



PSERS PRIVATE INVESTMENT PROGRAM

**Recommendation for Investment in
Lehman Brothers Venture Partners V, L.P.**

Charles J. Spiller
Director of Private Markets and Real Estate

May 3, 2007

Lehman Brothers Venture Partners V, L.P.

INTRODUCTION

Lehman Brothers Venture Partners V, L.P. is a \$300 million venture capital investment partnership being formed and managed by Lehman Brothers Venture Partners. The Partnership will seek to achieve superior risk-adjusted returns through investments in venture-backed technology companies. LBVP intends to leverage the Lehman Brothers platform to source, evaluate and execute investments, as well as to assist portfolio companies in their growth and development.

Lehman Brothers launched a formal venture investment program in 1995, and have since established a strong position in the venture capital market. Since inception, Lehman has invested a total of \$695 million generating a gross IRR of 30%. They seek to build a portfolio that is diversified across segments of the technology industry, such as software, communications, enterprise infrastructure and electronics. The majority of the Partnership's investments are expected to be in mid-stage – where companies have demonstrated initial product or revenue traction, and are seeking to scale their operations. On a selective basis, they will also evaluate early-stage and late-stage investment opportunities as a part of an overall portfolio risk/return management strategy. The average initial portfolio company investment is expected to be \$5-10 million, with follow-on financings bringing the total investment to \$10-15 million.

The partnership offers the resources and relationships offered by the Lehman Brothers global platform and the expertise of its five senior investment principals who have worked together for an average of six years. Collectively, the principals have worked at Lehman Brothers for over 40 years, and have built longstanding relationships throughout the company and the venture community.

As part of their strategy, the principals have focused on building strong relationships with the industry's premier early-stage venture funds. In prior funds, this strategy has provided them with high quality deal flow, as well as access to the industry's best entrepreneurs and technologists. The principals take an active role in investments, typically by serving on a portfolio company's Board of Directors. In addition to aiding the prospects of each portfolio company and protecting the interests of the Partnership's limited partners, the principals believe that active management is crucial to building credibility and relationships in the investment and entrepreneurial communities.

LBVP is targeting capital commitments of \$300 million for LBVP V. Lehman Brothers and certain eligible employees will make a commitment of 25% of total capital commitments to the Partnership (up to a maximum of \$75 million). Lehman Brothers' significant financial commitment reflects its strong belief in the venture capital opportunity and is designed to align more closely the interests of the Firm with those of the Partnership's limited partners.

KEY INVESTMENT HIGHLIGHTS

The Fund's strategy presents an attractive investment opportunity for the following reasons:

Strong, Cohesive, Investment Team

The Partnership is designed to benefit from the powerful combination of the Lehman Brothers global platform and the expertise of its dedicated venture capital investing team. The core team of five Venture Principals has worked together at LBVP for an

average of six years, and each of the Venture Principals has been with LBVP since at least 2001. Collectively, the team has extensive investing, operating, and financing experience, as well as a long tenure at Lehman Brothers. Tom Banahan, the senior Venture Principal, has over 20 years of technology operating experience, and has been with LBVP for seven years. The other Venture Principals have an average of 11 years of investment and financing experience and nine years at Lehman Brothers. With more than 40 years of collective tenure at Lehman Brothers, the Venture Principals have built longstanding relationships throughout the Firm, which they intend to use to leverage appropriate resources for the benefit of the Partnership.

The Partnership's investments will be vetted through an Investment Committee process, which has been utilized to review all of LBVP's transactions since 1995. The Investment Committee has been a source of continuity and has allowed the Venture Principals to leverage the expertise of some of Lehman Brothers' most senior professionals and has ultimately strengthened the investment decision process. LBVP's founder, Mike Odrich, is a member of this Investment Committee and will continue to play an active role in the management of the Partnership.

Strength of the Lehman Brothers Platform – Lehman Brothers has been an active private equity investor since 1984, when it became one of the first investment banks to enter the institutional principal investment business. As the sponsor of multiple private equity funds, Lehman Brothers is experienced in leveraging its platform in order to identify, evaluate and develop portfolio companies. Lehman Brothers focuses its private equity activities in sectors, industries and geographies where it perceives compelling investment opportunities and where it possesses substantial capabilities, strong deal flow, and an excellent reputation.

Lehman Brothers' strong brand and global resources are expected to provide a distinct competitive advantage to LBVP and the Partnership. When evaluating venture funding sources, it has been LBVP's experience that entrepreneurs and their existing venture sponsors seek investors who can provide strategic value as well as capital. Because of Lehman Brothers' brand and prominence as a financial institution, an investment by the Partnership can often enhance a company's credibility and status among customers, partners and suppliers, as well as in the capital markets at large. LBVP also leverages the Firm's extensive resources to identify and evaluate new investment opportunities, and to assist portfolio companies in both business development (such as partner and customer introductions) and product development activities. The Venture Principals actively coordinate with Lehman Brothers' investment banking, research, IT, and other professionals to find compelling investment opportunities. The Venture Principals primarily interact with four areas of Lehman Brothers:

1. **IT Organization** With over 3,000 IT professionals and an annual budget of over \$1.0 billion, Lehman Brothers IT Organization ("LBIT") offers the Partnership the prospect of a significant competitive advantage in investment due diligence and sourcing, as well as portfolio company development. LBIT works closely with many of the LBVP's prior funds portfolio companies, evaluating products and providing guidance as a progressive, early adopter of technologies, practices which LBVP expects to continue in LBVP V. Additionally, LBIT frequently assists LBVP's early-stage venture investment partners, which further strengthens LBVP's relationships and deal flow from these firms.
2. **Investment Banking** Lehman Brothers is a recognized global leader and innovator in investment banking, and LBVP leverages this network primarily for

deal flow and strategic introductions for portfolio companies, such as customers, partners and potential acquirers. Lehman Brothers employs over 1,600 investment bankers covering a broad range of industries and geographies and ranks fifth in global equity and debt underwriting. In particular, Lehman Brothers has a strong technology banking franchise, with approximately 100 investment bankers covering hundreds of public and private technology companies worldwide.

3. **Research** The Firm employs more than 250 equity and fixed income research analysts covering over 1,500 companies globally. Approximately 60 of these research professionals are focused on covering technology companies. The strength and breadth of the Lehman Brothers global platform provides a powerful source of industry and market information to bolster the Venture Principals' investment evaluation skills.
4. **Private Investment Management ("PIM")**. The Firm's approximately 600 private investment management professionals provide investment, wealth advisory and capital markets execution services for high net worth individuals and businesses and manage approximately \$204 billion of assets. PIM clients include senior executives and entrepreneurs, which have been a solid source of deal flow and strategic introductions for LBVP.

ESTABLISHED RELATIONSHIPS WITH KEY VENTURE SPONSORS

The Partnership's primary source of deal flow is the Venture Principals' relationships within the venture community, and LBVP has demonstrated a record of partnering with the industry's top early-stage venture sponsors. LBVP has built these relationships over the last 11 years through its conduct, diligence, and value-added management on the Boards of its portfolio companies. The strength of LBVP's relationships is evident through the number of transactions completed with such well-known and respected firms as Sequoia Capital, Kleiner Perkins Caufield & Byers, New Enterprise Associates, Austin Ventures, Redpoint Ventures, and U.S. Venture Partners, among others. In many instances, the Venture Principals have been invited by these firms to proactively target preferred opportunities within their portfolios, independent of specific fund raising efforts by these companies.

Established Position in the Mid Stage Venture Investment Market

A high proportion of LBVP's investments to date have been in the mid-stage of the market, in companies that have developed a product and are beginning to generate customer traction and revenue. Mid-stage transactions are typically Series B or Series C financings. The Venture Principals feel strongly that this is a relatively less competitive segment of the market. In mid-stage companies, the underlying investment risk is related primarily to "business execution" rather than "technology development." By focusing on the evaluation of market adoption, competitive advantage, managerial ability, strategic partnerships, sales channels, and other elements of business plan execution, the Partnership will seek to better leverage the Venture Principals' extensive experience and the expertise resident throughout Lehman Brothers. Furthermore, companies at this stage of development have a strong appreciation for the value that can be created by an investment from a prominent firm such as Lehman Brothers.

Strong Investment Record

As of December 31, 2006, LBVP had invested approximately \$695 million in 76 portfolio companies through its four predecessor funds (the “LBVP Aggregate Portfolio”). Significant value has been created within the LBVP Aggregate Portfolio through multiple realizations and third-party driven valuation events. As of December 31, 2006, the LBVP Aggregate Portfolio had a gross IRR of 30%. Furthermore, LBVP IV portfolio companies have experienced significant revenue growth since the initial date of investment. On average, the 20 active companies in this portfolio grew revenue by 173% from 2004 to 2005, with 10 of them exceeding \$10 million in revenue in 2005. While final 2006 revenue numbers are not yet available, the portfolio companies have continued to experience strong revenue growth in 2006.

Substantial Lehman Brothers Commitment and Alignment of Interests

Lehman Brothers (Firm and certain eligible employees) has committed 25% of total capital commitments to the Partnership. Eligible employees are expected to represent a significant amount of the Firm’s total commitment. This significant commitment to LBVP V reflects a strong belief in the Venture Principals, the Lehman Brothers global platform and the venture capital opportunity. To provide appropriate incentives to the Partnership and align the interests of the General Partner with those of the limited partners, the Venture Principals will also be limited partners of the General Partner and, as such, will invest capital in the Partnership through the General Partner. The Venture Principals will share in the profits of the Partnership through a carried interest program.

INVESTMENT STRATEGY

Over the last decade, LBVP has developed and executed a differentiated investment strategy that capitalizes on the strengths of the investment team and the Lehman Brothers platform.

Invest with Industry Leaders

LBVP’s strategy is to partner with the industry’s premier early-stage venture funds and, over the past decade, the Venture Principals have built strong relationships with these firms. In prior funds, this strategy has provided LBVP with high quality deal flow, as well as access to the industry’s best entrepreneurs and technologists. Historically, a disproportionate amount of the venture capital industry’s returns have been generated by the companies backed by a relatively small group of top-tier early-stage venture funds. LBVP has established strong relationships with many of these funds, through the Venture Principals’ interaction as well as longstanding institutional relationships with Lehman Brothers.

Leverage the Lehman Brothers Platform as a Competitive Advantage

Lehman Brothers’ strong brand and global resources are expected to provide a distinct competitive advantage to LBVP and the Partnership. In LBVP’s experience, when evaluating venture funding sources, entrepreneurs and their existing venture sponsors seek investors who can provide strategic value as well as capital. LBVP also intends to leverage the Firm’s extensive resources to identify and evaluate new investment opportunities, and to assist portfolio companies in both business development (such as partner and customer introductions) and product development activities. The Venture Principals actively coordinate with Lehman Brothers’ investment banking, research, IT and other professionals to find compelling investment opportunities.

Maintain Leadership in the Mid-Stage Venture Investment Market

The Venture Principals anticipate that a majority of the Partnership's investments will be in mid-stage technology companies, where LBVP has established a strong market position. Mid-stage companies have demonstrated momentum with a developed product, and customer and revenue traction. Mid-stage transactions are typically Series B or Series C financings. LBVP believes that investments in this market segment have been critical to building its differentiated franchise.

- *Ability to lead & actively manage investments* – Unlike late-stage or passive investments, mid-stage companies typically require active involvement from the Board over a number of years. In addition to providing LBVP with access to directly aid its portfolio companies and control to protect its interests, Board membership creates strong ties with the other investors in LBVP's portfolio companies and with the entrepreneurial community. These relationships then lead to strong deal flow. Since the inception of Fund III, LBVP has been the lead or co-lead investor in over 95% of its initial financings, and has served as a Director or Observer on the Board of all of its portfolio companies.
- *Reduced risk profile* – In mid-stage investments, the underlying investment risk is related primarily to “business execution” rather than “technology development.”
- *Few consistent competitors* – LBVP believes that the mid-stage market is relatively less competitive. In LBVP IV, many of the completed deals were non-competitive. In deals where the fundraising process was competitive, LBVP rarely encountered repeat competitors.
- *Minimal conflict with key partners* – LBVP's market position minimizes potential conflicts with its key early-stage venture sponsors. LBVP does not compete directly with early-stage funds by funding companies, but may consider partnering with these groups selectively on early-stage investments.
- *Competitive advantage of Lehman Brothers' platform* – As mid-stage companies take their products to market, an investment by LBVP enhances a company's credibility and status among customers, partners, and suppliers, as well as in the capital markets at large.

As a result of LBVP's reputation in this market segment, LBVP expects that the Partnership will also be invited to evaluate some investment opportunities in early-stage and mezzanine-stage companies. LBVP will evaluate these opportunities selectively as a part of its overall portfolio risk / return management strategy

Building a Diversified Portfolio

The Partnership will seek to develop a portfolio of 20 to 30 investments that are diversified by technology sector, other investors and, to a limited extent, stage of development. The average initial portfolio company investment is expected to be \$5–10 million, with follow-on financings bringing the total investment to \$10–15 million. LBVP believes that sector diversification is a critical element of fund management, as it minimizes exposure to an individual segment's customer demand and fundraising environment. The Venture Principals seek to diversify the Partnership across several broad segments:

- *Software* – Enterprise applications and infrastructure software.
- *Communications* – Wireless and wireline equipment, devices and applications.
- *Enterprise Infrastructure* – Storage, computing and enterprise networking.

- *Electronics* – Semiconductors, electronic equipment and devices.
- *Internet* – Online content, services, retailing and infrastructure technologies.
- *Opportunistic* – Energy, materials sciences or other emerging technology sectors.

Investment Sourcing

LBVP sources prospective investments through the Venture Principals' relationships, proactive targeted sourcing, and Lehman Brothers' platform. As LBVP has established its position in the market over the last decade, the quality of deal flow has become exceptional: in LBVP IV, many of the completed investments were non-competitive.

- *Venture Principals' relationships* – LBVP expects the Partnership to benefit from the breadth and depth of the Venture Principals' network of business relationships formed over years of serving on Boards and investing alongside the industry's premier venture sponsors.
- *Proactive investment sourcing* – The Venture Principals actively monitor key companies in the Partnership's targeted industries, and attempt to establish a dialogue with promising management teams in advance of a fundraising process.
- *The Lehman Brothers platform* – Deal flow is also generated through the Firm's IT organization, investment banking, research and private investment management relationships. Lehman Brothers' approximately 26,000 employees have an extensive network of relationships with corporations, managers, entrepreneurs, and venture capitalists.

EXIT STRATEGY

Liquidity for leading private technology companies has continued to improve. After reaching a low in 2003, M&A activity has rebounded to reach \$16.6 billion in disclosed value for 2006, the highest level of M&A activity since 2001 and the second year in a row in which the disclosed value of M&A activity exceeded \$16 billion. In the more restrictive post Sarbanes-Oxley environment, M&A exits significantly outnumber IPO's. The IPO market also improved, as 58 venture-backed IPO's raised \$5.3 billion in 2006, the second largest amount raised since 2000.

LBVP anticipates that the Partnership will exit portfolio investments primarily through the public capital markets or through a sale or merger of a portfolio company. The Venture Principals along with their Investment Committee will determine the appropriate timing and manner of disposition of freely tradable securities, either through sale in the public markets or distribution to the Partners, based on multiple factors, including, but not limited to market liquidity, regulatory restrictions, and potential future share price appreciation.

KEY PERSONNEL

The Partnership will be managed by a core investment team of five Venture Principals who have worked together at LBVP for six years on average, and each of which has been with LBVP since at least 2001. Collectively, the team has extensive investing, operating, and financing experience, as well as a long tenure at Lehman Brothers. Tom Banahan, the senior Venture Principal, has over 20 years of technology operating experience, and has been with LBVP for seven years. The other Venture Principals have an average of 11 years of investment and financing experience and nine years at Lehman Brothers. With more than 40 years of collective tenure at Lehman Brothers, the

Venture Principals have built longstanding relationships throughout the Firm, which they use to leverage appropriate resources for the benefit of the Partnership.

The Partnership's investments will be vetted through an Investment Committee process, which has been utilized to review all of LBVP's transactions since 1995. This has been a source of continuity and organizational learning that strengthens the investment decision process. LBVP's founder, Mike Odrich, is a member of this Investment Committee and continues to play an active role in the management of the partnership.

Michael J. Odrich (43) is a Managing Director and Head of Lehman Brothers' Private Equity business, which includes Merchant Banking; Venture Capital; Real Estate; Private Fund Investments (Fund of Funds, Secondary Opportunities and Co-Investments); Credit-Related Investments (Mezzanine, CDOs and MLPs) and other private investment activities. In aggregate, Lehman Brothers' Private Equity business currently oversees in excess of \$13 billion of committed and invested capital.

Mr. Odrich joined Lehman Brothers in 1986 in the M&A Department. Beginning in 1992, he spent three years working directly for Lehman Brothers' Chairman and Chief Executive Officer, involved in strategic and financial planning, Board of Directors matters and merchant banking and investment banking transactions. In 1995, he joined the Firm's Private Equity business, responsible for identifying, executing and managing investments for the Merchant Banking Group. Also in 1995, he established the Firm's venture capital investment program and has led that business since inception. Mr. Odrich became Head of Private Equity in 2000. Mr. Odrich is a member of the Lehman Brothers Management Committee. He is also a member of the Firm's Investment Committee, Valuation Committee and the Screening Committee for the five asset classes of private equity. Mr. Odrich is currently a director of Firth Rixon LLC and Regeneration Technologies, Inc. (NASDAQ: RTIX).

Mr. Odrich holds an M.B.A. from Columbia University and a B.A. from Stanford University

Thomas E. Banahan (48) is a Managing Director in Private Equity, head of Global Venture Capital and a partner in Lehman Brothers Venture Partners. Prior to joining Lehman Brothers in 1999, Mr. Banahan spent 20 years working as an operational manager in the technology industry. Most recently, he was the vice president of business development for Marimba, Inc. (NASDAQ: MRBA). Mr. Banahan joined Marimba as the 14th employee and was involved in all areas of the company's growth through its successful public offering in April 1999. Prior to Marimba, Mr. Banahan was the vice president of worldwide sales for Spyglass, Inc. During the six years prior to Spyglass, Mr. Banahan worked for Comdisco, Inc. (NYSE: CDO) as a vice president of sales, with his sales team directly responsible for significant revenue generated from sales to Fortune 1000 companies. He currently is a director of Aspen Aerogels, Composite Software, GameFly, Infoblox, Kontera, Mark Logic, MotoSport, Primarion, and Tira Wireless, and was formerly a director of PentaSafe Security Technologies (acquired by NetIQ) and SevenSpace (acquired by Sun Microsystems). Mr. Banahan holds a B.A. from the University of California, Santa Barbara.

Brian K. Paul (38) is a Managing Director in Private Equity and a partner in Lehman Brothers Venture Partners. Prior to joining Private Equity in 1999, Mr. Paul worked in Lehman Brothers' Global Technology and Healthcare Investment Banking Groups in New York, London, and Los Angeles. Within these investment banking groups, Mr. Paul was responsible for public and private equity offerings as well as strategic advisory assignments. Before joining Lehman Brothers in 1994, Mr. Paul was an associate at

First Boston where he was responsible for the purchase and sale of mortgage loan portfolios. He was previously a director of Isilon Systems (NASDAQ: ISLN), E2O Communications, Inc., (sold to JDSU) and Creekpath Systems (sold to Opsware). Mr. Paul holds an M.B.A. with distinction from the Kellogg Graduate School of Management and a B.S. in economics from the Wharton School of the University of Pennsylvania.

Stewart A. Gollmer (40) is a Senior Vice President in Private Equity and a partner in Lehman Brothers Venture Partners. He joined Lehman Brothers in 1998 and has been with Lehman Brothers Venture Partners since 2001. Prior to joining Lehman Brothers Venture Partners, he was a member of Lehman Brothers' Technology Investment Banking Group where he was responsible for corporate finance and strategic advisory assignments. Prior to joining Lehman Brothers, Mr. Gollmer was a corporate attorney. He currently is a director of Navini Networks, Kodiak Networks, and Health Language, and a Board observer of TeleNav and comScore Networks. Mr. Gollmer holds an M.B.A. from the University of Chicago, a J.D. from Brigham Young University, and a B.A. from the Johns Hopkins University.

Brian G. Melton (34) is a Senior Vice President in Private Equity and a partner in Lehman Brothers Venture Partners. He joined Lehman Brothers in 1994 and has been with Lehman Brothers Venture Partners since 2000. Prior to joining Lehman Brothers Venture Partners, Mr. Melton was a member of Lehman Brothers' Merchant Banking Group based in Hong Kong and New York. Prior to joining Private Equity, he was a member of Lehman Brothers' Financial Sponsors Group. Mr. Melton is currently a director of Active Semiconductor and Mobilygen Corporation, and a Board observer of Fortémedia and Valere Power. Mr. Melton holds an M.B.A. from Stanford University and a B.S. from Wake Forest University.

Benjamin A. Boyer (30) is a Vice President in Private Equity and a partner in Lehman Brothers Venture Partners. Mr. Boyer joined Lehman Brothers in 1998 and has been with Lehman Brothers Venture Partners since 2000. Prior to joining Lehman Brothers Venture Partners, he was a member of Lehman Brothers' Technology Investment Banking Group where he was responsible for corporate finance and strategic advisory assignments. Mr. Boyer is a Board observer at Endeca and Tira Wireless and is also involved with the Firm's investments in Elemental Security, GameFly, Isilon, Navini, ShoreTel, and TeleNav. Mr. Boyer holds an M.B.A. from Stanford University and a B.S. in human and organizational development from Vanderbilt University.

CONCLUSION/RECOMMENDATION

Based upon the successful track record and experience of the principals and the recommendation of PSERS' consultant, Portfolio Advisors, staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed \$75 million plus reasonable normal investment expenses, in Lehman Brothers Venture Partners V, L.P. The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Executive Director.