

# Accessing Private Equity through Evergreen Funds

## What You Should Know:

- Traditionally, private equity (PE) funds were the domain of institutional investors. Now, new regulations and investment vehicles have overcome barriers to entry for non-institutional investors.
- Evergreen funds are open-ended vehicles that allow investors to subscribe to and redeem capital from an existing, diversified portfolio.
- Capital invested in evergreen funds is invested immediately (fully deployed), so returns begin compounding right away.

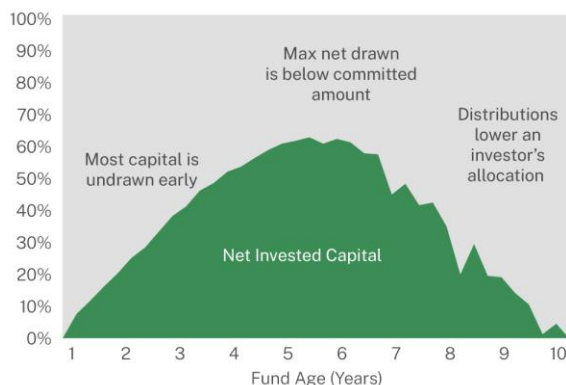
The emergence of evergreen funds, which are semi-liquid, open-ended vehicles, has made PE investing more accessible. Thanks to updated fund structures, an evergreen solution may now be a pragmatic entry point to PE investing for all types of investors. In this paper, we will review some of the attributes that distinguish evergreen funds from their closed-end fund peers.

## The Traditional Private Equity Fund Investment

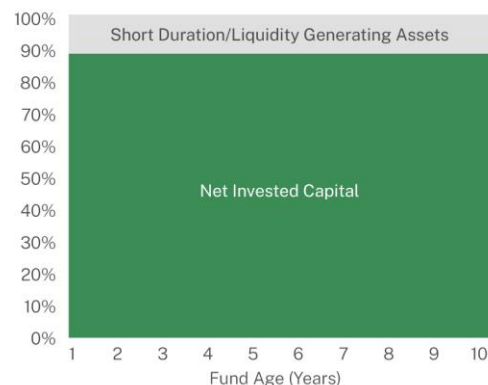
The case for adding private equity to an investment portfolio is strong, as exposure to this asset class may provide opportunities for increased diversification, outperformance and enhanced risk-adjusted returns. Closed-end fund structures have historically been more accessible to investors with deep pools of capital, a tolerance for illiquidity, and the resources to oversee the complex administration of private equity portfolios. Think: Institutional investors. This has rendered the asset class largely inaccessible to investors that may have different resources, liquidity needs, and portfolio goals. The advent of evergreen funds can make investing in the asset class more attainable.

The chart below illustrates the difference in invested capital over time between a traditional private equity fund and an evergreen fund.

**Traditional PE Fund<sup>1</sup>**



**Evergreen Fund<sup>2</sup>**



Source: Hamilton Lane Data via Cobalt (May 2023). For illustrative purposes only. Please refer to endnotes.



Let's examine a few challenges to investing in a "traditional" drawdown PE fund.

- **Capital Calls** – A PE fund with a drawdown structure requires investors to commit capital that the fund deploys over a multi-year investment period. While the investment period is contractually defined, the exact timing of capital calls during the investment period is uncertain. Investors must, therefore, manage their cash to fund future capital calls.
- **Full Deployment** – Because of the multi-year capital call structure, investors may not be "fully invested" for a few years, if ever.
- **Maintaining Allocation** – As the traditional PE fund matures, the fund manager exits the investments in the portfolio and distributes the proceeds back to its investors. These are positive outcomes, but investors then must deal with a shrinking allocation to PE and the reinvestment risk associated with solving that.

## Evergreen Funds: An Alternative Approach to Private Equity Investing

Put simply, evergreen funds resemble the mutual fund structure: They are open-ended vehicles that allow investors to periodically (often monthly or quarterly) subscribe to and redeem capital from an existing, diversified portfolio. Given these benefits, it's no surprise that evergreen fund strategies have grown in popularity as an alternative or complement to traditional closed-end structures.

We are often asked about the difference in performance between a traditional PE fund IRR and an evergreen fund return. One key difference is that an evergreen fund's full deployment of capital at the time of investment means that returns begin compounding from the outset.

### Evergreen Return Required for Same End-of-Day MOIC as a Closed-End Fund<sup>3</sup>

Evergreen Annualized Return	10%	12%	14%	16%	18%
Closed-End Fund IRR Required	16%	20%	25%	29%	33%
Multiple on Invested Capital	2.1x	2.5x	2.9x	3.3x	3.8x

The middle row illustrates the equivalent return needed on a traditional closed-end fund, akin to the return of a given evergreen strategy (top row), in order to achieve an identical dollar-for-dollar multiple. The term "closed-end fund" pertains to a traditional private equity fund. Source: Hamilton Lane data via Cobalt (May 2023). Returns presented are net of fees and expenses. Contributions and distributions in this example are determined by actual cash flow patterns derived from Hamilton Lane's proprietary Horizon Model. These are further modified using Hamilton Lane's forward-looking return expectations. For illustrative purposes only. Please refer to endnotes.

As seen above, a traditional PE fund needs to generate a higher IRR equivalent than the annual return of an evergreen fund in order to generate the same investment multiple. This highlights the potential benefit an evergreen fund investor can get from having all capital invested in private equity and compounding from the outset of their investment.

## Making the Most of Committed Capital

For investors who have historically had less access to PE funds, evergreen funds can serve as a strategic entry point. Why? Because evergreen funds offer investors a fully deployed, diversified vehicle that simplifies access to the private markets. With a ready-made portfolio, evergreen investors have an opportunity to experience a private equity allocation that fully compounds over the life of their investment – without the reinvestment risk typically associated with traditional, closed-end funds.



## Endnotes

1: Based on historical private equity buyout cash flows over a 10-year time frame.

Source: Hamilton Lane proprietary Horizon Model via Cobalt.

2: For illustrative purposes only. Does not represent actual allocation totals of a fund.

3: Evergreen annualized return is observed as a hypothetical time-weighted return.

Multiple on Invested Capital is computed as the compounded return over an 8-year period for each respective Evergreen Annualized return. For illustrative purposes only. Does not represent returns of an actual fund.

Closed-ended fund IRR represents the performance of the capital invested in a buyout fund over an 8-year time frame. Source: Hamilton Lane proprietary Horizon Model.

The Multiple on Invested Capital of the closed-ended fund assumes that both unfunded capital and distributions received from the buyout fund grow at a 5% interest rate per annum.

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