

The following responses pertain to our venture capital survey administered in October/November 2009. Our results are based upon 111 responses to this survey. The respondents are geographically dispersed throughout the United States.

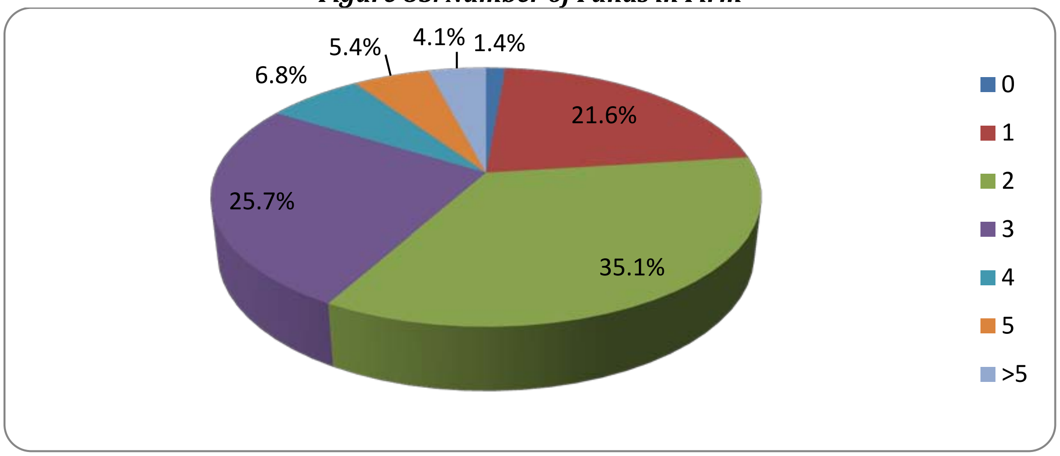
The majority of survey participants are from the western and northeastern regions. Nearly 42% of respondents indicate their office is located in the western region while 26.1% are located in the northwest.

Figure 84. Geographic Location of Venture Capital Office



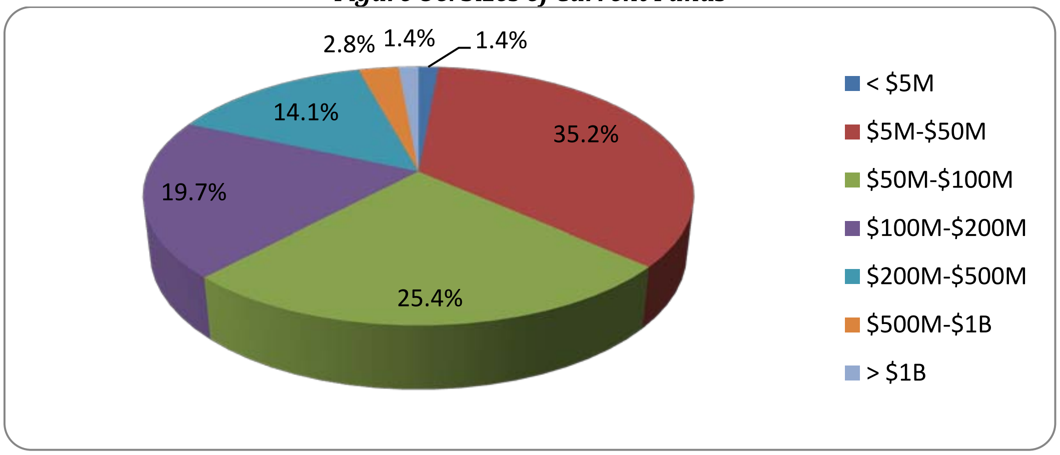
Approximately 35.1% of respondents indicate having two funds in their firm, while 25.7% have three, and 21.6% have one fund.

Figure 85. Number of Funds in Firm



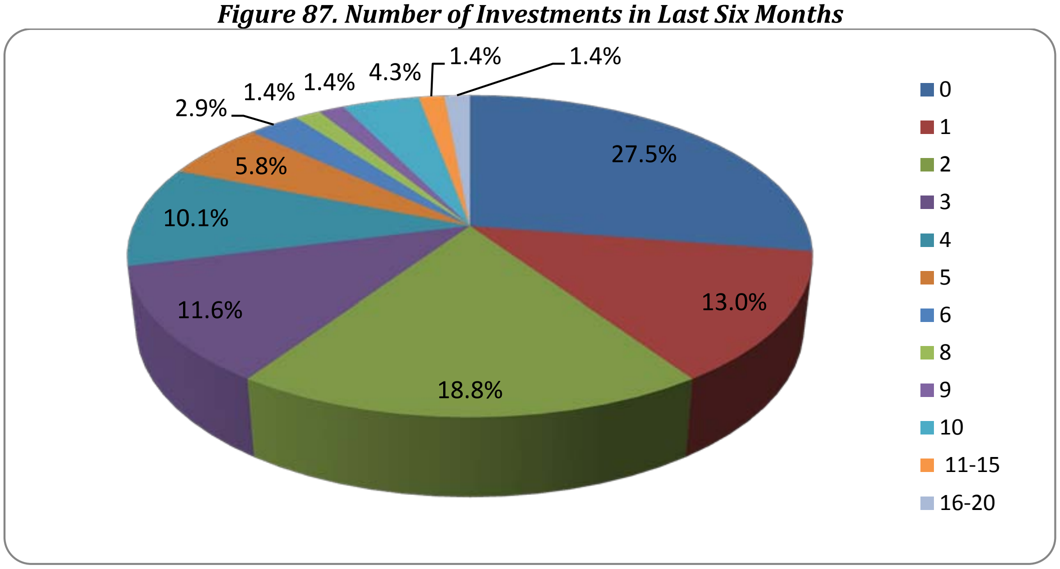
Current fund sizes vary considerably but the largest concentrations were reported in the ranges of $5 million to $50 million (35.2% of responses), $50 million to $100 million (25.4% of responses), and $100 million to $200 million (19.7% of responses).

Figure 86. Sizes of Current Funds



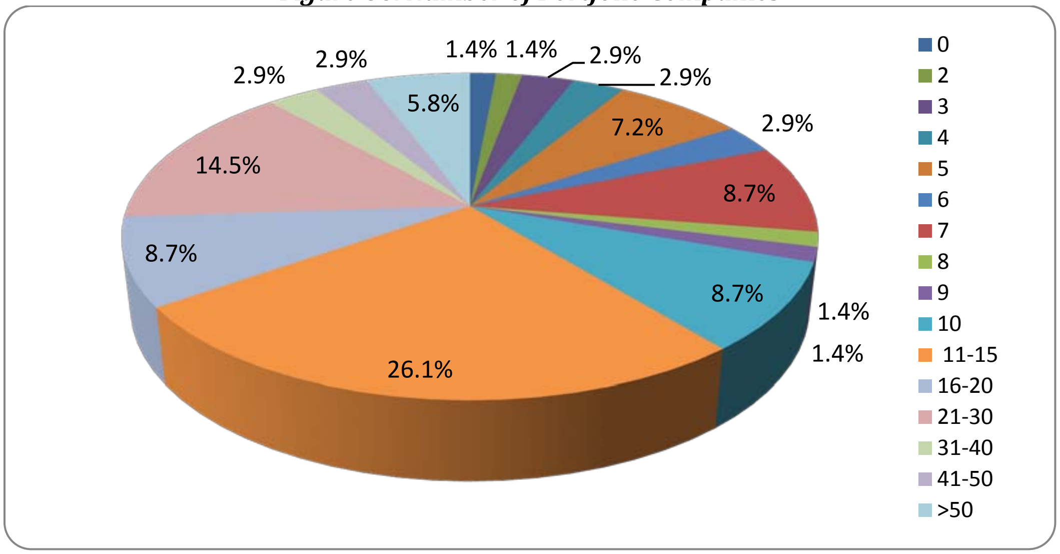
Most respondents indicate having made fewer than three investments in the prior six months. Nearly 27.5% reported making no investments while 13.0% made one investment, and another 18.8% made two.

Figure 87. Number of Investments in Last Six Months



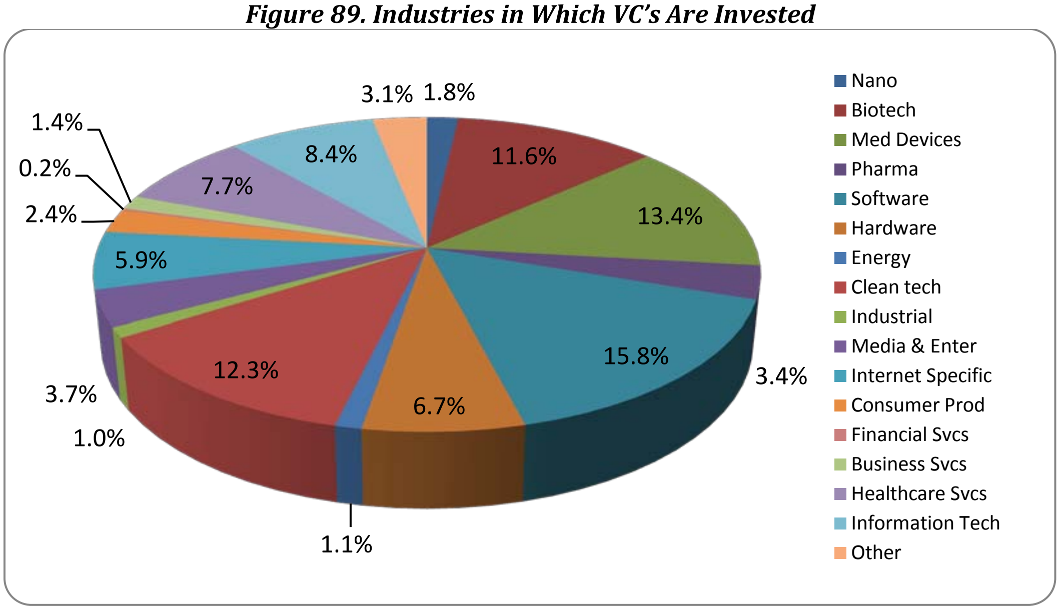
Venture capital funds report having a number of portfolio companies in their fund. Most respondents indicate having 15 or fewer. The largest concentration reported is in the 11-15 range with approximately 26.1% of funds reporting this category.

Figure 88. Number of Portfolio Companies



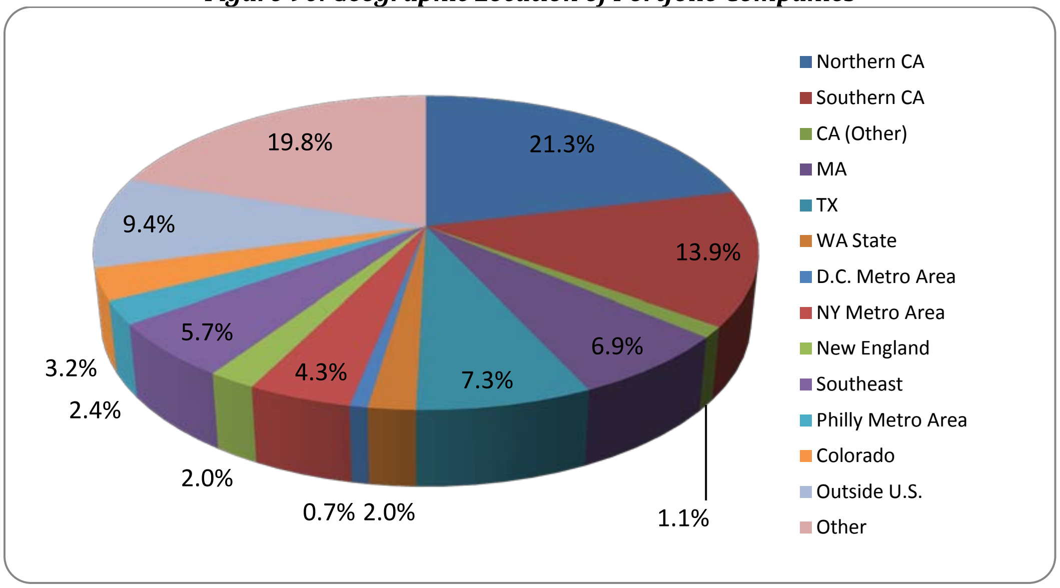
Respondents indicate investing in a variety of business industries. Current investments are in software (15.8%), medical devices (13.4%), clean technology (12.3%), biotech (11.6%), and others.

Figure 89. Industries in Which VC's Are Invested



Respondents indicate that the largest concentration of portfolio companies is located in Northern California (21.3%) while 13.9% of companies are in Southern California. Approximately 7.3% are located in Texas, and 6.9% are in Massachusetts.

Figure 90. Geographic Location of Portfolio Companies



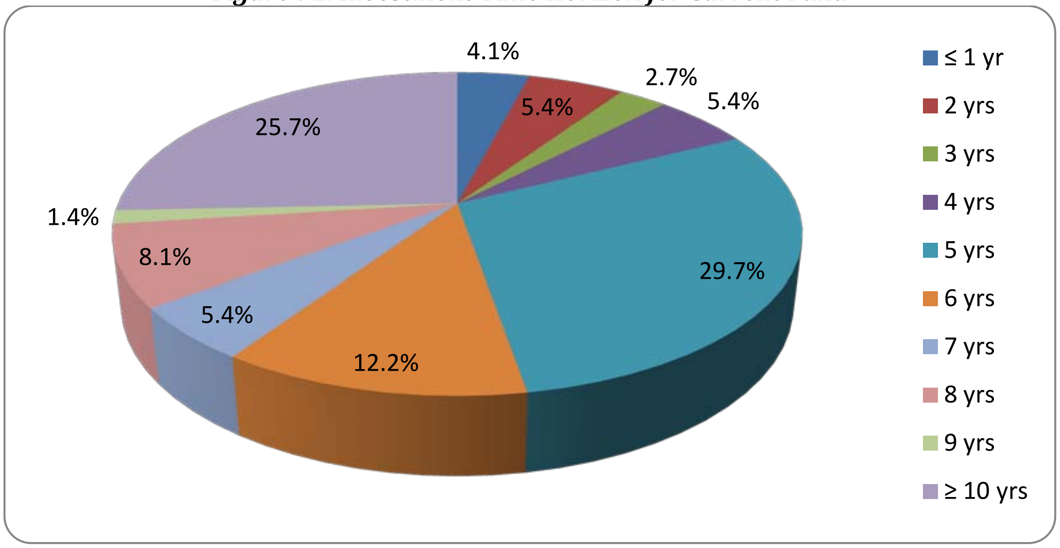
Our survey respondents indicate their firms invest in companies at various stages of their life cycles. The largest concentration reported was Stage 4 with approximately 27.2% followed by Stage 2 with 19.7%.

Table 59. Stages of Companies in Which Investments Are Made

Answer	Average Value
Stage 1 (no product revenues to date and limited expense history, typically and incomplete management team with an idea, plan, and possibly some initial product development.)	18.3%
Stage 2 (still no product revenue but substantive expense history, as product development is underway and challenges are thought to be understood.)	19.7%
Stage 3 (significant progress in product development; key development milestones met and development is near completion, but generally no product revenue.)	18.4%
Stage 4 (additional key development milestones met and some product revenue, but still operating at a loss.)	27.2%
Stage 5 (product revenue and operating profitability or breakeven/positive cash flows.)	12.9%
Stage 6 (established financial history of profitable operations or generation of positive cash flows.)	3.5%

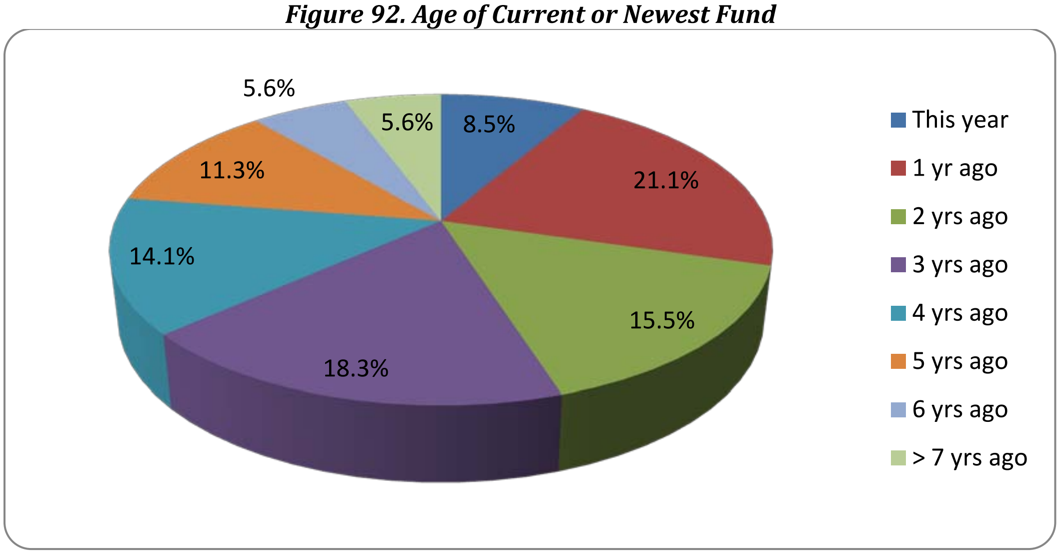
Respondents report the largest concentration of investment time horizon for the current fund is approximately five years (29.7%) while 25.7% indicate a horizon greater than 10 years, and another 12.2% responded with six years.

Figure 91. Investment Time Horizon for Current Fund



The most recent or current fund was launched one year ago according to 21.1% of firms. Another 18.3% report a launch of three years ago while nearly 15.5% were started two years ago.

Figure 92. Age of Current or Newest Fund



Respondents report varying levels of experience in the venture capital industry. Nearly 20.6% of respondents report having venture capital experience in the two- to five-year range, while 31.7% have logged in five to 10 years, and another 27% indicate 10 to 20 years.

Table 60. Years of Experience in Venture Capital

	You individually	Your firm
< 1 yr	0.0%	1.6%
1-2 yrs	6.3%	1.6%
2-5 yrs	20.6%	6.3%
5-10 yrs	31.7%	28.6%
10-20 yrs	27.0%	31.7%
> 20 yrs	14.3%	28.6%
N/A	0.0%	1.6%

Nearly 68.6% of respondents report they assisted other startups prior to working in venture capital. Less than half (45.1%) launched their own entrepreneurial venture while just 15.2% purchased and operated an existing company. Approximately 61.1% of respondents worked in corporate finance prior to joining a venture capital firm.

Table 61. Types of Experience Prior to Venture Capital

	Yes	No
Launch your own entrepreneurial venture?	45.1%	54.9%
Purchase and operate an existing company?	15.2%	84.8%
Assist other startups with their development?	68.6%	31.4%
Work as a scientist?	25.5%	74.5%
Work in corporate finance?	61.1%	38.9%
Work as an attorney?	13.3%	86.7%
Work as an artist in some form?	2.3%	97.7%
Work as a behavioral scientist?	4.5%	95.5%

Operational and Investment Characteristics

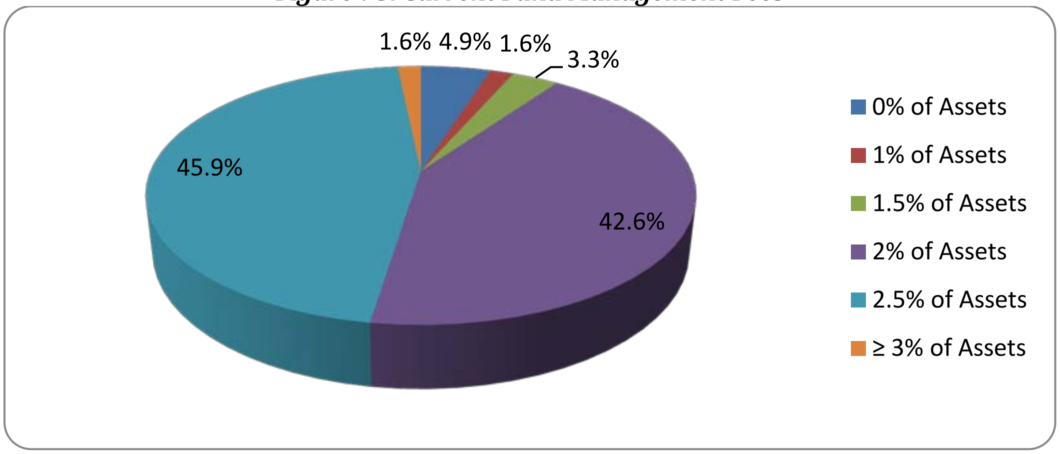
We asked respondents to report on various operational and industry items as compared to six months ago. Significant increases were reported in the number of business plans received, number of high- quality investment prospects, expected time to exit investments, and quality of portfolio. Significant declines were reported for the following categories: percentage of "up" rounds, percentage of business plans funded, size of venture capital industry, appetite for risk, and fundraising prospects. Respondents also report relative declines in the expected sales to total venture investment ratios and average investment sizes.

Table 62. Operational Overview: Now Versus Six Months Ago

	Increased	**Decreased**	**Stayed about the same**
Number of business plans received	47.7%	22.7%	29.5%
Number of high-quality investment prospects	45.5%	25.0%	29.5%
Percentage of "up" rounds	11.4%	65.9%	22.7%
Percentage of business plans funded	4.5%	59.1%	36.4%
Average investment size	11.4%	29.5%	59.1%
Expected sales to TVI ratios	16.3%	27.9%	55.8%
Expected exit time	61.4%	9.1%	29.5%
Size of venture capital industry	4.5%	90.9%	4.5%
Appetite for risk	6.8%	72.7%	20.5%
Quality of portfolio	45.5%	25.0%	29.5%
Fundraising prospects	14.0%	60.5%	25.6%
International capital flight	25.0%	7.5%	67.5%

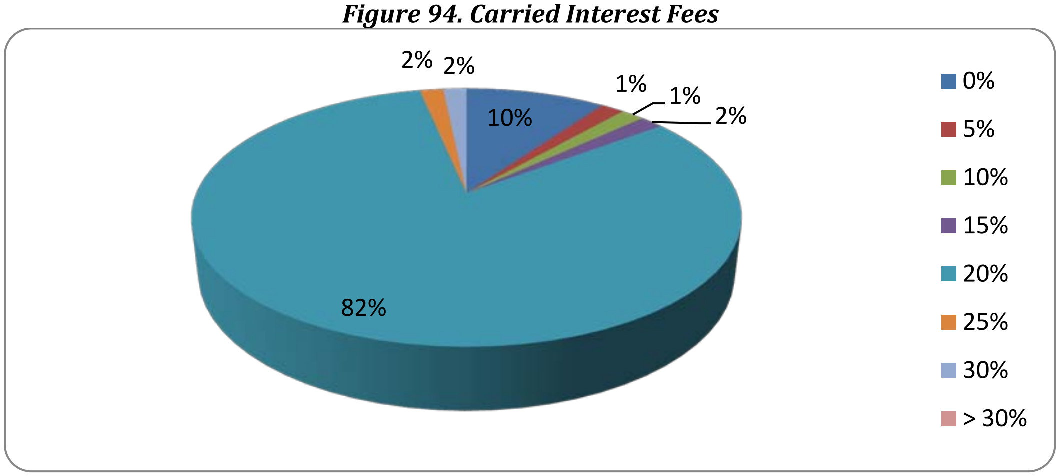
Nearly 45.9% of respondents report charging a management fee of 2.5% of assets while another 42.6% charge 2% of assets.

Figure 93. Current Fund Management Fees



The carried interest fee of 20% is reported by approximately 82% of respondents. Nearly 10% report charging no carry while approximately 2% indicate charging a fee of 25%, and another 2% charge 30%.

Figure 94. Carried Interest Fees



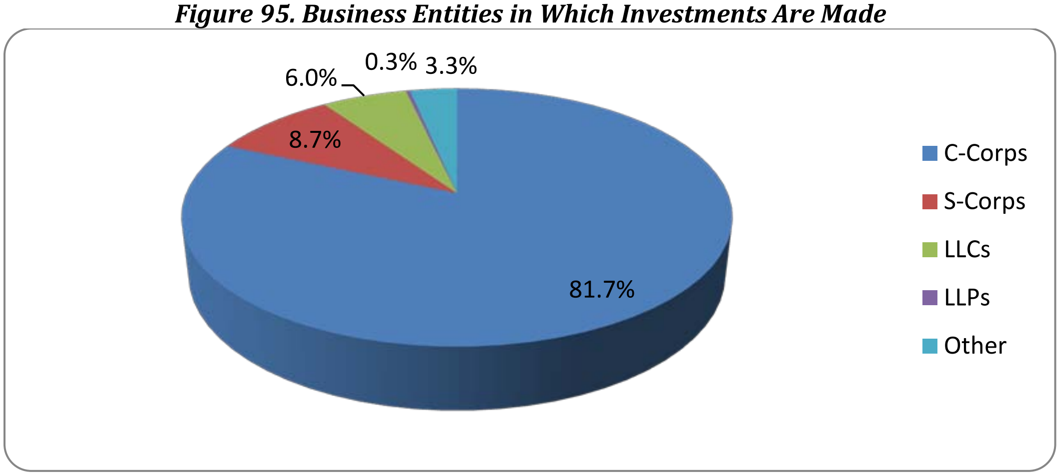
Approximately 15.8% of respondents report a typical investment of less than $1 million, 24.6% report $1 million to $2 million, 33.3% indicate $2 million to $5 million, and 24.6% invest between $5 million and $10 million.

Table 63. Investment Amounts per Deal

	Minimum	Maximum	Typical
< $1M	48.0%	7.4%	15.8%
$1-2M	26.0%	16.7%	24.6%
$2-5M	26.0%	22.2%	33.3%
$5-10M	0.0%	22.2%	24.6%
$10-20M	0.0%	25.9%	1.8%
$20-50M	0.0%	3.7%	0.0%
$50-100M	0.0%	1.9%	0.0%
>$100M	0.0%	0.0%	0.0%

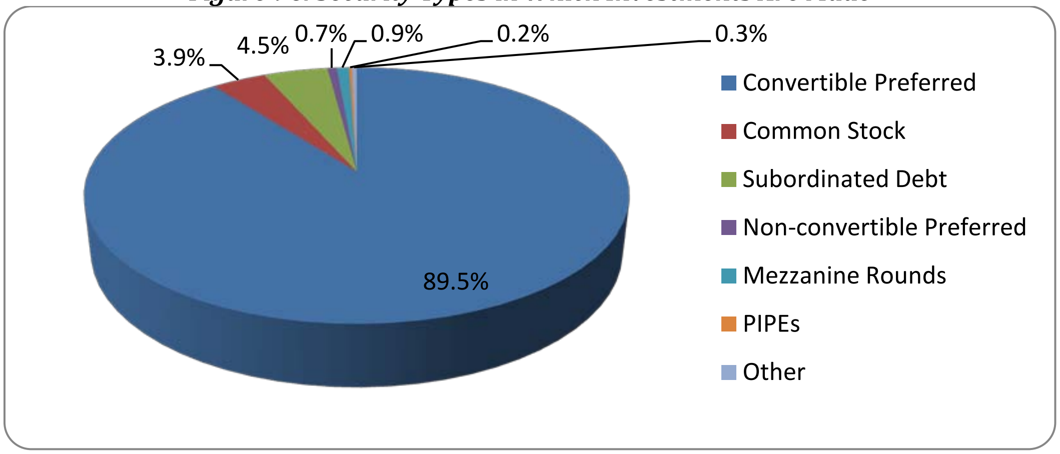
Most investments are made in C-corporations (81.7%) while 8.7% are made in S-corporations, and another 6% are made in limited liability companies.

Figure 95. Business Entities in Which Investments Are Made



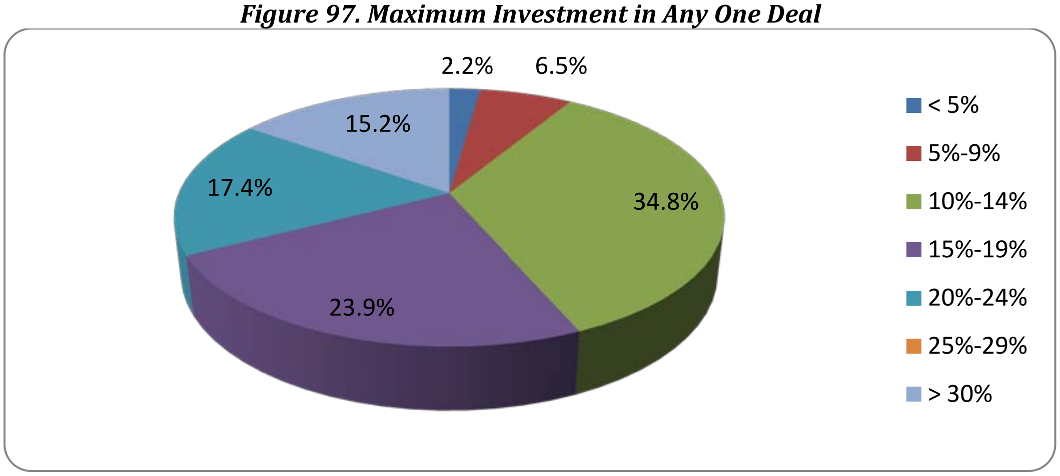
Approximately 89.5% of respondents report making investments in convertible preferred stock while 3.9% invest in common stock.

Figure 96. Security Types in Which Investments Are Made



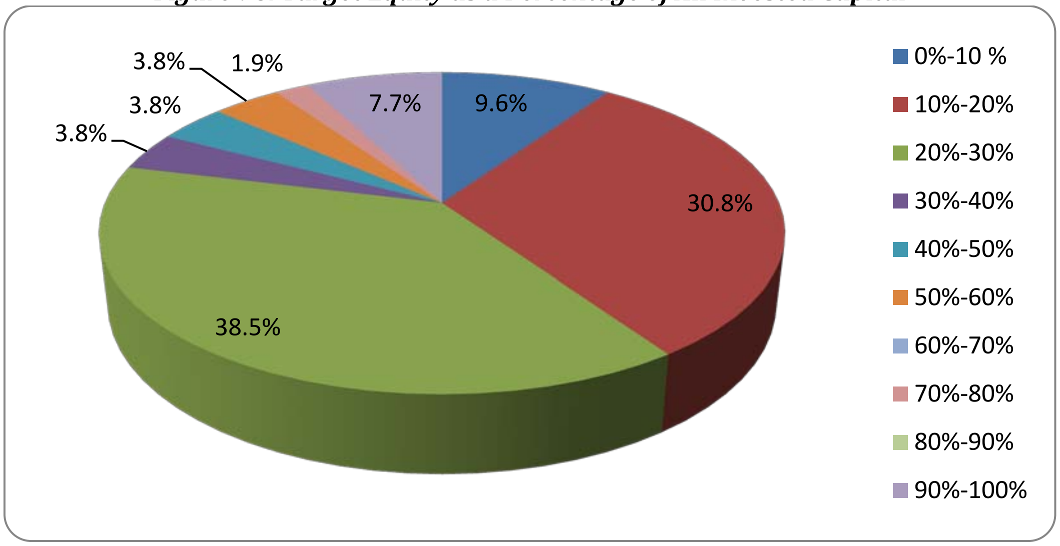
The investment policy or fund charter specifies the maximum investment percentage that can go into any one deal. The largest concentration of responses was in the 10-14% range followed by 15-19%, and then 20 - 24%.

Figure 97. Maximum Investment in Any One Deal



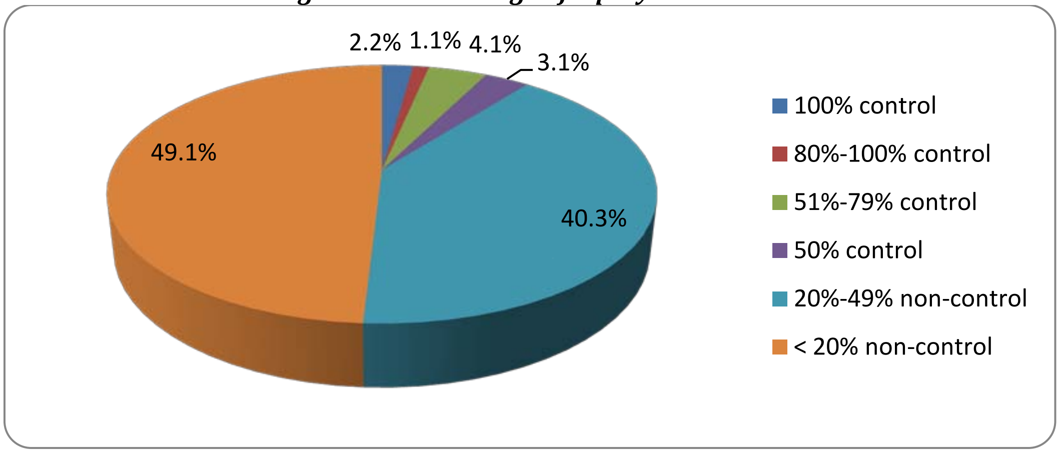
Respondents indicate the target equity percentage as a percentage of all invested capital in the capital structure is most frequently between 10% and 30%. Approximately 30.8% of respondents report a range of between 10 and 20% while another 38.5% indicate a range between 20 and 30%.

Figure 98. Target Equity as a Percentage of All Invested Capital



Most equity investments made by venture capital firms are minority interests and range up to 49% ownership. Approximately 40.3% report taking equity stakes in the range of 20-49% while another 49.1 indicate less than 20%.

Figure 99. Percentage of Equity Purchased



Approximately 94.1% of respondents indicate that they are willing to invest in minority equity interests with investor protections. Just 5.4% of respondents report their willingness to invest without investor protections such as shareholder agreements, buy/sell agreements, and employment agreements.

Table 64. Willingness to Invest in Minority Equity Interests

	Yes	**No**
With investor protections (shareholder agreement, buy/sell, and employment agreements)	94.1%	5.9%
Without investor protections	5.4%	94.6%

The median discount from pro rata equity value applied for taking a minority equity position with investor protections is 20%.

Table 65. Discount from Pro Rata for Investing in Minority Equity Interests

Discount from pro rata	
0.0%	1st quartile
20.0%	Median
27.5%	3rd quartile

Respondents report that certain minimum revenue growth rates are targeted for new investments. These rates are identified in the following table and are classified by stage of investment.

Table 66. Minimum Annual Revenue Growth Rates for New Investments

	< 10 %	**10-20%**	**20-30%**	**30-40%**	**40-50%**	**50-60%**	**60-70%**	**70-80%**	**> 100%**
Stage 1 (no revenue, incomplete team, idea)	16.7%	5.6%	0.0%	22.2%	16.7%	11.1%	5.6%	5.6%	16.7%
Stage 2 (no revenue, expense hist. , some product dev.)	8.0%	4.0%	8.0%	24.0%	16.0%	8.0%	8.0%	4.0%	20.0%
Stage 3 (no revenue, product dev. near completion)	4.3%	4.3%	17.4%	30.4%	4.3%	4.3%	13.0%	8.7%	13.0%
Stage 4 (revenues, operating at loss)	0.0%	0.0%	19.4%	35.5%	19.4%	9.7%	6.5%	6.5%	3.2%
Stage 5 (revenues, near breakeven or operationally profitable)	0.0%	10.7%	32.1%	25.0%	17.9%	0.0%	14.3%	0.0%	0.0%
Stage 6 (revenues, hist. of profitability or positive cash flows)	0.0%	14.3%	38.1%	19.0%	0.0%	19.0%	0.0%	9.5%	0.0%

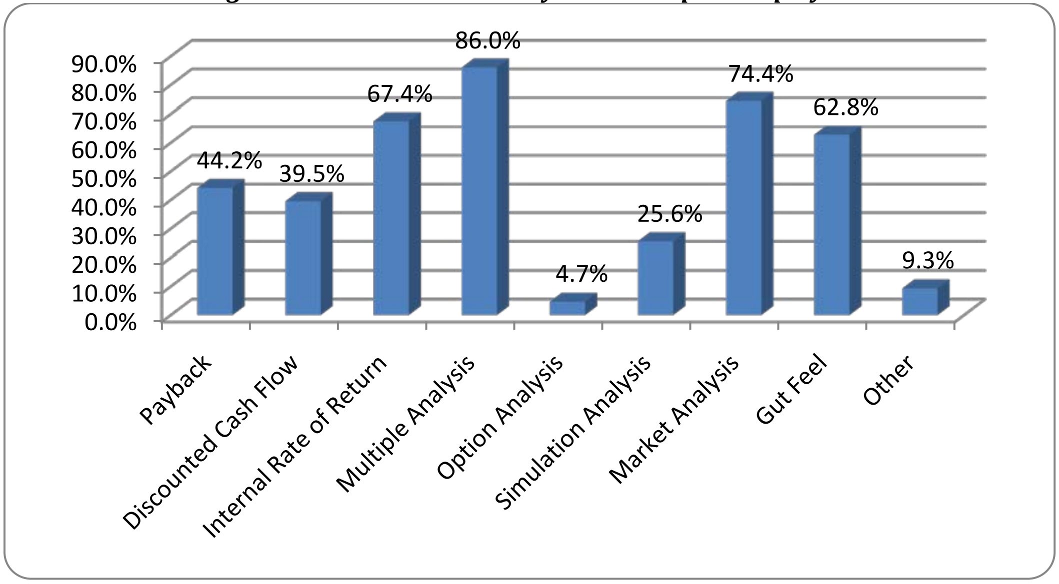
Respondents also report that certain minimum EBITDA growth rates are targeted for new investments. These rates are identified in the following table and are classified by stage of investment.

Table 67. Minimum Annual EBITDA Growth Rates for New Investments

	< 10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-100%	> 100%	N/A
Stage 1 (no revenue, incomplete team, idea)	10.0%	3.3%	3.3%	6.7%	16.7%	6.7%	0.0%	0.0%	3.3%	10.0%	40.0%
Stage 2 (no revenue, expense hist., some product dev.)	11.1%	2.8%	0.0%	13.9%	13.9%	5.6%	0.0%	0.0%	5.6%	5.6%	41.7%
Stage 3 (no revenue, product dev. near completion)	11.8%	2.9%	5.9%	14.7%	5.9%	2.9%	2.9%	2.9%	5.9%	2.9%	41.2%
Stage 4 (revenues, operating at loss)	6.1%	6.1%	9.1%	18.2%	12.1%	9.1%	6.1%	6.1%	3.0%	3.0%	21.2%
Stage 5 (revenues, near breakeven or operationally profitable)	6.7%	6.7%	30.0%	16.7%	6.7%	6.7%	0.0%	3.3%	3.3%	0.0%	20.0%
Stage 6 (revenues, hist. of profitability or positive cash flows)	0.0%	19.2%	15.4%	19.2%	7.7%	7.7%	3.8%	0.0%	0.0%	0.0%	26.9%

Respondents were asked about investment analysis techniques and reported that multiple analysis is used most frequently (86%) followed by market analysis (74.4%) and internal rate of return (67.4%). The influence of gut feel is acknowledged by nearly 62.8% of respondents.

Figure 100. Investment Analysis Techniques Employed

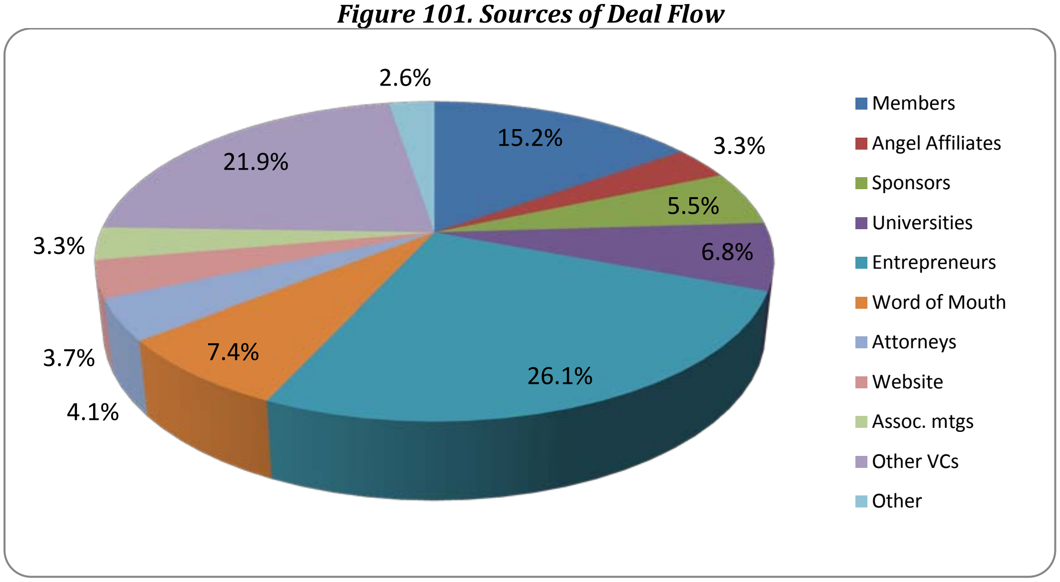


Survey participants who acknowledge the influence of gut feel were asked to explain what it meant to them. The responses were generally categorized as the following:

- Knowledge of and experience with industry, competitors, and products
- Feeling that company will be important (big winner) in the next five to seven years
- Are customers likely to make this solution a budget priority?
- Knowledge of relevant value chains and earnings models
- Familiarity, experience, and confidence with current market and historical exits
- Experience with pricing VC deals
- Confidence in management team (experience, believability, level of commitment, repeat entrepreneurs)
- Chemistry with management team
- Who are the other VCs and capital providers involved?
- A general good feeling and intuition about the relevant factors that are not quantifiable

Respondents report that the largest concentration of referrals come from entrepreneurs (26.1%) followed by other venture capital firms (21.9%) and members (15.2%).

Figure 101. Sources of Deal Flow



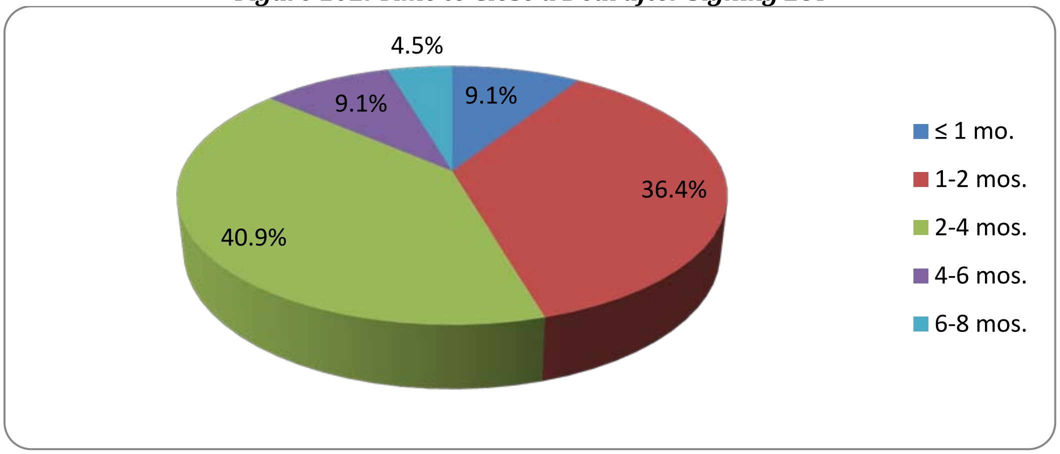
In order to close one deal, the typical respondent reports reviewing 100 business plans, conducting 20 meetings with principals, issuing two term sheets, and signing one letter of intent.

Table 68. Activities to Close One Deal

Bus. plans or memos are rec'd	Mtgs with principals are conducted	Term sheets are issued	Ltrs of intent are signed	
50	10	2	1	1st quartile
100	20	2	1	Median
100	27.5	3	1.6	3rd quartile

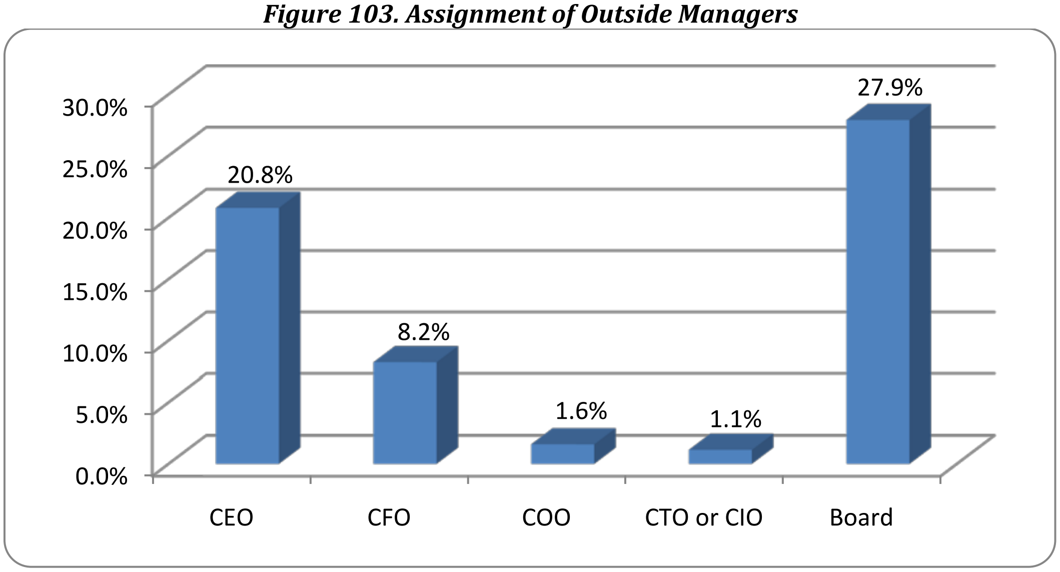
Most of the deals are closed within four months of signing a letter of intent. Approximately 36.4% report one to two months, and 40.9% report two to four months.

Figure 102. Time to Close a Deal after Signing LOI



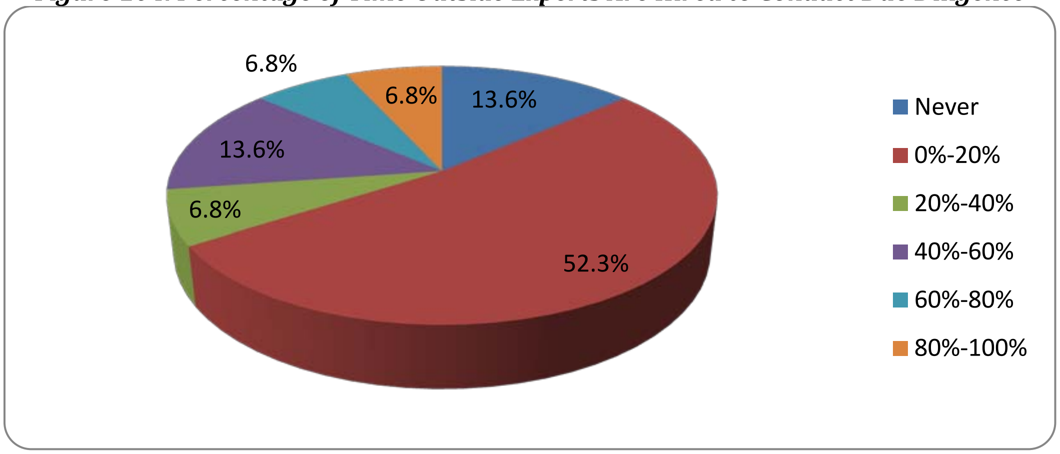
Respondents report occasionally making managerial changes when investing in new companies. In particular, 27.9% of the time a board member is assigned while the CEO is assigned 20.8% of the time.

Figure 103. Assignment of Outside Managers



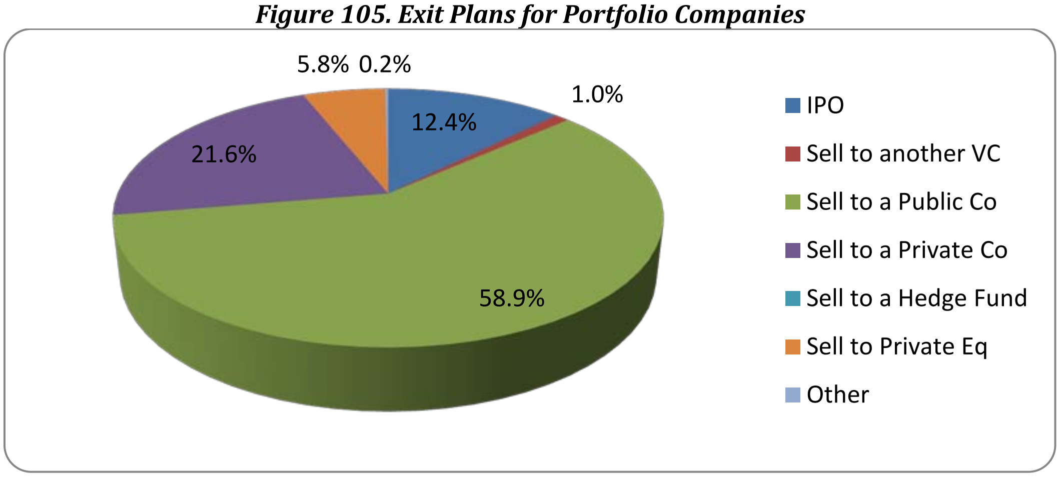
Venture capital firms infrequently hire outside experts to conduct their due diligence. The majority of respondents indicate this frequency is less than 20%.

Figure 104. Percentage of Time Outside Experts Are Hired to Conduct Due Diligence



Regarding exit plans for portfolio companies, 58.9% report an intention to sell to a public company while 21.6% indicate plans to sell to a private company, and another 12.4% anticipate an initial public offering.

Figure 105. Exit Plans for Portfolio Companies



Returns and Exit Data

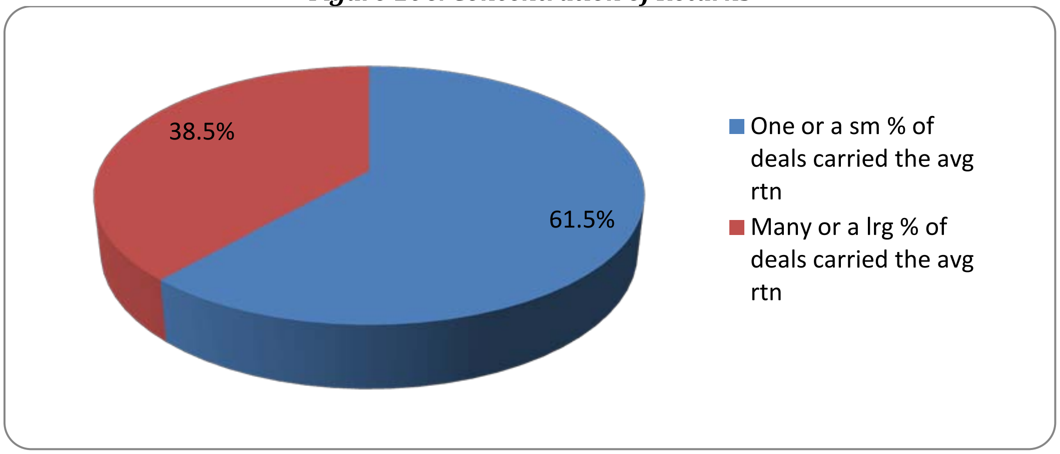
Respondents were asked about their actual realized return on investment (IRR) on a pre-tax basis for the last closed fund and reported 20% (median).

Table 69. Return on Last Closed Fund

Pre-tax return %	
15.0%	1st quartile
20.0%	Median
30.0%	3rd quartile

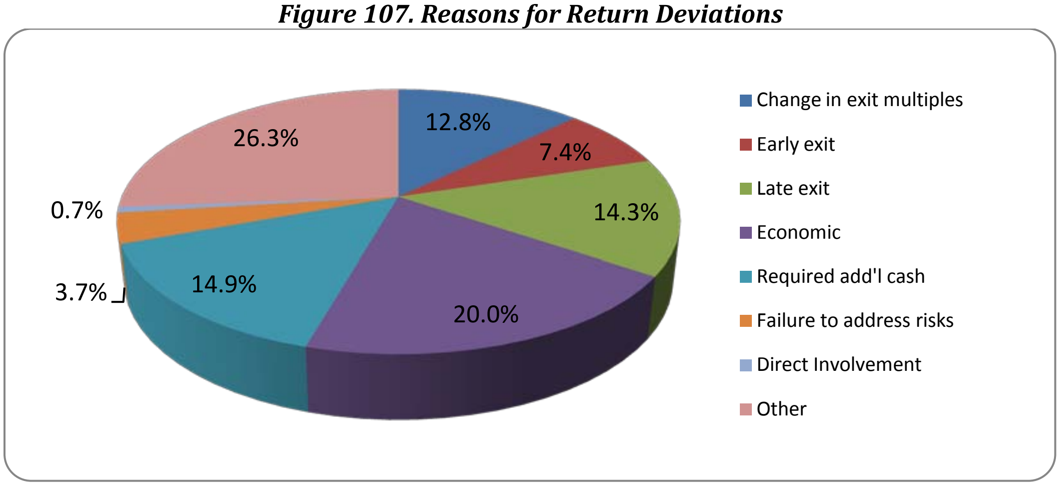
Regarding their last fund, 61.5% of respondents report that one or a small number of investments carried the average return while 38.5% indicate that many investments contributed to the average return.

Figure 106. Concentration of Returns



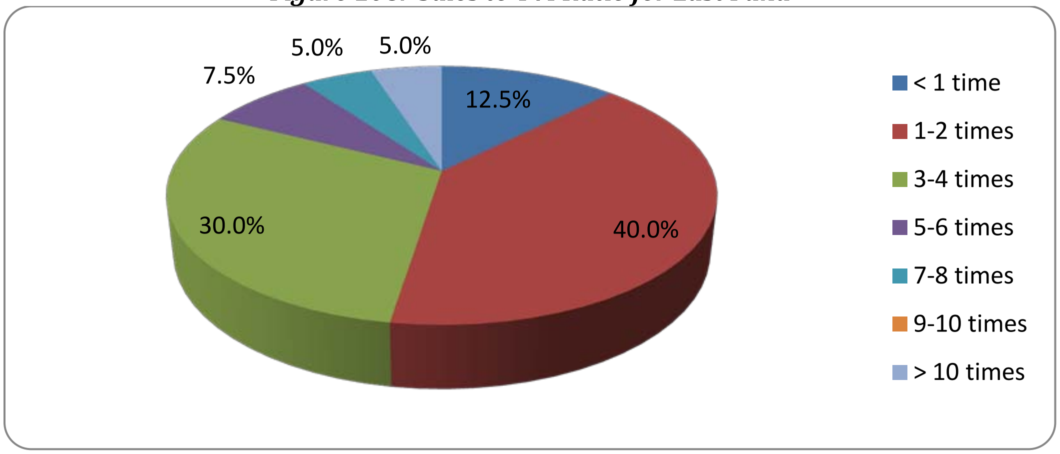
In the case where actual returns deviated from the hurdle rates, economic influences (20%), necessary unplanned additional investments (14.9), and late exits (14.3%) were cited as identifiable reasons.

Figure 107. Reasons for Return Deviations



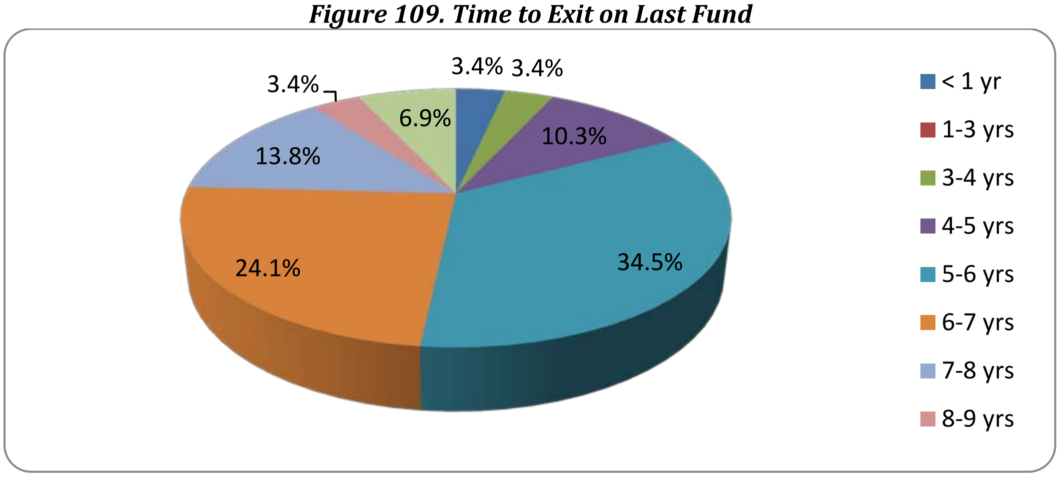
Regarding the ratio of sales to total venture investment on the last fund, approximately 40% reported earning 1-2X while another 30% indicated 3-4X.

Figure 108. Sales to TVI Ratio for Last Fund



Approximately 34.5% of respondents reported the weighted average time from initial investment to exit on the last fund was five to six years while 24.1% indicated six to severn years, and another 13.8% identified seven to eight years.

Figure 109. Time to Exit on Last Fund



Respondents indicated, regarding their last fund, the following sales prices to total venture investment ratios by stage. Funds reported that "Did not sell or worthless" ranged from 12.1% of the portfolio for Stage 5 investments to 25.7% of investments for Stage 1. Other returns are listed below.

Table 70. Sales to TVI Ratios by Stage for Last Fund

	Didn't sell or wrthls	1-2X	3-4X	5-6X	7-8X	9-10X	11-12X	13-14X	15-20X	20-25X	>25X
Stage 1 (no revenue, incomplete team, idea)	25.7%	14.3%	8.6%	17.1%	0.0%	5.7%	5.7%	0.0%	0.0%	2.9%	20.0%
Stage 2 (no revenue, expense hist., some product dev.)	20.0%	17.1%	17.1 %	14.3%	2.9%	5.7%	0.0%	2.9%	0.0%	0.0%	20.0%
Stage 3 (no revenue, product dev. near completion)	21.2%	12.1%	27.3 %	12.1%	0.0%	9.1%	0.0%	0.0%	0.0%	0.0%	18.2%
Stage 4 (revenues, operating at loss)	13.9%	33.3%	27.8 %	13.9%	0.0%	2.8%	0.0%	0.0%	0.0%	0.0%	8.3%
Stage 5 (revenues, near break- even or operationally profitable)	12.1%	36.4%	27.3 %	6.1%	3.0%	0.0%	0.0%	0.0%	0.0%	3.0%	12.1%
Stage 6 (revenues, hist. of profitability or positive cash flows)	16.0%	28.0%	16.0 %	4.0%	0.0%	8.0%	0.0%	0.0%	0.0%	4.0%	24.0%

Respondents also reported the following times to exit for the last fund by stage of investment.

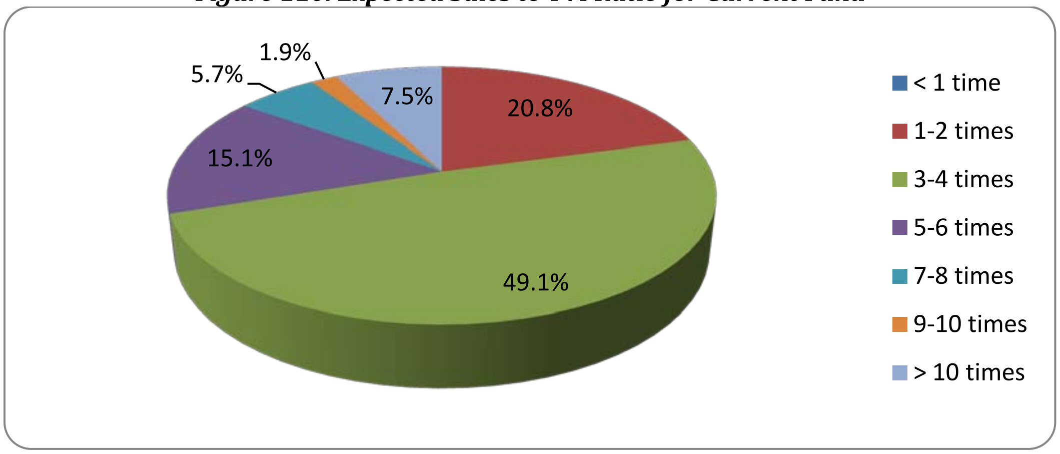
Table 71. Time to Exit by Stage for Last Fund

	Didn't sell/wrthls	0-1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5-6 yrs
Stage 1 (no revenue, incomplete team, idea)	23.7%	0.0%	0.0%	0.0%	0.0%	10.5%	5.3%
Stage 2 (no revenue, expense hist., some product dev.)	22.2%	0.0%	0.0%	0.0%	2.8%	11.1%	13.9%
Stage 3 (no revenue, product dev. near completion)	22.9%	0.0%	0.0%	2.9%	0.0%	17.1%	8.6%
Stage 4 (revenues, operating at loss)	11.8%	2.9%	0.0%	5.9%	14.7%	20.6%	5.9%
Stage 5 (revenues, near breakeven or operationally profitable)	13.3%	0.0%	3.3%	10.0%	16.7%	20.0%	13.3%
Stage 6 (revenues, history of profitability or positive cash flows)	15.4%	0.0%	11.5%	23.1%	7.7%	7.7%	15.4%

	6-7 yrs	7-8 yrs	8-9 yrs	9-10 yrs	11-12 yrs	13+ yrs
Stage 1 (no revenue, incomplete team, idea)	21.1%	15.8%	7.9%	13.2%	2.6%	0.0%
Stage 2 (no revenue, expense hist., some product dev.)	25.0%	8.3%	11.1%	5.6%	0.0%	0.0%
Stage 3 (no revenue, product dev. near completion)	17.1%	17.1%	5.7%	8.6%	0.0%	0.0%
Stage 4 (revenues, operating at loss)	14.7%	11.8%	5.9%	5.9%	0.0%	0.0%
Stage 5 (revenues, near breakeven or operationally profitable)	13.3%	10.0%	0.0%	0.0%	0.0%	0.0%
Stage 6 (revenues, history of profitability or positive cash flows)	15.4%	3.8%	0.0%	0.0%	0.0%	0.0%

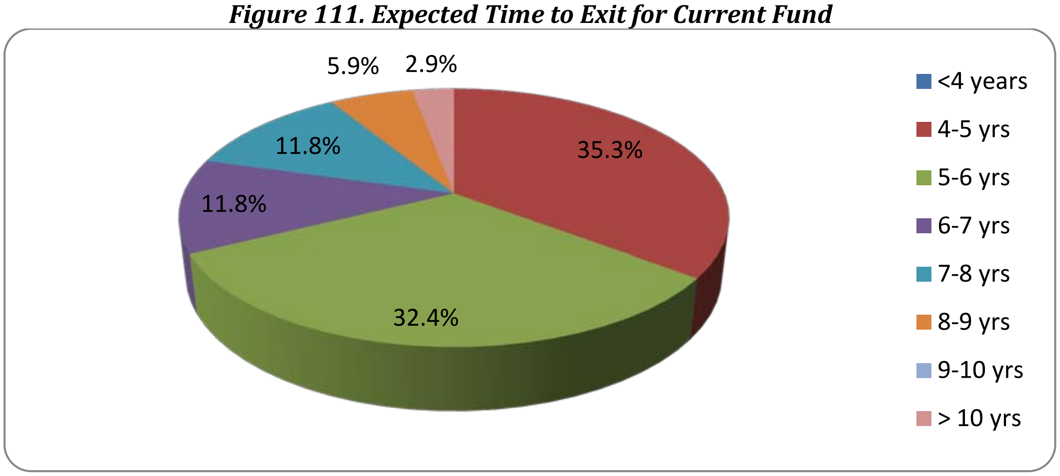
Regarding the current fund, approximately 49.1% report an expected weighted average sales to total venture investment ratio in the range of 3-4 times while 20.8% believe a payback of 1-2X is most likely, and another 15.1% report an expected multiple of 5-6 times.

Figure 110. Expected Sales to TVI Ratio for Current Fund



For the current fund, approximately 35.3% of respondents indicate an expected weighted average time from initial investment to exit for the entire portfolio of current investments to range from four to five years while 32.4% say five to six years, and another 11.8% indicate six to seven years.

Figure 111. Expected Time to Exit for Current Fund



Respondents indicate, regarding their current fund, the following sales prices to total venture investment ratios by stage. As expected, funds report consistently higher multiples for lower-stage companies. The expected returns are listed below.

Table 72. Sales to TVI Ratios by Stage for Current Fund

	1-2X	3-4X	5-6X	7-8X	9-10X	11-12X	13-14X	15-16X	17-18X	19-20X	20-25X	> 25X
Stage 1 (no revenue, incomplete team, idea)	4.7%	7.0%	14.0%	9.3%	23.3%	4.7%	0.0%	7.0%	0.0%	4.7%	4.7%	20.9%
Stage 2 (no revenue, expense hist., some product dev.)	2.2%	13.3%	15.6%	15.6%	22.2%	2.2%	4.4%	2.2%	4.4%	2.2%	2.2%	13.3%
Stage 3 (no revenue, product dev. near completion)	0.0%	9.3%	23.3%	14.0%	30.2%	4.7%	0.0%	2.3%	0.0%	2.3%	2.3%	11.6%
Stage 4 (revenues, operating at loss)	6.8%	22.7%	25.0%	15.9%	18.2%	0.0%	0.0%	0.0%	2.3%	0.0%	2.3%	6.8%
Stage 5 (revenues, near breakeven or operationally profitable)	10.8%	27.0%	37.8%	13.5%	2.7%	0.0%	0.0%	2.7%	0.0%	0.0%	2.7%	2.7%
Stage 6 (revenues, history of profitability or positive cash flows)	17.2%	37.9%	24.1%	3.4%	3.4%	0.0%	3.4%	0.0%	0.0%	3.4%	0.0%	6.9%

Respondents report below the expected times to exit for the current fund by stage of investment.

Table 73. Expected Time to Exit by Stage for Current Fund

	Didn't sell/ wrthls	0-1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5-6 yrs	6-7 yrs	7-8 yrs	8-9 yrs	9-10 yrs	>10 yrs
Stage 1 (no revenue, incomplete team, idea)	2.6%	0.0%	0.0%	0.0%	5.3%	10.5%	15.8%	31.6%	13.2%	2.6%	18.4%	0.0%
Stage 2 (no revenue, expense hist., some product dev.)	2.6%	0.0%	0.0%	0.0%	0.0%	13.2%	36.8%	18.4%	15.8%	5.3%	7.9%	0.0%
Stage 3 (no revenue, product dev. near completion)	2.6%	0.0%	0.0%	0.0%	10.5%	28.9%	28.9%	7.9%	10.5%	5.3%	5.3%	0.0%
Stage 4 (revenues, operating at loss)	0.0%	0.0%	2.4%	2.4%	24.4%	34.1%	17.1%	0.0%	7.3%	4.9%	7.3%	0.0%
Stage 5 (revenues, near breakeven or oper. profitable)	2.8%	0.0%	2.8%	13.9%	33.3%	16.7%	11.1%	8.3%	5.6%	0.0%	5.6%	0.0%
Stage 6 (revenues, history of profitability or positive cash flows)	3.7%	0.0%	11.1%	11.1%	22.2%	22.2%	7.4%	11.1%	3.7%	0.0%	7.4%	0.0%

Regarding current investments, the median responses for expected returns range from 36% to 45%.

Table 74. Implied Returns by Stage for All Investments in Current Fund

	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6
1st quartile	30.0%	26.8%	34.3%	32.1%	25.6%	31.0%
Median	37.6%	36.3%	43.6%	43.6%	36.3%	44.5%
3rd quartile	56.5%	46.1%	63.2%	61.2%	62.8%	64.3%

Regarding new investments made in the last six months, the median responses for sales to total venture investment ratios vary considerably by stage. Respondents report an expected Sales/TVI ratio of 9.5 for Stage 1 and Stage 2 investments and ratios of 5.5 for Stage 5 and Stage 6 investments.

Table 75. Expected Sales/TVI Ratios by Stage for New Investments Made in Last Six Months

	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6
1st quartile	7.5	6.5	5.5	3.5	3.5	3.5
Median	9.5	9.5	8.5	7.5	5.5	5.5
3rd quartile	21.5	15.5	9.5	9.5	7.5	6.5

Regarding new investments made in the last six months, the median responses for exit times range from 3.5 years for Stage 6 investments to 7.5 years for Stage 1 investments. Other details can be found in the table below.

Table 76. Expected Time to Exit by Stage for New Investments Made in Last Six Months

	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6
1st quartile	6.25	5.5	5.5	4.5	3.5	2.5
Median	7.5	6.5	6.5	5.5	4.5	3.5
3rd quartile	8.75	8.5	7.5	6.5	6.5	6.5

Regarding new investments made in the last six months, the median responses for expected returns range from 35% to 43%.

Table 77. Implied Returns for New Investments Made in Last Six Months

	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6
1st quartile	26.7%	26.7%	25.6%	30.0%	24.7%	19.6%
Median	35.8%	35.0%	41.4%	36.3%	39.7%	43.0%
3rd quartile	53.6%	40.3%	50.6%	50.6%	46.1%	64.5%

Respondents report that their hurdle rate for new investment is 30%. The median number is reported.

Table 78. Hurdle Rates

Hurdle rate (%)	
20.0%	1st quartile
30.0%	Median
36.0%	3rd quartile

Firms indicate they expect a pre-tax IRR of 30% on new investments in privately-held operating companies.

Table 79. Expected Returns on New Operating Company Investments

Expected annualized pre-tax gross return on new investment (IRR) (%)	
28.5%	1st quartile
30.0%	Median
38.8%	3rd quartile

Respondents expect an improvement in returns to limited partners over the next 12 months.

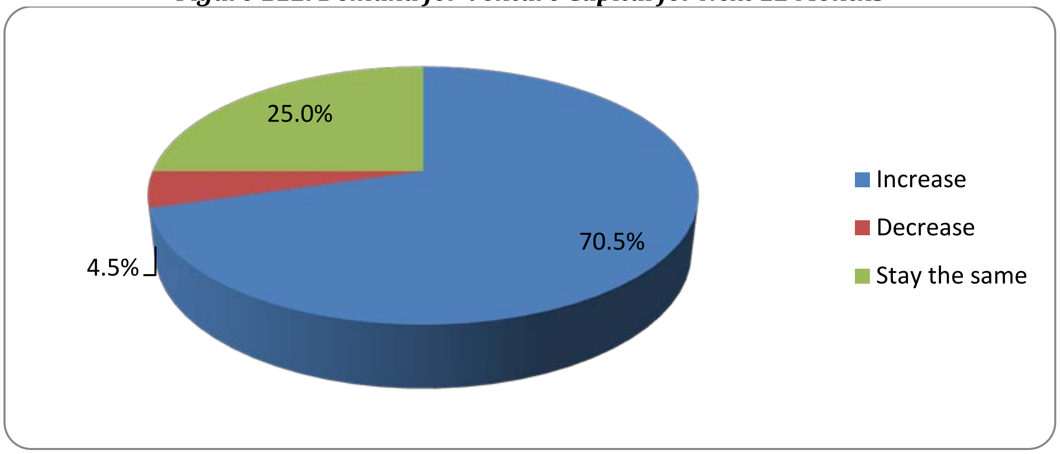
Table 80. Returns to Limited Partners: Last and Next 12 Months

Last 12 mos. (historical)	Next 12 mos. (expected)	
0.0%	10.0%	1st quartile
7.0%	15.0%	Median
16.0%	26.3%	3rd quartile

Industry and Economic Outlook

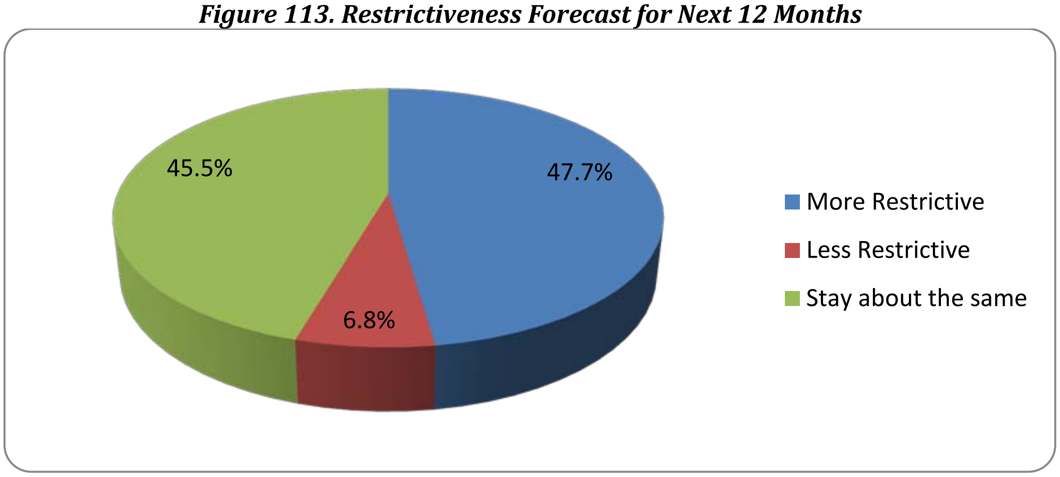
Respondents expect an increase in demand for venture capital over the next 12 months. Nearly 70.5% believe an increase is on the horizon.

Figure 112. Demand for Venture Capital for Next 12 Months



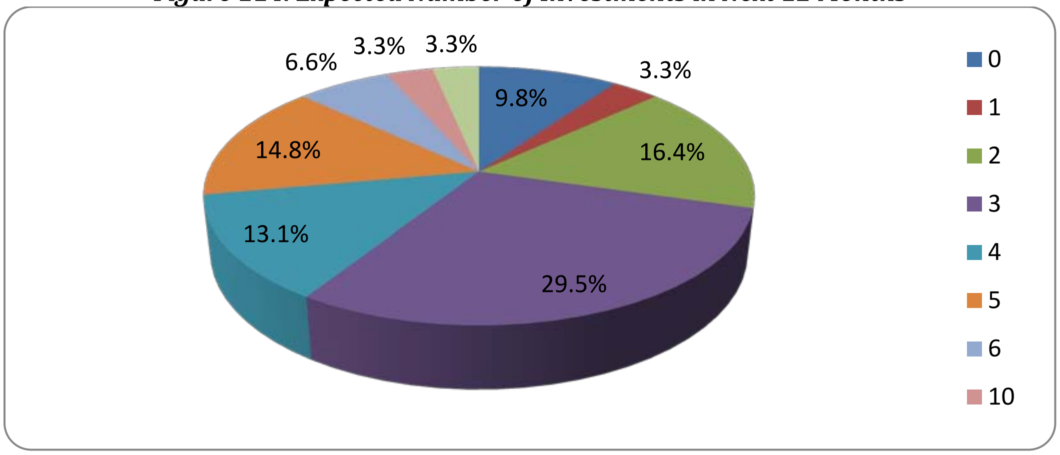
Nearly half (47.7%) of respondents believe venture capital investing over the next 12 months will be more restrictive while 45.5% believe it will stay about the same, and another 6.8% expect it to be less restrictive.

Figure 113. Restrictiveness Forecast for Next 12 Months



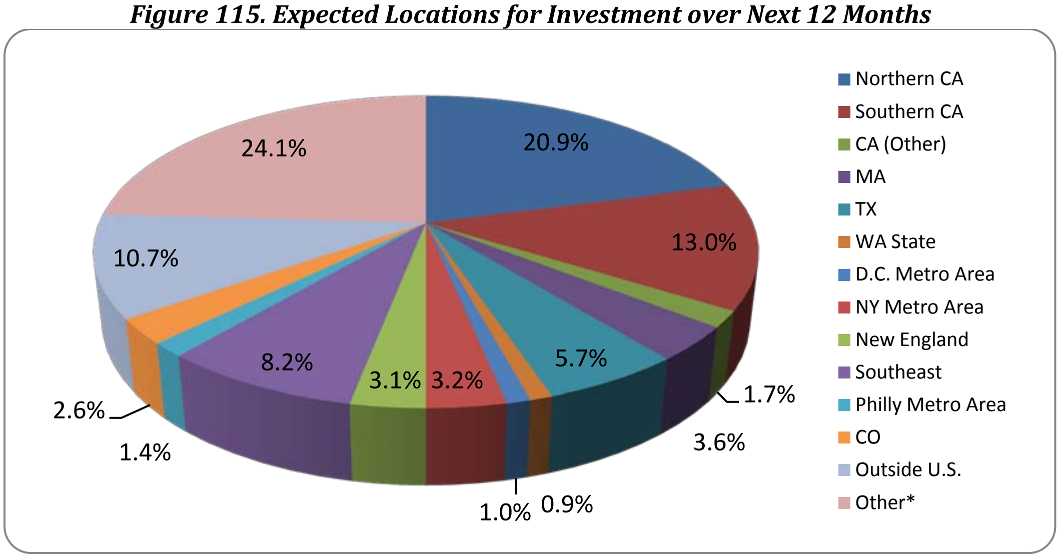
Nearly 29.5% of respondents expect to invest in three new ventures in the next 12 months while 16.4% anticipate making two investments, and another 14.8% are planning for an investment in five companies.

Figure 114. Expected Number of Investments in Next 12 Months



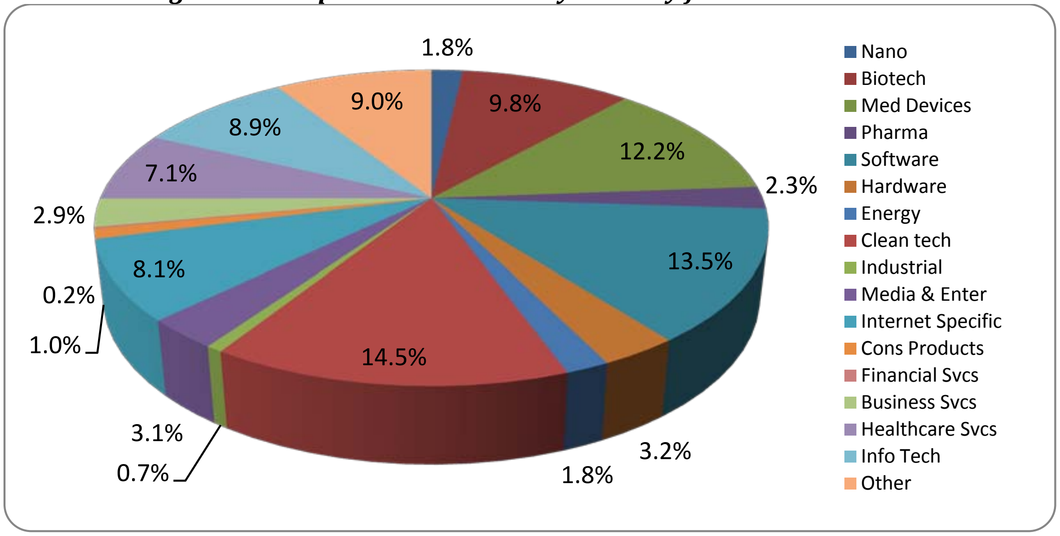
Respondents' funds are planning to invest more than 35% in California over the next 12 months while 10.7% is expected to be invested internationally, and another 8.2% will be invested in the southeast. Approximately 5.7% of investments will take place in Texas and another 2.6% is expected in Colorado.

Figure 115. Expected Locations for Investment over Next 12 Months



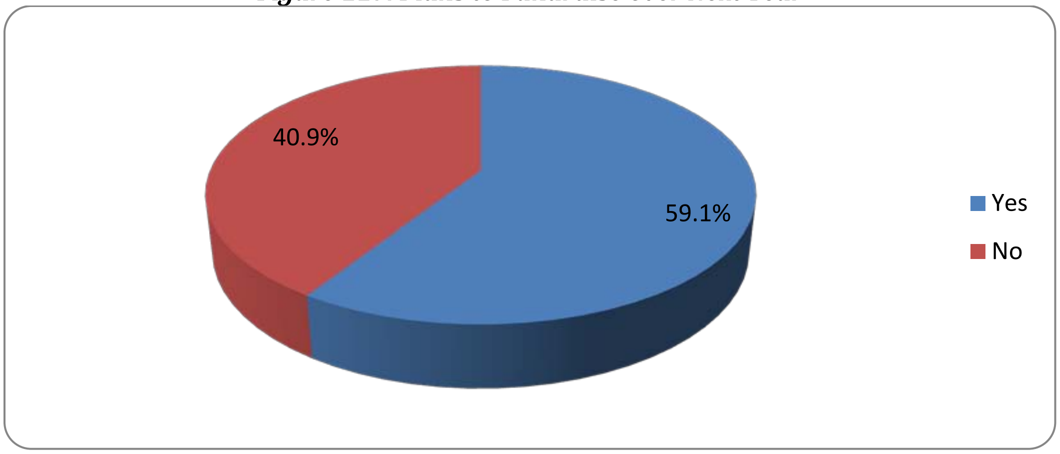
Respondents report investing the largest concentration of money in clean technology (14.5%) followed by software (13.5%), medical devices (12.2%), and biotech (9.8%).

Figure 116. Expected Investment by Industry for Next 12 Months



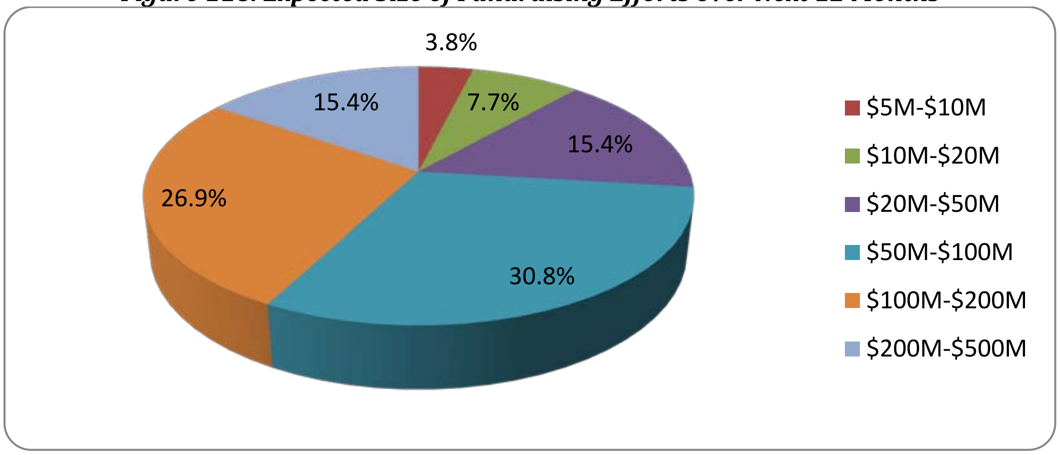
Approximately 59.1% of respondents report plans to fundraise over the next year while 40.9% do not.

Figure 117. Plans to Fundraise over Next Year



For those respondents who plan to raise funds over the next year, expected sizes vary considerably. The largest concentration is in the $50 million to $100 million range (30.8%) followed by $100 million to $200 million (26.9%).

Figure 118. Expected Size of Fundraising Efforts over Next 12 Months



Nearly 61.4% of respondents expect business conditions over the next 12 months will improve slightly while 22.7% believe conditions will be about the same.

Table 81. Expected Business Conditions over Next 12 Months

	Business conditions over next 12 mos.
Decline significantly	6.8%
Decline slightly	4.5%
Be about the same	22.7%
Improve slightly	61.4%
Improve significantly	4.5%

Respondents believe GDP will increase by 0.89% over the next 12 months while an equivalent measure for privately-held companies is expected to rise by 2.76%.

Table 82. GDP Expectations over Next 12 Months

	Expected GDP change (%)
Overall GDP	0.89%
Privately-held company equivalent GDP	2.76%

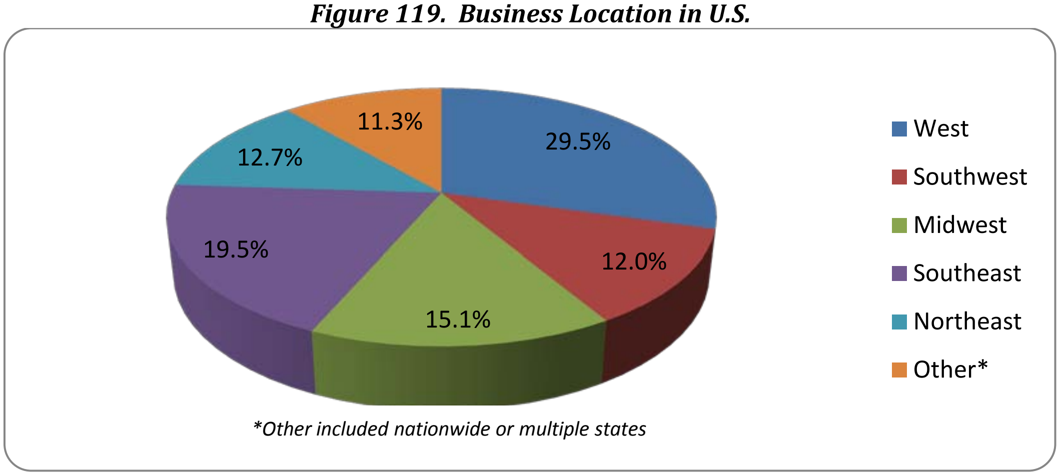
PRIVATELY-HELD BUSINESS SURVEY INFO

Profile of Respondents

The following responses pertain to our privately-held business survey administered in October/November 2009. Results are based upon 304 responses to this survey. The respondents are geographically dispersed throughout the United States.

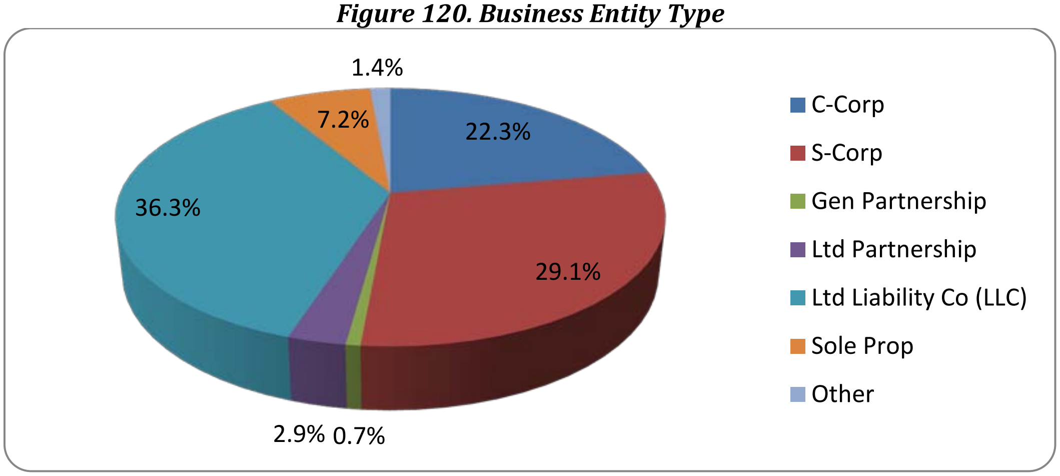
The largest concentration of respondents is located in the west (29.5%) followed by the southeast (19.5%) and midwest (15.1%).

Figure 119. Business Location in U.S.



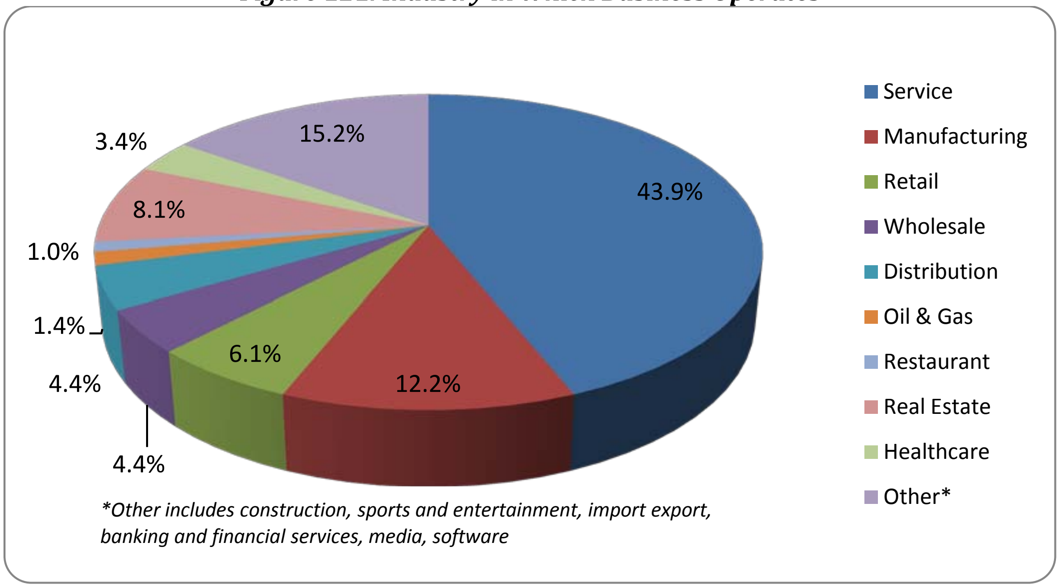
The largest concentration of business type is limited liability company (36.3%) followed by S-corporation (29.1%) and C-corporation (22.3%).

Figure 120. Business Entity Type



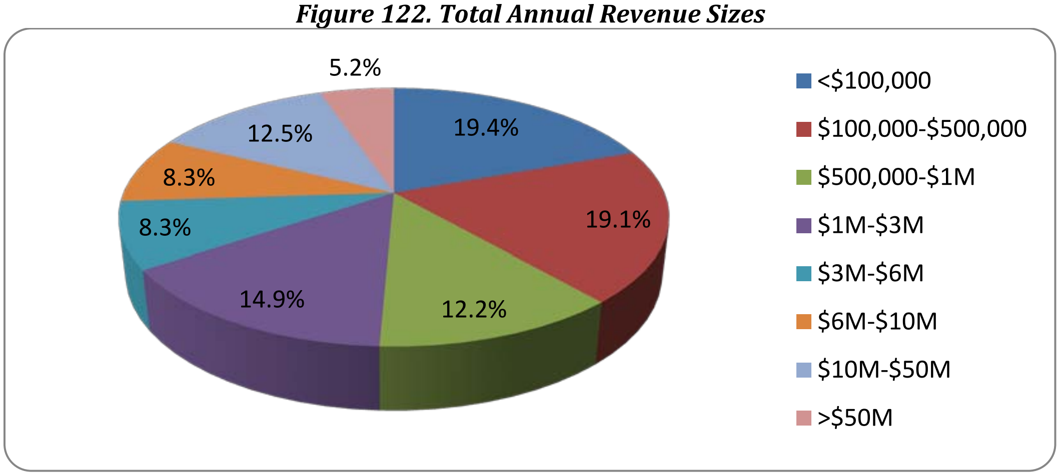
Approximately 43.9% of businesses are in the service industry followed by other (15.2%), manufacturing (12.2%), and real estate (8.1%).

Figure 121. Industry in Which Business Operates



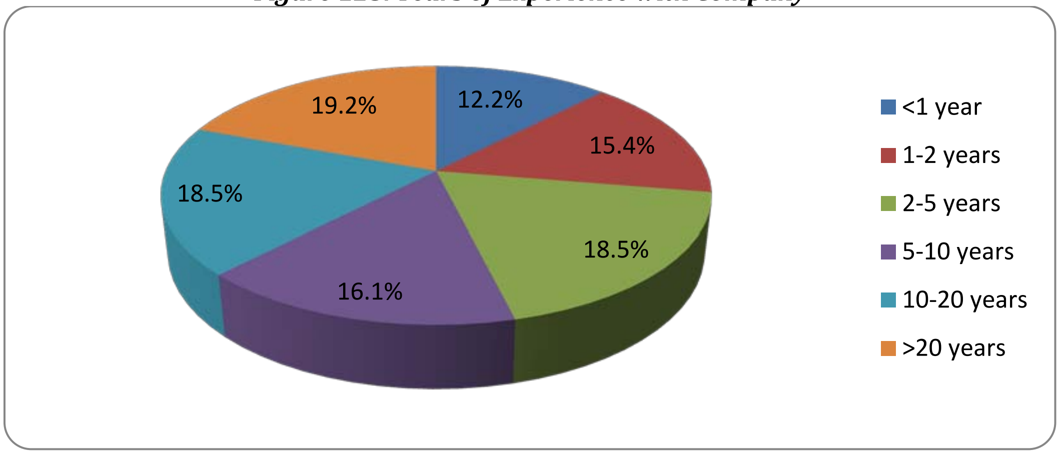
The largest concentration of sales exists in the range of less than $100,000 (19.4%) followed by $100,000 to $500,000 (19.1%) and $1 million to $3 million (14.9%).

Figure 122. Total Annual Revenue Sizes



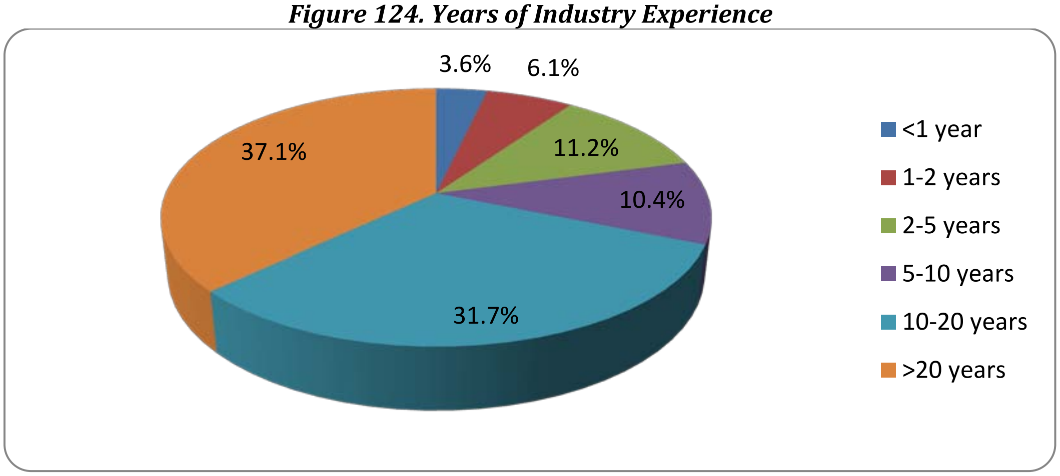
Nearly 19.2% of respondents report their company experience as being greater than 20 years followed by an even split (18.5% each) who report ranges of 10 to 20 years and two to five years.

Figure 123. Years of Experience with Company



The majority of respondents report their industry experience as being greater than 10 years. The largest concentration (37.1%) reports greater than 20 years experience.

Figure 124. Years of Industry Experience



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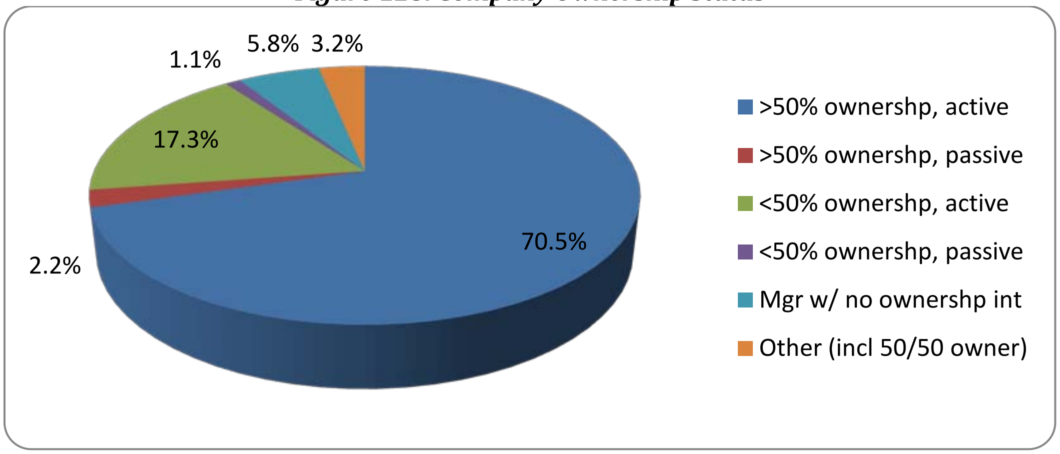
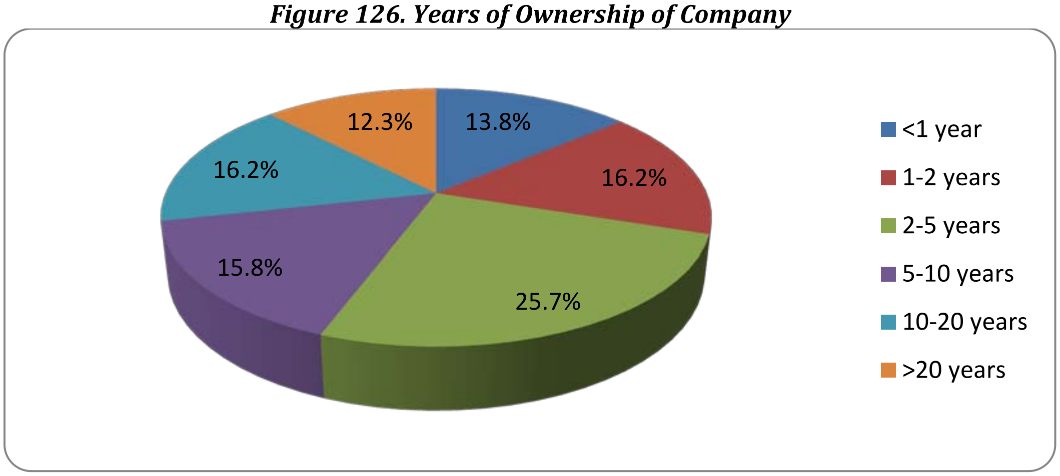
Over 90% of respondents are owners of their companies. Most (70.5%) are active owners with greater than 50% ownership.

Figure 125. Company Ownership Status



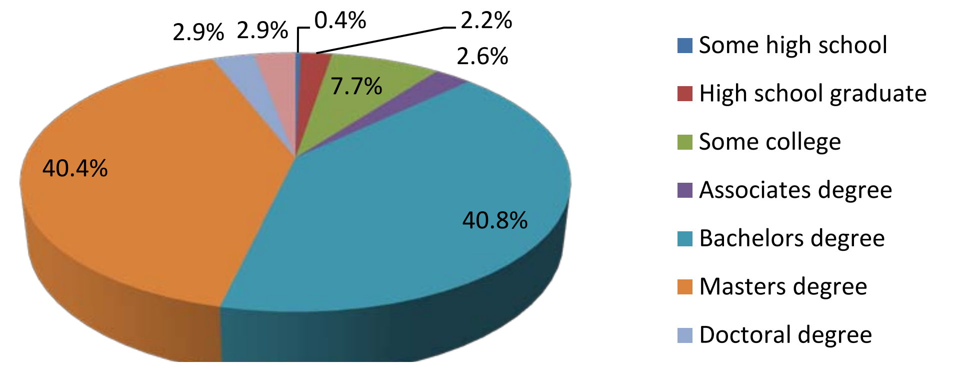
For those owners, approximately 25.7% report being an owner for two to five years while an even split (16.2% each) follows between the ranges of one to two years and 10 to 20 years.

Figure 126. Years of Ownership of Company



Nearly 40.4% of respondents report their highest level of formal education as “master’s degree” while 40.8% identify “bachelor’s degree.”

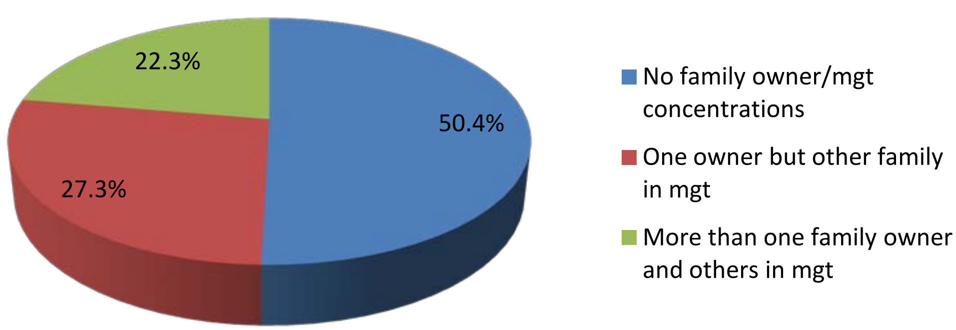
Figure 127. Highest Level of Formal Education



**Other includes law degrees and certification courses*

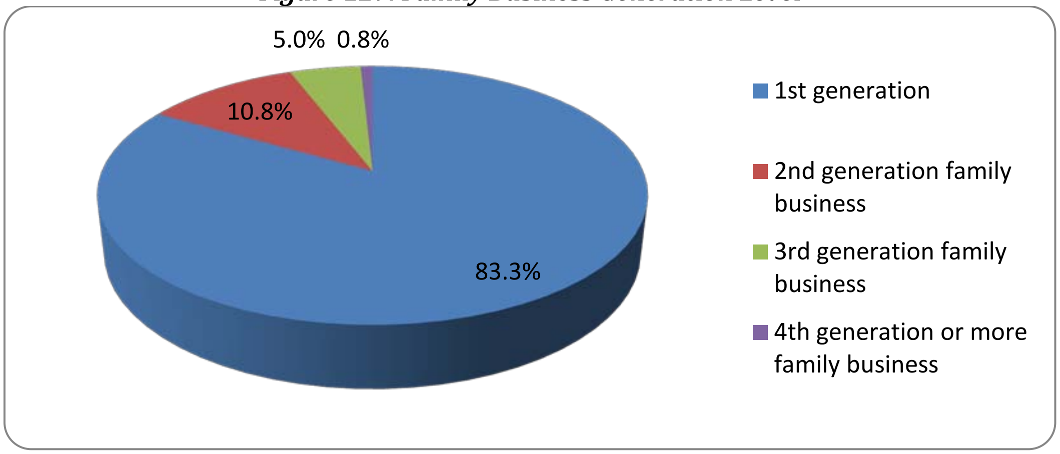
Nearly half of respondents identify their companies as a family business. Approximately 50.4% report no family ownership or management concentrations.

Figure 128. Family Business Status



Approximately 83.3% of family business respondents report "first generation" status while 10.8% are second generation, 5.0% are third generation, and another 0.8% are classified as fourth generation or more.

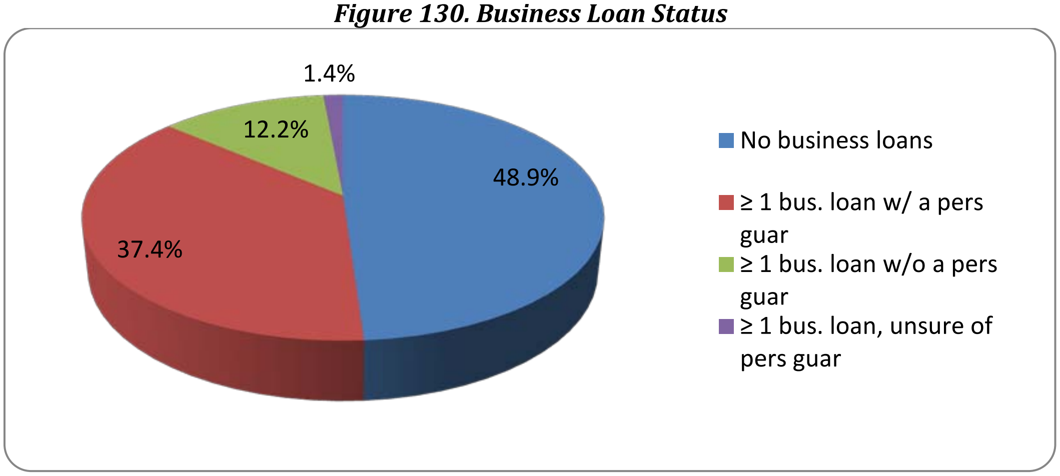
Figure 129. Family Business Generation Level



Borrowing Characteristics and Preferences

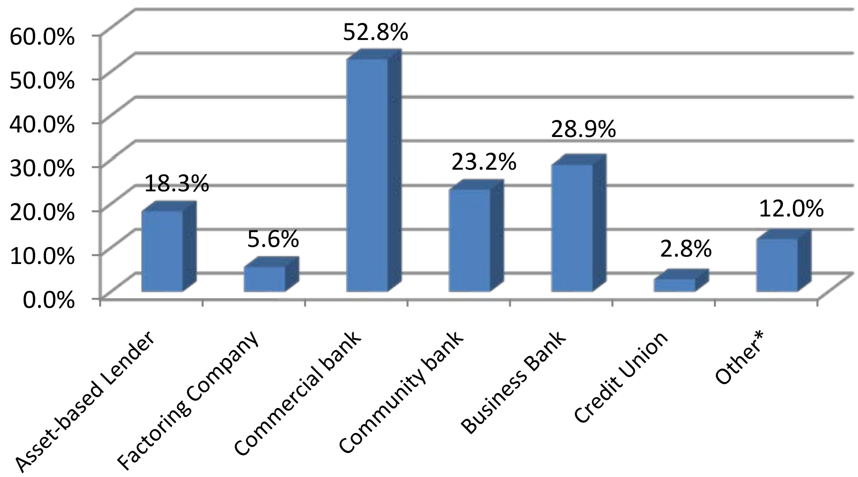
Approximately 48.9% of respondents report their company as having no business loans while 37.4% indicate having a loan with a personal guarantee, and another 12.2% have a business loan without a personal guarantee.

Figure 130. Business Loan Status



Of those with loans outstanding, most respondents (52.8%) report their use of a commercial bank for loans while 28.9% use a business bank, and 23.2% rely, at least in part, on a community bank. Approximately 18.3% use an asset-based lender and 5.6% employ the services of a factor.

Figure 131. Borrowing Sources



**Other includes private investors, friends, family economic development agency, SBIC lender, suppliers, SBA*

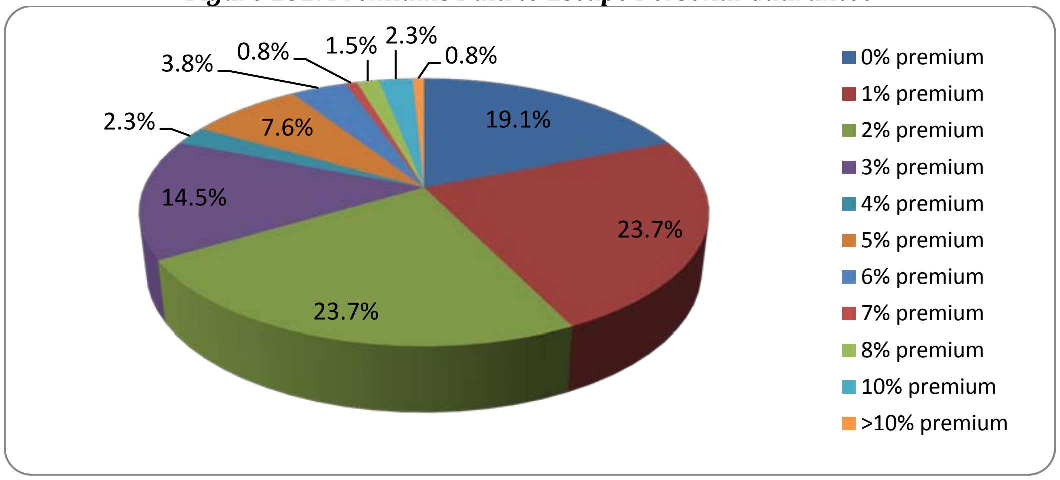
When choosing a senior lender, the most important items (ranked by mean score) are interest rate, collateral requirements, loan size, customer service, loan fees, and lack of personal guarantee. The least important items are (in order of mean score) location of lender, sophistication of financial institution, length of loan term, strength of financial institution, and lack of loan covenants.

Table 83. Most Important Factors When Choosing a Senior Lender

	Unimportant	Slightly important	Important	Very important	Extremely important	Mean
Interest rate	0.8%	8.3%	29.3%	28.6%	33.1%	**3.85**
Lack of loan covenants	5.4%	7.7%	36.2%	36.9%	13.8%	**3.46**
Lack of personal guarantee	3.0%	17.4%	27.3%	23.5%	28.8%	**3.58**
Size of loan qualified for	4.5%	3.0%	28.0%	36.4%	28.0%	**3.80**
Location of lender	41.7%	30.3%	12.9%	11.4%	3.8%	**2.05**
Length of loan term	3.0%	15.2%	36.4%	34.1%	11.4%	**3.36**
Loan fees	0.8%	9.8%	30.8%	34.6%	24.1%	**3.71**
Collateral requirements	0.8%	6.1%	27.3%	40.2%	25.8%	**3.84**
Strength of financial inst	8.3%	16.5%	25.6%	26.3%	23.3%	**3.40**
Sophistication of financial inst	13.0%	13.0%	35.1%	19.8%	19.1%	**3.19**
Customer service	3.7%	11.9%	20.9%	32.8%	30.6%	**3.75**

Respondents were asked how much they'd be willing to pay to escape a personal guarantee on their loans. An even split (23.7% each) existed at the 1% and 2% premium amounts. Another 19.1% indicated they wouldn't be willing to pay a premium while another 14.5% reported an interest in paying a premium of 3%.

Figure 132. Premiums Paid to Escape Personal Guarantee



Respondents with financial institution debt outstanding reported their ratio of senior debt to book equity as being 1X and their senior debt to EBIT as being 2X.

Table 84. Financial Institution Debt Outstanding Ratios

Bank debt to book equity	Bank debt to EBIT	
0.25	0.65	1st quartile
1.00	2.00	Median
2.00	4.00	3rd quartile

Respondents report that they could comfortably handle 2 times their book value in debt to banks and other financial institutions. They also indicate their ability to comfortably handle 2.5 times their EBIT.

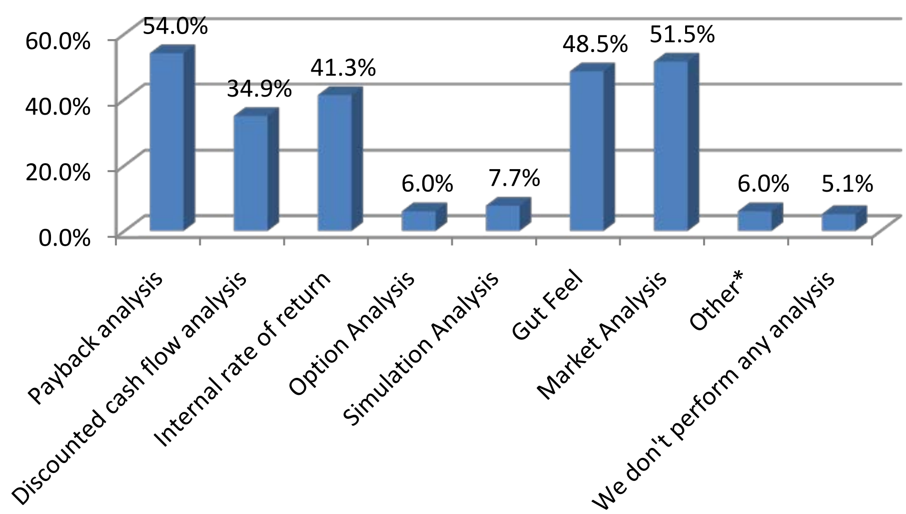
Table 85. Borrowing Capacity Ratios

Max bank debt to book value	Max Bank debt to EBIT	
1.00	2.00	1st quartile
2.00	2.50	Median
3.00	4.00	3rd quartile

Investment Behavior and Evaluation Characteristics

Privately-held companies rely on the following investment analysis techniques ranked by frequency of use: payback analysis (54.0%), market analysis (51.5%), gut feel (48.5%), internal rate of return (41.3%), and discounted cash flow analysis (34.9%).

Figure 133. Investment Analysis Techniques



Other includes surveys, sensitivity analysis, strategic fit, industry specific multiples, focus group

Respondents report payback period thresholds for various investment types ranked in order of length. These include hiring a salesperson (1.52 years), new computer system (2.05 years), new phone system (2.07 years), expanding a current market niche (2.48 years), general investments in the business (2.69 years), entering a new market niche (2.77 years), and acquiring a competitor (3.22 years).

Table 86. Maximum Payback Period for Various Investments

	≤ 1 yr	2 yrs	3 yrs	4 yrs	5 yrs	6 yrs	≥ 7 yrs	Average
New phone system	45.9%	25.5%	17.3%	3.0%	5.6%	0.4%	2.2%	**2.07**
New computer system	35.9%	34.2%	25.1%	1.3%	2.2%	0.0%	1.3%	**2.05**
Hiring a salesperson	57.9%	35.2%	4.7%	1.3%	0.9%	0.0%	0.0%	**1.52**
Acquiring a competitor	10.7%	23.2%	32.6%	8.0%	19.6%	3.6%	2.2%	**3.22**
Expanding a current mkt niche (product/service)	16.9%	39.4%	30.3%	6.9%	6.1%	0.0%	0.4%	**2.48**
Entering a new market niche	12.6%	36.4%	29.9%	9.5%	8.7%	0.4%	2.6%	**2.77**
General investment in your business	19.0%	37.1%	23.7%	5.2%	10.3%	1.3%	3.4%	**2.69**

Privately-held companies expect pre-tax annual returns between 10% and 30% (medians) for various investments. They expect, in order of lowest to highest returns, 10% for a new phone system, 20% for a new computer system, 20% for a general investment in their business, 25% for expanding a new market niche, 25% for entering a new market niche, 30% for hiring a salesperson, and 30% for acquiring a competitor.

Table 87. Expected Annual Pre-Tax Returns for Various Investments

	1st quartile	Median	3rd quartile
New phone system	5%	10%	20%
New computer system	10%	20%	30%
Hiring a salesperson	20%	30%	50%
Acq a competitor	20%	30%	50%
Expanding a current mkt niche (prod/svc)	15%	25%	33%
Entering a new mkt niche	15%	25%	50%
Gen invest. in your business	10%	20%	30%

Respondents were asked to share their annual pretax required rates of return (hurdle rates) for different investments. Ranked in order of lowest to highest are the following: new phone system (10%), new computer system (10%), general investment in the business (19%), hiring a salesperson (20%), expanding a current market niche (20%), entering a new market niche (20%), and acquiring a competitor (25%).

Table 88. Hurdle Rates for Various Investments

	1st quartile	Median	3rd quartile
New phone system	2.8%	10.0%	15.0%
New computer system	5.0%	10.0%	20.0%
Hiring a salesperson	12.0%	20.0%	35.0%
Acq a competitor	15.0%	25.0%	33.0%
Expanding a current mkt niche (prod/svc)	10.0%	20.0%	26.3%
Entering a new mkt niche	10.0%	20.0%	30.0%
Gen invest. in your business	10.0%	19.0%	30.0%

Respondents were asked to estimate a pre-tax annual rate of return they would require for investing in another business identical to theirs where their role was none other than a passive non-control investor. The median response for a one year investment was 12% annually while a five-year investment was 15% annually, and a 10-year investment return was 20% annually.

Table 89. Annual Return Requirements for Passive, Non-control Investment in Identical Business

1-year investment	5-year investment	10-year investment	
10%	10%	10%	1st quartile
12%	15%	20%	Median
15%	25%	30%	3rd quartile

Businesses were asked about the instances in which they would invest additional personal equity versus raising it from outside investors. The instances where the preference was to invest personal equity include the following: banks require an additional capital infusion (55.6%), expansion of business (53.8%), and buyout of existing partner (68.1%). There was one instance in which the majority of respondents indicated a preference to raise outside equity. This item was identified as "acquisition of competitor."

Table 90. Investing Personal Equity Versus Raising Outside Equity

	Prefer to invest personal equity	Prefer outside investor to invest equity	Not invest any equity--personal or outside investor
Bank reqs add'l investment	55.6%	34.6%	9.8%
Acq of a competitor	31.9%	56.3%	11.9%
Expansion of business	53.8%	38.7%	7.5%
Buyout of existing partner	68.1%	24.3%	7.6%

Respondents were asked to rank three items in order of importance to them. The item that ranked the highest was “financial independence” followed by “maintaining current lifestyle” and then “dramatically increasing lifestyle.”

Table 91. Responses to “What Is Most Important to You as a Business Owner?”

Answer	Most important	Next most Important	Least Important
Maintaining current lifestyle	22.8%	38.7%	29.5%
Dramatically increasing lifestyle	9.9%	37.4%	54.1%
Financial independence (increasing value of business by at least three times)	67.3%	23.9%	16.4%

Survey participants were asked to consider an opportunity to expand their business where they have a comfortable lifestyle and a $200,000 salary. Respondents were asked to choose one scenario when risk and additional expected returns, ranging from 0 to 50%, are introduced. Based upon the responses, the largest concentration (34.1%) reported the desire to pursue an expected return of 30% while 23.3% chose an option that produced an expected return of 50%. Approximately 9.1% indicated a general lack of interest in pursuing a risky investment that was expected to increase their salary.

Table 92. Opportunity to Expand Business: A Risk and Return Tradeoff

Answer	%	Expected return (given)
None of the below. I would prefer not to risk my current lifestyle.	9.1%	0.0%
90% chance of increasing income to $225,000; 10% chance of decreasing income to $190,000	10.2%	10.0%
80% chance of increasing income to $255,000; 20% chance of decreasing income to $180,000	14.2%	20.0%
70% chance of increasing income to $305,000; 30% chance of decreasing income to $150,000	34.1%	30.0%
60% chance of increasing income to $380,000; 40% chance of decreasing income to $130,000	9.1%	40.0%
50% chance of increasing income to $500,000; 50% chance of decreasing income to $100,000	23.3%	50.0%

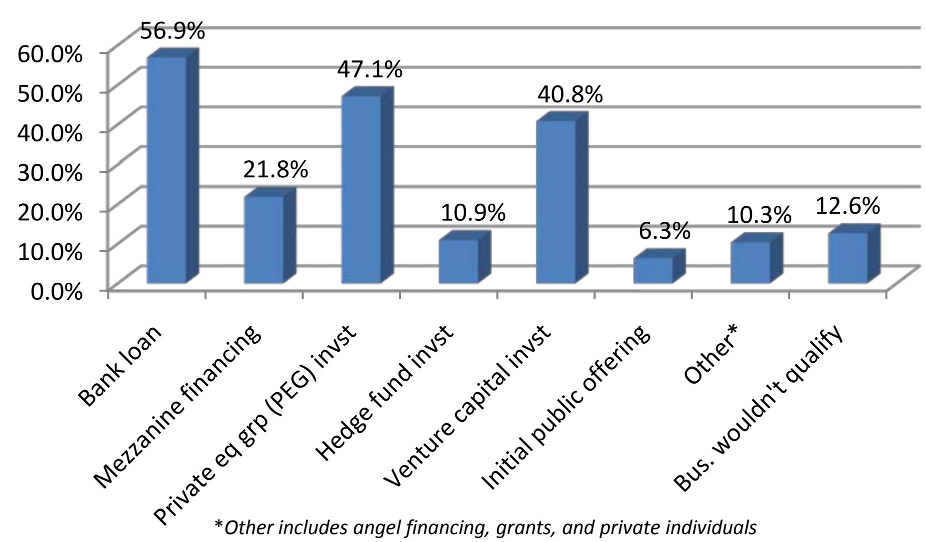
Businesses were asked to evaluate six competing projects with varying levels of risk. Respondents were told that each had an expected return of 10% and then were asked to choose the one they would pursue. Approximately 27.3% picked the option with the guaranteed return of 10% and another 23.3% selected the next least risky project. Approximately 9.3% of respondents reported their indifference between the options available.

Table 93. Choosing Among New Projects with Identical Expected Returns but Varying Levels of Risk

Answer	%
Project A: 100% chance of earning a return of 10%.	27.3%
Project B: 10% chance of earning a return of 40%; 90% chance of earning 6.7%	23.3%
Project C: 20% chance of earning a return of 60%; 80% chance of losing 2.5%	15.1%
Project D: 30% chance of earning a return of 80%; 70% chance of losing 20%	14.0%
Project E: 40% chance of earning a return of 100%; 60% chance of losing 50%	6.4%
Project F: 50% chance of earning a return of 200%; 50% chance of losing 180%	4.7%
I would invest in all of the projects since they all offer the same rate of return	9.3%

Respondents reported that their businesses were qualified to receive various financing types. Approximately 56.9% believed they would qualify for a bank loan, 47.1% reported meeting the guidelines for a private equity investment, 40.8% identified venture capital as a source of funds, and 21.8% believe they could raise money from a mezzanine fund.

Figure 134. Qualification for Various Capital Types



**Other includes angel financing, grants, and private individuals*

Business Conditions and Economic Outlook

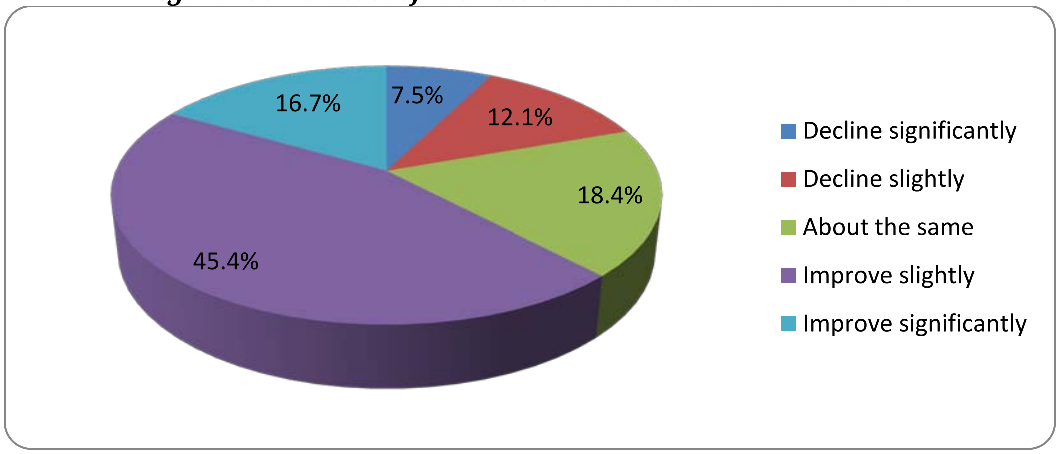
We asked respondents to report on various operational and industry items as compared to six months ago. Significant increases were reported in opportunities for growth and competitive pressures. Significant declines were reported for the category of access to capital. Respondents also report relative declines in expenses, number of employees, and size of industry. Relative increases were identified in revenues, net income, and probability of failure.

Table 94. General Business and Industry Assessment: Today Versus Six Months Ago

	Increased	Decreased	Stayed about the same
Revenues	41.8%	32.9%	25.3%
Expenses	31.6%	38.6%	29.8%
Net Income	39.6%	34.9%	25.4%
Opportunities for growth	63.7%	19.6%	16.7%
Access to capital	19.9%	45.8%	34.3%
Prices of your products or services	21.1%	22.2%	56.7%
Number of employees	19.0%	33.9%	47.0%
Size of industry	23.6%	38.2%	38.2%
Competitive pressures	50.0%	16.1%	33.9%
Probability of failure	30.4%	26.2%	43.5%
Confidence in economic growth	36.9%	35.6%	27.5%

When asked about business conditions over the next 12 months, approximately 45.4% of respondents indicated an expectation for slight improvement.

Figure 135. Forecast of Business Conditions over Next 12 Months



Respondents believe that GDP will increase by 0.52% over the next 12 months while an equivalent measure for privately-held companies is expected in rise by 1.10%.

Table 95. GDP Forecasts for Next 12 Months

	Expected GDP change (%)
Overall GDP	0.5%
Privately-held company equivalent GDP	1.1%

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