

# Dunedin Enterprise Investment Trust

## Mature portfolio raises realisation prospects

Investment trusts

Dunedin Enterprise Investment Trust (DNE) is a private equity investment specialist, which is differentiated from peers by its focus on UK lower mid-market buyouts. Three of the top five portfolio companies saw significant valuation uplifts driven by strong earnings growth in 2014 and, while overall performance was held back by disappointing developments at two companies in particular, these issues have been addressed. The majority of portfolio companies are budgeting higher earnings in 2015 and DNE's relatively mature portfolio provides the prospect of an increase in realisations that could enhance NAV performance in the current year.

12 months ending	Total share price return (%)	Total NAV return (%)	FTSE Small-Cap ex Inv. Trsts. (%)	UK Private Equity ex-3i NAV (%)	FTSE All-Share ex Inv. Trsts. (%)
30/04/12	4.3	11.6	(2.5)	5.0	(1.9)
30/04/13	24.4	(2.6)	28.2	6.5	17.8
30/04/14	1.0	1.5	31.8	1.3	10.7
30/04/15	(15.1)	(1.3)	3.8	2.9	7.3

Note: Twelve-month rolling discrete total return performance.

### Investment strategy: Lower mid-market private equity

DNE specialises in providing private equity finance to established, potentially high-growth companies aiming to achieve substantial long-term growth through capital gains. DNE invests through Dunedin LLP (Dunedin), an independent private equity partnership focused on transactions between £20m and £100m with extensive experience in UK lower mid-market buyouts. Dunedin aims to help drive the growth and internationalisation of its investee businesses and focuses on sectors including industrials, business services and financial services. Dunedin targets businesses with the following characteristics: a proven management team with the desire to create and deliver value; a strong market position, niche or brand; clear organic growth potential; internationalisation opportunities; potential for buy and build or roll-out; barriers to entry; and legislation-driven products or services.

### Outlook: Prospects for exits considered good

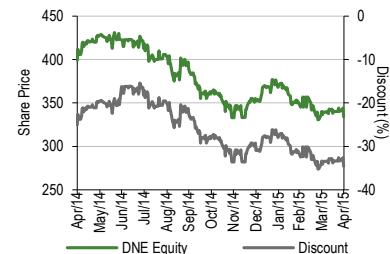
The manager sees the unpredictable outcome of the May 2015 general election and the possibility of an EU referendum contributing to a climate of political uncertainty and considers it increasingly hard to predict the prospects for the UK economy. Relative to Europe, the UK is seen as demonstrating reasonable growth and falling unemployment, although these trends are not immune to external influences. Despite an uncertain backdrop the prospects for exits are considered to be good, and this is helped by the majority of portfolio companies budgeting for an increase in maintainable earnings in the current year.

### Valuation: Scope for narrowing discount

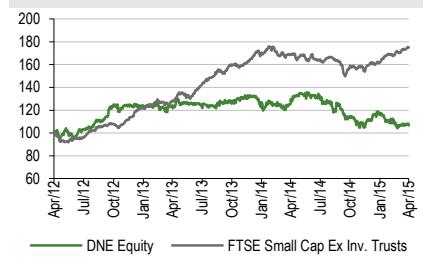
During late 2014 and early 2015, DNE's discount moved to its widest level since September 2012, which appears to be a reflection of the recent relatively weak NAV performance. However, standing at 35%, there is significant scope for the discount to narrow as NAV performance improves.

1 May 2015

Price	334p
Market cap	£70m
AUM	£105m
NAV*	510.6p
Discount to NAV	34.6%
Yield	1.4%
Ordinary shares in issue	20.9m
Code	DNE
Primary exchange	LSE
AIC sector	Private Equity
<b>Share price/discount performance</b>	



### Three-year cumulative perf. graph



52-week high/low	431.3p	330.5p
NAV high/low	532.3p	501.7p

### Gearing

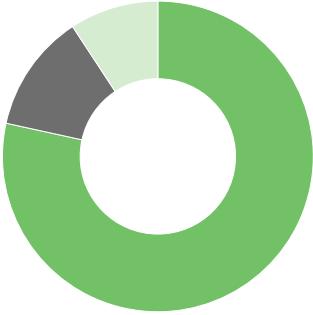
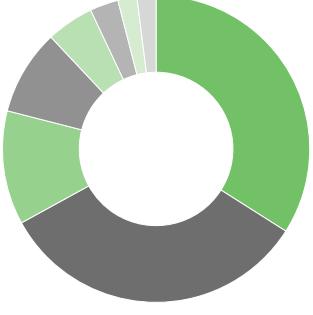
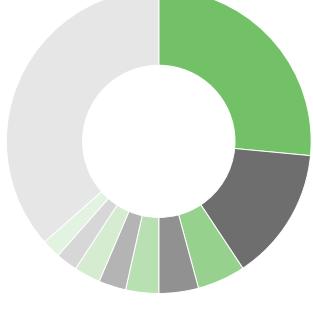
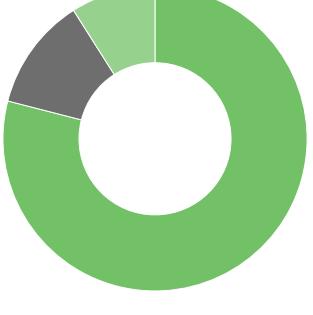
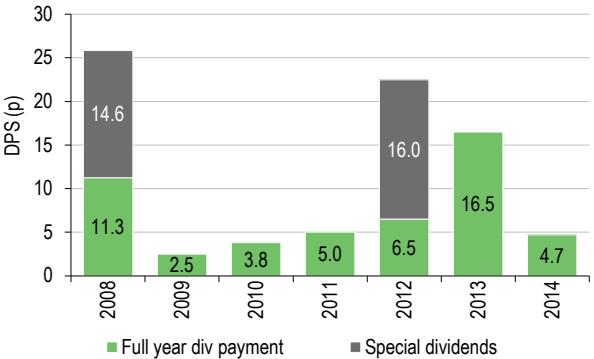
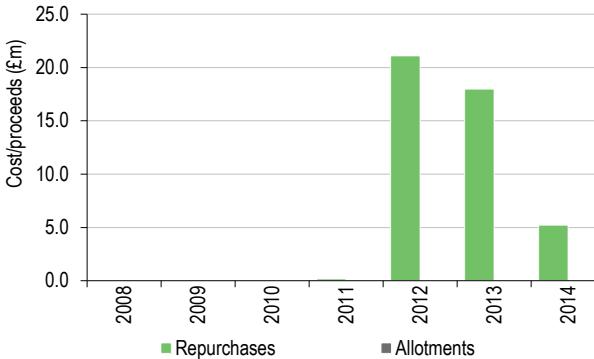
Gross	0.0%
Net cash*	9.2%

\*As at 31 December 2014.

### Analysts

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Andrew Mitchell	+44 (0)20 3681 2500
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<a href="#">Edison profile page</a>	

**Exhibit 1: Trust at a glance**

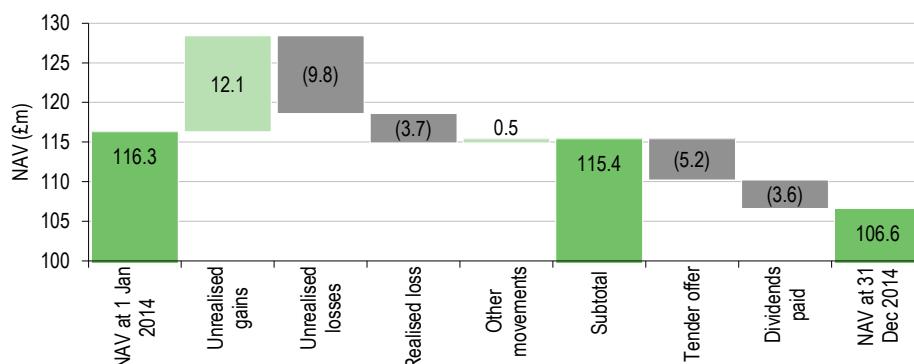
Investment objective and fund background		Recent developments																																																	
<p>Dunedin Enterprise aims to achieve substantial long-term growth in its assets, with a return on equity of over 8%. The trust mainly invests in UK lower mid-market management buyouts with an enterprise value of £20m to £100m with the aim of partnering with management to build better businesses. The strategy was amended in 2011 to focus on this area and the remaining third-party European managed fund investments are being reduced over time.</p>		<ul style="list-style-type: none"> <li>1 April 2015: £5m investment in construction consulting services firm, Blackrock Programme Management announced.</li> <li>20 March 2015: FY14 results – NAV total return -0.4%; £6.1m realisations and £16.0m new investment; 4.7p dividend declared.</li> </ul>																																																	
Forthcoming		Capital structure																																																	
AGM	13 May 2015	Ongoing charges	2.9%																																																
Interim results	28 August 2015	Net cash	9.2%																																																
Year end	31 December	Annual mgmt fee	see page 11																																																
Dividend paid	May	Performance fee	see page 11																																																
Launch date	1974	Trust life	Indefinite																																																
Continuation vote	No	Loan facilities	£20m																																																
Funds under management (as at 31 December 2014)		Sector breakdown (as at 31 December 2014)																																																	
 <ul style="list-style-type: none"> <li>Dunedin managed (78.4%)</li> <li>Third party (12.3%)</li> <li>Cash (9.2%)</li> </ul>		 <ul style="list-style-type: none"> <li>Support services (34%)</li> <li>Industrials (33%)</li> <li>Financial services (12%)</li> <li>Construction &amp; building mats. (9%)</li> <li>Healthcare (5%)</li> <li>Consumer products &amp; services (3%)</li> <li>Automotive (2%)</li> <li>Technology (2%)</li> </ul>																																																	
Shareholder base (as at 31 March 2015)		Geographic split of investments (as at 31 December 2014)																																																	
 <ul style="list-style-type: none"> <li>Legal &amp; General IM (26.5%)</li> <li>Alliance Trust Savings (14.2%)</li> <li>Baillie Gifford (5.1%)</li> <li>East Riding Pension (4.2%)</li> <li>Brewin Dolphin (3.5%)</li> <li>Hargreaves Lansdown AM (2.9%)</li> <li>LPX Group (2.8%)</li> <li>British Airways Pension (2.3%)</li> <li>Standard Life (2.0%)</li> <li>Other (36.5%)</li> </ul>		 <ul style="list-style-type: none"> <li>UK (79%)</li> <li>Rest of Europe (12%)</li> <li>Cash (9%)</li> </ul>																																																	
Dividend history		Share buyback history																																																	
 <table border="1"> <thead> <tr> <th>Year</th> <th>Full year div payment (p)</th> <th>Special dividends (p)</th> </tr> </thead> <tbody> <tr> <td>2008</td> <td>11.3</td> <td>14.6</td> </tr> <tr> <td>2009</td> <td>2.5</td> <td>0</td> </tr> <tr> <td>2010</td> <td>3.8</td> <td>0</td> </tr> <tr> <td>2011</td> <td>5.0</td> <td>0</td> </tr> <tr> <td>2012</td> <td>6.5</td> <td>16.0</td> </tr> <tr> <td>2013</td> <td>16.5</td> <td>0</td> </tr> <tr> <td>2014</td> <td>4.7</td> <td>0</td> </tr> </tbody> </table>		Year	Full year div payment (p)	Special dividends (p)	2008	11.3	14.6	2009	2.5	0	2010	3.8	0	2011	5.0	0	2012	6.5	16.0	2013	16.5	0	2014	4.7	0	 <table border="1"> <thead> <tr> <th>Year</th> <th>Repurchases (£m)</th> <th>Allotments (£m)</th> </tr> </thead> <tbody> <tr> <td>2008</td> <td>0.0</td> <td>0.0</td> </tr> <tr> <td>2009</td> <td>0.0</td> <td>0.0</td> </tr> <tr> <td>2010</td> <td>0.0</td> <td>0.0</td> </tr> <tr> <td>2011</td> <td>0.0</td> <td>0.0</td> </tr> <tr> <td>2012</td> <td>21.0</td> <td>0.0</td> </tr> <tr> <td>2013</td> <td>18.0</td> <td>0.0</td> </tr> <tr> <td>2014</td> <td>5.0</td> <td>0.0</td> </tr> </tbody> </table>		Year	Repurchases (£m)	Allotments (£m)	2008	0.0	0.0	2009	0.0	0.0	2010	0.0	0.0	2011	0.0	0.0	2012	21.0	0.0	2013	18.0	0.0	2014	5.0	0.0
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Source: Dunedin Enterprise Investment Trust, Edison Investment Research, Morningstar																																																			

## FY14 performance

2014 was a year of relatively weak performance for DNE with valuation write-downs of two investments in particular largely offsetting valuation gains across the rest of the portfolio. DNE has addressed the disappointing developments at these two companies, selling its stake in Trustmarque and taking a conservative approach by substantially writing-down the value of its investment in Red. This leaves minimal further valuation downside and provides scope for upside as the outlook for this business improves.

Exhibit 2 illustrates the movement in DNE's NAV during 2014, highlighting that underlying realised and unrealised valuation changes together with other revenue and capital movements led to a minor reduction in NAV, while distributions to shareholders in the form of a tender offer and dividends contributed the majority of the total £9.7m reduction in NAV.

**Exhibit 2: DNE's NAV progression during 2014**



Source: Dunedin Enterprise Investment Trust, Edison Investment Research

Exhibit 3 shows a more detailed analysis of the change in NAV during 2014, highlighting the most significant valuation movements for individual investments. For the year as a whole, the value of investments in Dunedin-managed funds declined by £0.3m, while the value of investments in third-party managed funds reduced by £1.1m. Although NAV declined over the year, this does not reflect an underlying trend. The fourth quarter saw an increase in the overall valuation of both Dunedin and third-party managed investments and, together with the effect of other revenue and capital movements, this led to a 1.8% rise in NAV.

Within the Dunedin-managed direct investments, there were some significant valuation gains:

- **Weldex**, the largest crawler crane hire company in the UK, saw a 26% increase in maintainable earnings during 2014, justifying the return to an earnings- rather than net assets-based valuation. Weldex has benefited from an increase in construction activity across a number of areas, including construction of a wind turbine test site, oil and gas terminal and power station refurbishments, as well as several other large infrastructure and construction projects.
- **CitySprint**, the UK's leading same-day delivery service network, saw maintainable earnings increase by 18% in 2014 through organic growth and the expansion of its network through four acquisitions. Organic growth was driven by online retail fulfilment and new healthcare contracts in relation to pathology and home delivery of medicines. CitySprint now supports Hermes in delivery of the John Lewis/Waitrose Click and Collect service and Hermes Parcelshops.

Two of the most recent investments contributed significant valuation gains in the fourth quarter:

- **Kee Safety**, a global market leading provider of safety systems and personal hazard protection products, increased its maintainable earnings by 12% during the year, justifying the change of valuation from a cost to an earnings basis. Growth was primarily driven by an increasing number of installations of group fall arrest systems in the US market.

- **EV Offshore**, a market leading provider of oil and gas well diagnostics using high-performance, ruggedized video cameras, has traded strongly since the investment was made in June 2014, supporting the valuation moving from a cost to an earnings basis. Demand has been growing globally for the company's services.

Three investments saw material reductions in valuation during the year:

- **Red**, the SAP-focused global IT staffing business saw maintainable earnings fall by 53% due to lower net margins in its Contract division and a lower level of activity in its Permanent division. The effect of this was compounded by start-up costs for its US Consulting division. A new executive team has recently been appointed and a Dunedin-commissioned market and business review concluded that an attractive business opportunity exists. A further small investment has been made in 2015 to ensure compliance with loan covenants.
- **Trustmarque**, the software management services provider, saw a substantial reduction in maintainable earnings due to a change in revenue recognition accounting. Having invested £4.3m in the company since June 2013, DNE sold its entire stake in September 2014.
- **U-POL**, the automotive products manufacturer, saw a 17% decline in maintainable earnings, affected by the strength of sterling, which reduced customers' margins, leading to payment delays and a reduced order intake, particularly in Africa.

**Exhibit 3: NAV movement attribution for 12 months to 31 December 2014**

£m	H114	Q314	Q414	FY14
<b>Dunedin-managed direct investments</b>				
Weldex	2.2	1.8	-	4.0
CitySprint	1.4	1.6	-	3.0
Enrich	1.8	-	(0.1)	1.7
EV Offshore	-	-	1.4	1.4
Kee Safety	-	-	1.1	1.1
Steeper	0.6	-	-	0.6
CGI	-	-	(0.3)	(0.3)
Hawksford	-	(1.2)	0.7	(0.5)
U-POL	(0.7)	(1.0)	0.3	(1.4)
Trustmarque	(3.0)	0.3	-	(2.7)
Red	(2.5)	(1.2)	(2.2)	(5.9)
<b>Sub-total</b>	<b>(0.2)</b>	<b>0.3</b>	<b>0.9</b>	<b>1.0</b>
Other	(0.3)	(0.4)	(0.6)	(1.3)
<b>Total Dunedin funds</b>	<b>(0.5)</b>	<b>(0.1)</b>	<b>0.3</b>	<b>(0.3)</b>
Third party funds	(0.9)	(0.6)	0.4	(1.1)
<b>Total portfolio NAV (1)</b>	<b>(1.4)</b>	<b>(0.7)</b>	<b>0.7</b>	<b>(1.4)</b>
<b>Other factors</b>				
Tender offer	(5.2)	-	-	(5.2)
Dividend	(3.6)	-	-	(3.6)
Other movements	(0.7)	-	1.2	0.5
<b>Total other factors (2)</b>	<b>(9.5)</b>	<b>-</b>	<b>1.2</b>	<b>(8.3)</b>
<b>Total NAV change (1+2)</b>	<b>(10.9)</b>	<b>(0.7)</b>	<b>1.9</b>	<b>(9.7)</b>
Opening NAV	116.3	105.4	104.7	116.3
Closing NAV	105.4	104.7	106.6	106.6

Source: Dunedin Enterprise Investment Trust, Edison Investment Research

Two portfolio companies are exposed to the oil sector. The most affected by the oil price fall is likely to be Premier Hytemp due to its dependence on exploration expenditure. However, DNE's investment in the company was written down to a distressed asset sale valuation in 2013. EV Offshore has limited revenue visibility and its growth may not follow a smooth path but it operates in an expanding market niche, which is not directly affected by oil industry capital expenditure cuts.

## New investments and realisations

A total of £16.0m was invested in 2014 with £11.6m invested in Dunedin managed funds and £4.4m drawn down by European third-party managed funds. In June 2014, a new investment of £5.9m was made in EV Offshore with a further £1.2m invested in November 2014. Follow-on investments were made in Hawksford (£1.3m), Premier Hytemp (£0.6m) and Red (£0.3m). £2.3m in management fees was drawn down by Dunedin-managed funds. The European funds Innova/5 and

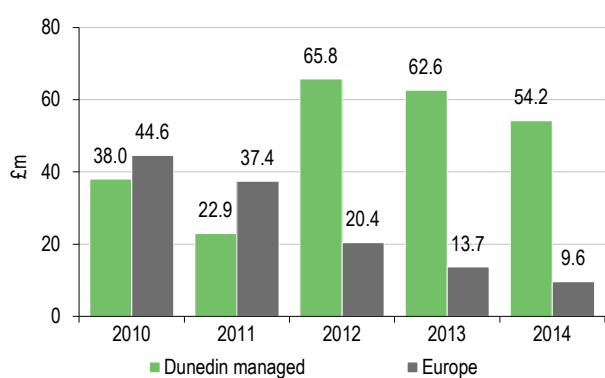
Realza Capital drew down a total of £4.4m including £0.5m to cover management expenses and operating costs. Innova made new investments in Polish internet portal company, Wirtualna Polska (£1.1m) and home-baking products manufacturer, Delecta (£1.1m), while Realza made a £1.7m new investment in Spanish automotive water pump manufacturer, Grupo Dolz.

As well as selling Trustmarque in September 2014 for £1.6m, the investment in OSS Environmental was realised through a trade sale to Hydrodec for £0.3m following a period of disappointing trading. Deferred proceeds of £0.8m were received from the prior year realisations of Capula, etc.venues and Practice Plan. Innova returned a total £1.5m to DNE including £1.4m proceeds from the sale of Polish TV and radio broadcast provider Emitel, which represented 2.0x the original investment. Realza returned a total £2.0m to DNE including £1.4m from the sale of digital photobook manufacturer Hofmann, which represented 2.3x the original investment. Realza also distributed £0.6m due to strong cash generation from Spanish tax management services provider GTT.

## Cash and commitments

As shown in Exhibit 4, DNE's total investment commitments have declined over the last three years as funds have been drawn down and no new commitments have been made. The most recent new commitment was £60m to Dunedin Buyout Fund III, which closed at £306m in July 2013. In November 2011, a strategy was approved to focus on Dunedin managed funds and make no further commitments to third-party managed European funds.

**Exhibit 4: DNE year-end commitments over five years**



Source: Dunedin Enterprise Investment Trust

**Exhibit 5: Commitments and funding (£m)**

	2014	2013
<b>Outstanding Fund Commitments</b>		
Equity Harvest Fund		
Dunedin Buyout Fund I	(0.9)	(0.7)
Dunedin Buyout Fund II	(12.4)	(14.6)
Dunedin Buyout Fund III	(40.9)	(47.3)
Realza	(3.8)	(6.5)
Innova	(5.8)	(7.2)
<b>Total outstanding commitments</b>	<b>(63.8)</b>	<b>(76.3)</b>
<b>Funding</b>		
Cash and near cash	9.9	27.9
Revolving facility	20.0	20.0
<b>Total funding</b>	<b>29.9</b>	<b>47.9</b>
<b>Unfunded commitments</b>	<b>(33.9)</b>	<b>(28.4)</b>

Source: Dunedin Enterprise Investment Trust

Exhibit 5 shows that during 2014, DNE's outstanding commitments reduced by £12.5m and total funding declined by £18.0m with £8.7m distributed to shareholders in addition to fund draw-downs. While unfunded commitments increased from £28.4m to £33.9m during the year, DNE expects only £40m of the total £63.8m outstanding commitments to be drawn over the remaining life of the funds. The majority of commitments are to Dunedin Buyout Fund III with draw-downs expected to be spread over the next three years. Management expects the £30m available funds together with potential realisations will be sufficient to meet the likely 63% implied take-up of commitments.

## Outlook

The manager sees the unpredictable outcome of the May 2015 general election and the possibility of an EU referendum contributing to a climate of political uncertainty. Given this backdrop, it is increasingly hard to predict the prospects for the UK economy. Relative to Europe, the manager views the UK as demonstrating reasonable growth and falling unemployment. While there have been some negative effects from the fall in the oil price, this is expected to provide a boost to UK economic growth. Despite an uncertain backdrop, the portfolio is mature and the prospects for exits are considered to be good. The manager also reports that, following some notable earnings reductions in 2014, the majority of portfolio companies are budgeting an increase in maintainable

earnings during 2015. While a weaker outlook is seen for new investments, Dunedin has recently made three appointments to its deal origination team and, in April 2015, DNE announced a £5m new investment in Blackrock Programme Management, a provider of consulting services to large, international construction projects.

DNE management has indicated that there are no current plans to divest its European fund investments as it believes there is further value to be realised from holding them. However, the secondary market for Spanish funds such as Realza is relatively strong and DNE could review its plans following publication of the March 2015 valuation report.

## Fund profile: UK mid-market private equity investor

DNE specialises in providing private equity finance to established, potentially high growth companies. DNE's investment objective is to achieve substantial long-term growth in assets through capital gains. DNE is managed by Dunedin LLP (Dunedin), an independent private equity partnership operating from Edinburgh and London which finances transactions between £20m and £100m. Its new investment team of 16 professionals has extensive experience in UK lower mid-market buyouts. Dunedin aims to help drive the growth and internationalisation of its investee businesses and focuses on sectors including industrial, business services and financial services.

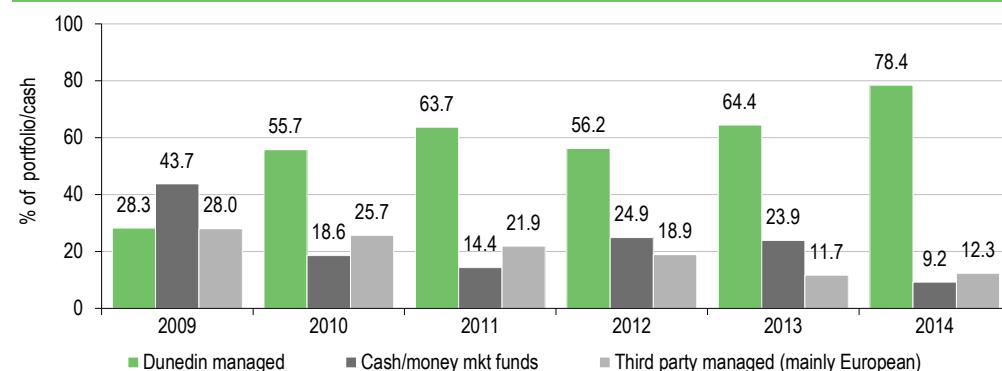
Dunedin targets businesses with the following characteristics:

- proven management team with the desire to create and deliver value;
- strong market position, niche or brand;
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## Current portfolio positioning

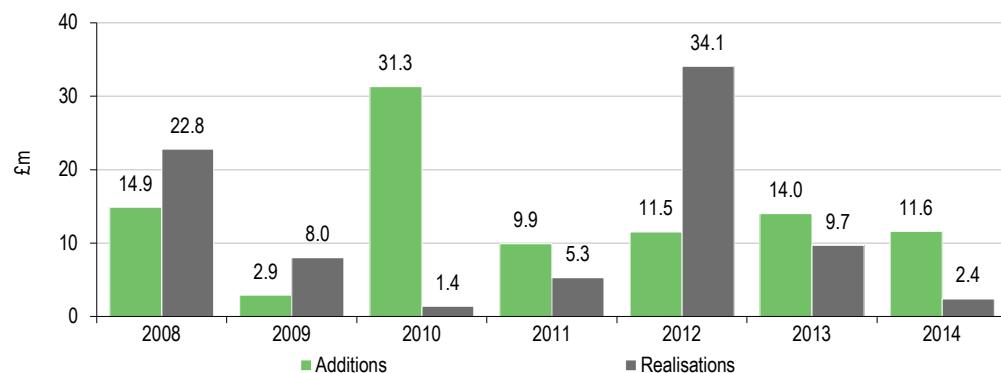
As shown in Exhibit 6, since 2009 DNE's portfolio has been increasingly directed towards UK-focused Dunedin managed funds. Since November 2011, policy has been to make no further commitments to third-party managed European funds. Geographic exposure between UK and Europe mirrors the split between Dunedin and third-party managed funds (see Exhibit 1). Sector exposure largely reflects Dunedin's core expertise with support services, industrials and financial services accounting for 79% of DNE's portfolio (see Exhibit 1).

**Exhibit 6: DNE funds under management**



Source: Dunedin Enterprise Investment Trust, Edison Investment Research

Following a peak in disposals from the Dunedin-managed investments in 2012, there was a much lower pace of realisations in 2013 and 2014 (see Exhibit 7). As a consequence, DNE's investment portfolio has matured such that 31% of the portfolio value at the end of 2014 is represented by investments that have been held for more than five years. Together with DNE management's view that the prospects for exiting investments are favourable, this suggests scope for the pace of realisations to pick up during the current year. Media reports in January 2015 that Dunedin had appointed advisors to explore strategic options for CitySprint, its largest investment, support expectations for an increase in the value of realisations in the near term.

**Exhibit 7: Additions and realisations within Dunedin-managed investments**


Source: Dunedin Enterprise Investment Trust, Edison Investment Research

DNE's portfolio concentration has increased over the last year with the top 10 investments representing 81% of net assets at the end of 2014 (see Exhibit 8) compared with 66% a year earlier and the top five investments increasing from 40% to 51% of net assets over the year. CitySprint accounted for nearly 18% of net assets at end 2014, having increased in value by 19% during the year to £18.9m.

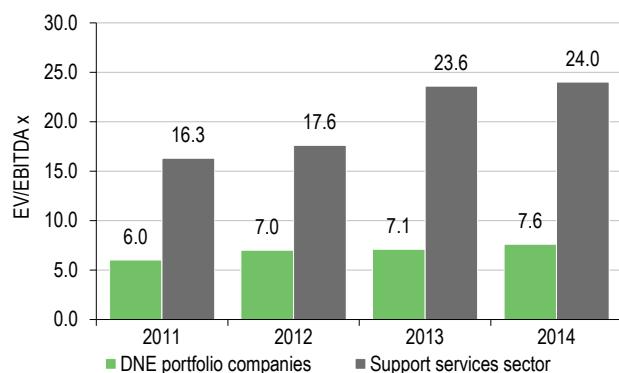
**Exhibit 8: Top 10 investments by value at 31 December 2014**

Company	Description	Original investment	Type	Total Dunedin holding	DNE holding	DNE Cost £m	Valuation £m	% of net assets	EV / EBITDA	2013 Revenue £m	2013 EBITDA £m
CitySprint	UK's leading same day distribution network	Dec 2010	MBO	40.0%	11.9%	9.8	18.9	17.8	8.0x	112.7	12.4
Weldex	Largest crawler crane hire company in UK	Jun 2010	MBO	51.0%	15.1%	9.5	10.3	9.6	6.8x	23.1	13.1
Hawksford	Trust & fiduciary services for ultra-high net worth individuals	Oct 2008	MBO	54.5%	17.8%	5.6	8.8	8.2	7.0x	19.6	5.5
EV Offshore	Leading provider of high performance video camera diagnostics for oil & gas wells	Jun 2014	MBO	54.5%	10.7%	7.1	8.4	7.9	9.5x	N/A	N/A
CGI	Manufacturer & supplier of fire resistant glass globally	Dec 1998	MBO	41.7%	41.7%	9.5	8.1	7.6	5.5x	17.0	2.9
Kee Safety	Leading global provider of safety systems & personal hazard protection products	Dec 2013	MBO	36.9%	7.2%	6.3	7.4	7.0	9.0x	N/A	N/A
Realza	Spanish PE fund investing in Spain & Portugal	Sep 2008	Fund	8.9%	8.9%	6.5	7.1	6.6	N/A	N/A	N/A
Formaplex	Tooling and component manufacture and other services in advanced materials	Dec 2007	MBO	53.1%	17.7%	1.7	6.7	6.3	7.0x	33.2	7.8
Innova	Polish PE fund investing in Central & Eastern Europe	2009	Fund	3.9%	3.9%	6.5	5.6	5.3	N/A	N/A	N/A
U-POL	Leading independent manufacturer of automotive refinish products	Dec 2010	MBO	17.5%	5.2%	5.7	4.8	4.5	7.5x	62.5	15.2
<b>Top 10</b>						<b>68.2</b>	<b>86.1</b>	<b>80.8</b>			

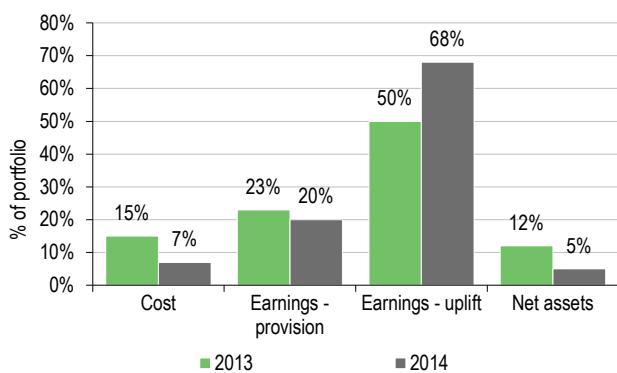
Source: Dunedin Enterprise Investment Trust, Edison Investment Research

The valuation multiples applied to DNE's top 10 investments (excluding third-party funds) range from 5.5x to 9.5x EV/EBITDA based on management's estimates of maintainable earnings at end

2014. While there has been a steady increase in the average portfolio EV/EBITDA multiple since 2011 (see Exhibit 9), the current 7.6x multiple appears conservative in comparison with the 24.0x average for the support services sector, which represents 34% of the portfolio. Exhibit 10 shows an analysis of the portfolio by valuation method, highlighting that 88% of the portfolio is valued on an earnings basis at end 2014 (68% where maintainable earnings have increased and 20% where a provision for a reduction in value has been made) compared with 73% a year earlier.

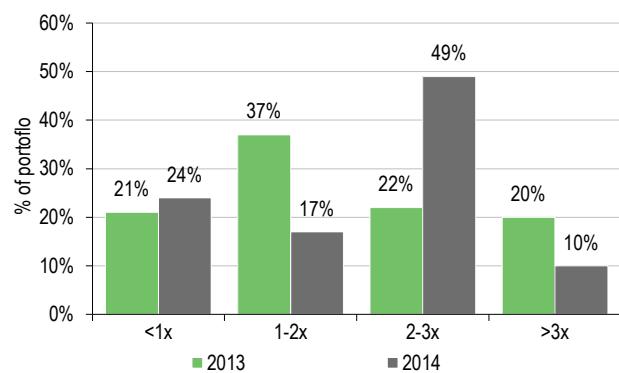
**Exhibit 9: EV/EBITDA valuation multiples**


Source: Dunedin Enterprise Investment Trust

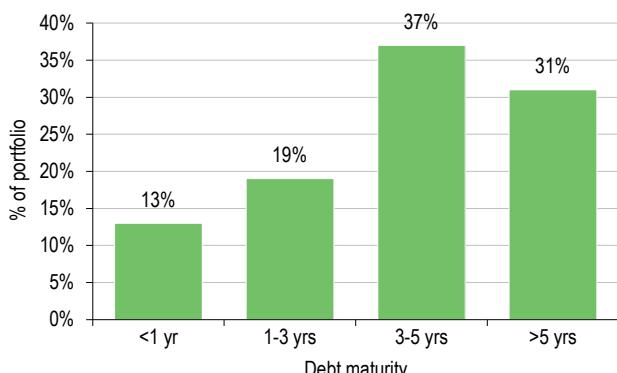
**Exhibit 10: Portfolio valuation methods**


Source: Dunedin Enterprise Investment Trust

Exhibit 11 shows the gearing levels of portfolio companies at end 2014 based on net debt as a multiple of EBITDA. There has been a decline in the proportion of companies with net debt above 3.0x EBITDA over the year and, although the proportion of companies with net debt higher than 2.0x has increased from 42% to 59%, the weighted average net debt/EBITDA multiple has declined from 2.3x to 2.2x. Exhibit 12 shows that 68% of portfolio companies' debt matures after more than three years, which provides reassurance that they are appropriately financed for the medium term and that growth prospects should not be constrained by the requirement to make debt repayments.

**Exhibit 11: Portfolio companies' net debt/EBITDA**


Source: Dunedin Enterprise Investment Trust

**Exhibit 12: Portfolio company debt maturity profile**


Source: Dunedin Enterprise Investment Trust

## Performance

As shown in Exhibit 13, DNE's NAV total return underperformed the UK private equity investment trusts ex-3i peer group, FTSE Small-cap and All-share indices over the periods from three to 10 years, while relative performance has been stronger over one year. We attribute the weaker performance over five years partly to DNE's diversification into European funds in 2007 and the associated hedging of euro exposure, which weighed on 2010 and 2011 performance. Shorter-term performance has been affected by a relatively slow pace of realisations as well as the poor performance of two investments in particular during 2014.

**Exhibit 13: Cumulative performance comparison: DNE, UK private equity and FTSE indices**

% total return	Six months	One year	Three years	Five years	10 years
DNE Equity	(16.6)	(15.8)	25.8	50.7	42.1
DNE NAV	0.2	1.8	2.3	37.0	68.2
FTSE Small-Cap Ex Inv. Trusts	(3.1)	(2.7)	90.8	89.2	85.0
UK Private Equity ex-3i NAV	0.8	1.3	13.9	47.3	72.2
FTSE All-Share Ex Inv. Trusts	(0.6)	1.0	37.0	51.4	106.8

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-December 2014.

Over 10 years to end December 2014 (the date of DNE's last reported NAV), DNE's NAV total return underperformed its FTSE Small-cap ex-IT index benchmark as well as the FTSE All-share ex-IT index. DNE's longer-term returns have been similar to the UK private equity investment trusts ex-3i peer group. DNE's annualised NAV total return over 10 years is 5.3%, which compares with 5.4% for the UK private equity peer group.

Exhibit 14 shows annual total return performances for DNE, UK private equity investment trusts ex-3i and FTSE Small-Cap and All-share indices over 10 years. This illustrates that private equity NAV returns lagged the quoted indices going into and coming out of the 2008 global financial crisis slump. DNE has delivered a differentiated performance with notable NAV outperformance in years of negative index performance and its NAV total return has outperformed the private equity peer group and the FTSE Small-Cap ex-IT index in six of the last 10 years.

**Exhibit 14: DNE, UK private equity ex-3i and FTSE indices discrete performance over 10 years**

% total return	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
DNE Equity	40	(7)	(0)	(48)	39	13	6	39	7	(16)
DNE NAV	28	9	5	(18)	1	22	9	2	(1)	2
FTSE Small-Cap ex Inv. Trusts	19	23	(18)	(48)	58	17	(15)	36	44	(3)
UK Private Equity ex-3i NAV	27	22	22	(28)	(13)	19	9	6	6	1
FTSE All-Share ex Inv. Trusts	22	17	5	(30)	30	14	(3)	12	21	1

Source: Thomson Datastream, Edison Investment Research

Private equity NAV returns again lagged the quoted indices during the more recent period (2012 and 2013) of small-cap quoted equity strength.

Historically, management reports typical valuation uplifts of c 20% on the sale of investments and so the recent low rate of realisations provides scope for NAV performance to pick up as mature investments are realised. DNE has sold its stake in Trustmarque to address the poor outcome from this investment and has substantially written down its investment in Red Commerce, leaving scope for upside to the valuation as the outlook for this business improves.

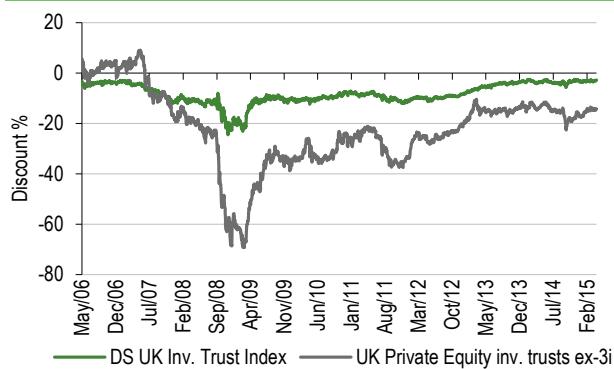
## Discount: Scope for narrowing

As illustrated in Exhibit 15, DNE's share price discount to NAV narrowed from over 35% to below 25% between September and October 2012, and remained at a similar level averaging 22% over the subsequent two years. During the second half of 2014 and in 2015, DNE's discount widened back to the 35% level, which appears to be a reflection of the lacklustre performance during this period with the partial write-down of a couple of investments largely offsetting valuation gains across the rest of the portfolio. Currently standing at 35%, there is scope for the discount to narrow significantly as NAV performance improves.

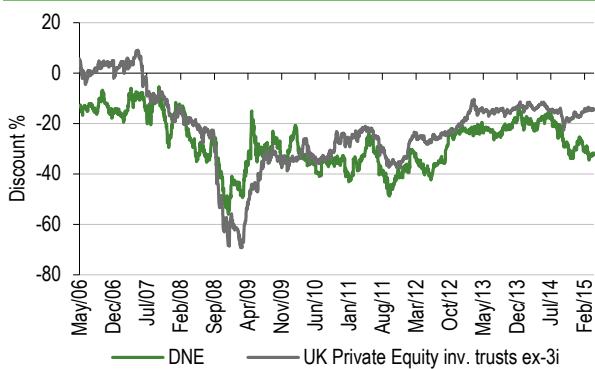
**Exhibit 15: Share price discount to NAV over three years (%)**


Source: Thomson Datastream, Edison Investment Research.

Exhibit 16 illustrates the extreme widening (to c 70%) of the share price discount to NAV experienced by the private equity investment trust sector during the 2008 global financial crisis, which overshadowed the not insubstantial discount widening (to c 25%) across the investment company sector as a whole. While the private equity sector discount narrowed markedly in 2009 and subsequently followed a narrowing trend, it has remained relatively stable over the last two years in contrast to the broader investment company sector, which has seen a continued discount narrowing.

**Exhibit 16: Discounts: inv. trusts and PE inv. trusts**


Source: Thomson Datastream, Edison Investment Research

**Exhibit 17: Discounts: DNE and PE inv. trusts**


Source: Thomson Datastream, Edison Investment Research

Exhibit 17 illustrates that DNE's share price discount to NAV has followed a broadly similar pattern to private equity peers before, during and after the 2008 global financial crisis. However, over the last six months, DNE has seen its discount widen noticeably while the private equity sector overall has had a relatively stable average discount, apart from a brief widening in October 2014.

## Capital structure and fees

DNE has 20.9m ordinary shares in issue with no buybacks or allotments made since a tender offer in May 2014 for 5% of the share capital at 475p per share, which represented a 10.3% discount to the NAV as at 31 December 2013. DNE is permitted to borrow up to the value of the issued share capital and capital and revenue reserves; however, the board's policy is to limit gearing to 40% of gross asset value. DNE has a £20m bank facility maturing in February 2017, which the board believes will be sufficient to meet future funding requirements. At 31 December 2014, DNE had no debt, £8.7m cash and £1.2m invested in money market funds, with the £9.9m net cash position representing 9% of gross asset value.

Fees are typically higher for private equity investment funds than for funds investing in listed companies due to the level of management involvement required for a private equity portfolio, and DNE is no different in this respect. Dunedin management fees are 1.5% of the value of investments for direct investments, the Fund of Funds and Co-investment limited partnerships (LPs), and third-party managed funds. There is a 0.5% charge on undrawn commitments to third-party funds and other cash balances. DNE also pays the same fees as other investors in Dunedin-managed funds. Dunedin executives participate in carried interest schemes operated by Dunedin-managed funds and the two LPs.

In November 2012, a performance fee was introduced in relation to the European fund investments held via Dunedin Fund of Funds LP. Dunedin is incentivised to realise the underlying investments and commitments in the European funds based both on the value realised compared with the third-party manager's valuation and the timing of the realisation. The performance fee is up to 1.5% of proceeds received from the realisations achieved plus the associated undrawn original commitments from which DNE is released.

**Exhibit 18: Fee and expense analysis**

£m except where shown	2009	2010	2011	2012	2013	2014
Investment management fee	0.98	1.06	1.38	1.13	0.73	0.42
Management performance fee	0.00	0.00	0.00	0.00	0.48	(0.03)
Management fee for investing in Dunedin funds	1.60	1.60	1.20	0.90	2.00	2.20
Other expenses (admin, directors, audit etc.)	0.74	0.64	0.68	0.70	0.66	0.63
<b>Total fees and expenses</b>	<b>3.32</b>	<b>3.30</b>	<b>3.26</b>	<b>2.73</b>	<b>3.87</b>	<b>3.22</b>
Net assets	122.86	150.08	162.96	137.20	116.27	106.56
Average net assets	126.83	136.47	156.52	150.08	126.73	111.41
Management fees as % of average net assets	2.0%	1.9%	1.6%	1.4%	2.5%	2.3%
Other expenses as % of average net assets	0.6%	0.5%	0.4%	0.5%	0.5%	0.6%
Total fees and expenses as % of average net assets	2.6%	2.4%	2.1%	1.8%	3.1%	2.9%
<b>Ongoing charge ex-performance fee</b>	<b>2.6%</b>	<b>2.4%</b>	<b>2.1%</b>	<b>1.8%</b>	<b>2.7%</b>	<b>2.9%</b>

Source: Dunedin Enterprise Investment Trust, Edison Investment Research

Exhibit 18 shows an analysis of fees and other expenses over the last six years. Total fees and expenses were stable during 2009, 2010 and 2011 and ongoing charges declined as a proportion of net assets due to rising average net assets. After a decline in 2012, the value of fees and expenses (excluding performance fees) has returned to its historical level while declining average net assets has led to an increase in the ongoing charge level.

## Dividend policy

In November 2011, DNE introduced a distribution policy aiming to maximise the use of capital resources within the trust. Under this policy, at least 50% of capital gains made on realisation of investments in UK lower mid-market buyouts and a substantial proportion of realisations of third-party managed funds will be used to fund distributions including share buybacks, tender offers, returns of capital and dividends. A total of £44.3m has been returned to shareholders through tender offers since the introduction of this policy, in addition to dividends distributed of £11.0m (including a £4.3m special dividend paid in September 2012). A 4.7p dividend has been proposed for 2014, which compares with 16.5p in 2013 and an average total dividend payout of 9.7p over the last five years (see Exhibit 1). The dividend is reduced from the previous year due to the lower level of income generated from realisations in 2014.

## Peer group comparison

Exhibit 19 shows a comparison of DNE with a peer group of UK-focused funds selected from the AIC private equity sector, which comprises 41 companies. DNE's NAV total return has lagged the

selected peer group and broader private equity sector over one, three, five and 10 years, which may be a reflection of the relative maturity of DNE's portfolio and management's conservative valuation approach. Historically, management reports a c 20% average valuation uplift on the sale of portfolio investments and thus portfolio valuation and underlying returns will tend to be depressed as the portfolio matures. However, this potentially indicates the prospect of significant near-term valuation gains as mature investments are realised. DNE's Sharpe ratios over one and three years are close to zero which is a reflection of underlying returns. DNE's share price discount to NAV is wider than average among both the selected peers and the broader private equity sector. There is a wide range of discounts across the private equity sector and a number of outlying funds distort the sector average. DNE's below average 0.97% ongoing charge is stated ex-performance fees and does not capture the Dunedin fund fees that we incorporate in our fee and expense analysis (see page 11). DNE's 1.4% dividend yield is a further reflection of the relatively low number of realisations over the last 12 months.

#### Exhibit 19: Private equity closed-ended peer group at 30 April 2015

% unless stated	Market Cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing Charge	Net Gearing	Dividend yield (%)
Dunedin Enterprise	69.8	(1.7)	(1.2)	30.9	56.1	(0.0)	(0.2)	(32.1)	0.97	91	1.4
Electra Private Equity	1,111.4	8.6	34.0	66.5	212.5	0.9	1.2	(1.6)	2.97	108	
Graphite Enterprise Trust	416.0	4.4	23.4	55.7	131.2	0.9	1.1	(16.9)	2.05	100	1.3
HgCapital Trust	399.4	17.5	28.6	57.6	229.2	1.2	0.7	(14.6)	2.54	84	3.0
Selected peers average	499.1	7.2	21.2	52.7	157.3	0.7	0.7	(16.3)	2.13	96	1.9
Sector median	110.0	4.4	23.4	34.1	99.2	0.6	0.8	(17.7)	2.19	94	2.3

Source: Morningstar, Edison Investment Research. Note: TR=total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and cash equivalents as a percentage of shareholders' funds.

## The board

The board currently comprises four independent directors and DNE is in the process of recruiting an additional director. The directors are Duncan Budge (appointed director April 2012, chairman May 2014), Liz Airey (appointed 2005), Brian Finlayson (appointed 2007), Federico Marescotti (appointed 2009). David Gamble retired from the board in May 2014 after 13 years' service, the last two as chairman.

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