Private Equity Glossary

Alternative asset class: a class of investment that includes [private equity, real estate, and oil and gas, but excludes publicly traded securities. Pension plans, college endowments and other relatively large institutional investors typically allocate a certain percentage of their investments to alternative assets with an objective to diversify their portfolios.

Acquisition: the obtainment of control, possession or ownership of a company.

Bridge Financing: short-term debt financing that will eventually be replaced by permanent capital from equity investors or debt lenders.

Buyout: a sector of the private equity industry. Also, the purchase of a controlling interest of a company by an outside investor (in a leveraged buyout) or a management team (in a management buyout).

Carried Interest: a share in the profits of a private equity fund. Typically, a fund must return the capital given to it by limited partners plus any preferential rate of return before the general partner can share in the profits of the fund. The general partner will then receive a 20% carried interest, although some successful firms receive 25%-30%. Also known as “carry” or “promote”.

Commitment: an obligation, typically the maximum amount that a limited partner agrees to invest in a fund.

Deal flow: a measure of the number of potential investments that a fund reviews in any given period.

Direct Investment: an investment in an operating company in exchange for a direct equity ownership stake in that company.

Discounted cash flow (DCF): a valuation methodology whereby the present value of all future cash flows expected from a company is calculated.

Due Diligence: the investigatory process performed by investors to assess the viability of a potential investment and the accuracy of the information provided by the target company.

Earnings before interest and taxes (EBIT): a measurement of the operating profit of a company. One possible valuation methodology is based on a comparison of private and public companies’ value as a multiple of EBIT.

Earnings before interest, taxes, depreciation and amortization (EBITDA): a measurement of the cash flow of a company. One possible valuation methodology is based on a comparison of private and public companies’ value as multiple of EBITDA.

Exit Strategy: a fund's intended method for liquidating its holdings while achieving the maximum return possible. Typically, the options are merge, be acquired or make an initial public offering (IPO).

Fund: the investment vehicle, often a limited partnership, to which the limited partners commit capital.

Fund Capitalization: the total amount of capital committed to a fund by the limited partners or investors.

Fund of Funds: a fund which takes minority equity positions in other funds. If the focus is primarily investing in new funds, this is a primary fund of funds and if focusing on investing in existing funds, this is referred to as a secondary fund of funds.

Fund Size: the total amount of capital committed by the limited and general partners of a fund.

General Partner (GP): a class of partner in a partnership. The general partner retains liability for the actions of the partnership. In the private equity world, the GP is the fund manager while the limited partners (LPs) are the institutional and high net worth investors in the partnership. The GP earns a management fee and a percentage of profits (see Carried interest)

Holding Period: the amount of time an investment remains in a portfolio.

Internal Rate of Return (IRR): the interest rate at which a certain amount of capital today would have to be invested in order to grow to a specific value at a specific time in the future.

Initial Public Offering (IPO): the first offering of stock by a company to the public. New public offerings must be registered with the Securities and Exchange Commission. An IPO is one of the methods that a start that has achieved significant success can use to raise additional capital for further growth. Leveraged Buyout (LBO) –the purchase of a company or a business unit of a company by an outside investor using mostly borrowed capital.

Limited Partnership: a legal entity composed of a general partner and various limited partners. The general partner manages the investments and is liable for the actions of the partnership while the limited partners are generally protected from legal actions and any losses beyond their original investment. The general partner receives a management fee and a percentage of profits (see Carried interest), while the limited partners receive income, capital gains and tax benefits.

Limited Partner (LP): an investor in a limited partnership. The general partner is liable for the actions of the partnership while the limited partners are generally protected from legal actions and any losses beyond their original investment. The limited partner receives income, capita; gains and tax benefits.

Liquidation: the selling off of all assets of a company prior to the complete cessation of operations. Corporations that choose to liquidate declare Chapter 7 bankruptcy. In liquidation, the claims of secured and unsecured creditors, bondholders and preferred stockholders take precedence over common stockholders.

Management buyout (MBO): a leveraged buyout controlled by the members of the management team of a company or a division.

Management Fee: a fee charged to the limited partners in a fund by the general partner. Management fees in a private equity fund typically range from 0.75% to 3% of capital under management, depending on the type and size of fund.

Market capitalization: the value of a publicly traded company as determined by multiplying the number of shares outstanding by the current share price.

Net Asset Value: the term used by a fund to designate the excess of fair value of investments owned, cash and other assets over the liabilities of the fund.

Paid-in Capital: the amount of committed capital a limited partner has actually transferred to a fund. Also known as the cumulative takedown amount.

Primary Investments: an original limited partner commitment to a private equity fund, which does not include any transfer of limited partner interests / ownership. These commitments are typically made during the fundraising period for that private equity fund and are sometimes referred to as blind pool commitments.

Private Equity: equity investments in non-public companies. More specifically, private equity firms offer capital in return for participation in the company's share capital. At the same time they may also support portfolio companies on technology, organizational, commercial and financing issues.

Portfolio Company: a company that has received an investment from a private equity fund.

Price earnings ratio (PE ratio): the ratio of a public company’s price per share and its net income after taxes on a per share basis.

Return on investment (ROI): the proceeds from an investment, during a specific time period, calculated as a percentage of the original investment. Also, net profit after taxes divided by average total assets.

Strategic investor: a relatively large corporation that agrees to invest in a young company in order to have access to a proprietary technology, product or service. By having this access, the corporation can potentially achieve its strategic goals.

Syndicate: a group of investors that agree to participate in a round of funding for a company. Alternatively, a syndicate can refer to a group of investment banks that agree to participate in the sale of stock to the public as part of an IPO.

Trade Sale: the sale of a portfolio company to another company, typically operating in the same industry.

Turnaround: a process resulting in a substantial increase in a company’s revenues, profits and reputation.

Valuation Method: the policy guidelines a management team uses to value the holdings in the fund's portfolio.

Venture Capital: a segment of the private equity industry which focuses on investing in new companies with high growth rates.

Vintage: the year that a private equity fund stops accepting new investors and begins to make investments on behalf of those investors.

Write-down: a decrease in the reported value of an asset or a company.

Write-off: a decrease in the reported value of an asset or a company to zero.

Write-up: an increase in the reported value of an asset or a company.