

Private Equity Extended Glossary

Advisor

Also called Investment Advisor. External person/entity designated by the management company that advises the management company on the purchase and sale of investments and the investment activities of the fund. Of particular relevance when special expertise is required for valuation and/or selection of investments.

Alignment of Interest

Describes the (desired) alignment of the intrinsically divergent interests of the sponsor (fund manager) and the investors of a fund through the fund agreement as a compromise bringing these interests as closely together as possible. An example is fund management making an investment in the fund, such that the fund manager has its own funds invested alongside the investors.

Alternative Investment Fund (AIF)

An alternative investment fund (AIF) is any collective investment undertaking which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and which constitutes neither an operative company outside of the financial sector nor an Undertaking for Collective Investments in Transferable Securities (UCITS).

Alternative Investment Fund Manager (AIFM)

Alternative investment fund manager (AIFM) is a company that manages alternative investment funds.

Alternative investments

Alternative investments are those made into any asset class that falls outside of the three traditional ones - stocks, bonds and cash. Private equity and venture capital are two of the main categories within alternative investing. Other alternative investment strategies range from financial assets like cryptocurrencies, derivatives, hedge funds, and distressed securities, to tangible assets including real estate, art, wine, cars, and coins.

Anchor Investor

Also called Cornerstone Investor. The central investor of a private equity fund that makes a large capital commitment in an early stage of the fund's fundraising so as to ensure the fund reaches first close. The investment by an anchor investor in a fund strengthens the fund's reputation while fundraising. Public investors (such as the EIF) often take on this role, in particular in venture capital funds.

Blind Pool

A fund with portfolio companies that have not yet been determined at the time of fundraising.

Buy Out Fund

A fund generally focusing on acquiring majority stakes in established companies with stable returns and cash flow.

Cap (small/mid/large Cap)

Abbreviation of "capitalization." Often used to describe the market segment in which a fund makes investments. A distinction is drawn between the market capitalization of the average portfolio company (small = single millions to tens of millions / mid = tens of millions to hundreds of millions / large = hundreds of millions to billions).



Capital Call

Private equity funds intended for institutional investors do not have the subscribed capital amounts paid in full when an investor is admitted to the fund, but instead called down from investors in multiple tranches on an as-needed basis to make investments during the Commitment Period and to cover costs.

Carried Interest

Carried interest is the capital-disproportionate profit participation of the AIFM in the success of the fund it manages, paid as performance fee-like amounts compensating in particular the rendering of final investment decisions and immaterial shareholder contributions. The typical 20% profit interest of a fund manager exceeds the AIFM's capital investment (usually 1-3%) and is thus "capital-disproportionate." The Carried interest is often paid by the fund to a Carry Vehicle of the AIFM.

Cash Flow

Accounting concept relating to a company's liquidity and presenting a balance of all income and expenditures.

Catch Up

Term used in the context of the Distribution Waterfall in the fund agreement. The catch up is the name for the stage of the distribution waterfall reached after the investors' Hurdle has been exceeded, when the fund manager receives subsequent distributions (thus "catching up" after previous stages in which all distributions were paid to the investors) until the agreed carried interest profit distribution (typically 80% to investors and 20% to the fund manager) has been reached.

Co-Investment

Investment by a third party or by a fund investor outside of a fund structure into a portfolio company of a fund. A co-investment is typically made in parallel to the investment by the fund, at the same time and on substantially identical terms (pro rata purchase price) as the fund's investment. In the compensation context, the term can also be used to describe the AIFM's own investment in a private equity fund. This investment by the team is intended to ensure Alignment of Interest.

Commitment

Also Capital Commitment. The amount an investor obligates itself to pay to the fund in its subscription agreement. The aggregate amount of the commitments of all investors (plus any commitments of fund management) is equal to the total fund volume.

Commitment Period

Also called the Investment Phase and the Investment Period. The period of time during which the fund makes new investments and draws down capital from investors for investment purposes.

Debt Fund

Funds that invest exclusively or predominantly in debt securities.

Distressed Debt

Loans and borrowings relating to debtors experiencing financial or operational distress, default, or bankruptcy.



Distributed to Paid-In Capital (DPI)

Distributed to paid-in capital is also known as the realisation multiple. It is calculated by dividing the cumulative distributions by paid-in capital. The DPI multiple, in conjunction with the investment multiple, gives a potential private equity investor insight into how much of the fund's return has actually been "realised", or paid out, to investors.

Distribution

Payment to the partners of profits and other amounts returned from investments made by the fund.

Distribution Waterfall

The provisions of a fund agreement governing the sequence of payments to investors and the fund manager. See also Hurdle, Catch-Up and Carried Interest.

Divestment Period

The stage following the investment period during which a fund disposes of its investments. Fund agreements typically allow four to six years for the divestment period.

Equalization Payments

Payments to the Fund made by investors who are admitted to the Fund after the Fund has already admitted investors and called-down capital from those other investors. The equalization payments are used to "equalize" the percentage of called-down capital commitment of each investor. This is done by distributing amounts to the "old investors" so that "old investors" and "new investor" have paid into the fund the same percentage of their Capital Commitment. Equalization Payments often require the "new investor" to pay compensatory interest to the fund to compensate the "old investors" for pre-financing the fund's activities.

Feeder Fund

Pursuant to the KAGB, a feeder fund is a fund that invests at least 85% of its assets into a master fund. See also Master Fund.

Final Closing

The end of the Fundraising and the last time at which new investors are accepted into closed-ended funds.

First Closing

Fundraising stage at which the first investors are accepted into a fund.

Fund-of-funds

A fund that does not invest directly in operating companies but instead into target funds. A fund-of-fund's target funds (also called directly investing funds) invest into portfolio companies that are operating companies.

Fundraising

Refers to the stage during which funds are raised from investors for a newly established fund. It ends with the Final Closing.

GP Commitment

The management company's contractual agreement obliging it to invest in the fund it manages.



General Partner (GP)

The partner of a limited partnership having unlimited liability, usually itself structured as a limited company to minimize potential liability (for example, in the German context, using a GmbH as general partner of a GmbH & Co. KG). In the English-speaking world, the term is often used as synonymous with fund manager.

Hard Cap

A legally binding upper limit contained in a fund agreement beyond which no further capital commitments to the fund can be accepted from investors.

Hedging

Use of options and other offsetting positions to limit economic risks.

Hurdle Rate (Preferred Return)

Also called Hurdle Rate and Preferred Return. Contractually fixed minimum return for investors that must be attained before the fund manager receives distributions of its carried interest. The traditional hurdle for private equity funds is 8%, although rates of 6-10% are possible depending on the investment strategy and the reputation of the manager. Many traditional US venture capital funds do not provide for a hurdle at all.

IPO

Abbreviation of initial public offering. A stock market launch of a company on a public market.

Internal Rate of Return (IRR)

Internal Rate of Return (IRR) represents the annualised implied discount rate calculated from a series of cash flows. The IRR-method is the typical performance method for private equity funds because portfolio investments are bought and sold over time with several capital contributions and distributions. The IRR-method cannot be compared to interest rates of typical bank account interest rate calculations. The IRR-method considers only the tied up cash and only over the period of time during which the cash is tied up. The IRR-method typically indicates therefore a higher return than the use of another calculation methodology. Investors should therefore not use IRR-numbers as a return measure in comparison to other investments. Furthermore, it is important to scrutinize the assumptions for the calculations when comparing returns of various investments.

Investment Strategy

Every fund will set forth a strategy (e.g., buy-out or venture capital) in its fund documentation (fund agreement, prospectus) according to which the capital raised from investors will be invested in suitable investment assets in a manner consistent with the applicable investment objectives, risks and time period.

Investment Vehicle

Term used both to describe the fund itself (or Investment Platforms) and companies or legal arrangements used by the fund for the purpose of investing into acquisition targets and situated in an acquisition structure between the fund and the acquisition target.

J-Curve

Describes the development in stages of a private equity fund's returns, generating negative results in the initial years due to acquisition costs and initial losses, followed by returns exceeding costs in later years through the disposition of individual investments.



LPA

Abbreviation of Limited Partnership Agreement. Refers to the agreement governing the operation of a fund, which is typically organized as a limited partnership. The LPA is the central legal document of a private equity fund.

Leverage

Increase in the level of investment by a fund through financial means, such as borrowing and derivatives. The impact on returns is termed a leverage effect.

Leveraged Buy-Out (LBO)

Leveraged buy-out is a technique used to acquire companies, for the most part established companies with stable revenue and cash flow that can be used to service borrowing incurred by the company for its own acquisition. See also Buy-Out Fund.

Limited Partner (LP)

A partner having limited liability in a partnership. This is the position of an investor in funds structured as partnerships.

Liquidation stage

Refers to the stage in the life of a fund in which, after expiration of the term of the fund, the remaining assets are sold to wind up the fund and distribute disposition proceeds to investors. During the liquidation stage, the corporate purpose of the fund changes to be focused solely on final termination of the fund.

Liquidity Premium

A liquidity premium is an incremental return that compensates an investor for owning an asset that is not highly liquid.

Management Buy-In (MBI)

Management Buy-In (MBI) is the acquisition of a company by external company management with support from investors providing additional capital.

Management Buy-Out (MBO)

Management Buy-Out (MBO) is the acquisition of a company by its own company management with support from investors providing additional capital.

Management Fee

Contractually determined amount paid for the AIFM's performance of its management activity.

Management Fee Offset

An offset against the management fee of certain kinds of third-party compensation received by the fund manager.

Master Fund

The master fund in a Master-Feeder Structure, assuming the role of main fund and serving as the target fund of one or more Feeder Funds.

Master-Feeder Structure



Describes a fund structure comprised of a master fund and one or more feeder funds. Each feeder fund invests its assets as an investor in the master fund. Structures of this kind are widespread to accommodate regulatory and/or tax or other requirements of certain categories of investors.

Modified Internal Rate of Return (MIRR)

Modified Internal Rate of Return (MIRR) is a method of calculating the return on an investment with multiple, irregular cash flows.

Multiple on Invested Capital (MOIC)

Multiple on Invested Capital (MOIC) is a metric commonly used to describe the value or performance of a private equity investment relative to its initial cost. If you invest Euros 1,000,000 and return Euros 10,000,000 in 10 years your MOIC is 10x. The MOIC does not take into account time. If you invest Euros 1,000,000 and return Euros 10,000,000 in 3 years your MOIC is still 10x.

Net Asset Value (NAV)

Net Asset Value (NAV) is a term applied to companies, funds, partnerships, trusts or other investment entities that describes the current value of the entity, usually expressed on a per-share basis.

No Fault Dissolution

Some fund agreements grant a right to investors to terminate the term of the fund early with a supermajority consent (e.g. 75%) without the requirement of good cause or misconduct on the part of fund management. This is an important investor right in the Fund Governance context.

No Fault Termination

Also called No Fault Cancellation. Fund agreements often provide an investor right to end the investment period early with a supermajority consent (e.g. 75%) without the requirement of good cause or misconduct on the part of fund management. This is an important investor right in the Fund Governance context. If the fund agreement provides only for a suspension, not a termination, of the investment period, this is called a No Fault Suspension.

PIC Multiple

The PIC multiple is calculated by dividing paid-in capital by committed capital. This ratio shows a potential investor the percentage of a fund's committed capital that has actually been drawn down.

Private Equity

This refers, in very general terms, to equity investments in companies that are not listed on public markets.

Private Equity Fund

A fund making equity investments in companies not listed on public markets.

Private Markets

The term "Private Markets" refers to investments in debt or equity instruments that are not traded on public exchanges. The debt and equity components of private markets are individually referred to as Private Debt and Private Equity.

Private Placement Memorandum (PPM)

Private Placement Memorandum (PPM) is a written summary of key information on the category, objective and risks of a fund investment. This includes in particular a description of the investment strategy, the fund manager, the risk management and the legal and tax risks.



Residual Value to Paid-In Capital (RVPI)

Residual Value to Paid-In Capital (RVPI) is the current market value of unrealised investments as a percentage of called capital. The RVPI multiple is calculated by taking the net asset value, or residual value, of the fund's holdings and dividing it by the cash flows paid into the fund. Cash flows are representative of the capital invested, fees paid and other expenses incurred by the limited partners to the fund. It provides a measurement, in conjunction with the Investment Multiple, of how much of the fund's return is unrealised and dependent on the market value of its investments.

Senior Debt

Senior debt obligations (in particular debt obligations issued by banks) that take precedence over the claims of other creditors in the event of insolvency (or liquidation). The opposing term is Junior Debt.

Skin in the game

Unwritten principle for ensuring alignment of interest according to which the management team should use its own funds to acquire a significant investment of its own in the fund. The typical investment amount for fund management is in the range of 1-3%.

Special Purpose Vehicle (SPV)

Special Purpose Vehicle (SPV) is a company established for a limited specified purpose. SPVs are used in the context of acquisition financing of private equity transactions.

Subordinated (Junior) Debt

Subordinated debt obligations (in particular debt instruments issued by mezzanine funds) that will be paid, in the event of insolvency (or liquidation), only after satisfaction of other creditors of an issuer. The opposing term is Senior Debt.

Target Fund

A fund (making direct investments) into which a fund-of-funds wishes to invest.

Time Horizon

An investment time horizon is the time period one expects to hold an investment. Time horizons can be specific if associated with a stated maturity, or generalised as either short-term, medium-term or long-term.

Total Value to Paid-In Capital (TVPI)

The total value to paid-in (TVPI) is also known as the investment multiple. TVPI is calculated by dividing the fund's cumulative distributions and residual value by the paid-in capital. It gives a potential investor insight into the fund's performance by showing the fund's total value as a multiple of its cost basis. It does not take into account the time value of money.

Venture Capital Fund

A venture capital fund pools money from investors to finance early-stage startup companies. Venture funds focus on companies that have high long-term growth potential and are in need of capital to fuel their growth and development.

