HarbourVest Global Private Equity

Now could be an interesting moment to consider HVPE...

Update
09 October 2024

Overview

HVPE offers a unique exposure to a diverse range of private companies. Investments are made on a global basis, and across the maturity profile of businesses, with underlying exposure to more than 1,000 businesses. Within this portfolio there are relatively early-stage businesses which may be in their hyper-growth phase, more stable growth opportunities, and those which are highly predictable and generating significant cash. Importantly, private companies offer exposure to very different markets and niches than publicly listed companies. HVPE offers a simple one-stop-shop for private markets exposure, but one that manages risk by not exposing investors to a narrow group of investments, themes or areas of the market.

HVPE's portfolio is designed to capture the strong returns potential of private equity, but minimise risks. Historically, it has been a strong performer, with the annualised NAV per share total return of 10% outperforming the FTSE All World Total Return Index by c. 3% per year since HVPE's IPO in 2007 (to 31/08/2024). Company-specific risks are minimised by diversification. Currently Shein, the Singaporean-based fast-fashion on-line retailer reportedly aiming to list on public markets soon, is the largest position at 2.2% of NAV, and the top ten holdings only make up 7.3% of NAV (as at 31/08/2024). In other ways too, the portfolio is designed to potentially ensure a smoother trajectory over shorter timeframes than one focused on only one segment of the private market such as venture or buyouts.

The managers seek to ensure that HVPE remains as fully invested as possible, avoiding 'cash-drag', through an over-commitment strategy. Whilst underlying managers are continuing to find opportunities to invest capital, proceeds from exits do not always match these cash outflows and so HVPE draws on its credit facility as a working capital buffer. As we illustrate in the **Gearing section**, during the last financial year, HVPE became net geared. Incorporating fund-level borrowing, on a look-through basis we might consider HVPE to currently be 20 % geared on a net basis (as at 31/08/2024). Returning capital via buy-backs (see **Discount**) increases gearing, but during 2023, total commitments were reduced considerably from the original plan as a mark of caution. We understand new commitments will continue to be sized to preserve balance sheet strength and liquidity.

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Analyst's View

HVPE offers a differentiated and highly diverse exposure to private market investments. In our view, the portfolio has been put together in an intelligent way, which minimises risks for investors but offers the potential to capture high returns. The performance trajectory over the long term has been impressive, with NAV and share price significantly outperforming world equities (see **Performance section**). Over the last five years, the experience has been more mixed, with record levels of activity in the period post Covid leading to very strong NAV growth. Latterly, performance has been more muted, reflecting a slowdown in deal activity in private market transactions.

HVPE's manager notes that there are currently early signs that activity may be beginning to step up once again, which would be positive for NAV growth and the discount to NAV, which as we discuss in the **Discount section**, is at historically wide levels . HVPE has a mature portfolio, which means it should be well positioned to benefit if realisations start to ramp up. One of the catalysts for this to happen may be further interest rate declines following the US Fed's first cut of 50bps. This could be the blue touch paper which re-ignites animal spirits in the private equity world, which is otherwise sitting on record amounts of dry powder.

For investors looking to broaden their investment exposure, private companies may make a lot of sense, and HVPE has proved that it offers an attractive way for investors to access them. With 15% of realisation proceeds now earmarked for potential distribution to shareholders since the introduction of the distribution pool in February 2024, buy-backs may provide something of a backstop for the current wide discount to NAV. In our view the prospect of realisation activity improving in the near term is an attractive backdrop for investors to consider an investment in HVPE.

BULL
Long experience and expertise of manager in private markets is a clear differentiator
Low stock-specific risk, and broad exposure should smooth returns over time
Wide discount to NAV should provide reassurance to long-term investors

BEAR
Relatively opaque underlying holdings
Geared exposure can exacerbate downside , although we note that HVPE utilises borrowings to smooth cashflows not as structural gearing
High ongoing charges figure is likely to limit appeal for some investors

Portfolio

HVPE offers a unique exposure to a diverse range of private companies, and the portfolio also includes investments in private credit and infrastructure.

For investors looking to broaden their investment exposure, private companies may make a lot of sense. The apparent short-termism of public market investors, not to mention the myopic focus on the latest fads (AI being one?), as well as the high costs of regulation and disclosure that being publicly listed brings, means fewer companies actively seek a public listing. Increasingly, private companies are just public companies that haven't listed on a stock exchange, given the ever-deeper pools of private capital available to them. In this way, investors that restrict themselves to publicly traded equities might be considered as missing out on a whole world of potential opportunity.

In reality, most investors' portfolios are already heavily biased towards public companies. Whilst publicly listed investments may on the surface be considered 'lower risk', in that one can quickly recover one's invested capital if the need arises, they are very far from risk free, and there is always a potential high cost in terms of the opportunity cost of being invested elsewhere, in less visible or harder to access areas of markets. HVPE is differentiated from typical public equity funds or indices in that it arguably offers exposure to a more diverse set of opportunities and business niches. Investments are made on a global basis, and across the maturity profile of businesses, with underlying exposure to more than 1,000 companies. Within these companies there are relatively early-stage businesses which may be in their hyper-growth phase, more stable growth opportunities, and those which are highly predictable and generating significant cash flow. As such, HVPE offers a simple one-stop-shop for private markets exposure, but one that manages risk by not exposing investors to a narrow group of companies, themes or areas of the market.

As we discuss in the **Performance section**, over time HVPE's shareholders have significantly outperformed public markets in share price and NAV terms. Fundamentally, we believe the outperformance of public markets by private equity is down to the deep expertise within highly resourced private equity management houses, the truly active way in which these managers can influence investee companies, as well as the alignment of interests between manager and investor. In our view, private equity managers are able to generate incremental value through a repeatable process, and despite their higher costs, are well worth considering for an investment.

Despite the private equity market (as measured by the number of deals executed) slowing since 2022, we don't think there is any evidence that the market is fundamentally broken. As such, the long-term opportunity to invest in this area of the market remains tangible. Of relevance today, HVPE's manager notes that there are currently early signs that activity may be beginning to step up once again, which would be positive for NAV growth and the discount to NAV, which as we discuss in the **Discount section**, is at historically wider levels.

HVPE's portfolio is designed to capture the strong returns potential of private equity investing, but minimise risks. Company-specific risks are minimised by diversification; and the largest holding is relatively small. Currently Shein, the Chinese fast-fashion on-line retailer reportedly aiming to list on public markets soon, is the largest at 2.2% of NAV. As the table below shows, the next largest holdings are significantly smaller at 0.7% of NAV, with the top ten holdings only making up 7.3% of NAV (as at 31/08/ 2024). This clearly minimises the risk for shareholders that one company will have an outsized negative impact on their capital.

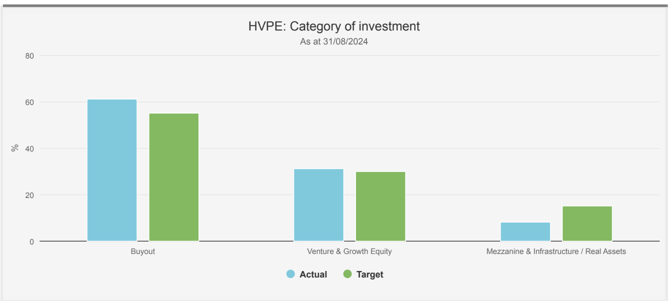
Top Ten Holdings As At 31/08/2024

COMPANY	SECTOR	INVESTMENT VALUE %
Shein	Consumer - fast fashion	2.2
Undisclosed	Tech & software	0.7
Action Nederland	Discount retailer	0.7
DP World Australia	Industrial & transport - ports	0.7
Preston Hollow Capital	Financial - municipal finance	0.6
Froneri	Consumer - ice cream & frozen food	0.6
Apotex Pharmaceutical	Medical - pharmaceutical products	0.5
Howden	Financial - insurance	0.5
Alpha Trains	Industrial & transport - train leasing	0.4
Smarsh	Tech & software	0.4
TOTAL		**7.3**

Source: HarbourVest

In other ways too, the portfolio is designed to potentially ensure a smoother trajectory over shorter timeframes than one focused on only one segment of the private market such as venture or buyouts. The performance of the portfolio during the financial year ending 31/01/2024 is illustrative in this respect, with HVPE's exposure to infrastructure and private credit performing strongly whilst that of the venture portfolio had a more challenging period. We show below the current allocations across the types of private equity opportunities, alongside the board's long-term target allocations.

Fig.1: HVPE Asset Allocation



Source: HarbourVest

The way in which HVPE makes its investments is reflective of the management set-up within a firm that focuses exclusively on private markets. HVPE has total net assets of $4.0bn , which despite standing on a 42% discount to NAV, means it is still a FTSE 250 Index constituent. Having a unique strategy and significant AuM, means HarbourVest have a large global team focused on implementing the HVPE investment strategy, which sees its assets invested through a series of dedicated sub-strategy funds. As we discuss in the **Management section**, HVPE invests in opportunities however they are presented – through making long-term commitments to primary funds, to purchasing secondary interests in funds, and making co-investments directly. What unites them all, is that they are made by highly specialist team-members responsible for running funds with specific sub-strategies – such as mid-market buyouts in the US for example. These specialist funds are selected for HVPE with the aim of bringing the overall asset allocation towards the investment committee's target over time. In total there are 63 underlying HarbourVest funds in the portfolio, which give exposure to 1,151 underlying LP funds managed by a huge variety of managers. Around half of the portfolio is invested through primary commitments, with 30% in secondaries and 20% through direct co-investments, in line with the board's target.

In this way, HVPE has access to what the team believe will be the top performing private market managers in the world. The venture portfolio for instance has investments with Andreessen Horowitz as well as Index Ventures, who are highly regarded global leaders in this space who continue to dominate venture investing. By investing with these groups and other similar managers, HVPE were early investors in Facebook, Twitter and Uber. Familiar high growth names in the current portfolio include Klarna, ByteDance (TikTok) and Revolut (now Europe's most valuable start-up). Elsewhere and as we highlight in the top ten above, readers may recognise the third largest holding Action Nederland, the discount superstore group which forms a majority of the 3i portfolio, and has been one of the most successful buyout deals in the history of private equity. HVPE is invested directly, through a HarbourVest co-investment fund. HarbourVest have long running relationships with many of the managers within the portfolio, many of which are nigh-on impossible to access as a new investor. As shown in the table below, the HVPE portfolio represents a diversified exposure to some of the best known and successful management groups in the private equity industry.

Top Ten Managers As At 31/01/2024

MANAGER	REGION	STRATEGY	INVESTMENT VALUE %
IDG Capital Partners	Asia	Venture & Growth Equity	3.4
Insight Venture Management	North America	Venture & Growth Equity	3.1
Index Ventures	Europe	Venture & Growth Equity	2.3
Thoma Bravo	North America	Buyout	2.2
Hellman & Friedman	North America	Buyout	1.7
SK Capital Partners	North America	Buyout	1.4
Battery Ventures	North America	Buyout	1.3
Andreessen Horowitz	North America	Buyout	1.3
Corsair Capital	Asia	Infrastructure &Real Assets	1.2
Berkshire Partners	North America	Buyout	1.1
Total			**19.0**

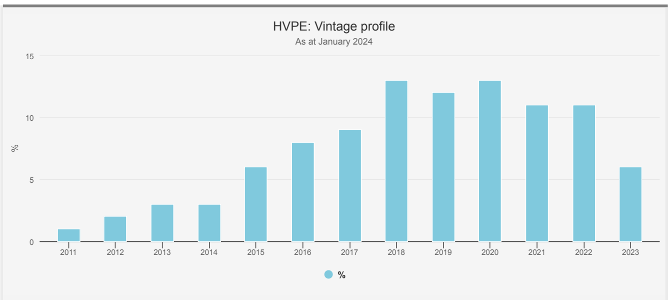
Source: HarbourVest

Making primary investments allows capital to be deployed consistently over time, which can be opportunistically added to through secondaries and co-investments. The result is that HVPE's portfolio has a broad spread of vintages (see chart below), and companies at very different stages of maturity. If private equity deal activity continues to pick up, as the managers expect, then this breadth of vintages will put HVPE in a good position to convert investments to cash. Historically, realisations have been achieved at an average valuation premium to carrying value of 52% (since 2012), which would provide a useful boost to returns if this continues into the coming months and years.

Given the long-term nature of private market investing, the asset allocation evolution is expected to be gradual over time. The board's asset allocation framework is reviewed on an annual basis. In 2023, the decision was taken to increase private credit and infrastructure exposures at the expense of buyout. The team observe that real assets and yield-oriented investments now offer an attractive risk/

reward profile, with yields on offer in private credit ranging from 10–12% at the senior level to 14–18% for junior credit. The managers expect a recovery in distributions from the considerable, and increasingly mature venture and buyout portfolio. As we discuss in the **Discount section**, HVPE now has a formulaic capital allocation policy, which will see 15% of realisation proceeds earmarked for potential distribution to shareholders. Given buy-backs are highly accretive at the current discount to NAV, in our view the prospect of realisation activity improving in the near time is an attractive backdrop for investors to consider an investment in HVPE.

Fig.2: Vintage Profile



Source: HarbourVest; note: 7% of NAV has a vintage prior to 2011

Gearing

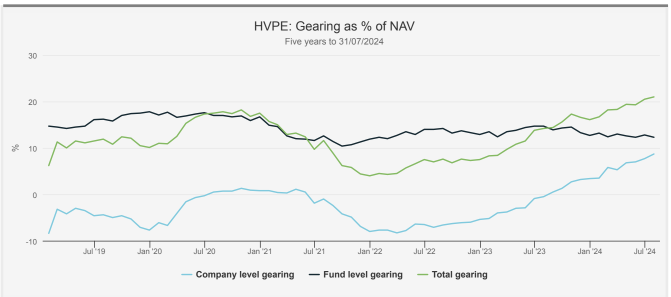
HVPE's managers see cash management as a critical component of optimising NAV per share growth. Over time, the managers seek to ensure that HVPE remains as fully invested as possible and avoid 'cash-drag'. In this way, HVPE intends to use company-level borrowings to smooth cashflows, rather than as structural gearing. The challenge of not knowing in advance when investments will be made or realised, means HVPE needs to run an over-commitment strategy, which sees it commit more capital than it actually has available in liquid form today. Over most years, capital invested will be met by cash distributions from the underlying funds. But having a company-level credit facility means that if investments are made faster than capital is returned, HVPE can meet its obligations.

We show below the historic level of company-level borrowings. Observable in this graph is that borrowings have risen this year, but we understand that the managers believe they may start to decline as new commitments have been scaled back. The private equity industry is experiencing a slower pace of realisations, and HVPE has not been insulated from this. As such, whilst underlying managers are continuing to find opportunities to invest capital, proceeds from exits are not matching these cash outflows. For example, over the last financial year to 31/01/2024 HVPE was a net investor of $283m, meaning that the balance sheet went from a position of net cash of $198m as at 31/01/2023 to net debt of $135m as at 31/01/2024. This year has seen the credit facility being drawn down further, and as at 31/08/2024, with net debt of $330m, HVPE is 8% geared at the company level on a NAV basis.

Returning capital via buy-backs (see **Discount**) also increases gearing, and we understand that over the course of 2023, total commitments were reduced considerably from the original plan as a mark of caution and to give the board headroom for buybacks. We understand that new commitments will continue to be sized to preserve balance sheet strength and liquidity, both of which are an important focus for the board. HVPE currently has a $1.2bn flexible credit facility which it may draw down if required until June 2029, equivalent to 30% of NAV. In general, HVPE does not intend to have company level gearing sitting in excess of 20% of the company's NAV. That said, HVPE may use additional borrowings for cash management purposes, or in the event of a material downturn. These borrowings could be for extended periods of time depending on market conditions.

Private equity funds also often use borrowing facilities to balance cashflows and reduce the frequency that the manager needs to ask investors for cash contributions, and HarbourVest's funds (through which HVPE invests) are no different. In the graph below, we show that over the past five years, HVPE's share of underlying fund-level borrowing has been relatively stable, and currently stands on a look-through basis, at $471m. If we incorporate this into the overall gearing figure of HVPE, we might consider HVPE to be c. 20% geared on a net basis as at 31/08/2024. As with any investment, it is worth remembering that whilst gearing enhances the upside, it also exaggerates the downside.

Fig.3: Gearing



Source: HarbourVest

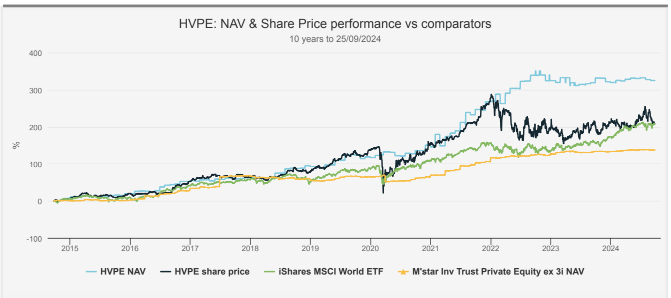
Performance

As we discuss in the **Portfolio section**, private equity is a long-term asset class, and likely requires a long-term investment horizon to achieve the best possible returns. The closed-ended fund structure suits the asset class well, although the managers need to carefully manage the balance sheet to avoid cash-drag (as we discuss in the

Gearing section). Private Equity managers aim to invest at mid- to high-teen IRR's (a measure of the annual rate of return of an investment), and so if they are successful and HarbourVest are successful at picking the best managers (and making sure HVPE is fully invested), the NAV should outperform equity markets over the long term. As evidence that HarbourVest have done their job successfully, HVPE's NAV total returns since inception in December 2007 have been 423% to 31 August 2024, which compares to the FTSE All-World Index total return over the same period of 211%.

HVPE has two share quotes, denominated in GBP (HVPE) and USD (HVPD). Both effectively offer USD exposure (the base currency of the fund) to UK investors, but the GBP share quote enables them to invest without an FX transaction. In this section, we use the GBP share quote to compare performance. Over the past ten years, shown in the graph below, HVPE's share price and NAV have outperformed world equities, as well as outperforming the listed private equity peer group NAV.

Fig.4: Performance Over Ten Years

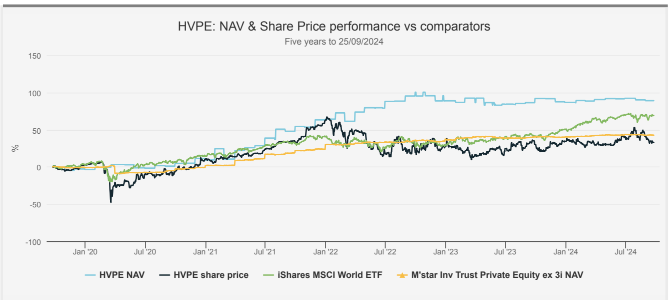


Source: Morningstar

Past performance is not a reliable indicator of future results.

In the graph above, it is noteworthy how strongly HVPE performed during 2021, and it has clearly had an influence on the total return statistics over the past decade, let alone the past five years. For the financial year ending 31/01/2022, HVPE delivered record NAV per share growth of 37%. Activity levels were high, and 2022 proved to be one of the strongest exit markets on record, driven by an open IPO window and strong M&A activity, combined with an element of catch up from 2020, when uncertainty caused by COVID-19 led many private equity managers to suspend or delay exit processes. Activity was matched by eyewatering valuation uplifts for many of these deals, with IPOs and subsequent share price rises from within the venture and growth equity portfolio a key driver. Since then, activity levels and valuation moves have been much more muted, as the graph below illustrates. Whilst venture valuations have retreated, relatively solid performance from buyout, credit and infrastructure investments have provided a positive NAV return on average.

Fig.5: Five Year NAV Returns



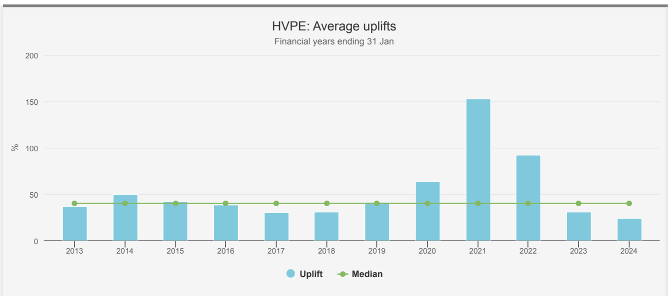
Source: Morningstar

Past performance is not a reliable indicator of future results.

In terms of the outlook for HVPE's NAV and share price performance, we believe that there are two main factors to consider. Firstly, NAV growth will in large part depend on the ability of the underlying portfolio to continue to deliver revenue and earnings growth. Over the long term, the underlying metrics for HVPE's portfolio have been better than those of world equities in aggregate. HVPE provide periodic updates on the underlying performance of the portfolio and for the 12 months to 31/12/2023 reported weighted average revenue growth of 10.9%, and EBITDA growth of 14.6%. This remains a healthy clip, and if strong growth continues, then this will be a useful tailwind to NAV returns.

The other factor to consider – which is of particular relevance now in our view – is the potential for a rebound in levels of realisation activity, and the impact this may have on sentiment (and therefore the discount to NAV). Historically, HVPE has achieved realisations in the range of c. 10% to 30% of NAV. The years since the end of 2021 have seen a slowdown, but we understand that 2024 looks to be shaping up as an improvement, but still well behind the average. Realisations are important because they represent one of the key drivers of NAV growth; historically HVPE has achieved sales of portfolio companies at premiums to the prior valuation at an average of over 50% since 2012. With private equity dry powder (i.e. capital committed, yet not invested) at record levels, we believe that any falls in interest rates should

Fig.6: Uplifts On Realistions



Source: HarbourVest; Kepler Partners LLP

Past performance is not a reliable indicator of future results.

precipitate a meaningful recovery in activity. As we discuss in the **Portfolio section**, HVPE has an increasingly mature portfolio, putting it in a good position to benefit from a sector-wide improvement in deal volumes.

Dividend

HVPE's investment objective is to generate superior shareholder returns through long-term capital appreciation. HVPE has not historically paid dividends, although has the ability to do so from its Distribution Pool (see **Discount section**), which was introduced in February 2024.

Management

HarbourVest is an independent, global asset manager which has been investing in private markets opportunities for a total of 42 years. HarbourVest focuses exclusively on private markets, and as at 31/03/2024 has a total AuM of $127bn. Aside from a proprietary database of deals that HarbourVest has been able to build up over this time, the length of experience of the team (25+ years on average for its managing directors, of which on average 13 years has been spent at HarbourVest) means the firm is a trusted partner to some of the biggest investors in private equity globally. HarbourVest currently has over 230 investment professionals, located in its offices in Beijing, Bogotá, Boston, Dublin, Frankfurt, Hong Kong, London, Singapore, Seoul, Sydney, Tel Aviv, Tokyo and Toronto.

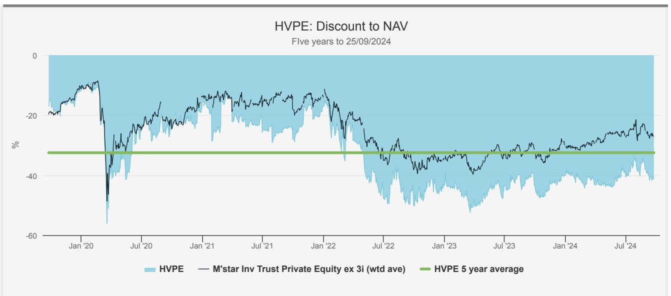
HVPE provides exposure to 63 individual HarbourVest funds, each managed by experts in their respective strategy. Richard Hickman is responsible for the day-to-day management of the company. Richard joined HarbourVest in 2014 and has a total of 17 years' experience in the listed private equity sector. The HVPE Investment Committee (IC) is a dedicated body within HarbourVest, responsible for monitoring and reviewing the company's Strategic Asset Allocation (SAA) targets and for recommending any changes, thereby seeking to optimise the risk-adjusted performance of HVPE's portfolio. On an annual basis, the IC proposes a commitment plan for consideration by the HVPE board and, once approved, is responsible for executing against this plan. During the year, the IC also reviews and recommends specific investment opportunities to the HVPE board as they arise. The HVPE IC comprises four managing directors: John Toomey, Gregory Stento, Richard Hickman and Carolina Espinal.

Discount

HVPE, along with the wider sector, saw a significant widening of its discount during 2022. In fact, as we show in the graph below, the current discount to NAV of c. 42 % represents a significantly wider level than the average since HVPE listed in late 2007. The board has been buying shares back under a buy-back scheme, which seeks to balance the opportunity for accretive buy-backs with maintaining firepower to invest capital for the long term. From September 2022 to July 2024, HVPE repurchased c. 4.5% of HVPE's shares in issue.

In February 2024, the board announced a further step towards formalising the amount of capital available to be distributed back to shareholders, which could potentially see a significant increase in capital available to be returned. From February 2024, a distribution pool of capital, funded by 15% of cash realisations from the portfolio will be set aside as ring-fenced for buy-backs, special dividends or, should the board feel appropriate, fund commitments. In calendar year 2024, the pool is being seeded with three tranches of $25m, representing a re-allocation of a postponed commitment to a HarbourVest fund. At the time of writing, $50m of the seed capital has been allocated to the pool, and the balance is currently $35m as at 31/08/2024. Since the introduction of the distribution pool, HVPE has repurchased a further c. 2.2% of HVPE's shares. This means that 4.9% of issued share capital has now been bought back, which has added c. 2.2% to HVPE's NAV per share. Over time – especially if the pace of realisation activity steps up once again – we would expect the pool to grow. The board, based on detailed modelling from the manager, expects that the total allocated to the pool across the two calendar years 2024 and 2025 will be between $150m and $250m, inclusive of the existing balance.

Fig.7: Discount



Source: Morningstar

Several factors are weighed when determining the method of shareholder distributions. However, at the current wide discount the board has stated that the policy favours buy-backs. At the current level buy-backs are highly accretive, and represent a low-risk way of boosting NAV per share as well as showing confidence in the reported NAV. That said, as we discuss in the **Gearing section**, buy-backs leave HVPE more highly geared than would otherwise be the case. In our view, the main catalyst that will see the discount narrowing is shareholder appetites returning, possibly a result of bond yields declining as the interest rate cycle plays out, and the resultant level of private equity activity increasing. With HVPE's manager saying they are seeing early signs of a recovery, now could be an opportune time to consider HVPE for a portfolio.

Charges

As we explain in the **Portfolio** and **Management sections**, HVPE accesses investments through HarbourVest funds. The management fees on these funds were equivalent to 0.60% of average NAV over the 12 months to 31/01/2024. HarbourVest funds also charge a performance fee, not on primary commitments, but on any secondary (30% of the portfolio) and co-investments (20% of the portfolio) which is only charged after each investment exceeds a target IRR.

HVPE's total expense ratio (TER) including management and performance fees, but also interest costs (see **Gearing**), board fees, marketing and costs of maintaining a listing was 1.79% for the financial year ending 31/01/2024. Charges as a percentage of NAV have generally been coming down over the years, but this represents a slight increase over the previous year, largely attributable to the costs of the credit facility which was drawn down during the last financial year (see **Gearing**).

The KID reduction in yield figure is 5.74% as of June 2024, including 1.65% of carried interest, which is based on the average over the past five years, and also includes estimates of fees paid to underlying managers as well as those actually paid to HarbourVest as manager. Underlying GP funds typically charge a management fee of 1.5% on committed capital, and a performance fee (aka 'carried interest') of 20% of gains over an investment return net of fees of 8% per annum.

ESG

Being an investor in private companies alongside third party managers, HVPE and HarbourVest rely on these managers for any ESG integration or reporting. This notwithstanding, HarbourVest is driven by the belief that strong financial returns and positive social change can be accomplished in tandem. As such, it is committed to integrating ESG considerations into all stages of its investment activity. HarbourVest has been a signatory to the Principles for Responsible Investment (PRI) since 2013. HarbourVest strives to adhere to both the letter and spirit of the PRI: it considers the potential impacts that its investment and operational decisions could have, encourages the GPs it invests with to adopt the PRI, and has experience in helping clients achieve their ESG objectives through customised investment solutions.

HVPE's board is committed to the highest standards of corporate governance and to improving the social and environmental impact of HVPE's activities, in collaboration with HarbourVest as manager. As such, the board places high importance on the integration and monitoring of ESG at both the HVPE and HarbourVest levels. The manager presents frequent updates to the board on how ESG factors are considered in its investment process, its screening methods, and its reporting. This includes a steady increase in the scope and nature of the information that it can provide on HVPE's own portfolio. In addition, ESG risk has been integrated into the board's assessment of all the material risks faced by the Company to ensure that it is embedded as a part of HVPE's overall strategy. More detail is included in the HVPE annual report **available here**.

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