THE GLOBE AND MAIL

Private equity rewards investors with time and patience

THANE STENNER
Special to The Globe and Mail
Published Tuesday, Dec. 18 2012, 10:57 AM EST
Last updated Tuesday, Dec. 18 2012, 10:57 AM EST

Several weeks ago I noted that there are changes afoot in the high-net-worth portfolio. Simply put, high-net-worth individuals (HNWIs) are shifting out of fixed income and allocating to other assets. One of those preferred assets is private equity.

Over the past several quarters, allocation to private equity among Tiger 21 members has risen to 18 per cent of the total portfolio (a little under two years ago it stood at 9 per cent). That's a fairly sizable allocation, and a pretty dramatic rise of 100 per cent.

So what is private equity, and why are the wealthy so interested in it? And, perhaps most important of all, is there anything the "average investor" can learn from this trend?

As the name suggests, private equity is an equity investment in a business that is not publicly traded. The exact form of that investment can vary. It could be the direct purchase of an operating business (anything from an Internet start-up to a century-old manufacturing business). It could also be an investment in a fund, ETF or closed "pool."

Truth be told, many HNWIs prefer private businesses to publicly traded businesses. The vast majority of them are or have been business owners themselves, so they understand the different dynamics at play, and the opportunities in privately held business that aren't readily available in publicly traded equities.

But there's something else here too. HNWIs are beginning to sense a change in the air – that the growth prospects of privately held businesses currently seem more compelling than those in publicly held businesses.

I recently had the pleasure of speaking to Tom Kennedy of Kensington Capital Partners Limited to discuss the subject of private equity. He's the managing director and chair of the investment committee at one of the more successful private equity/hedge fund firms in the country. The firm has placed over $550-million to private equity investments through its private equity pools/funds over the years.

I asked Mr. Kennedy, why would you want to invest in private equity? "Private equity grows in value in a less volatile and more consistent manner than many other asset classes," he told me. "Its value is not affected by daily issues that impact public securities. Growth in value is driven by managers of the businesses whose interests are closely aligned with the interests of investors."

Another positive: private equity can offer great returns. "For over 25 years [private equity] has performed better than public equity," Mr. Kennedy told me.

Still, isn't private equity a risky business? The old saw is that for every start-up that succeeds there are nine others that fail – what do private equity managers do to ensure investors are on the right side of this equation?

Mr. Kennedy told me that in actual fact, start-ups are a very small part of the private equity world. "They are high profile when they succeed so people think of early stage venture capital as being private equity," he said. "But it represents less than 10 per cent of the private equity landscape."

"Because they are less exciting, most people don't talk about good companies purchased for five times cash flow. Those businesses are often sold to large corporations looking to expand by acquisition, and investors make two-three times their money in a quiet private sale."

But still, isn't there some risk by investing in things that are outside public scrutiny?

"The risk in the private equity is not greater than the risk in the public equity market, but it is different," he admitted. "Prudent diversification, concentrate on quality, intensive due diligence, and watch your investments carefully to be sure you know what is going on with your portfolio."

Is there something about the current climate that makes private equity particularly compelling?

"Buying well is an important component of investing," Mr. Kennedy said. "In this environment, sellers' price expectations are realistic so it is possible to buy well. Financing is inexpensive as well so the overall cost of ownership is good." Add both of these together and you get a pretty compelling case for private equity "With modest economic growth it is possible to build businesses, so value creation is underway in this environment."

Interested in putting some of your money to work in private equity? Here are some quick tips:

Patience is key

Let me be blunt: private equity is not for people looking to make a quick buck. This is a long-term asset for those looking for long-term appreciation. If you can't wait at least 5-7 years before seeing a payoff, take your money elsewhere. The higher return should make up for the lack of liquidity.

Not all private equity is created equal

A really important point, driven home by Mr. Kennedy. Don't assume private equity is a one-size-fits all investment – it comes in all shapes and sizes, and in all risk profiles. A private equity investment could be a venture capital/start up situation or just as easily an established business. Figure out which side of the game you want to play on.

Management, management, management

When you invest in private equity, you're really aligning your interests with management. So get to know them.

Understand their vision for the business. Find out what they plan to do to increase value.

Diversify

There's no reason why you need to put all of your private equity "eggs" into one basket. There are some good ETFs operating in this space, and some very good funds and pools run by professional managers. They're well worth checking out.

Thane Stenner is founder of Stenner Investment Partners within Richardson GMP Ltd., as well as portfolio manager and director, wealth management. Thane is also Managing Director forTIGER 21 Canada. He is the bestselling author of 'True Wealth: an expert guide for high-net-worth individuals (and their advisors)'.www.stennerinvestmentpartners.com(Thane.Stenner@RichardsonGMP.com). *The opinions expressed in this article are the opinions of the author and readers should not assume they reflect the opinions or recommendations of Richardson GMP Ltd. or its affiliates. Richardson GMP Limited, Member Canadian Investor Protection Fund.*

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • Fax: 1-866-722-4242 • www.portlandic.com • info@portlandic.com

PIC13-047-E(09/13)