Private Equity Fund Financial Statements: How to Break All the Rules

The Upside-Down World of 3-Statement Models for PE Funds

PE Fund Financial Statements

It's easy to find examples of **3-statement models** for normal companies – our tutorial on it is one of the most popular in this channel!

But it's much harder to find *specialized* models for something like a PE fund.

PE Fund Financial Statements

This topic is **not likely** in case studies, but you could still get **interview questions** about the financial statement differences.

(This is more probable if you interview for “funds of funds” roles rather than secondaries.)

PE Fund Financial Statements

For the files and resources, go to:

https://breakingintowallstreet.com/kb/financial-sponsors/private-equity-fund-financial-statements/

(This is a **summary** from our full PE Funds of Funds and Secondaries course.)

PE Fund Financial Statements 101

- **DIFFERENCE #1:** Standard items (COGS, OpEx) do not appear on the IS; it's structured more like a bank, with Gains/Losses, Investment Income, etc.

- **DIFFERENCE #2:** Most funds are **pass-through entities**, so there are no corporate-level taxes or related lines

- **DIFFERENCE #3:** The CFS is organized differently, with many "Investing" lines in Cash Flow from Operations instead

- **DIFFERENCE #4:** "Equity" is "Partners' Capital" and is split between the LPs and the GP; each one changes differently

Plan for This Tutorial

- **Part 1:** Gains, Losses, and Carried Interest **3:44**
- **Part 2:** PE Fund Income Statement **8:41**
- **Part 3:** PE Fund Balance Sheet and Cash Flow Statement **9:46**
- **Part 4:** Added Complexities in Real Life **15:01**

Part 1: Gains, Losses, and Carried Interest

- **IDEAL:** Information on each portfolio company's cost basis, fair market value, and realizations… but may not happen

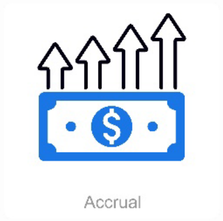
- **Unrealized Gains/Losses:** If there are unsold portfolio companies, this equals the FMV minus cumulative investments

- **Realized Gains/Losses:** Cumulative Realizations minus *either* the Unrealized Values in the previous period *or* Total Investments So Far minus previous Realized Gains/Losses

- **WARNING:** Not a fully robust setup! Only works for certain, simplified scenarios, just to teach the concepts

Part 1: Gains, Losses, and Carried Interest

- **Accrued Carry:** ~20% of the Unrealized Gains

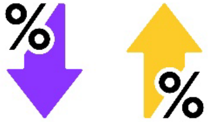


- **Realized/Distributed Carry:** ~20% of the Realized Gains

- **Reality:** Would have to set up a waterfall, include Allocated Management Fees + Invested Capital, check the Hurdle Rate, set up the Preferred Return, Catch-Up, etc.

Part 2: PE Fund Income Statement

- **Hard Part:** The Gains and Losses, which we already have



- **Investment Income and Interest Expense:** Could come up if the PE fund has other investments and/or uses a *fund-level* borrowing facility to fund investments, pay for expenses, etc.

- **Management Fees and Fund Expenses:** Typically, a simple % of the Committed Capital (~2%) or a % of NAV or the Remaining Cost Basis of portfolio companies

- **Bottom Line:** Still ends with Net Income, but this is a *pre-tax version* since most PE funds are pass-through entities

Part 3: PE Fund BS and CFS

- **CFS:** Starts with Net Income and then reflects Investment Funding, Proceeds from Portfolio Company Sales, and reverses all the Gains and Losses from the Income Statement

- **Cash Flow from Financing:** Distributions, Contributions, Realized/Distributed Carry, and Changes in Debt

- **Balance Sheet Links:** FMV of Investments equals the old number *minus* all the relevant CFS lines

- **GP/LP Capital:** Similar to Equity, but the *Change in Accrued Carry* affects both lines; Distributed Carry affects GPs' Capital

Part 4: Added Complexities in Real Life

- **COMPLEXITY #1:** Modeling individual portfolio companies requires separate schedules, formulas, etc.

- **COMPLEXITY #2:** There's typically a ~2% GP Commitment, so Net Income, Distributions, Contributions, etc., may be split

- **COMPLEXITY #3:** There are usually **payment deferrals** and **deferred distributions**, which complicates Working Capital

- **COMPLEXITY #4:** Specific portfolio company exits make Carry trickier (need to "allocate" Management Fees to companies)

Recap and Summary

- **Part 1:** Gains, Losses, and Carried Interest


- **Part 2:** PE Fund Income Statement

- **Part 3:** PE Fund Balance Sheet and Cash Flow Statement

- **Part 4:** Added Complexities in Real Life