

Alternative Investments: Private Equity

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Glossary of Terms

Private Equity Fund: A vehicle for enabling pooled investment by a number of investors in the equity of companies

Portfolio Company: A business entity that has secured at least one round of financing from one or more private equity funds

General Partner (GP): The manager/firm that raises private equity funds and controls the partnership's activities

Limited Partner (LP): A passive investor in a limited partnership (i.e., a private equity fund)

Exit/Realization: Liquidation of holdings by a private equity fund. Methods include trade sale; sale through IPO, sale to another PE fund

J-Curve: The tendency for a private equity fund to deliver negative net returns in its early years and net positive returns in the later years of the fund's life. In the early years, the assets are often held at cost but may be negative when net of management fees and costs

Return: Measure of profitability that evaluates the performance of an investment. The most common measures in PE/VC are Internal Rate of Return (IRR), stated in annual percentages, and cash on cash returns, stated in multiples of invested capital (MOIC)

Internal Rate of Return (IRR): The IRR is the interim net return earned by investors (LPs), from the fund from inception to a stated date. The IRR is calculated as an annualized effective compounded rate of return, using monthly cash flows to and from investors, together with the residual value as a terminal cash flow to investors

Carried Interest: A bonus entitlement accruing to an investment fund's management company or individual members of the fund management team. Carried interest (typically up to 20% of the fund profit) becomes payable once the investors have achieved repayment of their original investment in the fund plus a defined hurdle rate

Hurdle Rate: The IRR that private equity fund managers must return to their investors before they can receive carried interest

Glossary of Terms

Primary: Investing capital into new funds making new investments. Primaries offer investors exposure to a portfolio of direct PE investments

Co-Investment: Offer direct exposure at the portfolio company level. Co-investments often have no associated fees or carry

Secondary: Purchase of LP interests in existing private funds (mature primaries) from existing LPs with meaningful capital already deployed. Can be led by the General Partner or the Limited Partner

Buyout: Financing provided to acquire a majority stake in company. It may use a leverage (debt) as part of the cost of acquisition

Venture Capital: Often minority equity co-invested with the entrepreneur to fund an early stage (seed and start-up) or expansion venture

Small/Mid/Large-Cap: Often used to describe the size of company based on its capitalization (enterprise value) in the buyout space

Capital Call: A request made by a private equity firm to its investors for capital contributions to fund investments

Distribution: The return of capital and profits from an investment or fund to the limited partners. It represents the cash made by the private equity fund to its investors as a result of a full or partial exit of a portfolio company investment

Net Asset Value (NAV): Valuation metric often used to reference exposure to private equity. NAV is calculated by adding the value of all of the investments in the fund

Questions to Address

- Liquidity constraints
- Fee structures
- Planning for illiquid assets in your portfolio
- History of the marketplace and why it is growing
- Are banks being replaced by private equity?

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Polling Question

Do you manage a plan that is invested in private equity or actively considering investing in private equity?

A) Yes

0%

B) No

0%

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Polling Question

Do you manage a plan that is invested in private equity or actively considering investing in private equity?

- A. Yes
- B. No

Private Companies

Definition

- Closely held and controlled
- Not publicly traded



Source: Method Advisors.

Characteristics

- All types of business and industries
- Family-owned, entrepreneurial or multinational corporations
- Difficult to access information about them

Private Transactions

Drivers of Deal Flow

- Inter-generational transfer
- Capital for investment or growth
- Distressed situation
- Partnerships
- Public to Private/Carveout

Active Control

- Value creation
- Board representation
- Strategic
 - Key personnel
 - Long-term investments

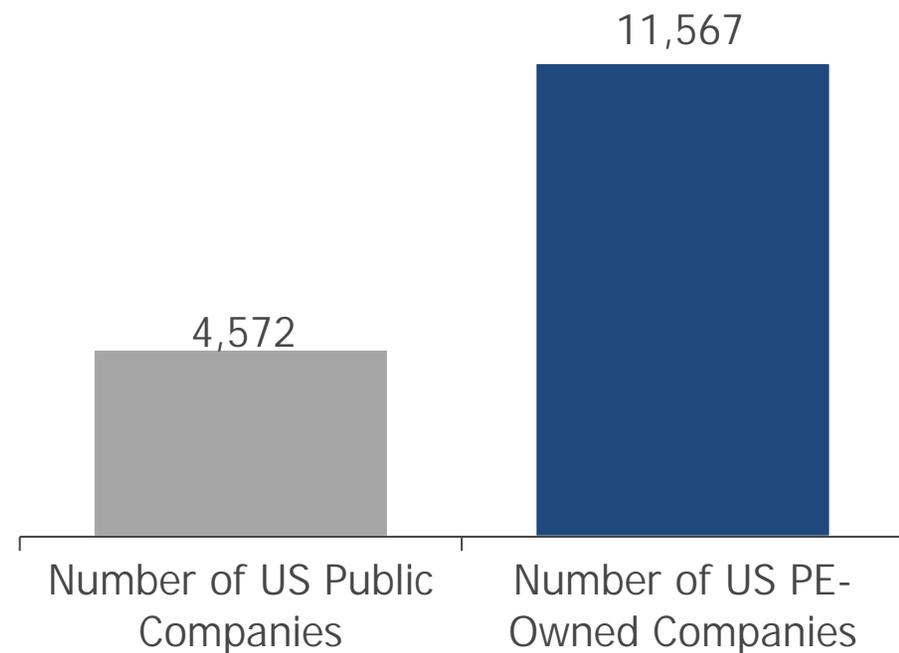
Source: Method Advisors.

Why Is Private Equity So Attractive?

- Large opportunity set
- Strong historical returns
- Operational value add

Opportunity Set

- Companies with more than \$10 million in revenue:
 - ~78,000 US Companies
 - ~97% are private



Source: Pitchbook. Data as of June and September 2024, the most current available data. Public market data available as of December 2023.

Benefits of PE: Strong Historical Returns

Comparison of Returns—Public vs. Private¹



1. For illustrative purposes only. The benchmark performance is presented for illustrative purposes only to show general trends in the market for the relevant periods shown. The investment objectives and strategies of the benchmarks may be different than the investment objectives and strategies of a particular private fund, and may have different risk and reward profiles. A variety of factors may cause this comparison to be an inaccurate benchmark for any particular type of fund and the benchmarks do not necessarily represent the actual investment strategy of a fund. It should not be assumed that any correlations to the benchmark based on historical returns would persist in the future. Past performance is no guarantee of future results. Indexes are unmanaged and are not available for direct investment. Source: Private equity data from Burgiss. Represents pooled horizon IRR and first quartile return for the US Buyout from Burgiss as of 2024 Q1, which is the latest data available. Public market data sourced from Neuberger Berman as of 2024 Q1.

Active Versus Passive Management

Acquisition

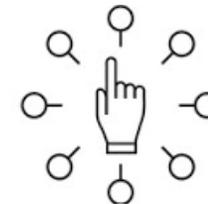
Value Improvement

Exit

Public



Private



- Detailed access
- Inefficient market
- Structuring

- Management and operational influence

- Multiple options
- Timing flexibility

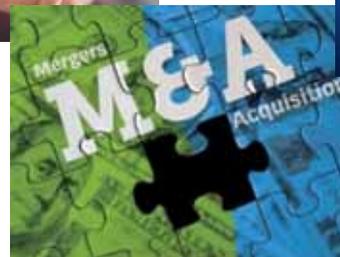
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Buyouts Use Leverage

Investors often use debt to finance the purchase of an asset



How PE Firms Add Value



Timeline of a Fund

Year 1	Years 2-10		Years 11-12
GPs market the fund	GPs search for, acquire, and operate companies	GPs exit companies and return capital to LPs	GPs may request additional time
Investors commit capital	LPs fund capital called by the fund	LPs receive distributions	LPs may approve request for additional time
Fundraise	Invest/Drawdown	Exit/Distribute	Extend

Liquidity

- PE is a long-term asset class (10–14 years)
 - Creates the illiquidity premium
 - Changes take time
- Exit options
 - Hold to end of fund life/extension period
 - LP secondary sale
 - GP liquidity option

Economics (Fees)

Management Fee

- Period payment from LPs to the GP for investment and portfolio management services
- Typically 2% of committed capital (though larger funds tend to range from 1.5%–1.75%)

Carried Interest

- GP's share of profits, typically 20%, after a hurdle rate, typically 8%
- Typically paid out on a fund-level basis or a modified deal by deal basis

Source: Method Advisors, Neuberger Berman.

Ways to Access Private Equity

Methods of Implementation	#of Managers	#of Companies
Direct company investment Or co-investments	0	1
Direct fund investment	1	10-20
Fund of funds/separate account/secondary fund	10-30	100-500

Risk Level



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Resources

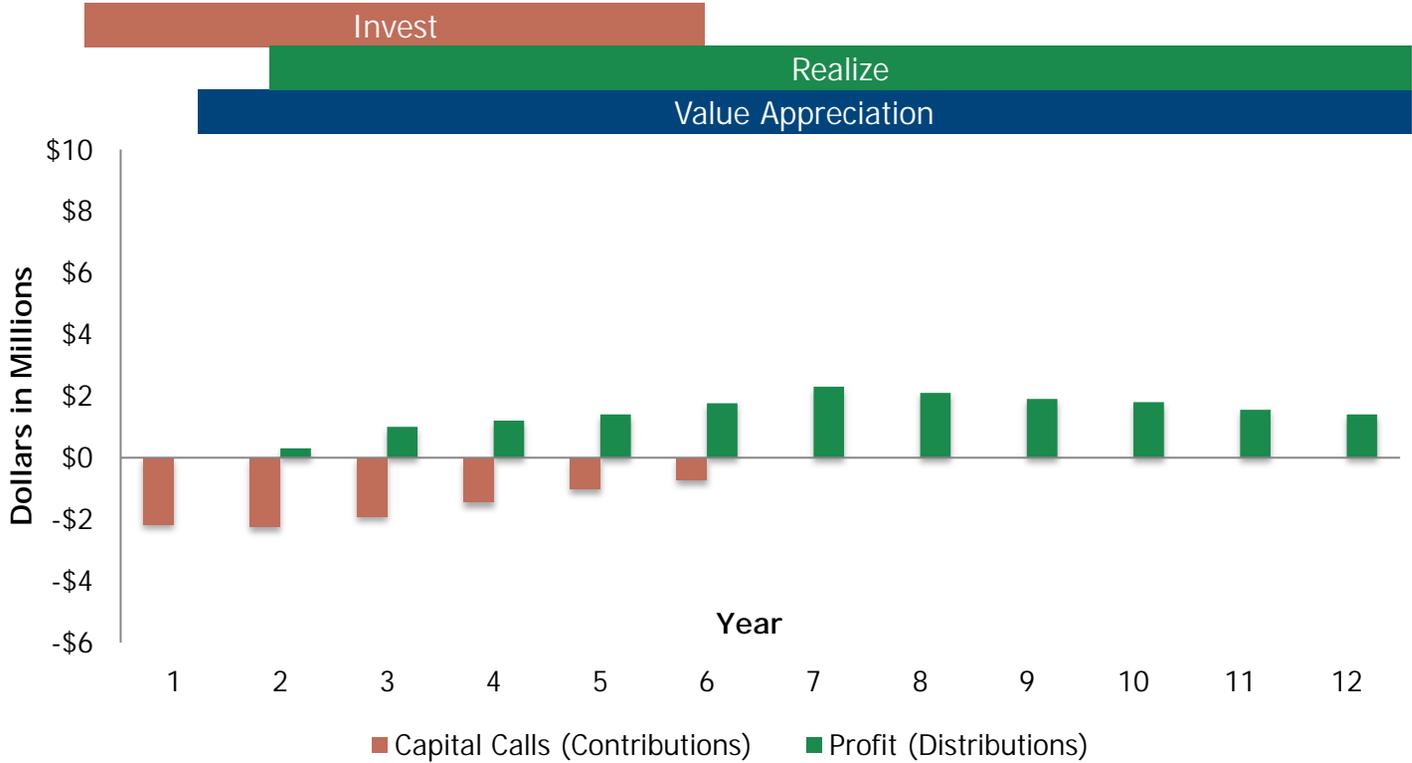
Dedicated Staff

- Recruit, train and retain
- Time and commitment

Consultant

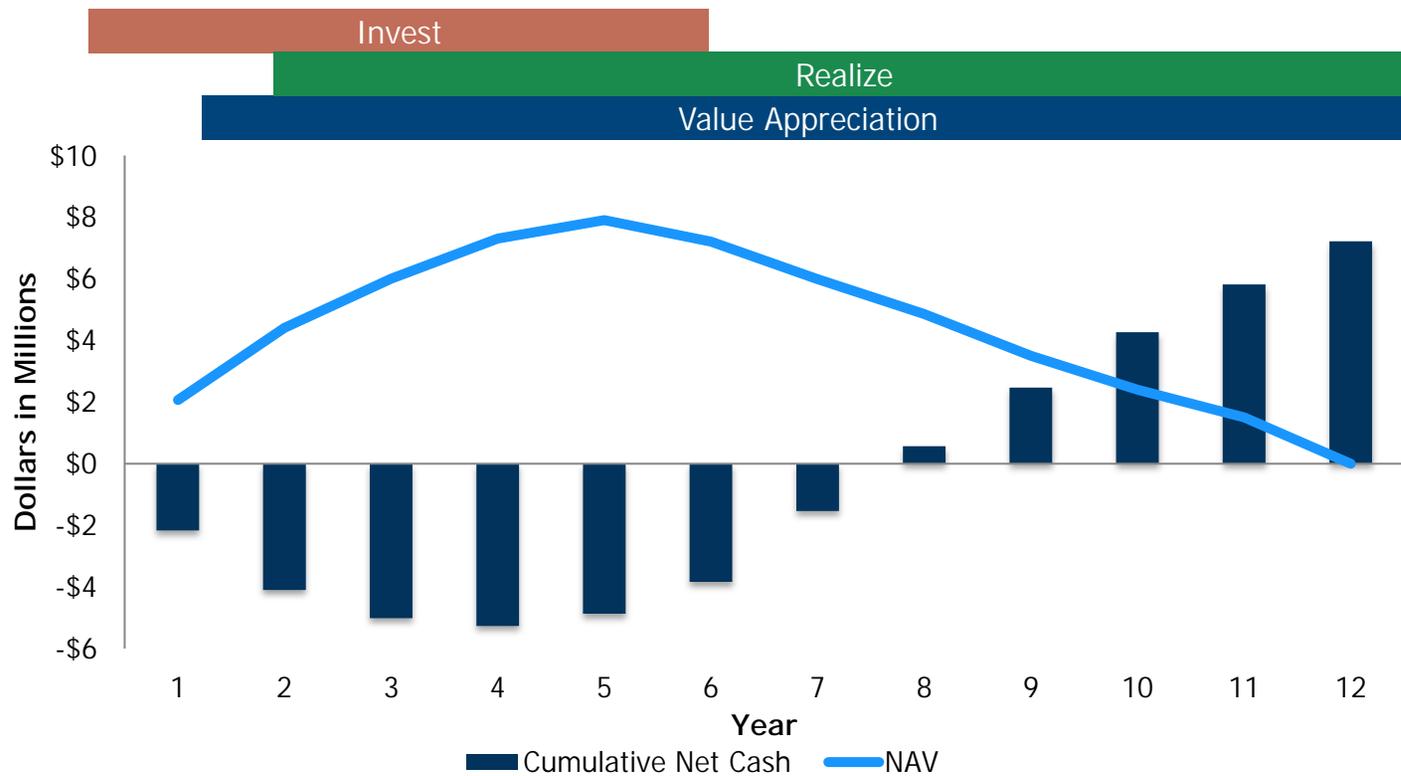
- Customizable
- Discretionary authority
- Potential conflicts

Cash Flow



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Net Cash Flow and Exposure



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Ingredients of a Diversified Portfolio

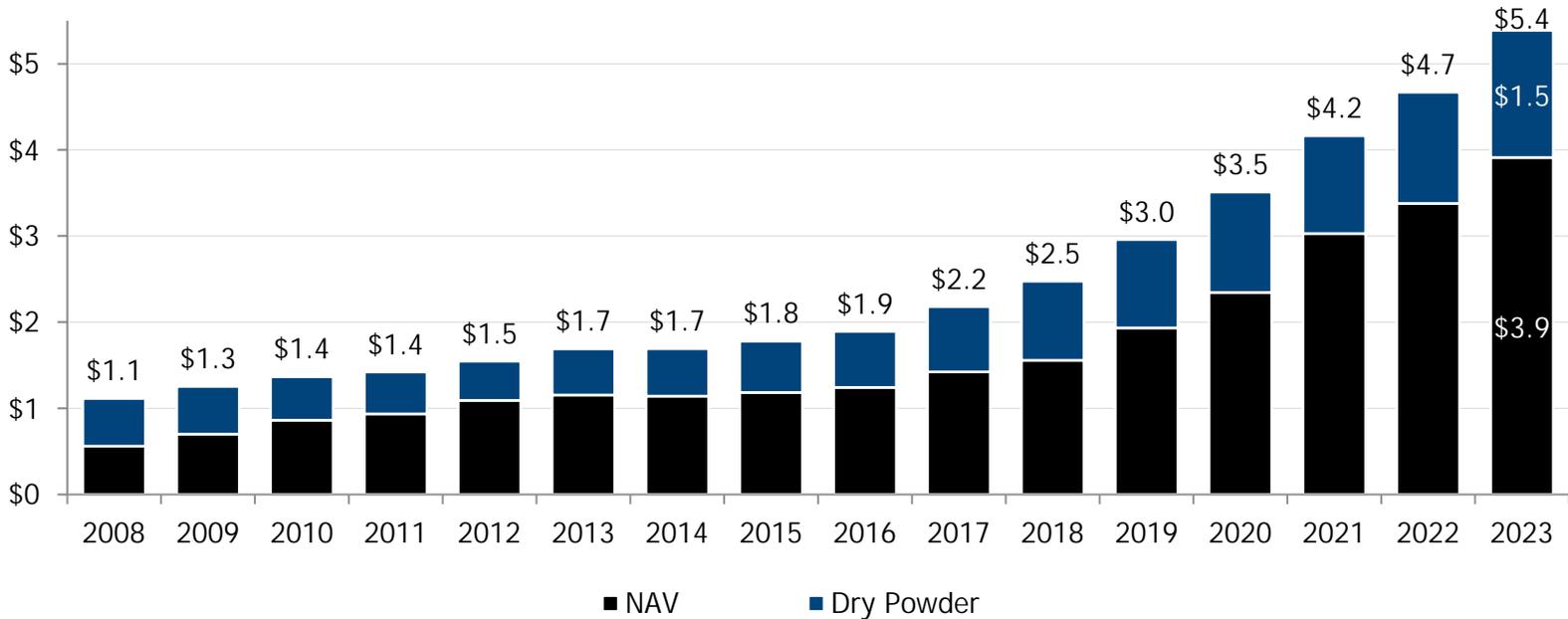
Strategies	Asset Classes	Geographies
<ul style="list-style-type: none">• Primaries• Secondaries• Co-Investments• Private Credit	<ul style="list-style-type: none">• Small/Mid-Cap Buyout• Large-Cap Buyout• Special Situations• Venture Growth Capital	<ul style="list-style-type: none">• United States• Western Europe• Developed Asia• Emerging Markets• Rest of World

History of Private Equity

- Pre-1970s
 - Primarily the domain of wealthy individuals and families before WWII
 - Few institutional investors allocated to private markets
 - Some firms gathered assets from outside investors
 - 28 firms involved in LBOs, growth equity, and venture capital in 1980 (now 3,300+)
- 1980s-2000
 - Emergence of firms capable of providing capital outside of traditional banking sources
 - Pension and endowment funds begin to allocate to private markets
 - Deal sizes began to increase using LBO techniques to drive M&A activity
- First Decade of the Millenium
 - Venture capital boom and the internet bubble and rise of technology
 - Development and growth of the secondary market
- 2010-today
 - Dodd-Frank Act: registration and reporting requirements aimed at fairness and transparency
 - Public and private financing gives companies more options to provide liquidity for founders, investors, and employees

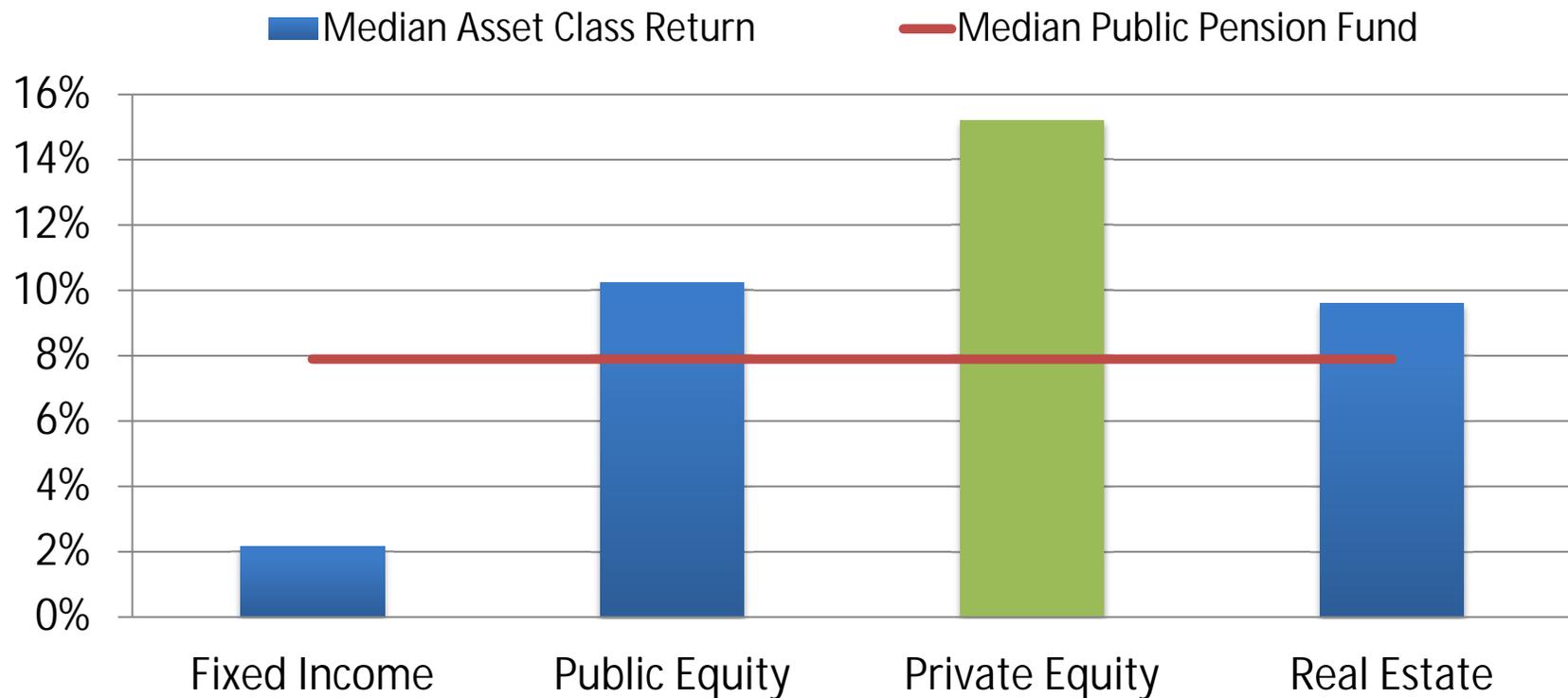
Private Equity AUM Growth

Global Private Equity AUM (\$T)



Source: Preqin as of Q4 2023, which is the latest available; includes Global Buyout, Growth and Turnaround and excludes Fund of Funds, Co-investments, Secondaries, and other.

Investors Drawn to Return Potential



Source: American Investment Council. 2024 Public Pension Study. Based on 10-year median annualized returns.

How Have Funds Changed?

Less focus on financial engineering and more focus on growth acceleration and operational transformation, which requires more resources



**Business
Development**



**Capital
Markets**



**Investor
Relations**



**Data and
Digital**



**Operating
Partners**



**Talent
Management**



Innovation



M&A

For illustrative purposes only.

Are Banks Being Replaced?



Private Equity

Private Credit

Growth Equity

Venture Capital

Key Takeaways

- Large opportunity set
- Superior long-term return potential
- Long-term nature creates illiquidity
- High economics, but largely aligned
- Significant resources to create value
- Focus on accelerating growth and enhancing operations
- Industry growth driven by market factors and investor sentiment

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