EDISON

LPE sector performance

Positive trends

13 June 2017

The LPX Europe Total Return Index (LPX) of major UK and European listed private equity (LPE) companies rose nearly 38% over the 12 months to end May 2017, outperforming the Stoxx Europe 600 and FTSE All-Share indices over one, three and five years. The LPX has lagged somewhat over 10 years despite NAV outperformance due to discount widening. However, the rolling 10-year relative performance is set to improve strongly as high pre-crisis valuations drop out of the comparatives. Assuming a flat performance going forward, the LPX would show over 7% outperformance of the major indices by end May 2018 and over 60% relative outperformance by May 2019. This could improve the perception of LPE as an asset class with long-term investors.

LPE has delivered strong medium-term returns…

We have analysed the absolute and relative returns of the LPE sector using the LPX Europe Total Return Index of major UK and European LPE companies and comparing it in sterling terms with the Stoxx Europe 600 and FTSE All-Share Index to end May 2017.

The LPE sector has delivered very strong returns as the LPX has risen by 38%, 67% and 186% over the last one, three and five years in absolute terms, outperforming the DJ Stoxx by 8%, 25% and 37% and FTSE All-Share by 14%, 33% and 61% respectively.

…driven by NAV growth and narrowing discount

The strong medium-term performance has been driven by both NAV growth and a narrowing of the discount from previously elevated levels. The LPX NAV total return was almost 80% over the last five years, while the discount to NAV fell from 38% in May 2012 to c 6% at the end of May 2017.

The long-term performance record as measured by 10-year relative returns, has still lagged somewhat despite the NAV total return outperforming by 5-10%. This is due to the impact of discount widening: the LPX traded at a 4% *premium* to NAV 10 years ago and currently trades at a 6% discount.

Long-term performance set to turn positive

The rolling 10-year relative performance figures are set to improve strongly as high pre-crisis valuations drop out of the comparatives. Assuming the LPX and major indices just perform in-line going forward, the LPX would show over 7% outperformance of the major indices by end May 2018 and over 60% relative outperformance by May 2019. This effect would only partially moderate even by 2020, as the relative outperformance would still be in the 35-45% range. This could improve the perception of LPE as an asset class with long-term investors and investment consultants.

Analysts

Robert Murphy	0203 077 5733
Gavin Wood	0203 681 2503

financials@edisongroup.com

This report has been commissioned by LPEQ Ltd

LPE sector performance analysis

We highlighted the relatively wide discount of the LPE sector despite strong recent performance in our note, Listed Private Equity – The Opportunities and Challenges for Investors (22 September 2016) and subsequently noted the impact of the financial crisis on the long-term risk-return history in Risk in LPE: Perception vs Reality (2 March 2017). Since these notes, the LPE sector has continued to deliver strong NAV returns and the sector discount has narrowed. We update the recent drivers of performance and analyse the potential positive impact on long-term rolling returns as the unfavourable pre-crisis comparatives fall out of the 10-year history.

LPE has delivered strong medium-term returns…

We have analysed the absolute and relative returns of the LPE sector using the LPX Total Return Index of major UK and European LPE companies and compared it in sterling terms with the Stoxx Europe 600 and FTSE All-Share Index to the end of May 2017. The results are summarised in Exhibit 1.

Exhibit 1: Total return indices to end May 2017

Price performance (£)	1yr	3yr	5yr	10yr
LPX Europe TR	37.9%	67.0%	186.4%	63.6%
DJ Stoxx 600	27.3%	34.0%	108.8%	79.9%
LPX price relative	8.4%	24.6%	37.2%	-9.0%
FTSE All-Share	21.1%	25.4%	77.6%	71.4%
LPX price relative	13.9%	33.2%	61.3%	-4.6%

Source: Bloomberg, Edison Investment Research

The LPE sector has delivered very strong medium-term performance as the LPX has returned 38%, 67% and 186% over the last one, three and five years in absolute terms, outperforming the DJ Stoxx by 8%, 25% and 37% and the FTSE All-Share by 14%, 33% and 61%, respectively. However, as we discuss in more detail below, the sector underperformed over 10 years.

…driven by NAV growth…

The strong medium-term performance has been driven by both NAV growth and a narrowing of the discount from previously elevated levels. We illustrate the NAV growth in Exhibit 2.

Exhibit 2: Total return indices to end May 2017

NAV performance (£)	1yr	3yr	5yr	10yr
LPX Europe NAV TR	23.8%	50.4%	79.7%	88.5%
DJ Stoxx 600	27.3%	34.0%	108.8%	79.9%
LPX NAV relative	-2.7%	12.3%	-13.9%	4.8%
FTSE All-Share	21.1%	25.4%	77.6%	71.4%
LPX NAV relative	2.2%	20.0%	1.2%	10.0%

Source: Bloomberg, Edison Investment Research

The LPX NAV total return was 24%, 50% and 80% over the last one, three and five years delivering a consistently strong outperformance on a three-year view, a roughly in line performance over one year and a mixed picture over five years depending on which comparative index is used. Thus the overall strong and consistent LPX price return is a combination of the NAV and movement in NAV premium/discount.

…and narrowing discount

As we show in Exhibit 3, the discount to NAV has consistently fallen from 38% in May 2012 to c 6% at the end of May 2017, helping to drive the one, three and five-year total price return.

Exhibit 3: LPX NAV total return index

LPX NAV total return index (£)	May-17	-1yr	-3yrs	-5yrs	-10yrs
Premium/discount	-5.5%	-10.6%	-12.4%	-37.7%	3.9%

Source: Bloomberg

However, we note that the 10-year NAV relative performance figures are solidly positive at +5-10 percentage points. Thus the weaker long-term relative *price* performance noted in Exhibit 1 is explained by the impact of discount *widening* over the 10-year period: the LPX traded at a 4% *premium* to NAV 10 years ago and currently trades at a 6% *discount* even though NAV total returns have beaten the indices since before the financial crisis.

Long-term performance set to turn positive

The rolling 10-year relative performance figures are set to improve strongly as the high pre-crisis valuations drop out of the comparatives. We can simulate the effect by assuming the LPX and major indices just perform in line going forward and calculating the rolling 10-year performance data. We show our calculations in Exhibit 4.

Exhibit 4: Implied 10-year rolling returns assuming flat markets

Major indices (£)	May-17	May-18	May-19	May-20
LPX Europe price	63.6%	97.9%	296.4%	184.0%
DJ Stoxx 600	79.9%	84.5%	146.0%	108.6%
LPX price relative	-9.0%	7.3%	61.1%	36.1%
FTSE All-Share	71.4%	84.6%	141.8%	96.7%
LPX price relative	-4.6%	7.2%	63.9%	44.4%

Source: Bloomberg, Edison Investment Research

Based on our assumptions, the LPX would show over 7% outperformance of the major indices by end May 2018 and over 60% relative outperformance by May 2019. Moreover, this effect would only partially moderate even by 2020, as the relative outperformance would still be in the 35-45% range. This could improve the perception of LPE as an asset class with long-term investors and investment consultants as long-term return data are an important input into asset allocation models.

Frankfurt +49 (0)69 78 8076 960	**London** +44 (0)20 3077 5700	**New York** +1 646 653 7026	**Sydney** +61 (0)2 8249 8342
Schumannstrasse 34b	280 High Holborn	295 Madison Avenue, 18th Floor	Level 12, Office 1205
60325 Frankfurt	London, WC1V 7EE	10017, New York	95 Pitt Street, Sydney
Germany	United Kingdom	US	NSW 2000, Australia