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Why staying "reassuringly dull" works for HarbourVest

Richard Hickman tells **Dave Baxter** what separates his private equity trust from rivals and why it can cope with the current challenging environment

By **Dave Baxter**

- One of the more diversified private equity trusts, HarbourVest has nevertheless posted stellar returns
- Richard Hickman discusses the challenges that lie ahead

Anything in your portfolio that quickens the pulse has likely had a bad start to the year. From crypto and more speculative ends of the tech sector to Environmental, Social, and Governance (ESG) funds and meme stocks, hyped-up parts of the market have taken a drubbing in recent weeks as investors worry about shifts in monetary policy.

Certain unlisted companies also fit into this category, with tech-minded late-stage private investors such as **Chrysalis Investments (CHRY)** and **Schiehallion Fund (MNTN)** struggling in recent months after a bout of strong returns.

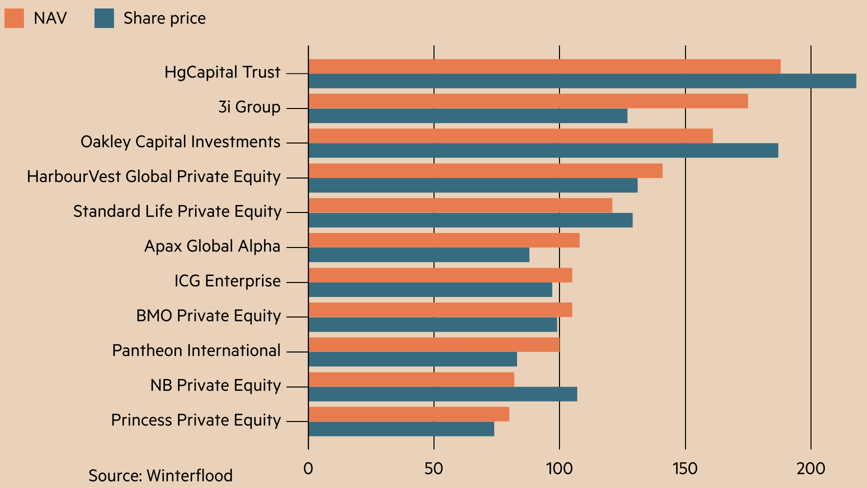
Elsewhere, the dedicated private equity trusts are more of a mixed bag. Those that invest directly in a handful of companies can serve as punchier options with a greater level of risk and reward, while other names in the sector focus on holding a huge selection of different funds and companies in a bid for diversification. While less exciting, the latter have still managed to post strong returns in recent years.

HarbourVest Global Private Equity (HVPE) fits that description. The portfolio provides exposure to private companies by investing in HarbourVest funds, ensuring significant diversification. As of 31 July 2021 the trust was invested in 56 HarbourVest funds and 12 investments made alongside them. Richard Hickman, director for investment and operations at the trust, notes that it had an underlying exposure to around 1,200 companies as of February 2022.

Fortunately, performance has not been held back by spreading the money so widely. Winterflood data shows that the trust made a net asset value (NAV) total return of 141 per cent in the five years to 14 February 2022. This puts it ahead of many others in its sector, as our chart shows. Both HarbourVest's NAV and share price performances are ahead of well diversified trusts viewed as more direct rivals, such as **Pantheon International (PIN)**.

HARBOURVEST HOLDS ITS OWN VERSUS PEERS

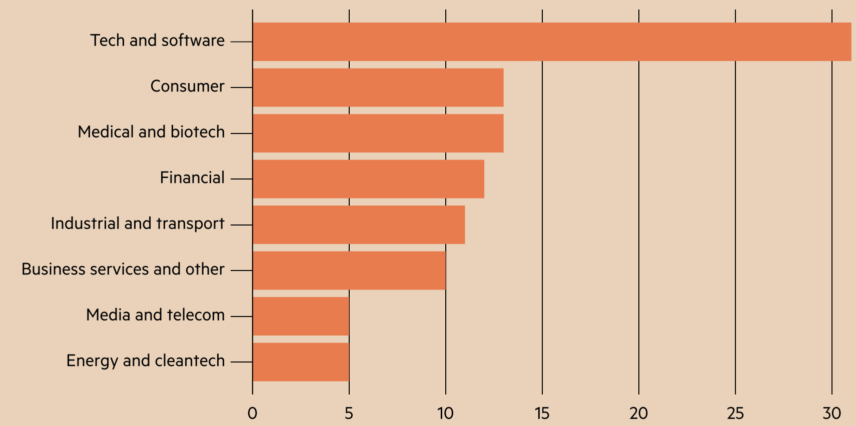
Five-year total return (%) to 14/02/22, ordered by NAV performance



Source: Winterflood

HARBOURVEST SECTOR EXPOSURES

Allocations (%) from the end of 2021



Source: HarbourVest

The road ahead

These returns can be attributed to a variety of factors. William Heathcoat-Amory, co-founding partner of Kepler Partners, suggests returns from both HarbourVest and Pantheon have been buoyed by high exposure to US dollar-denominated assets, allowing them to benefit from the currency strengthening against sterling in recent years. But other important portfolio characteristics have also played a big role in driving NAV gains.

In the case of HarbourVest, its investment team has tended to run a notably high allocation to venture and growth investments, giving it exposure to early-stage businesses with potential for fast growth in sectors such as technology and healthcare. At the end of 2021 the fund had 40 per cent of its assets in this area, with 51 per cent in buyouts and 9 per cent in mezzanine and real assets.

This venture exposure could equate to a higher level of risk, but it has certainly paid off recently. The trust's results for the six months to 31 July 2021 note NAV growth of 22.6 per cent for that period, and growth of 57 per cent over the year to the same date. Its its substantial exposure to venture and growth equity were key drivers of this.

The six months to the end of July 2021 also saw the trust benefit from a frenzy of corporate activity, with 223 merger and acquisition events and 96 initial public offerings (IPOs) affecting portfolio holdings. That has delivered a big capital uplift, with significant gains derived from the IPOs of venture and growth holdings.

When it comes to asset allocation Hickman is looking to do more of the same, describing the fund as "reassuringly dull" and stating that no dramatic changes will occur within the portfolio. This includes the venture exposure but also its focus on buyouts. If the asset allocation is broken out in different ways, the fund is also sticking with both its heavy weighting to the US (60 per cent of assets at the end of 2021) and a big focus on primary funds (54 per cent of assets).

To clarify private equity terminology, primary funds are newly formed private equity vehicles. With secondary funds (27 per cent of HarbourVest Global Private Equity's portfolio at the end of 2021), an investor buys into the remaining, more mature assets from an existing portfolio. Trusts can get direct exposure to companies (19 per cent of HarbourVest Global Private Equity's portfolio), including via co-investments made alongside other private equity investors.

Hickman believes the heavy use of primary funds is one thing that separates the trust from rivals, describing it as something "most peers have moved away from". He argues that they provide access to talented private equity teams, but also that these funds come with cash flow benefits, given that they put cash to work on a relatively gradual basis.

This is an important technical point, considering that private equity trusts need to ensure enough cash is available to fund future capital calls from their holdings. Famously, a number of private equity trusts ran into trouble during the financial crisis of 2008-2009 when they ended up over committed.

Hickman notes that HarbourVest Global Private Equity's current "unfunded pipeline" comes to £2.5bn, while the portfolio NAV is £3.7bn. "Over time that £2.5bn gets called at roughly 20 per cent a year, meanwhile the portfolio is throwing off cash," he says. The portfolio generated huge levels of cash on the back of corporate activity last year, with the team adding new capital commitments to offset this. The trust has an unused £700m credit facility and nearly £300m of cash on the balance sheet, suggesting it is well prepared to meet capital calls.

Unsurprisingly, Hickman also highlights the trust's diversification and unflagging performance when spelling out how it might differ from the competition. "Our key message is we're a one-stop shop without sacrificing performance," he says. "We're the largest after **3i Group (III)** so liquidity is [also] better than peers."

Dark clouds?

As pointed out in this week's funds feature, it is worth looking at whether exceptionally strong performance from the private equity sector in the past two years is at risk of a pullback. Take some of the names from within the HarbourVest portfolio that have debuted on public markets in the past couple of years: cloud specialist **Snowflake (US:SNOW)**, crypto exchange platform **Coinbase (US:COIN)** and video game developer **Roblox Corporation (US:RBLX)** may be seen as exciting plays on digital advances, but all their shares have struggled in recent months as market sentiment has turned.

Investec analysts Alan Brierley and Ben Newell recently highlighted concerns about the environment becoming less supportive for the likes of HarbourVest's venture capital investments, adding: "We regard this as an exceptional period and believe it is unrealistic to expect these returns to be repeated".

The trust seems highly exposed to sectors that could suffer in a market rotation. It had 31 per cent of assets in tech and software at the end of 2021, with 13 per cent in medical and biotech companies and, like its peers, tends to have an onus on growth.

The pain might be most acute for the listed shares held within the portfolio. Hickman notes that the trust has 14 per cent of its NAV in listed equities, mainly because of IPOs, with underlying funds often subject to lock-up periods before they can fully exit a position. However, he believes diversification should blunt some of the problems associated with any market rotation.

"We have the value side via our exposure to buyouts," he says. "Buyouts are the majority of the NAV – if there is a rotation HVPE could lose to some degree on the growth side but it might take up on the value side. We try to capture a broad swathe [of exposures]."

He adds: "We don't have a huge amount of energy exposure, so it isn't perfect. Through in some of the buyout funds there are businesses in more traditional sectors such as packaging, chemicals, valuations are relatively low. But private equity are looking for a growth angle."

Hickman stresses that diversification should aid the fund, adding that the listed portion of the portfolio is relatively small and unlisted venture holdings should see "less of the froth that you might see in public markets".

Some, including Investec's analysts, still expect HarbourVest to keep delivering superior long-term returns thanks to its diversification and multiple drivers of performance. And now may well be a time when diversification matters the most. ●