

**Teachers' Retirement System
of the State of Illinois**

Private Equity Manager Questionnaire

The Teachers' Retirement System of the State of Illinois ("TRS") Private Equity Manager Questionnaire will be the primary source of information for TRS to evaluate **Sterling Venture Partners II, L.P.** (the Manager) as a potential provider of services. For this reason, it is important that the information provided be complete and in the format requested. Please keep your response to each question to one or two pages. In addition, please restate the question on each response. Many questions can be answered with a brief response. Please submit your completed questionnaire with attached exhibits, tabbed accordingly, as a bound document.

Organization and Management

1. Contact and Company Information:

Name of Firm: **Sterling Venture Partners**
Mailing Address: **1033 Skokie Boulevard, Suite 600**
City: **Northbrook** State: **IL** Zip Code: **60062**
Phone: **847-480-4000** Fax: **847-480-0199**

Federal Employer Identification Number: **36-429-8625**

Contact Person(s):

Name: **Eric Becker** Phone: **443-703-1701**
Title: **Managing Partner** Fax: **443-703-1750** Email: **ebecker@sterlingpartners.us**

Name: **Michael Bronfein** Phone: **443-703-1710**
Title: **Managing Partner** Fax: **443-703-1750** Email: **mbronfein@sterlingpartners.us**

Name: **Daniel Rosenberg** Phone: **847-412-6252**
Title: **Partner** Fax: **847-480-0199** Email: **drosenberg@sterlingpartners.us**

2. Is your firm currently registered as an Investment Advisor under the Investment Advisors Act of 1940? If yes, please attach a copy of your most recent SEC Form ADV (tab as Exhibit A). If no, please explain why.

No, SEC regulations do not require private equity managers to be registered.

3. Is your firm currently registered to do business in the State of Illinois as an Investment Advisor?

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No, current regulations do not require private equity managers to be registered.

4. Describe the entity TRS would contract with for the proposed investment advisory services, and the ownership structure of that entity. Provide each identified entity's involvement in private equity within the last five years.

SV Partners II, L.P., the General Partner of the Fund, and Fund Management Services, LLC, an affiliated management company, will provide management and administrative services.

During the past five years, Fund Management Services has overseen the operations of Sterling Venture Partners L.P., a \$136 million Venture Capital Fund and Sterling Capital Partners, L.P., a \$316 million Middle-Market Buyout Fund.

5. Is the management entity covered by errors and omissions insurance? If yes, how much coverage do you have? If no, please explain why.

Yes, \$5,000,000.

6. A.) Have there been any changes in ownership structure in the last five (5) years? If yes, when? Please describe nature of change.

Yes, the ownership structure has remained an independent private partnership, although one new partner (Merrick Elfman, Managing Partner of Sterling Capital Partners) has been admitted in the past five years.

B.) Are there any anticipated changes in the ownership structure, core line of business, or senior staffing of your firm?

No.

7. What safeguards for the investors is your firm providing in the event there is turnover of key people in the firm (e.g. limited partner advisory board, key person provisions, and/or no-fault termination provisions)?

We will provide protection to the Limited Partners with a key person provision.

A Limited Partner Advisory Committee will be established.

There will not be a no fault provision.

8. Provide an organizational chart (tab as Exhibit B). Include the number of investment professionals and non-professionals. Identify your key employees by title, years with your

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firm, years as an investment professional, years of Private Equity experience, and educational background. Also, please provide a short biography of the individuals.

Attached as Exhibit B.

9. Give a brief description of your firm's compensation arrangements for investment professionals (e.g. salary, bonus, group/individual performance incentives, profit sharing, equity ownership, etc.).

The Manager's compensation structure is designed to align the interests of its investment professionals with those of its investors while attracting, developing and retaining preeminent talent at every level. In addition to competitive salaries and benefits, the Manager provides equity participation, in the form of the General Partner's carried interest which vests over time, to its professionals, beginning at the Associate level.

10. Is your firm planning to hire any additional personnel, professional or support, in connection with the management of the new fund? If yes, please explain. If no, please explain.

We anticipate hiring one additional Senior Associate/Vice President in the second half of 2004, to replace a current Senior Associate who is entering business school later this year.

11. Does your firm do business in areas other than asset management (brokerage, consulting, etc.)? If so, please provide a listing of your firm's divisions along with their contribution to the firm's total revenues and expenses (in percentage terms). Is it anticipated that the entity TRS is considering retaining will use the services of affiliate firms? Do you consider this a conflict of interest? Why or why not?

No.

12. Did or will the firm provide or share, agree to provide or share, or arrange to receive, provide or share any payment, compensation, benefit or reciprocal influence, direct or indirect, to any individual or entity for assisting in: (a) soliciting, marketing for, or obtaining the engagement; or, (b) maintaining the engagement or performing the services pursuant to the engagement? If the answer is "yes," provide for each such individual or entity: (a) the name and address of the individual or entity, (b) a description of the assistance provided, and (c) the payment, compensation, benefit or reciprocal influence. *(In the event the investment manager has agreed to pay a third party any introduction or referral fee in the connection with the proposed investment management relationship with the System, Staff shall disclose to the Board in writing before the investment relationship is approved by the Trustees the identity of the payee as well as the terms of any such proposed payment prior to the System becoming obligated to proceed with the investment.)*

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Yes.

Name of Agent: XXXXXX (an entity associated with Michael Winter)
Address: 853 N. Elston Avenue
Chicago, Illinois 60622

XXXXXX services consist of making introductions to various potential investors, coaching and consulting on the PPM and investor presentation, and acting as a consultant to the Manager with respect to its fundraising.

For its services, XXXXXX will be paid 1% of the aggregate capital committed by funds it introduces to the Manager.

13. Provide the firm's most recent financial statements (tab as Exhibit C).

Legal Issues

14. Has your firm ever been involved in any litigation arising from the firm's role as an investment manager? Is your firm currently involved in any litigation? Please comment.

Yes, an investment entity of Sterling Capital, Ltd. (the predecessor to Sterling Venture Partners) brought an action against a brokerage firm relating to the sale of securities to the entity. The brokerage firm counterclaimed that the entity's general partner was the reason for the losses. The case was settled in Sterling's favor and Sterling paid no money to the brokerage firm.

15. Has a civil legal judgment of any kind ever been entered against a shareholder, partner, member, officer or key employee of your firm? If the answer is yes, please provide the details including the date of judgment, jurisdiction and the current status of the proceeding.

No.

16. Has any current shareholder, partner, member, officer or key employee of your firm ever been terminated or forced to resign from his/her employment for reasons related to professional competence, ethical and/or financial improprieties and/or unsatisfactory performance? If the answer is yes, please provide the details including the name of the individual and the identity of the former employer. Please send a copy of the reference authorization letter to the terminated individual.

No.

17. Has any shareholder, partner, member, officer or director of your firm ever been charged with and/or convicted of a criminal offense (other than traffic court violations) or charged by any

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regulatory agency with violations of any of its rules and/or regulations or, to your knowledge, investigated by any regulatory agency for potential violations of any of its rules and/or regulations? If the answer is yes, please provide all details including the caption of the proceeding and its resolution and/or status.

No, none of the shareholders, partners, members, officers or directors of the firm have been charged or convicted of any such offense or violation and we have not been notified that any of them has been the subject of an investigation for potential violations.

Assets Under Management

18. Describe the total investment portfolio currently managed by your firm, including the total assets currently under management. Provide gross and net returns for prior fund(s) and for all investments made since inception. Provide a separate list for all private equity investments made, in the format requested in Schedule A (tab as Exhibit D).

Sterling Venture Partners and the General Partner were formed by the principals of Sterling Capital, Ltd., a private equity firm founded in 1983. Through 1999, Sterling Capital, Ltd. raised capital for its investments on a deal-by-deal basis. The following year, the firm began its transition to an institutionally-focused, fund-based investment model with the sponsorship of Sterling Venture Partners I, a \$136-million venture capital fund raised in 2000, which was followed by Sterling Capital Partners, a \$316-million middle-market buyout fund raised in 2002.

From its inception through 1999, Sterling Capital, Ltd. returned a gross IRR of 48% and 3.7x invested capital.

A schedule of all Sterling Venture Partners I investments has been included as Exhibit D. All of the unrealized investments in Exhibit D are valued at the lower of cost or market as directed by GAAP, and do not reflect the substantial value that has been created but not yet realized.

19. Provide a list of "hard" and "soft" commitments to the fund you are currently marketing. Please provide the allocation each investor has made, or is anticipating making, to your new fund. Please provide the total dollar amount of commitments you are seeking for the new fund. Also, please provide the maximum dollar amount of commitments your firm will accept for the new fund.

Fundraising began in March of 2004 with a select initial offering that only included existing Sterling investors and TRS. Based upon the meetings we have had to date, we are expecting hard commitments from the following investors:

SV Partners II, L.P. (the GP)	\$6,000,000 to \$10,000,000
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State of New Hampshire	\$15,000,000 to \$20,000,000
Mercantile Bank	\$5,000,000 to \$10,000,000
Phoenix Life Insurance	\$5,000,000
Massachusetts Bay Transit Authority	\$5,000,000
Phoenix Life Insurance	\$5,000,000
City of Boston	\$5,000,000

We are seeking \$250,000,000 with a hard cap of \$300,000,000.

20. Provide a schedule showing the projected capital calls to the new fund and projected distributions from the new fund for each year of the partnership.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Capital Calls	17%	22%	22%	17%	12%	7%	1%	1%	0%	0%
Distributions	0%	0%	0%	0%	50%	66%	66%	50%	33%	17%

*The capital calls include management fees. Distributions assume an average holding period of four years.

Deal Flow

21. How does your firm generate deal flow?

Our ability to generate proprietary deal flow and recognize attractive opportunities and trends results from years of experience in the industries in which we invest. We have significant expertise in healthcare, business services, education and industrial technology. This experience and knowledge allows us to identify emerging trends, target investment opportunities that are poised to benefit from industry changes, and position portfolio companies to take advantage of these evolving market dynamics. In Sterling Venture Partners I, 40% of our investments were derived from long standing industry relationships from our operating backgrounds.

22. How extensive is your firm's network of contacts that serve as a source of potential investments?

Given our long track record of operating and managerial experience in our sectors of focus, we have developed a unique network to generate deal flow. Sterling's long standing relationships in the sectors in which we invest, and our reputation as knowledgeable and active investors with significant operational and entrepreneurial experience, generated a number of proprietary deals for Sterling Venture Partners I and will continue to deliver such opportunities for Sterling Venture Partner II.

Sterling has been investing for twenty years, and during that time has built a very large network of deal sources including industry relationships, co-investors, investment banks, service providers, etc.

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Sterling's other investment divisions (middle-market buyouts and real estate) also offer access to deal flow, industry relationships and knowledge. In particular, we enjoy substantial synergy with Sterling Capital Partners, Sterling's middle-market buyout team. Sterling Capital Partners focuses primarily on control investments, but applies many of the same core practices, including a disciplined investment approach, emphasis on management development, and application of the Business Value Accelerator methodology, as we do.

23. How many potential investments does your firm review in a year? How many investments are made in an average year?

In an average year, we review approximately 750 investment opportunities. We have made 19 investments during the approximately four years that we have been investing Sterling Venture Partners I, for an average of about five per year. We anticipate a similar investment pace in this fund.

Investment Strategy and Process

24. Why do you believe institutional investors should consider investing in private equity in the current market? Please discuss both favorable and unfavorable characteristics of private equity from the perspective of institutional investors.

The primary reason institutional investors should invest in private equity vehicles is the superior returns they deliver. Private equity has historically out-performed the S&P 500, NASDAQ and other investment classes by a wide margin. The superior performance is consistent when viewed over 5, 10, 15 and 20-year periods. The following table shows relative performance of U.S. Venture Capital versus, U.S. Buyouts, the S&P 500 and the NASDAQ.

	5-Year	10-Year	15-Year	20-Year
U.S. Venture Capital	16%	25%	20%	16%
U. S. Buyouts	3%	13%	14%	N/A
S&P 500	-3%	10%	11%	12%
NASDAQ	-4%	8%	10%	8%

*Source: Cambridge Associates. Annualized returns, net of management fees, expenses and carried interest as of 6/30/03.

After several years of poor performance, the current environment for venture investing is very promising. According to a recent report by Thomson Venture Economics and the National Venture Capital Association, fourth-quarter 2003 posted a positive one-year venture capital return (8%) for the first time in three years. Although the returns are still below historical figures, the trend is promising. The improved performance

has been largely driven by improving exit opportunities as both the M&A and IPO markets have strengthened.

The most unfavorable characteristic of private equity is the illiquidity of the investment. Unlike investments in public securities, etc. the capital committed to a private equity fund is tied up for an extended period of time with no ability to exit the investment. Other unfavorable characteristics include the relative lack of visibility into the performance of the underlying portfolio companies, and potentially volatile returns.

25. What type of private equity strategy does your firm employ? How does it differ from your peers?

The Manager will seek expansion stage and growth capital investments. The investment philosophy behind the strategy is founded on deep industry knowledge and specialization, and a disciplined process that has effectively been used to source and create investment opportunities, conduct thorough and effective due diligence, develop strong relationships with management teams, and generate profitable realizations. Underlying this investment philosophy are four key principles that are strictly adhered to in order to optimize the prospects for success and differentiate us from our peers.

1. *We Only Invest in What We Know*

Eric Becker, Danny Rosenberg and Michael Bronfein, the management team, collectively have over 50 years of operating, managerial and investment experience in core verticals that the fund will target for investments including:

- Healthcare Services and IT,
- Business Services,
- Education, Testing and Training, and
- Industrial Technology/Clean Tech.

2. *We Apply Rigorous Criteria to Each of Our Investment Opportunities*

In particular, we place emphasis on the following factors:

- Strong Management Team with a Proven Track Record,
- Defensible Competitive Advantage,
- Recurring Revenue Model,
- Leverageable Operating Model,
- Diversified Customer Base,
- Attractive Underlying Fundamentals, and
- Fragmented Markets.

3. *We Are Actively Involved with Our Portfolio Companies*

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We believe that active involvement in our investments leads to better outcomes. We have founded and built successful businesses, and held a variety of senior operating positions in a number of thriving companies, which provides us a unique perspective into all aspects of operations at our portfolio companies. Central to our successful investment oversight and management is Sterling's Business Value Accelerator ("BVA") methodology. Developed and honed over Sterling's twenty-year investment history, BVA is a methodology by which the firm becomes actively involved in its investments, adding value at multiple stages of a company's development. BVA is described in more detail in the answer to question 55.

4. *We Critically Evaluate Our Performance and That of Our Portfolio Companies and Make Adjustments as Necessary*

We employ a defined process and discipline in all investment decisions and portfolio oversight. Much as an operating company must evolve in order to succeed, our firm's philosophy stresses the importance of continuous evaluation and refinement of our processes.

There are certain elements of our investment philosophy that we believe are proprietary to Sterling. Two concrete examples underscore this unique approach.

Tools To Assess Executive Talent

Industry studies, as well as our own experience, show a high correlation between great CEOs and great companies/great investment returns. In order to exploit this fact, we developed a proprietary management assessment and executive development tool that gives us better insight into the capabilities, fit, and potential of prospective managers. We have a dedicated human resources executive, Steve Thompson, who oversaw the development of these tools to identify, assess, and develop executive talent. The details of our proprietary assessment program is documented in our Human Capital Assessment Manual.

Business Value Accelerator

Sterling has developed the Business Value Accelerator methodology as a means to translate the decades of managerial, operational and industry expertise harbored at Sterling into a value-added benefit for our portfolio companies. The BVA process is customized for each company's competitive position, operating structure, and industry segment and guides a series of activities that are developed within a predefined framework. During the due diligence process, strengths and weaknesses are investigated and assessed so that an action plan for optimizing results may be developed prior to the transaction

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closing. We share our due diligence results with the management team post-closing, and collaborate with them to implement the action plan.

Our strategy to focus on expansion stage businesses and growth capital also differentiates us from many of our peers. Expansion stage companies entail less risk than do early stage companies by definition: they have a complete, or nearly complete, executive management team; are producing and shipping products; their assets are growing; and are nearly, if not already, profitable. Because of their maturity, they are generally expected to be more valuable than early stage companies. However, since 2000, the premium commanded for expansion stage companies has declined dramatically to the point that, on an historical basis, expansion stage companies offer a compelling value proposition vis-à-vis early stage companies.

According to data provided by the National Venture Capital Association and Thomson Financial, the average pre-money valuation of expansion stage companies dropped dramatically from \$89.5 million in 2000 to \$18.7 million in 2003. Over the same period, the average pre-money valuation of early stage companies declined from \$26.7 million to \$7.9 million. The result is a contraction of the risk premium from \$62.8 million four years ago to \$10.8 million last year, an 80% decrease.

Beyond their relative attractiveness on a risk/reward basis, we believe our operational focus, the business value accelerator methodology, and our human capital process have the greatest impact on the rapidly developing operations of expansion stage companies. Our operating experience and focus uniquely positions us to provide leverage to expansion stage businesses.

26. The investment opportunity that has been presented to TRS by your organization has been defined in general as a private equity opportunity. Below, please indicate which investment strategy, as defined by TRS, best describes your proposed investment strategy. Please comment as necessary.

Venture Capital (focusing on Expansion Stage companies).

27. Please provide, based on your firm's current private equity strategy and policies of diversification in building a portfolio of private equity, the following diversification breakdown. What would be your firm's largest recommended exposure in the diversification models listed below?

By Industry Sector Strategy

% of Investment

of Investments

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Healthcare Services and IT	35%-50%	8-12
Business Services	15%-25%	4-6
Education/Testing/Training	15%-25%	4-6
Industrial Technology/Clean Tech	15%-25%	4-6

By Geography

North America	100%	20-25
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By Investment Stage Strategy

Expansion	100%	20-25
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28. If applicable, please describe the firm's experience in international private equity investing.

Not applicable.

29. What size of a position (% of total capitalization) do you typically purchase in companies?

Our ownership positions the current portfolio range from 10% to 45%. We anticipate that the positions will range from 20% to 45% in this fund.

Investment Due Diligence

30. What key management qualities are sought in potential investments?

A critical success factor in any investment, and an important component of our due diligence, is centered on assessing the capabilities of the management team. We have developed a proprietary method for determining the strengths and weaknesses of the management team, and the alignment of their skill sets with the strategy and operational needs of the business, and crafted an approach that integrates the two. The process includes an in-depth evaluation of management's past experiences and the correlation of those experiences to the needs of the prospective portfolio company.

With a dedicated, in-house human resources executive (Steve Thompson), we are uniquely positioned to conduct a comprehensive and accurate assessment of our management teams.

31. How are objective references obtained?

Due to our depth of experience in the industries in which we invest, and our longstanding investment history, we are able to tap into our networks to obtain references from people that did not appear on someone's reference list. These references may be from industry sources, or investors who may have had prior experience working with a candidate. Because these references come through our

personal relationships, we get much more accurate and thorough information than we would obtain from a stranger. Our human capital assessment process also yields names from a candidate's past work experience that we are able to track down either directly or through our relationships.

32. What questions are the references asked?

A sample reference call template is attached as an exhibit.

33. How are the products/services of a potential investment evaluated?

Our initial analysis is based on the knowledge we have of the markets in which we invest. Investments we analyze are usually addressing market needs that we have identified prior to reviewing the particular company. We analyze multiple companies in the same space, giving us excellent understanding of the pros and cons of competitive offerings. By understanding the market need before beginning the analysis of the potential investment, we are attuned to the market needs, and how well the company may be addressing them.

The analysis continues with a thorough review of the behavior of the potential customer base. This is accomplished through the assessment of the sales pipeline and conversations with current, prospective and former customers. We often introduce potential customers to the company during the due diligence process to gain first hand knowledge of both the product or service, and the company's ability to sell.

In situations where the technical aspects of a business exceed our internal abilities to conduct an appropriate analysis, we go to our network of industry specific experts for a more thorough review.

34. How is the past performance of a potential investment evaluated?

We conduct detailed financial analysis that compares actual results with historical budgets. The review focuses on the detailed financial drivers of the business and determines which variances are the result of poor execution, and which are determined by market realities. The analysis also focuses on the company's ability to determine market needs and demands, and its ability to drive sales and develop a meaningful pipeline that is predictive of actual results.

Reference calls also play an important role. Both existing customers, and potential customers are contacted to determine how well the company has delivered on its commitments, and how well it is addressing market needs. In the case of companies that are venture-backed, we discuss historical performance with the existing investors. Although the existing investors are motivated to say positive things, our longstanding relationships with many of these firms allows us to get the "real story".

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35. How are the pro forma projections for potential portfolio companies analyzed?

Initially, we look for companies with operating models that satisfy our primary financial criteria including: recurring revenue, highly leverageable (i.e; non-capital intensive), diversified customer base, fragmented market and predictable sales cycle. Businesses that satisfy these basic standards are put through a detailed financial analysis that focuses on the economic drivers of the business down to a unit basis. By understanding how a company makes money at a micro level, we can better analyze the potential risks and opportunities that are presented by the company's model and product offering. We then utilize a bottoms-up approach to determine the actual addressable market, focusing on the specific market needs and niches that a company's product satisfies. Based on this series of analyses we adjust the company's projections, and/or create our own model to make our determination of the company's actual potential. From this model, we determine if the potential of the business justifies the risk, what the appropriate investment terms are, the potential exit value, and our projected investment return.

If we make the investment, the depth of our understanding of the operating model allows us to monitor the performance of the business at a very detailed level.

36. How is the rate of return analyzed for a potential portfolio company?

The exit strategy is one of the key determinants of our investment decision, and the strategic decisions we drive, as Directors, always have the achievement of that end goal in mind. By realistically assessing the likely exit, it is a relatively straightforward analysis to look at comparable companies and comparable transactions to determine the valuation techniques (multiples of EBITDA, multiples of revenue, etc.) that can be expected. By applying these exit valuations to the financial model that we develop (discussed in question 35) we are able to determine the projected returns.

37. How are potential investments valued (multiples, cash flow, etc.)?

Potential investments are valued using industry-accepted techniques, including comparable company analysis and comparable transaction analysis. Typically, a pre-money value for a potential investment will be calculated by applying an appropriate multiple to forward revenue or operating income.

38. What internal review processes are used to screen potential investments?

The table below illustrates the Sterling Venture Partners investment decision-making process.

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Action Step 1.	Incoming deals are logged into Deal Database (DDB). The responsible investment professional will populate the following: entry date, deal name, company (name/phone/address), date received, industry, stage of development, source (type/name/phone/address), SVP contact, deal description and comments. Note: There should be at least one phone number (source phone number / company phone number) entered into DDB.
Action Step 2.	The Sterling Venture Partners' investment professional reviewing the specific deal will conduct a preliminary evaluation, criteria screen, and may solicit feedback from other investment professionals.
Action Step 3.	Responsible investment professional will present potential acquisition that meets investment criteria at the Staff Meeting. Valuation expectations should be prepared and discussed at this time, as well as potential syndicate partners (if necessary).
Action Step 4.	The designated reviewer selects an investment team to work with. At least one member of the team must be a Partner.
Action Step 5.	Subsequent to performing the preliminary assessment and criteria screen, the investment team will initiate a complete review of company, management team, market and financial projections.
Action Step 6.	The investment team will qualify the deal for the next action step. If not the team will promptly decline the opportunity. The investment team will update DDB to reflect the opportunity in the deal pipeline as a "dead company" and will enter the "reason declined."
Action Step 7.	The team prepares the Prospective Investment Overview (P.I.O.) for the acquisition and presents it at the weekly meeting for discussion. After presenting the P.I.O. at the weekly meeting, the meeting participants evaluate and discuss the opportunity. A decision is drawn whether or not to pursue the opportunity further. If team declines, the investment professional initiates the rejection process per Step 6.
Action Step 8.	A draft of a non-binding letter of intent or term sheet (agreement in principle) will be prepared.
Action Step 9A.	If the non-binding letter of intent is signed, the investment professionals will develop a detailed due diligence plan.
Action Step 9B.	Sterling Venture Partners executes initial due diligence work. The initial due diligence review serves to achieve an understanding of the opportunity including the industry and competitive landscapes and an analysis of multiple exit strategies. Site visit and management meeting and interviews are included.
Action Step 10A.	Sterling Venture Partners prepares and identifies on the Due Diligence Master Project Plan the assigned parties and deadlines to carry out the due diligence procedures.
Action Step 10B.	Sterling Venture Partners requests legal counsel to begin document preparation.
Action Step 10C.	The Due Diligence Master Project Plan has been completed. As a result of Step 10A, 10B, and this action step, the investment professionals create, compile, and update the Due Diligence Binder .

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Action Step 11.	Once the Due Diligence Master Project Plan is executed and completed, the investment professionals can assess and evaluate the acquisition through review of the Prospective Investment Overview, Due Diligence Binder, LOI, draft closing documents, and other materials.
Action Step 12.	Sterling Venture Partners negotiates final terms and documents and notifies accounting of wire instructions and estimated funding date. All three Partners (Eric Becker, Michael Bronfein and Danny Rosenberg) approve transaction by execution of Transaction Approval Form and forward to accounting.
Action Step 13.	Upon final approvals, professional responsible for the deal executes documents and forwards copies of all signature pages to accounting. CFO submits wire instructions to financial institution. The legal documentation is filed and maintained alphabetically.
Action Step 14.	The CFO will update the database system for quarterly and annual reporting purposes, as it is important that the deal information is correctly and completely reflected.

39. Who makes the final decision to invest? Under what circumstances would you decline an investment?

The investment decision is subject to the unanimous approval of all three Partners of Sterling Venture Partners (Action Step 12). Investment can be declined at any time due to any issues raised during the investment decision-making process outlined in question 38 above.

40. Describe how post-investment decisions related to the investment will be conducted.

The primary Partner on each investment prepares and presents a written update on the portfolio company on a regular basis. This update addresses financial performance, recent developments, sales pipeline, management, exit, etc. The summary is discussed by the entire team in the weekly meeting, assuring that everyone is familiar with any issues facing each of the companies. This practice also assures that each company benefits from the collective experience and input of the entire Sterling Venture Partners team.

Any follow-on investments must be approved by unanimous consent of all three partners.

41. How is the due diligence process documented?

Prior to making an investment, we complete a rigorous investigation of the target company that follows our due diligence procedures as documented in the firm's Investment Policies and Procedures manual. The process includes a thorough examination of the prospective portfolio company, including its management (including third party assessment, background checks and reference calls), internal systems, financial statements and forecasts, customer and supplier relationships, and sales and

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marketing strategies. We also consider a number of external factors, typically including the industry and competitive dynamics, existing and prospective strategic relationships, technological developments, regulatory considerations, the total addressable market size, and exit opportunities. The results of our due diligence, including any third party assessments, are compiled in the Due Diligence Binders discussed in the process outline in question 38 above.

42. What portions of the due diligence process does your firm outsource or subcontract (e.g. legal, audit)? Please describe.

Documentation is always prepared by outside legal counsel, however, the Partner sponsoring the investment addresses all investment negotiations and business issues directly. Financial due diligence is conducted in-house, but, from time-to-time, a nationally recognized firm may be hired to assist in the review. The final piece of our proprietary management assessment process is outsourced to a firm specializing in management analysis for private equity investors. In certain instances where the ability to assess a company's technology exceeds our internal capabilities, we will utilize experts to assist in our analysis.

Negotiation

43. Describe the key considerations and deal points in negotiating the pricing, terms, conditions, representations, and warranties of an investment.

Our primary objective is to protect the downside of the investment while securing maximum participation in the upside. We also strive to structure terms that will most effectively align our interests with management.

44. Do you conduct investment negotiations in-house, and to what degree do you use outside counsel in the negotiation process?

The Partner sponsoring the investment conducts all investment negotiations. Outside counsel is utilized primarily for documentation purposes.

45. How many times in the last five years has the firm discontinued interest due to negotiation of terms and/or pricing?

We do not track this figure, but we are focused on value investing and pride ourselves on not overpaying for investments. As a result of this pricing discipline, we have walked away from a great number of deals when we were unable to receive investment terms with which we were comfortable.

46. Provide specific examples of contract provisions your firm has incorporated in contracts to protect investments.

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We incorporate a number of protective provisions in every investment we make. Below is a list of some of the terms that we typically require.

Board Seats	CEO Selection Approval
Liquidation Preferences	Subsequent Financing Approval
Participating Preferred Securities	Board Expansion and New Member
Tranched/Milestone Fundings	Acquisition and Divestiture Approval
Anti-Dilution	Audit Committee Participation
Capital Expenditure Approval Rights	Compensation Committee Participation
Budget Approval Rights	

Documentation and Closing

47. Describe the process used in the documentation and closing of investments.

See Table on Question 38.

48. What portions of the documentation and closing process does your firm outsource or subcontract, (e.g. legal, audit)? Please describe.

Legal only.

Exiting/Liquidity

49. How does your firm plan for liquidity in private equity?

Prior to making an investment, we identify multiple exit scenarios for the company. We then assist in crafting the company's strategy with the probable outcomes in mind. We share the experience we have in the monetization of our investments with management so they can operate the business in a manner that creates the greatest value. When the company's performance and market conditions indicate the time is appropriate, we work with management to best utilize our extensive network of likely buyers, investment bankers and other agents to identify the most profitable exit. After an exit vehicle is selected, we remain actively involved in all aspects of the process to drive the most successful outcome.

As both investors and operating executives, we have gained significant experience developing high-value exit strategies for companies through both sales and public offerings. These profitable exits reflect a disciplined process that includes preparing the company for its liquidity event while carefully assessing and proactively identifying strategic buyers, value-added intermediaries, or other parties critical to the sale process.

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50. How many investments has your firm managed through to disposition or complete liquidity?

The Manager has directly managed nine investments in Sterling Venture Partners I through to disposition or liquidity, and its predecessor firm, Sterling Capital, Ltd. has managed an additional 22.

51. How many public offering exits from private investments has your firm accomplished?

Sterling Venture Partner's predecessor firm has completed two successful public offerings.

52. Describe your firm's policy and outlook on public offering versus trade sale exits.

We prefer trade exits unless there is an extremely compelling reason to take the illiquidity risk associated with a public offering.

53. Does your firm plan to make in-kind distributions or cash only? If in-kind distributions are expected, under what circumstances will you make in-kind distributions?

We anticipate making primarily cash distributions, but may occasionally make distributions of highly liquid securities.

Monitoring and Adding Value

54. What observer/directorship rights does the partnership have in a typical investment?

We are directors in 17 of the 19 investments in Sterling Venture Partners I, and have observation rights in the remaining two investments. We anticipate directorships in all of the investments in this fund.

55. What does your firm do to add value to the investments after they are made? Please provide an example of how your firm's active participation enhances investor value once an investment is made.

The ability to effectively transfer our extensive operating experience to our portfolio companies has been a critical component of our success. The product of this expertise has been codified as Sterling's proprietary Business Value Accelerator methodology.

The BVA process is customized for each company's competitive position, operating structure, and industry segment, and guides a series of activities that are developed within a predefined framework. During the due diligence process, a company's strengths and weaknesses are investigated and assessed so that an action plan for optimizing results may be developed prior to the transaction closing. We share the due

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diligence results with the management team post-closing, and collaborate with them to implement the action plan.

As active Board members, we continue this process via ongoing and rigorous strategic planning and the creation and updating of metrics that enable us to both mentor the management team and hold them accountable for specific results. We capitalize on our operational expertise and entrepreneurial experience in setting strategy, guiding management, and using our industry contacts to help our portfolio companies expand.

The effective assessment, recruitment, and development of prospective executives are a critical competitive advantage of ours and that of our portfolio companies. Sterling is one of only a few private equity firms with a full-time human resources executive devoted to the evaluation of prospective management teams, staffing and recruiting, and the establishment of appropriate policies and strategies. Sterling has developed a proprietary management assessment methodology to evaluate prospective management teams and their alignment with the strategic and tactical priorities of their companies.

All investing principals at Sterling have received training for this process, and training is offered to portfolio company executives to improve their hiring success. Sterling's methodology involves multiple steps including the development of scorecards of skills and key attributes, a specialized and extensive interview process conducted by multiple members of the Sterling team, and finally third party validation by a consulting firm. As a result of this rigorous process, we believe we have a superior ability to assess and select senior executives who can build valuable franchises.

56. How frequently is your firm in contact with the management at the companies your firm has invested in? How often does your firm occupy a Board seat on the companies your firm has invested in?

Active involvement in our portfolio companies is a critical component of our investment thesis. As such, we maintain frequent and active contact with the management teams at all of our portfolio companies.

We are directors in 17 of the 19 investments in Sterling Venture Partners I, and have observation rights in the remaining two investments. We anticipate directorships in all of the investments in this fund.

57. Describe the methods employed to determine investment valuations in reporting to investors.

Private Securities:

Investment cost is presumed to represent value except as indicated otherwise as follows:

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Valuation should be reduced if a company's performance and potential have significantly deteriorated. Indications of such deterioration may include, but are not limited to, the following:

- Insolvency
- The loss of a major customer/client
- Material credit facility defaults not waived or cured

Valuation should be adjusted to reflect a subsequent significant equity financing that includes a sophisticated and unrelated new investor. (Note: A subsequent significant equity financing that includes substantially the same group of sophisticated investors as the prior financing should generally not be the basis for an adjustment in valuation). If substantially all of a significant equity financing is invested by an investor whose objectives are in large part strategic, it is presumed that no more than 50 percent of the increases in the investment price compared to the prior significant equity financing is attributable to an increase in the value of the company.

Warrants should be valued at the excess of the value of the underlying security over the exercise price.

The carrying value of interest bearing securities should not be adjusted for changes in interest rates.

Public Securities:

Public securities should be valued at the closing price or bid price except as indicated otherwise in these guidelines.

The valuation of public securities that are restricted should be discounted appropriately until the securities may be freely traded. Such discount should directly reflect the length of the holding period at the beginning of the holding period and should decline as the restrictive period lapses.

When the number of shares held is substantial in relation to the typical trading volume, the valuation should generally be discounted by at least 10 percent.

58. Has your firm ever managed an investment in a crisis? Please give a brief description.

The firm has a deep legacy of active involvement with our portfolio companies including serving as interim CEO, bringing in turnaround specialists, making CEO changes, etc. Below are examples of two companies in the Sterling Venture Partners I

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portfolio that we helped manage through crises, and a brief summary of the role we played in their turnarounds.

Argent Trading provides a financial service to large companies to help them restore value to impaired assets. The Company began to struggle financially as the result of both disappointing sales traction and high operating expenses. After spending considerable time on-site at the company analyzing the situation and developing a strategic plan to cut costs and ramp up sales, we determined the founding management team would need assistance solving the problems. We brought in a new CEO, with whom Sterling had worked before, and worked with him to finalize the strategic plan for turning the business around. Many aspects of the plan required our direct involvement, including our assistance in helping to secure new partnership agreements, introduction to prospective clients, assistance in recruiting additional new employees, etc. The company has been successful executing on the strategic plan, driving an increase in revenues of 60% and the company's first profitable year.

VISICU offers a new approach to patient care in the intensive care unit of hospitals through the eICU. Michael to draft.

59. What information is required to be reported by portfolio companies? How often is this information reported?

A strategic plan and annual budget are presented to the Board prior to the start of each fiscal year, and are subject to Board approval. Detailed strategic and financial updates are delivered monthly and are compared to the annual plan with a particular focus on key metrics that are set out for the management team of the company.

60. What key financial performance measures does your firm use to evaluate the financial statements of portfolio companies?

In each company, we work with management to determine the divers of value creation on a unit basis. These key measures are tracked on a monthly basis to determine how the business is tracking to plan, and what areas of operations may be falling behind and are in need of management and Board scrutiny. In addition to tracking these performance metrics, we closely monitor the balance sheet with a particular focus on the company's liquidity and financial resources in order to assure it has the financial resources to deliver on its plan.

61. What post investment services does your firm provide to the investment companies?

We believe in building strong and sustainable businesses of enduring value. To successfully accomplish this, we have assembled a team with a thorough understanding of the operational, human capital, and industry dynamics of each of our portfolio companies. The ability to effectively transfer this knowledge and experience to our

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portfolio companies has been a critical component of our success. The product of this expertise has been codified as Sterling's proprietary Business Value Accelerator methodology.

The BVA process is customized for each company's competitive position, operating structure, and industry segment, and guides a series of activities that are developed within a predefined framework. During the due diligence process, a company's strengths and weaknesses are investigated and assessed so that an action plan for optimizing results may be developed prior to the transaction closing. We share the due diligence results with the management team post-closing, and collaborate with them to implement the action plan.

As active Board members, we continue this process via ongoing and rigorous strategic planning and the creation and updating of metrics that enable us to both mentor the management team and hold them accountable for specific results. We capitalize on our operational expertise and entrepreneurial experience in setting strategy, guiding management, and using our industry contacts to help our portfolio companies expand.

The effective assessment, recruitment, and development of prospective executives are a critical competitive advantage of ours and that of our portfolio companies. Sterling is one of only a few private equity firms with a full-time human resources executive devoted to the evaluation of prospective management teams, staffing and recruiting, and the establishment of appropriate policies and strategies. Sterling has developed a proprietary management assessment methodology to evaluate prospective management teams and their alignment with the strategic and tactical priorities of their companies.

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62. In what situation(s) would your firm replace the management of a portfolio company?

Although there are a number of reasons that may cause us to replace the CEO of a company, the primary situations are the following:

- Breach of ethics or fiduciary trust;
- Inability to execute against the business and strategic plans;
- Inability to attract or retain appropriate management talent; and
- Inability to attract capital to the business.

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Partnership Reporting

63. Briefly describe your internal accounting capabilities and your abilities to fulfill the necessary reporting requirements of an institutional client.

We have a full-time CFO and accounting staff who prepare monthly financial statements and quarterly reports, and who work with Ernst & Young to complete the annual audit.

64. Is your firm flexible in generating investor requested reports?

Yes.

65. Attach a sample of the most recent quarterly financial report your firm prepares for investors (tab as Exhibit E).

Sterling Venture Partners I report dated December 31, 2003 is attached as Exhibit E

66. Describe your firm's information management system. Please provide specifics on hardware and software.

All limited partner and portfolio investments are tracked via an internally developed database using Microsoft Excel. All data is housed on a company network server with access limited to senior accounting personnel. The network server is backed up daily by both local tape drive and off-site web facility. Maintenance is managed by an outsourced IT services firm.

References (tab as Exhibit F)

67. Provide a complete current client list with the contact person, address and telephone number. Please specify the type of client (e.g. public fund, endowment, corporate, or private investor). Also provide a list of former clients, with contact person, address and telephone number, who have discontinued their relationship with your firm in the past five years and state the reasons the client discontinued the relationship. Please send a copy of the reference authorization letter to all listed contacts. Please also send a copy of the authorization letter to TRS.

Attached as Exhibit F.

No clients have left in the past five years.

68. Provide a complete current investment list with the name, address and telephone number of the CEO for each investment. Also provide a complete list of liquidated investments with the name, address and telephone number of the CEO for each investment. Provide a complete list of contact persons, addresses and their telephone numbers for co-investors and/or

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financing sources in any of the investments listed. Please send a copy of the reference authorization letter to all listed contacts. Please also send a copy of the authorization letter to TRS.

Attached as Exhibit F.

69. Provide a list of all legal firms, audit firms, and principal banking relationships your firm has used in the last five years, with contact name, address and phone number, and any other relevant information. Please send a copy of the reference authorization letter to all listed contacts. Please also send a copy of the authorization letter to TRS.

Attached as Exhibit F.

Other

70. Include any additional information that TRS should be aware of to complete the due diligence process.

At a previous meeting, we provided a copy of our proprietary Human Capital Assessment manual. We encourage you to review that along with this questionnaire to further illustrate the critical role human capital plays in our investment analysis and portfolio management.

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Schedule A

Fund Name: XYZ Partners
Manager: XXXX

Company Name	Inv Dates	Location	Inv Stage	Security Type	Inv Amount	Realized Amount	Current Value	IRR
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REFERENCE QUESTIONNAIRE AUTHORIZATION LETTER

[Prospective Private Equity Manager Letterhead]

[Month, Day, Year]

[Reference Name]

[Reference Title]

[Company Name]

[Reference Address]

[City, State Zip]

Dear [Reference Name]:

(Prospective Private Equity Manager Name) is currently negotiating with the Teachers' Retirement System of the State of Illinois ("TRS") with regard to providing asset management services. TRS is conducting its due diligence with regard to *(Prospective Private Equity Manager Name)*. Through this written authorization, *(Prospective Private Equity Manager Name)* hereby authorizes any individual, business, corporation, investment management company, or other entity to release any facts and information it may have concerning *(Prospective Private Equity Manager Name)*, its principals, employees and agents, to TRS.

A copy of this authorization may be used as if it were an original. Thank you for your assistance.

Sincerely,

Prospective Private Equity Manager Name

Authorized Signature and Title

cc: Scott K. Parrish
Investment Officer – Private Equities
Teachers' Retirement System of the State of Illinois

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The undersigned hereby attests that the information provided herein is true and accurate. The undersigned also acknowledges that he/she is aware that pursuant to the Illinois Pension Code, 40 ILCS 5/16-198 that "any person who knowingly makes a false statement or falsifies or permits to be falsified any record of this Retirement System in any attempt to defraud such System as a result of such act, or intentionally or knowingly defrauds this Retirement System in any manner is guilty of a Class A misdemeanor."

Prospective Manager Name

Authorized Signature and Title

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Please return one copy of the questionnaire to Teachers' Retirement System of the State of Illinois:

Scott K. Parrish
Investment Officer – Private Equities
Teachers' Retirement System of the State of Illinois
2815 West Washington
Springfield, IL 62702

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