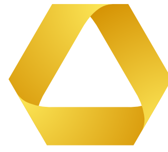

COMMERZBANK

Product Group

Financial Instruments with an Investment Focus on Private Equity

In this information sheet, Commerzbank provides information on the underlying characteristics as well as the opportunities and risks of the financial instruments with investment focus on private equity product group.

General characteristics and investment opportunities
Private equity investments refer to equity investments in companies that are not listed on the securities markets ("target companies"). Investors are usually institutional investors; retail/private investors usually do not have direct access, but invest e.g. via investment funds or shares of respective investment companies. The corporate assets held by private equity companies are typically unlisted which restricts the ability to quickly disposed of the assets. Only occasionally are investments also made in listed securities of target companies. Private equity investors aim to raise the value of their investment in the target company and often realise this through a resale. Buyers can be other private equity companies or corporations. The target company may also go public via an IPO. Private equity transactions regularly involve a large percentage of debt financing aimed at raising the return potential of the equity capital invested. Investors in private equity products could benefit from value appreciation after taking into account costs at the various levels (product, target company or investment). Furthermore, private equity investments may pay regular distributions and dividends, which may vary in amount or be cancelled.

Typical product characteristics
Private equity companies invest in different types of target companies. Firstly, private equity companies invest in already established, mature companies, and secondly, they invest in venture capital companies. Private equity companies that invest in venture companies, invest in companies that are at a very early development stage. Private equity investors often need a lot of time and patience, as they try to influence the operating business of the target companies, etc. Both the entry into and an exit from a target company may take place over a longer period of time. This is why investors in such products need to have a very long investment horizon.

Since individual investments in a target company can often only be realised together with other private equity investors (co-investment), a minority shareholding can lead to disadvantages, for example, in the event of a later sale.

Particularly in the case of private equity funds, it happens that these are often not or not fully invested at the time of launch and that no or no sufficient companies can be acquired on the market to meet the projected investment criteria. This may reduce the return prospects accordingly and lead to less risk diversification (diversification of the invested capital). In the event of negative business performance of one or more target companies, a complete write-off of the respective equity stake in the target company may occur. Private equity funds can also be designed as so-called funds of funds, i.e. the capital management company itself does not invest the investors' money directly in respective target companies, but only allocates its funds to private equity target funds, which are ultimately responsible for the selection of the target companies. Typically, funds of funds invest in several target funds in order to achieve a sufficiently broad risk diversification.
In private equity funds, the payment of the investment amount is often made in stages over a longer period of time at the request of the private equity target funds (so-called capital calls), requiring the investor to keep the necessary funds available for this purpose over a longer period of time.

The redemption price of these products is based on the held assets, whereby the continuous valuation of the unlisted target companies is key in determining the intrinsic value. This value is determined and published regularly by the company based on valuation reports.

A special form are private equity investment companies whose shares are often listed on securities exchanges. The share price

is determined by supply and demand from market participants. Regularly, the shares trade below their intrinsic value, and only very rarely at premiums to the intrinsic value. Private equity companies often specialise in certain sectors and may concentrate their investments in a single or small number of target companies.

Material risks of the product group
By investing in these products, investors benefit from return opportunities, but are also exposed to additional material risks. These include the following:

Risk of loss: Private equity investments are tied to individual companies and as such are typically exposed to a higher specific risk of capital losses. Because of the indirect participation, investors are exposed to the risk that decision-making about a target company is transparent only to a limited extent and cannot be influenced. Private equity funds invest in companies with special characteristics, which means that forecasting the future performance of private equity investments is subject to even greater uncertainty than is the case with many other types of investment. It is impossible to predict with any certainty to what extent investors will receive redemption payments from the sale of target company equity stakes. Specifically, in the event of adverse economic or financial market conditions, it may be difficult or even impossible for the private equity fund to dispose of its target company investments within the targeted time frame. In addition to company-specific factors, political and general economic trends - the economic risk - as well as sector-specific economic trends - known as sector risk - are also key drivers of equity prices. Factors that are beyond the scope of rational analysis are also relevant in the pricing process. In this context, the psychology of market participants plays a significant role.

Issuer risk - Also referred to as default risk - when the issuer fails to meet its obligations or can only meet them in part, for example because of insolvency or following a credit restructuring. Investors are exposed to the possibility of a total loss of the capital invested. Sustainability-related decisions relating to the environment, social aspects and corporate governance also impact on the credit quality of the issuer.

Liquidity risk - Investors or an equity fund may not be able to sell certain equities or equities held in the fund at all or may only be able to sell them at a possibly much lower price. Furthermore, investors are exposed to a de-listing risk if specific equities are delisted from the securities exchange.

Foreign currency risk - The fund, the shares and the target company may be denominated in either euro or a foreign currency. If denominated in a foreign currency, investors are exposed to adverse changes in the exchange rate of the foreign currency.

Leverage risk - The acquisition of target companies usually involves loan financing to increase the return on investment. This leverage may result in additional risks, such as the need to sell an investment to repay a loan at an inopportune time. Furthermore, investors may be exposed to an interest rate risk for borrowed funds and any bonds held by the target companies.

Special characteristics of investment funds
Holders of investment fund units are subject to special risks, for example that unit redemption may be temporarily suspended due to insufficient fund liquidity, for example in the event that many investors wish to redeem their units at the same time, or that a fund may be liquidated in an orderly manner.

When funds experience liquidity shortages, fund management companies have certain options to address them. They may, for example, introduce redemption notice periods. This means investors would have to notify the fund company of their intention to redeem their fund units some time in advance.

The fund company may also impose redemption restrictions. For example, fund companies may choose not to meet redemption requests for a certain period of time, or only partially, if the number of redemption requests exceeds a certain threshold.

Furthermore, a fund company may allocate transaction costs arising from unit redemptions or unit issues based on the cost originators. These transaction costs may be included in the calculation of the net asset value of a fund, up to a predefined rate.

These options are intended to prevent fund companies from having to completely suspend unit redemptions, which would be even more detrimental to investors.

Further information and costs
For further details on these aspects and the product, please refer to the relevant sales prospectus and any basic or product information sheet. In principle, inflation trends impact your investment performance. A resulting loss of purchasing power affects both the income generated and your capital invested. When acquiring, holding and eventually selling securities and derivatives, costs will impact returns. For further details, please refer to the respective cost information before entering into a securities transaction.

For further details on the characteristics and risks of the products, please refer to the brochure “Basic Information on Securities and Other Investments”.