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Annual overview | Investment companies

17 July 2018

Standard Life Private Equity Trust

Putting capital to work

Following on from last year's compelling returns, Standard Life Private Equity's (SLPE's) recent results show a modest NAV total return of 1.5%, over the six months to 31 March 2018, that is markedly ahead of the LPX Europe Index's return of -4.9%. Distributions from underlying companies have remained strong, enabling further new commitments to be made, laying the foundations for future performance.

There is scope for further investment; the aggregate level of commitments remains at the lower level of the manager's long-term range and the unused debt facility can finance investments if needed. The manager continues to expect that, in the absence of major 'shocks', the portfolio should benefit from strong exit activity over the next 12 months, which bodes well for further NAV development.

Private equity fund of funds with a European bias

Standard Life Private Equity Trust aims to achieve long-term total returns through a diversified portfolio of private equity funds, the majority of which will have a European focus. Its portfolio is also more concentrated than those of most of its peers; the top 10 underlying private equity fund managers comprise 66.4% of the net asset value and the top 30 underlying companies represent 30.5%.

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 (%)
31/05/14	18.6	6.8	21.1	11.9	11.6
31/05/15	0.7	7.8	9.0	5.2	16.7
31/05/16	9.0	15.1	5.4	(5.0)	(2.2)
31/05/17	40.0	26.1	32.0	32.7	39.6
31/05/18	7.6	8.1	9.5	2.3	4.0

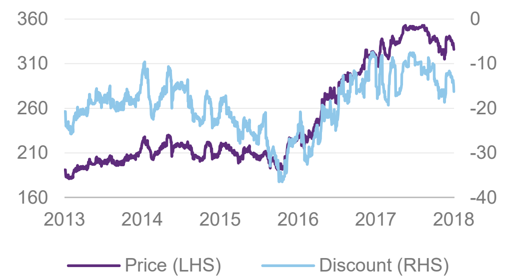
Source: Morningstar, Marten & Co

Sector	Private equity
Ticker	SLPE LN
Base currency	GBP
Price	334.50p
NAV*	392.16p
Premium/(discount)	(14.7%)
Yield **	3.7%

* Morningstar estimate as at 13 July 2018, last published 389.3p at 31 May 2018. ** based on a prospective dividend of 12.4p per share for 2018 year.

Share price and discount

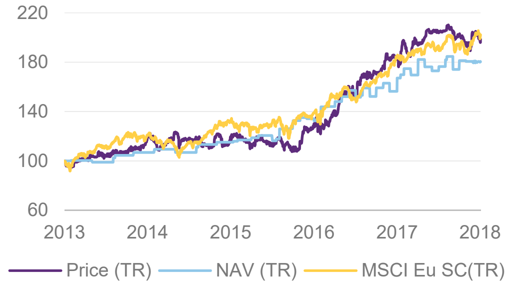
Time period 31/05/2013 to 31/05/2018



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/05/2013 to 31/05/2018



Source: Morningstar, Marten & Co

Domicile	United Kingdom
Inception date	May 2001
Manager	SL Capital Partners
Market cap	514.3m
Shares outstanding	153.7m
Daily vol. (1-yr. avg.)	140.0k shares
Net cash	12.8%

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Fund profile – European private equity

SLPE's approach involves a mix of primary commitments and secondary purchases.

SLPE is a pure fund of private equity limited partnerships (LPs or funds). It has a strong bias to (western) Europe and an increasing focus on North America.

SLPE has adopted a two-pronged approach that involves both making primary commitments to new funds managed by firms and teams that its manager rates highly and purchasing private equity funds in the secondary market at attractive values. It does not make direct co-investments. This is not because its manager lacks the necessary skills (this an activity that SL Capital engages in for other mandates), but the manager says that this is something that needs to be carefully considered and the costs and benefits weighed. Co-investments can offer very good investment opportunities but, given their typical size, including this strategy within SLPE has the potential to increase volatility and losses as well.

SLPE has a more focused underlying portfolio than most funds of funds, with around 350 underlying companies.

SLPE's manager believes that the 'conviction' fund of funds approach is optimal to achieve adequate diversification. SLPE's manager believes it is important not to be overly diversified and dilute returns unnecessarily. Therefore, SLPE operates with a fairly tight number of funds compared to peers (between 35 to 40 active positions), which equates to about 350 underlying companies. The funds that SLPE invests in are focused on making equity investments; there is no allocation to funds focused on mezzanine debt, for example.

History

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

SLPE was listed in May 2001. The trust's portfolio was seeded with a portfolio of 19 private equity funds from Standard Life's (as it was then) balance sheet and Standard Life Aberdeen remains a significant supportive shareholder in the company. SLPE's manager is SL Capital Partners (SL Capital) which is part of the Standard Life Aberdeen group.

At its listing in 2001, the trust was named Standard Life European Private Equity Trust, but the current name was adopted in January 2017 when shareholders approved a raft of measures that were designed to enhance returns to shareholders and thereby make SLPE more attractive to investors. Readers interested in more detail on the strategy change should see our update note of 22 February 2017.

Manager's view

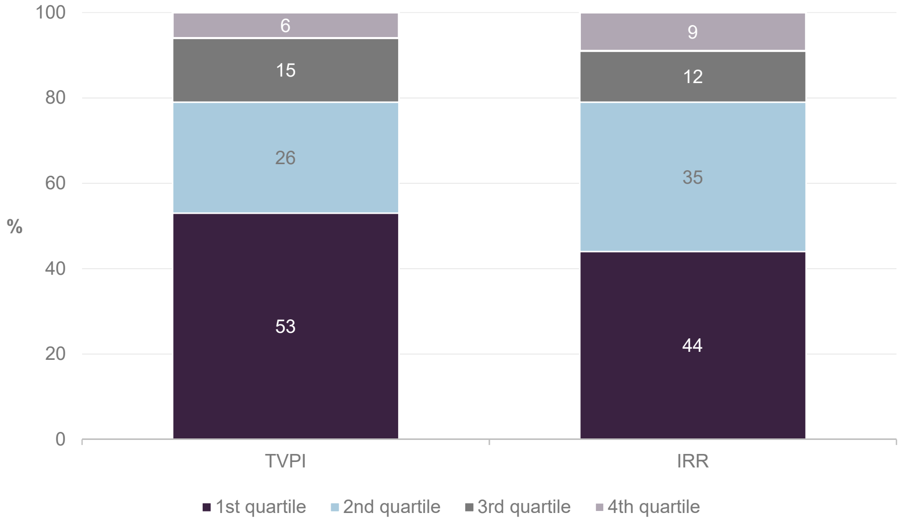
Our May 2016 initiation note provided a discussion of the merits of the European private equity market. Here, we take a look at the manager's view on its fund of funds approach and the valuation uplifts that tend to be seen on disposal.

The benefits of a fund of funds approach

The private equity market is colossal, accounting for some $2.8trn globally (Preqin June 2017), and offers a diverse range of opportunities. From a practical perspective, it is difficult for any one manager to be an expert in all areas and, almost inevitably, managers will have segments in which they have the scale, resources and skill sets to excel. In taking a fund of funds approach, SLPE is able to achieve greater diversification than can typically be achieved with a fund focused purely on direct investments.

As illustrated in Figure 1, SLPE's manager has a consistent track record of selecting the top performing managers. Figure 1 shows the rankings of the returns generated by SLPE's underlying funds on two measures; 1) total value to paid in multiple (TVPI or multiple of cost), and 2) internal rate of return.

Figure 1: SLPE underlying funds – total value to paid in multiple (TVPI) and internal rate of return (IRR), by number of funds*



Source: SL Capital Partners, ASI PE, Burgiss. Includes all primary fund investments made since SLPET's inception. For positions which were sold, where available, the current fund multiple and IRR are used. Funds benchmarked against European private equity funds of the same vintage. Excludes venture investments due to the lack of benchmarking data available. Data as at 31 December 2017.

Furthermore, SLPE has the ability to engage in both primary and secondary transactions. This allows its manager to deploy capital opportunistically to adjust SLPE's portfolio, modifying its profile in terms of vintage year, geography and sector, etc. to achieve one that the manager believes is optimal. The manager thinks that SLPE's stable NAV growth and, what it describes as a stable, market leading dividend yield are a direct result of the funds-of-funds approach, coupled with the ability to engage in secondary transactions.

Private equity exit valuation uplifts through the cycle

Analysis by SL Capital Partners suggests that private equity firms frequently exit portfolio companies at TVPI multiples materially greater than prior quarters, regardless of where we are in the cycle. Somewhat unsurprisingly, the manager found that the largest uplift at exit to prior valuation(s) was during 2007, immediately preceding the global financial crisis, when exit markets were most buoyant. It says that, during 2007, 13 companies exited at more than a 50% uplift to their valuation two quarters prior. Figure 2 illustrates the results.

Following the financial crisis, exit premiums fell to their lowest level in 2009, averaging 5-6%. However, post 2009, the manager's analysis suggests that portfolio companies have, on average, exited at approximately:

- a 39% uplift to valuation four quarters prior
- a 32% uplift to valuation three quarters prior
- a 24% uplift to valuation two quarters prior
- a 16% uplift to valuation one quarter prior.

The manager says that, with the exception of 2012, which was affected by the exit of Hozelock (it was written up from 0.1x to 0.4x, hence the spike in the one quarter prior valuation uplift to 27%) the uplifts for all other time periods, post 2009, have been broadly stable.

Figure 2: Exit TVPI uplift to valuation*

	1 quarter prior (%)	2 quarters prior (%)	3 quarters prior (%)	4 quarters prior (%)
2007	18	50	78	75
2008	7	24	34	47
2009	5	5	6	6
2010	9	22	24	39
2011	18	24	30	45
2012	27	21	33	37
2013	15	24	33	39
2014	16	29	37	37
2015	13	16	28	37
2016	17	23	34	40
2017	20	26	35	40
Average	15.6	25.2	33.8	39.5

Source: SL Capital Partners. *Note: pertains to SLPE portfolio. Excludes realised investments which have been written off, SEP I & II (venture funds) and listed investments. Excludes two outliers: EGX and Siteco (>200% uplift). Local currency. Approximately 300 data points. Uplifts are gross of fees and carry.

Investment process

SLPE's board provides oversight and challenges the investment strategy.

SLPE's board has oversight of strategy, gives guidance to the manager and challenges investment strategy annually. Day-to-day management of the fund is delegated to SL Capital.

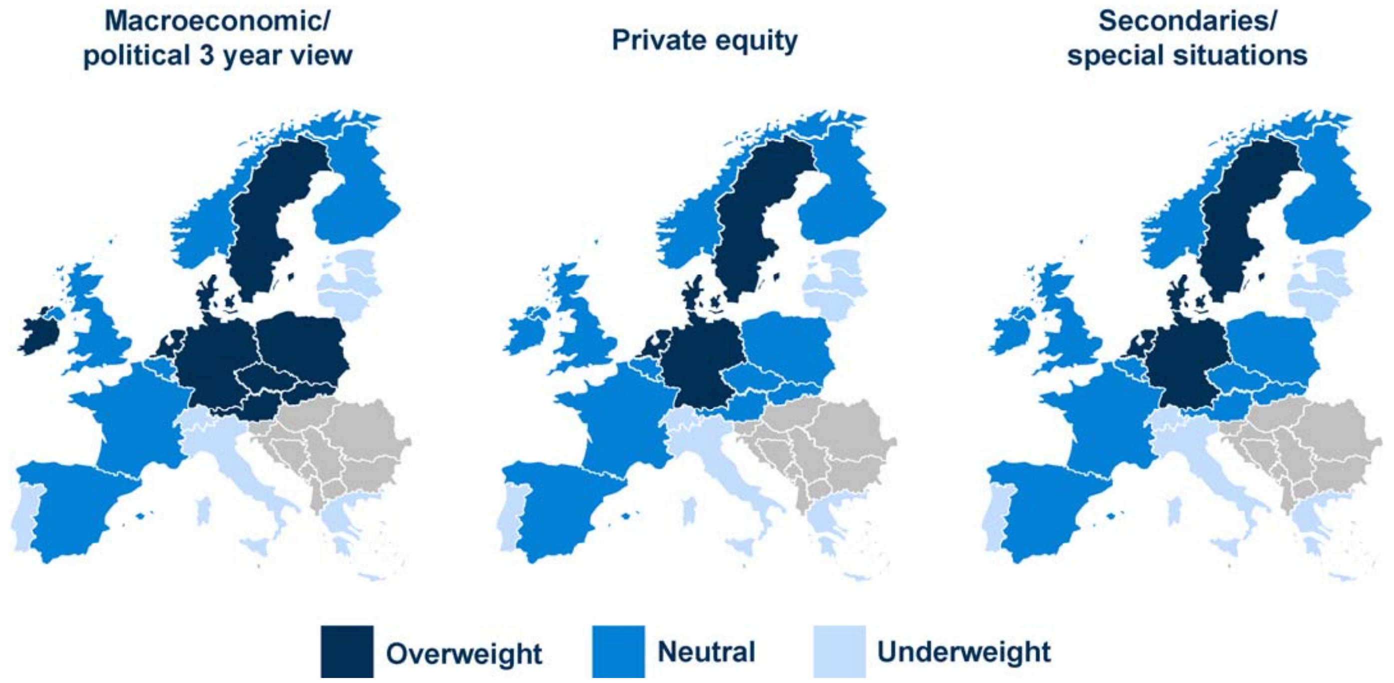
The wider team has raised over €10bn for private equity deals and is one of the most influential investors in private equity funds in Europe, having been established in the 1980s. It sources opportunities according to geographic responsibilities and team members spend a considerable amount of time visiting managers in their home markets, often meeting underlying portfolio companies as well. The manager typically deploys teams of four on both primary and secondary transactions.

A mix of top down and bottom up

SL Capital's portfolio construction committee drives the top down element of the investment process.

The top down overlay comprises the quarterly Portfolio Construction Committee (PCC) that considers the European macro environment. Its views inform asset allocation decisions. In practice, asset allocation evolves slowly. The PCC directs both geographic focus and the emphasis on the mix of primary versus secondary investments. The committee generates views on each country within the remit creating a 'heat map' of Europe that shows where it thinks the best opportunities are in the primary and secondary markets regionally. An illustration is provided in Figure 3 overleaf.

Figure 3: SL Capital European investment opportunity heat map (as at 31 October 2017)



Source: SL Capital Partners

SLPE's European remit includes the UK. The manager estimates there are about 1,500 funds in its European universe. It believes about 800 of these are 'institutional grade' and would fit its strategy. Through both its origination efforts and its regional experts, SL Capital aims to track and maintain a deep understanding of all of these funds. Private equity firms in Europe raise capital, on average, every three to five years, so it considers about 150 funds a year. In practice the filter is tight and few managers make it through to the final buy list.

It identifies its favourite funds in each market (between five and 10) and typically the best two of these will form a forward buy list. It has a predisposition towards funds specialising in Northern Europe, the most developed private equity markets.

Each week, after desk-top due diligence and manager visits, it will review a list of about 20 funds, which are discussed at a committee meeting. If a fund is deemed worthy of more detailed due diligence, the team will spend three to six months in due diligence for a potential primary fund investment, and from one to two months for secondaries.

SL Capital looks for 'operational alpha'.

The most important differentiator SL capital is looking for is 'operational alpha' from a fund – the added value generated by the LP managers in their underlying portfolio companies. It partners with firms that are very active in improving the businesses they invest in rather than simply being passive financial investors. Most of their favoured managers have considerable in-house industrial expertise that they can make available to portfolio companies. SL Capital cited the example of Advent International which has over 170 investment professionals complemented by a team of around 70 operating partners, industrial experts who they embed within the companies they invest in to drive top-line growth and profitability.

Beyond that, SLPE's manager is looking at factors, such as whether a fund has a unique strategy or unique resources for originating deals as well as the strength and depth of their investment team. Managers that focus on sectors where they have proven expertise are preferred and any sign of drift in strategy will trigger a review of the investment. SLPE's manager does not like concentration risk within a fund portfolio.

SL Capital looks for motivated and stable underlying managers

SL Capital wants to invest in funds run by motivated, stable teams so it looks at issues such as team growth, development and succession planning. This means that SLPE's manager will typically avoid firms, with an 'investment bank' model, where there is usually a higher turnover of personnel.

SL Capital looks at a broad range of fund managers and fund sizes but is focused on funds investing in companies with enterprise values between €100m and €2bn.

Looking at past performance, a fund with a high ratio of loss-making investments is not a good sign. SL Capital comments that it is unrealistic to expect zero losses – like all investment strategies, private equity investing is a trade-off between risk and reward. In fact, it prefers managers who have learned from their mistakes.

Fees on the underlying funds

SL Capital focuses on potential returns, net of fees.

SL Capital spends significant time analysing fund structures and ensuring they are acceptable. Part of this includes establishing that the fees it is being asked to pay are in-line with European market norms, incentivise the underlying managers appropriately and that the underlying managers' interests are aligned with investors' interests. However, when it is weighing up one potential investment against another, it will opt for the one that offers the best risk-adjusted net return (after fees). This might not necessarily be the one with the lowest headline fees.

Managing commitment levels

SL Capital's policy is to carefully managed over commitments to minimise cash drag.

One issue that dogged some funds of funds in the credit crisis was a problem of over commitments – a surfeit of obligations to provide funding for new investments and a lack of cash distributions being released by the portfolio, exacerbated by a sharp reduction in available credit. However, being overly cautious in this regard can hamper a portfolio, leading to a considerable cash drag on returns. SL Capital manages SLPE's portfolio with the aim of ensuring it has a spread of maturities. It uses a detailed cash flow model to forecast the timing of potential drawdowns and distributions.

We talk about the fund's borrowing facilities on page 17. In practice it will rarely dip into this. The manager does not hedge currency in the portfolio. It considers that the cost of doing this would likely outweigh any potential benefit. Uninvested cash is held in euros, sterling or US dollars, in line with the trust's underlying exposure. Excess cash can be invested in ETFs tracking UK and European large cap. indices as well as other listed private equity vehicles (the aim is to provide greater correlation of returns with the wider private equity market and limit the effect of cash drag).

Portfolio construction

SL Capital targets returns of 1.7x cost/ 15% IRR on primary transactions.

All of this activity boils down to four or five new primary fund commitments of around €30m each year. The target net return on these investments is 1.7x cost over the life of the investment and a 15% IRR.

The second element of the investment focus is on secondary transactions, an area that SL Capital has been placing increasing emphasis on in recent years as it seeks to minimise cash drag. This is particularly pertinent at present as SLPE has been benefitting from a high level of distributions. This is because LPs have been focused more towards realising investments and are aggressively distributing capital as they exit companies. Funds are purchased in the secondary market, often at discounts, where they can generate an instant uplift to SLPE's NAV as these are revalued at full asset value. If SLPE's manager is expecting attractive growth in a fund's NAV, as the underlying investments deliver, this may justify purchasing it at a premium to the prevailing NAV. Where secondary fund positions have been purchased at par value or even premiums, the manager says that it generally sees good uplifts coming through quickly.

SLPE's monitors the portfolio closely.

The manager monitors the portfolio closely. Members of SL Capital's team often sit on advisory boards of funds (not interfering in day-to-day decision making but providing strategic oversight and other ad-hoc advice) and they have quarterly meetings with the underlying managers.

SLPE's manager says that it is given a high level of transparency on the underlying portfolio. Unfortunately, it cannot share all of this information with shareholders, but it can publish useful aggregate information such as earnings growth and debt levels within the portfolio.

SL Capital usually holds funds to maturity but will occasionally sell funds in the secondary market if it believes the returns on these funds will not meet its minimum target future returns, or if it believes maximum value has been achieved.

Asset allocation

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

SLPE's manager tends to build a portfolio of core underlying managers, which it knows and trusts. The portfolio is concentrated; the top 10 underlying managers accounted for 66.4% of SLPE's investment portfolio as at 31 March 2018 (see Figure 4 overleaf) and near-term changes in allocations tend to be driven by realisations and the pace of reinvestment.

SLPE's portfolio provides exposure to around 350 underlying companies. It had cash and equivalents of £81.3m, as at the 31 March 2018.

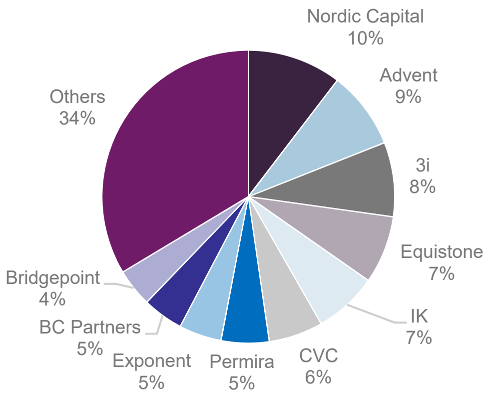
As at 31 March 2018, SLPE had total net assets of £600.2m (390.4p per share), £518.6m invested in 54 private equity funds and liquid resources of £81.3m (which includes £13.0m of listed equities). The portfolio provides exposure to around 350 underlying private companies and the top 10 underlying private equity managers accounted for 66.4% of SLPE's NAV. SLPE's manager remains comfortable with the trust's portfolio, which it considers to be well diversified but not overly so. Outstanding commitments (discussed below) have increased but remain at the bottom end of the trust's long term range.

The fund continues to be biased towards northern Europe and has a focus on buyout managers. When we last published, the allocation to North America had edged up at the expense of the UK (SLPE's manager is more cautious on the outlook for the UK following the Brexit vote) but this has seen a partial reversal. Exposure to the US has historically been gained by investing through European based managers or global groups. However, SLPE's manager expects to see this allocation to increase gradually over time as it makes more commitments to US focused managers.

Almost a quarter of SLPE's NAV is invested in 'exit zone' maturities, which could support further NAV development.

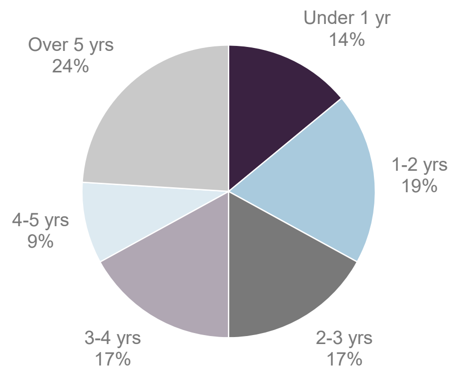
Looking at Figure 5, SLPE's portfolio continues to be well-balanced in terms of its maturity profile. When we last wrote, 36% of the portfolio was in the 'five-years or older' segment. This has reduced to 24% as at the end of March 2018 as realisations have come through but, nonetheless, SLPE retains a good level of exposure to companies in the 'exit zone'. Having almost a quarter of its NAV in the five-year or older segment could bode well for SLPE's NAV development; as discussed on pages 4 and 5, SLPE's manager says that it tends to see significant uplifts, relative to the last relevant valuation when a company exits.

Figure 4: Split by underlying manager as at 31 March 2018



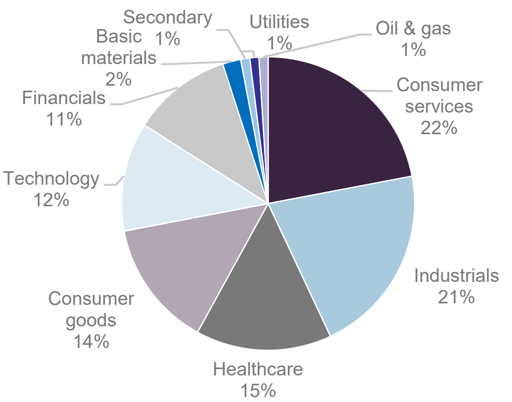
Source: SL Capital Partners

Figure 5: Maturity profile as at 31 March 2018



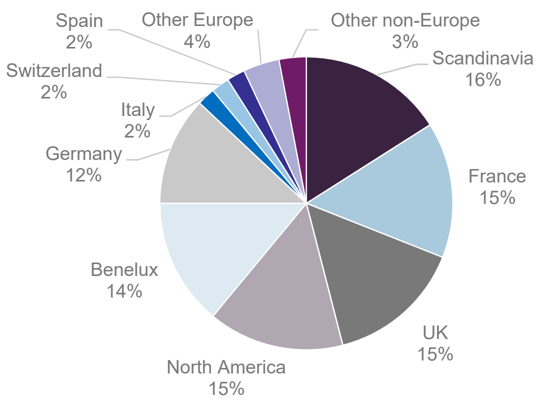
Source: SL Capital Partners

Figure 6: Sectoral exposure as at 31 March 2018



Source: SL Capital Partners

Figure 7: Geographic exposure as at 31 March 2018



Source: SL Capital Partners

Figure 8: 10 largest underlying holdings as at 31 March 2018

Company	Business	Fund	Position value 31 Mar 2018 £m	% of net assets 31 Mar 2017	% of net assets 30 Sep 2017	Change
Action	Non-food discount retailer	3i Eurofund V	43.2	7.2	7.1	0.1
Scandlines	Ferries between Sweden and Denmark	3i Eurofund V	16.8	2.8	2.3	0.5
Norican	Equipment and services for metallic parts formation	Altor Fund IV	6.6	1.1	0.9	0.2
Handicare	Technical aids for the elderly/physically disabled	Nordic Capital Fund VII	6.0	1.0	1.0	0.0
Element	Industrial materials testing	Bridgepoint Europe V	5.4	0.9	0.9	0.0
Lindorff	Debt collection and accountancy services	Nordic Capital Fund VIII	5.4	0.9	1.1	(0.2)
AniCura	European animal hospitals	Nordic Capital Fund VIII	5.4	0.8	0.4	0.4
ERT	Clinical trial risk management	Nordic Capital Fund VIII	4.8	0.8	0.6	0.2
Nordax Bank	Specialist banking in Northern Europe	Nordic Capital Fund VIII	4.8	0.8	0.0	0.8
Not disclosed	Consumer services	BC European Capital IX	4.8	0.8	0.9	(0.1)

Source: SL Capital Partners, Marten & Co

Figure 8 shows the top 10 underlying investments in the portfolio at the 31 March 2018. The largest company in the portfolio continues to be Action, a 3i-backed, fast-growth non-food discounter, with more than 1,000 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. Since we last published, an agreement has been made for the sale of Scandlines while both Schenk Process (products and services for the weighing, feeding, conveying, screening, automation and air filtration of bulk materials) and Vistage (executive coaching and business mentoring) have been sold.

Figure 9: 10 largest private equity funds as at 31 March 2018

Fund	Strategy	Geography	Fund value 31 Mar 2017 £m	% of net assets 31 Mar 2017	% of net assets 30 Sep 2017	Change
3i Eurofund V	Mid-market buyouts	Europe	49.0	8.2	8.5	(0.3)
Nordic Capital Fund VIII	Complex buyouts global health care	Northern Europe	41.5	6.9	4.5	2.4
Permira V	Transformational buyouts	Global	30.4	5.1	5.2	(0.1)
IK Investment Partners VII	Mid-market buyouts	Northern Europe	29.8	5.0	5.7	(0.7)
Exponent III	Mid-market buyouts	UK	28.2	4.7	3.8	0.9
BC European Capital IX	Mid to large buyouts	Europe, USA	27.2	4.5	4.8	(0.3)
Altor Fund IV	Nordic middle market	Northern Europe	24.7			
Equistone Partners Europe Fund V	Mid-market buyouts	UK, France, Germany	24.1	4.0	3.5	0.5
CVC Capital Partners VI	Mid to large buyouts	Europe and North America	22.5	3.7	0.0	3.7
Nordic Capital Fund VII	Complex buyouts global healthcare	Northern Europe	21.2	3.5	3.9	(0.4)

Source: SL Capital Partners, Marten & Co

Portfolio activity and outstanding commitments

During the six-months ended 31 March 2018, SLPE saw realisations of £75.5m, while there were £51.1m of drawdowns to fund new investee companies and £21.9m was invested through secondary investments.

The manager made three new fund commitments during the period: €30m to PAI Europe VII in December 2017, €30m to Equistone Partners Europe Fund VI and €30m to Bridgepoint Europe VI. The manager also undertook two secondary fund purchases totalling £21.9m. These comprise a $20m original commitment to Onex Partners IV and a €15.2m original commitment to Nordic Capital Fund VIII. Combined, these two secondary purchases added £8.9m to SLPE's total outstanding commitments.

Of SLPE's £360.0m of outstanding commitments, SLPE's manager expects that £60m will never be called.

Following these transactions, SLPE had total outstanding commitments of £360.0m as at 31 March 2018 (31 March 2017: £312.2m). Of these, SLPE's manager expects that £60m will never be called.

Since the half year end, SLPE has also made two new primary commitments: €25m to Investindustrial Growth Fund I and $21.5m to MSouth Equity Partners IV. All of these funds are discussed below.

PAI Europe VII

PAI is a well established European buyout manager focused principally on five sectors: food & consumer, retail & distribution, business services, industrials and healthcare.

SLPE's manager says that the PAI team is characterised as one with significant investment expertise, a long tenure with deep sector knowledge, promotion from within and a strong collegiate culture. In addition to a very strong presence and network in France and Southern Europe, the manager says that PAI has a proven ability to generate outsized returns, with very strong recent performance and a low loss ratio. The manager says that PAI has expertise in partnering with large corporates and family offices to generate deal flow and create value post investment.

Equistone Partners Europe Fund VI

SLPE's manager believes that Equistone Partners Europe Fund VI provides exposure to three high quality and experienced country teams that will execute deals within some of Europe's most attractive markets

The latest transaction is SLPE's sixth commitment to Equistone, which it describes as a well-established generalist buyout manager targeting the lower mid-market across the UK, France and the DACH and Benelux regions. The commitment takes SLPE's total commitments to Equistone funds to €193.4m. SLPE's manager says that the fund gives SLPE exposure to three high quality and experienced country teams that will execute deals within some of Europe's most attractive markets. Furthermore, it says that these teams have a proven ability to generate strong returns through the cycle. The manager takes a positive view on the consistency of the strategy over the last 10 years; the fund's ability to weight its capital towards those regions showing better risk-return dynamics; and the relatively large fund size for a lower mid-market manager, which it says gives Equistone an advantage against country-specific funds.

Bridgepoint Europe VI

SLPE has been a long-time investor in funds managed by Bridgepoint.

SLPE has been a long-time investor in funds managed by Bridgepoint, a European focused upper mid-market manager, that operates in the UK, France and the Nordic region. It has a particular focus on the consumer & leisure, healthcare & life sciences, industrials, media & technology and business services sectors. Bridgepoint seeks to acquire companies with strong market positions and earnings growth potential, where it believes significant additional value can be created through expansion and operational improvement. It typically makes equity investments of €75m to €400m in companies with capitalisations of between €200m and €1bn.

Onex Partners IV

This is SLPE's first commitment to the Onex programme of private equity funds.

This secondary transaction represents SLPE's first commitment to the Onex programme of private equity funds, although SLPE has exposure to Onex through ownership of listed shares in the management company. The manager says that, while new to SLPE's portfolio, Onex is one of the oldest and most successful North American private equity firms, whose success has been achieved by acquiring and building high-quality businesses in partnership with talented management teams. SLPE's rationale for holding the fund is that it thinks that the fund's mix of European and North American portfolio companies is attractive; it is a 2014 vintage fund that has not been meaningfully marked up; and it is generally seeing strong revenue and EBITDA growth trends across the underlying portfolio companies. SLPE's manager believes that this secondary investment is well placed to generate solid base case returns with strong upside return potential.

Nordic Capital Fund VIII

Nordic Capital is an established buyout manager with a particular strength in the Healthcare sector.

The secondary investment in Nordic Capital VIII is SLPE's fifth commitment to the Nordic Capital programme of funds (SLPE has made two primary and three secondary investments). Nordic Capital is an established buyout manager. It has a particular strength in the healthcare sector, but also has expertise in consumer & leisure, tech & payments, financial services and industrial goods & services. Since its establishment in 1989, the Nordic Capital team has invested €10.6 billion across eight funds. It is focused principally on the Nordic and DACH markets.

SLPE's manager says that it has a strong existing relationship with Nordic Capital and good visibility on the underlying portfolio given its primary exposure to the fund; the fund has a relatively immature portfolio that offers longer duration and more upside potential; and recent updates on the portfolio have been promising.

Investindustrial Growth Fund I

Investindustrial Growth Fund I provides exposure to a high quality and experienced Southern European group.

This transaction is SLPE's first with Investindustrial, which its manager describes as a well-established buyout manager primarily focused on Southern Europe. SLPE's manager says that the fund offers: exposure to a high quality and experienced Southern European group; the benefits of the Investindustrial platform – an advantage against other lower mid-market players; a clear opportunity set in the lower mid-market with attractive entry multiples; the manager's ability to transact on a proprietary basis; and the manager's proven ability to generate strong returns.

MSouth Equity Partners IV

This is SLPE's first commitment MSouth Equity Partners.

Created in 2007, MSouth Equity Partners is a lower middle market focused private equity firm located in Atlanta, Georgia. Since launch, it has raised three institutional funds totalling US$1.3bn in commitments. The US$21.5m commitment is SLPE's first to the fund.

SLPE's manager lists the fund's attractions as what it describes as a unique, regional sourcing angle that provides highly-actionable, 'advantaged' deal flow; a significant exposure to the southern region of the US, which represents a meaningful number of lower middle market businesses; limited competition; faster GDP growth than average in the US; the opportunity to acquire growth businesses at attractive purchase multiples with high quality management teams; the fund's focus on high free cash flow companies with low leverage capitalisation structures, which should be able to better weather an economic downturn; and the fact that Fund IV will be managed by an experienced team of six senior partners, most of whom have prior operating experience at the CEO level.

Performance

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

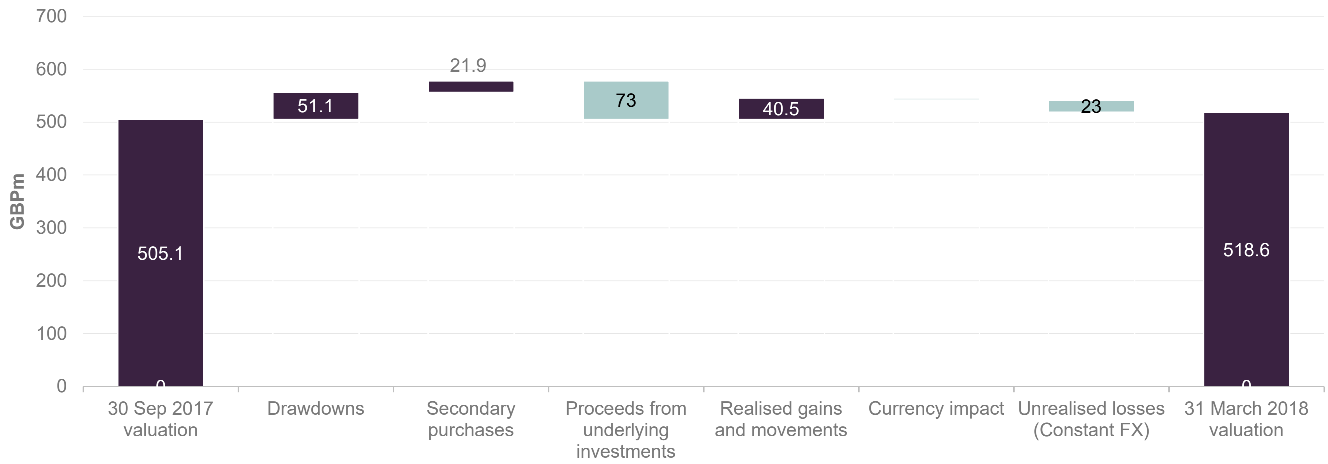
Further discussion of SLPE's long term performance record can be found in our previous notes (see page 20 of this note) while longer term performance figures can be seen in Figure 12 overleaf. For the half year ended 31 March 2018, SLPE reported an NAV total return of 1.5% and share price total return of -2.3%. The difference between the two reflects a small widening of the discount over the half-year.

SLPE reports that the NAV return during the period comprises 7.2% of net realised gains and income; 3.9% of unrealised losses (on a constant exchange rate basis); 0.7%

of negative exchange rate movements; and 0.9% of other items, fees and costs as well as the dividend payment, which accounted for 1.5%.

The manager advises that the company's performance was driven by trading in the underlying investee companies, as well as a positive flow of realisations. During the six months to 31 March 2018, SLPE's realisations totalled £75.5m (versus £130.7m for the 12 months to 30 September 2017). Against this, SLPE saw £73.0m drawn down to fund investee companies and secondary investments (versus £114.2m for the last financial year).

Figure 10: Movement in private equity portfolio valuation during the six months to 31 March 2018



Source: Standard Life Private Equity

Figure 11: SLPE NAV and price performance compared with the LPX Europe and MSCI Europe Small Cap. Indices (total returns) over five years

Source: Morningstar, Marten & Co

Figure 12: Cumulative total return performance to 31 May 2018

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)
NAV TR	0.7	(0.4)	2.3	8.1	56.9	80.7	69.7
Price TR	(3.3)	(3.2)	(3.9)	7.6	64.1	96.0	77.4
LPX Europe TR GBP	1.8	3.4	5.4	9.5	52.4	101.0	186.6
MSCI Europe TR EUR	0.3	2.2	1.1	2.3	29.0	51.8	83.1
MSCI Europe Sm Cap TR	3.7	1.6	3.4	4.0	42.0	85.0	110.0

Source: Morningstar, Marten & Co

Quarterly dividend payments

Beginning with the current financial year, SLPE has moved from semi-annual to quarterly dividends payments. For a given financial year, the first interim dividend is paid in April with the second and third payments made in July and October. The fourth payment remains a final dividend and will be paid in January following shareholder approval at the AGM. Ex-dividend dates and record dates occur the month prior to payment.

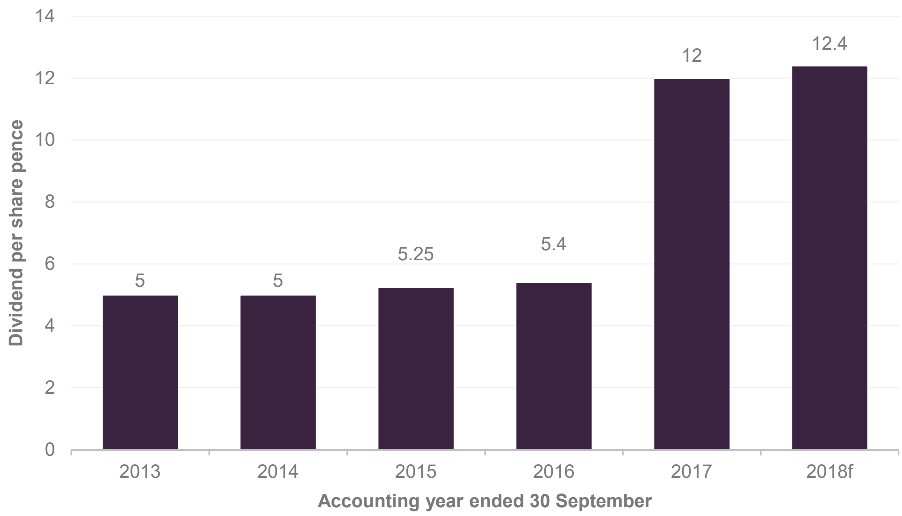
The board is committed to maintaining SLPE's enhanced dividend in real terms.

For the year ended 30 September 2017, SLPE's board rebased its dividend to 12p per share (an increase of 122.2% over the 5.4p dividend paid in 2016). The aim was to rebase SLPE's dividend to a higher level so that it offers a much higher yield. SLPE's board has said that it is committed to maintaining the real value of the enhanced 12p 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. The first interim dividend, for the current financial year, was paid at a rate of 3.1p per share on 27 April 2018. If SLPE at least maintains the quarterly dividend for the rest of the financial year, this suggests a minimum total dividend of 12.4p per share, which is equivalent to a yield of 3.7% on the share price of 334.5p as at 13 July 2018.

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

Historically, SLPE's policy had been to pay covered dividends out of income but, following the implementation of the enhanced 12p dividend, the manager expects that approximately 50% of the dividend will be covered by current year revenue, although the level of coverage 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. 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).

Figure 13: SLPE's five-year dividend history



Source: Standard Life Private Equity

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 3.7% 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.

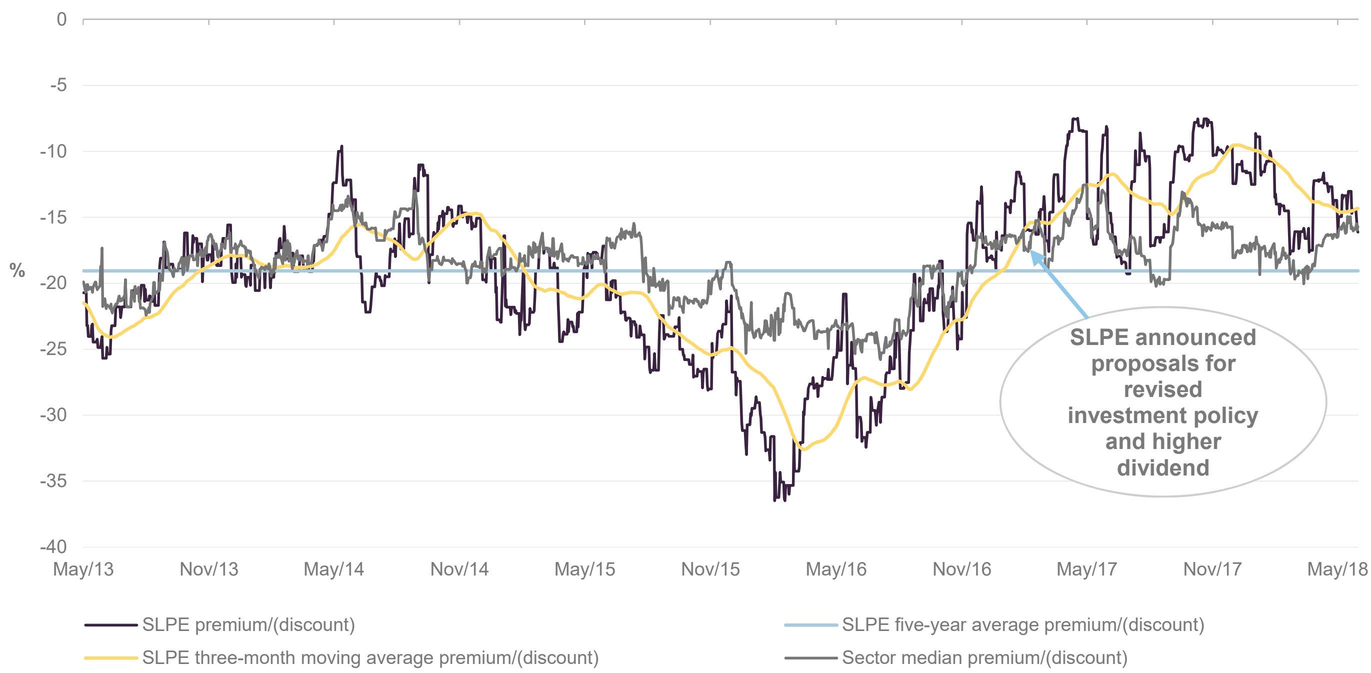
Discount

Figure 14 shows how SLPE's discount has moved over the past five years. The discount traded within an acceptable range for much of 2013 and 2014 (narrowing on occasion to around 10%) but widened markedly during 2015 and the first quarter of 2016. As discussed in our May 2016 initiation note, this was a period in which the investment trust sector in general saw discounts widening with private equity trusts being at the sharper end of this discount expansion. However, SLPE's widening appeared to be particularly anomalous, possibly reflecting the perceived outlook for Europe at that time. As illustrated in Figure 14, SLPE's discount was much wider than the peer group median during this period.

SLPE's annual report for the year ended 30 September 2017 highlighted that shareholders benefitted from a marked narrowing of the discount during the year. The wider listed private equity sector also experienced a general trend of discount narrowing, on the back of strong returns from private equity funds, as well as a general trend of investors looking for assets other than listed equities. Changes to SLPE's dividend policy, its revised investment policy and simplified fee structure can take some of the credit for the narrowing as can the manager and board's efforts to increase awareness of the trust among potential investors, in our view.

More recently, during the last six months SLPE's discount has been on a widening trend, in common with the broader private equity sector. This may reflect a view that the recent strong period of realisations is now drawing to a close. However, having traded at a premium to the broader private equity sector for the last 18 months, it seems anomalous that SLPE is currently trading in line with the sector median.

Figure 14: Premium/(discount) over the past five years



Source: Morningstar, Marten & Co

SLPE has the authority to repurchase up to 14.99% of it issued share capital, which is renewed annually. Given the importance of maintaining adequate cash flow, the board works closely with SL Capital in managing the buyback process. The trust has not repurchased any shares since August 2016, reflecting the narrowing of SLPE's discount.

Fees and costs

Management fee

SLPE pays a management fee of 0.95% of its total net assets. SLPE does not pay a performance fee.

Under the terms of its investment management agreement, with SL Capital Partners, SLPE pays a base management fee of 0.95% per annum of its total net assets. The investment management agreement does not include a performance-fee element and is terminable on 12 months' notice by either side. This simplified fee structure was put in place for the year ended 30 September 2017. Readers interested in further information regarding SLPE's previous fee structure should see our May 2016 initiation note. Our February 2017 note provides more information on the rationale for the changes.

Fees incurred by underlying funds

The managers of the underlying funds also charge fees – both annual charges and performance related fees. The method of calculating these varies from fund to fund. We discussed the manager's attitude to fees in the section on page 7. It is always worth bearing in mind when thinking about funds of funds that performance figures are quoted net of all fees. In relation to fees, the manager comments that the fee structures, in private equity, are the costs that have to be borne to access the strong performance of these funds.

Secretarial and administrative services

Maven Capital Partners provides company secretarial services to SLPE, while BNP Paribas Securities provides administrative services. The fees for both are adjusted annually in line with the retail price index. The secretarial agreement and administrative agreement can be terminated by either side on six and three months' notice respectively. The combined cost of the secretarial and administration fees, for the year ended 30 September 2017, was £181,000 (2016: £177,000).

Allocation of fees and costs

SLPE's ongoing charges ratio was 1.14% for the year ended 30 September 2017.

SLPE's management fee and finance costs are charged 90% to revenue and 10% to capital, with the exception of bank interest, which is charged wholly to revenue. All other fees are charged wholly to revenue with the exception of transactions costs, on the purchase and sale of investments, which are charged wholly to capital. The total expense ratio for the year ended 30 September 2017 was 1.14%.

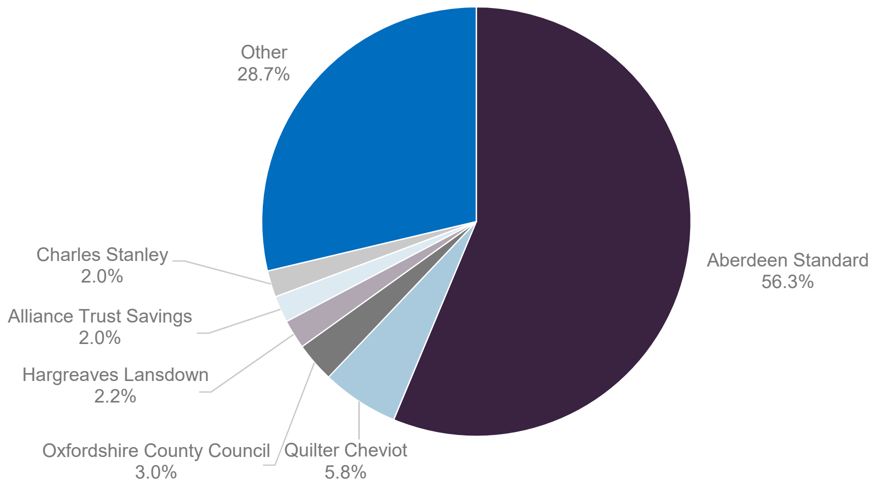
Capital structure and life

Simple capital structure

SLPE has one class of ordinary share in issue. It can gear up to 100% of net assets, but borrowings are not expected to exceed 30% of net assets.

SLPE has a simple capital structure with one class of ordinary share in issue. Its ordinary shares have a premium main market listing on the London Stock Exchange and, as at 13 July 2018, there were 153,746,294 in issue with none held in treasury. Aberdeen Standard Investments holds 56.33% of these (by virtue of the initial transaction that launched the fund – see page 3). Other large shareholders can be seen in Figure 15.

Figure 15: SLPE shareholder base as at 31 May 2018



Source: SL Capital Partners, RDIR

SLPE's articles of association permit it to borrow up to 100% of net assets although the board has said that it does not expect bank borrowings to exceed 30% of net assets. SLPE has an £80m committed, multi-currency syndicated revolving credit facility provided by Citi and Societe Generale for this purpose. The facility matures in 2020, has an interest rate of LIBOR plus 1.50%, rising to 1.70% depending on utilisation, and the commitment fee payable on non-utilisation is 0.7% per annum. SLPE is not using the facility at the moment and is ungeared.

Unlimited life

Arguably reflecting the longer-term nature of its underlying investments, SLPE has been established with an indefinite life and there is no specific mechanism, such as a regular continuation vote, to wind up the company.

Financial calendar

The trust's year-end is 30 September. The annual results are usually released in December (interims in June) and its AGMs are usually held in January of each year. As discussed on page 14, SLPE pays quarterly dividends in April, July, October and January (the fourth quarter dividend remains a final dividend).

Board

SLPE's compact board is appropriate for its current scale and helps to control costs.

SLPE's board comprises six directors (details of their individual experience are provided below); all members are non-executive and considered to be independent of the investment manager.

SLPE's board underwent a refreshment during 2017. David Warnock stood down after nearly nine years of service in June, with Diane Seymour-Williams joining in his place. Alastair Barbour, then chairman of the audit committee, stood down on 29 December after nearly seven years of service. Calum Thomas, who was appointed to the board on 30 November 2017, assumed the role of chairman of the audit committee following Alastair's departure. At the time of writing, the longest serving director is Edmond Warner OBE, who has provided almost 10 years of service.

This refreshment has continued in 2018 with the appointment of Jonathon Bond on 15 June 2018. Jonathon has over 30 years' experience in the private equity industry; a brief biography is provided overleaf.

SLPE's board members do not have any other shared directorships. All members have made personal investments in the trust.

The average length of service is 3.5 years (before Jonathon Bond's appointment it was 4.2) and all directors stand for re-election annually. The annual limit on directors' fees in SLPE's articles of association is £250,000 and, excluding Jonathon Bond who has only just been appointed, the board has an average of 1.4 years of their fees invested in the company. We are pleased to see that both of the board members that joined in 2017, have been building up their positions in the trust. We like to see directors making significant investments as it helps to align with those of shareholders.

Figure 16: Board member - length of service and shareholdings

Director	Position	Date of appointment	Length of service (years)	Annual director's fee (GBP)	Share-holding*	Years of fee invested*
Edmond Warner OBE	Chairman	27 Nov 2008	9.6	53,000	25,000	1.6
Calum Thomson	Chairman of the Audit Committee	30 Nov 2017	0.6	38,000	13,700	1.2
Christina McComb OBE	Senior Independent Director	29 Jan 2013	5.5	38,000	7,136	0.6
Jonathon Bond	Director	15 June 2018	0.1	34,000	-	-
Alan Devine	Director	28 May 2014	4.1	34,000	5,754	0.6
Diane Seymour-Williams	Director	7 June 2017	1.1	34,000	31,500	3.1
Average (service length, fee, shareholding, fees invested)			3.5	38,500	13,843	1.2

Source: Standard Life Private Equity, Marten & Co. *Note: shareholdings as per most recent company announcements as at 13 July 2018. Years of fee invested based on SLPE's ordinary share price of 332.0p as at 13 July 2018.

Edmond Warner OBE (chairman)

Edmond has previously been a top ranked investment strategist and a commentator on financial and business matters in both the press and broadcast media. He is chairman of Grant Thornton UK LLP; the online derivatives exchange, LMAX; and BlackRock Commodities Income Investment Trust Plc. He is also a non-executive director of Clarkson Plc and has previously been chairman of UK Athletics and the online financial broadcaster, Cantos.

Calum Thomson (chairman of the audit committee)

Calum Thomson is a qualified accountant with over 25 years' experience in the financial services industry. He has been with Deloitte LLP since October 1988 and, for 21 of those years he was a partner in the firm. Calum is a non-executive director and the audit committee chair of the Diverse Income Trust Plc, the British Empire Trust Plc and the BLME Holdings Plc. He is a non-executive director of Baring Emerging Europe Plc.

Christina McComb OBE (Senior independent director)

Christina has a background in private equity and venture capital investment, having spent 14 years at 3i Group. She is currently chairman of OneFamily Mutual Assurance and is a non-executive director of Baronsmead Venture Trust Plc, Nexeon Ltd and Big Society Capital Limited. She is also the senior independent director of the British Business Bank (a UK government owned development bank supporting access to finance for UK SMEs).

Jonathon Bond (director)

Jonathon has over 30 years' experience in the private equity industry and considerable extensive international and general management experience, having founded and served on the board of a number of significant businesses. Jonathon is currently the senior independent director of Jupiter Fund Management Plc, where he is a member of the audit, remuneration and nomination committees. He is also the executive chairman of the Skagen Group Limited, a family-owned group of companies operating in the UK, Europe and the USA; a non-executive director of The Farncombe Group; a non-executive director of Ruths Hotel; a Director of Chalke Valley History Festivals Ltd and a trustee of the Cecil King Memorial Foundation. Jonathon also holds an MA Honours degree in Law from Oxford University.

Alan Devine (director)

Alan has over 40 years' experience in both commercial and investment banking having spent his entire career working for The Royal Bank of Scotland Group. He held a variety of senior roles and was CEO of RBS Shipping Group. He holds an MBA, is a Fellow of the Institute of Bankers in Scotland and is a non-executive director of Capital Flow Holdings DAC.

Diane Seymour-Williams (director)

Diane Seymour-Williams worked for Deutsche Asset Management Group (previously Morgan Grenfell) for 23 years from 1981 until 2005, during which time she held various senior positions. These included CIO of Asian Equities, CEO of the Asian asset management business, head of European client relationships and head of global equity product. Diane then spent nine years from 2007–16 at LGM Investments, a specialist global emerging markets manager, where she was global head of relationship management. Diane is a non-executive director of Witan Pacific Investment Trust Plc and Brooks Macdonald Group Plc, where she has also chaired the Remuneration Committee since 2012. She is also non-executive director of Calculus VCT Plc.

Previous publications

Readers interested in further information about SLPE may wish to read our previous notes (details are provided in Figure 17 below). You can read the notes by clicking on them in Figure 17 or by visiting our website.

Figure 17: Marten & Co. previously published notes on SLPE

Title	Note type	Date
Sitting in a sweet spot	Initiation	10 May 2016
Reinvestment phase underway	Update	14 September 2016
Dividend doubled to 4.0%	Update	22 February 2017
Loading the portfolio	Update	3 July 2017
A good year; more to come?	Update	8 December 2017

Source: Marten & Co.

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