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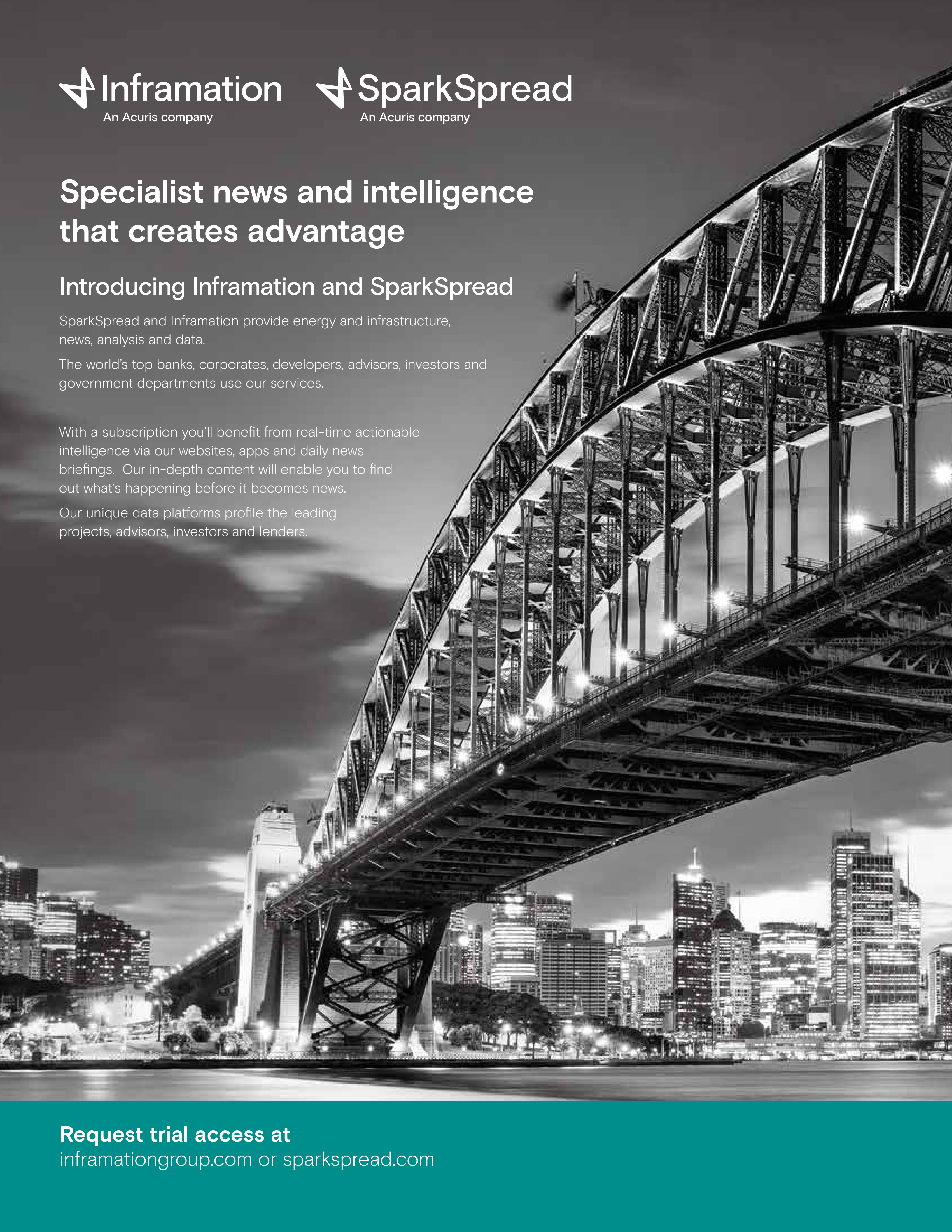
Listed Private Capital Report

October 2019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Foreword and contents

Listed private capital has seen significant growth over recent years as economic conditions have driven investors to look for returns in less traditional assets.

The listed infrastructure space has more than doubled in size since 2015, and currently has a market cap of £20bn across 20 funds offering access to assets that have inflation-linked incomes streams and long-term contracted revenues. A large area of growth within this has been the renewable energy space, which is targeted by nine of the last 12 funds to launch. This highlights another key feature of the listed infrastructure space; that it is in a position to make a positive contribution to ESG, meeting demands from investors.

Listed private equity is yet to see the boom that listed infrastructure has in recent years, but several trends in the public markets suggest this may be just around the corner. Public markets are shrinking, and investors are increasingly shut out from access to the fastest-growing companies, which are remaining private for longer. Listed private equity offers this access, and its history of outperformance is increasingly attracting investors.

This report, published in association with the Aztec Group, surveys the listed private capital space, looking at the lessons learned from the crisis and what the future might hold for the industry. ■

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Unlocking the potential of listed PE

Gareth Morgan
Research manager

Listed private equity has not seen the growth that wider private equity has in recent years, but is becoming increasingly relevant as public markets shrink and investors search for outperformance.

The term 'listed private equity' encompasses a wide variety of investment approaches, so it is a useful starting point to review the key models, what they offer to public market investors, and how they approach bridging public and private equity investment strategies.

Fund-of-funds model

Perhaps the method that best enables public market investors to replicate a diversified private equity portfolio is the fund-of-funds model. This involves a listed vehicle making investments in underlying funds managed by third-party managers, and also co-investing alongside these managers. Typically, these offerings are managed by established funds-of-funds managers, leveraging their experience and networks to offer access, and daily liquidity, to public market investors.

> "Some listed private equity firms are concerned with the discount to NAV that they are trading at... We prefer to focus on our value creation, portfolio performance and profitability growth"
> *Kristof Vande Capelle, Gimv*

Examples of this model include Pantheon International plc, which, as of 30 June 2019, had £1.43bn in net asset value, and Standard Life Private Equity Trust plc, managed by Aberdeen Standard Investments, which had a £676.5m net asset value as of July 2019. These offerings had seen one-year NAV growth of 12.9% and 8.8%, and share price growth of 5.2% and 11.9%, as of 30 June 2019 respectively. This discrepancy in share price and NAV highlights a historical challenge for these offerings: the shares consistently trade at a discount to their underlying NAV.

Kristof Vande Capelle, Gimv

"Some listed private equity firms are concerned with the discount to NAV that they are trading at," says Kristof Vande Capelle, CFO of Gimv. "Essentially they are marketing themselves as undervalued. We prefer to focus on our value creation, portfolio performance and profitability growth."

That there is a discrepancy between market value and the value of underlying assets is, in a way, not surprising. There is very little detail available to investors on the financials of the portfolio companies, or even comprehensive lists of holdings, making valuations a challenge.

Essentially functioning as an LP, listed funds-of-funds cashflows are very dependent on the exit environment for private companies, and

Gareth Morgan explores the development of the listed private equity industry and what it can offer returns-starved investors

management of cash reserves in order to finance the funding of commitments is crucial. Currently, and during recent years, these cashflows have been net-positive, leading to many managers establishing or increasing dividend payments to shareholders.

Running at a commitment deficit is not uncommon, with managers relying on distributions from more mature funds, along with leverage in the form of credit facilities, to finance undrawn commitments. On the plus side, this approach means that the impact of any cash drag, keeping the vehicles' assets in cash in anticipation of future commitments, is negated, meaning better underlying returns for shareholders.

As the 2008 financial crisis demonstrated, however, this approach can have significant drawbacks should extreme economic events occur.

Co-invest model

A more concentrated way for public market investors to access private equity is to buy shares in a vehicle managed by a private equity firm that acts as an LP in that firm's own funds, and as a co-investor on deals led by the manager. Examples of this are Hg Capital Trust plc and Oakley Capital Investments Limited.

For investors, these vehicles offer concentrated access to selected private companies, and are comparable to making LP commitments to the managers' funds. As with fund investing, manager selection is a big factor in performance, given the concentrated nature of this method of accessing private equity.

The benefit for managers is a permanent pool of capital available for both fundraising and co-investments. To take HgCapital Trust as an example, this vehicle made a £350m commitment to the £2.5bn Hg Capital 8, representing 14% of total commitments, and wrote co-investment cheques on a number of deals in the fund.

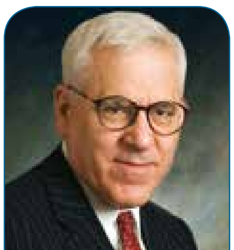
> "Despite the benefits that the sector provides, for some wealth managers listed private equity is a bold bet"
>
> *Steven Tredget, Oakley Capital Investments*

A slightly different example of this type of structure is Gimv, a Brussels-listed investment company that manages c.€1.6bn of assets across 50 portfolio companies. Gimv operates as an evergreen fund making PE investments, and the fact that it is a listed vehicle offers advantages.

"Being listed means Gimv can be much more flexible around hold periods," says Vande Capelle. "This can be a differentiating selling point in winning deals, particularly in the growth equity space, as companies don't want to be seen as potential exit candidates as soon as they're acquired."

Listed management company model

A third way for private equity firms to access the public markets hit the headlines recently, with Stockholm-based EQT announcing in September its intention to list approximately 20% of its shares on Nasdaq Stockholm, aiming to raise €500m. This would make the Swedish GP the largest European PE firm to list, ranked by AUM. The rationale given by the firm is that floating part of the management company will increase financial flexibility and enable continued expansion across geographies and investment strategies.


David Rubenstein, Carlyle

Since Blackstone listed in 2007, other brand-name US buyout houses have also taken this approach to raise capital, but have not found life on the public markets entirely plain sailing. "I can't imagine why any private equity firm would ever want to go public," Carlyle co-founder David Rubenstein said at a conference in February 2016. "Private equity firms that are public have underperformed virtually every other publicly traded stock." Indeed, from 2007 to the end of 2018, Carlyle and Blackstone stocks underperformed the S&P 500 index.

This illustrates the significant downside of a private equity management company IPOing: that stock price becomes an additional concern in the management and governance of the firm.

> "I can't imagine why any private equity firm would ever want to go public… Private equity firms that are public have underperformed virtually every other publicly traded stock"
> *David Rubenstein, Carlyle*

Unrealised potential

As an asset class, private equity has seen enormous growth in recent years. Macroeconomic conditions since the financial crisis, particularly continued historically-low interest rates, have created favourable conditions for financial sponsors, and have resulted in the AUM of the global private equity industry reaching $1.79trn in 2018, according to figures published in McKinsey's *Global Private Markets Review 2019*.

A trend running alongside this increase in available private capital is a decrease in the number of quoted companies. Figures in Pantheon International plc's latest annual report show that the number of public companies in the United States and Europe has declined by 3.8% annually since 2008, falling from 20,326 to 14,393 in 2017. In contrast, the number of private-equity-backed businesses has grown by 4.2% annually, from 7,236 in 2008 to 10,440 in 2017. Additionally, an *S&P Global Market Intelligence* study clocked the average age of US companies at IPO at 13.3 years-old in 2018, up from 3.1 years-old in 2002.

In this context, listed private equity provides investors with access to a universe of businesses that are becoming more and more inaccessible. "The strength of underlying portfolio companies is far beyond the majority of those found in the public markets," says Steven Tredget, head of investor relations at Oakley Capital Investments. "Oakley's portfolio has 30%-40% average EBITDA growth year on year, and this drives NAV growth. Listed private equity also provides access to sectors that public markets don't cover particularly well, for example healthcare in the past, and education currently."

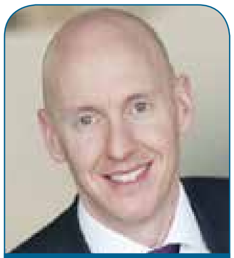
Despite these natural growth conditions, listed private equity has failed to match the growth rate seen in the unlisted space: McKinsey's *Global Private Markets Review 2019* cites data showing that global private equity NAV has grown by 7.5x since 2002, whereas LPX data shows the NAV of listed PE companies has grown by just 3x during the same period.

Obstacle course

A core reason that listed PE has struggled in recent times is that a number of high-profile failures occurred during the global financial crisis, and the headlines these generated linger on in the minds of investors.

A policy of overcommitment meant that as it became harder for PE firms to sell portfolio companies, distributions from underlying funds dried up and overcommitted listed funds-of-funds risked defaulting on their commitments.

An extreme example of this was APEN Private Equity, which at 31 December 2009 was trading at CHF 15.00 per share, against a NAV per share of CHF 61.04, according to its 2009 annual report. The first two sentences of the chairman's letter to shareholders paint a fairly grim picture: "2009 proved to be the second consecutive very challenging year for APEN Ltd. The primary order of business in 2009 was to address APEN's liquidity, with existing lenders requesting repayment and relatively high levels of unfunded commitments." Ultimately the company reduced its unfunded commitments from CHF 744m to CHF 200m, partly by selling at a significant discount on the secondaries market, and was restructured with a new preferred equity layer injecting new capital.



Steven Tredget, Oakley Capital

The depth of these discounts is revealed later in the report: "In order to fund capital calls [...] the company was forced to sell portfolio funds. Initially, the company sold funds that were fully invested, to generate liquidity. The discount on top-brand funds with virtually no unfunded commitments was at about 60% of NAV. Some funds with significant open commitments were sold at 100% discounts." This effectively means that fund stakes were given away to avoid having to make future commitments.

> "Firms have the challenge of education to help people understand what listed PE is and how it works. Once the sector is understood, its benefits are obvious"
>
> *Steven Tredget, Oakley Capital Investments*

Another factor that impacts listed private equity is the activities of private wealth advisers, who control a significant amount of capital. "Despite the benefits that the sector provides, for some wealth managers listed private equity is a bold bet," says Tredget. "It's not like buying a FTSE 100 company, like Vodafone or BP, where there is scale, limited perceived risk and a broad public understanding of the business. With private equity there is poor understanding of the asset class, little knowledge of the underlying portfolio companies and wariness based on historical failures within the sector, all of which can make it a tougher sell, despite the superior returns they generate."

Perhaps the crucial factor inhibiting the growth of listed PE, though, is a lack of understanding of the asset class among public market investors. "Listed PE is a relatively small sector in the public markets." Tredget says. "Firms have the challenge of education to help people understand what listed PE is and how it works. Once the sector is understood, its benefits are obvious." With a growing number of market participants dedicated to increasing this level of understanding, this particular factor could soon be a thing of the past.

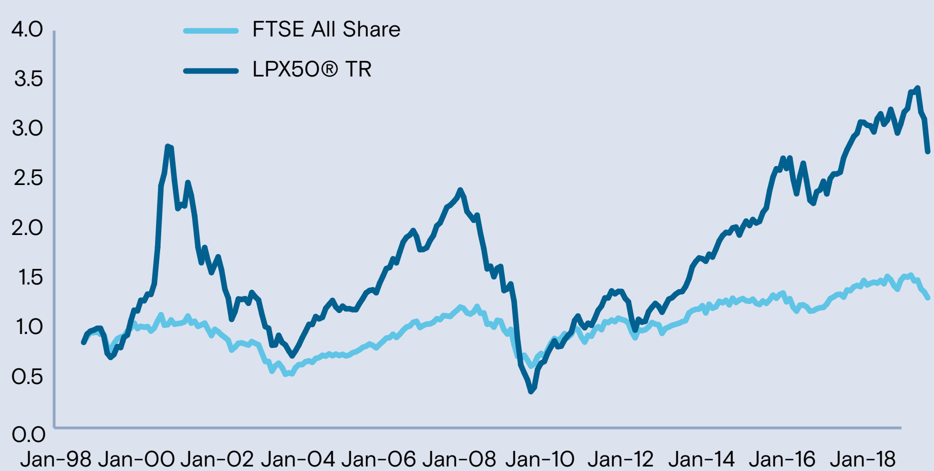
In a world of companies staying private for longer, the options for public market investors to access fast-growing, young businesses are increasingly limited. Listed private equity can fulfil this demand and should be set for a surge in popularity, with lessons learned from the crisis-era struggles and developments such as the maturation of the secondaries market. ■

Listed private capital statistics

LPX50 total returns vs FTSE All Share Index 1998-2018

Source: *LPX Group*

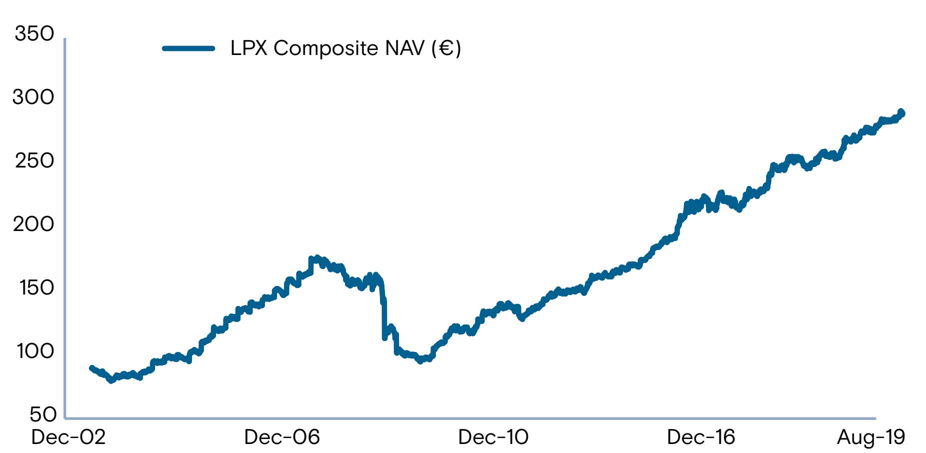
- The LPX50 tracks the performance of the 50 most highly capitalised listed private equity companies. This chart shows the net total returns of the index plotted against the FTSE All Share index in the 20 years from 1998. Both indices have been rebased to 1998.



LPX Composite NAV

Source: *LPX Group*

- The LPX Composite NAV represents the NAV growth of diverse listed private equity vehicles following a total return (gross) reinvestment scheme. Since 2002, the index has grown by 3x.

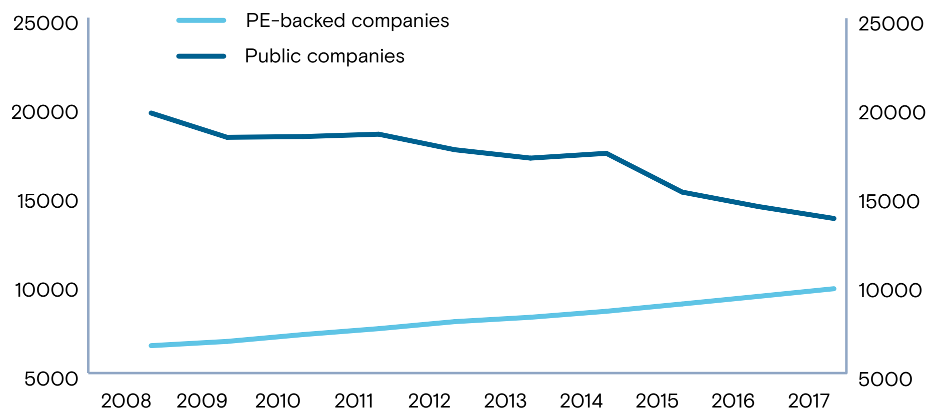


A selection of data insights highlighting the past performance of listed private equity and infrastructure, and future opportunities available in the space

Comparison of number of public vs private equity-backed companies

Source: *Pantheon International*

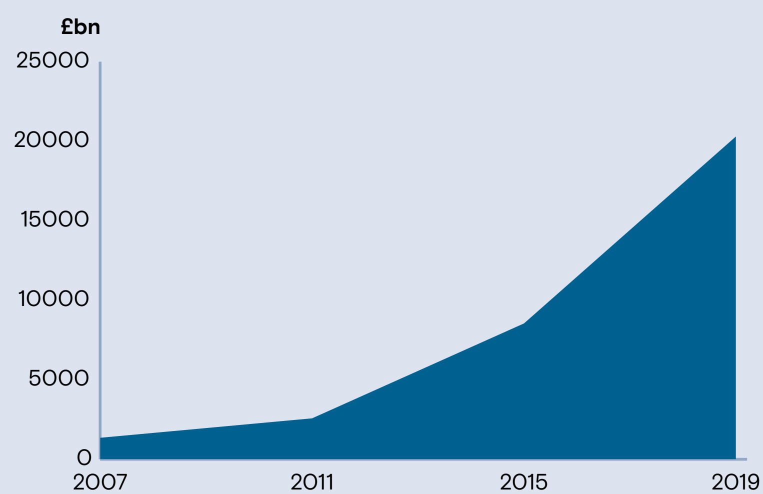
- Since 2008, the number of public companies in the US has dropped by around 30%, from 20,326 to 14,393, where the number of private equity-backed businesses has grown by 44% over the same time period, from 7,236 to 10,440.



Growth of listed infrastructure market cap

Source: *analysis of Euronext, LSE*

- The listed infrastructure space has seen significant growth over recent years, with the market cap of listed funds topping £20bn in 2019, more than doubling in the four years since 2015. Growth over the longer term is equally impressive, with the market cap in 2007 having been just £1.34bn.



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Administration Q&A: Outsourcing explained

What are the main drivers behind a decision to outsource?
There is growing recognition that fund management is an area of specialist skills and knowledge. On the one hand, managers have specialist expertise in working with investors, watching markets and allocating capital. On the other hand, the operational side of that expertise is a specialist field in itself; this is especially true of policies, procedures, controls and day-to-day operations, all of which are influenced by rapid technological innovation and regulatory changes on regional and global scales. The impact is that managers are focusing more on their clients' investments, working with an outsourced administrator to provide the operational underpinning to their investment decisions.

It can be very costly and time-intensive to recruit operational teams, provide ongoing training, and invest in technology and controls that keep pace with regulations and client requirements. Outsourcing provides a cost-effective solution whereby these costs are absorbed by the administrator and spread across all clients; managers are left to focus on their specialist 'front-of-house' activities, safe in the knowledge that back-office activities are streamlined, efficient and fully compliant. Experienced administrators will also have knowledge of various sectors, different listing rules and funds of all sizes, so are well placed to offer advice and apply best practice.

To use a technology analogy: the outsourcing provider's services are the continually-updated and efficient cloud-based software; the fund manager relies on that software to operate their system and deliver results.

What does a typical outsourcing partnership look like?
There's nothing typical about it! Every partnership is shaped around the client's needs.

Some managers may only need to outsource certain elements of their operations, such as the company secretarial function. Others look for a fully comprehensive partnership that includes the setup of vehicles and the listing processes, through to the ongoing administration of the fund structure. Ongoing administration services can include financial reporting, transaction management, liaising with listing sponsors, managing stock exchange announcements, the maintenance of statutory records, compliance and client due diligence – to name a few. Some outsourcing partnerships may also extend to the administrator acting as the fund's depositary.


Chris Copperwaite, Aztec Group

Listening is key. The administrator should take time to note their client's needs, shaping a service and building a unique operational platform around those needs. Partnerships that start on a good footing can evolve, and many managers test the

Listed funds specialist Chris Copperwaite from the Aztec Group explains why many fund managers take the decision to outsource the administration of their operations to an external team, and describes the steps to a fruitful outsourcing partnership

water with a small suite of services before growing into a more fully-fledged arrangement over time.

What should managers look for in an outsourcing partner?

On the face of it, most outsourced administration service providers seem the same: all have invested in technology, all have specialist teams, and all have an impressive list of clients. Managers should lift the bonnet and consider how that technology and those specialist skills have actually been put into place for those clients.

Take technology, for instance. How does that technology enhance a manager's operating platform rather than being a token piece of software? Look out for best-of-breed administration systems, client portals, compliance tools and digital boardroom software.

Seeking client testimonials will indicate whether the administrator is as good as their word, and whether they truly take time to learn about their clients' needs. It is important to understand if the administrator genuinely has a specialist listed funds team and that they understand the additional complexities and requirements involved with listing on various exchanges. Listed company secretarial services, for example, can add clear value at board level, with a good administrator displaying clear understanding of regulations, transactions and corporate governance.

At a high level, managers should take the time to learn about the outsourced partner's overall business. Are their teams functional or centred around their clients? How can continuity of service be provided and what is the business's staff turnover rate? Does the business have specialist support in the form of legal, risk, IT and regulatory reporting teams? The whole is often greater than the sum of its parts.

> "The administrator should take time to note their client's needs, shaping a service and building a unique operational platform around those needs"
> *Chris Copperwaite, Aztec Group*

What steps can be taken to ensure a successful partnership?

A good start is critical. This begins with the administrator really learning about the manager's business and aims, but that's only the first step. Migration or onboarding is particularly important: how has the administrator managed the process for other clients and what is their action plan? How has that action plan been tailored to the manager's specific needs, and what are the exact timeframes and deadlines? No detail is too small, and no stone should be left unturned.

Administrators should introduce the manager to the proposed relationship team. Everyone should be crystal clear about individual responsibilities and service agreements and, equally, it's important for a manager to meet the people who will be managing the day-to-day operations of their fund. ■

Listed infra funds stand firm in the face of volatility

Paul Tilt
Head of fund research

There are typically two routes for investors to access the infrastructure sector through the listed space – infrastructure vehicles investing directly in unlisted assets, and investments in listed corporates that exhibit infrastructure attributes. The former offers public market investors access to private opportunities that they would otherwise struggle to access, and it is a market that has ballooned to £20bn in the last few years.

Public fund for private assets

The most widely used route for retail investors to gain exposure to unlisted infrastructure assets such as transportation, social, energy and renewables is through listed infrastructure investment vehicles. These funds democratise access to assets that have inflation-linked income streams, high barriers to entry, long-term contracted revenues and are traditionally only accessible to large institutional investors.

From a nascent segment of the infrastructure market pre-crisis, with three funds and a combined £1.3bn in market capitalisation in 2007, this has grown to 20 funds and more than £20bn in AUM. Since 2015, the market has more than doubled in size.

Indeed, demand for infra assets in this format is evident from the healthy premium to net asset value that many of these trusts are trading at – in some cases up to 20%. "More money is chasing deals than supply and there is a scarcity factor, and this has driven valuations up," says Frank Schramm, co-CEO at BBGI. "We invest in availability-based projects only and are transparent about how we value [and] what discount rates and assumptions we are using. Based on this, a lot of investors think that our portfolio is conservatively valued and are prepared to buy at a premium."

Although the listed space is undoubtedly benefiting from the tailwinds of investor sentiment to the infrastructure asset class, the performance of these funds has been a key driver of their growth. "These funds generate long-term cashflows through exposure to infrastructure projects, offering dividend yields in excess of 5% in a low-interest rate environment", says Dion Di Miceli, director and head of investment companies at Gravis Capital Management. The consistent dividends and capital appreciation from investments positioned at the lower end of the risk spectrum, with little correlation to wider stock market volatility, has been extremely attractive for investors.

Renewables revolution

Many of the earlier listed funds to IPO had investment mandates to target public-private partnerships, but much of the recent growth has been in renewables, with nine of the last 12 funds launched targeting renewable energy infrastructure.

This is perhaps unsurprising – in 2009, the renewable energy market totalled £8bn, according to Inframation. By 2018, this had reached £98.8bn. According to the Aquila European Renewables Income Fund prospectus, the latest renewables fund to list, growth in the renewables market is

Although unlisted funds typically dominate infrastructure fundraising headlines, there is also a flourishing listed infrastructure sector in Europe. Paul Tilt explores the growth of this space

Listed infrastructure trusts

Company	Market cap 2019 (£m)	Market cap 2015 (£m)	Market cap 2011 (£m)	IPO date
HICL Infrastructure Company	2979	2564	763	Mar-06
International Public Partnerships	2298	1507	646	Nov-06
3i Infrastructure	2375	1363	1042	Mar-07
GCP Infra	1109	709	115	Jul-10
BBGI	979	451	–	Dec-11
Greencoat UK Wind plc	2413	546	–	Mar-13
Renewables Infrastructure Group	1905	51	–	Jul-13
Bluefield Solar Income Fund	480	315	–	Jul-13
Foresight Solar Fund	686	274	–	Oct-13
John Laing Environmental Assets	587	165	–	Mar-14
NextEnergy Solar Fund	696	286	–	Apr-14
Sequoia Economic Infrastructure Income Fund	1594	303	–	Mar-15
TINC	334	–	–	May-15
GCP Asset Backed	476	–	–	Oct-15
Greencoat Renewables	523	–	–	Jul-17
Gore Street Energy Storage Fund	35	–	–	May-18
Gresham House Energy Storage Fund	171	–	–	Nov-18
SDCL Energy Efficiency Income Trust	192	–	–	Dec-18
US Solar Fund	160	–	–	Mar-19
Aquila European Renewables Income	296	–	–	May-19

Source: *analysis of Euronext, LSE. *2019 data correct as at 25 September 2019*

anticipated to drive investments in the amount of £1.5trn until 2050.

Listed renewables funds have evolved along with the maturation of the renewables sector. Where early funds were typically country-specific, reliant on subsidies and biased towards onshore wind and solar, today's vehicles are much more varied. The Aquila fund targets a diversified renewables portfolio across Europe. US Solar focuses on the unsubsidised US market, and a flurry of energy storage and efficiency funds have emerged to provide flexible capacity to integrate intermittent and often distributed, renewable energy generation.

ESG is only natural

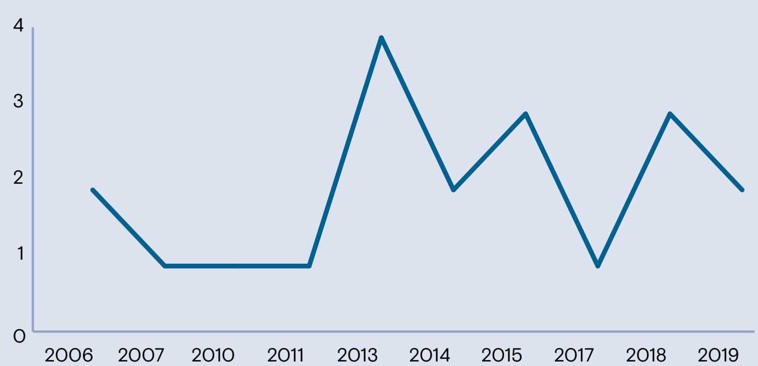
On the face of it, infrastructure and renewables assets, by definition, should appeal to investors with a focus on environmental, social and governance (ESG) criteria. Infrastructure managers provide essential services, such as investments in schools and hospitals, and invest in and build assets with strong environmental credentials.

Another manager argues that as little as three years ago, many investors were ticking the 'couldn't care less' box on their annual investor survey in answer to the 'how important is ESG?' question, whereas today most tick 'important' or 'very important'. Having an investment in a windfarm is no longer enough to satisfy many investors who expect responsible investing to be central to fund managers' business models across the whole ESG spectrum. "A windfarm is no good if it disrupts local communities and a road project, although connecting communities could contribute to more pollution," says one fund manager.

That said, many listed managers have some novel approaches to ESG. HICL, for example, has implemented road surface technology in France that generates electricity from solar energy, known as Wattway. The energy generated will supply most of the Saugnac-et-Muret toll gate's needs. Meanwhile, BBGI secured an award for work done to ensure the haul roads on the salt marsh did not interfere with bird nesting in constructing the Mersey Gateway Bridge.

HICL's manager InfraRed Capital Partners has had an A+ rating from the UN's Principles for Responsible Investment programme for the past four years, and InfraRed co-head of infrastructure Harry Seekings says: "As investors in public infrastructure, which is at the heart of communities, there is a duty to take a long-term view and act responsibly in the interests of all stakeholders. Delivering long-term, sustainable returns from an infrastructure investment is dependent on this mindset."

Infrastructure trust IPOs per year



Source: *analysis of Euronext, LSE.*

Positioned to weather political risk

Despite the growth seen in the listed space, BBGI's Schramm does not expect to see many new entrants emerge: "To be able to list a new infrastructure vehicle you need a seed portfolio, not a blind pool, and to be able to differentiate yourself from existing companies. I have not seen much differentiation in the last few years and the IPO market is quite difficult at the moment."

Much like with unlisted funds, the established, larger managers in the listed space have had little difficulty selling to investors. Many issuances have been oversubscribed, enabling managers to issue shares at a placing price greater than the NAV per share. This is accretive to the NAV attributable to shareholders and enhances further growth. Some of the largest listed managers are near £3bn in market cap and have hundreds of assets in their portfolios.

Delving into the 2019 results announcements, the listed funds reveal several common potential uncertainties regarding future performance: political risk in the UK, with the Labour Party voicing its ambition to bring PPP projects back in-house and to nationalise assets such as rail and utilities; Brexit, which poses a potential risk to the performance of the wider UK and European economies; and counterparty/regulatory risk, particularly for the renewables managers for whom investments are largely dependent upon governmental grants and permits or licences.

Should these fears materialise, listed infrastructure funds should be well placed to weather the storm. They have built strong, balanced portfolios and are delivering attractive income and capital appreciation for investors. Although market conditions have meant competition for infrastructure has been strong, this has also created a healthy exit environment for these funds. The perceived stability of infrastructure assets and higher yields than currently achievable through holding cash are likely to see the sector continue its ascent. ■

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