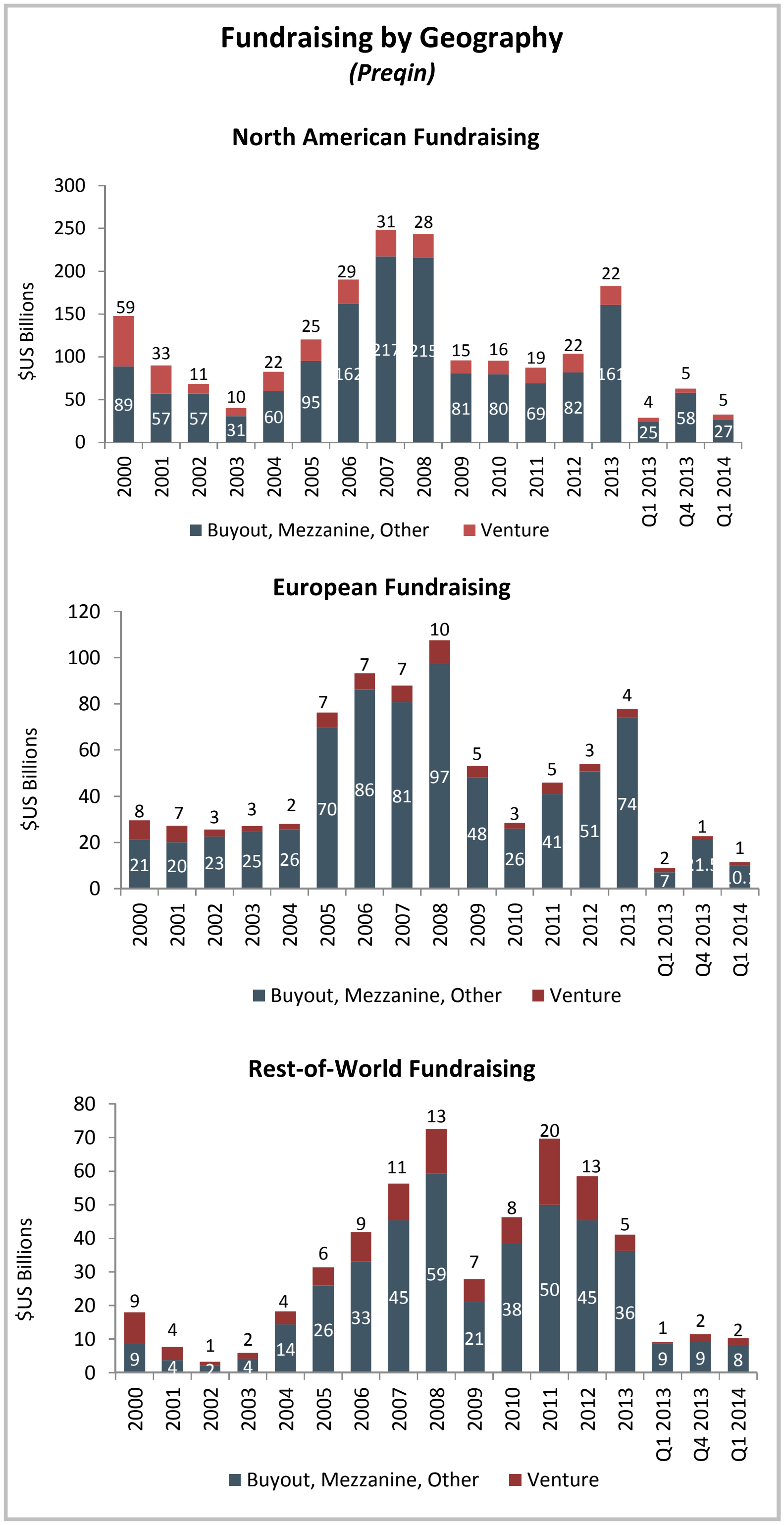
Summit Strategies Group

PRIVATE EQUITY | 1Q 2014 MARKET UPDATE

North American fundraising continued to be strong in Q1 2014. Fund closes are typically down in the first quarter after year-end fundraising efforts by managers that push up fourth quarter figures. This year is no exception, with the Q1 total down almost 50% quarter-over-quarter, yet up 12% year-over-year. And fundraising totals for the second quarter thru April have already surpassed the first quarter total.

Several market participants believe the strength in total fundraising to be slightly misleading. While the market is strong, it's not necessarily deep or broad based. Reputable GPs are able to raise significantly larger funds in very short times, continuing a trend toward LPs concentrating their commitments. Less reputable managers, without clean stories, are experiencing lengthier and in some cases unsuccessful fundraises.

Fundraising in Asia and Rest-of-World was weaker in 2013, but is anticipated to pick up in 2014 with several higher profile managers beginning their fundraising process including Baring Asia, CDH, Hopu, Helios and Abraaj. However, Q1 2014 only matched the same period in 2013.



INDEX **PAGE**

Featured Note: Africa, the Opportunity at Hand*

In contrast to developed and highly competitive markets like the US and Europe where private capital is often used to finance the exchange of equity interests in companies, private capital in Africa typically supports growth initiatives for underlying companies. Africa has the most attractive economic growth prospects of any emerging market, and local governments and regulators continue to take steps to encourage and support private investment. This result is a positive structural shift in Africa's private equity market that has improved investors' ability to effectively unlock value in the region. And while heightened interest in the continent has led to greater capital inflows, the private equity market remains very inefficient, meaning there is still significant opportunity for investors to capitalize on.

What is Driving the Opportunity in Africa?

1) Rapid Economic Growth

Africa contains seven of the 10 fastest growing economies in the world, and it has experienced close to 5 percent annual GDP growth over the past decade. A large reason for this growth has been the rise of the African middle class, which grew from 126 million people in 1980 to 350 million people in 2010 (African Development Bank, 2014). This trend should continue, particularly if foreign direct investment in the region continues at a strong pace.

With this growth has come a significant increase in urbanization—Africa's urban population nearly doubled to 401 million people between 1990 and 2010 (Ernst & Young, 2013), and by 2030, Africa's top 18 cities are projected to have a combined spending power of $1.3 trillion (McKinsey & Company, 2010). In addition, this growth has fueled Africa's labor force, which is expected to double by 2020 to over 1 billion people, surpassing both China and India (AfricInvest, 2014). Since higher employment translates into greater aggregate income and demand, this growth in the labor force will help perpetuate GDP growth in Africa.

2) Inefficient Markets

Despite its rapid economic growth over the past decade, Africa remains a highly inefficient market. It has a nascent public equity market, which makes comparable pricing difficult and decreases the viability of one of the primary exit routes (IPOs) chosen by US and European private equity firms. Africa also lacks the infrastructure seen in developed markets, which means that information can be hard to access and hard to leverage on a widespread basis. This means that private equity on the continent is highly relationship-driven, with the majority of deals happening without an intermediary.

3) Regional Integration

As its economy has grown and domestic consumption has increased, Africa has experienced a high level of regional integration. Political efforts to sustain the continent's economic growth have assisted in promoting intra-Africa trade, resulting in a large number of regional trade pacts being signed over the past 10 years. The trend has also partially been driven by the global financial crisis, which resulted in stagnant growth in developed markets and forced Africa to turn inward for demand. Between 2002 and 2010, intra-Africa trade grew 237 percent, or about 17 percent per year. This growth in domestic trade has led to increased cooperation among nations, improved transparency and coordinated economic policies. It has also created a means for dominant local companies to achieve greater scale through regional expansion, which has both supported the companies' own growth and allowed them to create value in lesser developed areas of Africa. These elements are all positives for the African economy, promoting a more cohesive economic structure, improved governance and a more equitable distribution of wealth across the continent.

4) Favorable Private Equity Dynamics

Compared to other emerging markets, private equity remains an underutilized investment approach in Africa. Private equity fundraising in Africa is less than half the level seen in India and Latin America, and is well below the level seen in China. Based on the anticipated growth of the African economy, fundraising levels will naturally increase as private capital comes into greater demand. However, the market is so underpenetrated that modest inflows should not have a material adverse effect (in the short run) on the opportunity set for private equity investors.

*Please see Summit's website for the full white paper.

Performance

(Preqin as of 9/30/2013)

	Internal Rate of Return						Total Value to Paid In Capital					
	Buyouts			Venture			Buyouts			Venture		
Vintage Year	Upper Quartile	Median	Lower Quartile	Upper Quartile	Median	Lower Quartile	Upper Quartile	Median	Lower Quartile	Upper Quartile	Median	Lower Quartile
2012	n/m	n/m	n/m	n/m	n/m	n/m	1.1x	1.0x	0.9x	1.0x	0.9x	0.7x
2011	n/a	n/a	n/a	22.4	7.2	-8.8	1.2x	1.1x	1.0x	1.3x	1.1x	0.9x
2010	16.1	10.0	5.6	17.9	10.5	4.2	1.3x	1.2x	1.1x	1.4x	1.2x	1.0x
2009	18.2	12.0	7.5	18.8	11.5	0.5	1.5x	1.2x	1.1x	1.4x	1.1x	1.0x
2008	17.9	10.6	6.5	19.0	8.8	1.4	1.5x	1.3x	1.2x	1.4x	1.2x	1.0x
2007	15.2	9.1	5.8	15.3	8.0	0.1	1.6x	1.4x	1.2x	1.6x	1.2x	0.9x
2006	12.9	8.2	4.4	10.3	3.8	-4.4	1.6x	1.4x	1.1x	1.5x	1.1x	0.9x
2005	13.7	9.7	6.3	9.5	2.4	-5.4	1.7x	1.5x	1.3x	1.5x	1.1x	0.8x
2004	24.5	14.2	9.5	8.9	2.2	-2.8	2.2x	1.8x	1.5x	1.5x	1.1x	0.8x
2003	32.1	16.1	7.9	8.0	1.2	-3.4	2.4x	1.7x	1.3x	1.4x	1.1x	0.8x
2002	30.5	19.6	9.0	9.1	2.2	-5.3	2.2x	1.8x	1.3x	1.5x	1.0x	0.7x
2001	33.5	23.6	3.2	10.4	2.9	-3.0	2.8x	1.9x	1.6x	1.6x	1.2x	0.8x
2000	23.6	14.3	8.6	4.9	0.1	-6.3	2.2x	1.7x	1.4x	1.3x	0.9x	0.6x
1999	17.0	11.1	3.8	5.7	-2.3	-11.3	2.1x	1.5x	1.1x	1.3x	0.8x	0.5x
1998	14.4	9.1	2.9	16.0	5.2	-6.5	1.8x	1.5x	1.1x	1.6x	1.1x	0.6x
1997	15.0	9.9	1.9	63.8	29.8	6.2	2.1x	1.5x	1.1x	3.3x	1.8x	1.2x
1996	20.8	10.3	3.9	61.1	13.9	5.0	2.3x	1.5x	1.2x	2.5x	1.7x	1.1x
1995	24.5	14.8	2.3	76.2	26.5	8.5	2.2x	1.7x	1.1x	5.0x	2.5x	1.6x
1994	36.3	17.8	10.1	63.3	27.1	8.3	2.4x	1.9x	1.5x	5.5x	2.2x	1.1x
1993	28.1	16.8	12.0	54.0	31.7	3.4	3.3x	2.0x	1.5x	3.5x	2.5x	1.1x
1992	35.2	17.5	10.1	25.5	17.5	4.4	2.3x	1.8x	1.3x	2.4x	1.6x	1.1x
1991	25.9	23.5	11.6	39.7	26.7	12.7	3.0x	2.2x	1.9x	3.6x	2.8x	1.9x
1990	26.5	17.4	9.5	22.0	14.7	2.7	2.6x	2.1x	1.6x	2.6x	1.8x	1.2x
1989	38.5	27.4	16.8	23.5	14.6	7.0	3.5x	3.3x	1.7x	3.1x	2.2x	1.4x
1988	20.1	14.9	11.2	31.0	22.4	9.8	2.5x	2.1x	1.8x	3.4x	2.6x	1.7x
1987	24.9	19.4	14.2	17.7	11.9	7.0	4.9x	3.2x	2.1x	2.9x	1.9x	1.3x
1986	24.0	18.0	9.4	14.7	10.3	5.5	4.3x	2.4x	1.9x	2.2x	1.8x	1.4x
1985	n/a	10.8	n/a	17.5	13.0	8.8	n/a	2.7x	n/a	3.1x	2.1x	1.5x

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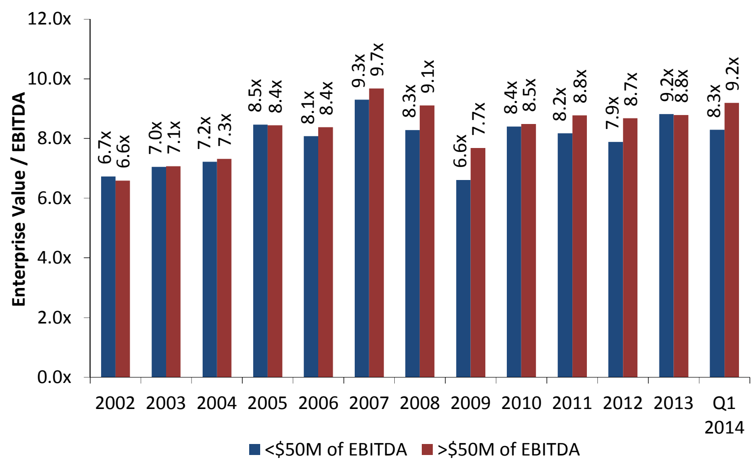
The volume of private equity deals in Q1 2014 was 13% lower than the Q1 2013 level, the lowest since Q1 2010. However, the aggregate value of announced deals is 24% higher than the preceding quarter and at one of the higher levels of the last 5 years. Average deal size continued to increase to its highest level since 2007. Valuations are also at or near peak levels despite coming in from the previous quarter. Smaller company purchase price multiples (EBITDA <$50 million) moderated almost a full turn from the 2013 average (8.3x from 9.2x). Larger company multiples remain high and above the full year 2013 level, but came in from record highs in Q4.

Hefty valuations are being driven by frothy debt markets. Average debt to EBITDA levels are 4.9x in the lower middle market and 5.6x for larger companies. These levels are approaching 2005-2007 buyout boom peak highs.

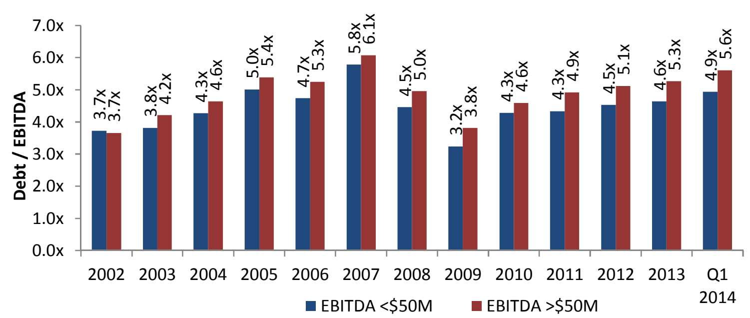
Equity capitalization of smaller companies decreased in Q1 2014 after peaking in 2013 at levels not seen since 2009 following the financial crisis. Smaller companies now require equity near the long term average of 40%. Equity contributions for larger companies have fallen to 2007 levels. Both cases demonstrate the wide spread ability to access debt markets, with lenders willing to go 5x-6x deep into the capital structure.

Pricing and Credit Statistics (S&P LCD)

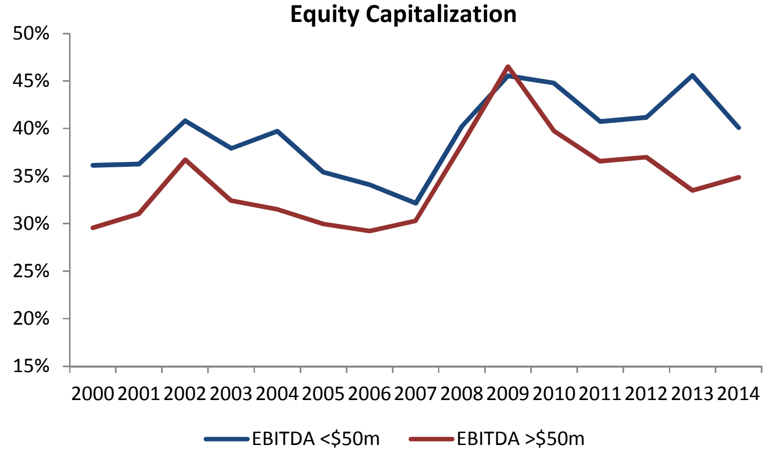
Purchase Price Multiple



Average Debt to EBITDA

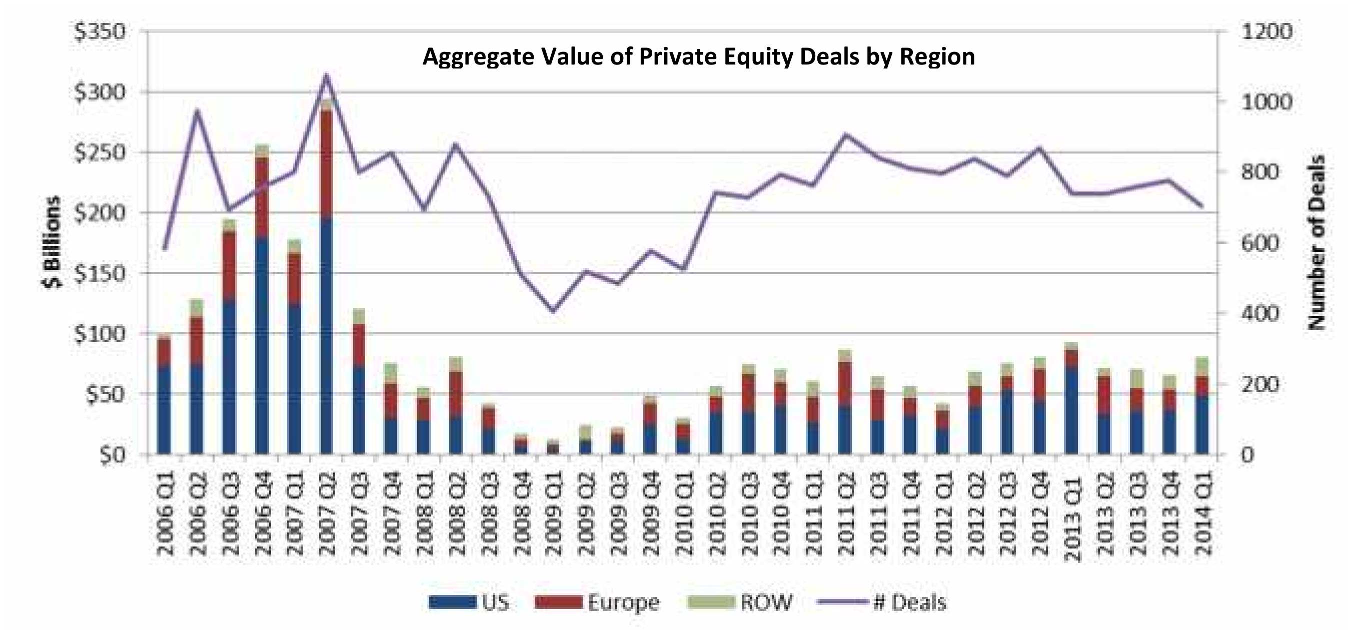


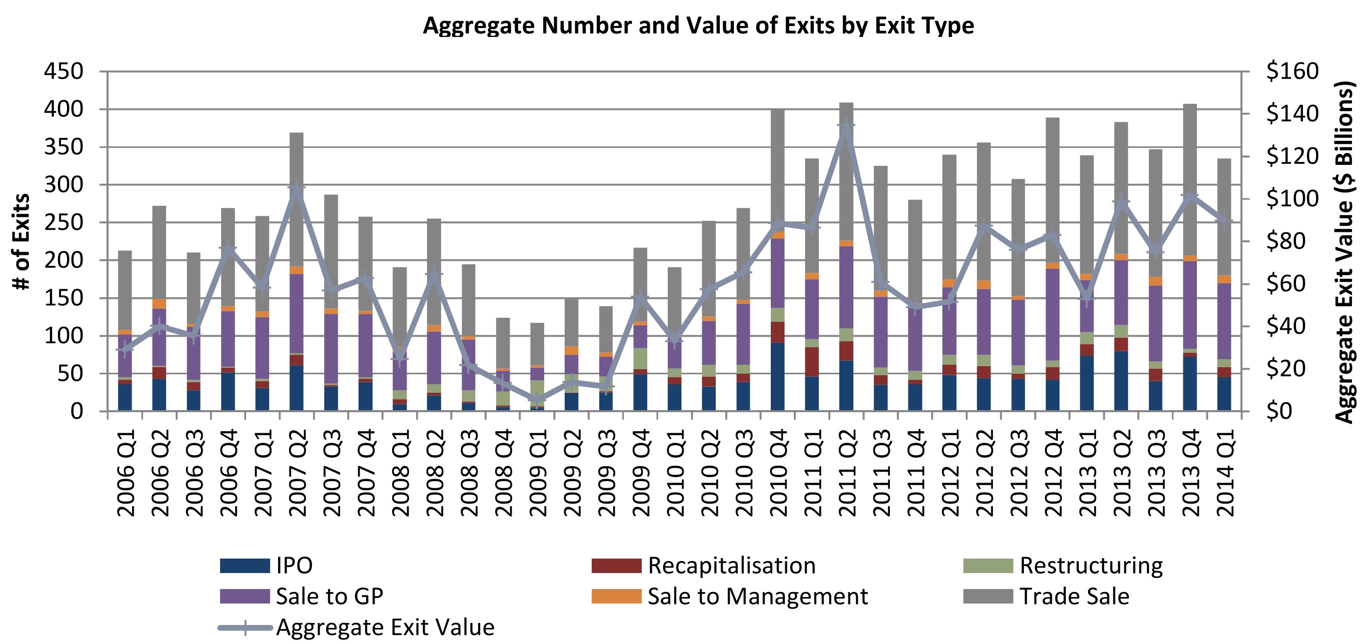
Equity Capitalization



Deal Volume

(*Preqin)*





The IPO window continued to be open in Q1 2014, with another 36 venture backed IPOs. This marks the 4th straight quarter of 20 or more venture backed IPOs and a 350% year-over-year increase from Q1 2013. For the full year 2013, it was the most number of venture backed IPOs since 2007. Biotech IPOs continued to lead the way, representing two-thirds of the IPOs in the quarter. As of April, there were 46 venture backed companies who filed publicly for IPO with the SEC. The hot market looks likely to continue in the near term. This figure does not include confidential registrations filed under the JOBS Act where many believe the majority of venture backed companies now file. The strength of the IPO market weakened in March as the Nasdaq experienced a sharp correction. Pockets of the technology sector that had experienced hyper gains in 2013, such as cloud computing, were particularly weak.

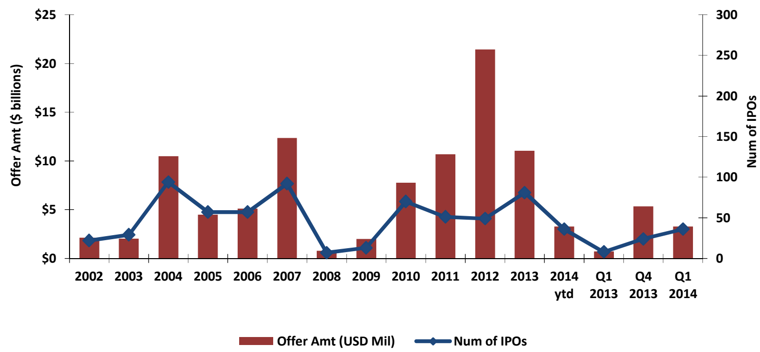
The National Venture Capital Association (NVCA) reported on an interesting trend in their 2014 Yearbook. The number and reach of corporate venture capital groups is increasing. These groups were involved in 11% of venture capital deals in 2013, the highest level in five years. The study points to further signs that these entities will continue to become more involved alongside independent venture firms, and are looking to do deals even without independent third parties.

It's unclear whether this trend is good or bad for venture investors. On one hand, active corporate venture groups getting an earlier look at developing companies could foreshadow future M&A events. On the other, increased corporate involvement could be viewed as additional competition in an already crowded market.

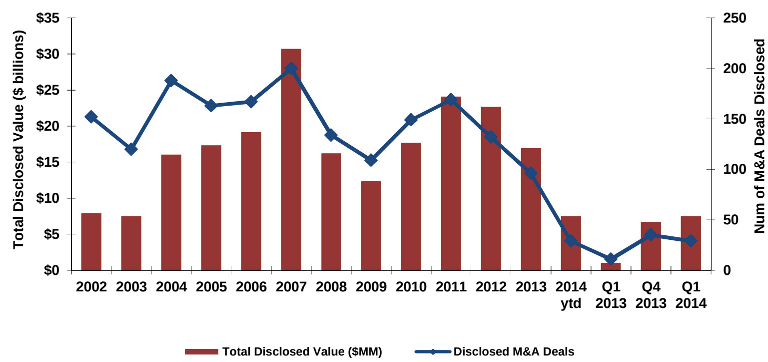
Venture Activity

(*NVCA/Thomson/Reuters)*

Venture-Backed IPO Exits



Venture-Backed M&A Exits



Venture Investments

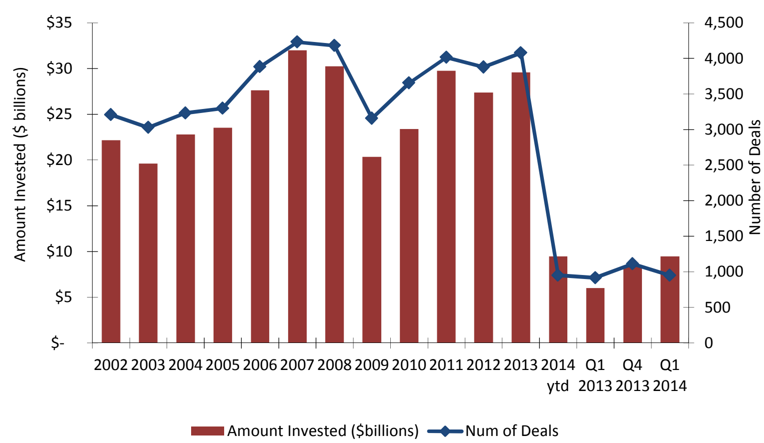


Table 1: Glossary of Terms

Distributions to Paid-in Capital (DPI)	The amount a partnership has distributed to its investors relative to the total capital contribution to the fund
Early Stage Venture	A fund investment strategy involving investment in companies for product development and initial marketing, manufacturing and sales activities
Financial Accounting Standards (FAS)	The Financial Accounting Standards Board (FASB) is a private, not-for-profit organization whose primary purpose is to develop generally accepted accounting principles (GAAP) within the United States in the public's interest
J-Curve	The curve realized by plotting the returns generated by a private equity fund against time (from inception to termination). The common practice of paying the management fee and a start-up cost out of the first draw-down does not produce an equivalent book value. As a result, a private equity fund will initially show a negative return. When the first realizations are made, the fund returns start to rise quite steeply. After about three to five years, the interim IRR will give a reasonable indication of the definitive IRR. This period is generally shorter for buyout funds than for early-stage and expansion funds
Lower Quartile IRR	The point where 75% is above the quartile and 25% below
Pooled Internal Rate of Return	A method of calculating an aggregate IRR by summing cash flows together to create a portfolio cash flow and calculate IRR on portfolio cash flow
Large Buyout	Issuers with EBITDA of $50 million or more
Late Stage Venture	A fund investment strategy involving financing for the expansion of a company which is producing, shipping and increasing its sales volume
Middle-market Buyout	Issuers with EBITDA of $50 million or less
Top Quartile IRR	The point where 25% of the sample is above the quartile and 75% below
Total Value to Paid-in Capital (TVPI)	Calculation performed by adding the residual value and the distributions received (cash out) and dividing that amount by the total capital contributed (cash in)

Table 2: Data Sources

S&P Leveraged Commentary & Data
Bloomberg
Preqin
Capital IQ
Private Equity International
National Venture Capital Association
New York Times
Financial Times
Wall Street Journal
The Deal
PitchBook Data, Inc.