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Investing in listed private equity – more than just an alternative

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Private market investments are gaining increasing popularity because they are less dependent on traditional asset classes and the general "investment crisis". The market for "private" investments – including private equity (private company holdings), private bonds, real estate and infrastructure – is currently estimated at around 6,000 billion US dollars, or about one-twelfth of the market capitalisation of the global equity markets of 73,000 billion US dollars. In times of increasing uncertainty and rising interest rates, investment volumes in private-sector investments are likely to continue to rise: according to Preqin, a provider of financial data for alternative investments, an annual volume increase of around ten percent is expected over the next five years.

The advantages of private equity are obvious: as with a typical equity market investment, but with smaller fluctuations in value, a private equity investment offers investors a real interest in companies that are active in development or production and allow equity investors to share in the success. An additional diversification effect can be exploited with the option of investing in different development phases and financing stages of companies – from the start-up phase and interim financing for expansion plans, to management buyout. As a general rule, a significant portion of added value is achieved in companies prior to the IPO. In the health care sector, for example, it may be prudent to supplement core investments in the pharmaceuticals area, such as Novartis and Roche, with an investment in private biotech companies in order to gain early access to promising innovators upstream in the value chain. Private equity managers generally make an "active contribution" to appreciating a company -–often through the introduction of strategic impulses. The influence on "direct" performance is many times greater than that of a pure equity market investment, in which many factors beyond influence play a direct role.

In general, patient long-term investors are unlikely to care much whether or not their shares are listed on the stock exchange. The classically structured private capital market investments that comprise a portfolio of direct or indirect investments typically have a ten-year term and are not tradable. In contrast, investments in listed private equity *(see the info box*) can be traded at any time. The LPX Composite Index, which is calculated by the Swiss LPX Group, comprises 91 publicly traded private equity (PE) companies worldwide – including listed fund managers – and has a market capitalisation of approximately 140 billion US dollars. Well-known examples of companies listed in the Swiss index include Partners Group, Castle Private Equity, Private Equity Holding and HBM Healthcare Investments. The listed private equity asset class enjoys much greater popularity In the English-speaking world than in this country, which is actually unjustified. A glance at performance shows that an average return of 12 percent per annum (in Swiss francs) has been achieved over the last 10 years – a fact that is reflected in the performance of the LPX50 Listed Private Equity Index.

Listed private equity is probably the easiest way for a private investor to invest in private equity. Traditionally, private equity investments were only open to selected investors who controlled a certain investment volume and who met the legal and organisational criteria. In the listed private equity segment, there are now equities, ETFs (exchange traded funds) on indices, as well as various actively managed funds (including the LPActive Value Fund). There are no fixed terms, and no minimum investment amounts: the minimum investment is one share or one fund share, and the complex processing of subscriptions and administration of deposits and withdrawals can be dispensed with. Although the vehicle structure, with its unlimited term, often fails to provide for actual dividends as with traditional limited partnerships, most PE companies now pay out attractive dividends from inflows derived from the sale of companies or IPOs. In the case of HBM Healthcare Investments, for example, this is achieved through a nominal value repayment, which is also tax-exempt for private investors in Switzerland.

However, the tradability of listed private equity introduces the element of price volatility. An investment in PE company stock is subject to greater volatility than a similar investment in a limited partnership. Even though the net asset value (NAV) resulting from portfolio investment valuations is relatively constant, the share price of the portfolio may suffer from adverse financial market turmoil, as it did 10 years ago during the financial crisis. During this time, the share prices of PE companies traded at significant discounts compared to the NAV for a long period. It should also be noted that shares in PE companies with lower trading liquidity tend towards a higher discount over time. Thus, the performance of PE companies should not be judged solely on share price performance. Even more important for the purpose of estimating future potential value is the ability to increase the NAV (i.e. the value of the underlying portfolio investments) across different business cycles through the strategic efforts of the PE managers. Generally speaking, listed private equity is still a relatively "new" asset class and has not yet been discovered by a broader investor base. Nonetheless, a closer look may prove worthwhile.

Info box: Listed Private Equity

As the name suggests, listed private equity involves listed investment funds or investment companies that are invested directly in private companies or indirectly through funds in private companies, usually in the form of a stock corporation. Listed fund managers, such as the Partners Group, Blackstone or KKR, are also considered as listed private equity in a broader sense, but are not covered by this article. Private equity (PE) companies who invest directly, i.e. from their own balance sheets, are the most important organisational form of listed private equity.

In the case of classic investment funds (for example, equity funds) that invest in listed companies, the investor acquires shares in the fund at net asset value; these are usually issued and redeemed by the provider once each day. The unit value is generally only calculated once a day. In the case of listed private equity portfolios, on the other hand, the investor acquires shares in the listed investment company at the stock market price. The immediate performance for the investor depends on the share price and not on the net asset value – the sum of all investments including additional assets and liabilities (referred to in total as the "net assets"). The difference between the stock market price and the NAV (net asset value) is referred to as the "surcharge" or "discount". Unlike classic private market investments, or "limited partnerships" – similar to KGK limited partnerships for collective capital investment under Swiss law – the term of the investment company is unlimited; however, the investor has the option of buying or selling shares each day via the stock exchange, depending on trading liquidity. Popular stock exchanges in Europe are London, Amsterdam and Zurich and the Swiss LPX Group is a well-known provider of research and indexing services.

Author

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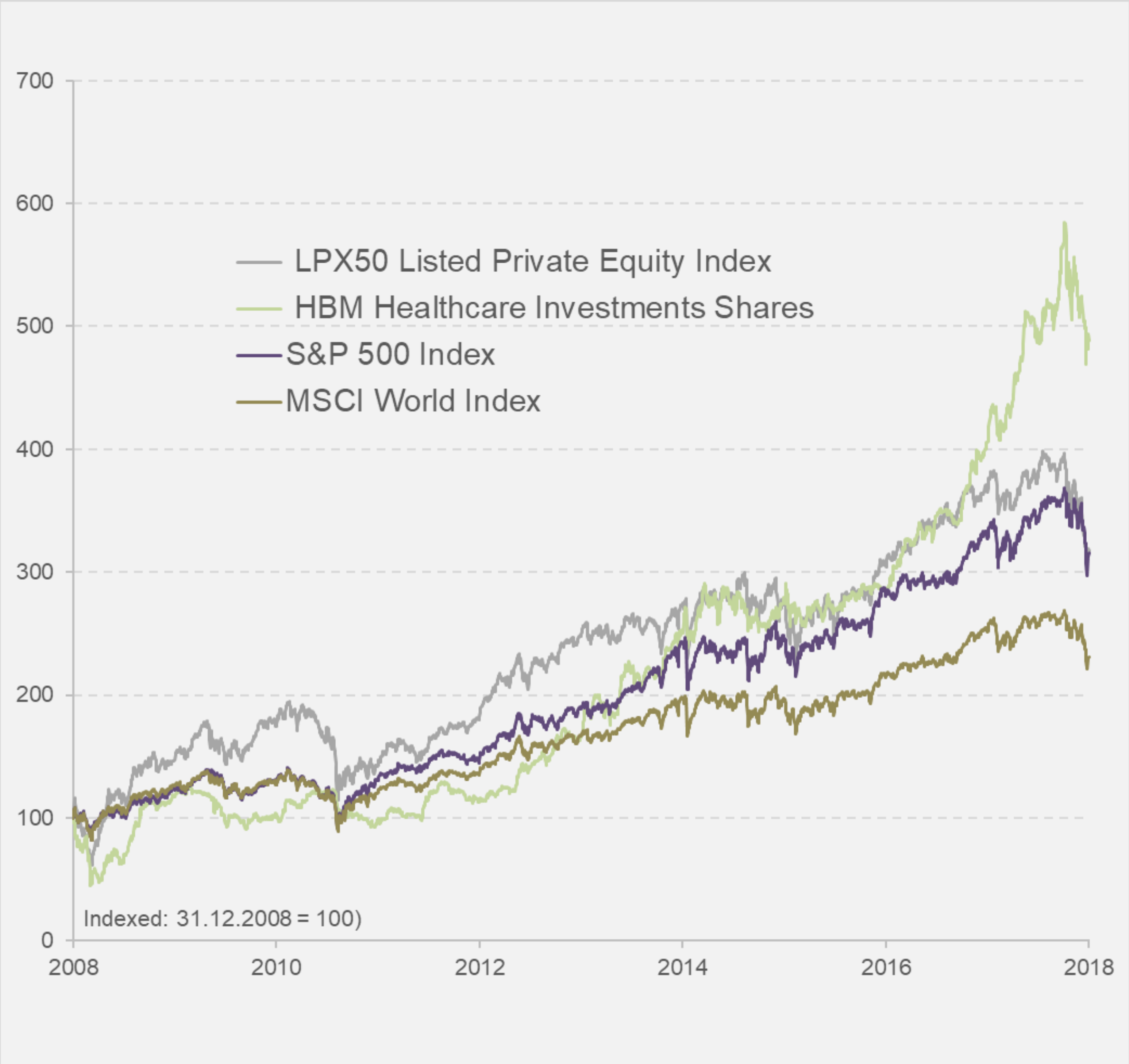
Performance over the last 10 years (in Swiss francs, including dividends)



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