Alternative Investments – Private Debt and Equity

Private Debt (PD) and Private Equity (PE) are alternative investment categories which are characterized by a low correlation with other, traditional investments, an underlying asset difficult to value, relatively low liquidity and high purchasing costs.

Next to PD and PE, alternative investments include a range of additional instruments and types, such as venture capital, hedge funds, managed futures, art and antiques, commodities, derivatives contracts, or real estate. Characterized as complex and not much regulated, alternative investments are usually held by institutional investors, alternative investment funds, accredited family offices or high-net-worth individuals.

PD comes in many forms, but most commonly refers to non-bank institutions extending loans to private companies. Whilst typically held till maturity, sometimes PD-related loans are traded on the secondary market. - PD funds come in different shapes and sizes and focus on following strategies, among others:

- Direct lending: Foremost senior loans made to mid-market companies without an intermediary. May include revolving credit lines, second lien loans.
- Special situations: Debt or structured equity investments made with the intent of gaining control of a company, often one in financial distress. Can include trading in the secondary market, direct origination or distressed debt where the manager believes price dislocation is present.
- Distressed debt: Differs from special situations, as usually involves purchase of securities in the secondary market, rather than new origination of debt or structured equity.
- Mezzanine debt: Subordinated debt, generally with features like preferred equity, or such as warrants — which increase the value of the debt. Often used in Leveraged Buyouts (LBOs).
- Infrastructure debt: For development of as well as already existing, standing assets, generally longer term (30+ years).

Common investment strategies in the asset class of PE are medium- to long-term in illiquid instruments and comprise among others leveraged buyouts (LBOs), venture capital, growth capital, as well as distressed investments or mezzanine capital. When used at investment level, PE typically refers to investment funds, most of them organized as limited partnerships that buy, grow or restructure companies that are not publicly traded.

- In an LBO transaction, for example, a PE fund acquires control in a firm, restructures the acquired asset and attempts to resell it at a substantially enhanced value, aiming for a high return on equity. Restructuring frequently involves cutting costs, resulting in higher profits short-term (whilst by times damaging customer relationships and workforce morale long-term). Almost always, LBOs rely on financial engineering (enhancing return on equity by extensive use of tax-deductible debt financing).
- Venture capital investments, for instance, are characterized by providing capital to startups or early-stage businesses that have the potential to innovate markets and grow quickly. Usually minority investments, they are deemed high risk, involve straight equity only and bet on company growth with the business´s valuation increasing.
- Growth capital refers to equity investments, often minority stakes, in relatively more mature companies seeking capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business. Companies seeking growth capital often do so to finance a transformational event in their respective life cycle stage.

Whilst PE-related investments are rather illiquid, a secondary market (PE secondaries) has developed, addressing demand by investors with somehow less risk appetite.

PE investment groups are geared towards long-hold, multiyear investment strategies in illiquid assets, often having control and influence over operations. Hedge funds, on the other hand, rather focus on short- / medium-term liquid securities, which can – if required – be quickly converted to cash. Also, hedge funds usually do not seek direct control over a business or an asset they are invested in.

DEBT

	PUBLIC	PRIVATE
TERMS	RATHER STANDARDIZED, AS PER MARKET REQUIREMENTS	INDIVIDUALLY AGREED UPON
ACCESS TO INFORMATION	PER LISTING REQUIREMENTS PUBLICLY DISCLOSED	CONFIDENTIAL, DISCLOSURE AS AGREED UPON
HOLDING PERIOD	AS PER TERMS, BUT TRADABLE	USUALLY HELD TILL MATURITY
LIQUIDITY	HIGH	LOW OR NONE

EQUITY

	PUBLIC	PRIVATE
OWNERSHIP	BROAD & PUBLIC CHANGES FREQUENTLY	CONCENTRATED & PRIVATE STABLE
ACCESS TO INFORMATION	MATERIAL INFO THAT MAY IMPACT SHAREPRICE IS PUBLICLY DISCLOSED	INFO IS CONFIDENTIAL DISCLOSED UPON PRIVACY OBLIGATIONS
INVESTOR INVOLVEMENT	RELATIVELY PASSIVE LIMITED TO AGMS	OFTEN DIRECT INVOLVEMENT IN KEY DECISIONS REGARDING STRATEGY
MANAGEMENT FOCUS	INFLUENCED BY SHORT-TERM FACTORS, QUARTERLY REPORTS	LONGER TERM VIEW MULTI-YEAR PLANNING
MATURITY STAGE	LARGE, MATURE COMPANIES, STOCK EXCHANGE REQUIREMENTS EXPENSIVE & TIME CONSUMING	ANY STAGE IN LIFE CYCLE, EARLY STAGE TO BUY-OUTS OR RESTRUCTURING
ILLIQUITY PREMIUM	NO, AS READILY TRADED AND LIQUID	HIGHER RETURNS, HELD LONGER, MORE DIFFICULT TO SELL

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