

LPE sector performance

10 years of outperformance

Financials

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The LPX Europe Total Return Index (LPX) of major UK- and Europe-listed private equity (LPE) companies rose 26% over the last year to end October 2017, outperforming the MSCI Europe and FTSE All-Share indices over one, three and five years. More importantly, the LPX has also now outperformed over the last 10 years. As we pointed out in our [June](#) note, the rolling 10-year relative performance should continue to improve as basis effects dominate. Assuming flat performance, the LPX would show over 66% outperformance of MSCI Europe by end October 2018 and 61% relative outperformance by October 2019.

LPE in Europe has outperformed over 10 years

We update our [June 2017](#) report and analyse the performance of the LPX Index in sterling on an absolute basis and relative to the MSCI Europe and the FTSE All-Share indices.

In absolute terms, the LPX has risen 26%, 93%, 169% and 91% over the last one, three, five and 10 years, respectively. Compared to the MSCI Europe total return over the same time periods, the LPX has outperformed by 7%, 35%, 46% and 8% and compared to the FTSE All-Share total return the LPX has outperformed by 11%, 47%, 65% and 12%.

NAV growth and narrowing discount remain drivers

The overall strong performance has been driven by NAV growth in absolute terms and a narrowing of the NAV discount from previously elevated levels. The LPX NAV total return was 79% over five years and 76% over 10 years, slightly below the MSCI Europe total return but above the FTSE All-Share total return. 10 years ago the LPX NAV discount was 8.4% and currently stands at 1.3% so this narrowing of the discount has carried the overall LPX Index total return into clear outperformance of both major market indices.

Is a change in perception in the offing?

With the LPX outperforming over all major time periods, we would expect investment consultants to begin to look on the LPE sector more favourably. While one cannot rule out volatility in the future, rolling 10-year returns should be supported by improving comparatives. Assuming flat performance, the LPX would show 66% outperformance of MSCI Europe by end October 2018 and 61% relative outperformance by October 2019.

Most LPE companies came through the financial crisis well, but overall sector performance was affected by a few companies that employed leverage at both the fund and company level. This leverage was accentuated by significant declines in portfolio valuations, raising investor concerns about the funding of outstanding commitments. Such strategies are not a feature of the sector today, which implies an improved risk-reward and perception of the asset class in the future.

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LPE: 10 years of outperformance

The LPE sector has continued to deliver strong NAV returns and the discount has continued to narrow since our last performance analysis in June 2017. Importantly, the LPX has now outperformed the major market indices over a rolling 10-year period and favourable comparatives are likely to support this relative performance over the next couple of years at least.

We update our analysis of the LPE sector using the LPX Total Return Index of major UK and European LPE companies. Performance is compared in sterling terms with the MSCI Europe and FTSE All-Share indices to the end of October 2017. The results are summarised below in Exhibit 1.

Exhibit 1: Total return indices to end October 2017				
Price performance (£)	One year	Three years	Five years	10 years
LPX Europe	26.2%	93.1%	168.8%	91.0%
MSCI Europe	17.6%	43.6%	84.5%	77.2%
LPX price performance relative to MSCI Europe	7.3%	34.5%	45.7%	7.8%
FTSE All-Share	13.4%	31.0%	62.5%	71.0%
LPX price performance relative to FTSE All-Share	11.3%	47.4%	65.4%	11.7%

Source: Bloomberg, Edison Investment Research

The LPE sector continues to deliver very strong performance with absolute returns of 26%, 93%, 169% and 91% over one, three, five and 10 years. Over the same periods, the LPX has outperformed MSCI Europe by 7%, 35%, 46% and 8% and the FTSE All-Share by 11%, 47%, 65% and 12%.

Strong NAV growth

Strong NAV growth has been a key driver of overall total return for the LPX. Exhibit 2 below shows NAV growth of 14%, 49%, 79% and 76% over the last one, three, five and 10 years, respectively. On a relative basis, however, the LPX NAV has very slightly underperformed the MSCI Europe over 10 years, with mixed relative performance in other periods, but outperformed the FTSE All-Share index over all time periods.

Exhibit 2: Total return indices to end October 2017				
NAV performance (£)	One year	Three years	Five years	10 years
LPX Europe NAV	14.3%	49.4%	79.0%	76.0%
MSCI Europe	17.6%	43.6%	84.5%	77.2%
LPX NAV performance relative to MSCI Europe	-2.8%	4.0%	-3.0%	-0.6%
FTSE All-Share	13.4%	31.0%	62.5%	71.0%
LPX NAV performance relative to FTSE All-Share	0.8%	14.0%	10.2%	3.0%

Source: Bloomberg, Edison Investment Research

Narrowing discount

As the LPX NAV has broadly kept in line with the MSCI Index, the narrowing discount explains the overall relative outperformance. Exhibit 3 shows the development of the LPX discount over the last 10 years.

Exhibit 3: LPX NAV index					
LPX Europe NAV	Oct-17	One year	Three years	Five years	10 years
Premium/discount	-1.3%	-9.3%	-10.9%	-17.8%	-8.4%

Source: Bloomberg

The trend in discount shows a steady reduction over the last five years to only -1.3% at the end of October 2017, helping to drive overall total returns of the LPX Index. However, in contrast to our previous performance analysis in June, the discount has also now narrowed over the 10-year period, resulting in positive total returns over this period.

Is a change in perception in the offing?

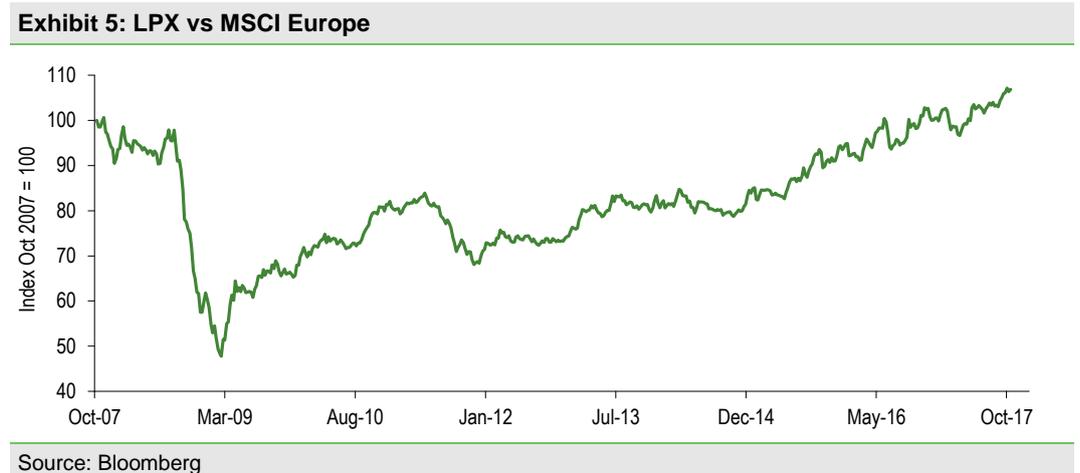
With the LPX outperforming over all major time periods, investment consultants may begin to look on the LPE sector more favourably. While one cannot rule out volatility in the future, rolling 10-year returns should be supported by more favourable comparatives in particular over the next two years. We show our calculations in Exhibit 4.

Exhibit 4: Implied 10-year rolling returns assuming flat markets				
Major indices (£)	Oct-17	Oct-18	Oct-19	Oct-20
LPX Europe price	91.0%	169.9%	236.6%	254.8%
MSCI Europe	77.2%	62.2%	108.9%	186.2%
LPX price performance relative to MSCI Europe	7.8%	66.4%	61.2%	24.0%
FTSE All-Share	71.0%	60.5%	111.0%	179.6%
LPX price performance relative to FTSE All-Share	11.7%	68.2%	59.6%	26.9%

Source: Bloomberg, Edison Investment Research

Assuming flat performance, the LPX would show 66% outperformance of MSCI Europe by end October 2018 and 61% relative outperformance by October 2019. Similarly, the LPX would show 68% and 60% outperformance of the FTSE All-Share respectively. One can also see that even by October 2020, the impact of favourable comparatives would only partially moderate with 24% outperformance implied relative to the MSCI Europe.

Exhibit 5 below illustrates how the performance of the LPX relative to MSCI Europe has developed over time and illustrates clearly how improving comparative figures will remain a supportive factor to rolling 10-year returns in the medium term.



Most LPE companies came through the financial crisis well, but overall sector performance was affected by a few companies that employed leverage at both the fund and company level. This leverage was accentuated by significant declines in portfolio valuations, raising investor concerns about the funding of outstanding commitments. Such strategies are not a feature of the sector today, which implies an improved risk-reward and perception of the asset class in the future.

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