Introduction to Private Equity

What is private equity?

In the simplest terms, private equity, also known as PE, is an investment in which funds are raised from investors, pooled-or co-mingled, and used to acquire equity ownership in private companies that are not listed on a public stock exchange.

Private equity firms use these funds to invest debt or equity in businesses, referred to as portfolio companies. Private equity-backed companies run the gamut, from early-stage start-ups to decades-old businesses of all sizes across many industries throughout the world. PE firms selectively choose portfolio companies they believe can increase in value, with the aim of generating positive returns.

Newer forms of private investments can take the form of loans to private companies, investments in real estate, and the funding of critical infrastructure projects, as just a few examples.

PE firms have more control over private companies versus ones that are publicly traded. They often take an active management role, which can mean that the Private equity firms work alongside the portfolio company management team, providing strategic guidance and operational support. This often involves implementing operational improvements, expanding the business or restructuring the company's operations to increase its profitability.

Private equity firms typically operate with a long-term investment horizon and have a set timeline for their investments. They may hold onto their investments for a number of years and sell them vis-à-vis an initial public offering (IPO) or to another company. Active management, long investment time periods and financial leverage can all contribute to increasing a portfolio company's value.

WHAT YOU SHOULD KNOW:

- Private equity (PE) is the investment of capital in a private company as opposed to the stocks of companies listed on public exchanges.
- Hamilton Lane data shows that private equity significantly outperformed publicly traded equities over the last two decades.[1]
- Private equity can help investors gain diversification since private companies represent a wide variety of industries; meanwhile, the public equity market tends to be dominated by companies in a limited number of industries.

[1] Hamilton Lane Data, Bloomberg (January 2023)

How to access private equity buying opportunities?

Historically, investors accessed private equity investment opportunities through a range of vehicles, including direct investments into companies, commingled funds that invest in a mix of private companies, multi-manager funds that invest in a group of investment managers' funds and separately managed accounts (SMA) - a fund structure between one fund manager and one investor. More recently, many private market managers have launched funds in investor-friendly structures (i.e., evergreen funds) that have made private markets more accessible to a wider group of investors. These investment vehicles may acquire private companies, they may purchase public companies or even invest in buyouts as part of a consortium. However, they typically do not hold stakes in companies that remain public. To learn more about evergreen funds, read here.

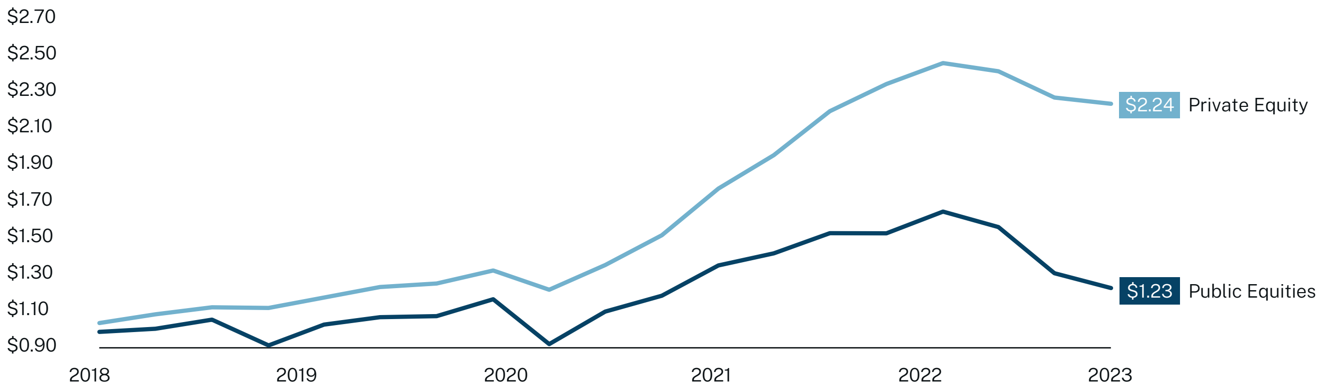
How can private equity fit in investors' portfolios?

Private equity can play a few different roles in an investor's portfolio. One of the primary goals is to deliver returns that exceed those of the public market, and this has historically been the case. In fact, our data suggests that global private equity funds, on a net basis (after all management fees, expenses and performance fees are accounted for), have consistently outperformed traded equities over most of the past 20 years.

Private Equities Have an Impressive Track Record Outperforming Public Equities

Private vs. Public

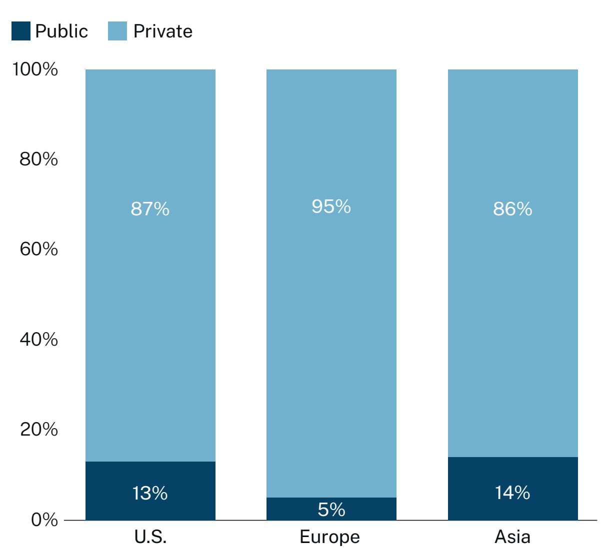
Private Equity vs. MSCI World total returns, Growth of $1



[1] Hamilton Lane Data, Bloomberg (January 2023)

Private equity may also give investors exposure to the broader economy, thereby increasing portfolio diversification. And many companies with annual revenues in excess of $100 million are choosing to stay private for longer. This variety can help investors tap into a broader base of investment opportunities. In comparison, public markets in many major economies are concentrated. They are dominated by a small number of very large companies and because early-stage companies are naturally not suitable candidates for public listing, they are under-represented in the public markets.

Public and Private Companies by LTM Revenue > 100M



Source: Capital IQ, February 2021 - February 2022

As you consider how this asset class fits into your portfolio, here are just some of the investment strategies you may hear discussed:

Buyout: This strategy typically uses financial leverage to acquire mature companies that tend to generate operating cash flows.

Venture/growth equity: These investments aim for growth over the long term by investing in startup and early-stage companies that are relatively mature.

Secondaries: This is a strategy whereby investors buy into previously issued private equity investments. For instance, a secondary buyer can purchase pre-existing shares in private equity funds from their original investor and, in turn, become a replacement investor (i.e., as a limited partner or LP).

Direct or co-investment: These investments are made directly in a company or asset alongside a general partner (GP). These investments are minority, passive positions that are made on the same terms as the GP.

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