

LPE sector performance

Outperforming through market uncertainty

Financials

20 February 2018

Investors in European-listed private equity (LPE) have been presented with two sources of uncertainty recently: disclosures in the new key information documents (KIDs) required under MiFID II and increased market volatility. In the 12 months to 9 February 2018, however, the LPX Europe Total Price Return Index (LPX) of major UK and European LPE companies returned 16% compared to 8% for the MSCI Europe index. Over the same period, the LPX total NAV return was even higher at 18%. Over 10 years the LPX returned 119% compared to 93% for MSCI Europe. Thus, LPE has continued to deliver impressive net-of-fee returns for investors.

Confusing KIDs?

The release of KIDs at the beginning of this year has been a source of confusion and uncertainty for investors in closed-end funds. In particular, performance scenario methodology using five-year data has resulted in positive projections of returns in 'unfavourable' scenarios and anomalous differences between individual companies. Fee disclosures have also put LPE in an unfavourable light. Indeed, the Investment Association called for an 'urgent' review of KIDs on 25 January. The key focus for investors, of course, should be net returns over the cycle.

LPE outperformed in the recent sell-off

The recent increase in equity market volatility was sharp but by no means unprecedented and occurred against a supportive economic backdrop. Perhaps surprisingly, the LPX slightly outperformed MSCI Europe in the three weeks to 9 February 2018 and has outperformed by 7%, 40% and 13% over the last one, five and ten years respectively.

LPE continues to deliver impressive returns

LPE has performed well over the last year. In the year to 9 February 2018, the LPX returned 16% compared to 8% for the MSCI Europe index. Over the same period, the LPX total NAV return was even higher at 18%. Private equity, and by implication LPE, is a long-term asset class, however, and we would argue investors should look through periods of market volatility and focus on net returns over longer investment horizons. Over 10 years the LPX has returned 119% versus 93% for MSCI Europe. The NAV net return was strong but slightly below the index at 76% over this period due to unfavourable comparatives which should improve as we have discussed in previous notes. Thus, LPE has continued to deliver attractive net-of-fee returns for investors.

Analysts

Robert Murphy +44(0)20 3077 5733

Gavin Wood +44(0)20 3681 2503

financials@edisongroup.com

*This report has been
commissioned by LPEQ Ltd
www.lpeq.com*

LPE: Outperforming through market uncertainty

Investors in European-listed private equity (LPE) have been presented with two sources of uncertainty recently: disclosures in the new key information documents (KIDs) required under MiFID II and increased market volatility. Investors appear to have taken these uncertainties in their stride with the LPX returning 16% over the 12 months to 9 February compared to 8% for MSCI Europe. Over the longer term, LPE has continued to outperform as the LPX returned 119% compared to 93% for MSCI Europe over the last 10 years.

Confusing KIDs?

The release of KIDs at the beginning of this year has been a source of confusion and uncertainty for investors in closed-end funds. In particular, the performance scenario methodology using five-year data has resulted in positive projections of returns in 'unfavourable' scenarios and anomalous differences between individual companies. Fee disclosures also generally put LPE in an unfavourable light when taken in isolation from returns. Indeed, the Investment Association called for an 'urgent' review of KIDs on 25 January. The key focus for investors, of course, should be net-of-fee returns over the cycle. Thus, focusing on short-term performance figures and fees in isolation from net returns does not make sense.

We present NAV returns which are all net-of-fees for the LPX in Exhibit 1. We can see that the LPX has strongly outperformed both the MSCI Europe index by 9%, 20% and 14% over one, three and five years and the FTSE All-Share index by 15% 32% and 27%.

Absolute NAV performance has been solid at 76% over 10 years but has trailed the major indices due to unfavourable comparatives which should improve, as we have discussed in previous notes.

Exhibit 1: NAV performance				
(£)	One year	Three years	Five years	10 years
LPX Europe NAV	17.8%	55.8%	78.8%	75.8%
MSCI Europe	8.4%	29.8%	57.0%	93.4%
LPX NAV relative to MSCI Europe	8.6%	20.0%	13.9%	-9.1%
FTSE All-Share	2.5%	18.2%	41.4%	89.4%
LPX NAV relative to FTSE All-Share	14.9%	31.8%	26.5%	-7.2%

Source: Bloomberg, Edison Investment Research

LPE outperformed in the recent sell-off

The recent increase in equity market volatility was sharp but by no means unprecedented and occurred against a supportive economic backdrop. Using weekly data we take the performance from the recent weekly peak and trough (a three-week interval) of the relevant indices with the results shown in Exhibit 2.

Exhibit 2: The sell-off performance			
(£)	Weekly peak 19 January 2018	Weekly trough 9 February 2018	Change (%)
LPX	841.3	789.5	-6.2%
MSCI Europe	170.9	159.1	-6.9%
LPX relative to MSCI Europe			0.8%

Source: Bloomberg, Edison Investment Research

The LPX fell 6.2% compared to a 6.9% decline in MSCI Europe and perhaps surprisingly, outperformed by 0.8% in the three weeks to 9 February 2018. This might be explained by the market expecting continued strong NAV performance for LPE given the positive economic growth environment both in Europe and globally.

LPE continues to deliver impressive returns

We highlight performance data for the LPX in Exhibit 3.

Exhibit 3: Price performance					
(£)	One year	Three years	Five years	10 years	
LPX Europe	15.5%	67.9%	120.3%	118.9%	
MSCI Europe	8.4%	29.8%	57.0%	93.4%	
LPX price relative to MSCI Europe	6.5%	29.3%	40.3%	13.2%	
FTSE All-Share	2.5%	18.2%	41.4%	89.4%	
LPX price relative to FTSE All-Share	12.7%	42.0%	55.8%	15.6%	

Source: Bloomberg, Edison Investment Research

As the table shows, LPE has performed well over the last year. In the year to 9 February 2018, it returned 16% compared to 8% for the MSCI Europe index and only 2.5% for the FTSE All-Share. In addition, over three and five years the LPX has hugely outperformed the major indices by between 29% and 56%.

However, private equity, and by implication LPE, is a long-term asset class and we would argue that investors should look through periods of market volatility and focus on net returns over longer investment horizons.

Over 10 years the LPX has returned 119% compared to 93% for MSCI Europe and 89% for the FTSE All-Share equivalent to outperformance of 13% and 16% respectively.

The reason for the outperformance is the narrowing discount, as we showed above that the NAV return has lagged the indices somewhat. We illustrate the development of the LPX discount below.

Exhibit 4: LPX Europe price index					
	February 2018	One year	Three years	Five years	10 years
NAV premium/discount	-6.6%	-5.8%	-11.3%	-23.9%	-19.3%

Source: Bloomberg, Edison Investment Research

The NAV discount of 19% ten years ago illustrates that the market was most likely expecting a much weaker return outcome than was actually delivered by LPE over the subsequent 10-year period.

Comparatives to remain supportive in future

Exhibit 5: LPX total return relative to MSCI Europe (£)



Source: Bloomberg, Edison Investment Research

The LPE sector is gradually leaving behind the negative effect created by a handful of companies that made missteps during the financial crisis, as shown in Exhibit 5 above. In fact, the sector ought

to begin to benefit from a significant tailwind to rolling 10-year returns in future as comparatives improve.

We update our projection of rolling 10-year relative returns in Exhibit 6 below. Assuming flat markets going forward, one can see that LPX relative returns should actually improve strongly into the high, double-digits in the next three years. This should continue to support and improve the perception of the LPE asset class.

Exhibit 6: Price performance				
(£)	February 2018	February 2019	February 2020	February 2021
LPX Europe price	118.9%	419.7%	211.7%	128.4%
MSCI Europe	93.4%	151.5%	101.0%	67.9%
LPX price relative to MSCI Europe	13.2%	106.7%	55.1%	36.0%
FTSE All-Share	89.4%	149.1%	95.6%	58.7%
LPX price relative to FTSE All-Share	15.6%	108.7%	59.4%	43.9%

Source: Bloomberg, Edison Investment Research

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Pty Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Copyright 2018 Edison Investment Research Limited. All rights reserved. This report has been commissioned by LPEQ and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Investment Research Pty Ltd (Corporate Authorised Representative (1252501) of Myonlineadvisers Pty Ltd (AFSL: 427484)) and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). It is not intended for retail clients. This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2018. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.