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RIT Capital Partners

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Compelling Contrarian Opportunity

- RCP suffered a big share price move yesterday, down 9.5% in response to downgrades.
- The focus of attention is on the private investments in RCP's portfolio and concerns that these positions will suffer large drawdowns in light of last year's volatility.
- We take a different view and reiterate our confidence in the manager and this diversified strategy, highlighting some important mitigating factors that may have been missed.

With RCP trading on a 19% discount, there has rarely been a better time to pick up the shares, for those investors that can look beyond the headline grabbing concerns.

RIT Capital Partners (RCP) is one of a handful of more directional (higher equity beta) trusts in the flexible sector. This vehicle has a long track record of producing equity-like returns with lower than market volatility and an asymmetric return profile – capturing more market upside than downside.

The shares have been under pressure over the past 12 months to 4 January 2023, down 19% versus an NAV TR down 11% (to end-November 2022). Yesterday the shares were down another 9.5%, as concerns over the private equity exposure in the portfolio were flagged by a high profile share tip column. These concerns are not new and are not exclusive to RCP. A number of the hybrid (public/private equity) strategies have had their private investments exposure scrutinised and, in the current environment, the default response is to assume NAV downside and sell.

RCP has 41% of NAV exposed to private investments (as at end-November 2022), through both funds (28% of NAV) and direct investments (13% of NAV). The concerns range from the negative impact of future valuations, read-across to both listed and private market comparable indices, and the potential for a deterioration in market conditions impacting the individual companies.

We see things differently:

- RCP is a **diversified multi-asset portfolio** that has seen a number of different cycles. Private investments are not new to RCP, the combined exposure to private equity funds and direct private investments has averaged c.27% over the past 10 years (16% funds, 11% directs), with the bias being consistently towards diversified funds exposure. Today's level of private investments is higher but this is a function of strong NAV growth from this "cylinder" over recent years.
- RCP's **direct private investments** exposure is focused on the digital economy transition and has a growth/technology bias. However, it is not blue-sky. Four out of the five top direct holdings are profitable and across the whole direct portfolio, the median cash runway is estimated to be over five years. Therefore, we feel that a read-across to a benchmark such as the Goldman Sachs Non-Profitable Tech index might not be the most reflective.
- RCP's **asset allocation** offers diversification and, within this, a portfolio construction discipline that seeks to avoid unintended concentration of risk. Hence the long-only quoted equity exposure has low exposure to information technology sectors and strategies that sit in the Absolute Return & Credit allocation offer a counterpoint to the equity-risk.
- Given that private investments can be opaque and infrequently valued, it is understandable as this should cast doubt over future NAV prints for RCP.
- We note that the **fund valuations**, which appear in RCP's NAV as they are received, are up-with-events. RCP's end-November 2022 NAV includes 92% of fund investments valued at end-September 2022. This is important as the bulk of 2022's de-rating appeared in 1H22. Since end September 2022 to date, the MSCI World Index is up 11% and the MSCI World Technology index is up 5% in USD terms. This is also relevant to the direct private investments.
- The **fund portfolio is diversified** by sector, stage, geography and maturity profile.
- In terms of **monitoring**, the direct private investments are monitored closely by the investment team and, in exceptional circumstances, some positions will be adjusted between the formal six-monthly valuation points (eg Coupang). RCP's has board seats on direct holdings and sits on a number of fund advisory boards.
- The **direct portfolio valuation** is overseen by an independent Board Committee chaired by Mike Power and the valuations are also subject to an external audit. In line with RCP's overarching philosophy, the aim has always been to operate at the more conservative end of fair value and the interim results confirmed that this Committee has been proactive in reflecting the de-rating in 1H22. Also, the team prides itself on buildingin structural protection into their private investments.

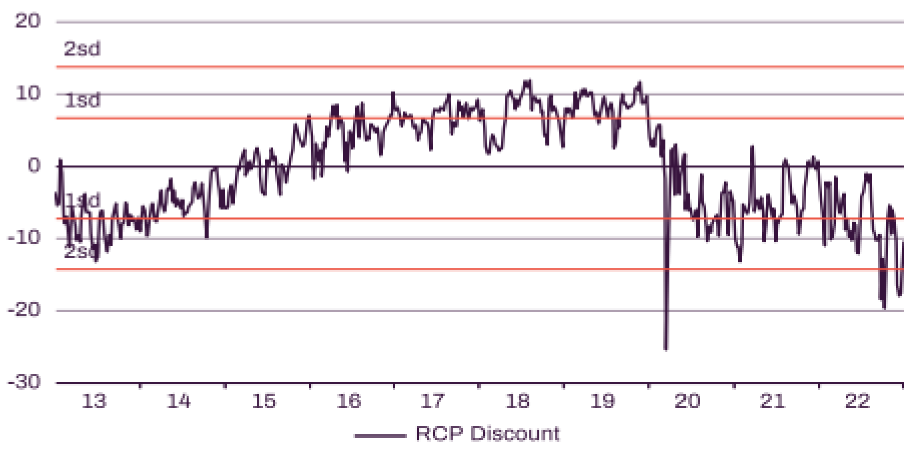
- In spite of all the negativity and the IPO market being closed, there are bright spots on the private investment portfolio, which get too easily overlooked. Specific names that we would highlight include Motive, Epic Systems and Animoca. We also note that in the interim results to 30 June 2022, there were some funding rounds at higher valuations for holdings such as Motive and OneFootball, which helped to partially offset multiple compression. More recently, we understand that a long-term direct holding is in sale discussions.
- RCP benefits from the **closed-end structure** at times like these and the release of funds from realisations and fund distributions will help the team to recycle capital and take advantage of opportunities.

To conclude, there are a number of mitigating factors to consider when assessing the risks presented by RCP's private investments exposure. At 41% of end November 2022 NAV, private investments are a material part of the portfolio. However, they are not homogeneous. The fund holdings offer diversification and the direct holdings are idiosyncratic.

Looking back at equity markets in 2022, 1H22 and 2H22 were quite different (MSCI World TR -20% and +3%, respectively) and this may have a part to play in assessing the valuation of direct holdings. We consider 1H22 to be in the NAV and not new-news. The next NAV print (expected end January/early February 2023) will reflect not only the read-across to listed markets and transactions in the private markets but also the operating performance of the companies.

Yesterday's sell-off implies there is lots of bad news to come. However, we do not believe it will be as bad as the market suggests and see considerable value with the shares on a 19% discount. This discount is more than two standard deviations away from the 10-year mean and this is only the second time that we have seen this happen in the last decade.

Figure 1: RCP discount (last 10 years)



Source: Datastream