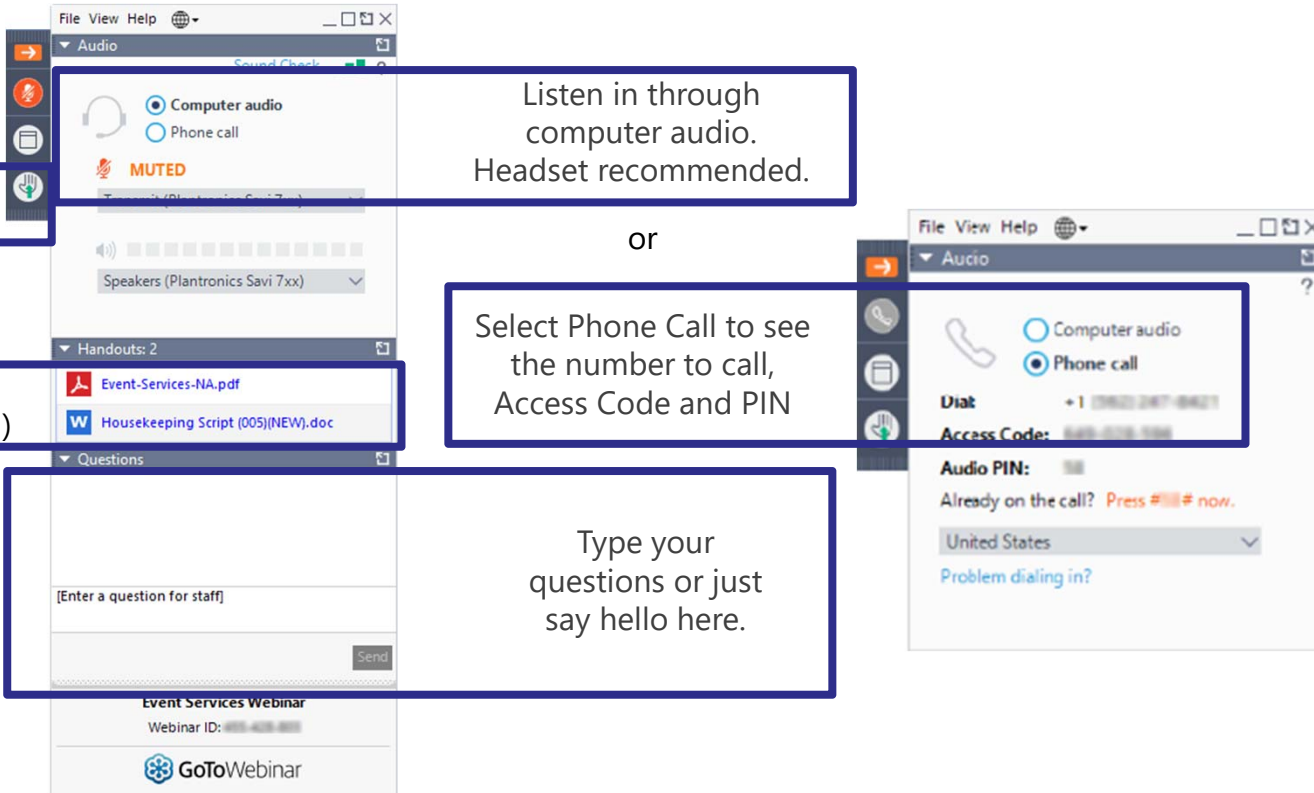




# PRIVATE EQUITY INVESTING 101: AN OVERVIEW FOR NEW INVESTORS

August 1, 2019

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# CAMPTON PRIVATE EQUITY ADVISORS

## CAMPTON PRIVATE EQUITY ADVISORS

- **Campton advises clients on their private equity investment programs**

- Founded in 2006
  - Based in San Francisco, CA
- 

- **Advisory services offered:**

- Asset Allocation
  - Portfolio Strategy and Construction
  - Fund Investing
  - Direct Investing
  - Co-Investing
  - Secondary Transactions
  - Portfolio Monitoring
  - Performance Evaluation
  - Distribution Advisory
  - Advisory Committee Representation
-

## ALLEN LATTA BIOGRAPHY



**Allen J. Latta, CFA, CAIA**  
Managing Director

Allen has 30 years of experience in venture capital, private equity, corporate finance, public offerings and mergers and acquisitions. Prior to forming Campton in 2006, he was the Director, Business Development, member of the Board of Directors and head of the San Francisco office of global private equity fund-of-funds manager VenCap International plc.

Previously, he was an Executive Director in the Telecom Investment Banking Group at Bear, Stearns & Co. and before that a Director in the Media and Telecom Investment Banking Group at CIBC World Markets. Prior to investment banking, Allen was a corporate finance attorney with Morgan, Lewis & Bockius and with Buchalter, Nemer, Fields & Younger, specializing in private equity/venture capital transactions, public offerings, mergers & acquisitions and international business transactions.

Allen received an MBA from UCLA Anderson, a JD from UC Hastings College of Law, and a BA in Economics from UCLA. Allen is a CFA Charterholder and a CAIA Charterholder. Allen publishes a blog on private equity at [www.allenlatta.com](http://www.allenlatta.com).

## POLL QUESTION

How much experience do you have with private equity investing?

- None
- Fund investing experience only
- Direct / co-investing experience only
- Fund and direct/co-investing experience



# PRIVATE EQUITY OVERVIEW



# WHAT IS PRIVATE EQUITY?

The term “Private Equity” is used in different contexts

## ASSET CLASS

### Private Equity Asset Class

- Includes buyouts, growth equity, venture capital
- May also include private credit strategies, some private real estate and infrastructure

## TRANSACTIONS

### PE Transaction

- Generally refers to buyouts
- May also include growth equity transactions
- Does not typically refer to venture capital transactions

## FIRMS

### Private Equity Firm

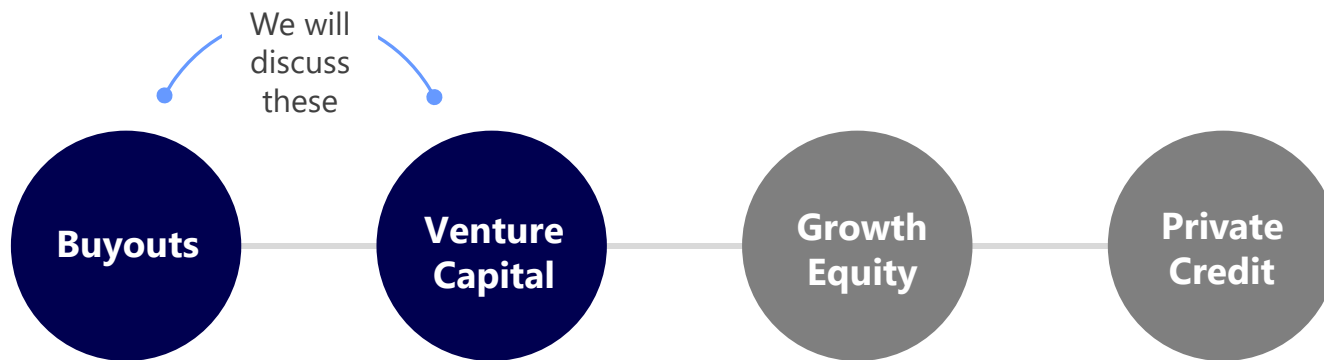
- Primarily refers to firms that mainly invest in buyouts
- Does not typically refer to venture capital firms

## INDUSTRY

Attorneys, Auditors, Bankers, Advisors, Placement Agents, Fund Administrators, Media

# WHAT IS PRIVATE EQUITY?

## Strategies Within the Private Equity Asset Class



Note: Private real estate, infrastructure and natural resources investments are sometimes included as strategies in the private equity asset class.



# VENTURE CAPITAL

# EARLY-STAGE VENTURE CAPITAL - OVERVIEW

## COMPANY CHARACTERISTICS

### Early-Stage, Private

Early in development; no to low revenues; privately held

### Huge Opportunity

Market / technology has huge potential

### Unproven

Unproven business model, technology, management and/or market

### Innovation-based

Innovation driving the business (tech, life sciences)

### IPO/M&A Exit

Company is sold or goes public as exit

## INVESTMENT CHARACTERISTICS

### Minority Equity

Minority equity investment (not control); no debt

### High Return Potential

Potential for significant return on investment

### High Risk

High risk of loss of entire investment

### Illiquid

Restrictions on transfer or sale of investment

### Long Holding Period

Holding periods of 3 to 10+ years are common (average = 8)

Note: The above is a description of some of the main characteristics of direct early-stage venture capital investing and is highly general in nature. Venture capital investors also invest in later stages of a company's development. Source for holding period: NVCA 2019 Yearbook.

## VENTURE CAPITAL-BACKED COMPANIES



## VENTURE CAPITAL FIRMS



sequoia capital



NEA®  
New Enterprise Associates®



LIGHTSPEED  
VENTURE PARTNERS



ACCEL®



ANDREESSEN  
HOROWITZ



greylockpartners.



IVP INSTITUTIONAL  
VENTURE  
PARTNERS



khosla ventures



BV  
Battery Ventures



NVP  
NORWEST VENTURE PARTNERS®



KPCB | KLEINER  
PERKINS  
CAUFIELD  
BYERS



MAYFIELD FUND

Source: Campton Private Equity Advisors.

Note: In 2018 there were 1,047 venture capital firms in the United States, according to the NVCA 2019 Yearbook.



# BUYOUTS

## BUYOUTS - OVERVIEW

### COMPANY (TARGET) CHARACTERISTICS

#### Large and Mature

Developed operations and market

#### Cash Flow Positive

Usually significant revenues and stable and positive cash flow

#### Inefficient / Undervalued

Company may be undervalued by the market or have operating inefficiencies

#### Public or Private

Company can be a publicly-traded company (or division) or a privately-held company

### INVESTMENT CHARACTERISTICS

#### Control Transaction

Investor acquires control of company

#### Leverage Used

Debt is a significant portion of the purchase price

#### Operational Improvement

Operational improvement drives value creation; add-on acquisitions

#### Illiquid

Illiquid investment

#### Long Holding Period

Holding periods of 3 to 8+ years are common

Note: The above is a description of some of the main characteristics of buyout investing and is highly general in nature.



## EXAMPLES OF BUYOUTS



## PRIVATE EQUITY (BUYOUT) FIRMS



KKR



Blackstone



TPG



THE CARLYLE GROUP



APOLLO



SILVERLAKE



Advent International  
GLOBAL PRIVATE EQUITY



WARBURG PINCUS



HELLMAN &  
FRIEDMAN



FP  
FRANCISCO  
PARTNERS



GOLDEN GATE CAPITAL



IG  
&P

# VENTURE CAPITAL AND BUYOUTS COMPARED

	EARLY STAGE VENTURE CAPITAL	BUYOUTS
<b>Control?</b>	✗	✓
<b>Leverage (debt)?</b>	✗	✓
<b>Company Stage</b>	Startup	Mature
<b>Company Revenue</b>	None to Little	Large, Stable
<b>Company Value at Initial Investment</b>	Millions	Tens of Millions to Billions
<b>Innovation as Basis of Investment?</b>	✓	Sometimes; Mainly No

Note: Venture capital description is for early-stage venture capital. Descriptions are general and will vary based on a specific company or transaction structure.



# WHY INVEST IN PRIVATE EQUITY?

## POLL QUESTION

What annual returns do you expect from investing in private equity?

- 5% to 9.9%
- 10% to 14.9%
- 15% to 19.9%
- 20% to 24.9%
- 25% and over

## POLL QUESTION

What premium over public markets should investing in private equity provide?

- 0.0% to 0.9%
- 1.0% to 2.9%
- 3.0% to 4.9%
- 5.0% to 6.9%
- 7.0% and over

## WHY INVEST IN PRIVATE EQUITY?

- **Potential for long-term outsized returns**

- Private equity has outperformed public equity and bond markets over long investment horizons

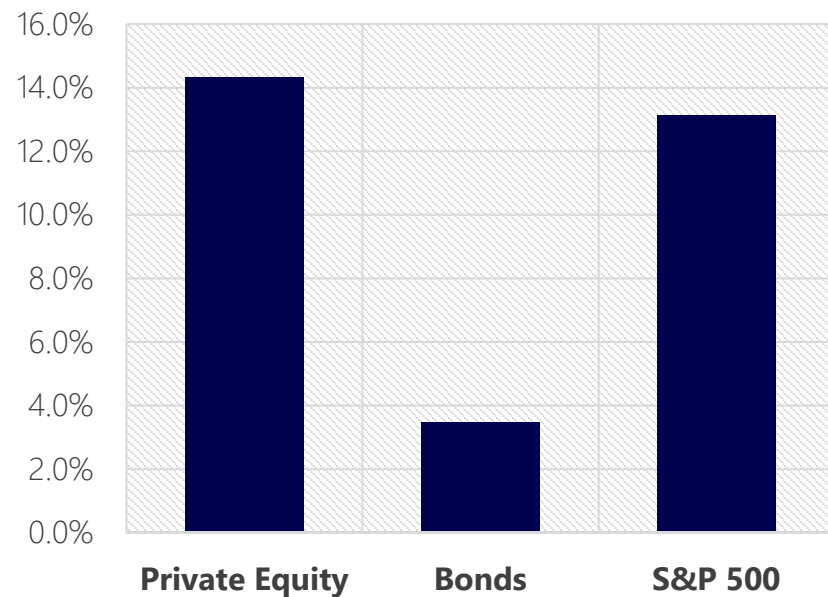
- **Diversification benefits**

- Low correlation to equity and bond markets
- 0.69 correlation to US Large Cap and 0.04 to US Investment Grade Corporate Bonds\*

- **Long-term investment horizon required**

- Private equity fund terms have an initial 10-year term, plus extensions

### 10-YEAR RETURNS



\* Source: JP Morgan Asset Management 2019 Long-Term Capital Market Assumptions. US Investment Grade Corporate Bonds Hedged.

Chart source: Cambridge Associates U.S. Private Equity Index® and Selected Benchmark Statistics as of September 30, 2018. Private equity fund performance. Bonds based on performance of Bloomberg Barclays Capital Government/Credit Bond Index. Please see the Cambridge Associates report for methodology. Past returns are not necessarily indicative of future performance.

## WHY INVEST IN PRIVATE EQUITY?

- **Number of public companies has declined over time**

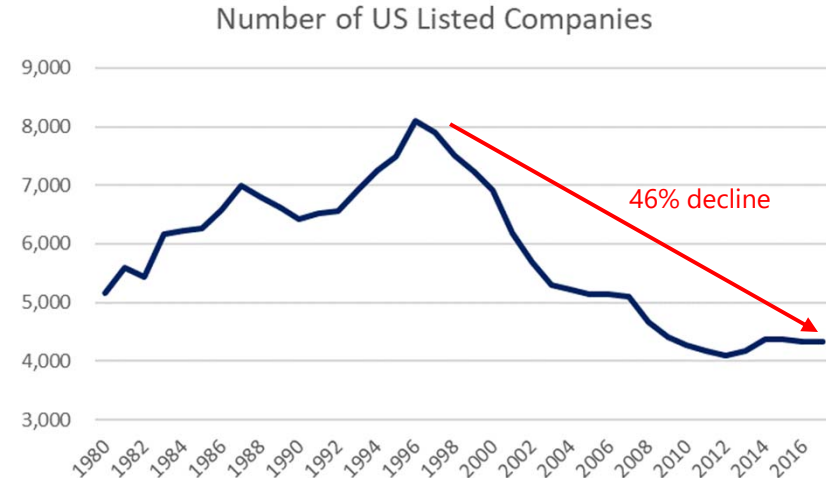
- Number of US public companies has declined by almost 50% since 1996
- Only 4,300 US public companies

- **There are nearly 7 million US private companies**

- Almost 2.3 million US private companies have over 20 employees\*

- **The number of private investment opportunities dwarfs public opportunities**

- The situation is unlikely to change in the near term



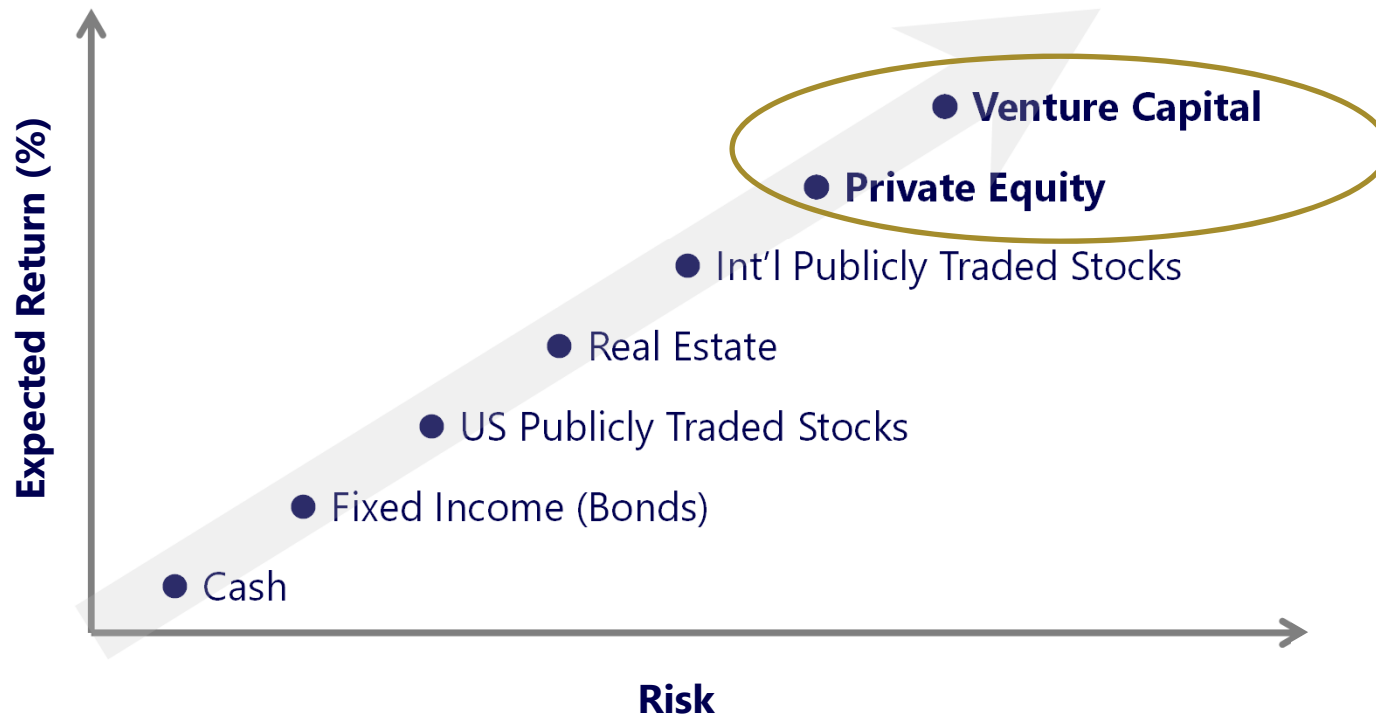
Source: The World Bank (data through 2017).

\*Source: US Census Bureau (2016 data).



# WHY INVEST IN PRIVATE EQUITY?

**Private Equity and Venture Capital Offer Potentially Higher Returns but with Greater Risk**



Note: Illustration for discussion purposes only. Risk is measured by volatility.

## PRIVATE EQUITY ALLOCATIONS

- **PE allocations vary widely**

- From 0% to over 30%

- **Family Offices**

- 62% of family offices invest in private equity
- PE allocation was 17% of portfolio at the end of 2018

- **Foundations and Endowments**

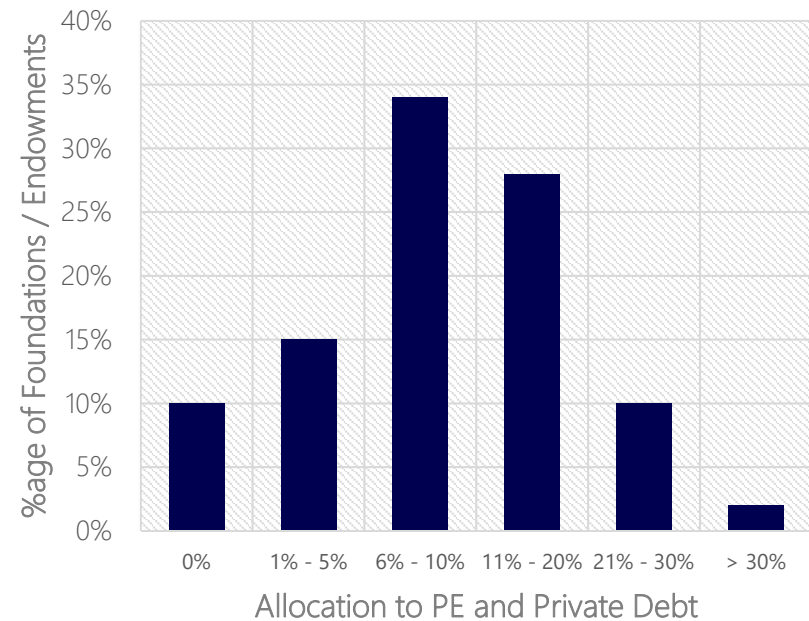
- Allocation varies widely
- Yale allocation = 33.1%

- **Allocation is unique to each investor**

- Depends on each investor’s unique circumstances and risk appetite

### Foundations & Endowments

Percentage of Portfolio Dedicated to PE and Private Debt



Source: NEPC Year-End 2018 Endowments & Foundations Survey

Sources:

"Single-Family Offices Increasingly Find Private Equity Investments Appealing." Prince, Russ Alan. Forbes.com 3-15-2016

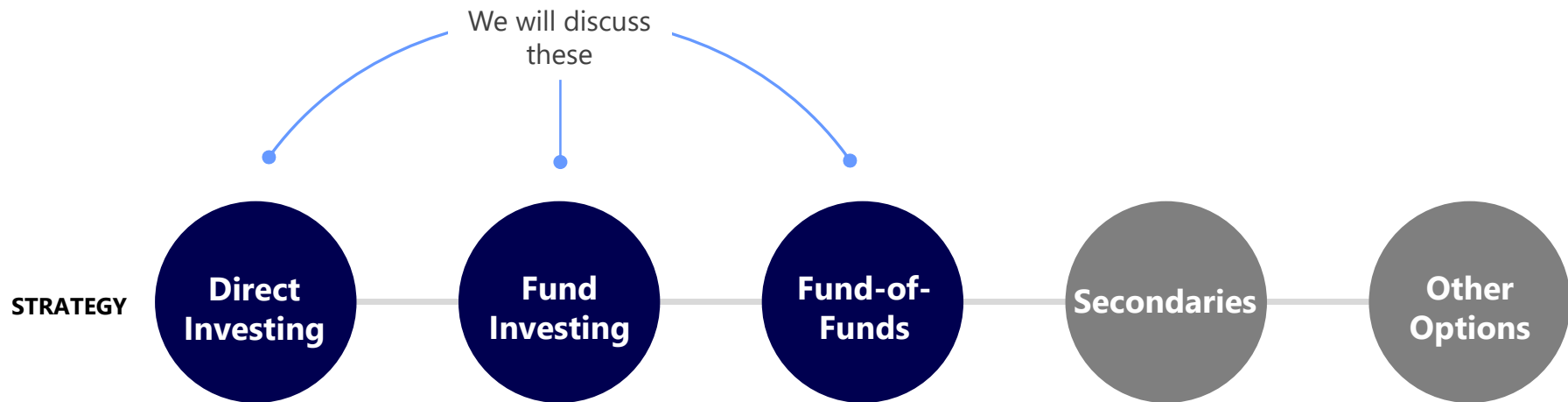
2019 FOX Global Investment Survey. Copyright © 2019 Family Office Exchange.

Yale Endowment 2018 Annual Report; combination of allocations to leveraged buyouts and venture capital.



# PRIVATE EQUITY INVESTMENT STRATEGIES

# PRIVATE EQUITY INVESTMENT STRATEGIES



## CHARACTERISTICS

- Invest directly into companies
- Co-invest alongside portfolio fund directly into companies
- Invest in a fund
- Fund invests in a portfolio of companies
- Invest in a fund-of-funds
- Fund-of-funds invests in a portfolio of funds
- Funds invest in a portfolio of companies
- Acquire fund interest from existing investor
- Acquire company shares from existing investor
- Listed private equity



# DIRECT INVESTMENT

## DIRECT INVESTING

- **Direct equity investment in company**

- Very high-risk investments
- Potential for significant returns

- **Venture capital**

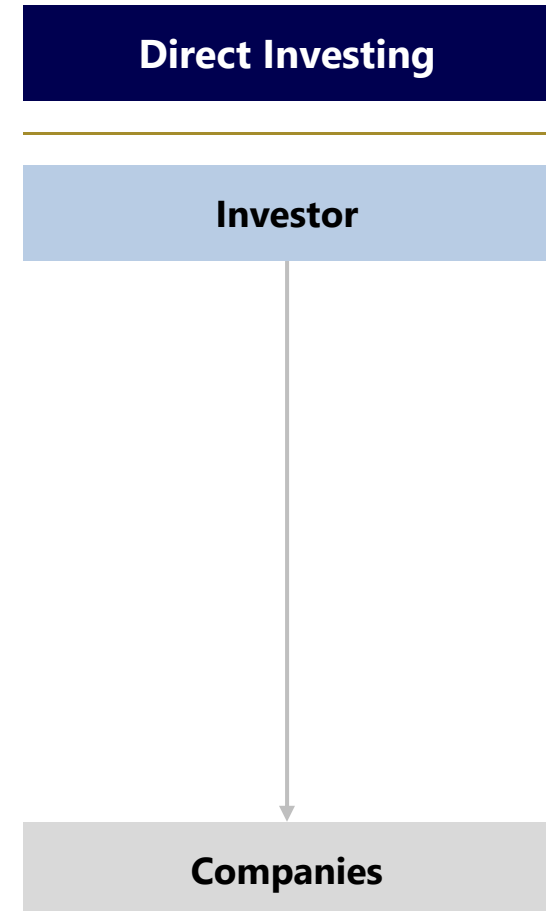
- Early stage investment has very high loss rates
- Industry rule of thumb for early-stage venture investing:
  - 1/3 of investments fail
  - 1/3 fail to return capital
  - 1/3 drive the returns

- **Buyouts**

- Leverage increases the risk but can also increase returns

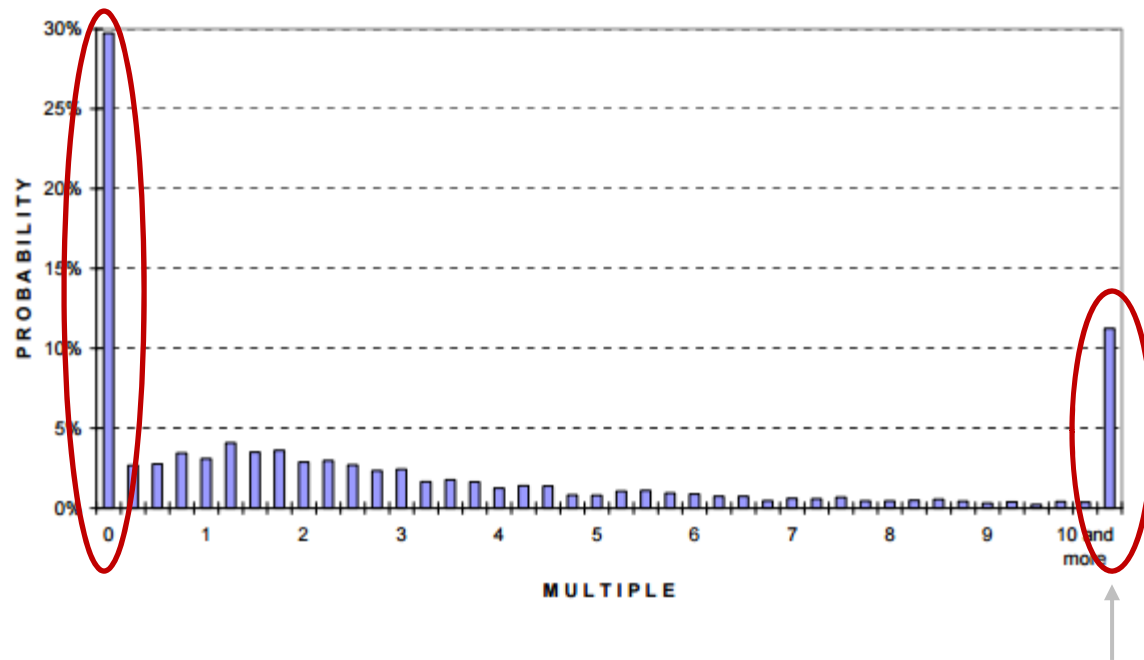
- **Co-Investment**

- Invest alongside a fund into a company



## DIRECT VC INVESTMENT RISK PROFILE

- **30% probability of total loss for early-stage investments**
  - More recent research suggests up to 65% of early stage venture investments do not return capital



**But, opportunity for significant returns (10x+)**

Source for 65% loss rate: Swildens, Hans and Leung, Nate, "Winning by Losing in Early-Stage Venture Investing." Dec. 20, 2016. Link: <http://www.industryventures.com/2016/12/20/winning-by-losing-in-early-stage-investing/>. Source for chart: Weidig, Tom and Mathonet, Pierre-Yves, "The Risk Profiles of Private Equity." January 2004. This research should not be relied upon for investment purposes. Past performance is not indicative of future returns. Private equity investing has numerous risks, including the potential of total loss of investment.

## DIRECT INVESTING CONSIDERATIONS

<b>Potential for Significant Returns</b>	<b>Extremely High Risk</b>	<b>Illiquid</b>
<b>Long Holding Period</b>	<b>Deal Sourcing</b>	<b>Due Diligence</b>
<b>Sector Expertise Important</b>	<b>Deal Structuring</b>	<b>Valuation Issues</b>
<b>Additional Investment May be Necessary</b>	<b>No Fund Fees</b>	<b>Portfolio Approach is Key (20+ investments)</b>

Note: Private Equity investing involves significant risks, including the possibility of complete loss of investment. The above listing is a small subset of risks and considerations.

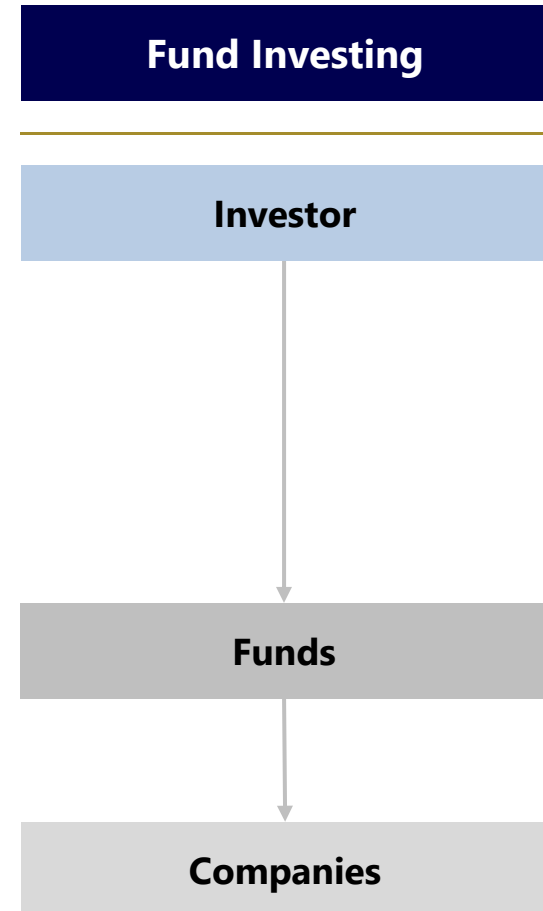




# FUND INVESTING

## FUND INVESTING

- **Investment in private equity fund**
  - Passive investment
  - Fund manager has total investment discretion
- **Fund invests in a portfolio of company investments**
  - “Portfolio companies”
- **Funds are blind pools**
  - Strategy is known at fund inception but portfolio companies are generally not known
- **Diversification across funds is key to managing risk/return profile**
  - Diversification across managers, sectors, stages, geographies and fund formation (vintage) year



## PE FUND CASH FLOWS

### Committed Capital

- Investor commits an amount to the fund

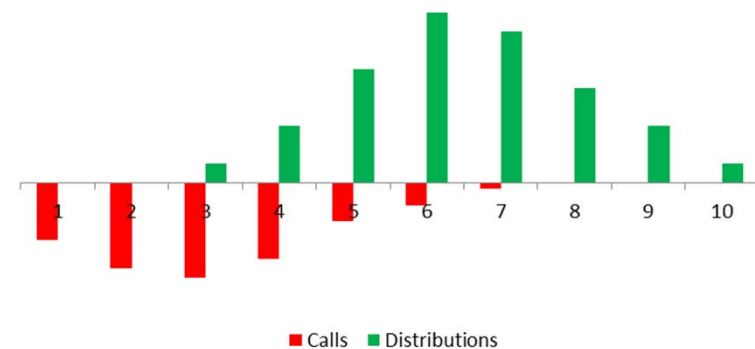
### Capital Calls

- Fund manager calls capital when needed
- Timing of calls uncertain, but typically most calls occur during investment period (first 5 years)

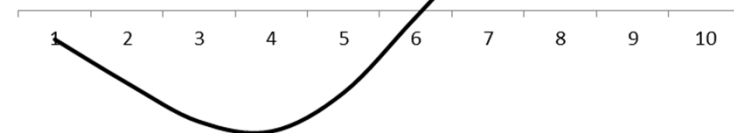
### Distributions

- Fund distributes capital to investors
- Timing of distribution uncertain, but most distributions occur after investment period

### CASH FLOWS TO/FROM A FUND



### CUMULATIVE CASH FLOWS



Notes: Above illustrations are hypothetical and are not based on an actual fund. Actual fund results will vary, and may vary significantly. Private Equity investing involves significant risks, including the possibility of complete loss of investment.

## FUND FEES AND EXPENSES

### MANAGEMENT FEE

- Paid to fund manager for overhead costs
- 2% per annum is standard
  - Ranges from 1.25% to 2.5% depending on fund size and strategy
  - Typically decreases after a 3 to 5-year investment period

### PROFIT SHARE

- Known as “Carried Interest” or “Carry”
- 20% share of profits is standard
  - Paid after investors receive an 8% preferred return (buyout, growth)
  - Some venture funds charge premium carry of 25% to 30%

### EXPENSES / OTHER

- Organizational expenses
- Ongoing insurance, audit, administration and legal
- Management fee offsets for monitoring, transaction, director fees, etc.

## THE “J-CURVE”

- **Early negative returns**

- Impact of
  - Organizational expenses
  - Management fees and fund expenses
  - Early investment losses

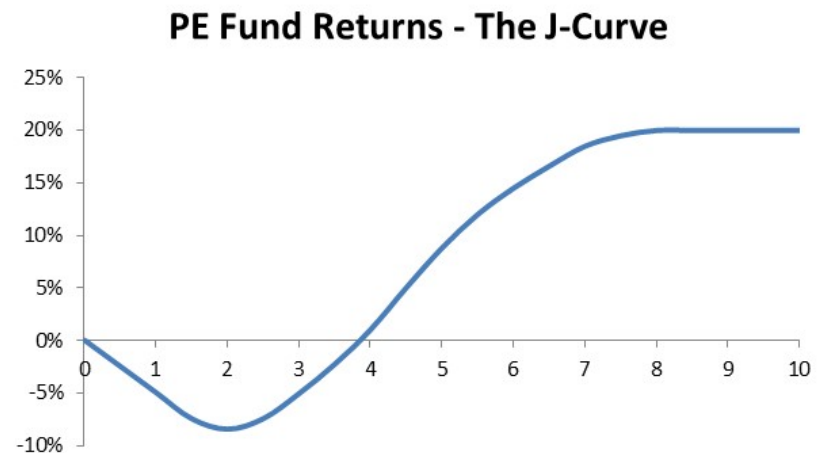
- **Later positive returns**

- As investments mature, returns turn positive

- **Most pronounced in early stage venture capital funds**

- Often have a more pronounced J-Curve as “lemons ripen faster than pearls”

### PE FUND RETURNS – THE J-CURVE



Notes: The above illustration is hypothetical and is not based on an actual fund. Actual fund results will vary, and may vary significantly. Private Equity investing involves significant risks, including the possibility of complete loss of investment.

## RISK PROFILE OF A VC FUND INVESTMENT

- **Venture capital funds have low probability of total loss**
  - Probability of not returning capital invested is around 30%
  - Compare to 65% of not returning capital for direct early-stage investing



**Small number of venture capital funds may have 10x+ returns**

Source: Weidig, Tom and Mathonet, Pierre-Yves, "The Risk Profiles of Private Equity," January 2004. European VC funds from 1980 to 1998. This research should not be relied upon for investment purposes. Past performance is not indicative of future returns. Private equity investing has numerous risks, including the potential of total loss of investment.

## FUND INVESTMENT CONSIDERATIONS

<b>Potential for Strong Returns</b>	<b>High Risk</b>	<b>Illiquid</b>
<b>Long Term Investment</b>	<b>Valuation and Reporting Lag</b>	<b>Blind Pools</b>
<b>Uncertain Cash Flows</b>	<b>Fund Fees, Carry and Expenses</b>	<b>Target Top Quartile Managers</b>
<b>Lack of Transparency</b>	<b>J-Curve</b>	<b>Need for Diversification</b>

Note: Private Equity investing involves significant risks, including the possibility of complete loss of investment. The above listing is a small subset of risks and considerations..



# FUND-OF-FUNDS INVESTING



## FUND-OF-FUNDS INVESTING

- **Investment in private equity fund-of-funds**

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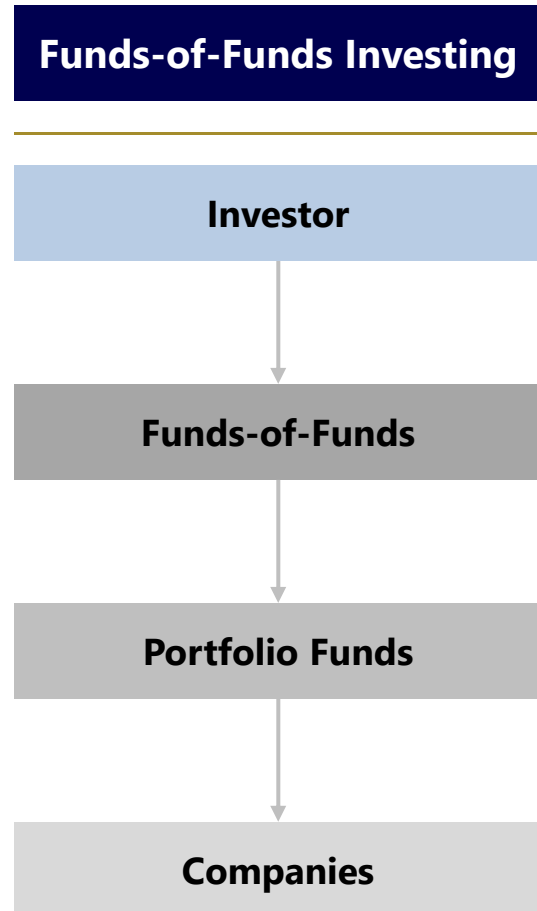
- **A fund-of-funds invests in a portfolio of private equity funds**
  - “Portfolio funds”
  - Portfolio funds invest in companies
    - “Underlying portfolio companies”

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- **Diversification benefits built-in**
  - Portfolio of 10+ funds
  - Underlying portfolio of 200+ companies

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- **Funds-of-funds are usually blind pools**
  - Some funds-of-funds will identify “target” funds



# FUND-OF-FUNDS INVESTING

## Funds-of-funds invest in a portfolio of funds

### BENEFITS

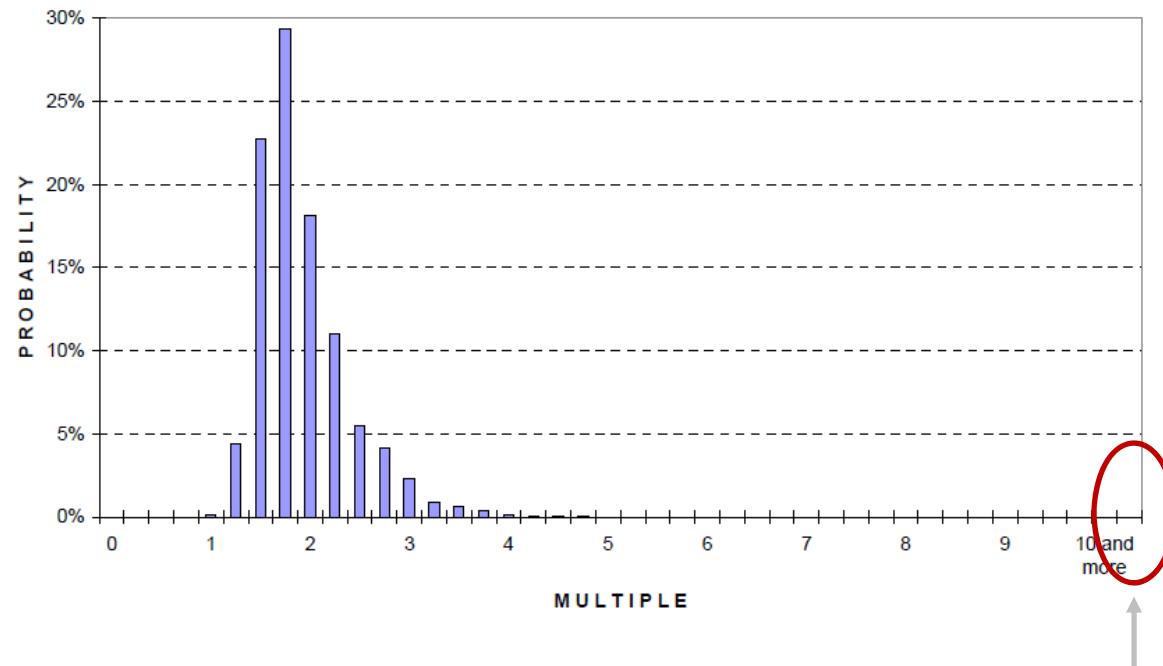
- Efficient way to obtain initial exposure to a strategy
- Good option for smaller investment programs
- Good way to obtain exposure to a specific strategy that may require specialized knowledge/skills (e.g., venture capital)
- Built in diversification
  - Underlying portfolio of funds
- Many offer a cash-in, cash-out solution

### ISSUES

- Fees on fees
  - Management fees of 1% or less
  - Carry of 5% is common
- Relationships with funds owned by funds-of-funds

## FUND-OF-FUNDS RISK PROFILE

- **Funds-of-funds have low probability of any loss**
  - Extremely low probability of total loss



**But, lose possibility of exceptional returns**

Source: Weidig, Tom and Mathonet, Pierre-Yves, "The Risk Profiles of Private Equity." January 2004. Simulated results for European VC funds-of-funds from 1980 to 1998. This research should not be relied upon for investment purposes. Past performance is not indicative of future returns. Private equity investing has numerous risks, including the potential of total loss of investment.



## TAKE-AWAYS

## TAKE-AWAYS

### INVESTING IN PRIVATE EQUITY

- Potential outperformance compared to other asset classes
- Very risky
- Provides diversification benefits
- Is not for everyone

### EXPERTISE NEEDED

- Investing in high quality managers is key to obtaining outperformance
- An experienced advisor is needed to create a successful PE investing program

## CONTACT

### **CAMPTON PRIVATE EQUITY ADVISORS**

[www.camptonpe.com](http://www.camptonpe.com)

Allen J. Latta, CFA, CAIA

Managing Director

Tel: (415) 644-5065

Email: [allen.latta@camptonpe.com](mailto:allen.latta@camptonpe.com)

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### **Allen Latta's Blog on Private Equity**

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