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Private Markets – Accessing the Best Opportunities

Hubbis and GAM Investments invited a small group of private wealth management gatekeepers and other professionals to a private discussion on the evolution of demand in Asia for private assets. We have summarised some of the key insights below.

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KEY LIBERTY STREET AND GAM INVESTMENTS EXPERTS ATTENDING:

- Kevin Moss, Managing Director and Portfolio Manager at Liberty Street Advisors (he manages a portfolio of privately-owned, late-stage, growth companies, predominantly in the US and is to handle a new private equity investment mandate in association with GAM Investments).
- Rossen Djounov, Managing Director, Head of Asia, GAM Investments
- Terence Bong, Managing Director, Head of Singapore, GAM Investments

THESE ARE SOME OF THE QUESTIONS RAISED AND ADDRESSED IN THE DISCUSSION:

- What role do private assets perform in your private client portfolios today?
- What is the trend in demand for private investments and how will you participate in that evolution?
- Where will the best opportunities be in 2022, and what themes, sectors, or geographies will offer the best potential?
- Is there a major transitional shift from high-growth disruptors to older economy investments taking place globally and how does that play out in the private markets, where holding periods are far longer than in the public arenas?
- Is the volatility in the public markets being reflected in reduced private market valuations and/or a reduction in the sheer volume of money chasing deals? What does that all mean for the private equity market?
- How should private assets be valued relative to public markets, and what sorts of investments are required and over what time frames?
- Is the private equity market's lack of liquidity adequately compensated by valuations and returns? Is there a viable secondary market?
- Are private markets only for HNW and UHNW investors, or is there a strong case for the democratisation to more mass affluent and event retail investors, and if so, how should that be achieved?

WELCOME INTRODUCTION FROM ROSSEN DJOUNOV, GAM INVESTMENTS:

"It seems that by good fortune we have timed this event remarkably well, given the substantial volatility in the public markets and the rotations taking place from some high growth sectors to more cyclical value stocks. I would like to thank everyone for joining us today and introduce Kevin Moss from Liberty Street Advisors, a specialist private assets investment management firm based in the United States and with which GAM Investments has entered a partnership. He kindly joins us today from San Francisco. And we also have my colleague Terence Bong, Managing Director - Head of Singapore for GAM Investments joining us for this event. Welcome all."

More and more private banks offering private market investments

A leading private banker in Asia opened the discussion by commenting on the strong and rising interest of his clients in private equity and added that there is also growing liquidity in the secondary market, opening the door even further to greater private investor participation. He observed that the track record of private equity over the past five plus years provided a good platform for expansion, especially as the sell-off in many high-performance sectors of the public markets was manifesting itself more robustly, driving more private clients to request enhanced allocations to private equities.

And more private banks are offering private equity access within their DPM offerings

Another guest commented on the rising prevalence of private markets mandates housed within discretionary mandates. "Despite the liquidity constraints and the time horizons required, we believe this works well and it is a key focus for us this year and beyond," he reported. "We want to extend the offering to not just family office clients, but other normal accredited investor clients."

For many private clients, safety and capital preservation are as important as performance in the current financial market environment

Safety allied to performance were the two key ingredients today, an expert observed. "Right now, forget about outperformance, preservation of capital is the prime driver," he reported. "Everybody agrees that this is a full-on correction taking place in the markets now, and our view is this is actually the correction of the last 24 to 28 years of the equity bull market. Moreover, it might last until early 2024 to complete a correction."

He did however assert that what is taking place is not a catastrophic crash. "We see this as a long correction, so investors need to position for safety and liquidity."

Seeking safe havens of return in the private assets markets worldwide

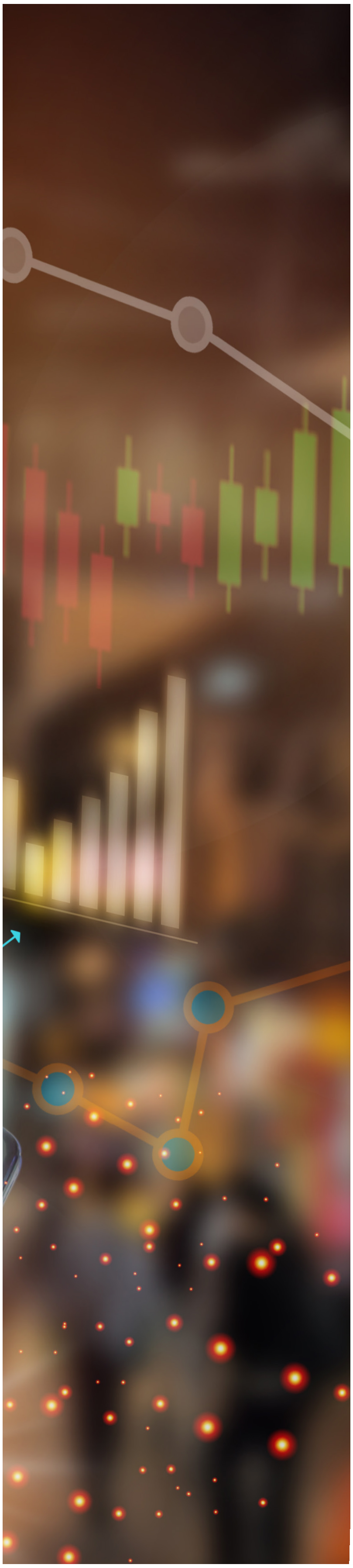
On the theme of safety allied to returns, this same guest added that his firm was focusing on private investments in student housing, which he said offers very stable income, and on arbitrage funds, some of which can deliver up to 8% annually with regularity, and with volatility of less than 1%. Additionally, he said they focus on SME funding in Europe, producing 12% to 15% annually.

Another invitee highlighted the activity levels of 2021 as having been considerably higher than a somewhat muted 2020, when the pandemic first hit. He explained that they remained focused on the US and Europe, on real estate and affordable housing. "I think again there's going to be opportunities here, as some companies will struggle with rising interest rates and valuations will have to come down ultimately in some areas," he reported. "I think there'll be some interesting gems to be picked up."

Accessing late-stage high growth private companies with a mission to democratise access to a wide range of investors

Kevin Moss of Liberty Street Advisors took the opportunity to offer his context and perspective:

"Liberty Street fairly recently announced a strategic partnership with GAM Investments, which will shortly provide GAM clients with access to leading privately-owned, late stage, high growth innovation companies through a new fund. It



will build further on the expertise and track record that Liberty's portfolio management team has built in private equity, investing mainly in late-stage private companies, and with a stated mission to achieve the democratisation of access to this asset class and private equity."

Democratising access

Typically, you see private equity funds with a 10-plus year lockup, with a prescribed fee structure and not a whole lot of liquidity. But our core mission was to make this asset class easier to access, we wanted to provide a liquidity feature, we wanted to make it much more flexible really for the financial advisor to be able to put their clients into this type of asset class.

We have assets today of around USD800 million, having started at a very nominal level, and we are seeing an extra inflow of around USD40-50 million a month. We deployed around USD300 million in new investments in 2021, for example.

Providing liquidity

And we offer limited quarterly liquidity for investors, subject to certain restrictions, so it is more liquidity than in typical private equity funds.

The sell-off in the public markets has been reducing some of the froth in valuations, and valuations are starting to come down somewhat in the private market.

A buyers' market...at last

It is moving to more of a buyers' market, and that means a lot more secondary transactions, and many of the more transient buyers of private equity may start to go away, and the more sophisticated institutional buyers may stay. This means for us we are going to increasingly look to take advantage of dislocations and that may be through more secondary transactions. We still see plenty of companies raising capital in primary transactions, but we look at secondary transactions as well.

A stable of stable investments

We also agree with the comment that investors are increasingly seeking stability. Actually, you would be surprised how stable our investments are and private equity in general. We are not trading on supply and demand like you would be in the public market, you're not getting shorted, you don't have an institution dumping a position, you don't have rotation, there's not that type of market pressure. What we're doing is valuing these companies at fair value. And in our case, our NAV has historically been stable.

The private companies we invest in can go public and typically after an IPO there is a lock-up period of 180 days. These are times where we hold listed/public companies. However, after the lock-up period expires, we generally look to exit that position opportunistically. We are not in the business of holding listed/public companies but rather buying private companies, letting them mature in the portfolio over a period of time and once there is an exit, whether it be a public exit or M&A exit, we will opportunistically close the position and hopefully realize our gains at that point.

How private equity funds can offer investors some liquidity, a rare feature in long-term funds

Kevin Moss explained in some detail how liquidity can be offered to investors in a private equity portfolio such as Liberty manages:

"As I have said, we had a mission to provide some kind of liquidity even though this is an illiquid asset class. In the US, we have quarterly a repurchase program limited to 5% of the outstanding shares at NAV. We hold back that 5% in cash, although we typically run at somewhere between 10 to 12% cash, not only for any quarterly redemption, but more in times of volatility."

Private equity is typically a lock-up of 8-10 plus years, so this means our approach offers some liquidity to investors for this asset class. The flexibility is what we sought to offer, so investors can if required rebalance their portfolio, or because sometimes investors suddenly have a life event that requires action. "As I said, that's how we expect to treat it in our next fund as well."

Offering a daily NAV update for any private equity portfolio is rare but it is possible

A guest highlighted the value of a daily NAV report for private equity portfolios, noting that this is very rare but significantly enhances confidence in entering these types of opportunities.

Kevin Moss responded by noting that this was one of their objectives from the early days of their efforts to democratise this asset class and was of course critical to the provision of a certain level of liquidity, as he had described.

"For our first private equity fund in the USA, we wanted to bring in non-accredited investors from early on, so a daily NAV report was central to the regulatory side as well as our perspective on our mission," he explained. "And achieving this is a lot simpler than a lot of people might think, and moreover from our positive experience in this regard, we expect to do this when appropriate with any new funds, as well."

"We have an accounting standard here that we utilise in order to determine fair value," he explained. "For around 70% of the holdings we have 7 to 10 valuation inputs, and we open on average somewhere between five to eight files a day, aside from any Level 1 publicly listed securities. We also open a file on any particular company if something major is happening with them. And as I mentioned earlier, we have some 88 companies we hold. We have three analysts and a CFO, all experts in valuation, so it is manageable."

He added that this means that investors are getting in, or out, at that NAV. "There are no premiums or discounts, we consider this fair value for the underlying securities. We could of course go into vastly more detail on the valuations, but that is it in a nutshell."

Companies stay private longer these days, there are fewer listed companies today, therefore democratised access is essential for the average investor as well as for the accredited buyers

Kevin Moss highlighted the longer staying power of the private companies nowadays and how that means a reduced pool of listed stocks:

"We have robust regulatory oversight in the US for the structure and access we provide, so while we are not restricted to the accredited

investor route in the USA, we are comfortable that there are plenty of protections here. Companies are staying private for much, much longer, in general some ten to 15 years, rather than the average of four years some two decades ago for a high-growth technology company. That meant so much more of the incredible value rise took place in the public markets, but today more of those great gains are taking place while private.

Additionally, the volume of capital that has been targeted at late-stage venture-backed companies in the private market has risen dramatically in the same timeframe. We estimate the pool has risen by over USD1 trillion in the US alone. Meanwhile, we reckon the pool of private companies valued at more than USD1 billion, commonly referred to as unicorns, has soared dramatically in the past decade to more than 900 at present globally, of which roughly half reside in the US. Moreover, many of these companies never list on public exchanges, but rather they get acquired. Unless investors have access to private market strategies, in our view they are missing out on a significant capital appreciation opportunity as we believe alpha generation potential has shifted markedly to the private market.

In short, a huge amount of the growth that we used to see in the public space is now taking place in the private space. That in turn means that if the unaccredited investor does not have access to these types of investments, they would effectively be barred from a lot of growth that's taking place in these types of companies. We are essentially tackling that with our structure and our access."

As democratisation of access to private equity takes place, a careful eye must be focused on negative cycles and market stresses

A guest commented that in the public markets, there had been a lot of stocks driven upwards and far beyond reality by liquidity, and that there is now a major rotation in public markets from pure liquidity driven bubbles into more value situations. But he indicated that private markets have actually in patches suffered even more bloated bubbles, with some big-name vehicles swelling valuations to far beyond reality.

"I like this trend to greater access away from the traditional HNW and family office type investors, but there are risks emerging if there are bad cycles coming," this expert commented. "I think the banks are in much better shape now and will be fine. But I also think that whatever crisis comes next, the risk is now more in the private space, and of course it is more difficult for the regulators to oversee that, and the regulators are actually not really that interconnected and coordinated, even today. In short, I see clear risk here, if there's another major cycle and if we see stress across the markets, and the private market space is going to get hit ultimately. We can fantasise about not having mark to market and all that. But at the end of the day, there would be stress."

There are silver linings for private equity funds as valuations in the public markets drop and as volatility rises

Kevin Moss also commented on some observations from the guests on the rotation taking place in the public markets, which naturally means some private company valuations are also coming down, but he observed that this means potentially the chance to access investments that might have been priced out of their range, or where they might as investors have been crowded out by rampant demand.

He said: "We agree there is going to be stress on valuations in the private space. However, this is well overdue, and even though we don't like to see investors lose in the public space, valuations in that public arena then put pressure on private valuations, upwards and downwards, so in a sense, this is what we have waited for in recent years. We hope now to be able to pick up some of the gems that we really couldn't have acquired before as there was too much money chasing them. So now in 2022, more opportunity awaits in the right types of valuation range."

Tailoring the right private investments to market conditions and investor demand

Kevin Moss then explained more about how Liberty Street had assembled its [current] portfolio of 88 private equity investments.

The investments centre on technology, innovation, and disruption, focused through some 18 different sectors. The focus is predominantly on North America, but we also invest in Europe and in some highly developed Asian markets such as Singapore, while typically steering clear of emerging market opportunities.

The companies they look at range from the space economy to cybersecurity to education technology, transportation technology, healthcare, genomics, agricultural technology, food technology and so forth. The investments are not at the start-up stages, as they typically steer clear of taking on that early-stage risk. Rather, the typical company has at least USD50 million in revenue and often hundreds of millions, in some cases billions.

Liberty has many key determining factors for the selection process, but in broad terms, we need to see very strong long-term value metrics in these businesses, companies that are going after large markets, and businesses with differentiated offerings and diversified customer bases. The target investments are usually two to four years from an exit event such as a public listing or a takeover, the latter which historically accounts for roughly two-thirds of all such private market exits.

Their data shows very clearly that in the US, the private market investor who came in at the last round phase can significantly outperform investors who waited to access those companies once they became public.

"We continue to try to allocate capital towards the space economy," Moss told, "and we are focusing on three areas. First is getting to space, so a company like SpaceX that provides the rockets. Then you are in space and need international space stations, especially with the current ISS to be decommissioned in 2028. Then you have the space infrastructure companies. We think the opportunities are incredible in this particular area, with some great business growing revenues at 100% to 150%.

He reported that other interesting sectors are digital health, education, and despite the public sell-

off, technology, especially areas such as cybersecurity where they see a stream of interesting companies. "Every time somebody creates a secure environment, somebody comes along and hacks it, and then you have to fix it and it just keeps on going round, and there are some very high-quality businesses there," he reported.

In a period of excess, excessive things often happen, but when the music stops there is opportunity

Moss observed that in the past year or more, some private companies had been raising capital not just once a year but twice.

"You might see a 300% increase in the valuation applied from the first to the second raising, in the same year, with employees and executives selling shares at the last round price at a big premium," he reported. "But I think that party is over, and now you see some of these valuations come back to earth, and with many investors hurt, including some of the stocks that went public and are now down 50% or more from listing prices. The buyers that were chasing those valuations are disappearing from the market now."

He explained that this represents a moment of opportunity for long-term investors such as Liberty, with the right connections and dialogue. "Many companies have actually been showing us secondary transactions at very different prices than we might have seen only a month or two before. We will have to see how the year ahead evolves, but I do think that these valuations are going to start coming in at more reasonable levels."

Opportunity knocks

Responding to an earlier comment on rotation and bloated valuations driven by excess liquidity, he agreed that had indeed happened, but that they now see an opportunity to take advantage of the deflation of valuations, and the price dislocations.

"For example," he told guests, "I recently saw a company raise capital at a USD2 billion valuation at a 20x multiple, which frankly, was reasonable compared to some of the things you saw this past year, with 50x, 100x multiples, in short, crazy stuff. We are happy to deploy capital at these more modest levels and sit with these companies for two to three years until they're actually ready to have a proper exit into either public domain, or they get taken out in an M&A transaction."

Walking in when others are running out

He added that it is in markets like this, where you see financial distress, where buyers such as Liberty run towards these situations, instead of heading for cash. "We did really well in 2020, really well in 2021 and enjoyed the ride," he explained. "But that's because in 2018, 2017, 2019, we were building the bench of portfolio companies at reasonable valuations. Our position was to deploy capital and be in the seat ready for those much higher, even crazy valuations happen, and then we're selling into them, not chasing them."

Consistency counts

"We have seen some cycles in that time, and we are careful about valuations for deploying capital. We follow ASC 820 in terms of valuations in the US, we have regulatory oversight from the US SEC, we are independently audited by KPMG annually, and we do as much as we possibly can to make sure the most important thing about what we're doing is valuing our private companies at fair value."

The impact of tighter liquidity and rising inflation will be felt, but the effects will be sector and company specific

"Our holdings are not immune to this, especially some of our high growth companies where there will be a higher cost of capital," Moss commented, drawing the conversation towards a close. "However, we tend to stay away from capital intensive businesses that rely on lines of credit and generally stay away from companies that have any debt on their portfolio. We want healthy balance sheets and plenty of cash. There will naturally be pressure on some of these companies that will suffer in a higher interest rate environment. However, if they're high-quality companies with healthy balance sheets but they're coming under some valuation pressures, that doesn't mean we won't deploy capital into them if we think that we're getting at a really good price."

He added that they had been waiting for valuations and liquidity to deflate to more reasonable levels, so that the exits in a number of years may be at higher multiples via the IPOs or M&A. "Some of the companies in the portfolio had poor IPOs in more recent times, but that does not mean we did not make good money on those deals. In short, there are opportunities out there and we are poised and ready to build further on our track record and expertise for the funds' investors" ■