MARTEN & CO

Update | Investment companies

22 February 2017

Standard Life Private Equity

Dividend doubled to 4.0%

Standard Life Private Equity Trust (SLPE) is implementing a package of measures to refine its strategy that includes a significantly higher dividend, the removal of size and geographic restrictions, increasing flexibility in cash management and a simplified management fee structure. SLPE has provided strong absolute returns in recent years but, despite discount contraction during the last year, it trades at a low-teen discount. The changes are designed to make SLPE more attractive to investors, with the aim of stimulating a further discount narrowing.

European-focused private equity fund of funds

Standard Life Private Equity Trust aims to achieve long-term total returns through a diversified portfolio of private equity funds, a majority of which will have a European focus. Historically, SLPE has occupied a unique position within the UK-listed private equity sector as the only fund of funds focused solely on Europe and, while it has refined its strategy, it says it will continue to be the most European-focused fund in its peer group. Its portfolio is also more concentrated than most of its peers; around half of the portfolio accounted for by the top 10 holdings of leading private equity funds raised by leading managers.

Like many private equity funds, SLPE has no formal benchmark. Historically, the portfolio has been most closely correlated to European small cap indices and we expect this to continue. We have used the MSCI Europe Small Cap Index as a means of comparison.

Year ended	Share price total return (%)	NAV total return (%)	MSCI Europe Small Cap TR (%)	MSCI Europe total return (%)	LPX Europe total return (%)
31/01/13	42.6	(0.3)	24.2	20.7	28.1
31/01/14	12.4	10.8	25.7	10.4	18.7
31/01/15	5.6	2.4	3.1	7.4	10.2
31/01/16	0.0	18.0	8.8	(3.4)	6.5
31/01/17	50.3	21.9	25.3	23.5	37.9

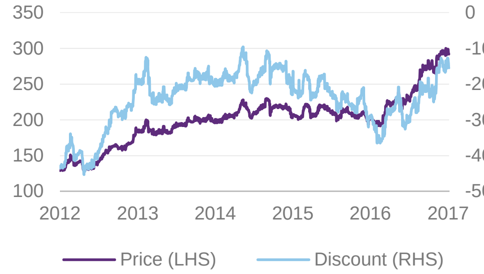
Source: Morningstar, Marten & Co.

Sector	Private equity
Ticker	SLPE LN
Base currency	GBP
Price	300.00p
NAV*	343.81p
Premium/(discount)	(12.7%)
Yield**	4.0%

* Morningstar estimate, last published 340.4p at 31 Jan 2017.
** based on rebased dividend of 12p per share for 2017 year.

Share price and discount

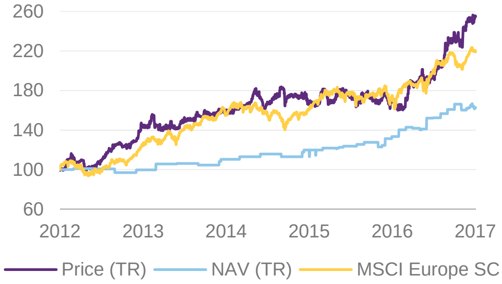
Time period 31/01/2012 to 31/01/2017



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/01/2012 to 31/01/2017



Source: Morningstar, Marten & Co

Domicile	UK
Inception date	May 2001
Manager	SL Capital Partners
Market cap (GBP)	461.1m
Shares outstanding	153.7m
Daily vol. (1-yr. avg.)	155.5k shares
Net cash	14.8%

Click here for our initiation note
Click here for our most recent update note

Strategy changes

On 24 January 2017, shareholders gave their approval to changes being made to the Trust's investment objective and policy and, to reflect these changes, a change in the Trust's name was approved as well. The changes are discussed in greater detail below but, in summary, comprise the removal of the geographic and size restrictions, while allowing greater flexibility in cash management. These changes have been accompanied by a significantly higher dividend and a simplified management fee structure. The revised strategy is designed to enhance returns to shareholders and thereby make SLPE more attractive to investors.

Background to the strategy changes

The strategy changes are being implemented with the aim that they will help address a discount that has been frustratingly high. We think the discount will continue to narrow following the new measures.

As discussed on page 8, the absolute returns generated by SLPE's strategy have been strong in recent years (to such an extent that its five-year performance fee hurdle was triggered). However, despite this, the discount has remained high (it averaged 26.7% during the 2016 financial year) and while this is consistent with SLPE's private equity peer group, it has frustrated the board. The board regularly assesses opportunities to address the scale of SLPE's discount and, following a strategic review, concluded that it would be beneficial to increase the private equity opportunity set available to SLPE's manager by removing the current size restrictions and broadening the geographic reach on private equity investments. SLPE's discount tightened during the course of 2016 from circa 25% to 13%; it continues to trade at a low-teen discount. We believe it will continue to narrow.

More than doubling the dividend

SLPE's board is more than doubling its dividend to 12p per share for the 2017 financial year (2016: 5.4p). This is a 4.0% prospective yield.

For the year ending 30 September 2017, SLPE's board is increasing the total dividend by 122.2% to 12p per share (the total dividend for the 2016 year was 5.4p per share). The board's aim is to rebase SLPE's dividend to a higher level so that it offers a much higher yield. Based on the share price of 300p per share, as at 20 February 2017, this puts SLPE on a prospective yield of 4.0% and places it towards the top end of its peer group range.

SLPE's manager expects that the new dividend will be approximately 50% covered by current year revenue with the rest being paid out of capital.

Historically, SLPE's policy has been to pay covered dividends out of income. For example, the dividends for 2015 and 2014 of 5.25p and 5.0p were more than covered by income during their respective financial years, of 5.69p and 5.69p. However, the dividend for 2016, of 5.4p was not covered by revenue income of 4.59p. Under the new policy, the manager expects that approximately 50% of the dividend will be covered by current year revenue, but this will vary from year to year. The rest will be paid out of capital. SLPE's manager says that while it does not expect the new dividend to be fully covered, SLPE has a relatively mature portfolio and so generates relatively high levels of cash. SLPE's cash balance was £77.3m at 31 January 2017.

The board is committed to maintaining SLPE's new higher dividend in real terms.

Further information regarding SLPE's previous dividend payments and dividend policy is provided in our May 2016 initiation note (see page 8 of that note). However, as per its existing dividend policy, SLPE's board has said that it is committed to maintaining the real value of the new enhanced dividend, and growing it at least in line with inflation, in the absence of unforeseen circumstances. This should offer shareholders some assurance that the new higher yield will likely be maintained.

Please click here for an up to date peer group comparison of SLPE versus its private equity peers.

Many of SLPE's private equity peers do not pay a dividend and we think that SLPE's prospective yield of 4.0% is sufficiently high that it could prove attractive to income investors who are prepared to look beyond the traditional sources of income, particularly given the intention to at least maintain the dividend in real terms.

Simplified management fee structure

SLPE has a new fee structure. The performance fee element has been removed altogether and, to compensate, the base management fee has increased to 0.95% of net assets, from 0.80%.

For the year ending 30 September 2017 (the current financial year), SLPE has a new simplified fee structure in place. Under the new arrangements, the base management fee has been increased from 0.80% to 0.95% of net assets, whilst the performance fee element has been removed. SLPE's board believes that the new arrangements will deliver value for shareholders and expect the Trust's total expense ratio to be in the region of 1.10% for the current year (2016: 0.99% excluding the performance fee).

Further information regarding SLPE's previous fee structure is provided in our May 2016 initiation note (see page 20 of that note). However, in summary, the performance fee was equivalent to 10% of any diluted NAV growth above an 8% annualised hurdle. This was measured over a five-year period, to reflect the longer-term nature of private equity investing, that ended on 30 September 2016. SLPE's NAV experienced strong growth during this period and, as a result, a performance fee of £6.4m was triggered. In our view, the new simplified fee structure makes sense in what is a competitive sector.

SLPE now aims to achieve long-term total returns.

Another subtle change is to the type of returns SLPE seeks. Previously, SLPE's investment policy aimed to achieve long-term capital gains, now it aims to achieve long-term total returns. We expect that, given the nature of the asset class, the majority of returns will likely be from capital gains, but believe that focusing on the overall return, whether through income or capital, is in shareholders' best interests.

Removal of geographic and size limits, while shifting to total returns, but retaining its European focus

SLPE's restriction on non-European exposure has been removed. However, the majority of SLPE's portfolio will still have a European focus.

Previously, SLPE's investment policy restricted it to having a maximum of 20% of gross assets, at the time of purchase, invested in private equity fund investments outside Europe, with the focus being on leading private equity buyout funds. Under the new investment policy, the 20% restriction has been removed. However, the Trust's investment policy still contains a commitment to Europe as the majority of the Trust's portfolio will continue to have a European focus.

SLPE remains focused on buy-out funds, but is no longer restricted to those focused on transactions in the €100m to €2bn range.

The principal focus remains on 'leading private equity buyout funds', although the restriction that these be focused on mid to large sized buyouts (categorised as transactions with enterprise values between €100m and €2bn) has been removed. SLPE's manager says that, as part of its broader business, it sees funds that are investing in smaller mid-market deals that are generating excellent returns. Removing the size restriction will allow it to allocate to this area (it currently has three to four European funds that it has identified as potential candidates). It also says that it has strong relationships with excellent North American managers that would be potential investment opportunities for SLPE. This becomes possible with the removal of the geographic restriction. Overall, SLPE's manager believes that the removal of the geographic and size restrictions increases the opportunity set and offers increased opportunities to add value for shareholders.

SLPE is now permitted to purchase packages of secondary fund positions.

Although not formally part of SLPE's investment policy historically, SL Capital, the Trust's investment manager, will continue to manage exposure through the secondary funds markets and this has now been formally incorporated into SLPE's investment policy. A key change is that SLPE now has greater flexibility when purchasing secondary positions. Historically, it normally purchased single lines and frequently these would be to bolster positions in funds the SLPE already held. The manager can now consider broader portfolios or bespoke opportunities with attractive return characteristics.

SLPE will continue to maintain a portfolio that is concentrated in terms of managers, but is diversified by country, sector, maturity and number of underlying investments.

SLPE has traditionally maintained a relatively concentrated portfolio; as illustrated on page 6, the top 10 managers account for 81% of the portfolio as at 30 September 2016. This concentration will remain and the portfolio will continue to comprise around 35 to 40 ‘active’ private equity fund investments. (Active excludes funds that have recently been raised, but have not yet started investing, and funds that are close to or being wound up.) SLPE will also continue to maintain a portfolio that is broadly diversified by country, industry sector, maturity and number of underlying investments.

Greater flexibility in cash management

The manager now has greater flexibility to deploy cash into other listed private equity vehicles. The aim is to achieve greater correlation of returns with the wider private equity market.

Historically, SLPE has been restricted on investment in other listed investment companies or listed investment trusts, but this restriction has now been removed. The rationale for the change is that, at times, SLPE may have significant cash balances, pending cash drawdowns for further fund investments. Cash can act as a drag on performance when markets are rising, although it can also be beneficial when markets are falling. However, the board has agreed to give the manager additional flexibility in how it deploys SLPE’s cash with a view to allowing this to earn a return that is more correlated with private equity by investing in other listed private equity vehicles. The exposure is limited to 15% of SLPE’s total assets.

SL Capital Partners’ knowledge of the private equity sector, positions it well to assess the value of other listed private equity vehicles.

SLPE’s managers say that, given their extensive knowledge of the sector, they are well-positioned to assess whether other listed private equity vehicles are trading at attractive valuations.

It should be noted that, while SL Capital Partners now has this greater flexibility, it does not expect it to be used in the short term. It says that it still needs to develop an internal process that ensures that the strategy has the necessary diversification and adequate liquidity. The manager says that it expects that any use of the new flexibility will be judicious and relatively limited. This is because in most circumstances it would expect to be able to achieve higher returns by investing in secondary fund positions.

The name change reflects evolution not a revolution

SLPE is to maintain its focus on European managers.

With effect from 31 January 2017, the Trust has changed its name to Standard Life Private Equity Trust Plc (Previously Standard Life European Private Equity Trust Plc), thereby dropping the word ‘European’ from its name. The name change reflects the changes in investment policy discussed above but, despite these changes, SLPE will continue to be focused on European Private Equity funds. As at 30 September 2017, the Trust had circa 80% of its assets invested in Europe.

The Trust’s ticker has changed to SLPE (previously SEP). SL Capital Partners, SLPE’s investment manager, has said that shareholders should not expect a radical shift in geographic exposures.

Market outlook

SLPE's manager is expecting a similar environment in 2017 to 2016, but expects the period of strong net realisations to draw to a close.

SLPE's manager says that, in part reflecting the long-term nature of private equity, little has changed regarding its outlook since we last wrote in May and September 2016. Considerable detail is provided in these notes and readers interested in the manager's outlook should review both (details are provided on pages 8 to 10 of this note). However, in summary, the manager is expecting to see a similar environment during 2017 as was experienced during 2016. Further realisations are expected at decent exit multiples, but as we discussed in the **note** we published in September 2016, the manager thinks that the period of strong net realisations is drawing to a close. It expects to see more balance between realisations and drawdowns going forward. (During 2016 SLPE received £127m from 63 exits and invested £42m in 44 new holdings; 2016 was very cash-flow positive for the Trust.)

Private equity managers took advantage of a fundraising window in 2016 and are expected to put this capital to work.

Private equity managers took advantage of a fundraising window in 2016, on the back of a strong period of realisations, to secure new capital. With a generally improving outlook, SL Capital Partners is expecting to see its underlying managers putting capital to work. As a reflection of this, SLPE's cash balances had stabilised around the £105m level from the year-end through to December 2016. The combination of the final dividend payment in January, a faster pace of drawdowns during the month and a recent secondary investment resulted in a cash balance at the end of January 2017 of £77.3m.

SLPE's manager has a considerable 'war chest' of liquid assets. These can be deployed to acquire cheaper assets in less buoyant markets. The manager sees potential market dislocations as buying opportunities.

As discussed in our previous notes, SLPE's managers have allowed its cash levels to rise in anticipation of being able to invest in assets more cheaply in the future when markets are less buoyant. They believe that this will pave the way for a period of strong returns in the future. SLPE continues to maintain a significant cash balance as there are a number of challenges ahead which could upset markets and lead to an uptick in volatility. SL Capital Partners says that, ideally, it would like to see more in the way of market dislocations as this would likely create buying opportunities. Either way, it believes that SLPE's portfolio is well-positioned for the long term as, in its view, SLPE is backing good quality managers that should deliver strong returns across the cycle. In this regard, it plans to make a commitment to HgCapital 8 this month, a secondary position was purchased in Nordic Capital in December and it expects to complete further secondary fund investments early in 2017. In terms of SLPE's portfolio, the manager says that it is high quality, mature and is demonstrating growth in profitability that will continue to enhance SLPE's NAV.

Asset allocation

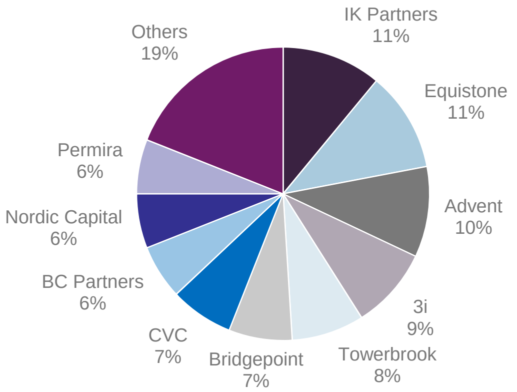
SLPE's manager focuses on a core group of underlying managers that it knows and trusts.

Readers interested in SLPE's investment process should see our **initiation note** of May 2016, which describes this in more detail. However, to summarise, SLPE's manager tends to focus on a core group of underlying managers, who it knows and trusts. In terms of underlying managers, the portfolio is concentrated; the top 10 underlying managers tend to account for approximately 80% of SLPE's portfolio (see Figure 1 below). Near-term changes in allocations tend to be driven by realisations and the pace of reinvestment.

Recent portfolio activity includes a secondary purchase of an original €20.0m commitment to Nordic Capital VI for €22.1m (a 2.0% premium to the 30 September 2016 valuation). As part of the purchase, SLPE assumed an outstanding commitment of £0.9m on acquisition. SLPE has an existing commitment of €15.0m to Nordic Capital Fund VII as well as a €30.0m commitment to Nordic Capital Fund VIII.

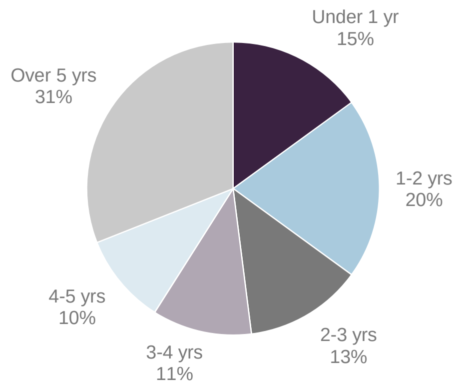
Figures 2, 3 and 4 illustrate that the portfolio is diversified by maturity, sector and geography. All of these weightings saw limited change between March 2016 (the data used when we last wrote on SLPE) to September 2016. Figures 1 to 4 are excluding SLPE's considerable cash balance, which accounted for 20.0% of net assets as at 30 September 2016. Excluding cash, the portfolio was 76% invested in European assets.

Figure 1: Split by manager as at 30 September 2016



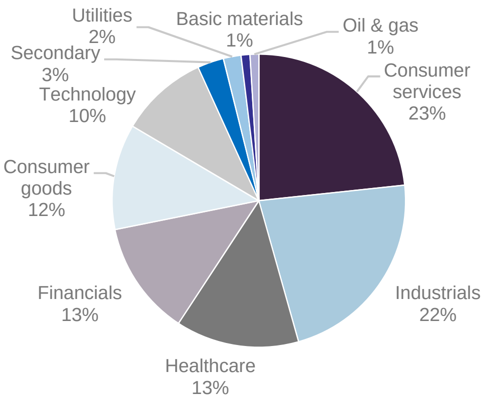
Source: SL Capital

Figure 2: Maturity profile as at 30 September 2016



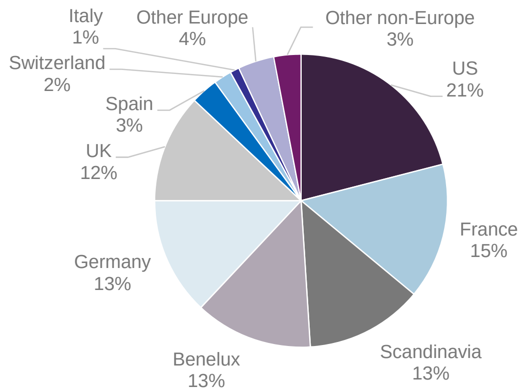
Source: SL Capital

Figure 3: Sectoral exposure as at 30 September 2016



Source: SL Capital

Figure 4: Geographic exposure as at 30 September 2016



Source: SL Capital

Figure 5 shows the top 10 underlying investments in the portfolio at the end of September 2016. The largest company in the portfolio continues to be Action, a 3i-backed fast-growth non-food discounter with more than 680 stores across the Benelux, French and Germanic markets. A further discussion of Action and its strong performance during the last year is provided in our **September 2016 note**.

Figure 5: 10 largest underlying holdings as at 30 September 2016

Company	Business	Fund	Value 30 Sep 2016 £m	% of net assets 30 Sep 2016	% of net assets 31 Mar 2016	Change
Action	Non-food discount retailer	3i Eurofund V	32.6	6.1	4.0	2.1
Scandlines	Ferries between Sweden and Denmark	3i Eurofund V	9.2	1.7	1.6	0.1
Lindorff	Debt collection and accountancy services	Nordic Capital VIII	6.8	1.3	0.9	0.4
Quirónsalud	Healthcare	CVC European Equity Prtnrs. V	6.6	1.2	0.6	0.6
Schenck Process	Measuring and process technologies	IK 2007	6.3	1.2	1.2	0.0
Parques Reunidos	55 leisure parks in Europe and the Americas	Candover 2005	5.3	1.0	1.7	(0.7)
AWAS/Pegasus	Commercial aircraft leasing	Terra Firma III	4.9	0.9	1.2	(0.3)
Cerelia	Ready to use chilled dough	IK VII	4.7	0.9	0.9	0.0
ConvaTec	Healthcare	Nordic Capital VII	4.4	0.8	0.8	0.0
Norican Group	Industrial goods and services	Altor Fund IV	4.3	0.8	0.7	0.1

Source: SL Capital, Marten & Co

Balance of cash, debt and outstanding commitments

SLPE has significant cash to deploy into new opportunities.

A buoyant period for exits has allowed SLPE to build up a considerable cash balance (even after deploying considerable capital through purchases of LPs in the secondary market). As discussed on page 5, the manager expects that the period of strong net realisations is drawing to a close, with more balance between realisations and drawdowns going forward, but SLPE still has considerable liquid resources (£77.3m as at 31 January 2017) to deploy into new opportunities. SLPE's Liquid resources are currently held entirely as cash. As explained in our initiation note of May 2016, SLPE is permitted to hold its liquid resources as both cash and ETFs (tracking UK and European equity indices). However, this is authority is not currently being used and, with cash levels currently on a downward trend, the manager does not have any plans to utilise ETFs in the near term. SLPE also has an undrawn £80m revolving credit facility which expires in 2020 (see page 20 of our May 2016 initiation note for more details). Liquid resources accounted for 14.8% of net assets as at 31 January 2017.

SLPE's manager believes that much of the Trust's outstanding commitments, that are likely to be drawn, can be funded by distributions from existing fund investments.

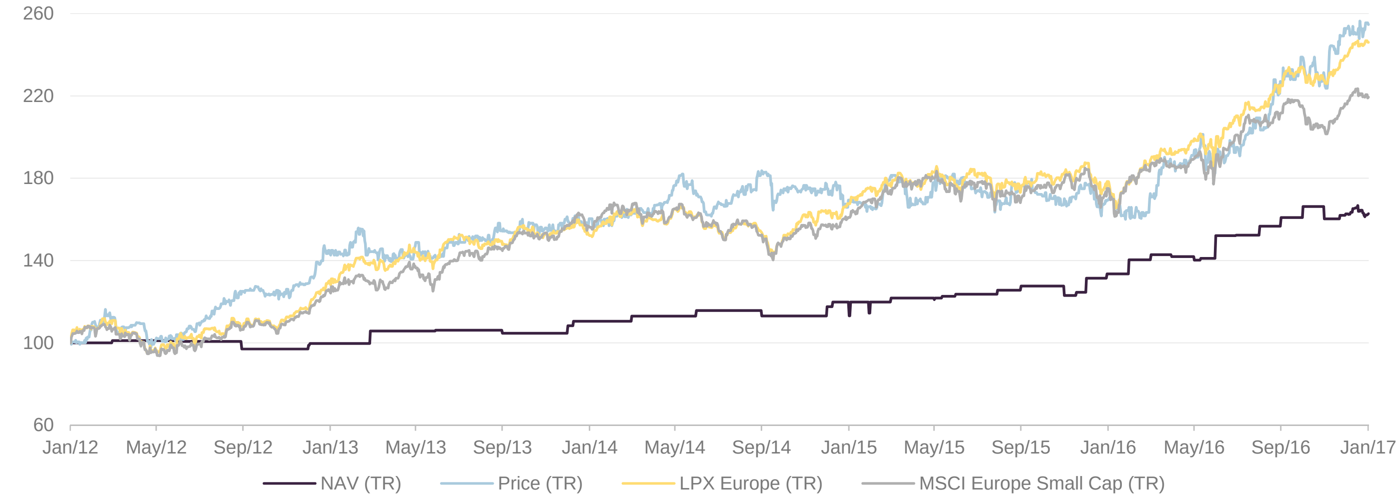
SLPE had £306.2m of outstanding commitments as at 31 January 2017. The manager believes that £55.0m of these commitments are unlikely to be drawn and that much of the remainder will be met by distributions from existing fund investments. This means that SLPE still has considerable capacity to make further new commitments during 2017. As discussed on page 5, SLPE's manager would like to see more in the way of market dislocations as this would likely create buying opportunities.

Performance

Please click here for an up to date peer group comparison of SLPE versus its private equity peers.

As illustrated in Figure 6, which shows the progression of SLPE's NAV and share price total returns, over the past five years, alongside those of the LPX Europe and the MSCI Europe Small Cap Index, SLPE's NAV has followed a path of steady progression in contrast to the higher volatility witnessed in the listed equity indices and its own price series. SLPE had previously faced a currency headwind from its significant European exposure with a weakening euro (SLPE does not hedge currency exposure) but, this has reversed and has been a significant tailwind during the last six months as sterling has weakened following the results of the EU referendum. This effect is particularly apparent in the one-year performance figures, although SLPE's absolute returns are attractive over all of the longer-term horizons provided in Figure 7.

Figure 6: SLPE NAV and price performance compared with the LPX Europe and MSCI Europe Small Cap. Indices (total returns).



Source: Morningstar, Marten & Co

Figure 7: Cumulative total return performance to 31 January 2017

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)
NAV TR	0.1	(2.1)	6.8	21.9	47.3	62.8	101.3
Price TR	0.8	6.8	30.6	50.3	58.9	154.7	57.4
LPX Europe TR GBP	2.8	5.3	17.0	37.9	61.8	146.0	63.7
MSCI Europe TR EUR	0.3	2.0	8.6	23.5	28.0	70.5	73.7
MSCI Europe Sm Cap TR	1.5	2.4	9.1	25.3	40.5	119.3	124.3

Source: Morningstar, Marten & Co

Previous research publications

Additional information is available at the fund manager's website, **www.slcapital.com/slpet/index.html**

Readers interested in further information about SLPE may wish to read our initiation note ***Sitting in a sweet spot***, published on 10 May 2016, and our update note ***Reinvestment phase underway***, published on 14 September 2016. The contents pages have been reproduced below. You can read the notes by clicking on the menu below or by visiting our website.

Sitting in a sweet spot – 10 May 2016

Reinvestment phase underway – 14 September 2016

MARTEN & CO

Authorised and regulated by the Financial Conduct Authority
123a Kings Road, London SW3 4PL
0203 691 9430

www.martenandco.com

Registered in England & Wales number 07981621,
2nd Floor Heathmans House
19 Heathmans Road, London SW6 4TJ

Investment company sales:

Edward Marten
(em@martenandco.com)

Christopher Bunstead
(cb@martenandco.com)

Investment company research:

James Carthew
(jc@martenandco.com)

Matthew Read
(mr@martenandco.com)