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1

David Stevenson: Private equity trusts face a new kid on the block

Their massively entrenched discounts show no signs of narrowing, but City veteran Fred Bouverat may have found a solution.

BY **DAVID STEVENSON**

Fred Bouverat knows a thing or two about private assets. The experienced City veteran, in an earlier incarnation, was tasked by Invesco Perpetual with cleaning up the private assets within the Woodford portfolios before moving on to manage private assets for, amongst others, Jupiter.

Along the way, Bouverat has been involved with floating 28 companies as a major investor, including AJ Bell. He knows better than most how badly the plumbing works when illiquid assets try to live inside structures built for liquid ones. So, when Bouverat talks about private equity investment trusts, I tend to listen.

For many investment trust enthusiasts, the yawning discounts on private equity funds is hard to explain. But not for Bouverat. In his view private equity investment trusts have a structural problem that nobody really wants to talk about: they almost always trade at massive discounts to their stated net asset value, and there's not much anyone can do about it.

'All of the listed private equity funds pretty much trade at a persistent discount, including **Hg Capital** (HGT),' Fred says. Take **Chrysalis** (CHRY) as the obvious example. The fund holds a huge position in Starling Bank and has been stuck trading at around 45% below NAV.

The kicker is that Fred thinks that the discount is actually fair. Secondary buyers in the private equity market, such as Coller Capital, would pay you roughly 30 to 40% below portfolio value anyway, so the market is just pricing in reality.

But there's a nasty twist in terms of the follow-on investment for companies in the portfolio. 'The very time that you need to be able to follow your money in a private company is typically the time when markets are poor and your trust trades at a discount. Therefore, you can't raise primary capital.'

And if you can't follow your money in a new funding round, your existing shares 'could be entirely wiped out by a new class of shares'.

That leaves funds like Chrysalis cornered. 'The only way they could resolve that is effectively sell an asset, return cash, which is what Chrysalis are doing.' Fred says their shareholders are essentially begging the company to just 'sell our bloody shares'.

In Bouverat's mind, the listed PE fund is at a structural dead end. The investment trust wrapper was designed for a different era, and forcing private equity into it creates exactly this kind of slow squeeze where everyone ends up worse off than they should be. And investors end up trapped, watching their NAV erode while waiting for an exit event that may be years away.

That, in Fred's view, is the problem worth solving, and he reckons he can do it via an entirely new market: PISCES, or the Private Intermittent Securities and Capital Exchange System.

This is a new type of private stock market, a platform that allows private companies to trade their securities in a controlled environment and on an intermittent basis, incorporating elements from public markets, such as multilateral trading, alongside elements from private markets that offer greater discretion over what company information is disclosed.

A few weeks ago, Bouverat's business, Tradable Private Equity, executed its first public markets, PISCES-based transaction involving the leading university spin-out technology investment firm, Oxford Science Enterprises, worth around £1.3bn.

His grand plan is deceptively simple. About half the private equity market already trades informally through special purpose vehicles anyway, so why not bring that activity onto a regulated exchange with proper governance, pricing transparency, and genuine investor protections?

His preferred vehicle is called a Tradeable Private Equity Investment Company, or TPEIC, pronounced 'T-pick'. The name sounds technical, but the concept behind it is straightforward. It is an investment company that holds shares in a single private company, sits on PISCES, and trades through quarterly auctions, exactly as you would trade any public equity.

Crucially, it settles on CREST, and there is no bilateral paperwork, no side pocket negotiation, no ringing around to find a willing buyer. You place your order, the auction runs, and the transaction clears electronically.

Bouverat describes the TPEIC as a hybrid sitting somewhere between two existing structures. On one side you have the special purpose vehicle (SPV) market, which has been facilitating private equity secondaries for about 20 years and accounts for roughly half of all secondary volume.

The problem with that market, as Bouverat bluntly puts it, is that it a tad difficult. Deals are bilateral, documentation is heavy, they are often several layers away form the company and not approved, settlement is manual, and the liquidity pools on platforms like Forge remain siloed and largely inaccessible to mainstream institutional investors.

On the other side you have the investment trust market.

The TPEIC is neither of those things. What it does is bolt the regulated market infrastructure of the London Stock Exchange onto the exposure mechanics of a secondary SPV, giving investors something that behaves like a public equity from a settlement and distribution perspective while still giving investors access to a private company.

Once an investor has bought shares through the TPEIC, they have quarterly liquidity. If they want to sell, they participate as a vendor in a subsequent auction, and the same price discovery mechanism applies. The TPEIC can trade at a premium or a discount to the fair value of the underlying shares, which is how liquidity develops over time.

Unlike investment trusts or SPVs, TPEIC are passive and do not charge carry, nor performance fee. Sole a 25bps is charged on a quarterly basis as a servicing fee for quarterly auctions. Bouverat is confident, however, that the structure will not replicate the chronic discount problem that plagues the listed private equity investment trust market.

For the first auction in March involving OSE, TPE worked with brokers including Rothschild, Canaccord, Peel Hunt Cavendish and Winterflood to distribute participation to their clients. Wealth managers and platforms that lack a direct market-making presence access the market through intermediaries like Retail Book, in the same way they would for any other equity transaction.

Time will tell if Bouverat's elegant new design will work – the next auction will probably be in late June or July, and he plans more auctions after that involving plenty more private companies and other investment vehicles. But at long last, public markets do have a rival to the challenged private equity investment trust model.

If PISCES does succeed in attracting a greater range mature private businesses and PE funds, then maybe the investment trust sector will face a real challenge, prompting it to think about the next stage in the evolution of listed alternative funds owning private assets.

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3

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