



## **An Introduction to Private Equity**

### **Emma Cory**

Hello. I'm Emma Cory, the Alternatives Specialist for the HSBC UK Private Bank. And today we're going to be introducing private equity as an asset class.

Private equity is often expected to achieve higher returns than that of public equity markets. This makes it attractive to large scale investors who are looking to solve long-term return requirements. Despite this, many UK charities have not traditionally included private equity in their portfolios. This can be due to concerns around the lower income yield, the illiquidity, and the increased risk. However, given the potential return profile and the long-term horizon nature of private equity, our view is that this asset class should be considered more broadly across the sector.

For a charity with a perpetual time frame, private equity return profile can be attractive. A trend prevalent in US endowments has been the increase of alternative investments. This includes that of private equity. This has been something that's been slower to arrive here in the UK.

Private equity can be considered an important part of a charitable organisation's diversified portfolio, as it seeks to take a long-term approach to investing to deliver for future generations, whilst still balancing the needs of the present.

Broadly speaking, private equity reflects an ownership or interest in entity that is not publicly listed or traded. Or, essentially, equity that is privately held. While private equity can be a catch-all term, specifically today, we're referring to private equity growth and private equity buyout funds.

In terms of classifications, companies can be Early Stage. This can include: Seed, where it's usually the first external investment into a company. It can be Venture Capital, where there's usually a product or concept, but maybe not revenue generating yet. Or later stage Growth Capital. Here there is revenue for potentially early stages of profitability. Or buyout where the company is large and mature with sizable cash flows.

Therefore, private equity is taking equity, active management and illiquidity risk. Where active decisions are being made by the fund manager, usually across ten or so years, on which companies to acquire, how to add value and grow these, and how and when to exit these over time.

## **Kutty Dutta**

Hello. My name is Kutty Dutta, I'm the Managing Principal at HSBC Alternatives. Over the last several years, a decline in publicly listed companies means that there is now a greater universe of private, not public, opportunities, as companies choose to stay private for longer. This means investors only focusing on public markets are facing a shrinking opportunity set and missing out on a wide range of private opportunities. Private equity also offers a high potential upside. There is a high degree of active management, which can drive attractive returns above those in public equity. For example, instead of company management focusing on short-term, quarter-to-quarter earnings, which they typically do when it's a listed company, they can focus on more strategic, long-term value creation opportunities to enhance revenue and profitability by deploying long-term expansion plans over several years, unlocking true potential.

This tends to be the key focus of fund managers so they have robust toolkits to systematically deploy. Private equity remains an institutional asset class where access to great managers is usually difficult and, furthermore, usually with higher dollar minimum commitments required. We are pleased to be able to provide access to private equity investments at HSBC Private Bank – where deemed suitable for client portfolios.

At HSBC, we follow a high conviction approach across three key aspects:

High conviction by strategy, so looking at areas which comprise a top-down, macro or micro conviction in the sectors and its long-term drivers; a compelling need for private capital; and a highly investable universe of opportunities available to HSBC Alternatives.

High conviction by manager. Given the active nature of private equity, there is a very wide dispersion of returns within the asset class, so selecting the right partner is key. We deploy a highly selective investment process screening thousands of funds over time, resulting in a marginal number of opportunities passing the due diligence for investment.

High conviction by portfolio construction. While we allocate to private equity funds, we also allocate to co-investments, which are individual company transactions. And secondaries, which are buying into an investment at a later stage when either additional external capital is required or an existing investor is bought out of their position.

### **Emma Cory**

Private equity is illiquid. What we mean by that is when you commit capital, it does not get invested right away. Typically, there is an investment period of five or so years where the fund manager is looking to identify companies to acquire. Private equity can be very flexible here. For example, for acquisitions, they can look at: distressed opportunities, taking public companies private, corporate carve outs, spin outs, or even existing private companies. The fund manager will then spend several years working through a specific business plan for the underlying companies. This can include: adding value through changing the strategic direction, adding new products, new geographies, organic growth, M&A expansion.

Then what they'll do is sell down their portfolio companies, usually of 30 or so companies, over time. And this is when they make distributions back to investors. This whole process, or term, is usually around ten years. During the time you cannot normally exit, nor be able to sell or transfer your position. For those who can tolerate the illiquidity, equity, and volatility risk as part of your diversified portfolio, we will typically discuss allocating to private equity every year.

Or what we call vintage diversification. This reduces the impact to market timing and also means your allocation becomes self-funding, as distributions from your older commitments are used to fund capital calls of newer ones. This results in a consistent exposure to the asset class. But, as always, investments must match your long term objectives and constraints. So please do speak to your Investment Counsellor to discuss what solutions are right for you.

Thank you for joining us today. If you have any questions on private equity or Alternative Investments, please speak to your Investment Counsellor or Relationship Manager.