DUFF & PHELPS

July 2009

Private Equity Insights

Inside

3 Yesterday's Returns vs. Today's Returns

5 Levered Cost of Equity Comparison

6 World Equity Historical Market Returns

Equity Returns Summary

Yesterday's PE Buyout Expected Return:	+25%
Today's PE Buyout Return:	approx. 15%
DJIA 20-Year Annual Return:	9.0%
S&P 500 20-Year Annual Return:	7.7%
FTSE 100 20-Year Annual Return:	7.3%
MSCI Asia Pacific Index 10-Year Annual Return:	0.0%

As of June 30, 2009
(Includes dividends)

Buyouts – Current Expected Returns

- Time to hit the reset button. Private Equity is here to stay.
- Private Equity investments may still be quite viable despite the current economic environment and dysfunctional credit markets.
- Today's private equity returns, based on the hypothetical structures illustrated on page 3, may outperform global equity markets (based on historical realized returns).
- Despite potential declines in Today's internal rates of return ("IRR") due to lower leverage and longer exit periods, cash-on-cash returns on investment ("ROI") are substantially similar to Yesterday's private equity returns.
- Current credit markets are dislocated as banks and financial companies are repairing their balance sheets and reluctant to lend to Today's private equity buyouts. However, Today's collateral coverage for lenders (e.g. 30% debt / enterprise value) may reduce required interest rates.
- Based on CAPM holding all other variables constant, lower financial leverage reduces the levered cost of equity (or expected return) for private equity investments.

Yesterday	vs.	Today
• High leverage		• Low leverage
• Low interest rates		• High interest rates
• Rapid EBITDA growth		• Slowed EBITDA growth
• **High expected equity returns, but with high financial risk**		• **Lower expected equity returns, but potentially less financial risk**

Yesterday's Returns vs. Today's Returns

The era of the *highly* leveraged buyout ("LBO") may be shut down for the foreseeable future, but…

Private equity managers today may still earn attractive returns for their LP's relative to other equity alternatives despite lower financial leverage, higher interest rates and less robust operating performance.

The table on the following page provides a comparison of the expected equity internal rates of return ("IRR") and return of investment ("ROI")[1] for illustrative private equity investments yesterday vis-à-vis today.

Yesterday: +25% Expected IRR, net to LP
A combination of high leverage, low interest rates, and strong operating performance catapulted Yesterday's expected returns to over 26% and over 2.0x ROI, assuming a 3 year holding period.

Today's Environment Scenario 1: 17% Expected IRR, net to LP
Assumes that operating performance remains the same. However, the amount of leverage decreases, the interest rate on debt increases to 12.0% and the expected holding period increases to 5 years from 3 years. Today's Scenario 1 expected returns are approximately 17% and 2.2x ROI.

Today's Scenario 2 (Dividend Recap): 15% IRR, net to LP
After two years, the borrower pays a dividend of 1.0x EBITDA to the equity holders in a leveraged recapitalization. Operating performance is assumed to be slightly worse than Scenario 1 with revenue growth of 6.0% per annum and EBITDA margins of 9.5%. Based on this scenario, the expected IRR is approximately 15% with a 1.9x ROI.

Today's Environment Scenario 3: 12% Expected IRR, net to LP
In addition to the amount of leverage and interest rate on debt, operating performance decreases. Revenue growth and EBITDA margins decrease to 4.0% and 9.0%, respectively. Today's Scenario 2 expected returns are around 12% and 1.8x ROI.

Note: For the illustrative scenario analysis described above, Duff & Phelps assumed the target company's debt would be rated S&P BB or higher based on the assumed capital structure shown.

Conclusion

- Based on the illustrative examples shown, Today's expected returns may be between 12% and 17% vs. Yesterday's expected returns of over 25%.
- However, Today's lower expected returns exceed historial public equity returns (20-year DJIA and S&P 500 returns of 9.0% and 7.7%, respectively.)

[1] ROI = Total Cash Return (Including Invested Capital) / Invested Capital

Equity Returns to a Financial Buyer

	Yesterday	Today Scenario 1	Today Scenario 2 [1]	Today Scenario 3
1. Revenue at Close	$1.0 billion	$1.0 billion	$1.0 billion	$1.0 billion
2. Annual Revenue Growth	7.5%	7.5%	▼ 6.0%	▼ 4.0%
3. EBITDA Margins	10.0%	10.0%	▼ 9.5%	▼ 9.0%
4. Fund Fee Structure	2% / 20%	2% / 20%	2% / 20%	▲ 1.5% / 15%
5. Debt Funding:				
Debt / EBITDA	6.0x	▼ 2.5x	2.5x	2.5x
Debt / Enterprise Value	74%	▼ 40%	40%	40%
Cash Interest Rate	8.0%	▲ 12%	12%	12%
6. Transaction Expenses	2.0%	▲ 4.0%	4.0%	4.0%
7. Exit Year	3	▲ 5	5	5
8. Going-In Multiple	8.0x	▼ 6.0x	6.0x	6.0x
9. Exit Multiple	8.0x	▲ 7.0x	▲ 6.5x	▲ 6.5x
Equity IRR, gross	**33.0%**	**22.0%**	**19.0%**	**16.0%**
Equity IRR, net	**26.0%**	**17.0%**	**15.0%**	**12.0%**
ROI, gross	**2.4x**	**2.7x**	**2.2x**	**2.1x**
ROI, net	**2.0x**	**2.2x**	**1.9x**	**1.8x**

[1] Assumes dividend of 1.0x EBITDA in year 2.
Note: Assumptions for illustrative purposes only. Net of 20% performance fee at exit.

Equity IRR Sensitivity Table

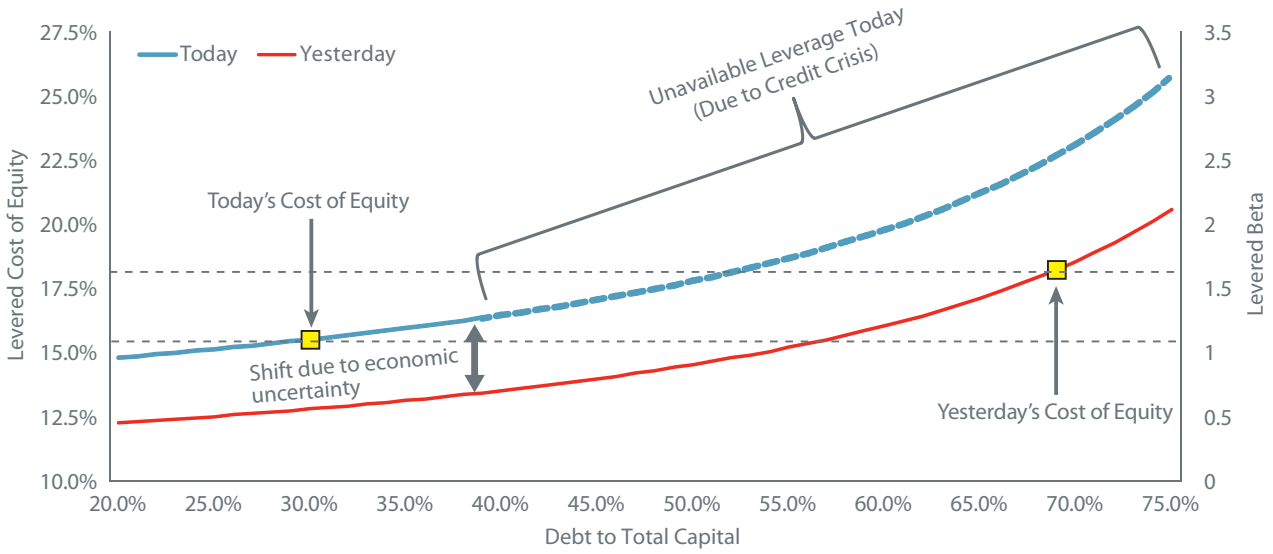
Exit Year	1.5x Cash-on-Cash Return	2.0x Cash-on-Cash Return	2.5x Cash-on-Cash Return	3.0x Cash-on-Cash Return
1 Year	50%	100%	150%	200%
2 Years	22%	41%	58%	73%
3 Years	14%	26%	36%	44%
4 Years	11%	19%	26%	32%
5 Years	8%	15%	20%	25%
6 Years	7%	12%	16%	20%
7 Years	6%	10%	14%	17%

Note: Assumptions for illustrative purposes only.

An investment exit in 3 years at 2.0x money yields a similar IRR to an investment exit in 5 years at 3.0x money.

Levered Cost of Equity Comparison – Yesterday vs. Today

Cost of Equity Analysis



Cost of Equity Analysis Assumptions

Yesterday	**Today**
Risk-Free Rate: 4.5%	Risk-Free Rate: 4.2%
Equity Risk Premium: 5.0%	Equity Risk Premium: 6.0%
Company Specific Premium: 2.0%	Company Specific Premium: 3.0%
Unlevered Beta: 1.0	Unlevered Beta: 1.1

This analysis implies that Today's private equity investor should be willing to accept a lower expected return on his or her investment compared to Yesterday's investor due to lower financial leverage (and associated financial risk) applied to Today's deals.

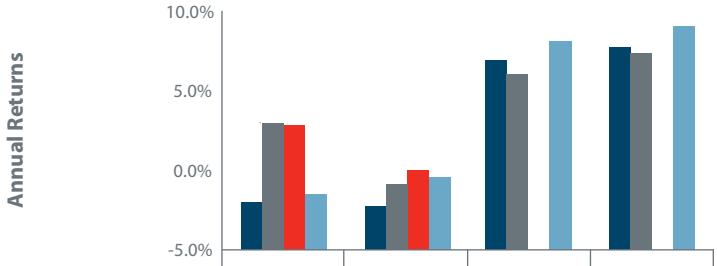
The cost of equity, derived from the capital asset pricing model ("CAPM"), is used to estimate an equity holder's required rate of return (or hurdle). This rate is often used to help determine discount rates and expected target returns.

Today's cost of equity exhibits higher market risk premium. More significantly, due to tightened credit markets, financial leverage Today is significantly lower.[1] The result is a lower levered cost of equity Today compared to Yesterday, primarily due to lower availability of financial leverage and/or prohibitively high interest rates.

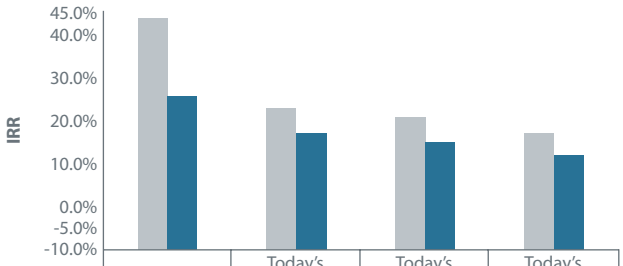
[1] Note that the capital structure shown above does not represent a target long-term capital structure, rather it represents what equity sponsors would utilize in an LBO transaction.

World Equity Historical Market Returns

Historical Equity Market Returns vs. Today's Expected Private Equity Returns



	5 Years	10 Years	15 Years	20 Years
S&P 500	-2.0%	-2.3%	6.9%	7.7%
FTSE 100	2.9%	-1.0%	6.0%	7.3%
MSCI Asia Pacific Index	2.8%	0.0%	NA	NA
DJIA	-1.5%	-0.5%	8.1%	9.0%



	Yesterday	Today's Scenario 1	Today's Scenario 2	Today's Scenario 3
Gross IRR	44.0%	23.0%	21.0%	17.0%
Net IRR	26.0%	17.0%	15.0%	12.0%

Note: The returns above are compound annual growth rates ("CAGR")
Equity market indices include dividends and are adjusted for splits. Performance as of June 30, 2009.
Source: Bloomberg LP
* Based on illustrative models

Primarily due to lower financial leverage from Today's transactions, the expected levered cost of equity (or "equity hurdle rate") declines, based on the assumptions summarized on page 5. This lower expected return of approximately 15.0% is superior relative to public equity returns over the past 20 years of less than 10%. This means financial sponsors may be willing to accept a lower expected return in an environment of reduced financial risk, especially when comparing historical global public equity returns to the range of returns indicated by our illustrative models.

Although Today's expected private equity returns may be below comparable private equity returns of Yesterday, actual private equity realized returns from investments made Today may still outperform comparable returns in the global public equity markets.

Duff & Phelps Experience

Duff & Phelps is a global leader in providing transaction opinions, M&A Advisory, and restructurings.

Transaction Opinion Experience

a portfolio company of **Kohlberg Kravis Roberts & Co.**, has completed a recapitalization transaction involving certain **KKR** funds

Financial advisor to Kohlberg Kravis Roberts & Co.

> FAIRNESS OPINION

(NYSE: HCR)

has been acquired by an affiliate of **The Carlyle Group**

Financial advisor to the board of directors of Manor Care, Inc.

> SOLVENCY OPINION

(NYSE: MGI)

has completed a comprehensive recapitalization by **Thomas H. Lee Partners, L.P.** and **Goldman Sachs & Co**.

Financial advisor to the board of directors of MoneyGram International Inc.

> FAIRNESS OPINION

has been acquired by

Rank Group, Ltd.

Financial advisor to the Trustee of the Blue Ridge Paper Products Inc. Employee Stock Ownership Plan

> FAIRNESS OPINION

M&A Advisory Experience

has been acquired by **YoCrunch** a portfolio company of **Catterton Partners**

Financial advisor to Coolbrands International

> SELL SIDE ADVISOR

has been acquired by **TA Associates**

Financial advisor to Professional Warranty Service Corporation

> SELL SIDE ADVISOR

has been acquired by **Leonard Green & Partners, L.P.**

Financial advisor to Tourneau, Inc.

> SELL SIDE ADVISOR

has been acquired by **The Carlyle Group**

Financial advisor to Wesco Aircraft Hardware Corporation

> SELL SIDE ADVISOR

Restructuring Experience

a subsidiary of **Fedders Corporation**, has been acquired by **Roberts-Gordon LLC**, a portfolio company of **Eastport Operating Partners**

Financial advisor to Fedders Corporation

> RESTRUCTURING / SECTION 363 ASSET SALE

has completed a **Chapter 11 reorganization** $1.5 billion

Financial advisor to the official committee of unsecured creditors

> RESTRUCTURING

and its subsidiary **Scotia Pacific Company LLC**

has completed a **Chapter 11 reorganization** $950 million

Financial advisor to the official committee of unsecured creditors

> RESTRUCTURING

has completed a **Chapter 11 reorganization** $224 million

Financial advisor to the Ad-Hoc Committee of Senior Secured Noteholders

> RESTRUCTURING

DUFF & PHELPS

Contacts

Steve Burt
Managing Director
+1 312 697 4620
steve.burt@duffandphelps.com

Robert A. Bartell, CFA
Managing Director
+1 312 697 4654
bob.bartell@duffandphelps.com

Mark J. Kwilosz
Director
+1 312 697 4677
mark.kwilosz@duffandphelps.com

Eric Mandell
Senior Associate
+1 312 697 4613
eric.mandell@duffandphelps.com

Amsterdam
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Boston
Chicago
Cincinnati
Dallas
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Detroit
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Tokyo
Washington, DC Metro

About Duff & Phelps

As a leading global independent provider of financial advisory and investment banking services, Duff & Phelps delivers trusted advice to our clients principally in the areas of valuation, transactions, financial restructuring, dispute and taxation. Our world class capabilities and resources, combined with an agile and responsive delivery, distinguish our clients' experience in working with us. With more than 1,200 employees serving clients worldwide through offices in North America, Europe and Asia, Duff & Phelps is committed to fulfilling its mission to protect, recover and maximize value for its clients. Investment banking services in North America are provided by Duff & Phelps Securities, LLC. Investment banking services in Europe are provided by Duff & Phelps Securities Ltd. Duff & Phelps Securities Ltd. is authorized and regulated by the Financial Services Authority. Investment Banking services in France are provided by Duff & Phelps SAS. For more information, visit www.duffandphelps.com. (NYSE: DUF)

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