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What's in Your Evergreen Private Equity Strategy?

2

Key Takeaways

4

Single-Manager
vs. Multi-Manager:
Conceptually

6

Single-Manager
vs. Multi-Manager:
Considerations

9

The Bottom Line

What's in Your Evergreen Private Equity Strategy?

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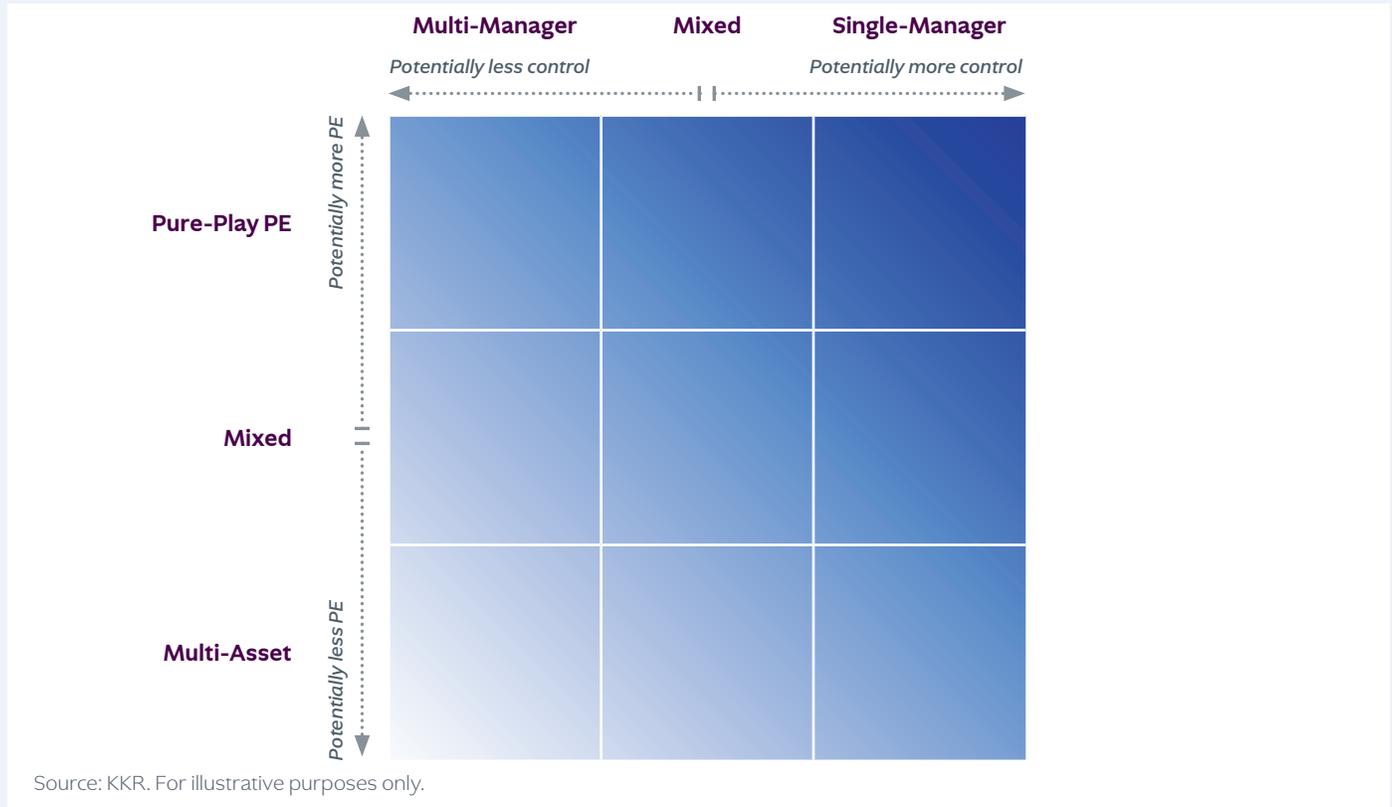
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KEY TAKEAWAYS

- As the number of evergreen private equity vehicles has increased over the last few years, so have the number of approaches to the asset class.
- Some evergreen private equity vehicles offer pure-play private equity exposure, while others are better described as multi-strategy private equity or multi-asset class given their exposures to secondaries or other asset classes across private markets, respectively.
- Some evergreen vehicles are focused around a single manager, meaning that they rely on their own deal flow and back their own track records. Others are described as multi-manager vehicles which, to varying degrees, tend to rely on the deal flow and track records of other managers. Even some single-manager strategies have exposure to other managers via secondaries positions, placing them in a mixed category rather than single-manager, pure-play private equity.
- For true single-manager strategies, depth and breadth of deal flow is required to execute and diversify. These strategies may benefit from priority access to deal flow, meaning that they invest alongside a manager's institutional strategies into the same deals at the same time.
- Not all strategies are created equal, whether pure-play vs multi-asset, or single-manager vs multi-manager. Knowing the details of a strategy's underlying investments, as well as how they are sourced and managed, can help investors choose a strategy that fits their goals and objectives.
- Ultimately, evergreen vehicles that are run by a single manager and that invest in pure-play private equity will have the most control over the underlying assets. This, in turn, gives them more control over investment outcomes and arguably provides the most effective way for investors to experience the potential benefits of private equity (Exhibit 1).

EXHIBIT 1:
Evergreen Vehicles Vary in Exposure to PE and Control Over Underlying Assets

Types of Evergreen Vehicles, Exposure to PE and Control Over Underlying Assets



Given the dispersion of returns in private equity between the best and worst performing managers, manager selection is critical. Top-performing managers have historically [earned 14% higher returns*](#) than bottom-quartile performers. However, evergreen strategies present additional layers of diligence and decision-making to work through before investing. With the advent of different types of evergreen private equity strategies in recent years, investors face the added complexity of understanding precisely what they are investing in, including the investment sourcing and portfolio construction approach an evergreen vehicle employs.

Those interested in evergreen structures may want to consider two more important questions about the underlying investments as they do their diligence.

Question 1: How much actual private equity is in the vehicle? Some evergreen vehicles contain only private equity investments, plus a relatively small set of liquid assets to manage liquidity. Some claim to provide pure private equity exposure but adopt what we believe is an overly broad definition of the asset class. Others are better described as multi-asset strategies that invest across private markets.

Question 2: How are the underlying investments in the vehicle sourced, managed, and valued, and who ultimately controls their outcomes? This is where it becomes critical to understand the differences between single-manager and multi-manager strategies.

* Source: eVestment Alliance database for 15-year period through December 31, 2023. US Equities include large and small cap indexes; Preqin online database, performance as of December 2023 (includes vintages for the 16 years to 2021), top quartile, median, and bottom quartile boundary net IRRs. Performance for later vintage funds not available because the funds have not had adequate time to deploy capital, operate assets, and exit. Preqin's database is continually updated and subject to change.

Single-Manager vs. Multi-Manager: Conceptually

Single-manager strategies invest directly in deals sourced and managed by one private equity manager (Exhibit 2). However, those deals may span multiple types of strategies (buyouts, growth, middle-market, and regional, for example).

EXHIBIT 2: A Model Single-Manager Strategy Structure

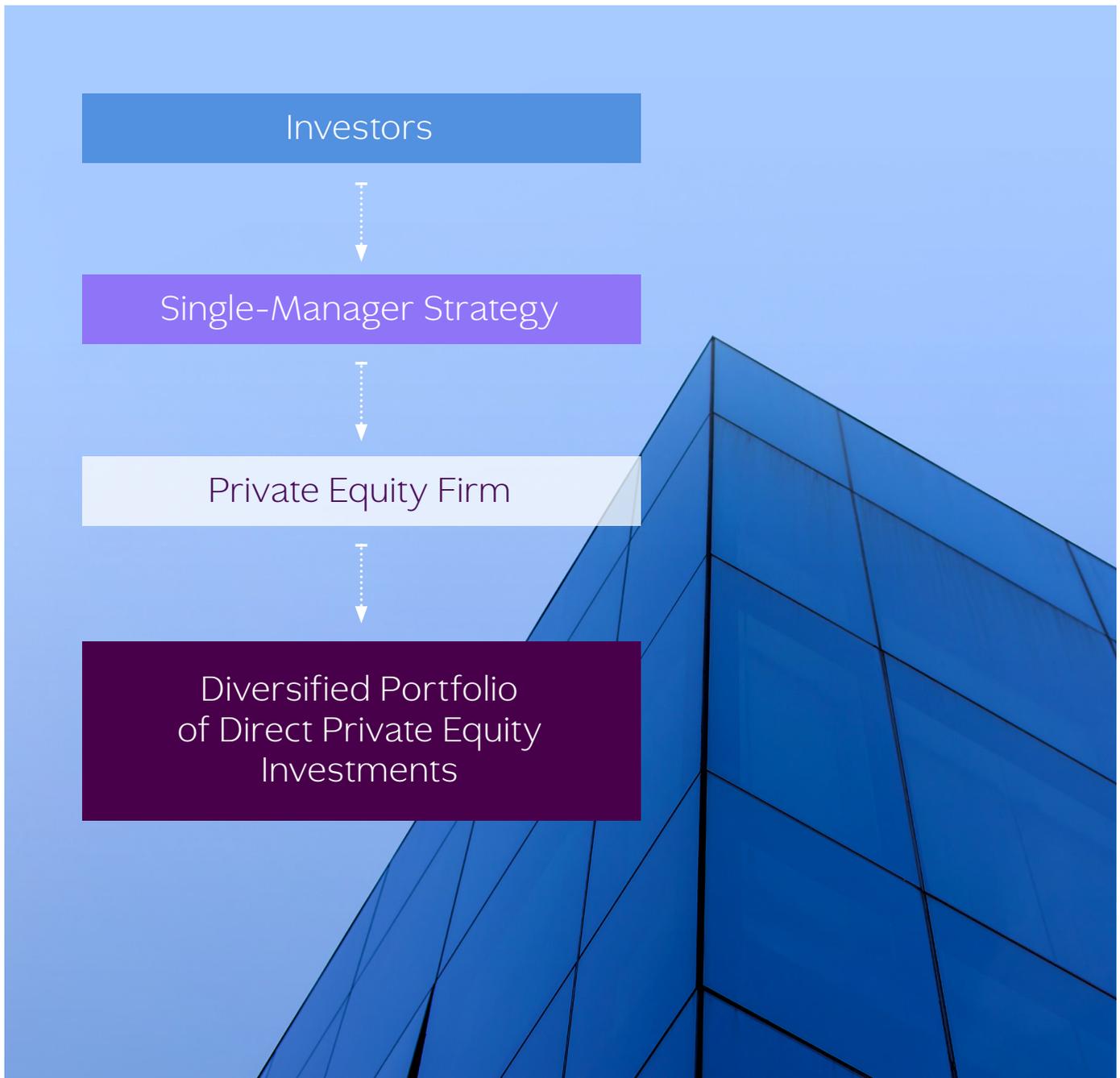
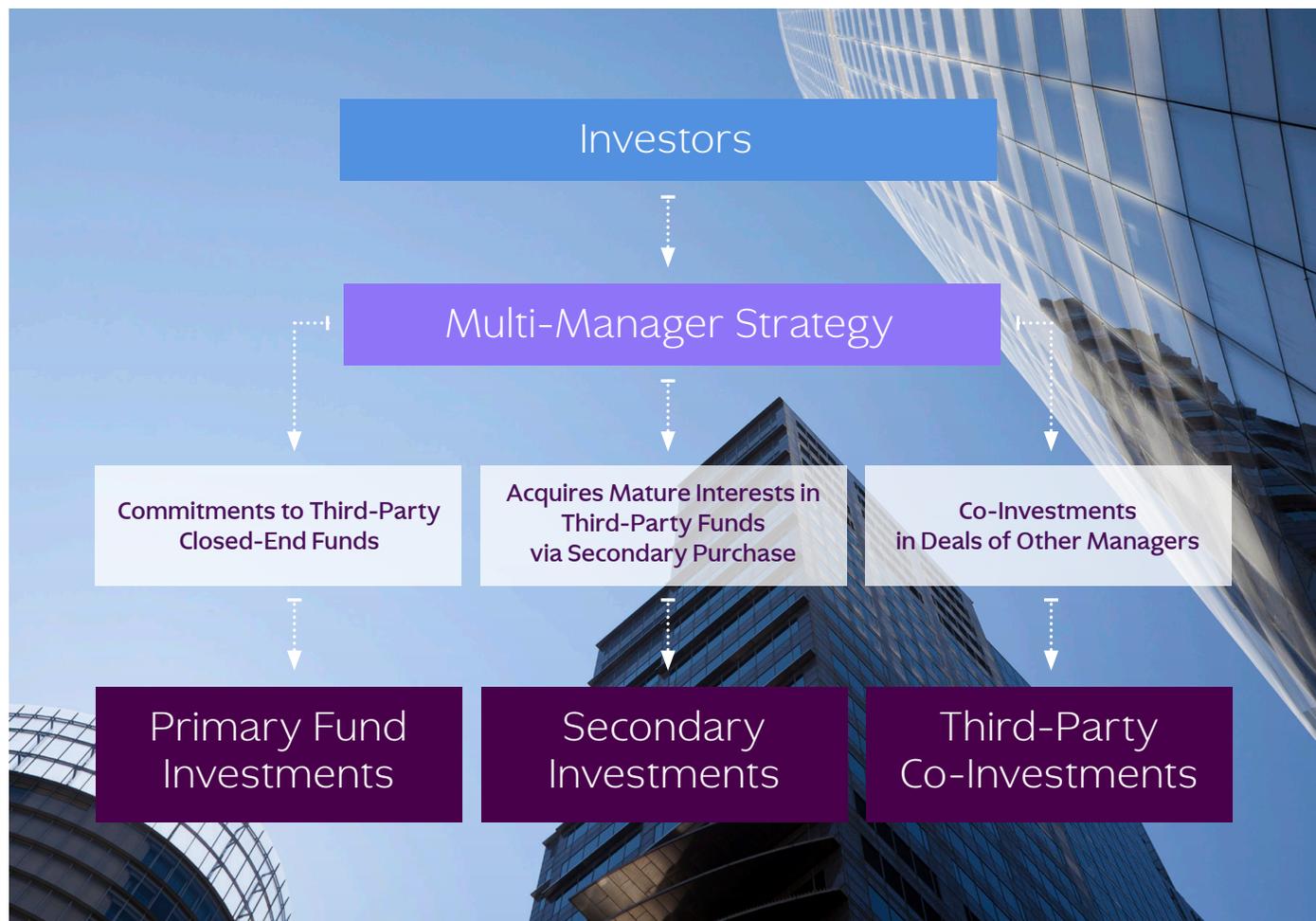


EXHIBIT 3: A Model Multi-Manager Structure



Multi-manager strategies source private equity investments from multiple managers, generally through a combination of commitments to third-party closed-end funds, secondary fund investments, and co-investments. The manager of the strategy oversees the portfolio allocations but does not directly source or control all the underlying investments (Exhibit 3).

A Glossary of Private Equity Investments

- **Primary Fund Investments:** Investors commit a certain amount of money to a private equity fund. The manager funds new investments over a period of several years by calling on investors periodically to deliver a portion of their committed capital. The proceeds from sales of portfolio companies are allocated to investors in proportion to their investment.
- **Secondary Investments:** Buying an investor's interest in a mature closed-end private equity fund, typically at a discount to net asset value (NAV).
- **Third-Party Co-Investments:** Direct investment in a private equity deal alongside a third-party private equity manager that requires additional capital to complete the transaction. Private equity managers typically provide co-investment opportunities to their clients before making them available to outside investors.

Single-Manager vs. Multi-Manager: Considerations

Single-manager structures and multi-manager structures may both have benefits for investors, but the details matter. Here are some considerations for investors as they examine different evergreen strategies (Exhibit 4).

EXHIBIT 4: How Do Single-Manager and Multi-Manager Strategies Compare?

Category	Single-Manager Strategies	Multi-Manager Strategies
Access to deal flow 	<p>Typically receive priority access to deal flow and can often choose the size of investments in individual deals. It is important to understand whether the fund manager is sourcing and investing alongside its other pools of capital, or if it is also investing in separate deals.</p>	<ul style="list-style-type: none"> – Co-investment: An evergreen manager only has access to another private equity manager’s deals when they offer co-invest, which not all deals do. – Secondaries: An evergreen vehicle gains exposure to all underlying portfolio companies in the fund that it acquires an interest in, with no ability to pick and choose deals.
Value creation 	<p>Investment teams at the firm are responsible for investing in good companies and trying to make them great.</p>	<p>The evergreen manager controls the allocation of capital to third-party managers but cannot implement value creation strategies at the portfolio company level.</p>
Portfolio construction 	<p>Receive best possible information about timing of investments, exits, and distributions, which can help manage capital more efficiently.</p>	<p>Often receive information about investments, exits, and distributions on a lag, which can make it difficult to deploy immediately when new subscriptions come in, portfolio company realizations are received, or both.</p>
Valuations 	<p>Follow a single methodology for regularly valuing companies, which often involves third-party validation.</p>	<p>May have to reconcile competing valuation methodologies among individual managers, which may in turn affect both portfolio management and calculating NAV.</p>
Fees 	<p>Single layer of fees (typically performance and management fees).</p>	<p>May pay fees to both the evergreen manager and managers of the underlying strategies.</p>
Diversification 	<p>Can be either concentrated or diversified across investment styles (buyout, middle-market, growth, etc.), regions, and sectors.</p>	<p>Often diversified across hundreds of managers and potentially thousands of underlying portfolio companies.</p>



Access to Deal Flow

A private equity vehicle is only as strong as its underlying investments. Evergreen private equity investors may want to consider how readily managers can access high-quality deals. Inconsistent access to deal flow can make it difficult to deploy the new capital that continuously comes into an evergreen fund. It can also make it more difficult to plan and manage portfolio allocations. Investors should also consider whether the evergreen manager participates exclusively in deals alongside its institutional pools of capital, or whether they also source and invest in separate “white space” deals, which are likely to be minority stakes in another private equity manager’s portfolio company.

Single-manager strategies are typically among the first in line to invest directly in transactions at their own firms, in some cases with a contractual right component, although this may vary by strategy and manager. Proximity to the investment teams may give portfolio managers more time to evaluate each deal and a greater understanding of companies under consideration, while insight into deal pipelines helps in planning the construction of the portfolio.

Because they invest across so many managers, multi-manager strategies have access to a wide swath of underlying investments. However, those that rely on co-investment opportunities may only get access to deals after the sourcing manager’s own vehicles and clients have had a chance to invest, and they may not be able to dictate the size of their investments. Not every deal even offers co-investment, so multi-manager strategies may not get the opportunity to participate in every transaction a particular firm originates.

Secondaries pose similar challenges. It is simply not always possible to make secondary investments in a particular fund, while others are only available at high prices. Multi-manager vehicles generally must accept whatever assets are in the funds, providing less flexibility in managing the portfolio at the individual asset level.



Value Creation

As we mentioned earlier, there is a large dispersion of returns among private equity managers. Investing in a single-manager strategy amounts to a strong vote of confidence that the private equity investment teams at a firm can select good companies and make them better.

A multi-manager strategy outsources some investment control to third parties. Co-investments take minority, non-controlling interests in individual investments and have comparatively little say over value creation strategies or the timing of investments and sales. Secondary investments depend on the ability of many different managers to create value.

As it relates to secondaries exposure, investors should be mindful that a meaningful driver of performance stems from the up-front discount that is negotiated with the seller. Cyclical factors outside the control of secondaries investors, such as general liquidity conditions, can influence the size of the discount. As evergreen funds scale to a larger size, secondaries discounts become less impactful to return attribution over time, with the existing portfolio base driving the bulk of returns.



Portfolio Construction

One of the chief advantages of evergreen strategies is the potential for smooth, fully invested exposure to private equity. End investors are not typically subject to capital calls, and distributions tend to be reinvested into the vehicle. However, the managers who build evergreen strategies do have to perpetually deploy into new deals and re-invest monetization and distribution proceeds. That creates a portfolio management challenge.

Because they are investing in transactions at their own firm, single-manager strategies have the best possible information about which companies their investment teams are considering, when deals might get signed and close, when exits are on the horizon, and when distributions might occur. Knowing that a deal may be closing soon or that an exit is being negotiated allows portfolio managers to have money ready to invest or plan for the distribution, respectively.

Multi-manager strategies rely on third parties for information and tend to find out about new deals, exits, and distributions with a lag. In our view, this makes it more difficult to manage a portfolio efficiently.



Valuations

Evergreen strategies offer periodic liquidity, as opposed to the long lock-up periods of traditional drawdown funds. The amount of liquidity offered to investors typically is based on the fund's NAV, which in turn makes it important for investors to understand what their investments are worth at any given time.

Since portfolio companies do not trade on public exchanges, private equity firms typically calculate valuations every quarter or every month. At KKR, we have used a consistent methodology for valuing private equity investments for more than 20 years and rely on third-party valuation experts to review our conclusions.

Single-manager strategies tend to use consistent valuation methods, but different managers may use different methods in multi-manager strategies. A few questions investors may want to consider asking multi-manager strategies are:

- Does the manager accept the valuations individual managers provide or vet them independently?
- How does the manager reconcile different valuation methods among private equity firms?
- Are there lags in the reporting process? If so, how does that affect both portfolio management and the process of offering investors liquidity based on NAV?



Fees

Fees are an important consideration in any investment. Private equity fees typically come in two categories:

- Management fees are often fixed and based on the amount of capital in the fund. These fees are generally used to cover the operational overhead necessary to source deals, operate the fund, and retain staff.
- Incentive or performance fees are a percentage of excess returns paid to the manager only if they deliver performance above a set hurdle or benchmark. The purpose of these fees is to align the incentives of managers and their investors.

Single-manager strategies have one layer of fees, and a manager's incentives are generally easy to understand.

In multi-manager vehicles, investors may indirectly pay management and performance fees to third-party firms managing the underlying positions, whether fund interests or deals, in addition to any fees charged by the manager of the evergreen strategy. This double layer of fees may mean that each private equity investment in the strategy must perform better for clients to receive the same net performance.



Diversification

Proponents of multi-manager strategies often tout the diversification benefits of investing in a variety of different managers across geographies and industries. With exposure to hundreds or thousands of underlying portfolio companies, we view this exposure as akin to a private equity index. The potential downside to “buying the market,” or achieving the median within the significant dispersion between top-quartile and bottom-quartile private equity managers, is that an investor may sacrifice the excess returns they might have achieved through more concentrated exposure to a single manager.

Meanwhile, single-manager strategies can diversify by investing globally, across multiple types of private equity deals, and across sectors. From a deal count perspective, in comparison to multi-manager strategies, single-manager, pure-play private equity strategies may have exposure to more than 100 underlying companies at any given point in time. By taking single-manager risk, it's important to conduct proper and thorough diligence as choosing the right manager is critical.

The Bottom Line

- As the number of evergreen strategies available has mushroomed over the last few years, so have the number of approaches to the asset class.
- Evergreen private equity strategies are not all created equal, and the details of the underlying investments can have important implications for a portfolio's performance.
- Across the spectrum of evergreen private equity strategies, from single-manager pure-play private equity at one end of the spectrum to multi-manager multi-asset strategies on the other, investors should be mindful of the key considerations discussed above such as access to deal flow, influence over value creation, portfolio construction, valuations, fees, and diversification.
- It's important to understand and weigh the pros and cons of each approach given a particular client's goals and objectives. Manager selection has always been a key consideration in private equity (the 'who'), but with such a wide variety of evergreen vehicles launching, understanding the structure (the 'what') is of equal importance.
- At the end of the day, being able to deliver performance over medium and longer term horizons is key. We believe control is a big piece of driving outcomes in private markets and that the single-manager, pure-play strategy is the most effective approach for investors seeking to experience the full potential benefits of long-term capital appreciation in private equity.

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