

## Standard Life European Private Equity Trust

### Countercyclical opportunity in prospect

Standard Life European Private Equity Trust (SEP) aims to achieve capital growth through investing in a focused portfolio of European (including UK) private equity funds that also give some underlying US exposure. SEP's NAV total return has outperformed the LPX Europe index, representing a European private equity (PE) peer group, and the FTSE All-Share index over one, three, five and 10 years, with recent returns enhanced by sterling weakness following the UK's vote to leave the EU. The manager sees anticipated slower UK economic growth as an opportunity for private equity fund managers to generate higher returns, and believes SEP is well positioned to provide investors with access to the countercyclical strategy of actively investing during a recessionary period and exiting as economies recover.

12 months ending	Share price (%)	NAV (%)	FTSE All-Share (%)	MSCI Europe (%)	LPX Europe NAV (%)	LPX 50 NAV (%)
30/06/12	(15.5)	(3.8)	(3.1)	(14.2)	(12.4)	(5.5)
30/06/13	36.0	7.4	17.9	23.9	14.4	17.7
30/06/14	21.4	7.6	13.1	15.3	6.9	4.1
30/06/15	3.2	6.6	2.6	1.1	0.6	4.6
30/06/16	7.3	21.4	2.2	5.4	18.4	23.3

Source: Thomson Datastream, Bloomberg. Note: Twelve-month discrete £-adjusted total return performance up to last published quarter-end NAV.

### Investment strategy: Focused fund selection

SEP invests via primary commitments and secondary transactions in what the manager views as the leading European private equity funds investing in mid- to large-sized buyouts (enterprise values €100m to €2.0bn). The aim is for the portfolio to comprise around 35 to 40 active private equity fund investments broadly diversified by country, sector and maturity. The manager employs a bottom-up approach to private equity fund selection, with a top-down overlay designed to direct the investment team towards attractive geographies, sectors and strategies.

### Market outlook: Downturn would present opportunity

The manager anticipates slower UK economic growth following the UK's vote to leave the EU, and expects that volatility will affect broader European markets. Recent market volatility has seen discounts widen across listed private equity trusts, but the manager believes this market reaction is ignoring the countercyclical nature of private equity investing, with the sector delivering its best performance during periods of economic downturn or market stress. The manager sees potential for an additional return to be generated by private equity fund managers who actively invest during a recessionary period and exit as economies recover.

### Valuation: Recent narrowing of discount

Having followed a broadly widening trend for much of the last three years within a 10% to 36% range, SEP's share price discount to NAV has narrowed noticeably since March 2016, recently moving below its 21.2% three-year average, and currently stands at 20.0%.

### Investment trusts

7 November 2016

**Price** 271.0p  
**Market cap** £417m  
**AUM** £529m

NAV\* 338.9p  
Discount to NAV 20.0%

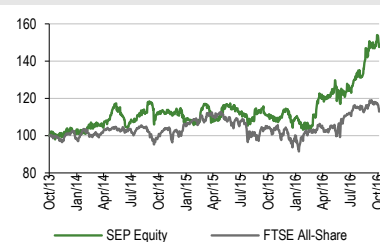
\* Estimated NAV as at 30 September 2016.

Yield 1.9%  
Ordinary shares in issue 153.7m  
Code SEP  
Primary exchange LSE  
AIC sector Private Equity  
Benchmark None

### Share price/discount performance



### Three-year performance vs index



52-week high/low 283.0p 191.0p  
NAV\*\* high/low 338.9p 271.7p

\*\*Including income.

### Gearing

Gross\* 0.0%  
Net cash\* 20.3%

\*As at 30 September 2016.

### Analysts

Gavin Wood +44 (0)20 3681 2503  
Sarah Godfrey +44 (0)20 3681 2519

[investmenttrusts@edisongroup.com](mailto:investmenttrusts@edisongroup.com)

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**Standard Life European Private Equity Trust is a research client of Edison Investment Research Limited**

### Exhibit 1: Trust at a glance

#### Investment objective and fund background

SEP's objective is to achieve long-term capital gains through holding a diversified portfolio of private equity funds investing predominantly in Europe, with a focus on funds that invest in mid-market buyouts and expansion capital. The board has concluded that there is currently no available benchmark that is an appropriate measure of SEP's investment performance.

#### Recent developments

- 14 October 2016: September 2016 estimated NAV per share 338.9p; estimated NAV total return +2.9% for three months to 30 September 2016 and +20.3% for 12 months to 30 September 2016.
- 29 September 2016: August 2016 estimated NAV per share 334.6p.
- 29 September 2016: Quarterly trading update to 30 June 2016: NAV per share +6.2% to 329.3p.

#### Forthcoming

AGM	January 2017
Final results	2 December 2016
Year end	30 September
Dividend paid	July, January
Launch date	May 2001
Continuation vote	N/A

#### Capital structure

Ongoing charges	0.98% (FY15 direct fees)
Net cash	20.3%
Annual mgmt fee	0.8% of net assets
Performance fee	10% above 8.0% pa hurdle
Trust life	Indefinite
Loan facilities	£80m revolving credit

#### Fund details

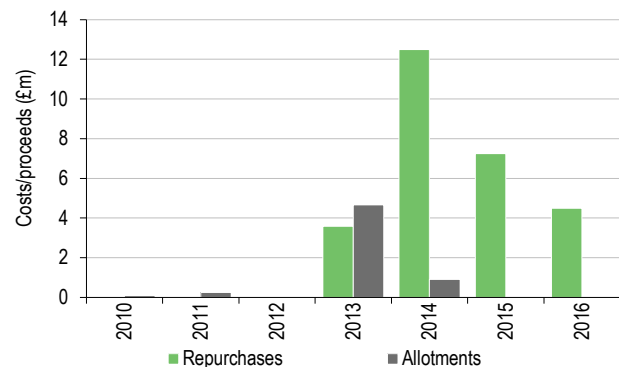
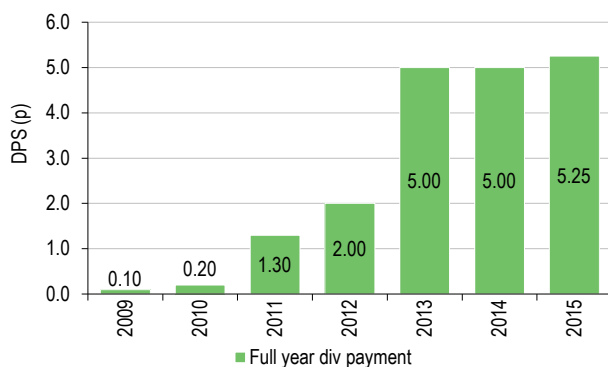
Group	SL Capital Partners LLP
Manager	Team managed
Address	1 George Street, Edinburgh EH2 2LL
Phone	0131 245 0055
Website	<a href="http://www.slcapital.com/SLEPET">www.slcapital.com/SLEPET</a>

#### Dividend policy and history

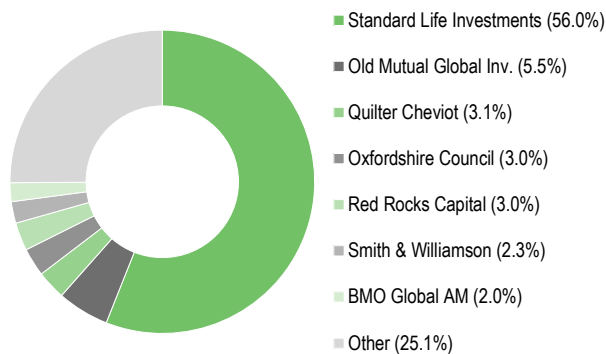
From FY14, the board has undertaken to maintain the annual dividend in real terms. An interim dividend was introduced in FY15.

#### Share buyback policy and history

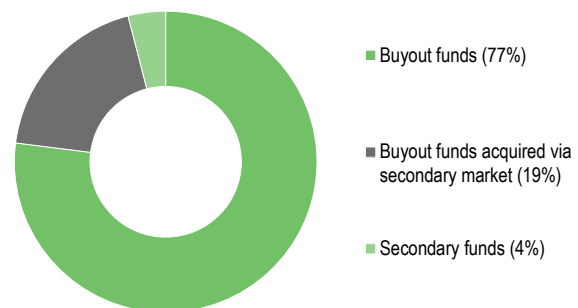
The board views buybacks as part of its strategy in relation to capital efficiency. SEP has authority to repurchase 14.99% and allot 5.0% of issued share capital.



#### Shareholder base (as at 30 September 2016)



#### Portfolio exposure by fund type (as at 31 March 2016)



#### Top 10 underlying holdings (as at 31 March 2016)

Company	Business	Fund	Year of investment	% of net assets	
				31 March 2016	31 March 2015
Action	Non-food discount retailer	3i Eurofund V	2011	4.0	2.8
Parques Reunidos	Amusement parks	Candover 2005 Fund	2007	1.7	1.5
Scandlines	N. European ferry operator	3i Eurofund V	2007	1.6	1.0
Schenck Process	Industrial weighing systems	Industri Kapital 2007	2007	1.2	1.2
AWAS/Pegasus	Aircraft lessor	Terra Firma Capital Partners III	2007	1.2	1.4
Not Disclosed	Information & risk management solutions	Advent Global Private Equity VI	2012	0.9	0.8
Amor	Affordable jewellery retailer	3i Eurofund V	2010	0.9	0.7
Technogym	Fitness equipment & wellness products	Candover 2005 Fund	2008	0.9	0.6
C�r�lia	Ready-to-use dough manufacturer	IK VII	2015	0.9	N/A
Lindorff	Debt collection & accounting services	Nordic Capital VIII	2014	0.9	N/A
<b>Top 10</b>				<b>14.2</b>	<b>13.9</b>

Source: SEP, Morningstar, Edison Investment Research. Note: N/A where not in March 2015 top 30.

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## Fund profile: European private equity fund of funds

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Launched in May 2001, SEP is an LSE-listed investment trust aiming to achieve long-term capital gains from a diversified portfolio of private equity funds investing predominantly in Europe, with a focus on funds that invest in mid- to large buyouts. The investment strategy involves detailed and rigorous screening and due diligence by the manager to identify and evaluate private equity fund offerings. The private equity asset class has historically exhibited a wide dispersion of returns across funds and the manager believes that access to leading private equity houses, manager selection and appropriate portfolio construction are vital to optimise investment performance. In that regard, the objective is for SEP's portfolio to comprise around 35 to 40 active private equity fund investments at any one time, with portfolio diversification being controlled through concentration limits applied at an individual fund (12.5% of NAV) and manager (20.0% of NAV) level.

SEP's investment manager, SL Capital Partners is one of the largest investors in private equity funds and co-investments in Europe, managing €10.0bn of commitments. Headed by Peter McKellar, Roger Pim and Graeme Gunn, the investment team comprises 28 professionals and the senior executive team has on average more than 12 years of tenure. The manager believes that its scale and the investment team's experience enables it to identify and invest in Europe's premier private equity funds, where knowledge of and access to these funds may be limited.

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## The fund manager: SL Capital Partners

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### The manager's view: Countercyclical opportunity

SL Capital senior executive Graeme Gunn conveys the manager's anticipation of slower UK economic growth following the UK's vote to leave the European Union, as well as an increase in market volatility that will affect broader European markets. While increased market volatility has seen discounts widen across listed private equity trusts in general, Gunn observes that this market reaction ignores the countercyclical nature of private equity investing, which has seen the sector deliver its best performance during periods of economic downturn or market stress. He also points to recent corporate activity in the sector, with bids to acquire portfolios being made at or around NAV, while the sector as a whole trades on a discount of more than 20%.

Gunn expresses the view that, while returns from private equity investing have the capability to outperform listed markets over the long term in benign conditions, there is potential for an additional return to be generated by private equity fund managers who actively invest during a recessionary period and exit as economies recover. He observes that this positive correlation was evident during the dotcom bubble and the global financial crisis, noting that private equity returns also spiked in the recession that followed the Greek/euro issues in 2011-12. He sees this as particularly relevant today, in the belief that the aftermath of the UK's EU referendum is likely to have a similar risk profile, and highlights that assets acquired during the 2011-12 recession were subsequently exited at highly attractive values, driving strong performance.

Gunn emphasises that during periods of dislocation, private equity strategies can employ a flexible approach and target companies that are under operational pressure. As the manager has previously observed, rapid change and uncertainty during tough market conditions drives deal flow towards private equity buyers: large corporates dispose of assets as they focus on core strategies, forced sellers emerge and the curtailment of the IPO market means that sources of liquidity are reduced. Gunn notes that the first element of additional return is achieved through buying well, as pricing and leverage reduce, while any downturn presents multiple strategic opportunities, enabling private equity managers to deploy their considerable resources to turn around underperforming companies or target M&A, seeking to generate top-line growth and profitability.

Gunn considers that SEP is well positioned to provide investors with access to this countercyclical strategy. At end-September 2016, the trust had £260m of undrawn capital committed to private equity funds (net of c £50m commitments considered by the manager as unlikely to be drawn), with £106m cash and an £80m credit facility. As a limited partner investor in the underlying funds, the manager has good near-term visibility over the expected timing of realisations and drawdowns, and Gunn indicates that the majority of SEP's current cash position could be invested tactically in potentially high-performing investment opportunities without prejudicing the trust's ability to meet existing commitments. He highlights the potential for SEP to increase UK exposure from its current relatively low level of 15% through secondary market transactions, as well as underlying private equity funds deploying SEP's committed capital into attractive UK-orientated investments. While any recession raises concerns over current portfolio value, in the manager's view, SEP's euro-denominated asset base will benefit from both sterling weakness and the strong underlying assets in delivering returns to sterling-based investors.

## Asset allocation

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### Investment strategy and process

SEP's principal focus is to invest in what the manager views as the leading European private equity funds investing in mid- to large-sized buyouts (transactions with enterprise values between €100m and €2.0bn). The aim is for the portfolio to comprise around 35 to 40 active fund investments. SEP's policy is to maintain a broadly diversified portfolio by country, industry sector, maturity and number of underlying investments. The investment team's extensive fund and direct deal experience gives the manager a strong insight into the strategies, processes and disciplines of the funds considered for investment, which should lead to better qualitative judgements being made.

In recent years, SEP has increased its focus on the private equity secondary market, whereby original investors sell their fund interests, which may comprise an unfunded outstanding commitment as well as invested assets. This enables SEP to buy and sell selected secondary fund interests to fine-tune portfolio exposures as well as maintain capital efficiency. Secondary investments typically generate lower absolute returns, but shorter holding periods can lead to higher internal rates of return (IRRs) being achieved. The manager expects c 1.4x exit multiples, with IRRs of 20% to 25% for secondary investments compared with c 1.8x exit multiples and IRRs of 17% to 18% for primary investments. Fully invested secondary interests also have a lower risk profile than primary commitments as the underlying holdings can be evaluated prior to purchase.

To maximise the proportion of invested assets, the manager follows an over-commitment strategy by making fund commitments that exceed the trust's uninvested capital, based on an assessment of available capital, and the amount and timing of expected and projected portfolio cash flows. SEP invests in private equity funds that invest principally in Europe, but has the flexibility to invest up to 20% of its gross assets in funds that invest principally outside Europe. SEP's non-sterling currency exposure is primarily to the euro and US dollar. Foreign exchange exposure is not hedged due to the irregularity in size and timing of individual cash flows, but cash balances and bank debt are held broadly in proportion to the currency of SEP's outstanding fund commitments.

The SL Capital Partners investment team follows a systematic, disciplined approach to investment selection, monitoring and realisation. The investment selection process broadly breaks down into three stages, resulting in the preparation of a deal qualification memorandum (DQM), preliminary investment recommendation (PIR) and final investment recommendation (FIR). DQMs are prepared each year on around 100 to 150 of the c 800 institutional-grade private equity funds in Europe that are monitored, with about 25 funds reaching the PIR stage. SL Capital as a whole typically commits to between 10 and 15 primary fund investments and completes at least 15 secondary transactions each year, while SEP makes around four primary and five secondary investments a year.

## Current portfolio positioning

At 31 March 2016, SEP was invested in 46 private equity funds, which collectively had interests in 476 underlying companies (excluding four secondary fund investments made in 2001 and 2005/06, there are c 300-350 'core' underlying companies). Highlighting its focused approach, SEP's top 10 fund holdings at 31 March 2016 represented 44.2% of NAV, equal to 54.3% of the invested portfolio, with each fund holding 16 investments on average (see Exhibit 2). Exposure to individual managers shows greater concentration, with over 80% of NAV attributable to 10 private equity managers. The top 10 underlying company holdings represented 14.2% of NAV (see Exhibit 1), with five companies each representing more than 1.0%, a level enabling them to make a material contribution to portfolio returns, thus differentiating SEP from the broader private equity market.

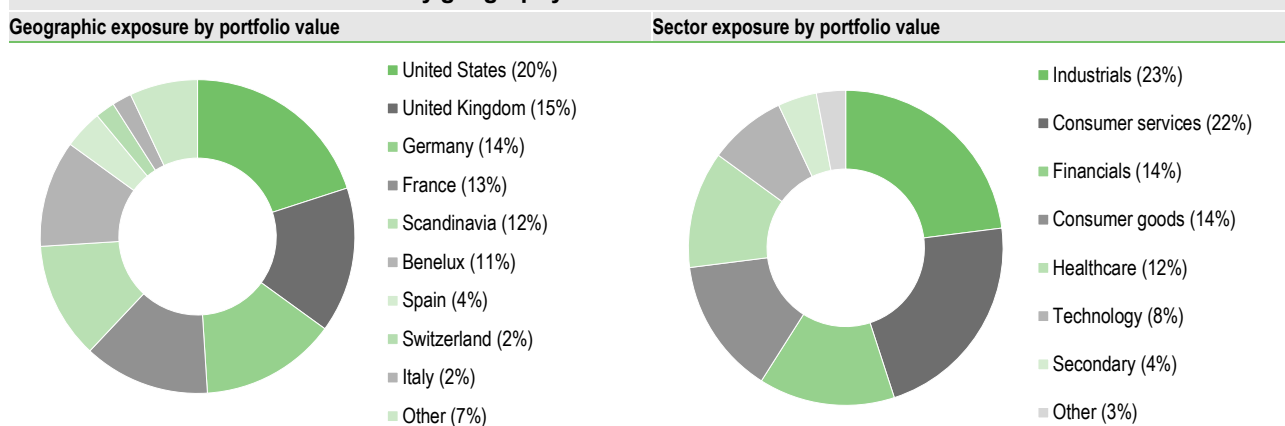
**Exhibit 2: SEP's top 10 private equity fund holdings as at 31 March 2016**

Fund	Description	Vintage	Number of investments	Outstanding commitments (£m)	Cost (£m)	Valuation (£m)	% of net assets	
							31 Mar 2016	31 Mar 2015
3i Eurofund V	Mid- to large European buyouts	2006	11	2.0	20.1	35.4	7.4	7.7
IK VII	Northern European buyouts	2012	12	4.5	22.7	25.7	5.4	2.8
Equistone Partners Europe Fund IV	European middle market buyouts	2011	23	1.8	20.3	22.9	4.8	5.6
BC European Capital IX	Buyouts of large companies	2011	15	5.3	17.9	21.8	4.5	4.1
TowerBrook Investors III	North American & European mid-market buyouts	2008	12	10.8	19.1	20.5	4.3	N/A
Advent Global Private Equity VI	Mid-market buyouts in Europe and North America	2008	19	0.6	15.3	20.0	4.2	5.9
Montagu IV	Northern Europe middle market buyouts	2011	12	2.4	16.2	17.9	3.7	3.9
Permira V	Mid- and large-cap buyouts in Europe & North America	2014	14	8.0	14.9	17.0	3.5	1.9
CVC European Equity Partners V	European medium and large buyout transactions	2008	18	1.3	14.3	15.6	3.2	4.8
Advent Global Private Equity VII	Mid-market buyouts in Europe and North America	2012	23	3.8	11.0	15.4	3.2	3.0
			<b>159</b>	<b>40.6</b>	<b>171.8</b>	<b>212.3</b>	<b>44.2</b>	<b>52.0</b>

Source: SEP, Edison Investment Research

Top-down allocations are not imposed and SEP's portfolio diversification by geography and sector (Exhibit 3) is the outcome of the investment process. The manager observes that investing in a broad portfolio of fund interests leads to a natural diversification of the portfolio due to the variety of investments within each fund, as well as the distinct specialisations of individual managers. SEP's 20% US exposure stands out given its European focus. This results from a number of the European managers investing part of their funds in stronger investment opportunities in non-European countries, principally the US.

**Exhibit 3: Portfolio diversification by geography and sector at 31 March 2016**



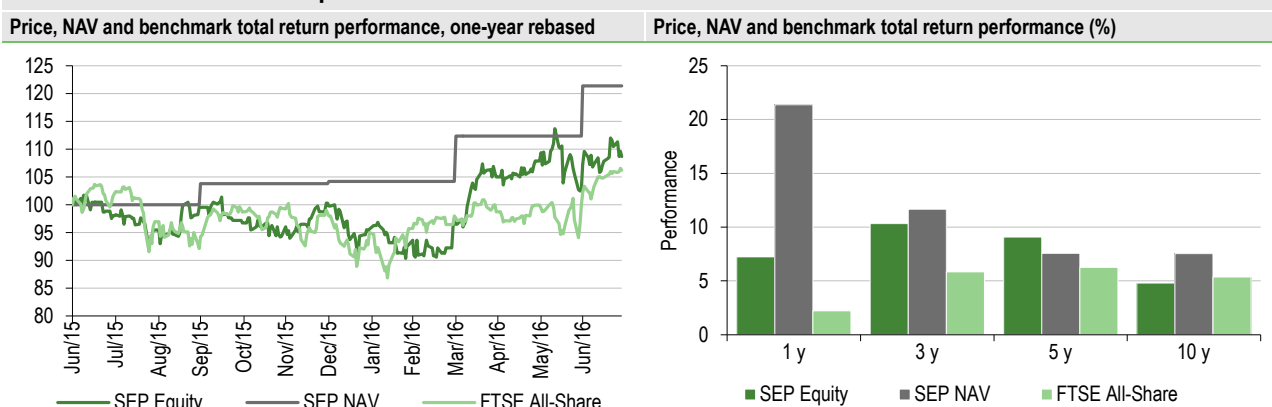
Source: SEP, Edison Investment Research

SEP's portfolio saw a 6pp decline in UK exposure over the year to 31 March 2016, continuing the trend since SEP's listing in May 2001 when UK exposure stood at 64%, while there was a 2pp increase in US exposure. These moves saw the US become the trust's largest exposure, accounting for 20% of the portfolio at 31 March 2016. Compared with a year earlier, the other most significant changes in exposure were 3pp and 2pp increases in Scandinavia and Benelux. The portfolio was well spread by sector at 31 March 2016, with the largest exposures in industrials and consumer services seeing 2pp and 4pp increases compared with a year earlier. Other notable changes were 2pp reductions in financials and basic materials and a 2pp increase in consumer goods. Secondary fund exposure declined 2pp over the year to 31 March 2016.

## Performance: Outperforming European PE peers

As shown in Exhibit 5, SEP's NAV total return has outperformed European private equity (PE) peers, represented by the LPX Europe index, over one, three, five and 10 years. Compared with global PE peers, represented by the LPX 50 index, SEP's NAV total return has outperformed over three and 10 years, while underperforming over one and five years. The strengthening of the US dollar against the euro over three, five and 10 years (+17.5%, +31.0% and +15.6%) is likely to account for a significant element of the stronger performance of the LPX 50 compared with LPX Europe over these time periods. Exhibit 4 illustrates SEP's NAV total return outperformance of the FTSE All-Share index over one, three, five and 10 years, with the decline of sterling against the euro in June 2016 contributing a large part of the outperformance over one year.

**Exhibit 4: Investment trust performance to 30 June 2016**



Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

**Exhibit 5: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-Share	(4.6)	6.2	3.1	4.9	13.2	13.9	(5.4)
Price relative to MSCI Europe	(5.9)	5.1	1.8	1.7	9.3	18.1	(6.8)
Price relative to LPX Europe	(0.7)	6.5	2.1	(4.8)	(4.5)	2.2	(2.2)
Price relative to LPX 50	(5.2)	6.2	(0.1)	0.5	0.4	(3.3)	2.8
NAV relative to LPX Europe NAV	(0.1)	(0.2)	4.0	2.5	9.3	12.8	21.7
NAV relative to LPX 50 NAV	(2.1)	(3.8)	0.1	(1.5)	3.7	(3.6)	11.0

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-June 2016. Geometric calculation.

## Discount: Recent narrowing

As illustrated in Exhibit 6, over the last three years, SEP's share price discount to NAV has ranged from 10% in June 2014 to 36% in March 2016. Having followed a broadly widening trend for much of the period, the discount has narrowed noticeably since March 2016 and has recently moved below its three-year average of 21.2%, currently standing at 20.0%.

**Exhibit 6: Share price discount to NAV over three years (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

SEP has 153.7m ordinary shares in issue, having repurchased 2.0m shares (1.3% of outstanding capital) in the year to 30 September 2016. The board views share repurchases in relation to capital efficiency, alongside new fund commitments, secondary fund purchases and dividend payments. At 30 September 2016, SEP's £80m credit facility to December 2020 was undrawn and £105.9m was held in cash and money market funds, equating to a 20.3% net cash position. At 30 June 2016, £40.5m of SEP's liquid resources had been invested in European and UK equity index tracker funds but these were sold in July, generating a realised gain of £2.3m.

SEP pays SL Capital a management fee of 0.8% pa of net assets. In addition, a 10% incentive fee is payable on NAV total return in excess of an 8% pa hurdle rate, measured over the five-year period to 30 September 2016. Based on estimated NAV of 338.9p per share at end-September 2016, NAV total return for the five-year period was 9.8% pa in sterling terms. While the decline of sterling against the euro following the Brexit vote appears to have contributed materially to the hurdle being exceeded, with NAV total return over one year of 21.0% in sterling terms and 3.1% in euro terms, we note that NAV total return for the five-year period was 9.7% pa in euro terms. For FY15, excluding indirect fund fees, the ongoing charge was 0.98% of net assets.

## Dividend policy and record

In FY14, the board modified its approach to dividends to reflect the importance many shareholders place on the reliability of income. Emphasising capital discipline, the board's intention is to at least maintain the real value of the dividend from the 5.0p paid in FY14. At 31 March 2016, SEP had revenue reserves equating to 8.0p per share after payment of the interim dividend.

An interim dividend was paid for the first time in FY15, amounting to 1.75p, with a final dividend of 3.50p, bringing the total dividend for FY15 to 5.25p, representing a 5% increase from FY14. The interim dividend for FY16 was increased by 2.9% to 1.80p and the final dividend is due to be declared with SEP's preliminary results on or around 2 December 2016.

## Peer group comparison

Exhibit 7 shows a comparison of SEP with a selected peer group of listed private equity funds of funds and direct investment companies. SEP's NAV total return in sterling terms to 30 June 2016 is ahead of the peer group average over one and three years, but modestly below the average over

five and 10 years. Sterling weakness has helped SEP's recent performance relative to UK peers, but over three and five years the euro declined by 3.5% and 9.1% against sterling and by 14.9% and 23.7% against the US dollar, weighing on SEP's performance relative to UK and global peers. Similar to most peers, SEP's share price total return has lagged NAV by a considerable margin, reflected in wider discounts across the sector at end-June 2016, suggesting that market sentiment towards listed private equity funds in general had weakened in spite of positive underlying performance. While wider than the peer group average, SEP's current share price discount to NAV is in line with the 22% average excluding funds trading at a premium. SEP's 1.9% yield ranks it at the lower end of the eight dividend-paying funds in the peer group of 13.

**Exhibit 7: Listed private equity investment companies peer group as at 4 November 2016\***

% unless stated	Region	Mkt cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Price TR 1 Year	Price TR 3 Year	Price TR 5 Year	Price TR 10 Year	Discount (ex-par)	Dividend yield (%)
Standard Life Euro Private Eq**	Europe	416.7	23.0	43.3	45.6	108.5	7.3	34.3	54.4	59.7	(21.9)	1.9
Aberdeen Private Equity**	Global	123.0	19.7	34.1	56.4		5.3	15.1	47.5		(24.2)	2.0
Altamir	Europe	374.1	33.3	45.9	54.9	126.0	18.4	28.7	45.8	86.4	(38.4)	4.8
Deutsche Beteiligungs	Europe	404.3	29.3	36.8	41.8	256.0	13.7	61.1	61.5	305.5	31.7	3.3
F&C Private Equity Trust**	Global	217.6	16.7	34.9	51.2	138.2	16.5	36.8	66.1	99.8	(6.4)	3.9
GIMV	Global	1,087.5	39.3	44.2	28.8	113.3	39.3	44.2	28.8	113.3	6.1	3.8
HarbourVest Global Priv Equity**	Global	848.9	23.9	55.8	90.3		5.1	41.7	95.9		(23.3)	
ICG Enterprise Trust**	UK	452.2	7.9	23.8	43.3	100.2	(2.9)	23.4	54.6	77.7	(21.1)	1.7
JPEL Private Equity**	Global	304.3	27.8	41.1	23.7	61.8	13.4	50.7	6.8	20.4	(20.1)	
NB Private Equity Partners**	Global	0.0	20.8	54.0	80.4		1.2	40.3	61.4		(22.8)	4.7
Oakley Capital Investments	Europe	279.0	18.1	10.3	19.4		(21.7)	(17.0)	(16.0)		(34.7)	
Pantheon International**	Global	1,023.3	22.3	40.7	69.7	135.1	1.0	23.3	80.0	76.9	(20.3)	
SVG Capital**	Global	1,095.1	12.5	38.6	69.1	(5.0)	6.7	35.3	97.3	(26.7)	(7.6)	
<b>Average</b>		<b>509.7</b>	<b>22.7</b>	<b>38.7</b>	<b>51.9</b>	<b>114.9</b>	<b>7.9</b>	<b>32.2</b>	<b>52.6</b>	<b>90.3</b>	<b>(15.6)</b>	<b>3.3</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance data to 30 June 2016. \*\*Company with fund-of-funds structure. TR = total return. All returns expressed in sterling terms.

## The board

SEP's board comprises five independent non-executive directors. Edmond Warner (appointed director November 2008, chairman January 2013) is chairman of Panmure Gordon & Co and a director of BlackRock Commodities Income Investment Trust. Senior independent director Christina McComb (appointed January 2013) spent 14 years with 3i Group. David Warnock (appointed January 2009) is chairman of Troy Income & Growth Trust and a director of Seneca Investment Managers. Alastair Barbour (appointed April 2011) is a director of Phoenix Group Holdings and Liontrust Asset Management. Alan Devine (appointed May 2014) is CEO of RBS Shipping Group.

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