CVCA Czech Private Equity & Venture Capital Association

Private Equity investments

Konference – Rozvoj a inovace finančních produktů

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Private Equity – an alternative asset class

Alternative investments (complementary to traditional stock and bond portfolios)			
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The Private Equity Industry – Terminology

- **Private Equity**
  - financing of unquoted companies with growth potential
  - all stages of financing: seed, start-up, expansion, replacement capital and buyouts

- **Venture capital**
  - limited to the early stages of a company, i.e. seed, start-up and growth capital; typically high growth technology companies

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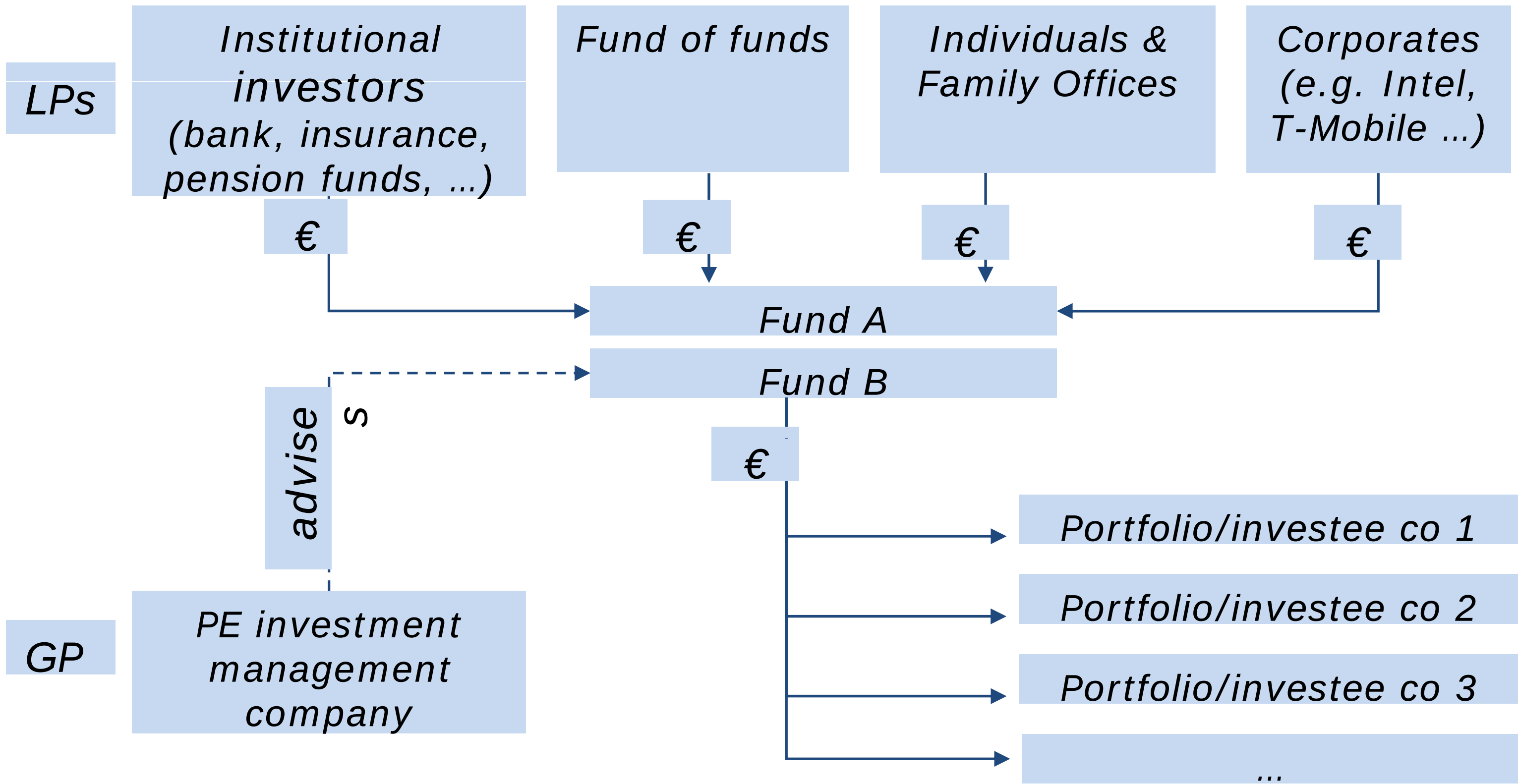
Typical characteristics of the Private Equity industry (*EC Expert Report 2006)

- Investment by a **dedicated professional team** predominantly in unquoted companies **(GP)**;
- Involving **active ownership** driving value creation;
- Drawing capital from a defined pool **(fund structure)**;
- Negotiated **contractual relationship** with qualified/ professional investors **(LP);**
- Need for **diversification** on segments/locations (funds/ funds of funds) to **mitigate risk**
- Profit-sharing schemes which **align interests** with investors (and investee management);

The Structure of PE Funds



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Types of PE Funds
(according to stages of a Company's Life Cycle)

(*Central and Eastern Europe Statistics 2008, EVCA, 2009)

Early stage fund	VC funds focused on investing in companies in their early stages of life (seed, start-up capital, survival)
Later stage venture fund	VC funds focused on investing in later stage ventures in need of expansion capital (already backed by VC funding)
Growth fund	PE funds who's strategy is to invest in or acquire relatively mature companies that are looking for capital to expand or restructure operations
Balanced fund	VC fund focusing on both early stage and development with no particular concentration on either

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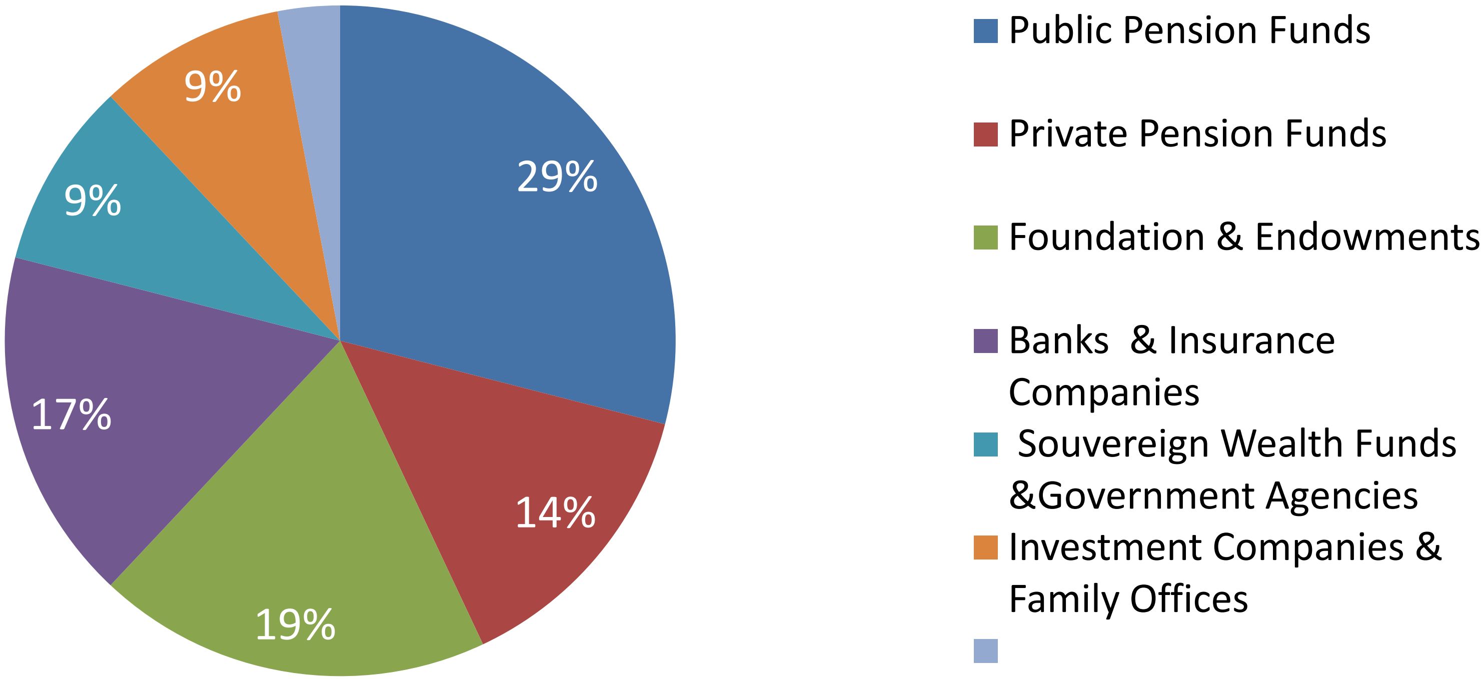
Types of PE Funds
(according to stages of a Company's Life Cycle)

(*Central and Eastern Europe Statistics 2008, EVCA, 2009)

Buyout funds	PE funds whose strategy is to acquire other businesses together with management
Mezzanine fund	Funds which provide (generally subordinated) debt to facilitate the financing of buyouts, frequently alongside the right to some equity up-side
Generalist fund	Funds with either a stated focus of investing in all stages of PE investments, or funds with a broad area of investment activity
Secondary funds	Funds focusing on the purchase of portfolios of direct investments in operating companies

Private Equity Investors by Capital Invested
2001-2011

Numerous types of investors with significant long-term commitments to the asset class:



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Private Equity and Pension Funds in Europe

Aging population:

- The number of retired people compared with those financing their pensions will double by 2060.
- Pension fund managers have to invest in long-term, growth asset classes.

Evident match between pension funds and PE:

- Match between pension funds' aims and long-term horizons and private equity's ability to provide strong, stable risk-adjusted returns over the live of a typical 10 years fund
- Between 2006 and 2010, pension funds accounted for more than 36% of all funds raised by the European private equity industry

Pension funds are boosting economic growth through investment in PE:

- Through private equity funds, they have invested EUR53bn in European companies in the past four years alone.

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Why to invest in Private Equity?

Private Equity has delivered superior risk adjusted returns for their pension fund investors over the past decade

- In the UK, private equity delivered a return of 13.4% IRR on annual basis over the past decade, compared with 3.7% from the FTSE All-Share.

(EVCA 2012: For the long term: private equity and pensions)

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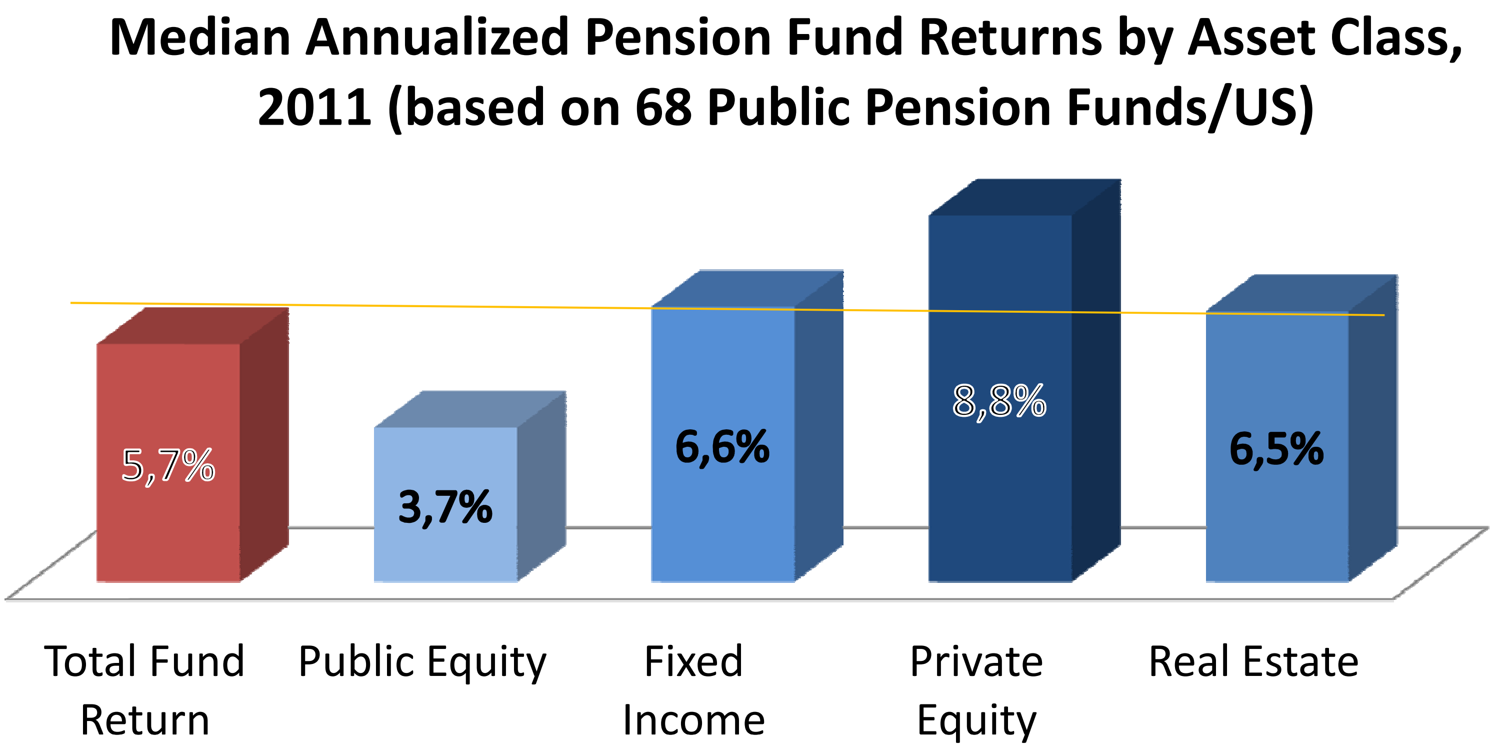
Long-term historical Out-Performance

Private Equity Growth Capital Council: Public Pension Analysis, 2012



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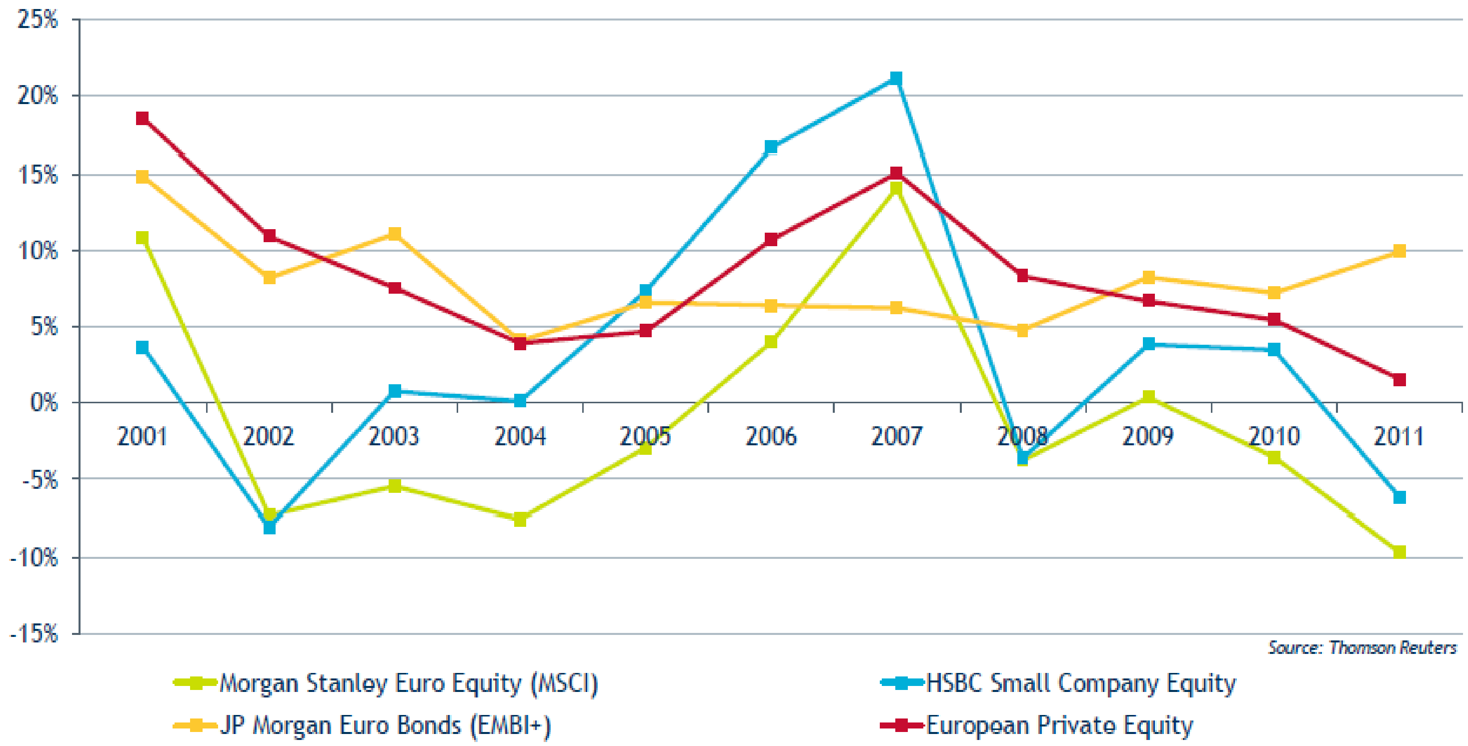
Private Equity Performance vs. Public Markets

(EVCA: European Benchmark report 2011)

Evolution of comparators - five-year rolling IRRs



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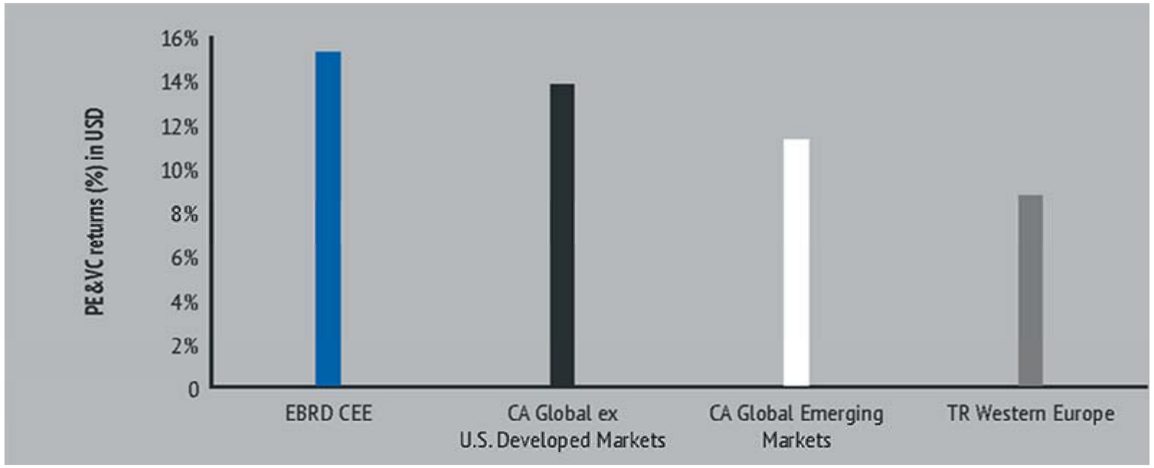
Central Eastern Europe Private Equity returns
EBRD return data (largest CEE PE investor)

(CEE Private Equity report by PSIK and CEE Task Force 2013)

COMPARISON OF HORIZON RETURNS TO 31.12.2011

10-year horizon net returns, 31.12.2011	CEE PE EBRD	Europe PE Thomson Reuters	Emerging Markets Cambridge Associates	HSBC Small Company Equity
EUR	9.95%	5.62%		3.33%
USD	15.66%	8.67%	11.23%	

10-YEAR HORIZON NET PE RETURNS, 31.12.2011



Why to invest in Private Equity?

True stock picking in a low growth environment

- Private equity managers pick companies with growth potential and actively create the conditions for growth in those companies.
- Invest in controlling stakes – exclusive access (in contrast to mutual funds)

Leveraging off balance sheet

- By organising the company's funding requirements efficiently (using all borrowing options), the equity returns are potentially enhanced.

The private equity business model allows to significantly reduce risk in an otherwise risky environment

- Access to legitimate inside information
- A much greater depth of information on proposed company investments is available to private equity managers (reduces significantly risk in private equity investments).

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Why to invest in Private Equity?

Influence over management and flexibility of implementation

- Active participation in a company's strategic direction, business plan ,selection of senior executives, introduction of, potential customers, M&A strategy and identification of eventual acquirers of the business.

Portfolio diversification improves risk and volatility characteristics

- Within a balanced portfolio, the introduction of private equity can further improve diversification/ imperfectly correlated to public equity
- During the crisis private equity has proofed to be more resistant against external shocks than public equity markets (strongest outperformance in times of market stress)

Access to returns streams, assets and strategies otherwise inaccessible

- (i.e. smaller, faster growing companies, turnaround strategies, private debt)

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Why to invest in Private Equity?

Alignment of interest between managers of private equity funds and investors – reduces agency problem prevalent in publicly owned equivalents

- Fund managers invests alongside investors and receives share in return only after investors

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Current Regulation - ČR

Pension Funds:

- 3rd pillar of pension system allows to invest up to 5% into unregulated assets in case of ”transformovane fondy”(including private equity)
- split assets between fund and the management company / return guarantee abolished for new funds
- opportunity for transformed funds with dynamic profiles

Insurance Companies:

- up to 5% investments into unquoted shares

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Summary

- Private equity is an attractive asset class delivering superior risk adjusted returns for their investors
- Private equity provides additional portfolio diversification improving risk and volatility characteristics (due to imperfect correlation to public equities)
- Czech regulation allows limited ways to invest into the PE asset class, however we believe this window will be gradually opening
- Typical structures for asset managers to participate in PE asset class are via internal PE programs or via Funds of Funds

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