

# Product Profile

Private Equity Distribution Management (PEDM)

# PRIVATE EQUITY DISTRIBUTION MANAGEMENT (PEDM)

## PRODUCT PROFILE

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# PRIVATE EQUITY DISTRIBUTION MANAGEMENT (PEDM)

## PRODUCT PROFILE

### Product history/background

J.P. Morgan Asset Management has been managing investment portfolios for institutional clients and high-net-worth individuals for more than 50 years, with approximately \$1.26 trillion in assets under management as of September 30, 2009. Our Private Equity Group manages a portfolio of private equity assets dating back to 1980.\* As of September 30, 2009, the group had approximately \$18 billion in assets under management for over 100+ institutional clients.

### Private Equity Distribution Management (PEDM)

#### *Why PEDM?*

The Private Equity Distribution Management (PEDM) program was developed to manage distributions from private equity partnerships. It is a managed liquidation product, with a process built to provide returns on distributions that maximize cash-to-cash IRRs (internal rates of return) on private equity investments.

#### *History and development*

Private equity funds (general partners) raise capital from institutional investors (limited partners) to fund the startup and development of new companies, finance buyouts and/or provide growth capital. If and when these companies go public or are acquired by existing public companies, the partnership's private equity holdings are converted to public equity shares. Often, following the initial public offering (IPO) or acquisition, investors receive returns in the form of a distribution of public shares in the company (rather than as cash). At distribution, the private equity partnership calculates its performance based on the distribution price. However, this leaves investors with shares of potentially illiquid public stocks, the performance and sale of which can greatly impact true cash-to-cash returns. Effective management of these distributed securities in this final stage of the private equity cycle may significantly enhance actual returns realized from private equity investments.

As a private equity fund of funds manager, J.P. Morgan Asset Management has conducted extensive research to understand how distributions impact returns and how these distributions can be managed to help maximize cash-to-cash returns for our clients. The Private Equity Distribution Management (PEDM) program incorporates the results of this analysis and our own experience and expertise in the public and private markets. PEDM was developed in an effort to provide other institutional investors with an effective approach to enhancing their private equity returns and overall plan performance, while minimizing trading costs and the administrative burdens associated with private equity distributions.

As of September 30, 2009, the PEDM program has clients including endowments, foundations, corporate and public pension funds, with a total of \$34 billion in private equity commitments.

\*This group has been with J.P. Morgan Asset Management since 1997.

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### Investment objective

The PEDM program is designed to manage private equity distributions with the goal of maximizing cash-to-cash returns on private equity investments. Specifically, we seek to complete the private equity cycle with the objective of providing:

- Maximize returns on the sale of distributed securities, relative to distribution price
- Return capital to investors as quickly as possible to maximize reinvestment opportunities

*\*The manager seeks to achieve the stated objectives. There can be no guarantee the objectives will be met.*

### Platform

We believe our platform is unique in the marketplace given that our group was born within one of the largest private equity limited partners in the world. This gives us complete alignment of interest with other LP's. In addition, we also draw on J.P. Morgan's vast resources which allow us to have a focused team. When people select a distribution manager they often ask themselves three key questions as they relate to a distribution managers platform:

- 1) Does the manager understand the private equity cycle and an LP's needs?
- 2) Is the group strategic to their parent company?
- 3) Does the group have the support of a larger organization?

We believe our position in a leading LP gives us unparalleled insights into the private equity cycle and needs. We are also strategic to our group and therefore able to continue through up and down market cycles without any impact. We also leverage J.P. Morgan's tremendous resources which provide us with key legal, marketing, trading and research support.

### Philosophy

We believe that maximizing returns for private equity distributions requires a disciplined sell process whereby poor performers are identified quickly and sold with the objective of obtaining the best price for the securities sold, while good performers are held until there is a change in fundamentals. PEDM's investment philosophy is based on the following premises, as indicated by our research:

- On average, across time periods, the majority of private equity distributions have negative long term returns
- The return spread between successful and unsuccessful distributions is significant
- Distributed stocks are generally illiquid and trading costs are usually high
- Distributions occur without warning; sell/hold decisions must be made quickly to maximize returns
- The alternatives to active management—selling all distributions immediately, holding all distributions either indefinitely or for a better price or “timed selling” (e.g. selling 20% now and 20% more at the end of the next 3, 6, 9 and 12 months)—do not appear to be return-maximizing strategies for private equity investors

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In our view, an effective private equity distribution management process is characterized by:

- A quantitative framework that relies, for the initial sell/hold decision, on fact-based, historical inputs—rather than on a more expectations-oriented approach—and can therefore, be implemented expediently when distributions occur
- Fact-based criteria for decision-making which reflect the simple belief that companies which have delivered historically on stated goals, product development milestones and earnings are more likely to deliver in the future than those without this track record
- A sell bias—designed to sell more distributed securities than it holds (given the negative performance of the majority of distributions and that private equity investors have owned these securities privately for a long time)
- A careful, ongoing monitoring process for securities that are held, to identify changes in fundamentals that may suggest a sell. Here, we believe a more traditional fundamental research approach can add considerable value in assessing future performance
- Trading capabilities designed to minimize transaction costs
- A back-office infrastructure which minimizes the significant administrative burden associated with a pool of distributed securities

The above philosophy is built into our Private Equity Distribution Management (PEDM) program, with the objective of providing enhanced returns to private equity investments

## Process

### *Overview*

As previously stated, the objectives of our distribution management process is to 1) maximize our clients returns on distributed securities, relative to distribution price and, 2) to return capital to investors as quickly as possible to maximize reinvestment opportunities.

Our investment process utilizes industry-specific quantitative screens of fundamental factors to separate the strong performers from the rest of the distributions. Each distribution received is evaluated immediately (within one day) using a proprietary screen developed for its industry. In this sell-biased process, only stocks scoring above a predetermined threshold are held.

Once a sell decision is made for a discretionary portfolio or distributions are received for a sell-only portfolio, our trading capabilities are leveraged to maximize gains and minimize losses, with exact timing of the sell transaction dependent on market conditions. Minimizing transaction costs is an important contributor to maximizing returns on private equity distributions.

For fully discretionary portfolios in the case of a decision to hold, stocks are carefully monitored for changes in the fundamental screening factors, and sold if they fall below the threshold score. Our experienced PEDM portfolio management team is dedicated exclusively to the management of

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private equity distributions and receives valuable support from J.P. Morgan Asset Management's specialized industry research analysts in monitoring securities they decide to hold.

### *Characteristics of our investment screens*

Industry-specific screens were designed through in-depth discussions with numerous industry experts, including consultants, research analysts (our own as well as third-party industry specialists), sell-side analysts and company management. These discussions were conducted to help identify the factors most likely to be predictive of future company success and strong stock performance in the public marketplace. Dozens of factors were identified and rigorously tested for their ability to discriminate between good and poor stock price performers.

Resulting industry screens contain 12–24 unique factors, across the following categories:

#### Quantitative factors:

- Momentum factors (earnings revisions, sales revisions or money flow)
- Fundamental factors (operating earnings, operating margin)
- Industry-specific financial metrics (e.g., return on invested capital, days of sales outstanding, inventory growth/sales growth)

#### Qualitative factors:

- Product quality
- Management quality
- Ability to meet product development milestones

Quantitative factors are based on readily available, public information primarily from financial statements and other data sources. For qualitative characteristics, a framework for translating “quality” into measurable, fact-based metrics was devised. For example, in the case of biotechnology, management quality is captured by determining the answers to a series of yes/no questions such as whether senior management has FDA or “big pharmaceuticals” experience, or whether any members of senior management have left in recent months.

For non-biotech industries, quantitative and qualitative factors each represent 50% of the combined score. For biotechnology, quantitative factors represent only 30% of the score and qualitative factors account for 70%, since quantitative factors (e.g., earnings revisions) for biotech firms are often limited.

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### Trading and administration

Effective trading is a critical component in our effort to add value to a client's portfolio of distributed securities. For distributed stocks that we decide to sell and for our clients who mandate a sell-only strategy, our objective is to sell quickly — and as close to distribution price as possible. In the case of stocks we choose to hold, we monitor trading volume, price and patterns, seeking to achieve best execution when these generally illiquid securities are sold.

To implement the PEDM program as cost-effectively as possible, we leverage our in-house team of equity traders. To accomplish their primary goal of best execution, our traders not only seek to find the best price, but more importantly, to minimize market impact. J.P. Morgan Asset Management has committed substantial resources to its trading capabilities. Our traders utilize a broad range of tools from traditional brokers to electronic trading and crossing networks (such as Liquidnet, Instinet and Posit) to seek out multiple sources of liquidity and implement our process as efficiently as possible. The PEDM program leverages this trading strength and expertise in an effort to enhance returns to private equity distributions.

On the operational side, our program uses back-office capabilities specifically designed for distribution management, enabling reconciliation across multiple distribution agents and custodians for each client account. Our operational capabilities address many of the administrative complexities faced by investors when distributions occur and provide our trading desk with the flexibility required to achieve best execution.

*\*The manager seeks to achieve the stated objectives. There can be no guarantee the objectives will be met.*

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### Research

#### *J.P. Morgan Asset Management*

We have unlimited access to J.P. Morgan Asset Management's extensive equity research capabilities covering the public equity markets. While the initial sell/hold decision relies on a fact-based analysis, once a decision is made to hold a stock, a more traditional analytical process must be used, leveraging these vast resources. Specifically, we can draw on internal industry-specific analysts covering technology and telecom, retail, media and healthcare.

Our U.S. analysts communicate with and leverage their regional counterparts. J.P. Morgan Asset Management equity analysts are located around the world enabling them to gain a truly global and unified perspective on the industries they cover. Our large presence in the equity markets provides our analysts with extensive access to company management, aiding in the creation of a valuable information advantage.

#### *Private Equity Team*

As part of the Private Equity Group at J.P. Morgan Asset Management, our PEDM Team has knowledge about companies early in their development cycle. Because our Private Equity Group invests in many start-up companies that could ultimately be distributed to us, our background knowledge further enhances our information advantage in managing distributions we decide to hold.

#### *External research*

We also have access to Wall Street research, which we use primarily for earnings revision information and to keep us updated on the facts of an investment situation. We do not rely on external research for investment decisions.

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### Investment professionals

We understand the need of PEDM clients to have a staff that is constantly available to them since distributions occur without warning, and decisions must be made quickly. Our approach does not rely on people who are working on different products or in other areas of the firm. However, our product does draw upon the resources of the entire organization, when needed.

Currently there are two full-time portfolio managers dedicated solely to PEDM, and we intend to add personnel as the business grows. Additionally, we draw talent from many functional areas across the organization. As of September 30, 2009, we had 43 private equity professionals, 54 research analysts, 9 traders and several client service, legal, account management and operations staff devoted to our product on an as-needed basis.

The table below lists the PEDM Team as of September 30, 2009

Name	Title	Responsibilities	Total Years of Industry Experience	Years with PE Group
Robertus W. Prajogi	VP	Portfolio Manager	11	8
Evrard Fraise	VP	Portfolio Manager	8	3
Lawrence M. Unrein	MD	Head of Private Equity Group	25	11*
Julian E. Shles	MD	COO and CFO	23	15
Katherine Q. Rosa	MD	Investor Relations	17	9

MD= managing director, VP= vice president

\* Includes tenure at JPM and AT&T

Please refer to the biographies below for additional information on the PEDM Team members.

**Robertus W. Prajogi**, *vice president*. Mr. Prajogi joined the Private Equity Group in 2001 as an analyst responsible for managing private equity stock distributions. Prior to joining the Private Equity Group, he was a member of the Strategic Investment Advisory Group, responsible for working with clients to develop thoughtful solutions to broad investment policy issues, including strategic asset allocation, active risk budgeting, and risk management. He has co-authored a number of papers, some of which were published in financial journals. Mr. Prajogi is a CFA charterholder and is a member of the CFA Institute. He holds a B.S. and Master of Engineering in operations research and industrial engineering from Cornell University.

**Evrard Fraise**, *vice president*. Mr. Fraise joined the Private Equity Group in 2006 and is responsible for managing private equity stock distributions. Prior to joining the group, he was an analyst at Smith Barney for five years where he initially worked as a research associate in the machinery sector and then worked alongside the Chief Equity Strategist to create and grow the equity strategy product. Mr. Fraise holds a BS in languages from Georgetown University and an MBA from Columbia University.

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### **Lawrence M. Unrein**

Mr. Unrein is Head of the Private Equity and Hedge Fund Groups, overseeing the management of \$24 billion on behalf of institutional and private investors. Prior to joining J.P. Morgan Investment Management in 1997, Mr. Unrein spent 17 years with AT&T Investment Management Corp., an investment management subsidiary of AT&T. He was responsible for managing the public and private equity and fixed income portion of \$80 billion in corporate employee benefit funds. A graduate of State University of New York, Plattsburgh, Mr. Unrein earned his MBA from the Wharton School, University of Pennsylvania. He is a CFA charterholder, a member of the CFA Institute, and a Certified Public Accountant. Currently, Mr. Unrein serves on the advisory boards of Accel Partners, Accel-IDG, Accel London, Apax US, Clayton, Dubilier & Rice, Fenway Partners, Great Hill Equity Partners, Highbridge Capital Corp., MeriTech Capital Partners, New Enterprise Associates, North Bridge Growth Equity, North Bridge Venture Partners, Redpoint Omega, Redpoint Venture Partners, TA Associates, and Valhalla Partners. He also serves on the board of directors of National Surgical Hospitals, Inc. and Response Insurance and is a board observer for Homesite.

**Julian E. Shles**, *managing director*, Mr. Shles is the CFO and COO of the Private Equity Group. Mr. Shles has been with the firm since 1994 and has served in a number of financial reporting and management positions at the organization. In his position prior to moving to the Private Equity Group, Mr. Shles supervised a staff of 45 people comprising three major groups: (1) fund administration, (2) performance, and (3) budget and expense analysis. He previously worked in public accounting for 10 years at Price Waterhouse LLP and Deloitte Haskins & Sells. Mr. Shles graduated with honors from the University of Cape Town, South Africa. In addition, he is a CPA, a Fellow of the Institute of Chartered Management Accountants and a Chartered Accountant.

**Katherine Quick Rosa**, *managing director*. Ms. Rosa has portfolio management, business development and investor relations responsibilities within the Private Equity Group, which she joined in February 2000. She spent the previous two years as a Chief Operating Officer for the sales and client service teams of J.P. Morgan Investment Management. Prior to joining the firm, Ms. Rosa was a relationship manager at Morgan Stanley Dean Witter. Her clients included regional banks, insurance companies, pension funds, and mutual funds. She started her career as a product specialist in J.P. Morgan's securities services business. Ms. Rosa earned a BA from Franklin & Marshall College, and has completed her Series 7, 24 and 63 certifications.

*There can be no assurance that the professionals currently employed by JPMAM will continue to be employed by JPMAM or that the past performance or success of any such professional serves as an indicator of such professional's future performance or success.*

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### Competitive advantages

#### Platform

The team is a strategic part of a leading private equity limited partner and operates with an LP's interest in mind. The team also leverages J.P. Morgan Asset Management's firm-wide resources — from its public equity research to its trading and operational capabilities — seeking to maximize returns in this final stage of the private equity cycle.

#### Philosophy

Distributed securities present short-term trading and poor long-term performance challenges for private equity investors. We provide an effective management to break even across a market cycle and return cash back to maximize reinvestment opportunities.

#### Process

We expect to add value by differentiating between successful and unsuccessful distributions, by executing sells to minimize transactions cost and by actively monitoring held securities for a change in fundamentals.

Private equity distribution management requires close scrutiny, quick response and a diverse set of capabilities. Our singularly focused PEDM team adheres to a strict sell discipline, utilizing a quantitatively oriented investment process and proprietary decision tools. We also expect to add value by alleviating the administrative burden associated with attempting to dispose of restricted securities.

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### Disclaimer

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