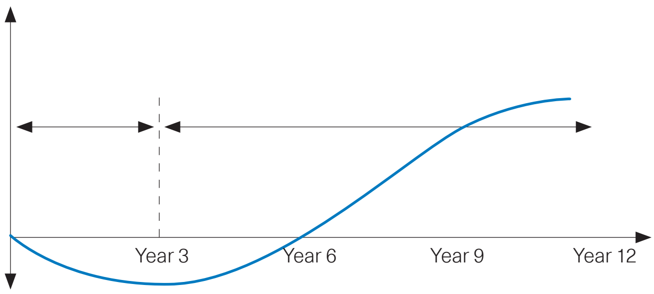
Private Equity

This document contains information about the properties of private equity and informs you about potential benefits and risks of this class of products. These principles can support you in your investment decisions. Please contact your Client Advisor if you would like further information or have any questions.

General Information

Private equity capital is made available to unlisted companies as equity capital. Private equity investments are often offered within the framework of fund structures.

Private equity investments are illiquid. They require a minimum investment horizon of 7 to 10 years. The investments are often spread over multiple years. In the beginning, an amount is agreed on that the investor wants to invest (capital commitment). This amount is called over a period of multiple years by private equity managers and invested in the target companies. During this investment period, mostly only minimum distributions are paid out to the investor. After the end of the investment period, the investor only receives distributions. This course is referred to as the J curve:



The success of a private equity investment depends, among other factors, on the correct timing of the "exit", or the sale. The quality of the private equity managers also plays a central role, as they generally have an active influence on the corporate strategy. The exit is achieved through an initial public offering, or IPO, a sale to another company (trade sale), or a management buyout. Among the factors that determine how simple or difficult the exit phase is and whether or not the proceeds meet the expectations, is the performance of the equity markets.

Possible types of private equity investments

Venture capital: Private equity that flows into young companies (start-ups) or small companies with growth potential in an early phase of development is referred to as venture capital. It is also referred to as risk capital, as this private equity strategy is associated with the highest risk. At the same time, it offers the greatest potential returns.

Growth capital: This form of private equity investment involves established companies. Such companies already generate revenues and profits but cannot finance major transformational steps (e.g. expansions or acquisitions) on their own.

Mezzanine capital: This form of private equity investment is a combination of debt and equity capital. The capital is invested in subordinated debt or preferred shares.

Buyout: When a change of ownership is financed; e.g., in case of a withdrawal from the stock market, the term "buyout" is normally used.

Secondaries: Secondary market funds purchase already running private equity investments from other private equity investors. Thus, the secondaries have a shorter investment phase and therefore generate quicker return flows.

Potential benefits

Diversification: Because of a lack of market valuations, private equity investments depend less on overall market fluctuations than traditional investments. Diversification effects can be achieved by adding private equity investments to a portfolio.

Return potential: As a shareholder of a private enterprise, the investor participates in the event of a profit. Because the companies generally demonstrate great growth potential, private equity investments usually offer the prospect of higher returns.

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Access to other investment opportunities: Private equity funds enable investments in privately held companies that are otherwise difficult or impossible for private investors to access.

Potential risks

Risk of loss: Poor performance by a private equity financed company may result ultimately in the insolvency of the company. Companies that come into consideration for private equity investments may be debt financed to a large extent. As a result, they react more sensitively than established companies to negative market developments, such as rising interest rates. The risk that the company will become unable to meet its obligations and enter into bankruptcy is greater than that of listed companies. The investor may therefore suffer a partial or total loss.

Long capital commitment: Private equity investments are long-term in focus and much less liquid than exchange-traded shares. Typically, private equity investments may only be sold years after the original investment. Distributions are not made until after the sale of investments. The investor basically has no right to back out early.

Potential capital calls: Typically, the initial investment is followed by further capital calls. Investors who do not comply with such a capital call may lose the entire capital invested up to that point.

Liquidity risk: Private equity investments are usually illiquid. The sale of positions may be not possible at all, or only under assumption of major losses. The sale of fund shares may even be prohibited by the provisions of the fund.

Low regulation: There is no protection for investors in the sense of traditional investment funds. Private equity funds are largely unregulated and fund managers do not need to be licensed by an authority.

Dependence on fund managers: Because private equity fund managers have a great deal of freedom in their investment decisions, the development in value depends heavily on the skills and experience of the fund managers. A change in management in a young company, in which individual personalities are a highly important factor, may have an extremely negative impact on a private equity investment.

Foreign currency risk: If the private equity fund or the underlying assets are listed in a different currency from the local currency of the investor, there is a risk that fluctuations in the exchange rate will decrease the value of the investment from the investor's perspective. It is possible that the price gains of an investment may result in a total loss for the investor due to exchange rate fluctuations. Exchange rates can fluctuate substantially.

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