



# Crossover Opportunities

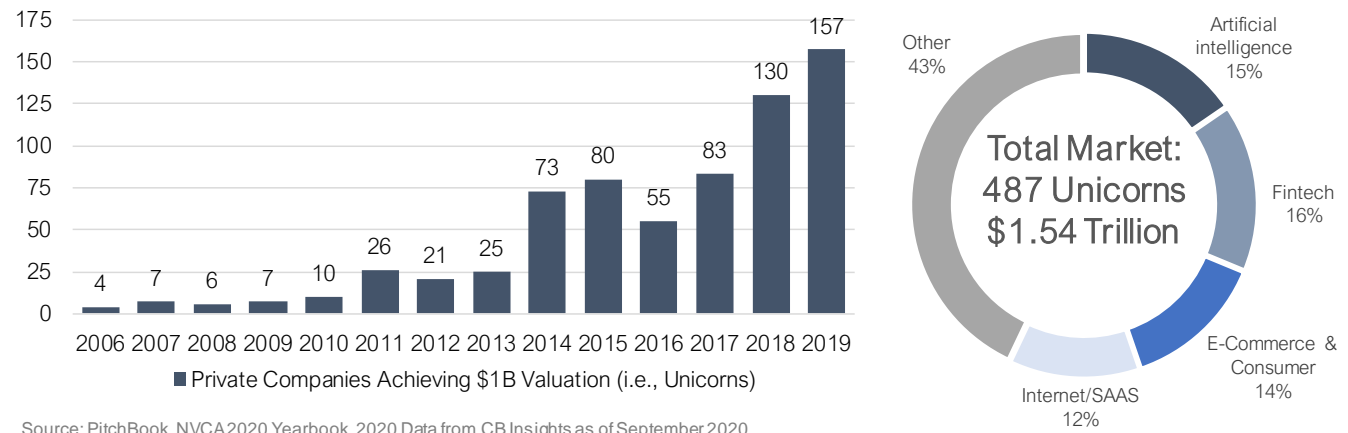
White Paper

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## Defining the Crossover Opportunity

The recent mega-IPOs of Uber, Snowflake, and ANT Financial have highlighted a growing trend in today's equity marketplace – companies are staying private longer and going public at more significant valuations versus the past. Smaller, more innovative private competitors have always been important industry participants, but over the past ten years, the desire to avoid the complexity/cost of public markets, technological efficiencies reducing capital needs and the wide availability of capital in private markets has relieved pressure on founders/entrepreneurs to go public early in a company's life cycle. The result is that more value is now accruing to private market investors.

Figure 1: Growth in Large Private Companies (i.e., Unicorns)

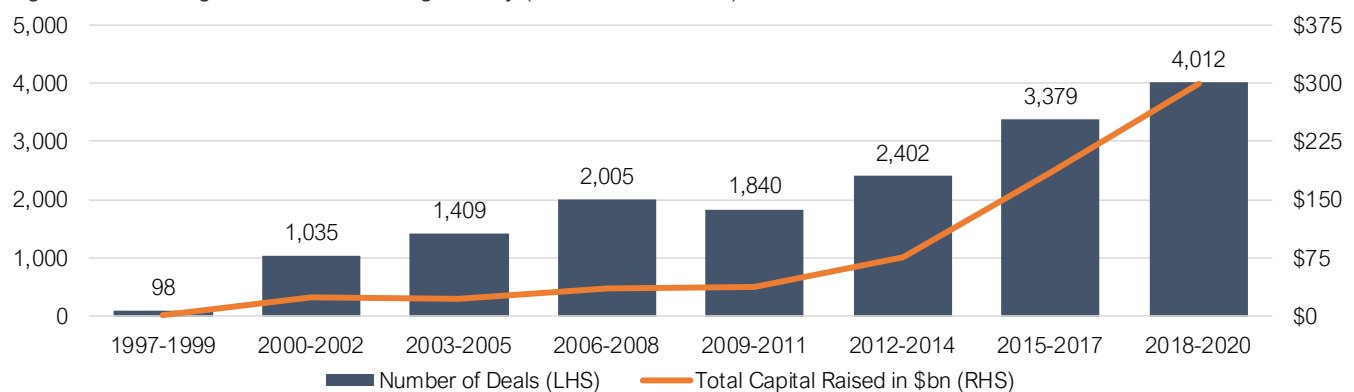


Traditionally, private companies were exclusively the domain of venture capital and private equity firms, while liquid equity strategies focused on companies after their Initial Public Offering (IPO). However, the extension of the private company life cycle has spawned growth in a new strategy: crossover investing. Crossover strategies attempt to bridge the gap between long duration, locked-up venture capital and public-only investing. Investors gain the flexibility to invest in various stages of a company's growth – starting with late stage private equity and continuing through the IPO lifecycle. By expanding the opportunity set across public and late stage private markets, crossover strategies offer a compelling option for investors looking for active management within the highly dynamic growth equity segment.

## Pre-IPO Market and Opportunity Set

Activity in the private marketplace has exploded in recent years, but unlike the speculative technology boom in the late 1990s, a significant amount of capital is migrating towards more established companies. In the past, emerging growth companies would typically raise capital via an angel or seed investor along with one or two follow-on rounds prior to IPO as a relatively unproven company. In today's market, however, private companies are offering many more rounds of private financing and delaying their IPO dates.

Figure 2: Late Stage Private Fundraising Activity (Series C and Later)



The result is that in many high growth industries, private disruptors are among the most compelling investments. Such companies have already cleared many of the early business development hurdles, have real revenue streams, and are well-established players in the competitive landscape. In prior periods, a vast majority of these companies likely would have already gone public.

Figure 3: Public/Private Research Example – FinTech Digital Payments

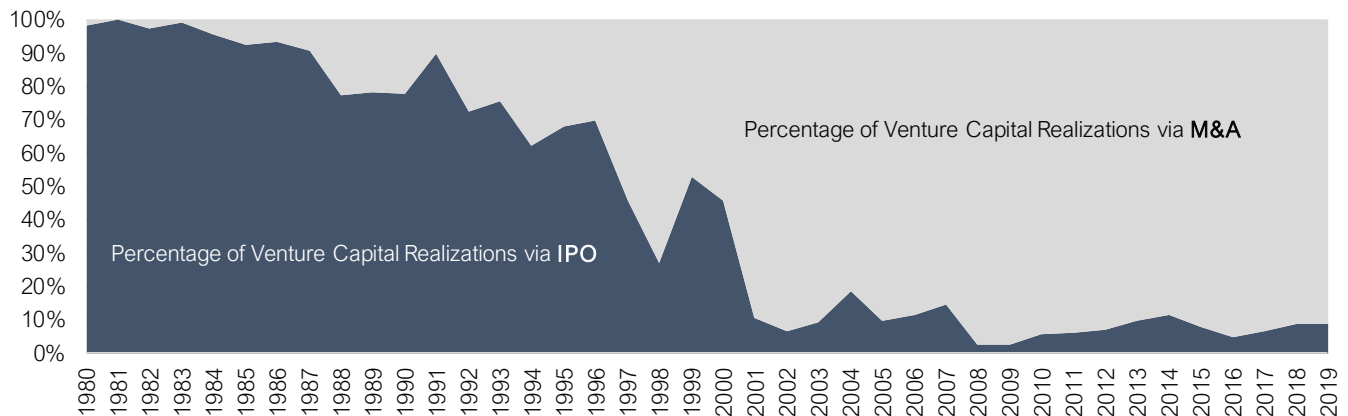


It has become essential for any diligent public market investor to understand both the public and private market competitive landscape. Building a private company network is now a critical tool for public market analysts. With the lack of fair disclosure restrictions, private company management teams can share much more information than their public peers. This private market intelligence is invaluable for investors analyzing an industry or company (public or private). The knowledge base and relationships built at a private company can benefit an investor for years to come, particularly once a company goes public and an investor has a multi-year head start on understanding the business. Pursuing a public only mandate limits the investable universe while crossover investing allows active managers to capitalize on their existing network by expanding the opportunity set.

### Duration and Exit Strategy

Companies targeted by crossover investors may be private today but there is typically a path to an Initial Public Offering within the near future (<3 years). These companies are often executing financing rounds with a variety of strategic objectives beyond simply raising capital. Valuations in these rounds are often substantial and reflect the blurred line between late stage private equity vs. early stage public equity. For the company raising the money, late stage rounds are often an opportunity to broaden their investor base beyond traditional venture investors. There is strategic importance attached to including crossover or traditionally public market investors in these rounds. Public market investors can offer insights about the intricacies of public markets and provide guidance for private companies as they make business decisions in the years leading up to a public listing. These public equity investors are also likely longer-term owners of the publicly listed stock as they have no pressure to return capital to investors the way their VC brethren do. In modern day capital markets, the crossover approach can be much more symbiotic for both the company and the investor.

Figure 4: Evolution of Exits for US Venture Capital, 1980-2019



Source: PitchBook, NVCA2020 and 2010 Yearbook

In addition, as shown in Figure 4 above, while many of the most high-profile companies eventually do enter the public market via IPO, many private companies are purchased prior to a public liquidity event. This includes several well-known brands such as WhatsApp, Instagram, YouTube, and Zappos. Public-only strategies may actively track these companies for competitive analysis but are unable to participate in these non-IPO monetization events.

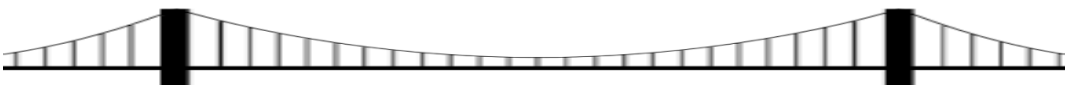
The evolution of the Special Purpose Acquisition Company (SPAC) industry could be a further accelerant to value creation and realization in the late stage private investment market. Improved structures, larger vehicle size and more reputable sponsors have established SPACs as a legitimate third option for private companies to utilize in going public (along with traditional IPOs and direct listings). This new crop of sponsors often includes highly respected private equity investors and/or individuals with deep industry contacts and insights. These sponsors are well situated to negotiate potential deals with high quality, mature private companies. From a company standpoint, a SPAC is a less invasive, more direct process which disintermediates the costs of traditional IPOs led by investment banks. Additionally, the directly negotiated deal between SPAC and entrepreneur eliminates the dependency on favorable capital markets conditions relative to IPOs and direct listings.

**Crossover Strategies: Bridging the Gap**

Crossover managers build hybrid portfolios that blend liquid and less liquid opportunities, often focusing on highly dynamic growth industries such as fintech, software, and biotech. Relative to traditional public equity managers, crossover strategies offer a wider set of opportunities to monetize their research efforts. In exchange, crossover strategies take modest illiquidity risk, typically focusing on late-stage investments that are 1-3 years from an expected IPO. This approach also allows crossover strategies to participate in potential M&A exits while still maintaining the optionality to participate in the long-term value creation as a public company.

Relative to venture capital, crossover investing seeks to reduce risk by making private investments after the company has established itself as a strong competitor but remains in a period of rapid growth. Venture capital has traditionally focused on high risk investing in early to mid-stage private companies, often making initial investments well before a business is generating any revenue. The venture model is typically built to invest in companies where the probability of failure is high but offset by the very substantial payoffs in a small number of winning investments. The early stage investment nature of VC also requires a longer time horizon until any gains are realized by investors – typically over 5 years and often closer to 10 years. Once a private company goes public, VC investors are typically eager to return cash to investors and are active sellers of the publicly listed shares (upon IPO or shortly thereafter). This leaves VC investors in a poor position to benefit from the long-term success of the best companies in their portfolios.

Figure 5: Bridging the Gap – Crossover Strategies Relative to Venture Capital and Public-Only Strategies

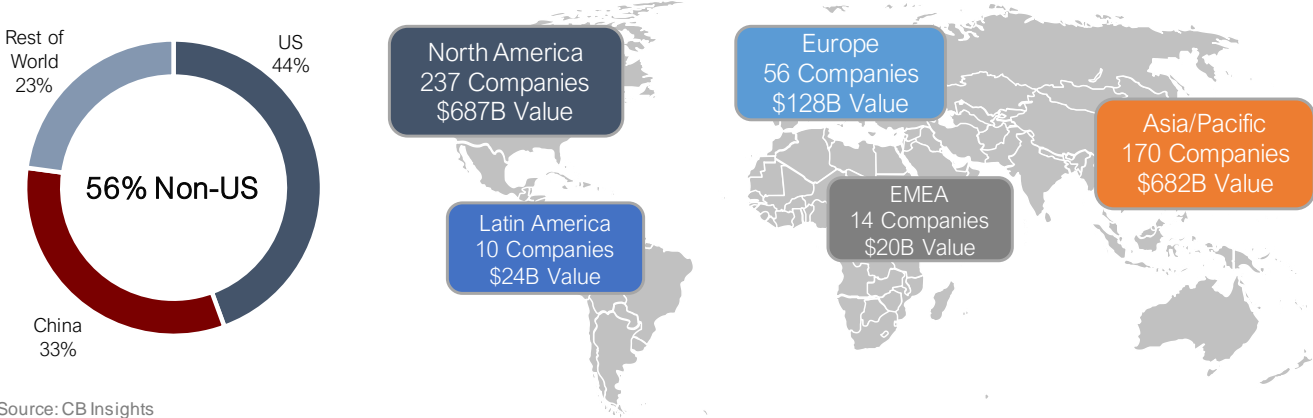


Product Features	Venture Capital	Crossover Strategy	Public Equity
Mandate	Early-Stage Private	Late Stage Private + Active Public	Active Public
Structure	Drawdown	Fully Invested	Fully Invested
Investment Strategy	Low Success Rate / Big Outliers	High Success Rate + Big Outliers	High Success Rate / Small Outliers
Investment Horizon	>5 Years	1-3 Years	Daily – Multi-Year
Liquidity Profile	Illiquid	Majority Liquid	Highly Liquid
Post-IPO Strategy	Cash Out	Total Flexibility	Total Flexibility
Capital Protection	Fully Exposed	Flexibility to Short	Strategy Dependent (long/short, long-only)

Crossover investing fills this void in capital markets by remaining actively involved throughout the private-to-public process. Importantly, crossover investing is not simply a long-only approach. While many verticals are not zero-sum games, there are typically winners and losers in any market segment. Being long the most dynamic public or private companies is only part of the opportunity. Often these innovators are taking market share or rendering obsolete the larger incumbents in the marketplace. There are also plenty of “me too” competitors who will not be long term value creators. Having the ability to short (bet against) the weaker competitors or obsolete technologies is a key element in managing volatility and generating alpha for the most flexible public equity investors.

Lastly, growth in late-stage private markets is not limited to the US. In fact, the majority of large private companies (i.e., unicorns) are based outside the US. In addition to China, large countries such as India and Brazil have seen growth in private market values as rapid adoption of technology by consumers and businesses has contributed to the rise of innovative growth companies in these markets. Given the lower technology penetration rates, companies in emerging markets often have much longer runways for growth than their developed market peers.

Figure 6: Unicorns by Region



Source: CB Insights

### Conclusion

Crossover investing is designed to combine the best of venture capital and public equity investing. The strategy provides access to many of the world’s fastest growing companies while maintaining flexibility to invest across a wide range of opportunities. Unlike public market investing where access and liquidity are readily available to all investors, late-stage private equity investing requires a much more intricate skill set – detailed private market insights, a robust network to access the top deals, and a highly selective process. These attributes are typically reserved for specialized managers that have an extensive history of investing in specific areas of the market. Given the highly active nature of the strategy and longer time horizon, investors should be highly selective about which managers they partner with to access this dynamic growth opportunity.

## Important Notes & Disclosures

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