* Retail Investors :- Salaried employees, Small business, Students
* Institutional Investors:- Employee P.F' of India, Pension funds etc.
* Sovereign funds / Govts :- Govt of Dubai, Singapore, Norway.
* HNI → High Networth Individuals.

Generally, retail investors invest Small amount of money, take low risk,

Note:
HNI :- Individuals with net assets more than 7.5crs.

HNI, Institutional investors, Govt's. Can invest more amount and they are ready to take more risk.

Based on the risk, type of investments etc, all these funds are classified into three major Categories, they are,

* Mutual fund
* Private Equity / Venture Capital fund
* Hedge funds

Mutual fund Collect the money from retail investors takes low risk, invest in Public Companies Shares / Debentures, Govt bonds etc. Private equity / vc fund Collects money from HNI's, Institutional Investors, Govts etc, take more risk, invest into any asset class (traditional / alternat

12/12/2020

Asset Management / Fund Accounting :-

Asset mangers (or Fund houses (or Asset management Companies Collect the money from investors and invest that money into various assets based on the investment objective of that fund. To manage the investors money these asset management Companies Collect a fee called as management fee.

The money Collected from different investors can be invested into various assets / asset classes, these assets are categorized into two main types. They are,

Traditional Assets	Alternative Assets.
→ Equity Shares	→ Real estate
→ Debt instruments (bonds, debentures)	→ Gold
→ Mutual Funds.	→ Pvt Equity Funds
	→ ARTS
	→ Precious metals.
	→ YACHT.
	→ Vintage Cars.
	→ Wine
	→ Hedge funds
	→ Commodities
	→ Currencies.

Business lessons from Private equity and Corporate Acquisitions

The money is collected from investors based on their income levels, risk ~~ent~~ appetite they can be classified as;

Calculation of Profit or loss on investments, Preparing of financial Statements of each fund etc.
Most Popular mo names in this business of fund administration is,

* State street
* BNY Mellon
* Northern trust
* CITCO
* BNP Paribas.
* Viteos.

These Companies main responsibilities are admin activities of fund, accounting for the transactions in the fund. So, they call these functions as fund accounting team etc.

Private Equity :- Venture 13/12/2020

Private Equity funds Pool the money from HNI's, Institutional investors, Govt's etc, and invest that money into any assets. Generally, they invest into Start-up Companies, real estate assets etc.

Generally, they make long term investments, invest huge amounts of money in any Companies/assets they Purchase.

If this Pvt. Equity funds Purchase shares in a Company they take major portion of shares, take significant Control in that Company So, that they Can involve in the management of that Company, Hedge funds also collect money from HNI, Institutionals, Govt, take more risk (more than Pvt equity funds) invest into any assets to make more Profits in short term.

There are many Companies who are into this Asset management / Investment management, they are,

Private Equity	Mutual Funds	Hedge Funds.
Black stone	Blackrock	Bridgewater associates
KKR	Vanguard	D E Shaw
Bain Capital	Fidelity.	rena
* * * *	* * *	xxx
		Karry
Motilal Oswal	SBI	
Godrej	HDFC.	

These Companies Concentrate on research, finding the right investment opportunities to give better Profits. / returns to the investors.

In this AM Industry, one of the Common Practice is to appoint fu an external Company as fund administrator who will take care of the day to day admin activities like Collecting money from investors, managing all bank Payments & receipts, Eg:- If KKR. launched fund in 2020 with a tenure of 10 years, the fund will be closed/ liquidated in 2030, investors money is locked for that time Period. However, the fund managers Can return if they have excess money in the fund during that Period of 10 years.

In a normal Pvt Equity fund with 10years tenure, the Sequence of activities will be as given below, (Pvt Equity fund life Cycle).

Screenshot:-

Fund Name : Warburg Pincus India fund ILP.

Tenure : 10 Year Fund.

Year	Time/Years	Activity	Detailed Activity
2020	1st year	Launch	wher to register, how to register
2020-23	1 to 4 Years	Investment Period	Research, finalise the valuations, make the investments.
2021-27	6/7 years	Operations	involve in implementation of strategies/decion making
2027-2030	2/3 Years	Exit Strategies	find the buyers to sell the Companies where to sell
2030.	Last Year	liquidate the fund	Close all entities in the fund.

take decisions to improve the Performance of that Company So, that the valuation of the Company can increase significantly. So, the fund can make more returns when they sell on exit that investment.

Though, they Pool the investment / money from investors, they do not collect that money at the time of launch Since they will take more time to make the research, find out a good investment opportunity and it will also take time to value that investment opportunity, negotiate the valuations, terms and conditions related to that investment.

Eg:- If a Pvt Equity fund invest in a Start-up Company / old Company, they will take 1 or 2 director seats in that Company So, that they will have more Control, insights on operations of that Company.

Most of the times these Pvt. Equity funds invest the money into illiquid assets which means they cannot sell those investments when ever they need money. So, they generally launch these funds as closed ended funds which means the money invested by the investors cannot be returned to those investors till the end of the ~~life~~ fund life time.

The Common levels in this journey of a start-up Company based on the risk, capital requirements given below,

Scrrshot
Company : Bounce/any startup Company

Source Capital

Bounce :-

Source Capital	Year	Capital	Type	Example
① Boot Capital	1 Year	5 lakhs	Individual	Savings, relatives, friends,
② Angel Investors	1 Year	50 lakhs	Individual	Ratan Tata, Sachin Bansal.
③ Venture Capital Firms	2-4 Years	1cr to 10cr	Family business	Catamaran, kalbin Capital.
④ Venture Capital funds	3-5 years	10 to 50cr	Pooled money	Sequoia Capital, lightspeed. Venture).
⑤ Private equity funds	5+ Years	50cr and above	Pooled money	Blackstone, KKR.
⑥ Public Company	10+	100/1000's of Crs	Public money	Public investments in Stock exchanges.

Venture Capital Start-up's :-

The Start-up Companies are those Companies having an innovative business idea, they do not have enough resources to implement that business idea. They need support on,

→ Funds - Capital
→ Advice - Support from experienced business houses or persons
→ Skilled resources
→ Regulatory Support / Govt Support.

Established businesses/companies will not invest in these kind of risky businesses since the failure rate is more and it needs huge amount of investments to implement, Popularise that idea (scaleup). Since these ideas are not implemented earlier, many unknown risks may come in the future. (Regulatory or Govt restrictions, new competitors, shortage of resources like relevant technologies etc.)

To get the investments into this kind of business/ideas the traditional sources like banks, govt funding, stock markets etc will not help. They should find the investors who can understand the future earning capacity of that business idea, who can take risk of failure, who can advice the promotors to turn that business idea into a successful venture.

Life Cycle of the Private Equity Fund :-

Private Equity funds generally have international investors, international investments. This means, they have to consider different regulations in different Countries where they have investors (or) investments.

Based on the regulations in different Countries they registered the fund as limited Partnership, limited Company etc and most Commonly used structure is limited Partnership structure.

Depends on the type of investments they are Planning to make, they Can target the right investors in 1 Country (or) more than 1 Country. If international investors are Part of a fund, more Complication Can Come like taxes to be Paid in two Countries on Same Profit (Double taxation), 1 Country investor / Company Cannot invest in other Country (regulatory issues) etc. To avoid these Complications, these funds generally registered more legal entities in different Countries.

To target the right investors, these fund houses (like KKR) use their existing client base (or) third Parties like Placement agents they will Provide all necessary details to those future / Prospective investors like investment objective of the fund, expected return, risk, where the fund will invest (country), fees to be Paid by the investors etc in a document Called as PPM. (Private Placement Memorandum).

Eg: If an investor from Singapore invested into an american fund, his investment is Rs. 100 crs, if that fund made huge losses beyond the total capital of that fund, this Singapore investor's maximum liability is restricted to Rs. 100 crs.

Names of these Pvt Eqty funds will be like KKR asia Fund LP, Blackstone India Fund LP etc.

General Partner (GP) :-

If a fund is registered as limited Partnership, the Partner who manages the fund is called as general Partner. This general Partner will be from the fund house like KKR, GoldmenSachs.

These funds houses registered the GP's also as a legal entity like Partnership firm (or) a Company and the fund manager / managers will be the employees in that legal entity.

KKR General Partner ltd is the GP for KKR Asia Fund LP.

Screenshot:

KKR Asia Fund LP. Delware / newyork.

once the list of investors are finalized they will register the fund by floating one (or) more legal entities. At this stage the fund has the list of investors, each investors amount of investment, total capital of the fund no. of legal entities in that fund etc.

Accepting investors into the fund, finalizing their Commitment (money to be invested) is called as close in the Pvt Eqty fund industry rather, at this stage, new investors are not accepted into the fund] it is closed. If the fund need more money in the future they can have Second close, third close etc where the funds Capital is increased and new Commitments are received from the old investors ar (or) new investors.

KEY TERMS:-

Limited Partnership (LP) :-

Most of the Pvt Equity funds (or hedge funds are registered as limited Partnership

all investors and the fund manager are treated as Partners

All investors ~~are~~ liability is restricted to the extent of their Commitment in that fund.

Structure of the fund, Master/onshore, Feeder/offshore :-

When there are international investors, international investments in a fund, the complication can come from,

→ Tax laws - Investors may need to pay income tax in their home country, in the country where the fund is registered. This will make the investor to pay major portion of income (upto 60%) as tax.

→ Regulatory Issues - One country may not allow a company/Individual from some of the countries to invest in that countries.

Eg:- Indian Govt have restrictions on Chinese companies to make investments in India.

→ To avoid these kinds of restrictions/ extra tax burden to the investors, these Pvt equity funds/hedge funds registered seperate legal entities/ companies/firms in more than one country, all those entities are part of the fund/one fund.

Eg:- Black Stone Company launced a Pvt Equity fund in america, they have investors from other countries also like Dubai, UK so, they have registered one limited partnership entity in america, one more limited partnership entity in Cayman Islands, all american investors can invest in the american fund, all international investors can invest in Cayman Islands fund. This

Cayman Islands fund will send the money to the american fund after receiving from the international investors.

* Master / onshore fund :-

This is the main fund in that Pvt Equity fund / hedge fund where majority of investors, investments are in that fund.

Eg:- Fund name : KKR Asia Fund LP.

Investors in the fund,

Investors	Commitment	
Trump	1,000	onshore.
Biden	500	
KKR Cayman Island LP	600	→ off shore.
Total Commitments	2,100	

Investments

Byju's	- Rs. 500 cr
EuroKids	- Rs. 1000 cr
OYO rooms	- Rs. 600 cr
	Rs. 2,100

* Off shore / Feeder Fund :-

This is a Seperate legal entity / company / firm registered outside the main Country to reduce the tax liability / any regulatory issues to the international investors.

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Limited Partners:-

An investor in a Private equity fund is limited Partner, if that fund is registered as limited Partnership entity.

These investor / limited Partners Commit Certain amount to the fund at the time of launch, Provide money to the fund when ever the fund need to make investments (or) to meet the expenses of the fund.

These LP's will Pay the management fee to the fund or house for managing their money by the fund house.

Limited Partnership aggrement :-

This is an aggrement between the Partners in the Private equity fund which is registered as limited Partnership entity. This aggrement will have all important details about that fund such as,

A → Tenure of the fund.

B → Financial reporting due dates

C → Detailed Provisions about management fee, incentive fee, like how they are charged in that fund, due dates to make the Payment

D → Rights & liabilities of all Partners in the fund etc.

invest into flipkart Company in India, Due to this there is not tax in India on Sale of flipkart Since that investments came from mauritius, not from america. and govt of India may have an aggreement with mauritius to allow investments from mauritius with no income tax on Profits,

Note: This Blocker entity is registered to save the tax at an investment level (flipkart), the offshore fund is registered to Save tax for the investors (Eg Johnson, Salman).

Close :-

A Pvt Equity fund finalise the list of investors, Commitment of each investor. At that point of time, the fund is closed for any new investors.

Eg:- KKR Asia fund has a first close with the fund Size of 2100 crs; below are the investors / limited Partners in that fund,

* Trump - 1000 cr, Biden - 500 cr, KKR Cyman Island - 600.

Either If the fund need more money they Can have second, third close etc where new investors Can come into the close or old investors Can increase their Commitments.

Generally, most of the funds will have only one close, other funds Can have more than one close. Generally all closes will be held within

Eg:- Fund name : KKR Cayman Island LP.

Investors :

	Country	Commitment
Johnson	UK	100 cr
Salman	DUBAI	500 cr
		600 cr

Investment :-

name	Amount
KKR asia fund LP	600.cr.

This fund is registered outside the home Country (america). So, it is called as offshore fund, this fund feeds/transfers/invest the money received from international investors into the main/master fund. So, it is called as feeder fund.

Blocker :-

It is a seperate legal entity registered to block/reduce the tax liability of the fund due to an investment (investment level).

Eg:- KKR Asia fund LP, is investing in flipkart in India, they have to pay 40% tax on profits made on sale of flipkart. To avoid this they can launch (or) register the company in Mauritius as KKR flipkart Pvt ltd where KKR asia fund LP will invest in to KKR flipkart mauritius Pvt ltd (Blocker entity), that entity will

The fund Collect the money towards expenses also by issuing Capital Call notice.

Eg:- Management fee is payable on a quarterly basis (most of the funds) So, the fund will call that money from each investor on a quarterly basis.

When the fund has money which is received as income (dividend, interest, rent etc) (or) by selling an investment, they will distribute that money to the investors. These transactions like Collecting the money distributing the money can happen any time in the fund's life cycle. Generally first 4 years will be the investment period so, fund collects the money, after 5^{th} year the fund will start selling the investments so, they will distribute the money. Most of the sales/exits will happen in 8^{th} to 10^{th} year of the fund where the fund life is 10 years.

first one (or two years in the fund life. So, that the fund can concentrate on investing that money in the next 2-3 years of the fund life cycle.

Vintage Year :-

If the fund is launched in 2010 with tenure of 10 years, the vintage year of that fund is 2010. It is the first year of the fund.

Investor Cash Flows :-

Private Equity funds cannot collect the money from the investors at the time of launch (like MF's, Hedge funds) since

(a) The amount of investment is huge
(b) The type of investments they make are different, most of the times private companies / assets where there is no active market for those investments.
(c) They buy a significant control / major stake in a company / property so, valuations, terms & conditions of the deal will take time.

This funds take promise / commitment from each investor in the fund so, they have an idea on how much they can invest, where to invest etc. based on that total commitments / fund size.

Once the fund has a close

investment and then they collect that money from all the investors in proportion to their ownership in the fund.

They issue a capital call notice to each investor, ask them to remit money within 5 days (approx) those terms in LPA should be followed.

Capital Call, Contributions:-

The fund need money for investments, towards expenses, they will issue Capital Call notice to each investor. If the investor send money against that Capital Call. it is contribution. Each Contribution will reduce the unfunded Commitment / future obligation of the investor.

In Some Cases, the fund may be distributing Some income / Proceeds from the Sale of investments to the investors and they will offset that amount to with Contributions we received from the investors.

Eg:- The fund Calling. Rs.100 cr from investors, the fund is also distributing Some dividend income of Rs.30 cr, they have Called Rs.70 cr as net Contribution. Calculate unfunded Commitment, the gross Contribution of Rs.100 cr should be Considered.

Distributions:-

The fund has money, they will distribute that amount to all the investors. These can be 3 types

(a) Income distributions - If the fund received dividend income, interest income, rental income, tollgate charges from their investments into shares, bonds, Properties etc they will distribute that money to the investors i.e, income distribution.

where the ana [illegible] [illegible] [illegible] [illegible].

Commitment: This is the amount Committed Promised by each investor in the fund to invest during the lifetime of the fund. 20/12/2020

If trump Committed 1000 Crores to KKR fund, he will invest upto 1000 Crore (maximum). From the beginning of the fund it will be liquidation of the fund.

Generally this amount include management fee etc also, which means there is not additional amount Payable by the investor to the fund towards expenses etc.

In Some of the funds, the management fee is Payable outside the Commitment, these terms will be defined in LPA. So, while Calculating each investors Capital Call money, unfunded Commitment, In each fund, this unfunded Commitment of each investor will be calculated on a regular basis. Since, that fund can only invest an amount equal to this unfunded Commitment at any Point of time, the fund manger will keep this amount in the Consideration to decide the future investments (maximum amount to Commit to the Company for investments.

Eg:- If KKR Asia fund has 2,000 cr UFC, KKR america fund has 5,000 cr UFC then the maximum amount available to the fund manager (both funds managed by the Same fund manager) is 7,000 cr So, he Can Commit that amount to OYO rooms as investments.

Re-callable Distribution :-

Any amount distributed to the investor belongs to that investor, the fund has no right on that money. However, in Some of the funds, they can Consider a Portion of that distribution amount as recallable distribution which means the fund Can recall that money from the investors if they need for future investments. This amount will increase the UFC, future obligation of the investor to the fund.

Generally, the fund will ensure the future obligation / unfunded Commitment will not exceed the original Commitments of the investors.

(b) Capital distribution :-

Distributions made out of cash received on sale of investment

(c) In kind distribution:-

If the fund distribute a share/bonds any other asset to the investors, it is in kind distribution.

Eg: If KKR fund invested in a start-up Company like Paytm that Company went for IPO, the shares of that Company owned by KKR fund are transferred to the investors in that fund. These investors in the fund can sell those shares in the market when the right price is there in the market. The fund will calculate the value of the distribution based on the fund policy to value those investments / securities. (like 10 days average price in the market)

Unfunded Commitment :-

Commitment - Contribution = UFC

Eg

Commitments	10000	5000
	4000	2000 invest in to YULU
Contributions	6000	3000
UFC	600	240 will not impact UFC.
Distribution		40 will impact UFC
recallable distribution	100	3040. ~~3000~~ 3000 + 40.
UFC. →	6100	

can change from fund to fund. based on negotiations between the investors and the fund house.

The fee negotiations are based on,

a) The efforts of the fund manager (investment in start-up may need more effects than other fund investing in real estate /Public Companies.

b) Negotiation Power of investors, fund manager based on the amount of investments, knowledge in that industry etc.

Common methods followed in the Pvt Equity industry are,

1.) Commitment based
2) Cost of the investment with (or) without leverage.
3) Market value of the investment
4) NAV based.
5) Switch/Conversion based.

① Commitment based :-

All investors will Pay the investors will Pay the fixed rate of fee on their Commitment. Though, the fund will take some time to make the investments, they will charge some fee from the first day of the fund.

Eg:- ~~F~~ Co

	Fund	Trump
Commitment	1000	500
Fee rate	2%	2%
Fee Per Year	20	10.

Same amount from 2020 to 2030 for 10 years fund, launched in 2020.

Management Fee :-

This is the Common expense to all the investors in MF/PEF/HF. This is charged at the fund level, based on the fee method aggreed at the time of launch of the fund.

In MF's, the fee method will be based on net asset value of the fund, generally it is charged as 2% on NAV of the fund. In Pvt Equity, hedge fund, the fee method and rate

② Tier based adjustment :-

Eg:-

Commitment	Fee rate
up to 100 cr	2%
100 cr to 200 cr	1.5%
above 200 cr.	1.25%

In this, investor Commitment committing more amount will pay less fee.

③ Side letter arrangements:-

The fund can enter into seperate aggrements, side letter ~~ag~~ arrangements with some of the investors to provide them a discounted fee, the reasons can be,

a) They have invested in other funds launched by same fund house,

b) Due to some regulatory reasons applicable to some investors based on their country

Side letter means an aggrement over and above the limited partnership aggrement the fund has entered into seperate agrangement on some of the terms related to management fee, incentive fee etc. LPA is applicable to all the investors, these investors with side letter has exceptions / exemption from some of the LPA terms.

Adjustments :- (Mainly for Commitment based fee) :-

Fee free investors : Employees of the Company.

Related Parties

G.P.

Based on the efforts of the fund manager / GP amount of investments made by different investors. etc, there are Common adjustments in fee terms, they are,

① Step down :-

The fee rate will go down over a Period mainly due to the efforts of the fund manager / GP is expected to go down.

Eg:- If the fund is investing into other funds, Public Securities / listed Companies, initial efforts of fund manager Can be more in research, negotiations to make investments etc, however the efforts will reduce during the later Part of the fund life cycle So, the fee arrangement Can be like,

Fee rate Year	Fee rate	effective rate
1-4 Years	2%	2%
5th Year	75% of Prv. Year	1.5%
6th Year	75% of Prv. Year	1.13%
7th Year	75% of Prv. Year	0.84%

Cost of the investment :-

Investors can ask for this type of fee method ~~for this type of~~ to pay fees only on the amount invested in the investments / assets. Since a private equity fund take some time to invest, investors will pay lower fee compared to the commitment - based fee. However, this will make the fund manager to invest in less time, that may impact the performance of the fund.

In the same method, common practice is to borrow the money from market / bank and invest more money. This will give more management fee to fund house.

Eg:- If the total commitments in the fund is 3,300 crs, fund may borrow another 3,300 crs and invest 6,600 Crs. this will give more management fee to the fund manager.

Market value of the investment :-

In this case if the market values are increasing, the fund manager will earn more ~~ma~~ management fee else, lower management fee income to them.

Generally market value of previous quarter will be applied for fee calculations and the fee can be updated / adjusted based on final market values of that quarter.

2) Cost of the investment :-

S.S;

Date of investments Investment

Date of Investment	Investment	Amount of Investment	Cumulative Fee base-cost of Investment	No. of days	Fee rate	Fee amount
01/01/2020	byjus	500	500	181	2%	
07/01/2020	unacademy	1200	1700	184	2%	
01/01/2021	CRED	800	2500	90	2%	
03/31/2021	Urbanclap	500	3000	275	2%	
01/01/2022	Aster	300	3300	365	2%	

Date 26/12/2x

Waterfall Provision / Incentive fee Provision /

Allocation of Profits / carried Interest:

- most of PE funds, Hedge funds will have a provision in the fund documents to share the profits between the fund house, investors, this is in addition to mgt fee.

- Compared to MF, this PE, Hedge funds take extra risk, the fund house / fund manager efforts are also more. Since these funds more efforts, most of the times generate more profits to the investor, the fund house will take some profit, and distribute the remaining profit to the investor

In most of the funds, the profit is shared at 20% to the Fund Manager, Remaining profits (80%) is taken over by the investors based on this only, this Asset mgt industry uses the word **2, 20** cost to be borned by the investor. which means the investors has to pay 2% mgt fee on their investments (generally), 20%. They have to share the profits with Fund Manager.

In PE funds the incentive fee paid to the fund manager is also called as "carried interest" as the fund manager will carry the fund approximately for 10 ye[ars] make profits to the investors, & earns carried interest / incentive fee, towards the end of the fund life time.

NAV Based :-

In this NAV (Assets - Liabilities) is Considered as fee based at any Point of time this net asset value belongs to the investors which means if the fund is liquidated on that date, this value will be distributed to the investors. So, charging fee on NAV is one of the Common Practice.

Switch / Conversion Method :-

In this Case, the fund Can change the fee base from one method to other method after Certain Period / years in the fund life time

Eg: Fee is charged based on Commitment for the first 4 years it is charged on based on Cost of the investment from 5^{th} year till the end of the life

This will give guaranteed fee for the first 4 years of the fund so, the fund manager is not in hurry to make investments, however, they Should ensure that all Committed amount is invested by end of 4^{th} year from the launch date. If not they will get less revenue.

Key terms related to Incentive fee.

1) Principal:

* This is the "amount invested by the investors in the fund.
* This investment may be towards management fee or contribution towards investments in the fund.
* Each investor in the fund. [LP w & GP, any other partner] should get their principal from the fund before the fund manager can take the profits. (In **European** waterfall method]
* Most of the times, the fund will repay this principal after 5 to 6 years of the fund life time as they will collect the money for the 1st 4 years, they start selling the investment only after the 5th year. (most of the times during 8th to 10th year.).

2) Hurdle Rate:

* This is the rate at which the fund house should generate the profits to the investors before they can get the profits / carried interest / incentive fee.
* In most of the internal funds, they consider 8% p.a cumulative rate this Hurdle rate as
* This is based on the investors expectations after considering:

a) Risk free return: what an investor can get by investing in Government Securities etc

* In private equity, the cash inflows & cash outflows will happen over a period. Generally, the fund will collect the money [contributions] the 1st 4 years, later, the fund will distribute the money to the investors, when the fund has income [int, dividend], or the fund sold some of the investments.

This carried interest / incentive fee is also called as waterfall provisions / method since the provisions in the LPA Agreement defines on "How the cash distribution" should be considered to know the incentive fee / carried interest earned by the fund manager / GP. The General Heirarchy of this cash flow distribution is,

1) Principal
2) Preferred Return
3) Catch Up
4) Profit share between GP, LPs.

* Similar to mgt fee, these incentive fee provisions be different for each fund, based on the fund managers efforts, negotiation skills of FM(s) & investor etc., these provisions are decided at the time of launch of the fund, they are included in LPA.

Ex(2): Calculate Preferred return Payable as of 12/31/2023.
Hurdle Rate is 8%.

	Contribution	
01/01/2020	100	for inv. in Trident Hotel
01/01/2021	500	for " " IT park
01/01/2022	600	for inv in Airport
01/01/2023	-800	Distribution by selling IT park

Ans:

Date.	Contribution	Cum. Principal	Cumulative Pref. Return	Cumulative Pref Return + Principal	Pref. Return @ 8% Hurdle Rate	Cumulative Amount.
01/01/20	100	100	0	100	8	108.
01/01/21	500	600	8	608.00	48.64	656.64
01/01/22	600	1200	56.64	1256.64	100.53	1357.17
01/01/23	-800	400	157.17	557.17	44.57	601.74
					201.74	

Question

Note: The fund should try to sell remaining 2 investments for a sale price of (atleast) 601.74 cr to get the incentive fee. if they sell both for 1000 cr, then the fund carried interest will be [if no catch up clause].

⇒ Sale price 1000
Unreturned Principal 400
Cum. Pref Return 201.74
∴ Balance 398.26.

Incentive fee ← GP@ 20%. 79.652. [398.26 × 20%]
LP @ 80% 318.608. [398.26 × 80%].

b) Risk premium : What they can expect from private equity in addition to risk free ret since they are taking more risk by investing private equity.

ex: If one investor invested ₹ 100 cr on 01.01. he can expect a return of 8 crores by 31.dec.2

Same investor invested that money on 1st July 2020 he can expect 4 crores by 31st dec 2020.

3) Preferred Return :

* This is the return / profits to be paid by the fund house to the investors before they can get the carried interest.

Preference Return = Principal (Un returned amount) * Hurdle rate

① Ex: 01/01/2020 : Contributions = 100 cr.

Date:	Principal	Principal + Unpaid Preference Return	Total	Hurdle Rate	Pref Return.
12-31-20	100			8%.	8.
12-31-21	100	8	108	8%.	8.64
12-31-22	100	16.64	116.64	8%.	9.33
12-31-23	100	25.97	125.97	8%.	10.08

2025	Sale of Investment		
2026	~~Khata book~~	CRED	Part Principal Repay
2027	"	Khata book	"
2028*	"	MPL	Principal + Pref Return
2030	"	OYO	Pref Return.
		Unacademy	catch up.

Principal = 1000
Pref Return = 2500.
last sale : 100.

∴ catch up = 500, 20% of Pref Return.
∴ last sale 100 (upto 500) will be fully given to Fund manager.

Note. In the above example assuming the principal is 1000 cr, Pref Return is 2500 cr, the fund will return that total of 3500 cr by end of 2028*. In the last year if the fund get 100 cr, by selling the last investment, the GP & LP can share in the ratio of 20:80, the fund manager's total earnings are 20 cr only.
where as, the investors profits are 2580 cr. (Pref Return of 2500 + profit share of 80). This can disappoint the fund mgr since his efforts to get good profits in the fund are more, the profit share is Just 20 cr.

If the fund has catchup provision it will allow to take 20% preferred return by the fund mgr before the profits can be shared between GP, LP.

In that case, entire 100 crs belongs to GP, since the eligibility amount is 500 Cr (20% of 2500 Cr), the available cash is just 100 cr

	Case (i) Sold for 3600 Cr		Case (ii) Sold for 5000 Cr	
	without catch up	with catch up	without catch up	with catch up
Principal	1000	1000	1000	1000
Pref Return	2500	2500	2500	2500
Catch up.	0	100 (2500 * 20% upto 500)	0	500 (2500 * 20% = 500)
Profit share-GP	20 (100 * 20%)	0	1500 * 20% 300	1000 * 20% = 200
Profit share-LP.	80 (100 * 80%)	0	1500 * 20% 1200	800
	3600	3600	5000	5000
			(5K - 1000 - 2500)	(5K - 1000 - 2500 - 500)

European waterfall distribution:

* In European waterfall method, the cash distribution will be done by considering the fund level investments.

Ex If investors are given 1000 Cr, to make investments into 5 companies, the fund manager can take the carried interest only after that 1000 cr, and pref return is paid back to the investors. If the fund makes 100% profit on one investment, fund manager will not take his carried interest unless the principal & pref return is paid fully.

* most of the funds follow this European

catch-up
↳ meet to update.
↳ meeting some one ahead of you so that both are @ equal level.

Catch up :

* In this stage, the GP / Fund House will "catch-up" with the investors in profits. As ~~Per~~ the waterfall provision the fund should repay the principal, preferred return and then the profits can be distributed between the General partner & Limited partners.
  Sometimes, the fund may take almost 9 to 10 years to repay the principal, preferred return, the remaining amount left in the fund is very negligable, the fund manager may not be happy to share that amount in 20: 80 ratio.

* This catch-up will allow the fund Mgr to get some profits before the investors, fund manager can share the profits. This will make the Fund mgr to earn some profits before the profit share stage, more amount in total also, when compared to a normal waterfall method where this catch up provision is not there.

Ex Fund : Sequoia India venture fund 1 LP :

Year.	Details	Name of the company	Applied for.
01/01/20	Investment	Oyo	
01/01/21	"	CRED	
01/01/22	"	Unacademy	
01/01/23	"	Khata book	
01/01/24	Investment	MPL.	

Date 27/12/20
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Q. Calculate carried interest based on below details.

Fund Name: Godrej real estate fund.

Vintage year = 2018.

Fund size = 5000 cr

Investments :

Godrej 1 building = 2000 cr

Godrej 2 " = 1000 cr.

Trees = 2000 cr.

Hurdle rate 8%, Prefered return payable as of 2020 is 2500 cr.

Assuming the sale price are.

Inv. details	Scenario 1	Scenario 2.	Scenario 3
Godrej 1	2000		
Godrej 2	1200		
Trees	1700		
	4900	7450	10700.

Cathup is 20% on Pref. Return.

Particulars	Eligibility (max)	Scn - ① Sale Proceeds - 4900 Amount	Balance	Scn - ② Sale Proceeds - 7450 Amount	Balance	Scn ③ Sale Proceeds - 10700 Amount	Balance.
Principal	5000	4900	0	5000	2450	5000	5700
Pref Return	2500			2450	0	2500	3200
Catchup	500					500	2700
GP Profit share						540*	
LP Profit share						2160*	

Carried interest = Catchup + GP's share = 0 = 0 = 1040.

2700 × 20% = 540, 2700 × 80% = 2160.

Waterfall method.

American Waterfall method:

In this method fund will calculate the eligibality of carried interest on deal by deal basis.

Ex: fund invested 1000 cr on 5 investments out of that 100 cr is invested in oyo rooms (one among 5). oyo rooms is sold for 200 cr in 1 year time. which means the profit is 100%, so the GP is eligible for carried interest on that deal and they will take in that year itself.

However, the total carried interest eligibility will be calculated towards the end of the fund life. and the fund manager took carried interest though he is not eligible or that carried interest paid to the fund mgr is more than the eligibility [at fund level], that excess carried interest should be returned to the investors. This provision of Repayment of excess carried interest is "CLAW BACK".

CLAW BACK

Investment Strategies:

- PE funds can invest in any Asset class, there are No restriction on where they can invest.

General Features of PE investments are:

→ Long term investments
→ Huge amount investments
→ Private investments / Other than public
→ Significant control.
→ Illiquid investments.

Common Strategies / Type of investments these funds made are

→ Venture Capital Strategy
→ Real estate
→ Infra
→ PIPE [Private Investment in Public Equity].
→ Distressed Assets
→ Mezzanine
→ Fund of Funds.

① Venture Capital Strategy:

In this strategy PE firms invests in startup companies / Pvt companies. Startup company is a company with an innovative idea, a new, small company. This strategy can be risky, since the success of that company / business model is unknown, it is experimental.

The venture capital funds need to assess the business model very carefully, including any that can create legal, political issues that can create trouble to that business. Most of the companies will incurr losses in the initial stages, the fund should be prepared to keep fund those companies

Investors who are ready for that kind of a risk where capital can also become zero can invest into these funds / funds with venture capital strategy. If one or two companies are successful in that portfolio, they can cover the losses made on other investments.

Ex: 1) Sequoia Capital
2) Accell partners
3) Kallari capital
4) Saif partners.

2) Real Estate strategy:

* In this strategy the funds will invest into Real Estate properties like office / Tech parks, hotels, shopping malls, wl houses etc.,

* They will own this properties for 5 to 7 years and then sell the properties to other PE funds / strategic buyers / public [IPO].

* The income for the funds will be
a) Rental income
b) Other income like Advertising revenue / Parking
c) Capital Appreciation when the property price are increasing

Note: If the sale proceeds are 7999 cr., then distribution will be as below.

Principal = 5000
Pref Ret = 2500
Catch up = 499. [upto 20% * 2500 = 500]
7999.

Carried Interest : Points to Noted.

1. Calculation to be made at **investor level** since the contribution towards management fee can be different for some investors.
i.e., If they are paying lower fee than others

2. Once all principal is paid to the investors preferred return calculation should be stopped from that time / period. As their principal is returned and Pref return is always on unreturned principal.

3. Some investors like GP, employee of fund house etc do not pay the carried interest so they should not be charged.

funds calculate the valuations and report the market values in the financial statements.

* In the accounting, financial reporting of these Real estates funds, few points to note are
1) Consolidated FS: most of the times each property owned by the fund will be registered as a seperate legal entity, all the books of these properties / legal entities should be consolidated to report the funds financial statements.

2) Adjustments like Rent free agreements - To attract anchor investors who can stay in the property for a long time, they offer rent free period to those tenants. Will be GAAP as per GAAP requirements, the revenue should be reported for that rent free period also. (Straight lining of the rent free amount)

ex: Fund : Black Stone Realty fund:
Tenant : Life Style.
Tenancy start date : 01/01/20
Tenancy end date : 12/31/2029.
Rent for a month : 100000.
No. of months in the contract : 120 m.
No rent / Rent free period : 6 m.
Total Rent income : 11,400,000.
Per month rent to be accounted = 95000 $\left[\frac{11400000}{120}\right]$

Journal entry :
01/01/20. Rent free Asset 95000
To Rental inc 95000.
!
(coming 6 months)

* Some of the funds will invest at the beginning stage of Real estate properties like residential properties where they can sell those properties over a period like 4 to 6 years and return the money to the investors.

* If they buy an existing property like shopping mall, star Hotels etc. they need other professionals to help on maintenance of those properties, bring the tenants into those property etc. and those charges paid to these Asset managers, property managers etc. are included in the firms financial statements as fund level expenses.

* Asset managers will help these PE funds to find the right tenants to the property [like Anchor tenants like lifestyle, Reliance Retail etc.] & negotiate the terms & conditions of tenancy agreements so that increase the revenue of the property which will increase the valuations of the property.

Ex: JLL, ANAROCK

* Property managers help these PE funds to manage the properties in a good condition that providing services like Amenities in those buildings like Gardening, desk management etc.

* Valuation of these real estate properties is difficult considering these investments are illiquid, No purchase or sale of similar Assets can happen on a regular basis. So, most of the

3. **PIPE: strategy.**

* In this case, the PE funds will invest into public / listed companies.

ex: KKR investment into JB chemicals, investment into bajaj finance by PE funds

* The idea to make investment in public company is to make profits with the share prices increases in the future are to make the company a delisted company, [Remove the companies shares from stock exchange] and increase the value of the company, then sell the shares again to the public, Relist the shares in the stock exchange.

4. **Distressed Assets:**

* These funds will invest into Distressed Assets like any real estate property that is incomplete due to insufficient funds to complete the project, the stressed debt like like company or borrower did not pay the interest or loan amount to the banker since they will be available at cheaper price, they can make quick profits if the value of that assets, / property increases in the market.

MEZZANINE:

In this case the funds will invest into those securities having equity, debt futures like warrants, convertible debentures etc., this means the investors can get the growth opportunities of equity and safety of debt both.

Fund of Funds:

This is also very common / popular strategy in the fund houses. All type of funds like MF, PE, Hedge funds invest into this strategy.
In this case one fund will invest the money into other funds (not directly into a company / Asset.)

Ex: Black Stone Asia fund collected 10K crs, they have invested into
→ KKR Asia fund - 2000 Cr
→ Bain capital Europe fund - 3000 Cr
→ Goldman Sachs India fund - 5000 Cr

* These funds from KKR, Bain will invest into Companies / Assets. This KKR Asia fund invested into ⇒ Reliance Jio - 500 Cr
→ JB Chemicals - 1000 Cr

→ this strategy is being one of the most popular strategy in the world are
* main reasons for
1) more diversification of Risk - Black stone fund if they invest in 20 companies
may be invested

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REIT(s)
↳ Real Estate Trusts Investment

Bank 100000
To Rental income 95000
To Rent free Asset 5000.

To exit from these Real estate properties. PE funds can follow the public issue route by converting these real estate properties into a Trust and issue units (or shares if it is a company) to the Public. It is easy to get more capital from the public in this route

Ex: Embassy Blackstone REIT.

office Park - Bangalore (ETV)	3000
office park - Bangalore (EGL)	2000
office park - Pune	3000
office park - Chennai	2000
	10000

→ make these portfolio of properties in to UNITS/Shares then sell out to the public.

→ 1 crore units at 10000 per unit.
→ These units will be listed in a stock exchange like shares and investors can sell and buy on a daily basis.

→ Investors in REITs will get the rental income and appreciation benefit of those properties (unit value increases in stock exchange)

RDP:- Retail Distribution Review.

Date 02/01/24
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INFRA [Infrastructure strategy]

In this ~~Strategy~~ the fund will invest into Infrastructure projects like Highways, Airports etc.

The income can be a recurring income like Toll charges, User charges etc., or Gain on sale of the project. [Capital Appreciation.]

Similar to REIT(s), INVIT(s) [Infrastructure Investment Trust] are created ~~there~~. to sell these properties. This INVIT Route is one of the option to a Private Equity firm to exit from the investment. Other exit options like selling the Investment to other PE fund, Other Buyers is anyhow available to this funds.

In INVIT, a portfolio of Infrastructure assets are pooled into an INVIT and Units / shares are sold to the public, most of the times, these units are shares are listed in a Stock exchange.

Ex:
RJIO Converted their telecom towers, cable network into INVITS and sold them to public/ PE funds.

IRB infra: IRB also converted some of their highway's into INVITS and sold to the public directly, in this case they gave money to many funds, each fund invested into many companies so the risk is diversified into many companies. Also diff fund mgrs will have diff risk strategies, that can help the invest

* Investments can be made into new markets & New Assets by knowing in which fund to invest or which fund manager to trust though one fund mgr do not know all other markets other opportunities.

ex: A fund mgr in India can collect the money, invest into funds launched in Russia, america and those local fund mgrs knows where to invest in that market.

* Main disadvantage of this strategy is more expenses since the investors has to pay all the expenses at mainfund, subfund level. In this example, investor in Black stone should pay mgt fee, audit fee etc at Black stone level, Bain capital Cr KKR etc.

Since all the investments should be reported at fair value, most of the investments in a PE fund are illiquid investments (Not traded regularly), PE funds follow different practices to value those investments and they have to disclose all that information in the notes to accounts so that investors / users of those financial statements can understand the risk associated with those investment valuations / performance of the fund.

Different valuation methods used by the funds are categorised into below 3 categories based on the source of inputs used in the valuation.

Level ①: Investments are that are traded in a stock exchange / In Active market. Investors has lower risk if most of the investments valued at level 1 since the fund can get similar cash / value if they sell the investment in near term also. (sale price may not vary from the value reported in the books.)

Level ②: Investments that are valued based on the market value of similar assets

Ex: If a fund invested into forward contracts to buy or sell foreign ~~token~~ currency, they can value that forward contract based on similar forward contracts price in the market.

Level ③: Investments that are not traded in the markets, similar assets market value is also unknown, then the PE fund should value those investments and report in the financial

Valuation of Investments:

1 * One of the major challenge in PE business or Financial reporting is to value the investments. It is important to know the Real market value of the investment (A company / A property) at all 3 important stages such as

a) At the time of investing,
b) At each financial reporting period
c) At each exit / sale of the investment.

2 * Based on the valuations, the company performance, investors return can increase or decrease, if a fund wants to report a better performance, they can increase the valuations by manupulating those valuation.

3 * In the Financial Reporting, the fund should disclose all important points related to the valuation of investments, since the fund gain or loss reported in the financial statement is depending on these valuations and any investors relations like transfer of investment from one investor to other investor can happen based on the NAV reported by that fund. In some of the funds the management fee is also charged based on NAV of the fund / market value of securities etc., So depends on the valuation technic, valuation process, investor returns, expenses are decided.

Financial Reporting:

Financial Reporting of different funds will follow different timings, most common timings are

- Mutual funds – daily NAV reporting, Yearly Financial Reporting.
- Hedge Funds – Monthly Financial Reporting, NAV reporting.
- Private Equity :- Quarterly Financial Reporting, NAV reporting.

In addition to this Annual FS will be sent to all the investors after the Audit (Quarterly – Unaudited Financials, Annual – Audited financials)

While sending the FS to each investor, the fund also include,

a) market summary report highlighting the investment industry, challenges & opportunities, management summary on the fund performance.

b) Capital statement of each investor (only that investor will receive his/her capital statement)

The financial Reporting Package will include the bellow sections

1) Statement of Assets & liabilities [B/S]
2) Statement of Investments
3) Statement of Operations [P&L A/C]
4) Statement of changes in partners capital
5) Statement of cash flows
6) Notes to financial statements.

statements:

ex: If PE fund invested into a start up like OYO Rooms, similar company shares are not purchased / sold by any company investor then it should be valued by using one of the valuation techniques like DCF etc., ~~if more~~ in

if more investments are reported under level 3, Risk is more in that fund since Actual Fair value may/will be different from these that are reported in FS, the profit making fund ~~into~~ may turn into loss making fund if some of the assumptions in the valuations are changed etc.

* These fund houses will have a valuation committee who will decide on the valuation method to be used, internal controls to be followed like appoint an external valuer to value some of the important investments at regular intervals like every 2 years once.

Journal Entries

To prepare the Financial Statements the Fund administrator will post all Journal entries on a regular basis [Daily / monthly]. The common Journal entries by each group are given below.

1) For all income related to the investments

a) Interest Receivable Dr
To Interest income

b) Bank A/c Dr
To Interest Receivable.

2) For all expense accruals [All common expenses, recurring expenses should be posted on a regular basis even if they are paid on a later date.]

Common recurring expenses are

- → Management Fee
- → Audit Fee
- → Custodian Fee
- → Tax Consultant Fee
- → Fund Admin Fee etc.

entry for accrual is

Mgt fee exp A/c Dr
To mgt fee payable

Once it is paid

mgt fee payable Dr
To Bank.

Non recurring expenses should be posted directly, they are

1) Legal exp Dr
To Bank

* General sequence of these financial Reporting / life cycle is given below.

Particulars	Who? Fund House / Admin/GP
1) Journal entries - Bank Payments/Receipts	Preparers / Fund Admin
2) Adjustment entries - Accruals, Prepaid, valuation entries.	Preparers / Fund Admin
3) General ledgers review & close	Preparers / Fund Admin
4) Trial Balance Preparation	Preparers / Fund Admin
5) Sending TB, Financial Reporting Package like mgt fee calc., etc.	Preparers / Fund Admin
6) Approval of TB	Fund House / GP
7) BS/PL/CF - Financial statements Preparation	Preparers / Fund Admin
8) BS / PL / CF - Approval	Fund House / GP
9) Allocations to Prepare and, send for approval	Preparers / Fund Admin
10) Allocation file review & approval	Fund House / GP
11) Individual Capital statement Preparation	Preparers / Fund Admin
12) Individual capital statement review & Approval	Fund House / GP
13) Once approved send all ~~Bet~~ to each	F... / GP

Key Terms : Financial Reporting :

1) Syndicate cost:

These are common cost paid by the fund house on behalf of many funds.

ex: KKR spends ₹ 5 cr on business meeting expenses to make investment in Flipkart co., they had meeting with Flipkart mgmt to decide on valuations then they want to invest in that Flipkart company on behalf of the below funds

KKR Asia fund, KKR Europe fund, KKR A fi.si. KKR Co., will pay these expenses and then allocate to each fund based on the amount invested by those respective funds.

2] Broken deal Cost : Deal means an investment made by a PE fund. Before making the investment / closing the deal, they do conduct research, due deligence etc., they also incur some expenses for different legal requirements in the process of conducting due deligence / Research.

After incurring some expenses, they decided to withdraw from that investment then the cost incurred so far is waste, it is called as broken deal cost. (The deal is broken). This is accounted as broken deal cost / expense in the financials.

3) ESCROW Account:

Escrow account means an account managed in a bank, the balance in that acc has restrictions it can be used only after fulfilling some conditions.

ex: PE fund sold some investment

3) Once the investments are made, the gain or loss should be reported, entries are

i) Increase in the valuation

Investment Dr

To Unrealised Gain/loss

ii) Investment sold for profit

Bank A/c Dr

To Investment

To Realised Gain

Since investment is sold, any unrealised gain relating to that investment should be reversed.

Unrealised Gain / loss Dr

To Realised Gain

4) When Money called from the investors, Receive that money.

→ Contributions Receivable Dr

To Capital

→ when money received.

Bank A/c Dr

To Contributions Receivable.

5) When investments are made.

Investment A/c Dr

To Bank

2) Expense Ratio:
This is calculated as % of all expenses in
the fund on NAV or on commitment etc.,
If exp ratio of one fund is 1%, the other
fund is 2%, then the 1st fund is the better
fund to make the investment. If exp ratio
is less, investors profit / Returns will be higher
in that fund.

Allocations:

- Allocation is a Process Performed by the fund
administrator / preparers of FS to allocate the
fund level, expenses to each investor in the fund.
- In a capital statement that is sent to each
investor in the fund, the allocation of fund level
income and expenses should be reported.
- After this allocation of common income and expenses,
each partners / investors NAV can be reported.
- To allocate these common income and expenses
the ownership percentage of each investor in that
fund is not sufficient, since there are many
other exceptions in charging the mgt fee,
incentive fee etc.,
ex: If there are 2 investors in that fund, (GP, LP)
if the total mgt fee exp is 10 Cr, that can
not be allocated to both the investors proportionately
to both of them based on the ownership percentage.
the GP will not pay the mgt fee he should be
excluded from charging that mgt fee.

to another co., the co. paid 90%. Bank/~~ac~~ remaining 10% deposited in ESCROW bank account that money will be released only after 3 months if they are happy with the results of the company which is purchased by them.

4) ~~Financial~~ Highlights (FiHis)

Most of the funds (MF, PE, HF) ~~[illegible]~~ will report the financial highlights that are relevant to the investors mainly to compare between two funds performances. In PE funds generally they disclose the below 2 parameters

1) IRR

Rate at which the fund is giving returns to the investors after converting the cash flows into the present value.

If an investor invested ₹ 100 in the 1st year (01/01/2021), sold that investment for ₹ 200 after 4 years, the simple return is 100%. (Two times the value). In IRR this return is calculated per year and after adjusting the cash flow for the time value of the money.

01/01/2021 0
31/12/2021 1
31/12/2022 2
31/12/2023 3
31/12/2024 4

Date	Amount	
01/01/2021	-100	Investment.
12/31/2021	0	
12/31/2024.	200	sale

IRR = 18.92%.

Allocations

ex(2):

Name	Commitments	% ownership	Opening Bal	Contributions	Distributions	U/R Gain	Realised Gain	mgt fee	Dividend	Closing Bal
Goldman Sach	100	5	50	10	-5	25	5	0	0.05	85.05
Trump	1000	50	495	100	-50	250	50	6	0.5	851.5
Bush	900	45	445	40	-45	225	45	4	0.45	764.5
	2000		990	200	-100	500	100	10	1	1701

CAPITAL STATEMENT:

Capital statement of Trump for the period 01/01/20 to 12/31/2021

OP. balance	495
mgt fee	
incentive fee	
Inv income	
U/R gain	
Closing bal	851.5

History (To) Till Date

Commitment	10000
Contributions	850
Distributions	250
Unfunded Commitment	150

Investment multiple

Distributions	250.
NAV as of today	851.5
TEV (total estimated value)	1101.5
investment	850

∴ Investment multiple = 1.30

$\frac{1101.5}{850}$

* Any investor paying discounted fee should be given the benefit of that discount, they should not be charged on ownership %.
ex: If Trump, Biden has 10% ownership, Fund agreed to charge 2% to Trump, 1% to Biden as per mgt fee, then allocation of fund should be based on that, and not based on ownership.

* When transfer happens from one investor to other, the new investor may be eligible for lower fee rate [Disc fee rate] due to the Jurisdiction of that person, or that person may be an investor in other funds, so keep charging same mgr fee / incentive fee will be incorrect, the eligibility of new investor for any discounted rate should be checked.

me: Similar to Goodwill

EQALISATION

* This means new parter/partners coming into the fund due to multiple closes, the old partners should be compensated for their earlier contribution so they will be in a same position like new partners for total contributions made.

* This situation can come when the below conditions are met.
1) The fund has more than one close.
2) Before the final close, old partners contributed some money already.

Div dend	Closing Bal
0.05	85.05
0.50	851.5
0.45	764.5
1	1701

classmate Date 09/01/2021 Page 59

Points to be noted in allocation:

* "Any fee" free investors are GP, Employees of fund house should be exempted from changing the mgt fee, incentive fee.

* If there is a transfer between the partners, the numbers to be allocated between them should be correct.

Ex: If the fund made a gain of 100 Cr on sale of an investment, this happened in the month of may-2020, the old partner got ₹ 10 Cr out of this Realised Gain. This old partner transferred his stake to a New partner on 1st July 2020, When preparing the allocations for the year 2020, If the total realised gain also 100 cr for the fund, then it should not be proportionate to both the partners. All the amount (10 cr) which is the share of that partner should be allocated to OLD partner since this realised gain happened in May-2020 the New partner is not part of the fund at the time.

Ex:

1101.5 / 50

ANR

Common terms in Fund Accounting:

Feature	Open Ended	Closed Ended
meaning	Investors can come and go any time	No exit, Once investor comes into the fund, money is locked for the fixed period.
Liquidity	more liquid to the investors.	Less or no liquid.
charges	Entry load and exit load may be applicable	No entry load & exit load.
No. of Investors & No. of units	Can change	Fixed.
Time Period	No specific time for the fund.	Fixed duration like 10 years.
Advantages & Disadvantage	Liquidity to investors, but fund mgrs can have pressure to provide cash & sell investments when investors need money.	Investors can face liquidity issues even if they are listed in stock exchange. Fund mgrs can be happy as they can time the purchase & sale of investments based on research.

INTERVAL FUNDS:

These are closed ended funds for most part of the time in a year, opened for a specific interval period. ex: Each year 1st to 10th Jan it will be open ended fund means; Investors can ask the fund house to redeem the units and pay money or buy the units from fund house for the remaining days. He can sell in stock exchange or buy

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to bring all the partners to a equal position, the fund will call more money from the new partners and pay to the old partners or adjust with their future contributions. Fund will also collect some interest from the new partner & pay to the old partners.

Ex: Fund name : Blackstone Business Fund 1 LLP.

vintage year : 2020

first close : 1000 crores.

Trump : 500

modi : 500.

money collected in 2020.

Trump : 250 } 1st Jan 2020.
Modi : 250

New investor biden came into the fund on 01/01/21,

Biden's committment : 500.

In Jan 2021, fund need 750 Cr to invest into PAYTM.

Investors	Commitment	Cn-1	Cn 2	Total Contributions for investment	For Int.
Trump	500	250	166.67	416.67	20
modi	500	250	166.67	416.67	20
Biden	500	—	416.66	416.67	−40
	1500		750	1250	0

stock exchange, & can not ask fund house.

Assets Under Management [AUM].
AUM refers to Asset under Mgmt, If a fund house like SBI says their AUM is 4 Lakh Cr, they are managing the assets worth of 4 lakh cr's on on behalf of investor.

* This is a relative term to compare between different companies & to decide on who is managing more assets in this industry compared to other companies.
* This also indicates, the growth rate of that Asset mgt company compared to other companies, the investors confidence on that company.
* This AUM is also considered to the growth of the AM industry in a country, to compare with same industry in other countries.

ex: In India total AUM is approximately 30 Lakh Cr, it was less than 16 Lakh Cr in 2010.
* Same way, India's AUM is less than -10% to GDP. It is more than 100% in America.

* Top Companies by AUM in India
  - SBI, 4 Lacs cr
  - HDFC 3.8 L cr
  - ICICI 3.59 L cr

* Top Asset mgr by AUM in World.

Name	USD (in Trillion)	Ind ₹.
1) Black Rock	6.84	513 Lakh Cr
2) Vanguard	6.2	465 lakh cr
3) UBS	3.26	244.5 lakh cr

* To calculate this AUM, the industry practice is to consider the assets which are earning Revenue to the company.
If the fund is charging Mgt fee / Any fee on NAV, NAV of all the funds managed by company will be as AUM.

ex: State Street

Type of Fund	No. of funds	Fee base	Amount of total NAV/ Commitment etc.
MF	10	NAV.	1000
PE	10	Committment	20000
PE	5	Cost of capital	5000
HF	10	NAV	9000
			35000

This means if the AUM is ↑, the revenue is also increasing to that company.

AUC

In the Asst mgt industry, it is general practice to outsource the custodian function to another company.
The custodian will charge the custodian fee for the fund, they will declare Assets under custody to indicate which co. has more assets in their custody.

If Gold man sachs has 10 PE funds, 5 Hedge funds of total Aum of 10k cr

BNY mellon as custodian, if they appoint reported as AUC, those Assets will be at GS, BNY). (Assuming fee base is same)

If BNY is appointed as custodian for 10 PE funds, they are changing the custodian fee on commitment, then all those commitments of those funds will be considered is AUC.

Top AUC's

1) BNY mellon 25 Trillion $
2) State street 20. ..
3) JP morgan 20 Trillion

* Custodians are responsible for

a) To safe guard the Assets of the funds such as stocks, Gold etc. where the fund is invested.

b) Participate in clearing & settlements on behalf of the Institutional investors, fund houses when they purchased securities in the stock exchanges.

c) Follow up, Receive, Account the corporate Actions benefits such as dividends, bonus shares etc. on behalf of the fund.

* This custodians are also appointed as Fund Administrators for the same fund as per the (General practice) in the industry. (Fund Admin, custodian can be different Also.)

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Amount of
total NAV/
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EPFO of India, LIC etc.,

Sovenign Funds

These are Govt funds managed by Govts like Singapore, Norway, Dubai etc., all these investors are major sources to raise the money in PE, Hedge funds.

Growth lin
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NAV

* Net Assets = Assets - liabilities of the fund.

* NAV per unit/share = $\frac{\text{NAV of the fund}}{\text{No. of units or No. of shares}}$

* NAV is the real value of the fund as on that day. Since the funds are in the business of pooling the money, making investments and report the P/L to the investors & report, distribute to the investors. It is important to report the value of the fund on a regular basis.

* In all type of funds, All assets & liabilities are reported at Fair Value (market) so net assets [A-L] represents the True value of the fund. To report the NAV per Unit or per share, the funds will devide NAV of the fund with No. of shares or units in that fund.

* This NAV per unit/share of each partner is very important to the investors since.
a) They can transfer/sell their ownership in the fund to others at this Net Asset Value.
b) Each investor can know if the fund is performing well or not.

Ex: An investor purchased 1 unit or 1 share in a MF at ₹ 100 on 01/01/20, If the NAV is ₹ 120 by Dec 2020, the fund made 20% profits in that year. So the NAV is increased from 100 to 120.

* All the funds should calculate NAV on a periodic basis, the frequency of calculating this, NAV is decided at the time of launch based on the type of fund, type of investment, Requirement of

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AUA

* The fund administrator like state street are responsible for to take care of day to day admin activities like taking care of bank payments, investor Reporting, FS preparation etc...
They change Fund Admin fee to each fund.

* To show which Company is biggest in this fund administration activity, they declare this AUA

* Top names are
~~SSGC~~ SS & C.
State street
SEI.
CITCO

HNI. (High Networth Investors)
These are investors who are individuals having more assets / cash who can invest, who can take more risk.
Generally investors with more than 10 mn $ (7.5 cr) net Assets is considered as HNI.
Bases on Income etc, also they are considered as HNI.

These are Institutions registered with SEBI to make investments.
etc to make investments by many big companies/
Ex: Pension funds mgd by states like JP morgan pension fund, canadia Pension fund.

This NAV can also be calculated using Income/exp statement approach :-
Where opening NAV is increased by Income & NAV can be reducing by expenses / losses.

Opening Balance (A)		20
Add:		
U/R Gain		7
Int income		2
Div income		1
	(B)	10
Less:		1
mgt fee		0.2
Other exp / losses		1.2.
	(C)	

∴ NAV closing (A+B−C) = 28.8.

* **Parties:**

Asset mgr / Fund manager : Launch the fund, manage the fund charge mgt fee, Incentive fee.

Custodian : Keep Assets in safe custody.

Fund Administrator : Admin Activities like Accounting.

RTA : Keeps ownership details / Investors details in the fund investors to report the NAV to buy or sell these units of shares etc.

The general frequency of reporting this NAV:

- M.F — Daily
- P.E — Quarterly
- HF — monthly.

Ex Balance sheet of a Mutual Fund:

Assets	
Investments	288
Cash	10
Receivables - Dividend, Interest etc.	2
Total Assets (A)	300
Liabilities:	
Management fee payable	5
Audit fee payable	2
Other Payables (custodian fee).	5
Total liabilities (B)	12
Net Assets (A-B)	288
No. of Units / Shares	10
NAV per unit or Share.	28.8

If an investor wants to leave the fund (Redemption the fund will pay ₹ 28.8 /unit, If the investor wants to invest / subscribe, to the fund, fund will charge 28.8 / unit.
If any entry / exit load, it should be adjusted.

Particulars/ [redacted]	mutual Funds	Private Equity	Hedge Fund
Investors.	Retail Investors	HNI, Institutional Inv, Sovereign Funds,	HNI, Inst. Inv Sovereign Funds
Investment	mainly liquid Securities	Anywhere, mainly Startups, Real estate.	Anywhere, main listed securities, derivatives more
Fund Structure	open ended (Generally)	closed ended (Generally)	open ended (Generally
Risk	Less	medium	High
Regulatory Restrictions	High	Low	Low
Fee	Management fee	mgt fee, Incentive fee	mgt fee, Incentive fe
Amount of Investment	Low [₹ 100 to 500 also OK]	Very High (Approx in Crores)	High (Approx in lakh
No. of Investors	many [1000 to 100000 of investors	1 to 1000	1 to 1000
Liquidity	High	Low	medium
Tenure	Open ended - No fixed Tenure, Closed ended - Approx 5 to 7 years	10 years (Generally]	OpenEnded - No ten Closed ended. Aprx 5 to 7 ye
NAV Reporting	Daily (Generally)	Quarterly (Generally)	Monthly (Generally)
Return	Low	High.	High

Hedge Funds

[redacted]. Hedge Funds pool the money from HNI's, Institutional investors etc. invest that money into ANY Asset, depending on the investment objective of the fund.

* Generally they invest in Listed co. shares, currencies, debt securities, However they use derivatives to a great extent to gain in short time. Due to more usage of derivatives, expecting more returns in short terms, these funds are considered to be more risky.

* Historically, these funds are doing hedging by using different strategies so the name of Hedge funds to this category of funds. The funds like MF's can only purchase the shares first & sell those shares later, which means the shares / Asset values are increasing in the market, these funds will make profit else they make losses.

* Hedge funds started buying some stocks & sell those stocks later, & also sell some stocks and then purchase those stocks later. The investments / portfolio is hedged against the market risk. If the market is increasing, decreasing the fund can still make profits.

* These funds can target " Absolute Return " which means the fund will make - profit,

Alternative Investments / Assets

* If an investor is investing into Assets like
a) Eq shares / Pref shares
b) Bonds / Debentures
c) MF's etc.,
That investor is considered to be making investment into Traditional Assets.

* Most of the countries [mainly developed countries] has matured financial markets, investors so investing into these Assets are common. So these assets are called as Traditional Assets.

* If an investor is investing into Any Asset other than Traditional assets they are considered as Alternative Investors.

Ex: of Alternative Investments are
1) PE
2) HF
3) Real estate, Gold, Currencies
4) Vintage cars, Arts, paintings
5) Wines

These alternate investments are considered Riskier (compared to) than Traditional Assets due to less liquidity. Features of those Assets are not known to the public like Traditional assets.

In Asset mgt industry / Investment banking industry, most of the organizations has seperate dept with the name of Alternative investment division / team etc. who will deal with these alternate Assets.

amount invested in one year.

c) Investor can withdraw amount only after giving one month notice / request a month before etc.,

These are called as "GATES", since these conditions are keeping checks or Hurdles to the investor to withdraw the money.

* Similar to PE Funds, these funds also charge Mgr fee + Incentive fee to the investors. Since these funds are mostly open ended funds there are different practices in this industry like "HIGH WATER MARK". (Incentive fee can be paid to the fund mgr once the fund crosses the highest NAV reported earlier.)

if the mkt is going UP or mkt is getting Down. Even if some stocks are giving loss since the markets are going down, that loss will be covered from the profits made on stocks that are SOLD [Short Selling].

* Selling the stocks today, buying then later is called as "SHORT SELLING". if the investor is bearish about a stock price / investment, they can sell today at a Higher price and then purchase at a later point of time when the stock price is decreased. the profit will be difference b/w SP, Buy price.

Ex: If WIPRO share is trading at 430, investor is price goes dow u can sell at ₹ 430 today. purchase the share at ₹ 380, (after a month), the profit is ₹ 50 per share.

* The Hedge funds can do this by borrowing the stock from their Prime brookers [ex GS, HSBC etc.], they will return their shares to their prime brokers after buying at later point of time.

open ended funds.

* which means investors can invest or withdraw any time from these funds.
However some of the assets invested by HF's can be illiquid, it will take time to settle the money to investors. so they keep some restrictions to investors on redemptions like

a) Amount can be withdrawn by the investor only during month end, quarter end, and not in

b) An investor can withdraw only 25% of the

	Formula	Comments	HDFC	ICICI	Better?
EPS	PAT/No. of shares.	More the Better	51.78	17.17	HDFC
PB ratio	market Price /Book value Per share	less the Better	4.57	2.92	ICICI.
P/E Ratio	MP/EPS	Less the Better	21.21	30.68	HDFC
Industry P/E			36.99	36.99	
market Price	Current Price		1466	543.	

Book value Per share = $\frac{\text{Net Assets of the Co..}}{\text{No. of shares}}$

* Apart from this quantitative data, the fund mgr should asses the qualitative factors like the expected Growth for that company, that industry, Quality of the mgmt etc., to decide if a company is in a good position to buy those stocks (Long positions) or to sell those stocks (short position).

* In this strategy, if the mkt is increasing, all the stocks may go up, however the stocks that are purchased may increase faster than the stocks that are sold.

Ex: If HDFC Bank shares are purchased, ICICI - Shares are sold then, in a bull mkt HDFC share may increase by 30%., ICICI share price may also increase but by 10%. which means the fund can make more profits on HDFC Bank, less loss on ICICI Bank

* Same way, if the mkt is going down, (bear market) ICICI will give more profits, HDFC may give some loss, it can be still net

Harsi

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Hedge Fund Strategies :

i) Long / Short Strategy

ii) Market Neutral Strategy

(iii) Short only Strategy.

(iv) Quant Strategy

v) Macro Strategy

vi) Merger Arbitrage Strategy

vii) Convertible Arbitrage Strategy

viii) Fund of Funds

ix)

1) Long / Short Strategy:

* In this Strategy the fund mgrs will use the money to buy certain stocks / Assets & sell certain stocks / assets

ex: If the fund has 10 cr they will use ₹ 7 cr to buy some stocks like INFY, TCS & they will use 3 cr to sell WIPRO, MINDTREE.

* Based on the research, they will find out the under valued stocks, so they will buy those stocks with an expectation those stocks will increase in the market price. Similar way, they will find out the Overvalued stocks & sell those stocks today with an expectation that those stock prices will go down in the future so they can buy, at low price and make the profits.

* Based on the Quantitative Data the stocks can be identified as Undervalued or overvalued mainly based on P/E Ratio, or P/Book Value Ratio.

houses will decrease since people will borrow less to buy those assets, since those borrowers has to pay higher monthly EMIs.
In this case hedge fund can start selling the stocks like Tata Motors, Prestige builders

Merger Arbitrage Strategy:

In merger Arbitrage Strategy, the fund mgr will decide on which company stocks to buy or sell based on the terms & conditions of a merger

ex: If Andhra Bank, BOB are merging, if it is expected that Andhra bank shares will go up then they will buy those stocks & sell Bank of Baroda

In Convertible Arbitrage: if a co. has convertible debentures, no. of shares in that company will increase after that conversion ~~will take~~. which means earnings per share, price to earnings ratio etc. will change. If it is expected that the debenture holders has more advantage in these terms & conditions, then they can buy the debentures & sell the shares to make profits.

Date
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profit to the fund.

ii) Market Neutral strategy:

* In this strategy, the implementation of Long/ Short strategy is modified where 50% of the money is used to take long positions [Buy] & 50% for short (sell) positions.
* In long/ short strategy the amount of money used can be 80% to long positions, 20% to short position.

iii) SHORT ONLY

* In this case, All the money used to sell the stocks that are over-valued, or the stocks in an industry where the industry is having more troubles
* In Long term, this strategy is more risky, since stock prices will go up in the long term.

(iv) Quant Strategy / Quantitative strategy:

* In this case funds will use statistics, computer program to analyze huge amount of data, about certain stocks, industry, market behaviour etc, to find out the correct time in to take long or short positions and take decisions to make Gains (most of the times short term profits)

(V) MACRO:

In this strategy the fund house will take investment decisions based on MACRO DATA such as inflation, interest rates, unemployment rate etc.,

ex: If Infiation is increasing, to control that inflation a central bank like RBI will increase the int rates.

If Int rates are increased, the demand for vehicles

charged incentive fee. In 2021 fund made a loss the NAV went to ₹ 13/unit, which means no incentive fee in that year.
In 2022, the fund NAV reached to ₹ 17/unit this year profit is ₹ 4/unit [17−13], However the fund mgr can not take incentive fee on that ₹4. since they have already taken incentive fee on profits upto ₹ 15/unit. This ₹15 is the High water mark as of 2022, in the next year ₹ 17 can be high water mark.

4) **SIDE-POCKET**

This means creating a seperate fund out of an existing fund to segregate one/few assets from the existing portfolio.

Ex: If HDFC MF/Hedge fund invested into the debentures of INFY, RIL, King Fisher & If King Fisher made a default on Repayment of Interest/principle, the fund can seperate King Fisher debentures & make it a seperate fund. The fund will calculate seperate NAV for both funds [main fund, side pocket], So that Investors can decide if they want to continue or exit in main fund also since there is a trouble in One Asset (King Fisher).
If this provision is not allowed, the fund manager has to sell the assets which are performing well to repay the investors. who are leaving the fund.
If funds started selling the Good Assets like debentures of INFY, RIL, that can create more

Panic in the markets (y more trouble for the companies who are raising money by issuing debt instruments like **Debentures.**

Rajani

KEY TERMS

1) GATES

Hedge funds impose restrictions to the investors to withdraw money (Redemptions) like

a) Minimum 1 month notice should be given to the fund manager for any redemptions

b) Investor should not withdraw more than 20% in 1 year or in the 1st year etc.,

c) There are called as GATES.

2) GAV (Gross Assets value) or G-NAV :

GAV = NAV + Incentive fee.

* Net Asset value in Hedge funds is after considering the incentive fee. To know How much is the incentive fee charged in a fund / what is the Return in a fund etc., this GAV / GNAV is calculated.

* Incentive fee in Hedge funds is also similar to PE funds where the fund mgr will take approximately 20% of the profits after the Hurdle Rate / minimum return.

3) High-Watermark

This is the Highest level of NAV where the incentive fee is already charged in the fund. So Any incentive fee in the future can be charged only if the funds NAV goes beyond this level.

Ex: The fund is launched in 2020, where the NAV/unit is ₹ 10 by end of 2020, the NAV of the fund is ₹ 15/unit, Since the return is 50%, fund mgr

SWAPTION:

* SWAPS are agreements b/w two parties to exchange a series of cash flows, in the future.

An option contract is a contract that gives Rights to the buyer of the contract. To use the contract if it is profitable or ignore the contract if it is not profitable.

ex: INFY Trading at ₹ 1200, you are expecting that it will go to ₹ 1500 in One month time. You can purchase a call option contract by paying a premium of ₹ 20, that call option contract will give you a right to purchase infy share @ ₹ 1200 after a month. If the mp is more than 1200, you will use the contract, purchase the share at ₹ 1200, & if the mp is only ₹ 1000 [<1200] then you can ignore that call option & if you want can purchase in open market for ₹ 1000. This means you have a RIGHT to purchase at 1200 but there is no OBLIGATION to purchase @ 1200 if the mp is less.

* SWAPTION contracts are combination of SWAP+ OPTION contracts where a party will enter into an option contract which will give a right to enter into SWAP agreement or not on a future date.

ex: PUJARA want to enter into a SWAP agreement (TRS) to reduce the risk, however he wants to decide that only after the UNION BUDGET is introduced on 1st Feb. Based on the announcements in the budget, he want to decide if the debt market will give better return or equity market will give better return. He paid a premium to ROHIT SHARMA,

Total Return SWAP

* In this agreement one party agrees to exchan[ge] the total return on One Asset, with Total returns on Other Assets.

* The reasons can be the assumptions made by the investor to make investment in One Asset may be changed after some time. So the investor deci[des] to exchange the return with other party, to make profits or To reduce the risk.

Ex: In Jan 2020, Rohit sharma Thought that equity markets will go up significantly so invested ₹ 100 Cr on equity shares. in march 20, due to CORONA the equity market went down as he is expecting the equity market will further go down.

On the Other side pujara Invested ₹ 100 Cr on debentures, Now he is planning to invest 50% of that money in equity markets so he can make more profits once the mkts started going up.

Now Rohit, Pujara can enter into a SWAP agreement to exchange total returns on ₹ 50 Cr worth of investment with each other &, the risk is reduced to both of them. In this case Rohit will pay the dividend income / Appreciation / depr^n on eq. shares to pujara, Pujara will pay interest income, Apr^n or depr^n on debt instruments to ROHIT.

Credit Default SWAPS :

Credit risk refers to the risk of default on a debt instrument. If the borrower like DHFL makes default to repay interest or principle on debentures, the investors will have this risk, they will make loss.

In MBS, ABS the investors like Hedge funds, High Net worth individuals, institutions etc has this Credit risk, which means if the borrower (Dhoni, Kohli) makes default, these Investors will make a loss (even after selling the Homes etc., they will make loss]. To transfer this Risk, they can purchase CDS, the seller of CDS will SWAP the risk with these investors so if the default happens, the seller of CDS should pay to the investors the invested amount. Insurance Co. like AIG sold these type of CDS to the investors

got a right to decide on 1st Feb whether he c
to enter SWAP Agreement or Not.
On 1st Feb, if the debt mkt is expected to giv
better return, He will ignore this option, &
Continue his portfolio (debt investments), else he w
use the option contract & enter into SWAP [T

* These are securities issued by an entity, these securiti
are backed by a mortgage or a loan given by the
bank etc.,
* Investors into these securities will get interest
income, they will the risk of default.
* If a bank like SBI given housing loans [mortgage
loans] worth of ₹100 cr, they can convert into
securities which are called as mortgage backed
securities. The assets [loans given to borrowers], the
risk on those assets are transferred from the
bank to the Investors

* Investors can be Hedge funds, Other investors,
they will invest to get better returns on these
instruments compared to interest on bank fixed
deposits, Govt securities etc.,
If these securities are created on other loans
like CAR loans, Credit card receivables etc., then
they are called as Asset backed securities.