Fund Structure & Investment Lifecycle in Private Equity

Comillas Private Equity & Venture Capital Club

Private Markets 101

Map of the Course

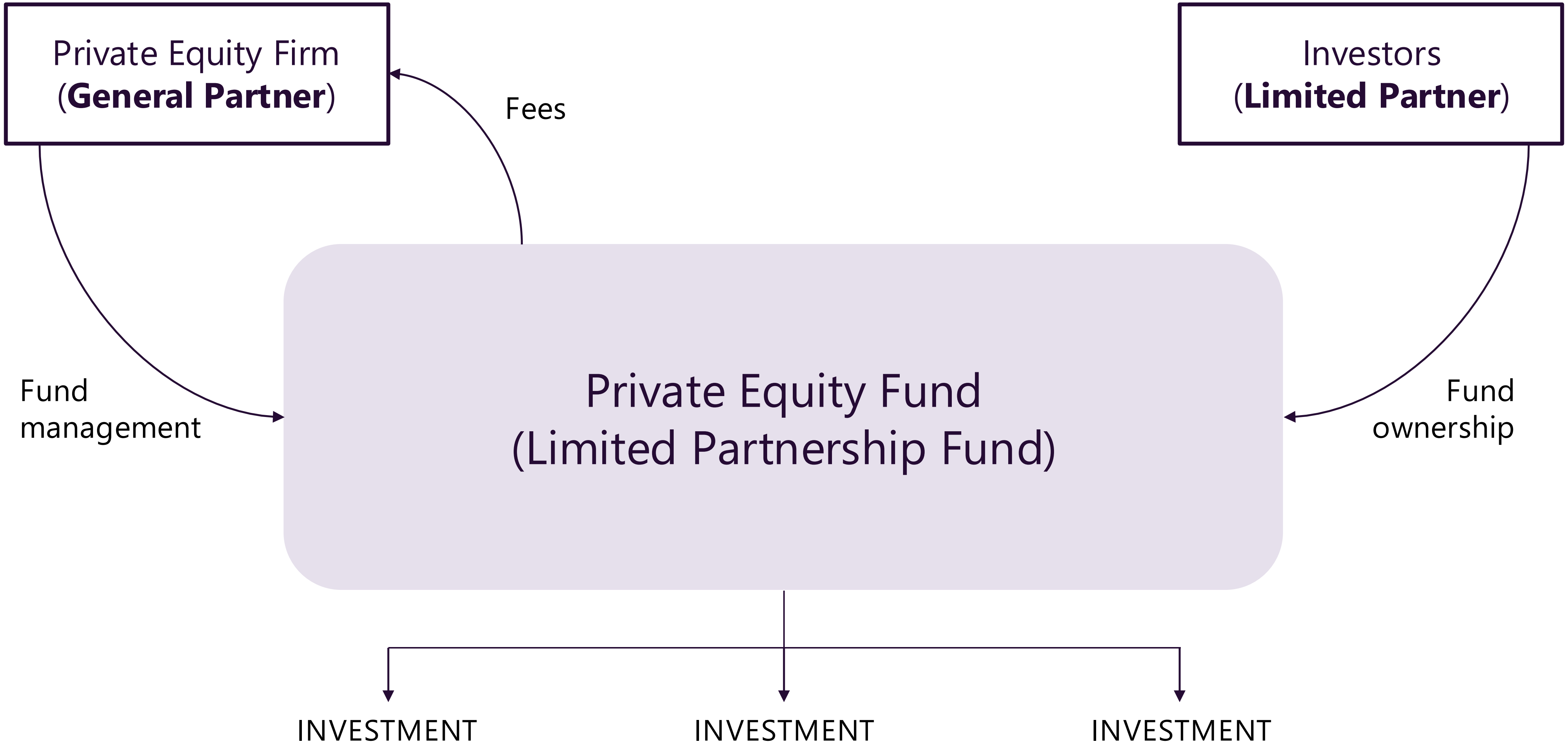
- Understanding Private Markets
- **Private Equity**
- Venture Capital
- Private Credit
- Infrastructure and Real Estate Investments

Private Equity Modules

- Introduction to Private Equity
- **Fund Structure & Investment Lifecycle**
- PE Entry & Exit Strategies
- Understanding Legal Structures in PE
- Sustainability in PE
- LBO model

PE Fund Structure

Private Equity Fund Structure



Capital Commitment & Fees

CAPITAL COMMITMENT

Amount of capital that LPs agreed to invest over its lifetime.

FEES

General Partners get paid through:

- **Management Fees** (2% on committed capital), paid annually.
- **Carried Interest** / **Carry** (typically 20% of the profits), paid after the preferred return is received by LPs.

PREFERRED RETURN

Or **hurdle rate**, is the minimum return that LPs must receive.

Carried interest aligns the interests of GPs and LPs by rewarding managers only when the fund performs well, acting as a powerful **incentive** for value creation.

Returns Distribution

PAYMENT WATERFALL

(1) LP's Contributed Capital

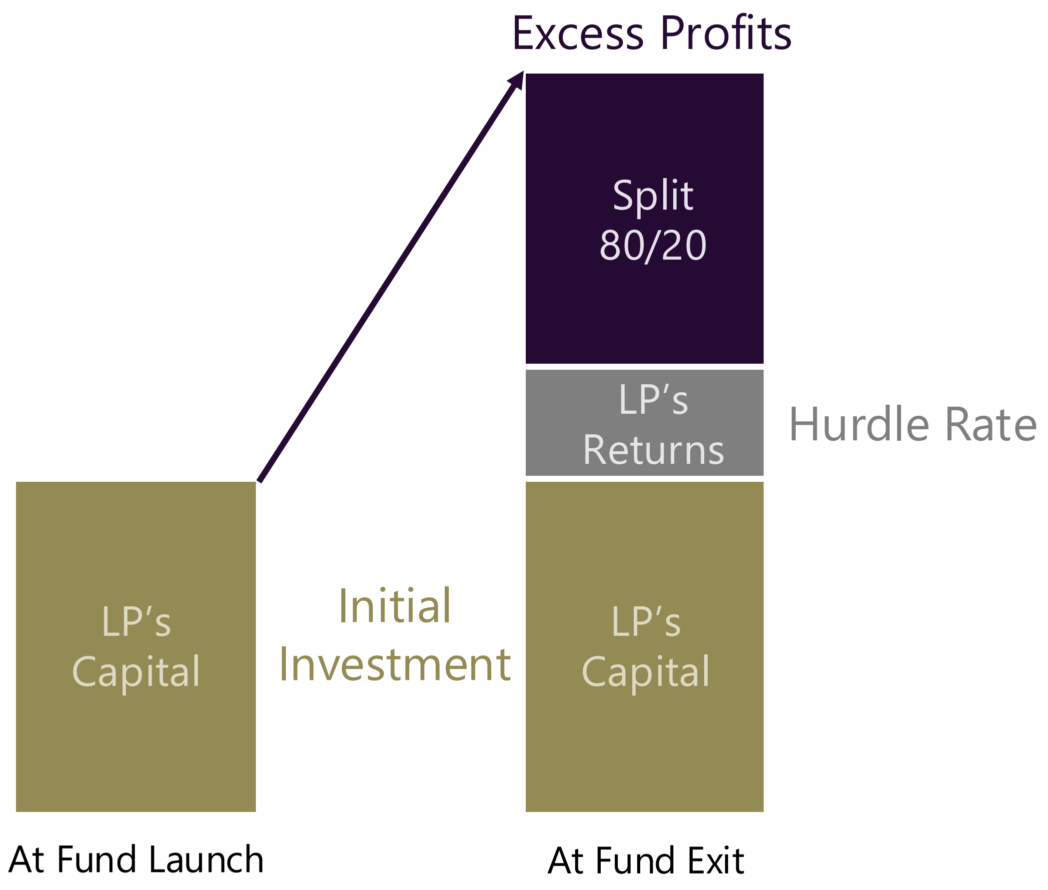
LPs receive back 100% of their initial investment.

(2) Preferred Return / Hurdle Rate

Capital is distributed to each LP until the hurdle rate has been achieved. Typically it is 8% to 10% per year.

(3) Final Split

The remaining capital is distributed between LPs and GPs according to the carried interest (carry).
If carry is 20%, 80% is perceived by LPs and the remaining 20% by GPs.



PE Fund Lifecycle

A typical PE fund spans 10 years with an additional fundraising and extension time

-1.5 | 0 | 3 | 7 | 10 | +3 (YEARS)

FUNDRAISING	CAPITAL DEPLOYMENT	VALUE CREATION	EXITS	EXTENSION (WIND-DOWN)
GP markets the fund, negotiates Limited Partnership Agreement (LPA) and secures commitments.	Capital is called progressively as GP sources deals and builds the portfolio.	Value is created in portfolio companies through operational improvements, governance, bolt-ons, revenue/profit growth, debt repayment…	Portfolio companies are exited and returns distributed to LPs. Carried interest is earned.	Operational period to fully exit remaining assets and wrap up the fund

Investment Process in PE

Investment Process in Private Equity

1. Deal Sourcing – GPs identify potential investment targets.
2. Due Diligence – In-depth analysis (financial, legal, ESG…) of the target company.
3. Deal execution – negotiation and signing of legal documents.[1]
4. Post-Investment – active ownership: board seat, value creation
5. Exit – through IPO, trade sale, secondary, etc.[2]

1. Legal aspects of private equity transactions will be covered in detail in a dedicated module.
2. Exit strategies can be found in the next module, together with entry strategies.

Deal Sourcing

After fundraising is completed and the fund is closed, GPs start looking for ideal companies to acquire that fit their objectives. Criteria followed when deal sourcing includes:

1

SIZE OF THE COMPANY

Growth equity funds target companies with $5-20M in revenues. Buyout funds target companies with +$50M in revenues.

2

SECTOR

Certain funds invest in specific sectors such as technology or healthcare. Synergies can be achieved by mergers between portfolio companies.

3

BUSINESS MODEL

Private equity firms look for companies with business models that they are familiar with and can manage effectively.

TWO SOURCES

PROPRIETARY DEAL FLOW

Sourced directly by a PE firm without the assistance of financial advisors.

INTERMEDIATE DEAL FLOW

Sourced by intermediaries: investment banks, M&A boutiques, advisors…

Due Diligence and Deal Execution

DUE DILIGENCE

The Due Diligence[1] is a thorough **investigation** of the target company to assess risks, validate assumptions, and confirm the attractiveness of the investments.
This investigation covers a range or areas including **financials**, **commercial positioning**, **legal risks**, **operational capabilities** and – increasingly- **ESG performance**.

PURPOSE

- ✓ Identify red flags
- ✓ Refine valuation
- ✓ Negotiate deal terms

DEAL EXECUTION

Following due diligence, investment terms are finalized and the transaction is legally formalized.

STEPS

1. Final investment committee (IC) approval
2. Term sheet / LOI[1] signed
3. SPA[1] negotiation and signing
4. Financing arrangements (for debt financing)
5. Closing and fund flow

1. For a more detailed explanation of Due Diligence, LOI (Letter of Intent) and SPA (Share Purchase Agreement), refer to the presentation “Understanding Legal Structures in PE”

Post-Investment Stage – Holding Period

GPs manage the portfolio company to:

- EBITDA expansion
- Improve margins
- Expand valuation
- Pay down debt (DE-leverage)

They create value through:

- Strengthening the management team
- Developing and launching new products
- Acquiring new businesses
- Improving operations
- Reshaping business strategy
- Optimizing capital structure[1]

1. Capital structure refers to the amount of debt and equity a company has.

Exit Strategies[1]

1. Initial Public Offering (IPO)
2. Strategic & Secondary Sales
3. Dividend Recapitalization
4. Mezzanine Exit
5. Chapter 11 / Liquidation

1. Exit strategies explained in the next module, together with entry strategies.