



PRIVATE EQUITY

Why does PSERS invest in Private Equity?

One of PSERS' primary objectives is to prudently invest the assets of the Fund. As a large, mature pension plan, PSERS supports this mission by diversifying the Fund's assets in many different asset classes (or "buckets"), which includes private equity funds.

The three primary benefits of investing in the private equity asset class are:

- 1) **Diversification** - PSERS Private Markets Program is very diversified with thousands of investments. Private Equity offers exposure to companies not accessible through traditional public markets.
- 2) **Returns**- Studies show that a private equity allocation can offer investors good absolute returns. Looking at historical returns in private markets, PSERS has achieved a net total return of 11.4% from inception, dating back to 1985, earning over \$13 billion for the Fund.
- 3) **Long-term investment horizon versus public equity (stocks)** - Private markets managers typically have a 3 to 5-year time horizon for their investments to mature and begin to show profits. Public stocks must report earnings on a quarterly basis which can lead to focusing on short-term goals rather than a long-term horizon.

What is Private Equity?

- Public companies are companies that have their stocks traded on open stock market exchanges.
- Private equity are investments in private companies that do not have access to public capital or have chosen not to list their securities in the public markets.
- Most institutional investors, like corporate and public pension funds, college and university endowments and other long-term investors, provide the capital for private equity funds to function.
- This capital can be used to fund new technology, make acquisitions, expand working capital for a company, improve an underperforming or undermanaged company, or bolster and solidify a company's balance sheet.
- Most of our members have no access to this critical asset class, other than their "look through" exposure as PSERS members.



Private Equity is essential to the growth and health of the economy. It is estimated there are over 600,000 private companies in North America and Western Europe. The number of private companies dwarfs the number of publicly-traded companies, and this gap has only widened in recent years as the number of publicly-traded companies declines.

Private Equity Performance

PSERS has made nearly all of its \$30+ billion of Private Equity commitments during the 20 years ending December 31, 2017. The resulting performance comparison, annualized over the 20 years, expressed as a dollar weighted internal rate of return (IRR), is 11.4% for PSERS' Private Equity portfolio and 7.54% for the custom public market equivalent index. **This performance is AFTER the payment of all fees, expense and profit sharing.** These results strongly support PSERS' conviction that Private Equity deserves its place in PSERS overall portfolio, as it has strongly outperformed the public equity market alternative.



PRIVATE EQUITY (CONT.)

Fees, Expenses, and Profit Sharing

During the life of a private equity fund, the General Partner (GP) receives payments as compensation for managing the fund. Private equity's fee structure is typically referred to as "2 & 20". This refers to a management fee of 2% and a profit share, also called carried interest, of 20%. PSERS negotiates discounts whenever possible. PSERS has been able to negotiate an average management fee and profit share of 1.6% and 18%, respectively, across over \$30 billion of commitments made from 1985 through 2017.

Management fees are typically paid quarterly. The GP is reimbursed by the Limited Partners (LPs) for expenses related to operating a fund such as accounting, audit, and legal expenses.

The profit share (combined interests) earned by the GP is paid from the profits the GP generates from the sale of the investments. Importantly, the GP receives its profit share only after the LPs have received (i) all the dollars they put into the fund to make investments and pay management fees and expenses and (ii) a preferred return (typically an ~8% annual rate of return) on all those dollars. For some funds, the profit share is received by the GP after the sale of each investment, with periodic reconciliations, and for other funds the GP receives it at the end of the life of the fund based on all sales.

Typical Private Equity Structure

A General Partner (GP) creates a fund in the limited partnership structure, puts some of its own capital in the fund, then seeks out Limited Partners (LPs) to commit the rest of the capital to the fund. The LPs usually make up over 90% of the capital committed to the fund. The GP often requires up to one year to accumulate the amount of total capital from LPs to reach the GP's target size for the fund. The limited partnership typically has a contractual life of 10 years and the GP spends the first 5 years of the fund finding and making investments. When the GP makes an investment, it calls the pro rata share of the required capital from each LP to pay for the investment. The GP also contributes its pro rata share. The GP can also call capital periodically from LPs for fund fees and expenses. The GP then spends the next 5 years selling (or harvesting) the investments it made during the first 5 years. As investments are sold the proceeds are distributed pro rata to the LPs. The life of the fund can be extended beyond 10 years if more time is necessary to sell the final investments.

How Private Equity Structures Work

