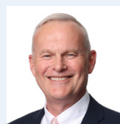
OMNIGENCE ASSET MANAGEMENT

Beyond the J-Curve: Accelerating Liquidity in Private Equity Through Income-Generating Strategies

JULY 2025



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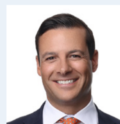

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ABSTRACT:
Private equity (PE) has long promised superior returns in exchange for patience. Yet the traditional J-curve — where initial years show negative returns before recovery and outperformance — remains a psychological and liquidity hurdle for many investors. This paper explores how income-generating assets, such as those found in lower mid-market serial consolidation strategies or real asset platforms, can provide positive cash flow early in the fund lifecycle. We propose that these models not only flatten the J-curve but also increase DPI (Distributions to Paid-In Capital), lower drawdown risk, and improve reinvestment dynamics.

INTRODUCTION:
Investors entering a conventional 10-year PE fund often endure 4–6 years of negative or flat net returns before exit-driven gains arrive. This J-curve effect creates challenges in portfolio planning, IRR modeling, and client communication. According to Cambridge Associates, fewer than 20% of global buyout funds reach DPI breakeven within the first four years. In practice, investors' capital may be tied up in negative or unrealized returns during years 1–5, complicating reallocation decisions and distorting performance metrics. In contrast, asset classes like public REITs, infrastructure debt, lower mid-market buyout often begin generating distributions in the first 1–2 quarters, offering better cash flow alignment with investor needs.

THE ALTERNATIVES: MODERN FUND STRUCTURES OFFERING NEAR-TERM DISTRIBUTIONS

- Income-Sweep Vehicles – Funds that distribute operating income prior to exit. These models are increasingly prevalent in infrastructure, real asset, and lower mid-market rollup strategies, where businesses generate distributable cash flow from day one.

- Evergreen Holdcos – NAV-based open-ended structures that allow periodic redemptions funded by incoming subscriptions, free cash flow, refinancing, and asset rotation. This structure facilitates smoother capital pacing and simplifies reporting for family offices and smaller institutions.

- Yield + Equity Strategies – These models acquire at low EBITDA multiples (often 4–6x), generating immediate yield. For example, an illustrative $3M acquisition at a 5x EBITDA multiple generating $600K in free cash flow can support a 10%+ net annual distribution yield with minimal operational disruption. Strong operating cash flow supports early distributions, while equity upside is preserved through operational improvement and multiple expansion upon exit. This approach creates a blended return profile with near-term liquidity and long-term value realization, helping investors escape the steepest portion of the J-curve.

- Emerging Managers –Notably, many of these income-focused and evergreen structures are being pioneered outside of legacy platforms. Newer entrants are often more nimble in fund design, unburdened by legacy GP-LP alignment models, and better attuned to the liquidity and transparency demands of today's allocators. The adoption of features like monthly redemptions and monthly cash yield targets is increasingly seen as a competitive signal—especially among LPs seeking differentiated alpha and more tactical portfolio liquidity. For allocators open to backing specialist managers outside of the traditional megafund universe, these structures offer conspicuous benefits.

BEYOND STRUCTURAL DESIGN:
The impact of these models is quantifiable—especially when measured against conventional PE benchmarks. The faster cash return profile and reduced leverage risk in yield-oriented strategies is useful for LPs with interim liquidity needs or reinvestment mandates. Traditional PE often draws down capital within the first 18 months, with early net IRR suffering

due to fees, investment ramp-up, and lack of interim income. Income-yielding PE strategies, by contrast, are structured to deliver regular cash distributions almost immediately, often within the first quarters. Investor benefits:

- Initial Drawdown: Traditional PE typically exhibits a NAV decline post-close. Income-focused vehicles achieve near-immediate breakeven.
- Time to Positive Net IRR: A median 5.4 years is required for traditional buyout funds to turn net positive, per Preqin. Income-generating strategies can do so within 12–24 months, enhancing IRR compounding via reinvestment.
- DPI at Year 5: Benchmark data shows traditional funds averaging ~0.3x DPI at year five, whereas income-centric models often exceed 0.7x—more than doubling realized capital within the same horizon.
- Typical Leverage: Traditional PE relies on 6x+ leverage to enhance equity returns, increasing cyclicality risk. Yield-focused vehicles typically operate with 2–3x leverage, improving interest coverage and reducing drawdown sensitivity in rising rate environments.
- Shorter Capital Lock-Up: Quarterly or even monthly distributions and refinancing events return capital faster, reducing reliance on long-duration exit assumptions.
- Improved Reinvestment Velocity: Higher early DPI enables faster capital recycling into new funds, enhancing compounding potential for LPs and increasing AUM velocity for GPs.
- Lower Risk of Write-Downs: Regular realized cash flow reduces dependence on unrealized valuations, decreasing the probability and magnitude of markdowns during market dislocations.
- More Defensible Valuations: Funds with income-based return profiles can be benchmarked using public comps and DCF-based metrics, reducing reliance on subjective exit multiple inflation.

PitchBook (2023) data confirms that income-generating PE strategies experienced less than 5% NAV volatility over a 12-month period spanning the 2022 rate shock, while traditional PE strategies saw 12–15% declines in marked NAVs during the same window. This underscores the value of recurring cash flows and conservative leverage in dampening valuation swings.

CONCLUSION: REDRAWING THE CURVE.

By targeting income from the outset, PE managers can better align their product with investor liquidity needs without compromising total return. Flattening the J-curve is not just about optics—it's about optimizing capital productivity. Looking ahead, macroeconomic volatility, aging investor demographics, and demand for stable yield suggest a continued shift toward these alternative structures. With LPs demanding more predictable cash flows and liquidity optionality, income-centric fund structures offer a compelling, risk-adjusted evolution of the traditional PE model.

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