



Beyond Valuation: Communicating Value

Alternative View November 2008

The following is an edited excerpt of a presentation I gave in Hong Kong to a group of hedge fund, private equity and traditional asset management executives, general counsels and compliance officers. The panel discussion was held in November 2008 and explored the complexities of valuing less liquid assets. It was hosted and moderated by Phillipa Allen and Alex Duperouzel of ComplianceAsia.

I hope you find it of interest.

Thomas Walek
President, Walek & Associates



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Over the 10-year history of Walek & Associates, we have been fortunate enough to work with most of the biggest and best traditional and alternative fund managers in the world, as well as with many smaller up-and-coming managers.

We look after our clients – large and small – by generating press coverage to build and support our clients' reputation, brand, and market position and to help them build their business.

That's a lot more than just knowing a few reporters. That's understanding how the press works and using the press to further the business interests of our managers.

I mention this background to underscore the point that I come to today's topic of securities valuation from a different place than my distinguished fellow panelists. My job is to help clients communicate valuations to the marketplace and, inevitably, to the media.

Below are some observations that guide my thinking on this topic.

Reputation Matters

We are in the midst of the biggest shake up in the history of the fund industry. For the hedge fund sector in particular, we are entering what I call Hedge Fund 3.0.

Hedge Fund 1.0 was the nascent period beginning in 1949 and ending with the start of the Long-Term Capital Management collapse in 1998, an event which put the hedge fund business on the global map.

Hedge Fund 2.0 spanned 1999 to 2008 and was a period of extraordinary growth.

Hedge Fund 3.0 begins today. As we enter this new era, there is a lot we don't know. What we do know is that one year from now many funds, fund managers and service providers will not be doing what they are doing today.

So who is going to make it?

The survivors will not just be the managers with the best numbers or the most assets. The survivors will be those who built solid reputations, high levels of trust and strong bonds of loyalty with their investors.

Valuation today – like never before – is front-and-center for investors. How you handle valuations says as much about your fund as the valuations themselves. Adopt a clear and consistent policy and stick to it.

Your firm's reputation, brand and relationships with your clients must be built on shared vision and purpose. Your reputation matters.

Eyes of the world

Much of my work is done through the filter of the media. What that means is that my clients communicate through letters, quarterly and annual reports, presentations, web sites, ads, speeches and the like – some of which, like it or not, is reported in the media.

When that happens, investors, allocators, credit providers, and competitors all read about your company. Ultimately, media coverage helps the marketplace



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form opinions about your firm.

Media attention on this industry is intense and is growing by leaps and bounds. And this media coverage has never been sharper than it is today. According to my firm's forecasts, in 2008 the press worldwide will write articles about or including hedge funds on average more than 200 times a day. That's double the number of articles of just two years ago. And from our Hong Kong perspective today, the Asia-Pacific region alone accounts for some 15 percent of this coverage, a level which has been growing by more than 40 percent annually for the last few years.

Communicate value, not just valuations

In working with both traditional and alternative funds for many years, I have never recommended that any client market their funds or brand their fund management companies based on performance alone.

Your investors are buying you – your intelligence, your experience, your insight, your strategy, your infrastructure, your processes – what you do and how you do it. They want you and that's the real value that you provide.

More and more funds are facing valuation challenges due to illiquid markets and securities, uncertain pricing, credit problems, and related developments. This is compounding already high investor anxiety.

As the recently released Alternative Investment Management Association's *Roadmap to Hedge Funds* makes clear – “a sound valuation policy is prerequisite for all financial institutions, including hedge funds.”

From a public relations perspective, proper handling of valuations is another chance to communicate your value to your investors. It's another chance to build a bridge of reputational strength to your investors that will pay dividends in your relationships long after difficult market conditions have passed.

Accountability and transparency in the valuation process are key. A weak valuation policy can have an extremely negative impact on investors and, by extension, on the media that are watching you so carefully. This situation is magnified in today's volatile and less liquid market conditions.

The last thing I want my clients to face is a very public pricing dispute with unhappy investors. The press will love this. You will not.

In communicating valuations and ultimately performance, you must communicate your value and your values to investors and to the market.

Tactics

Now let's turn to tactical recommendations.

First, client communications. Client letters, monthly statements, secure web postings and quarterly reports are often used as tools for communicating fund valuations and, of course, performance. Please do not think that in today's market conditions even confidential client letters are just being read by clients.

These communications are making it into the hands of the press very quickly. We continually see examples of client communications going from fund managers to public web sites and newswires in literally just minutes.

When writing client communications, be factual, be short, don't speculate, and



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Contacts:

Thomas Walek
President
852.2273.5102
twalek@walek.com

Armel Leslie
Principal
Global Capital
212.590.0530
aleslie@walek.com

Mary Beth Kissane
Principal
Investor Relations & Corporate
Transactions
212.590.0536
mbkissane@walek.com

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look ahead. If you make a mistake, need to revise a mark, or get something wrong with a valuation, fix it honestly and quickly. In reality, however, this is not the time to make mistakes.

Make decisions on sidepockets, delayed reporting, fact versus speculation, and other tactics as you believe you must. However, please factor in the possible long-term business and reputational impact of these decisions for you, your fund and your fund company.

Second, build your brand and build client loyalty. When done effectively, this process involves a smart combination of investor relations, media relations and corporate communications. It takes place over time and encompasses everything you do.

Third, if you have a problem or a crisis, treat it as such and handle it with respect. There is everything at stake. We see and help clients in many of these situations.

In one very high profile crisis we dealt with, the client initially and, as it turned out, mistakenly used incomplete marks to estimate large portfolio losses. This was done under pressure from investors. Making a bad situation worse, the client subsequently issued revised numbers that more than doubled the portfolio losses. That early, misjudged reporting helped set the stage for the end.

In a crisis, my first job is often to get clients to accept what is happening and get them to focus on dealing with the situation at hand. This is an even bigger problem in cultures that may not embrace an up-front, rapid handling of difficult situations. But in our view, delaying only compounds problems.

Fourth and final, build a business. The days when a manager could sit in front of his or her Bloomberg terminal, make investments and attract real outside money are over. In addition to investment edge and expertise, you must have and communicate confidence, structure, process and financial strength.

I know that this is not what some managers want to hear, but in today's market, you must build a business along with an investment portfolio.

Thank you.



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NEW YORK

LONDON

HONG KONG

Walek & Associates
317 Madison Avenue
Suite 2300
New York, NY 10017
T: 212 889 4113
F: 212 889 7174

Walek & Associates (Hong Kong) Limited
21/F, ICBC Tower, Citibank Plaza
3 Garden Road, Central
Hong Kong
T: 852 2273 5102
F: 852 2273 5999

www.walek.com