PRINCETON FUND ADVISORS, LLC

An Investor's Guide to Private Equity

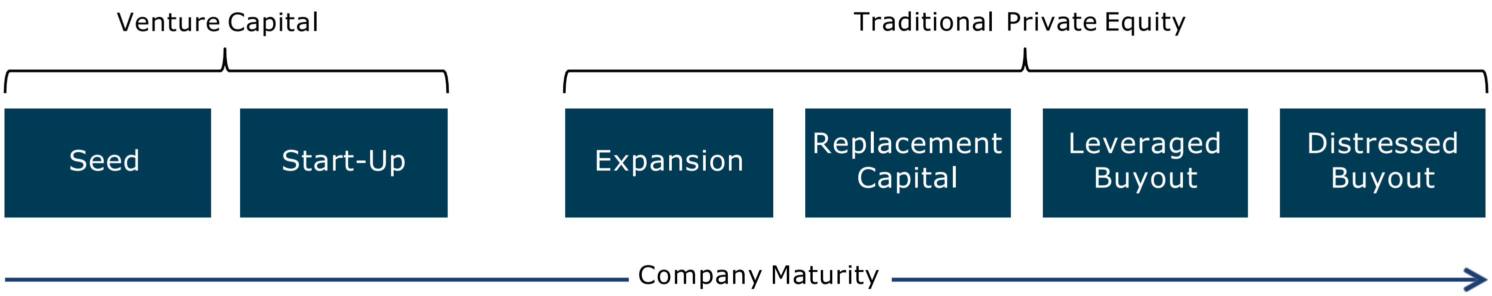
What is Private Equity?

Private equity investing is the acquisition and ownership of equity interests in private companies that do not trade on public exchanges. This is typically accomplished through funds organized as partnerships that establish the underlying investors as "limited partners," along with a primary manager of the fund, or "general partner." The general partner will work with the companies acquired on both a strategic and operational level, while playing the role of active shareholder, with the goal of adding value to each company.

Each partner to the fund agrees to contribute a predetermined amount of capital over the life of the fund for making investments. However, the timing and size of these contributions is not known in advance. It is then the responsibility of the general partner to manage the deployment of this capital into underlying companies of the portfolio, which typically involves taking a hands-on approach to the management of these underlying companies.

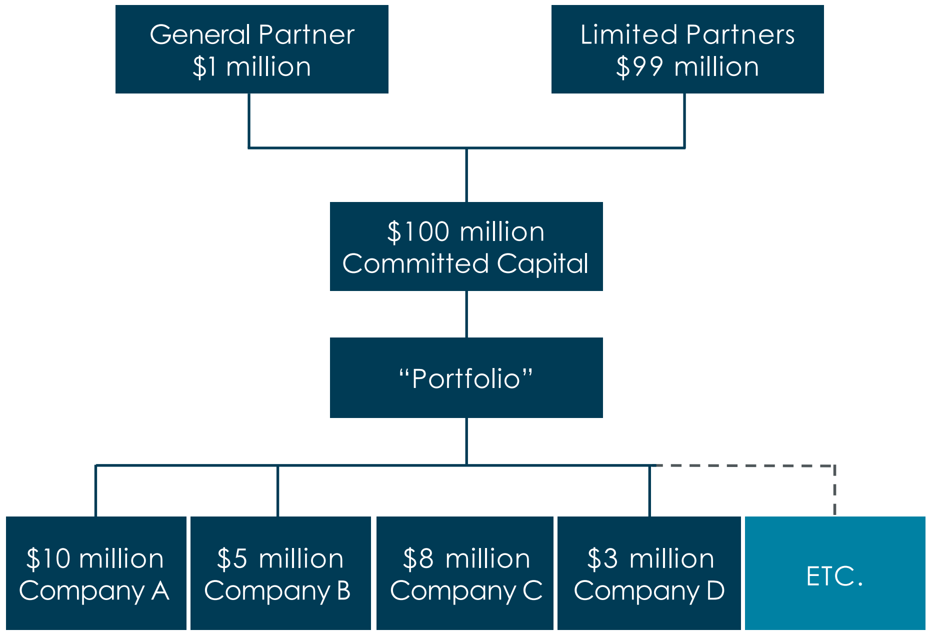
Types of Private Equity

Below is a sample of general styles and types of private equity funds:



Seed:	Seed stage funds provide capital for initial research and development of an initial concept prior to the start-up phase.
Start-up:	Companies who are yet to begin selling their products or services commercially are prime for start-up stage capital. This capital finances additional product development and marketing in preparation for an initial product launch. These companies have typically been in business for only a short period of time.
Expansion:	In the expansion stage, capital is typically used for increased production capacity, market or product development, or to provide additional working capital and, therefore, business liquidity. Expansion stage funding also includes bridge financing and rescue investments for companies nearing insolvency. Companies in this stage are typically breaking even or trading profitably in the marketplace.
Replacement Capital:	Replacement capital occurs when another party acquires ownership interest through a partial sale, or via the refinancing of debt.
Buyout:	Buyout funds typically target mature companies with established business plans to provide capital for consolidation, expansion, and/or spinoffs of subsidiaries. Buyout funds also commonly participate in corporate restructuring or business turnarounds by making debt or equity investments in financially stressed companies. These funds seek control through the acquisition of a majority stake of a business which also typically entails a change in ownership.

How does Private Equity work?



Investors in private equity, or private equity funds, hope to recognize a return on their invested capital as the result of one of many types of liquidity events that may occur , as well as any income and dividends paid during the hold period. Liquidity events include recapitalizations, direct sales of the companies themselves, mergers with other companies or an initial public offering (IPO) of a private company's equity ownership interests.

A private equity fund's success depends on the ability of the companies that comprise the fund's portfolio ("portfolio companies") to see an increase in market value after a given period of time and the fund's ability to realize the value created in these holdings. This time period can sometimes be the entire life of the fund and last several years. The fund's management, or general partner, often adds value to this process by actively playing a role in operational management of the portfolio companies, such as assisting the portfolio companies in achieving operating efficiencies, developing products or services, or reorganizing. After a time and depending on whether a given portfolio company has increased in value, a liquidity event may occur that allows the fund to realize its interest in the investment. The proceeds of these sales are then distributed to the private equity fund's investors, less applicable management fees and performance fees taken by the general partner. Above on the right is a sample ownership structure for a private equity fund, and below are key terms.

Key Terms

Committed capital:	The maximum amount of capital that a fund may call from a limited partner.
Capital calls (drawdowns):	The written notice of a partial drawdown of committed capital being requested for deployment to portfolio companies within the fund by the general partner. Capital calls are usually disseminated two to three weeks before the date for which the call is requested. Failure to meet a requested drawdown can result in severe penalties, and in some cases forfeiture of limited partnership interest in the fund.
Capital distributions:	Capital which has been realized as a result of a liquidity event occurring within a portfolio company and is being returned to investors. Similar to drawdowns, the timing of distributions are unknown.

A fund may withhold capital distributions as a way of reducing the total amount of future funding required by its individual partners and therefore reducing cash flow volatility. The amount of the next capital call can therefore be reduced in direct proportion to the withheld capital distribution.

Key Terms (continued)

Additionally, private equity firms typically structure debt at a company level, rather than the entire portfolio. This allows each company in the fund to remain insulated from the default risk of the other companies in the portfolio. A full range of borrowing options is often employed to different degrees within each of the types of private equity funds. The expected result is enhanced potential returns of a portfolio after leverage, with relatively less downside risk than if the leverage were applied to the fund as a whole.

Historically, private equity's correlation to traditional asset classes has remained low and stable. This feature, regardless of cash-flow volatility (discussed below), may increase the diversification of an overall portfolio containing traditional assets[1].

Returns in Private Equity

Private equity seeks to generate returns through several coordinated factors:

Purchase Price :	Private equity firms undertake a lengthy and exhaustive due diligence process prior to making a bid to acquire all or part of an interest in a potential portfolio company. They have significantly greater access to a company's accounting, holdings, personnel and operations than a team simply looking to purchase a stock or security in a public company, even though the target acquisition may be a public company. This insight gives them a more expansive data set by which they can determine an appropriate purchase price for the firm.
Time :	Private equity funds are not trading funds. They are funds designed to acquire companies with the potential for creating profit and value for investors and stakeholders, typically over a market cycle or longer depending on the scope of the work the management teams believe is required to optimize the portfolio company's performance. Private equity managers operate like business owners, not shareholders. They are focused on long-term business development, growth and improvement; not necessarily quarter to quarter performance, which enables them to act in a strategic manner, instead of a tactical or reactive manner when the managing the portfolio companies.
Cost of Capital :	Banks, private investors, non-financial institutional lenders and co-investors have historically provided capital to private equity funds at costs generally more favorable than prevailing public capital markets. Private equity funds may also use public markets to issue debt at terms favorable to the operational needs of the private equity firm, and to establish beneficial covenants with capital providers.
Operational Improvement :	Private equity firms have access to top professionals in dozens of industries around the world. Upon acquisition of the company, personnel are put in place that the private equity managers believe can have the greatest impact on operational improvement and EBIT-DA growth. From executives, to marketing, to floor managers, top talent is put in place to execute a well-developed plan to increase profits for the acquired companies. Proven processes such as Six Sigma, and strategies such as vertical integration focusing on core efficiencies (e.g., sale of non-core subsidiaries or product and service lines) are all employed to maximize long-term investor value.

[1]Diversification does not assure a profit or protect against loss.

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How does Private Equity work?

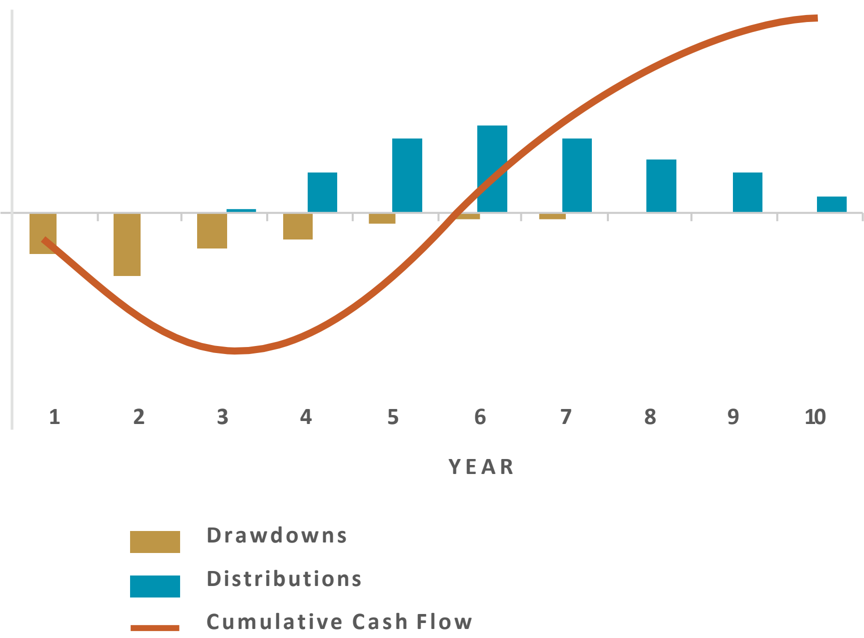
The factors from the previous page contribute to the performance of two primary measures of strong private equity management, and are measurable and reliable metrics for performance:

EBITDA	An acronym for Earnings Before Interest, Taxes, Depreciation and Amortization, EBITDA is a primary measurement for profitability of a single company or of the portfolio as a whole over a given time period, which can be compared to previous time periods or with peers in the same industry. EBITDA—and subsequently, EBITDA growth—can be measured on a pro-forma or absolute basis, with each method telling a distinctive part of performance regarding value creation.
Multiple	On an individual portfolio company level, the multiple is considered the enterprise value of a company divided by its EBITDA for a given time period. Using the enterprise value removes the differences in capital structures between comparable portfolio companies, so the multiple is considered normalized.

Cash Flow Voliatility and the J-Curve[1,2]

The volatility of cash flows over the life of a private equity investment needs careful consideration. In the early years of most funds, low or negative returns can be expected. This is due to the minimal amount of capital actually invested at the outset coupled with the initial establishment costs, management fees and expenses.

Subsequent drawdowns are then requested, the timing and size of which are typically provided to the investor two or three weeks in advance. These capital calls are used to fund additional investments. This is an important point, as investors need to maintain sufficient liquidity in other investments to meet call obligations as they occur.



By requesting additional drawdowns on an ongoing basis, the fund can limit the amount of uninvested cash it holds within the fund, which can be a drag on investors' performance. Proceeds begin to be distributed as portfolio companies mature and exits occur. This will usually take several years after the "closing" of the fund and the timing and value of the distributions may be volatile.

The chart to the left showcases the net cash flows to investors, which is a combination of both drawdowns and distributions from a private equity investment with an assumed 10 year horizon. These net cash flows usually result in a "J-curve," such as the chart showcases. Distributions normally begin before the total commitment has actually been drawn, so it is unusual for investors to ever have the full amount of their commitment actively managed by the manager.

[1] The performance data referenced above is not that of any specific investment. Past performance is no guarantee of future results of any investment. The investment return and principal value of any investment will fluctuate so that an investor's shares, when redeemed may be worth less than their original cost. Any investment's actual performance may be higher or lower than the performance data referenced above

[2] Cash flows from private equity may be paid from sources other than cash flows from operations, such as borrowings and return of capital.

Private Equity Investing Spectrum

Investors have different methods through which to gain exposure to Private Equity.

Primary Fund of Funds

- Diversified portfolio of interests in funds enables access as well as administrative and due diligence efficiency
- Broad exposure to arange of private equity fund managers
- Performance is dependent on the ability of the manager to select and manage successful investment opportunities

Secondaries

- Powerful tool to access mature funds with greater transparency and often at attractive discounts
- Diversification and potential early cash flow
- No established market for secondaries

Primary Direct Investments

- Local Market: LP interests in funds with direct control over portfolio in regions familiar to investor
- Ability to focus on high growth sectors, market segments, or industries directly

Co-Investments

- Flexibility to opportunistically participate in attractive private equity transaction alongside other partners
- Potential conflicts of interest between co-investors

Monitoring and Measuring Portfolio Performance[1]

Measuring private equity portfolio performance is different than most other asset classes. This is due to the relative illiquidity of private equity investments, turn around time of investments in underlying companies, and the timing of cash flows within the fund. Careful consideration must be paid to understanding the timing of drawdowns and distributions. For this reason, there are typically two performance metrics used: an internal rate of return ("IRR") and a multiple. The internal rate of return is defined as the discount rate used to equate the cash outflows associated with an investment and each of the cash inflows from realizations, partial realizations or its mark-to market (the expected value of an investment at the end of a measurement period). The IRR calculation covers only the time when the capital is actually invested and is weighted by the amount invested at each moment.

The second performance metric is the total multiple. The total multiple can be found by taking the cumulative distributions to date and dividing them by the total paid-in capital. This is distinctly different than the company-level multiple discussed earlier, as the total multiple applies to the portfolio at large and utilizes fund-level distributions and total drawdown. The total multiple, taken in conjunction with the internal rate of return, can lead to a proper understanding of the performance of a given private equity fund and its time frame.

Regardless of the current market and economic outlook, most private equity funds seek to achieve positive "absolute" returns. This is in stark contrast to attempting to match or outperform a given index. This is important to note, as attempting to achieve a desired absolute return regardless of market conditions may involve highly sophisticated and higher relative risk investment strategies.

[1] A private equity fund may take several years to invest its capital and investors may not realize the full potential benefits of a private equity investment in the near term, and there may be little or no near-term cash flow distributed during the commitment period. Such fund's shares may be highly illiquid and subject to significant limitations on transferability.
Private equity funds' investments may be priced in the absence of a readily available market or significant other information and may be priced based on determinations of fair value, which may prove to be inaccurate.
Private equity funds typically carry significantly higher costs and may have more complex issues involving taxation

Important Risk Information

A private equity investment is not appropriate for all investors. Private equity investments should only be made by investors: with adequate financial means; who can tolerate a high degree of risk and the potential of losing their entire investment; who do not require a liquid investment or access to their invested capital for a long period of time; and for whom the investment does not constitute their complete investment program.

A private equity investment may involve significant risks, including, without limitation: risks related to the fund's limited operating history; foreign currency risks; sector-specific risks; risks regarding financial and market conditions; risks regarding the legal, regulatory and political climate and changes therein; risks related to special situation companies; leverage risks; liquidity risks; risks related to lack of investment diversification; reliance on key personnel; conflicts of interest of the fund and its targeted investments relating to compensation and fees, including incentive fees, payable to their management; risks related to real estate-related assets; the risk of capital calls made on short notice; and risks related to investment in non-U.S. securities.

Private equity funds may borrow money for various purposes and may use derivative transactions for hedging purposes. Such transactions could present significant risks and may increase the funds' volatility and risk of loss. Investment in private equity funds may be less transparent than an investment in publicly-traded securities and investors in such funds are afforded less regulatory protections than investors in publicly-traded securities. Private equity funds' investments may be priced in the absence of a readily available market or significant other information and may be priced based on determinations of fair value, which may prove to be inaccurate.

Operating results for the companies, ventures and business in which a private equity fund may invest in a specified period may be difficult to predict and such investments may involve a high degree of risk that could result in substantial losses for the fund and its investors. There is no guarantee that the any investment a private equity fund makes will be successful or will produce positive investment returns.

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