
# On Your Mark... Get Set... Now Wait 3 to 5 Years

Private equity investing requires a long time horizon and patience – but there may be a way to accelerate returns

For many investors, private equity (PE) is an exciting and new asset class. Between strong historic returns and exciting stories of home runs from successful PE fund managers, there is tremendous appetite and enthusiasm for the asset class.

However, what new investors discover is that it can take years for their capital to be fully deployed and/or to achieve their target allocation in PE.

This long deployment can make for an underwhelming investor experience and make PE unsuitable for many private investors with shorter time horizons.

# Commitments vs. Investments

When an investor selects a new private equity fund, they are not making an investment. Rather, they are committing to fund new investments that the fund manager will make in the future. The fund manager is typically given three to five years in which to find suitable investments for the fund. In the case of fund of funds managers, the process is even longer.

Multi-year investment periods mean that it can take investors years to build a portfolio of private equity.

### So, I'm supposed to just wait and do what?

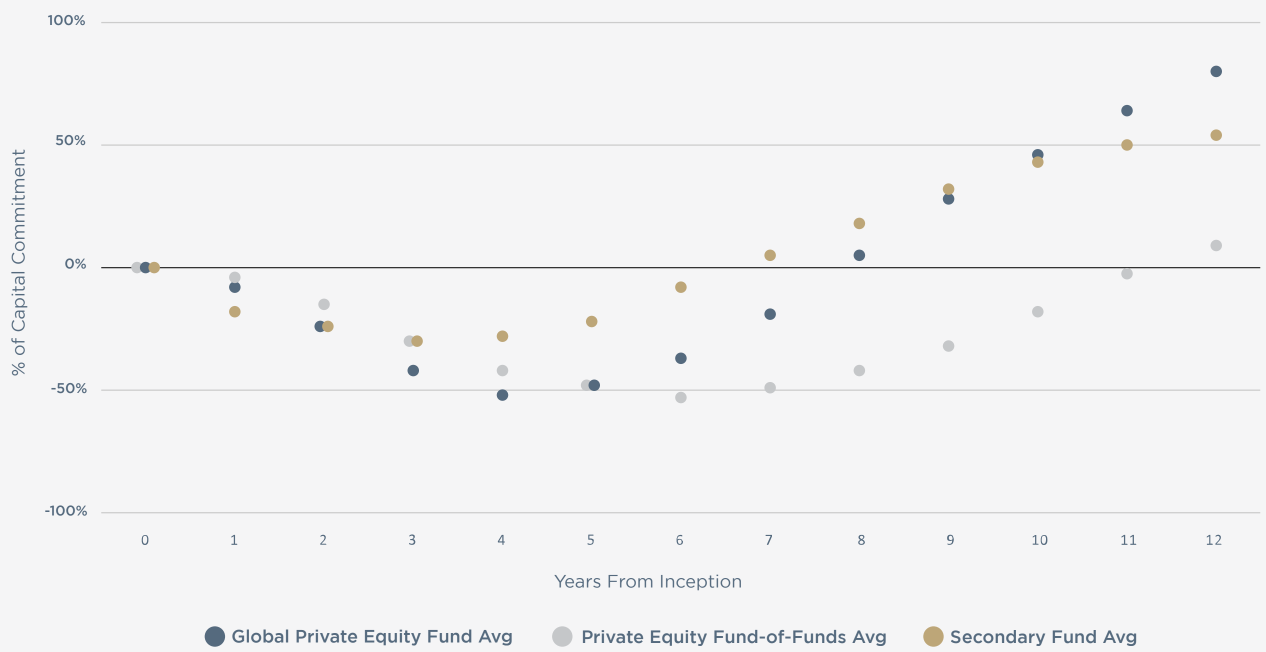
At the time of making their commitment, investors are typically holding the interest and liquidity they want deployed into PE. However, post-commitment there is typically a drawn-out period of capital calls, during which the manager controls the timing and magnitude of capital drawn to make their investments.

This type of fund structure raises the risk of capital calls coming at inopportune times for the investor. Investors often find managing liquidity to fund potential capital calls frustrating and are left with the dilemma of deciding whether to hold undrawn capital in cash and suffer cash drag on the investment or choose riskier assets like public equities and put the commitment principal at risk.

## When do I get my money back?

The knock-on effect of long deployments is that it can take much longer than originally expected for investors to have their capital returned and then several years to fully realize a profit. On average, private equity funds require four to five years before net cash flows begin to move in a positive direction, and as much as eight years before a profit is realized. For funds of funds (FoFs), investors typically don't realize a profit for as many as 11 years after making their initial commitment.

## Cumulative Net Cash Flow




*In the first few years, funds call capital to make new investments but they also distribute capital from occasional early realizations, making it challenging for investors to put money to work.*

Source: Cambridge Associates

# 3 Strategies to Get Invested

Typically, institutional investors employ up to three main strategies to get invested and achieve their target PE allocation sooner.

1. **Overcommitting**

   Investors may make much larger initial fund commitments than they otherwise would. For example, if a pension would like to ideally allocate $10 million on average to each of their private equity fund investments, they make $20 million commitments to funds in the early years of building a portfolio to get invested twice as fast.

   This is a risky strategy as it creates concentration in funds, managers, strategies, and vintage years, but also the attendant capital calls can be difficult to manage.

## 2 Co-investments

Investors may choose to co-invest in individual companies alongside their managers when transactions are too large for the managers' funds. For example, a pension may choose to invest $10 million in a single company as a passive co-investor alongside their manager.

While this does allow investors to immediately and precisely allocate to private equity, it does come with challenges and risks. First, the best co-investment opportunities are difficult to get exposure to and the decision-making time frame can be one to three weeks. Many institutions are not equipped to properly evaluate individual companies. Second, the strategy is obviously fraught with concentration risk.

## 3 Secondary Funds

Investors may commit to secondary funds. Traditionally, secondary funds acquired mature (three to 10+ years old) private equity funds from other institutions that sought liquidity. Today, many secondary funds are doing more concentrated transactions, but generally they have the same goals. Through purchasing assets "second-hand," secondary funds can deploy and return capital sooner.

Although faster than primary fund investing, secondary funds still take two to three years to deploy capital and they have long terms (10+ years). Also, depending on the secondary fund's approach, these funds may focus on more concentrated or exotic transactions and/or utilize considerable leverage, raising the risk profile of these investments.

| | Investment Period | Time Until Cash Flow Turns Positive* | Time Until Investor Gets Their Invested Capital Back (1x) | Total Fund Term |
|---|---|---|---|---|
| **Global PE Fund Average** | 5 years | 4.5 years | 8 years | 12+ years |
| **Fund of Funds Average** | 3 years + up to 5 years *(from underlying funds)* | 6 years | 11 years | 15+ years |
| **Secondary Fund Average** | 3 years | 3 years | 7 years | 10+ years |

**Point at which the fund's annual net cash flows turn from negative to positive (aggregate capital calls less distributions).*

Source: Cambridge Associates

# There's a Way to Realize Profits Sooner

Despite its appeal, investors need to fully appreciate the long and lumpy deployment of PE funds before they make a commitment. They should model out realistic cash flow scenarios to better understand how long it takes to get to a target allocation and the time it will take to realize profits.

Overbay employs a unique fund structure that is intended to solve these types of issues. Our strategy allows investors to build broadly diversified portfolios while having more control over their own deployment and realizing profits sooner from the private equity asset class.

## Enhance Your Portfolio Performance With Diversified PE Funds

Learn how Overbay overcomes the challenges of private equity with global diversification across hundreds of companies and varied sectors.

Discover Our Approach

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