



Mutual Funds Now Believe in Unicorns

By Tim McLaughlin and Heather Somerville (excerpt)
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Some U.S. mutual funds are boosting their performance with relatively big bets on private companies such as Uber and Pinterest, which they have been marking up at a rate far greater than the broad stock market.

Relied upon by millions of Americans to save for their retirement, mutual funds emphasize that their investments in young tech companies ahead of their initial public offerings are relatively small.

A Reuters analysis of fund filings and other data shows, though, that some have taken a more aggressive approach, boosting the share of these companies to more than 5 percent of assets and awarding them rich valuations that in some cases have helped them beat their benchmarks and peers by a wider margin.

Mutual funds' involvement also helped boost the number of so-called unicorns - private companies valued at \$1 billion or more. ...

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Mutual fund investments, however, have measurable effect on companies' valuations. Those that received such financing last year saw their valuations more than double over their previous funding round. In contrast, valuations of companies that raised cash without mutual fund investors grew 1.5 times, according to PitchBook, a private equity, M&A and venture capital database.

The Securities and Exchange Commission (SEC) has been asking mutual fund companies how they value their stakes in companies like Uber, Pinterest Inc and Airbnb. ...

...Pre-IPO investments are assessed by mutual funds valuation committees which look at revenue growth, competition, barriers to entry and what others paid in subsequent funding rounds. Fund managers are excluded from the discussion, but like other employees stand to benefit from mark-ups because management fees tend to rise with the value of assets. ...

...Venture capital firms typically value tech holdings quarterly, but share those valuations only with their limited partners - institutional investors with a greater understanding of the risks involved.

"Who doesn't think Uber has a great thing going?" said David Kudla, CEO of Mainstay Capital Management, which has \$2 billion under management. But many got caught off guard when valuations of firms such as Dropbox or Zenefits get slashed, he said. "There is a lot of risk in these pre IPO investments."



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