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ALTERNATIVES UNLOCKED

Unlocking Private Equity: Beyond the Stock Exchange

When you think about owning a company, what comes to mind? A scroll of stock tickers and prices? The opening bell ringing on an exchange floor?

That's only part of the story. In this guide to private equity investing, we'll share our perspective on investing in private companies.

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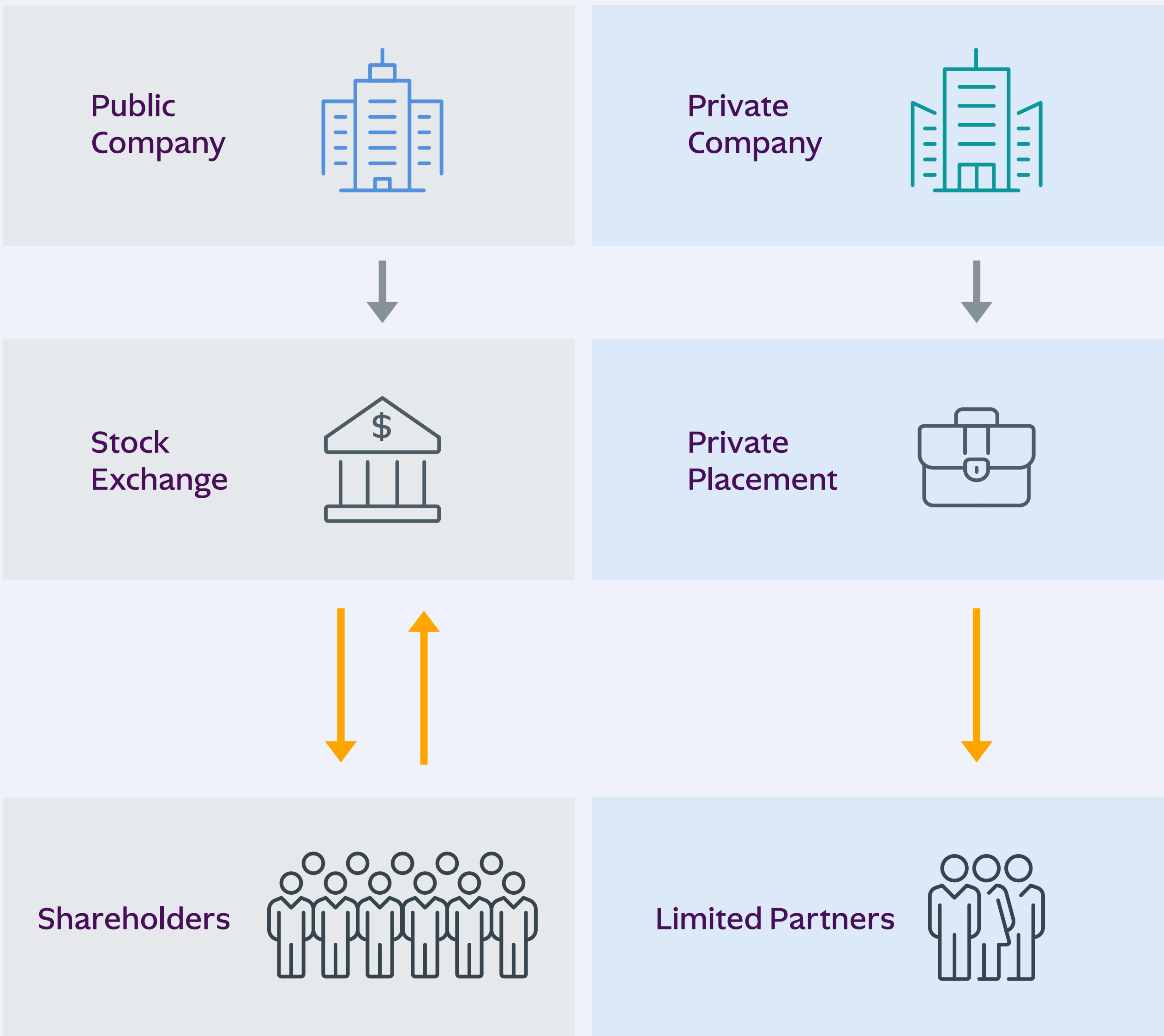
First Things First: What Is Private Equity?

Investing in Private Companies

Private companies typically raise funds by issuing shares through a private placement to a select group of institutional or individual investors who meet certain requirements for wealth, income, or financial knowledge. These shares do not trade on public exchanges.



A Typical Structure for Private Equity Investments

One of the most common ways investors get exposure to private companies is through a private equity fund. In a traditional private equity fund, a group of investors known as limited partners pool their money, and a professional manager known as the general partner is responsible for:

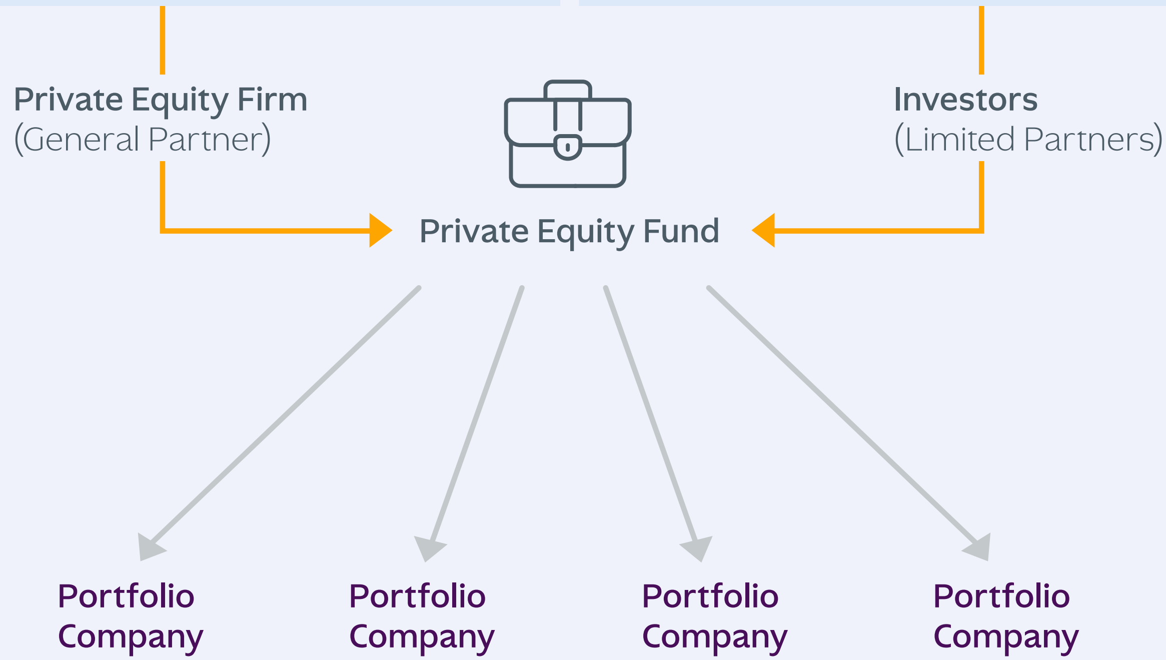
- finding companies to invest in or buy,
- negotiating the terms of the investments,
- managing or advising executive teams,
- working with management to make changes that increase the value of the business,
- playing an oversight role by sitting on the board, and
- either selling or taking the company public at the appropriate time.

General Partner

The general partner is the manager of the fund, taking care of day-to-day obligations and liable for the fund's financial obligations.

Limited Partners

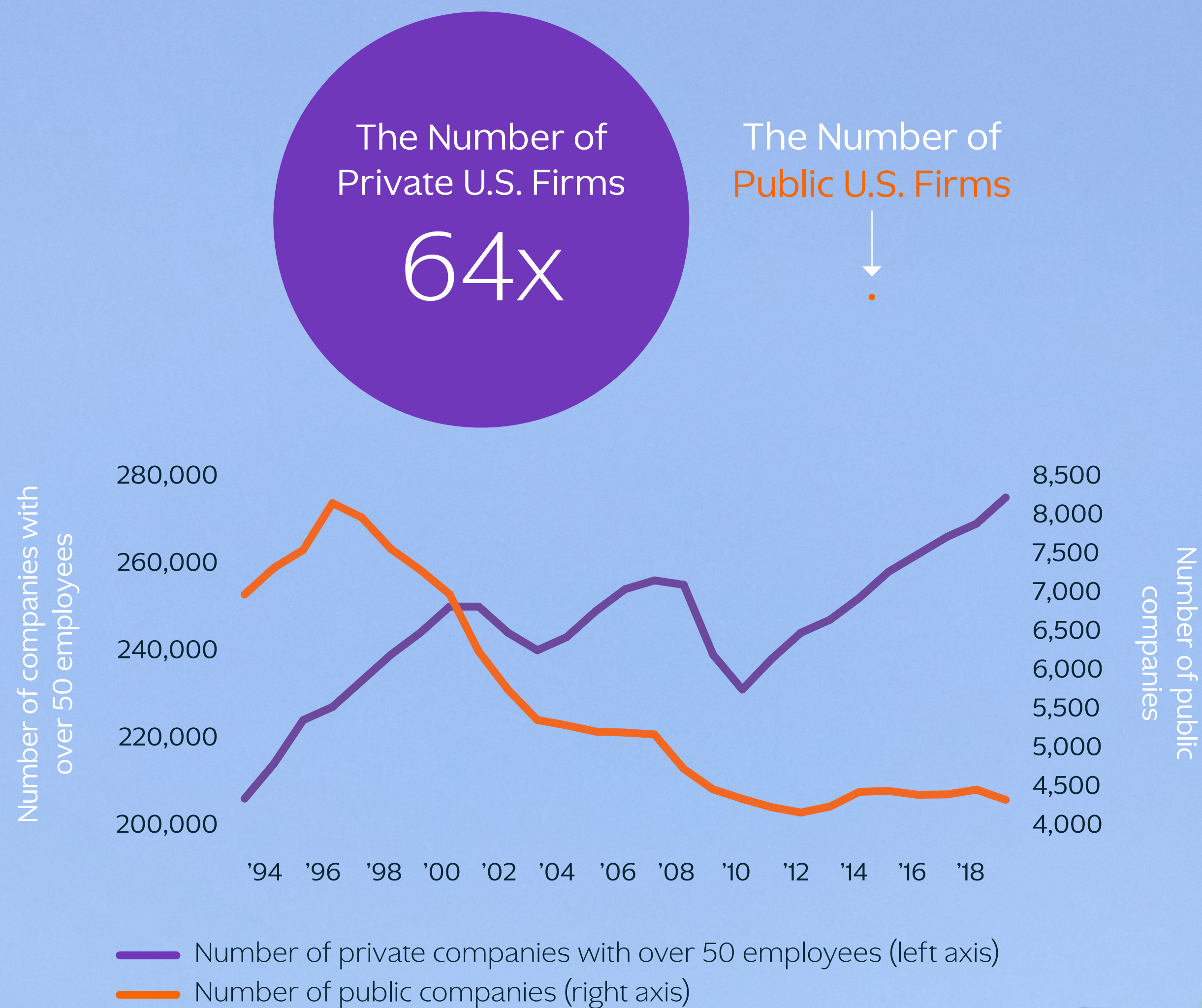
Limited partners are not involved in day-to-day operations. Their only financial obligation to the fund is the money they have committed to invest or have already invested.



The Size of the Private Equity Opportunity

Publicly traded stocks get a lot of media attention, but they represent only a small fraction of the world's companies. Using the United States as an example, there are many more private companies than public ones, and the gap has been growing over time (Exhibit 1).

EXHIBIT 1 | **Public Company Universe Shrinking; Private Company Universe Growing**

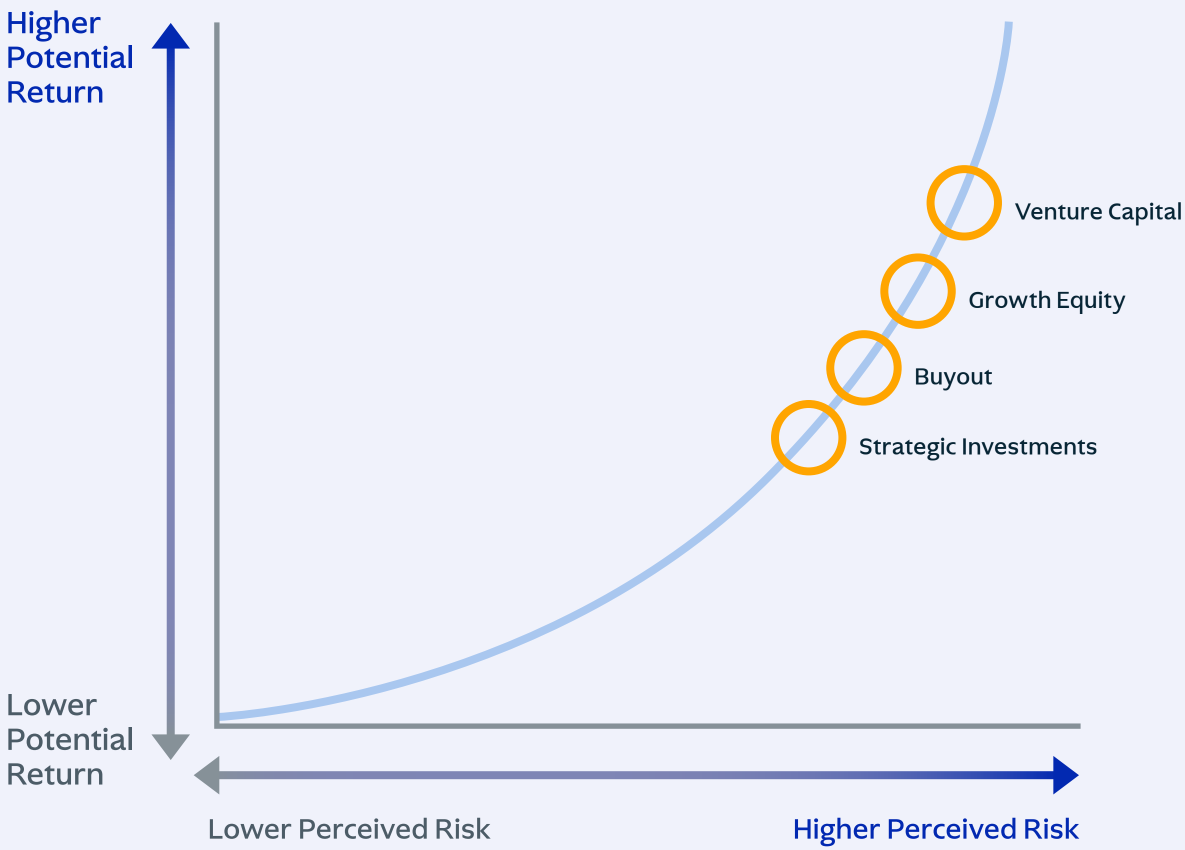


Source: U.S. Bureau of Labor Statistics, World Bank, KKR. As of October 28, 2022.
Note: The number of private firms includes those firms with more than 50 employees.
For more information, please see "Regime Change: The Role of Private Equity in the 'Traditional' Portfolio."

Private Equity Strategies in Focus

When investors decide to invest in private equity, they can choose from a variety of strategies (Exhibit 2).

EXHIBIT 2 | The Private Equity Investment Spectrum



Venture Capital

Minority investments in startups, which typically have unproven business models that may not yet generate revenue or profits. Funds invest in many businesses and rely on a small number of major successes to make up for high failure rates.

Growth Equity

Minority investments in companies that are more mature than a startup, but less established and faster-growing than a typical buyout target, and need capital to grow, commercialize, or professionalize.

Buyout

Traditionally, make majority investments in mature companies and restructure their finances, governance, operations, or some combination of those factors to maximize returns for fund investors.

Strategic Investments

Provide companies with financing that may have elements of both debt and equity.

A Closer Look: Types of Buyouts

Buy-and-Build:

A private equity fund buys a company with established businesses or capabilities and builds the enterprise by acquiring additional companies with knowledge, expertise, or capabilities that managers believe can add value.

Transformative M&A:

Acquisitions that fundamentally change the nature of the acquirer's business model or operations.

Public-to-Private:

Buying a public company and taking it private, meaning that its shares no longer trade on a public exchange.

Corporate Carveouts/ Non-Core Divestitures:

Buying a single business unit from a larger company and operating it as a standalone business.

How Private Equity Investments Seek to Create Value

A successful private equity investment should make a business more valuable, and fund investors should profit from that added value.

The ultimate goals are to create value in a business over the course of ownership and then to exit the investment, either by selling it or through an initial public offering. The goal at exit is not only to recoup the initial investment, but to realize additional returns because the operational investments and changes the general partners implemented made the business more valuable over time.

Ways private equity managers can try to make a business more valuable:

1. Strengthening the **management team**

2. **Acquiring new businesses** that allow the company access to new technology, product offerings, regional markets, or expertise

3. **Shaping business strategy** to position the company for future growth

4. Developing and launching **new products**

5. Streamlining and improving **operations**

6. Optimizing **capital structure** (the amount of debt and equity a company has)

> “Any fool can buy a company. What matters is what you do once you own a business.”
>
> — Henry Kravis

Private Equity Managers Have to Think Beyond the Next Quarter

The changes in value that private equity managers strive for are rarely quick fixes. Strategies may take many years to bear fruit. Public companies, on the other hand, are accountable to report results to their shareholders every single quarter.

Private Equity Managers Have Direct Influence over Strategy

Many public managers try to influence the strategy and direction of companies through informal engagements with management teams. However, their influence over day-to-day decisions and strategy is not comparable to that of a private manager. Public companies tend to have many shareholders’ interests to balance, while private companies may have a few or only one.

Learn More

To find out more about private equity, please contact your financial professional.

Disclosures

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