PRIVATE WEALTH SOLUTIONS

The Life Cycle of Private Equity

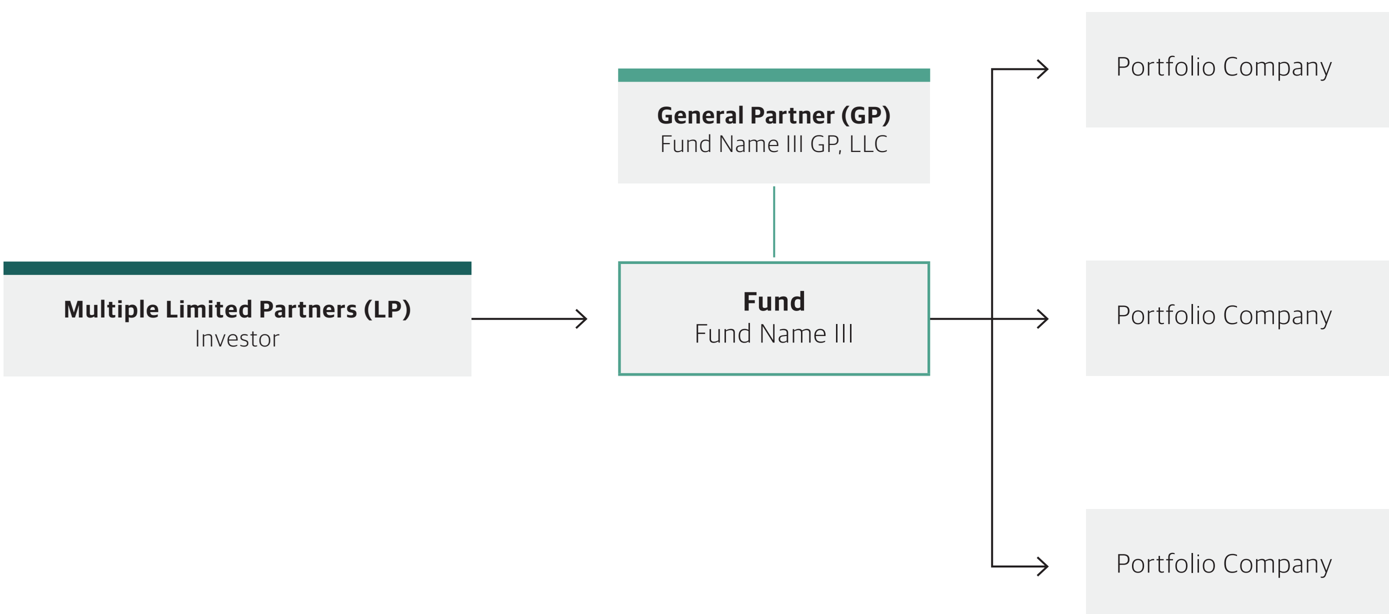
Private Equity managers aim to create value by providing investment capital to a wide range of businesses.

Private equity differs from public equity investing in several important ways. Here we explain the life cycle and key features of a private equity investment. In the three sections below, we examine private equity's (1) structure, (2) time horizon, and (3) differentiated performance measurements, each of which are critical to understanding the life cycle of private equity funds.

I. Building a Private Equity Fund: Structure Matters

Generally when a private equity fund is launched, the General Partner (GP) assumes responsibility for managing the fund and identifying investments. Limited Partners (LPs) are investors who contribute capital, but do not necessarily have discretion over the choice of investments. Performance incentives give the GP motivation to aim for strong performance, which, if successful, benefits both the GP and LPs. The alignment of interests to a certain extent between the two parties differentiates private equity from traditional investing. In their pursuit of returns, private equity managers typically aim to provide various resources to a portfolio company and work closely with them to foster operational improvements.

Figure 1: The Structure of Private Equity Funds



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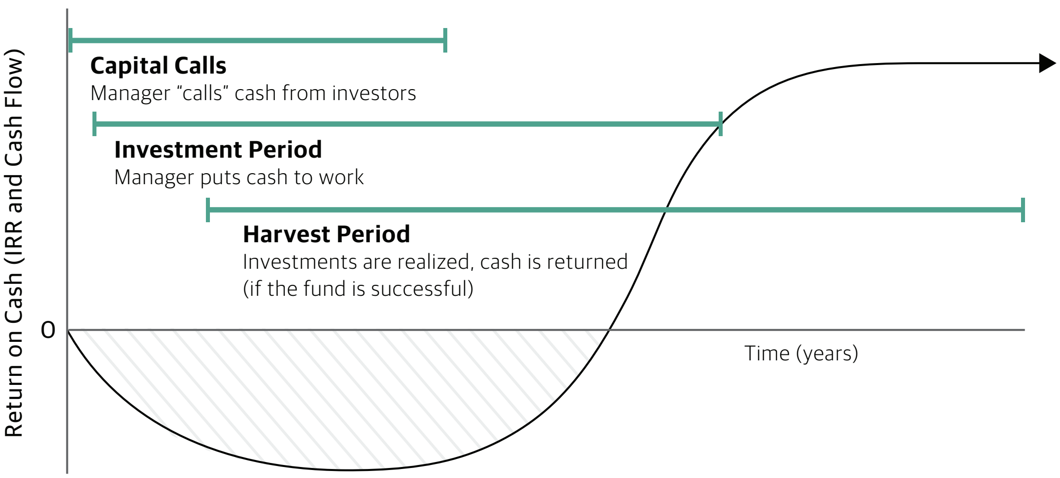
II. Staging the Time Horizon: Capital Calls, Investment Period and Harvest Period

The term of private equity funds can be upwards of 7-10 years. One way of thinking about the term is by dividing it into three stages: the fundraising period, the investment period, and the harvest period. After investors have committed capital during the fundraising cycle, the fund will begin to incrementally call this capital during the early stages of the investment period. This stage may span the first few years of the fund. Simultaneously, capital will begin to be deployed by investing in opportunities selected by the GP in the first 3-5 years. The final 3-7 years, the harvest period, is generally when most investments are realized, and the fund, if successful, returns any cash to investors.[1]

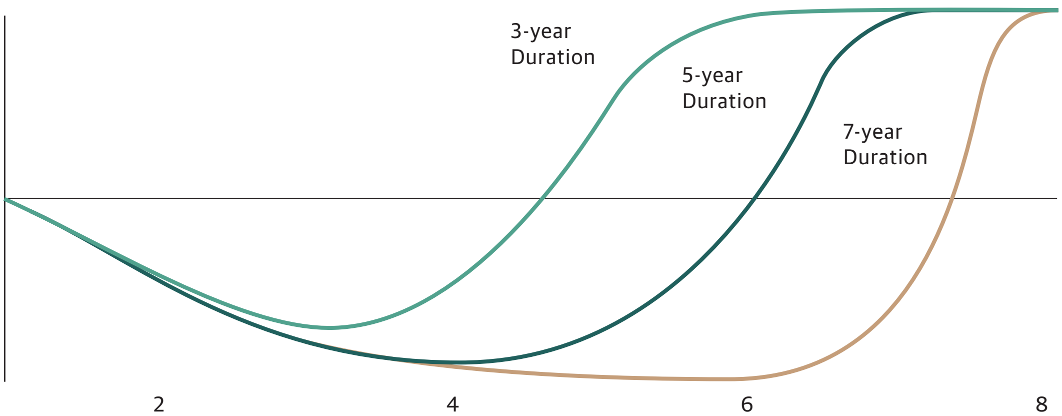
Figure 2: Illustrative Example of the Timeline of Private Equity Funds



III. Analyzing Performance: The J Curve Effect

The J-Curve characterizes an investor's potential performance experience through the life cycle of a fund. In the first few years, investors are providing capital while also paying management fees. As the fund deploys the capital, returns are not high enough to overcome fees, which results in a negative return. As time passes and if investments are successful, returns can improve. When this process is mapped out, it creates a "J" shaped curve as illustrated in Figure 3.

Figure 3: Illustrative Example of the J-Curve



1. The amount and priority of distributions will vary depending upon the terms of the specific fund.

For informational purposes only. A fund's offering materials provide specifics around terms and expenses. A fund's expenses may offset or exceed its profits. This information is not meant to be predictive of the performance of any particular fund, nor are they meant to suggest that all private funds result in positive returns or may avoid loss of principal. Private equity investments involve significant risk and typically high levels of leverage. Hypothetical performance results have many inherent limitations and no representation is made that any investor will, or is likely to achieve, results similar to those shown. Each investor's cash flows and returns will differ and may result in a total loss of principal. There can be no assurance that an allocation to alternatives would yield returns or protect capital. **Past performance does not guarantee future results.**

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