

# GRAB A PIECE OF THE FUTURE

PRIVATE EQUITY IS NOT AN ASSET CLASS WELL UNDERSTOOD OR ANALYSED BY INDIVIDUAL INVESTORS, BUT THE WAY THE INVESTMENT TRUSTS IN THIS CATEGORY HAVE PERFORMED INDICATES THEY COULD BE WORTH CONSIDERING

*By Lawrence Gosling.*

In general private equity offers potential returns uncorrelated to the public markets and can achieve what analysts often refer to as 'defensive' characteristics which can be very helpful when the markets are in phases like the current one.

The other reason to consider private equity is that increasingly the most exciting companies in the world do not need to raise money from public stock exchanges and are staying private for longer, given how much capital is available from institutions, sovereign wealth funds and high net worth individuals.

Equally many of the companies looking for vaccines or testing solutions to covid-19 are relatively small biotech and pharmaceutical business funded by venture capital or private equity money.

But investing in the private equity investment trust gives investors the opportunity to get involved in some of the most exciting future businesses.

The AIC's private equity category has more trusts in it than you might expect – currently 22 – but few will be familiar to readers.

Standard Life and BMO, which also runs the F&C trust, are recognisable names and the Standard trust has an excellent record, as does Hg Capital, which has long been a favourite for wealth managers.

The other standout is Pantheon International (PIP), which we have written about quite a bit in the last year or so, which combines an excellent dividend with a genuinely global portfolio.

Another trust we have spoken to this year, whose shares are at an attractive 20% or so discount, is ICG Enterprise, which is actually the oldest private equity investment trust.

## ICG Enterprise

ICG – Intermediate Capital Group – is itself a quoted business and a number of fund managers running open and closed ended funds have shares in ICG in their top 10 positions.

What we like about this trust is the team running it leverage off this expertise in the wider ICG to create a portfolio which is by its nature conservative – but do not make the mistake of associating that with sluggish performance.

ICG Enterprise essentially invests in other private equity group's funds as well as funds that the parent ICG group manages, which specialises in debt

investments. This focus on debt investing leads to the defensive, conservative approach where the analysis is a simple one: how likely are they likely to get paid back by a business if they lend it money?

By investing with other funds the trust has investments all over the world in major economies which creates genuine

diversification and a kind of smoothing over an economic cycle.

And while much of private equity investing is associated with areas like tech, another element of ICG Enterprise we like is that many of the underlying companies it is ultimately invested in are very simple to understand.

In the US it is invested in Leaf Home Solutions which provides protection for gutters as part of its home improvements solutions; in the Netherlands a caravan park operator; and in Norway an accounting software business.

In Singapore and the UK it invests in education providers; the second largest ice cream maker in the world, which happens to be based in the UK; as well as EG Group which manages over 5,000 petrol station forecourts around Europe and maybe familiar to readers as the group which recently bought Asda from WalMart.

So it has an excellent portfolio which is at least at a 20% discount to the headline share price of the trust; but equally the trust has always been very conservative about the way it values these investments.

This is borne out by the fact that when it sold off investments in 2019 it achieved a price over 30% above the value it had assigned to them.

This trend continued in 2020 as the results for the six months to the end of July 2020. In these figures there was an uplift of 7% of the value of those investments sold off, which means that with

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the trust's share at a 20% discount you would be buying a high quality portfolio even cheaper than the real value. The trust's shares are also trading at close to 300p below their all-time high, although at 800p each they have nearly double from the recent all-time low.

## Discounts

One of the challenges of looking at the private equity trusts is how to compare like-with-like, because looking through the portfolios usually shows quite different underlying investments.

Interestingly, looking at the discount is a good way. The average discount in the sector is around 27% with two trusts on a small premium and three trusts with a discount of over 50%.

So looking at trusts in and around the sector average is good indicator of the quality of the underlying investments. The sector faced some lack of confidence off the back of the problems with the Patient Capital Trust last year managed by Woodford Investment Management.

This trust, which has now been taken over by Schroders and renamed (see page 6), was not in reality anything like ICG Enterprise.

We really like ICG Enterprise because the shares are on a good discount for new investors, the group behind it has an excellent record, and the underlying portfolio looks like a group of businesses which will generate returns through the economic cycle and many of these are very resilient in the short term as we get to grips with covid-19.

So as well as long term share price growth, particularly from current levels, the shares also have a yield of around 2.9% so overall they look like a very good long-term buy and hold which would sit nicely alongside any mainstream UK equity investments an investor might hold. 

## THE TRUE INDEX OF THE ECONOMY

Investors have looked to stock markets as a barometer of domestic and global economic health since trading in corporate stock first began in the early 17th century.

Over the last 400 years, indexed lists of public companies have become the bellwether by which to measure domestic and global economies. Today, in markets all around the world, listed companies can be found across multiple sectors, allowing investors to buy and sell shares for their portfolios with ease. However, over the past 50 years there has been a dramatic reduction in the number of listed companies in developed markets.

Today, there are fewer companies listing, mergers and acquisitions have consolidated businesses, and many have chosen to go or remain private. According to figures from the London Stock Exchange, the number of UK listed companies stood at over 3,400 at 31 March 1970. Today that figure has fallen to just over 2,000.

For investors, this presents a problem. Not only does it reduce investment choice, but public market investors may be unwittingly concentrating their assets in a small group of sectors and individual companies. For example, financials account for more than 25% of the FTSE All Share Index, with relatively cyclical sectors such as consumer goods (16%) and industrials (12%) all heavily represented.

We believe that investors are only able to access the complete equity market by combining public market investing with exposure to private equity. Put simply, listed companies no longer offer the best index of the real economy with attractive sectors such as technology, healthcare and business services significantly under-represented in the UK listed market.

To uninitiated investors, private equity owned companies may seem unfamiliar, but most of us encounter these businesses every day in society. Whether it is your local veterinary clinic, ice cream shop, health and fitness centre or even your local dentist, with around \$4trn in assets now backing these companies globally, private equity has truly crossed over into the mainstream. For investors in the UK market, looking solely at the listed market would offer a universe of around 2,000 companies, but this can be expanded considerably if the 4,300 private equity-owned businesses are also reviewed. While investing in private equity owned companies offers a good diversification opportunity, this is not the only benefit.

The focus of private equity is long-term value creation, rather than the next quarterly results, which contributes to the asset class consistently outperforming listed indices for 19 of the last 20 years. Private equity managers drive value by providing capital to help good businesses grow and actively working with company management teams to deliver strategic change, operational improvements and financial discipline. Through these close lines of communication, private equity managers also have a greater degree of influence over the companies in which they invest.

Unsurprisingly given its strong track record, private equity has become a cornerstone of the investment programmes of some of the world's most sophisticated institutions, attracted by its superior returns, long term focus and ability to pivot to growing sectors. In recent years, many of the world's leading institutions have been increasing their allocations to private equity.

The question for all investors should therefore be: how can I access private equity? Direct investment is impossible for all but the largest and most sophisticated investors. However, the listed private equity sector makes this attractive asset class accessible to everyone with low minimum investment, liquidity, diversification and immediate deployment of capital. It also gives individual investors access to highly experienced investment teams and high-quality private equity managers.

Private equity provides investors with strong performance and diversified investment opportunities which better reflect the real economy than the increasingly concentrated listed markets. It is an investment philosophy and model which focuses on driving long term investment performance, driving the growth and development of better companies. However, for too long these benefits have been the preserve of only the largest and most sophisticated global institutions. The role of vehicles such as ICG Enterprise Trust is to democratise the asset class, providing unconstrained access and liquidity for retail and institutional investors to leading private equity managers. Now that private equity has entered the mainstream of the world's major economies, it is time for it to do the same in the portfolios of all investors targeting long term growth – and we believe that listed private equity has a key role to play.

OLIVER GARDEY, HEAD OF PRIVATE EQUITY FUND  
INVESTMENTS AT ICG ENTERPRISE TRUST

