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THE ALTERNATIVE
INVESTMENTS PLATFORM

Evergreen Private Market Funds

A Performance Analysis

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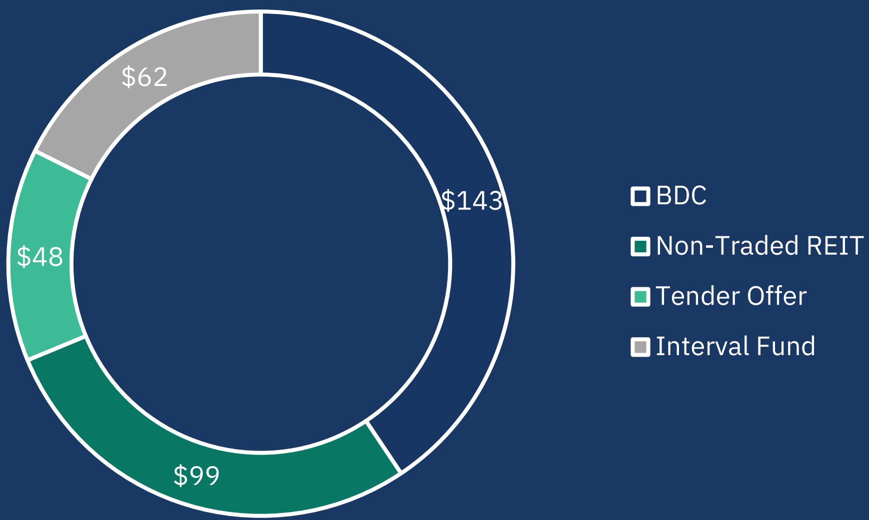
Evergreen Funds for Private Markets

With the rise in demand from individual investors for alternative investments, private markets specifically, financial advisors and other allocators of private wealth are increasingly being called upon for their advice in this area.

This involves identifying and accessing skillful managers – an especially important task given the wide dispersion of returns by managers within private markets – and providing advice on the suitability of different fund structures, including evergreen private market funds, into which significant private wealth capital has flowed over the last several years.

According to data from Preqin, evergreen private market funds accounted for at least $350 Billion USD of net asset value (globally) as of the end of 2023 with the number of individual products in market nearly doubling in the last 5 years to 520.

Evergreen Funds Net Asset Value by Fund Structure ($USD Billions)[1]



However, amongst some industry participants there is a view that the evergreen fund structure is the “poor relation” of the traditional closed-end fund through which the vast majority of private market investments have historically been made. This paper provides some perspective on this topic with a particular focus on the way in which returns are calculated and the impact on compounding wealth over the long-term.

1 Preqin as at December 2023

Evergreen Funds vs. Closed-end Funds – An Overview

The advent of semi-liquid, open-ended evergreen investment funds has marked a significant evolution in private markets. Unlike traditional closed-end funds, evergreen funds generally do not have a fixed term and continue in perpetuity, hence their 'evergreen' label. The benefits of evergreen funds can typically be summarized as follows:

1. Investing into an existing diversified portfolio of investments
2. Investor capital is typically fully deployed on day one of the investment, meaning that returns start compounding immediately, enabling the investor to better manage and control their target investment allocation
3. The sale proceeds from a profitable investment are re-cycled back into new investments, thus keeping capital fully invested and continuously compounding
4. A growing portfolio of companies can bring material diversification benefits as it allows the investor to take advantage of many different vintages
5. Certain liquidity rights are available that enable the investor to redeem their investment on a periodic basis, typically quarterly, subject to various conditions
6. Low investment minimum thresholds e.g., C$25,000 or C$50,000

Closed-end funds, often referred to as drawdown funds, have historically been more accessible to institutional investors with larger pools of capital, a tolerance for illiquidity, and the resources to oversee the complex administration of traditional private market portfolios.

Closed-end funds typically have an investment period of 4-6 years and a term or fund life of 10-12 years. A fund's investment period is the amount of time that the manager must find suitable investments for the portfolio, which are then funded by investor capital calls. The fund term is the timeframe by which the manager must fully realize the portfolio and pay all proceeds back to the investors.

Investors in closed-end funds are subject to re-investment risk as the sale proceeds from a profitable investment are distributed back to the investor in cash, who must then find a new home for that money.

An investor might consider an investment in a closed-end fund for several reasons. In any given year, there are certainly many more closed-end funds actively fundraising than there are evergreen funds, giving the investor a greater level of choice. This would allow them, for example, to target managers that might have expertise in a particular geography, or skill in the management of a focused strategy such as private equity buyout targeting middle-market companies. Such choices might appeal to a sophisticated investor seeking to construct a more tailored and focused investment strategy.

Investment Returns – Evergreen vs. Closed-End Fund

Given the different structure of evergreen and closed-end funds, there are important differences in how investment performance is calculated and reported. The most appropriate performance measure for an evergreen fund is *time-weighted rate of return (TWR),* and for a closed-end fund is *internal rate of return (IRR).*

- The TWR is a measure of the compound rate of growth in a portfolio. This measure eliminates the distorting effects on growth rates created by inflows and outflows of money
- The IRR is based upon the cash flows (contributions and distributions) and the valuation of the remaining interest in the fund. The Net IRR is the return earned by the investor after management fees and carried interest

To compare performance of evergreen funds with closed-end funds, we have prepared analysis, in collaboration with our external investment consultant, to assess and evaluate 'apples to apples' performance comparisons between evergreen funds and closed-end funds.

Scenario 1

Consider an investment in an evergreen fund that earns a 10% net annualized return over a 10-year hold period. After 10 years, a $1 million investment would grow to $2.59 million, a multiple-of-invested capital (MOIC) of 2.59.

Now, let's consider the return that same investor, choosing instead to invest in a closed-end fund, would need to earn to match the evergreen fund investment after 10 years. Here, it is assumed that the investor's capital is drawn equally over a 5-year investment period and invested mid-year in each of those five years. Once investments are called, they are compounded for 5.5 years before being distributed. Any uncalled or distributed capital in the closed-end fund earns a cash return of 2.69%.

Based upon these assumptions, the closed-end fund would need to generate a Net IRR of 16.4%.

If, on the other hand, the investor's capital was drawn more slowly in the early years at 15%/15%/20%/25%/25% over the 5-year investment period, with all other assumptions remaining the same, the closed-end fund would need to generate a slightly higher Net IRR of 16.5%.

Exhibit 1

Evergreen Fund - Scenario 1 - 10% Net Annualized Return			
	Breakeven IRR	Capital Call Pace over 5 years	MOIC
Closed-End Fund	16.4%	20%/20%/20%/20%/20%	2.59
Closed-End Fund	16.5%	15%/15%/20%/25%/25%	2.59

Source. Obsiido Alternative Investments Inc. This analysis had been prepared for illustrative purposes only.

Scenario 2

Consider an investment in an evergreen fund that earns a 12% net annualized return over a 10-year hold period. After 10 years, a $1 million investment would grow to $3.11 million, a multiple-of-invested capital (MOIC) of 3.11.

For the closed-end fund investment, depending upon the pace at which capital was drawn during the investment period and the timing of distributions – using the same assumptions as modelled in Scenario 1 - the investor would need to earn a Net IRR of over 20%.

Exhibit 2

Evergreen Fund - Scenario 2 - 12% Net Return			
	Breakeven IRR	Capital Call Pace over 5 years	MOIC
Closed-End Fund	20.4%	20%/20%/20%/20%/20%	3.11
Closed-End Fund	20.5%	15%/15%/20%/25%/25%	3.11

Source. Obsiido Alternative Investments Inc. This analysis had been prepared for illustrative purposes only.

To put all this in context, over the last 15 years, Private Equity has generated a Net IRR of 14.3% [1] . It should be noted that during that 15-year period, there were five vintage years (2008, 2011, 2012, 2020 and 2021) that fell below that average of 14.3%. The vintage year is defined as the year in which the fund's first investment was made. This is why investing in multiple closed-end fund vintages is recommended to manage vintage year risk.

Note. If in these two Scenarios, the uncalled or distributed capital in the closed-end fund earned an equity return instead of a cash return, the Breakeven IRR required to match the evergreen fund investment would be lower.

It would, however, add uncertainty into the process, as in a sharply declining equity market, the uncalled capital would have declined in value requiring the shortfall to be funded from other sources.

1 Preqin. As of March 2024. Past performance is not indicative of future returns. Horizon IRR is a capital-weighted pooled calculation based on cash flows (contributions, distributions, and remaining values) from all private equity funds populated in the Preqin database. Pooled IRRs consider the timing of each cash flow and the size of each fund. Returns are net of fees, expenses, and carried interest of each prospective investor.

Conclusion

A well-designed, open-ended evergreen fund from an experienced and capable manager is a viable alternative to a traditional closed-end fund investment. Evergreen funds provide considerable flexibility for investors seeking to invest in the private markets. One of the biggest benefits is the effectiveness with which wealth compounds over time given that capital is immediately deployed into a well-diversified portfolio. When capital is invested from day one, it begins compounding and generating returns faster.

For some investors, however, blending evergreen and closed-end funds may produce a more optimal solution. An investor may wish to consider investing in evergreen funds as a “core” part of their private markets’ allocation allowing for a baseline level of deployment and diversification. This could be complemented by a “satellite” allocation to drawdown funds to further diversify the portfolio by manager, strategy or geography.

DISCLAIMERS

All investing, including the alternative asset classes discussed in this publication, involves risk. The risk and return profile for each asset class can vary. Investors should consult their investment advisor, tax, legal, accounting, or other advisors about such information before making any investment decisions.

Past performance does not guarantee future results; no representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided. The value of an investment will fluctuate over time, and an investor may gain or lose money, or the entire investment.

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About Obsiido Alternative Investments Inc. ("Obsiido")
Obsiido is a technology enabled investment management firm that specializes in researching, structuring, and enabling investments in core alternative investment opportunities within private markets and hedge funds. Obsiido is registered as an investment fund manager in Ontario and as a portfolio manager and exempt market dealer in Ontario, British Columbia and Alberta.

Obsiido is a wholly-owned subsidiary of Obsiido Capital Management Ltd.
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