iCapital

What is Private Equity?

Private equity funds are designed to generate enhanced returns by pooling investors' capital and investing in private companies to drive business growth, streamline operations, and/or support acquisitions.

FOCUSED ON VALUE CREATION

Investors provide private equity fund managers with the capital needed to invest in strategically identified companies. Unlike public equity managers, private equity managers actively seek to work with management teams to improve companies with the goal of eventually selling shares at a profit and distributing those profits to investors. In return, fund managers receive a management fee and a share of the returns generated by the fund, further incentivizing value creation, and aligning the interests of fund managers, investors, and company management teams.

PRIMARY INVESTMENT STRATEGIES

Many fund managers specialize in a specific private equity strategy and stage of a company's development. These strategies include, but are not limited to:

VENTURE CAPITAL

Venture capital funds invest in early-stage companies that often do not have revenues and/or positive cash flow. It is the riskiest private equity strategy but also the one with the greatest return potential. Minority investments are usually made in companies with promising innovations.

GROWTH EQUITY

Growth equity funds invest in companies that are profitable but still maturing, with proven business models, established client bases, and/or strong revenue growth. Minority or majority investments are usually made in a growing industry or sector.

BUYOUT

Buyout funds invest in established and mature companies, typically using debt and equity financing to acquire a controlling interest and/or significant influence, with the intention of improving business operations. Buyouts can span investments in small, midsized, or large companies.

THE LIFE CYCLE OF A FUND

Private equity funds are considered long-term investments, typically with terms of seven to 10 years. This long-term approach is part of what allows fund managers to have a meaningful impact and provide investors with the potential for higher returns relative to other, more liquid asset classes.

Typically, there are four stages in the life cycle of a private equity fund, which form the J-Curve, a graphical representation of a fund's returns/cash flow.

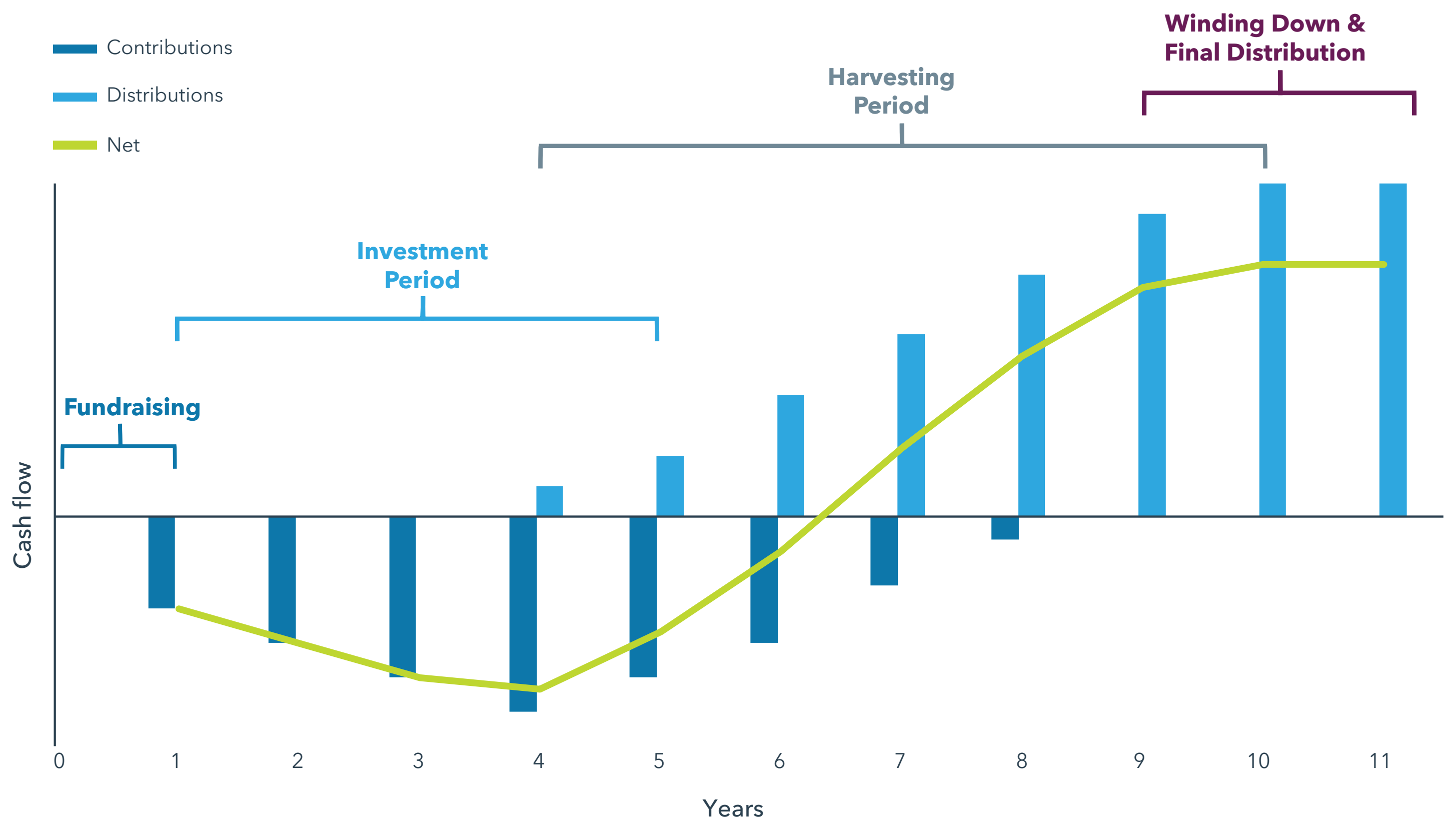
Stage 1: Fundraising | Finding investors and gathering commitments
The fund manager asks investors to make a capital commitment to the fund. Generally, no capital is taken from the investor upfront, but the commitment is legally binding.

Stage 2: Investment Period | Identifying and investing in companies
The fund manager sources and identifies investment opportunities. Investors typically receive a capital call, a notification by the fund manager for cash required to fund investments or fees and expenses during this period; however, capital calls can occur throughout the life of the fund.

Stage 3: Harvesting Period | Creating value, exiting companies, and distributing profits
The fund manager begins to monetize or exit the portfolio investments in the fund during the latter half of its term, and investors begin to receive distributions.

Stage 4: Winding Down and Final Distribution | Exiting remaining positions
The fund manager makes a final distribution to investors and closes the fund.

Sample Life Cycle of a Private Equity Fund



For illustrative and discussion purposes only.

BENEFITS

- Private equity has historically generated long-term outperformance relative to the public markets.[1]
- Private equity provides access to a larger investment universe with more opportunities than the public markets (i.e., a larger number of companies).[2]
- Private equity managers aim to create value by taking a long-term view, which can help reduce risk, particularly in uncertain markets.
- A private equity allocation can provide enhanced return potential and diversification benefits (i.e., uncorrelated investment exposure) in a portfolio.
- Private equity funds are accessible to a greater number of investors given today's innovations in product development and technology.

KEY RISK CONSIDERATIONS

Key risk considerations may include, but are not limited to, the following:

- **Manager Selection:** Not all private equity managers are the same. The experience, skill level, and track records of managers may vary greatly, and as a result, the dispersion (or difference) in returns is much wider than it is in other asset classes. It is critical to have a thorough diligence process in place to evaluate private equity fund managers.
- **Liquidity:** Private equity funds are considered longer-term investments, typically with terms of seven to 10 years.
- **Transparency:** Private equity funds may not offer the same level of transparency as traditional investments, which are required to provide frequent and full disclosures.
- **Fees:** Private equity fund managers charge an annual management fee, typically 1–2% of assets under management. Fund managers also collect performance fees, known as carried interest, which traditionally represent 10–20% of any value appreciation or aggregated profits generated by the fund.
- **Leverage:** Private equity funds may use some form of leverage, which offers the potential for higher returns, but also increases the downside risk.
- **Concentration:** Private equity funds may be highly concentrated in a few underlying portfolio companies.

Please contact your financial professional or a fund manager to learn more.

1. Source: PitchBook, iCapital Investment Strategy, with data compiled on November 8, 2023. Note: All return data is as of March 31, 2023. Global Private Equity is a composite of all private equity funds on the PitchBook platform. Horizon IRR is a cap-weighted pooled calculation that shows the IRR from a certain point in time. Historical IRRs are included solely for the purpose of providing information regarding private market industry returns and returns of other asset classes over certain time periods. While investments in private market funds provide potential for attractive returns, they also present significant risks not typically present in public markets, including, but not limited to, illiquidity, long term horizons, loss of capital, and significant execution and operating risks. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.
2. There are only 2,800 public companies with annual revenues greater than $100 million. That's a small slice of corporate America, where there are 19,000 private businesses of that size. Source: Hamilton Lane, Capital IQ as of February 2023. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.

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