EDISON

Aberdeen Private Equity Fund

Diligent selection key as deal market tightens

Investment companies

Aberdeen Private Equity Fund (APEF) provides access to a globally diversified portfolio of private equity funds and co-investments with a bias towards the US and technology. Recent changes to the manager's corporate structure have not specifically affected the fund but have brought direct investment and Asian expertise in-house. Share price performance ytd has been flat, while NAV gains have widened the discount. As the cycle matures there may be scope for it to narrow again, realisations may be the catalyst.

12 months ending	Total share price return (%)	Total NAV return (%)	FTSE All Share index (%)	LPX 50 TR GBP (%)	MSCI World Index (%)
31/10/12	23.3	8.2	9.8	28.2	10.3
31/10/13	29.5	1.9	22.8	33.7	26.8
31/10/14	7.3	13.0	1.0	7.3	9.7
31/10/15	8.0	7.7	3.0	25.0	6.0

Source: Datastream. Note: 12-month rolling discrete total return performance.

Investment strategy: Careful selection is key

The managers take a top-down approach to asset allocation by geography and sector but devote most time to selecting underlying PE funds. The Aberdeen Asset Management private equity team of c 50, which manages $15bn overall, devotes considerable resources to fund selection and has been strengthened by the acquisitions of Scottish Widows Investment Partnership (bringing direct investment expertise) and FLAG (which has Asia specialists). The remit to co-invest alongside managers whose funds APEF does not own has recently been approved by the board and co-investments are likely to become an area of greater focus.

Market outlook: Competition for deals rising

After bumper PE fundraising in 2014 and with a record $1.35bn of uncommitted funds globally, Q315 saw a slowdown in the number of individual funds and amount of capital raised compared to Q314 (data from Preqin). This implies that the opportunities to deploy such abundant capital at attractive prices are becoming limited. Increasing competition from low-cost capital sources such as sovereign wealth funds and from corporate takeovers exacerbates the challenge and increases deal prices. As a result, exposure to a range of managers who are thoroughly screened and researched by a well-resourced and experienced team may be attractive.

Valuation: Scope to narrow the discount

APEF's discount has grown in 2015 and is the widest in its peer group at 27.6%, near the upper end of its three-year range of 20% to 31%. With NAV total return ahead of peers in the twelve months to 30 January 2015 (the date of our last note) at 20.2% vs a 9.5% average, and matching the group so far in 2015 at 7%, it may be that the discount has widened because of corporate changes at the manager. There was a significant increase in the discount from 23.7% to 30.8% after the announcement that Aberdeen would buy SVG out of the joint venture in March 2015. That effect may be reversed as the market recognises the limited impact of the ending of the joint venture on the fund itself.

30 October 2015

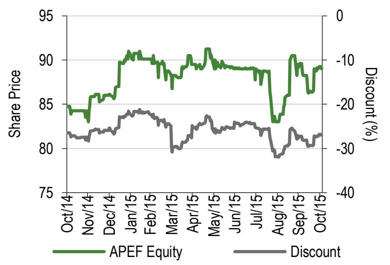
Price	**88.5p**
Market cap	**£97m**
AUM	**£134m**

NAV*	123.2p
Discount to NAV	27.8%
NAV**	123.2p
Discount to NAV	27.6%

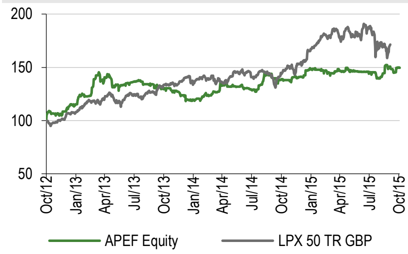
*Excluding income. **Including income. Data at 29 October 2015.

Yield	2.5%
Ordinary shares in issue	109.1m
Code	APEF
Primary exchange	LSE
AIC sector	Private Equity

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low	91.3p	82.3p
NAV* high/low	127.4p	113.9p

*Including income.

Gearing

Gross*	0.0%
Net cash*	17.3%

*At 30 June 2015.

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Edison profile page

Aberdeen Private Equity Fund is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

Aberdeen Private Equity Fund is a Guernsey-registered, London-listed, investment company seeking long-term capital gains by investing in a diversified portfolio of private equity funds. It may hold direct investments in unquoted companies and securities including fixed interest securities, hedge funds, cash-equivalent investments and cash.

Recent developments

- 15 September 2015: AGM, all resolutions passed.
- 1 July 2015: annual report released, NAV TR +18.2%, share price TR +15.5%.
- 2015: $15m commitment to CCMP Capital Investors III; $10m commitment to FFL IV.

Forthcoming

Interim results	24 November 2015
Year end	31 March
Annual results	July
Dividend paid	September
Launch date	July 2007
Continuation vote	Every three years, next in September 2016

Capital structure

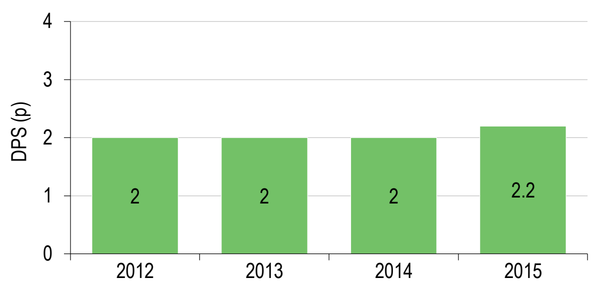
Ongoing charges	2.02%
Net cash	2.0%
Annual mgmt fee	1.5% of NAV (see page 7)
Performance fee	See page 7
Trust life	Indefinite
Loan facilities	£15m revolving credit facility with Lloyds, undrawn.

Fund details

Group	Aberdeen Asset Management
Managers	Alexander Barr, Colin Barrow
Address	Bow Bells House, 1 Bread Street, London, EC4M 9HH
Phone	0500 00 00 40
Website	aberdeenprivateequity.co.uk

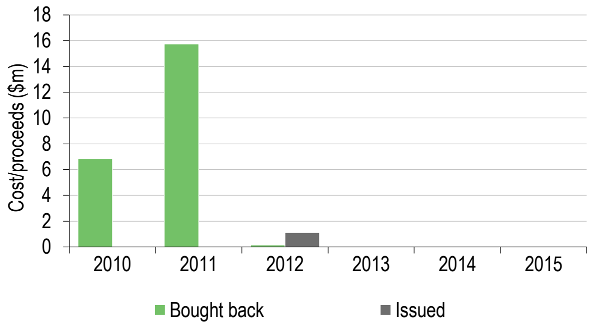
Dividend policy and history

Dividends are paid once a year with 10% of all distributions received (less recallable ones) paid out.

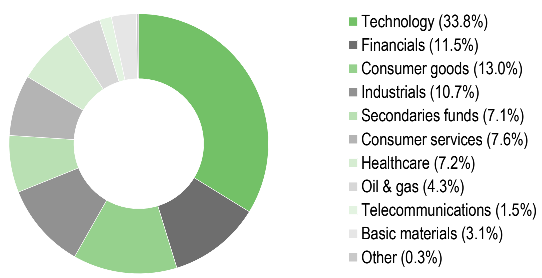


Share buyback policy and history

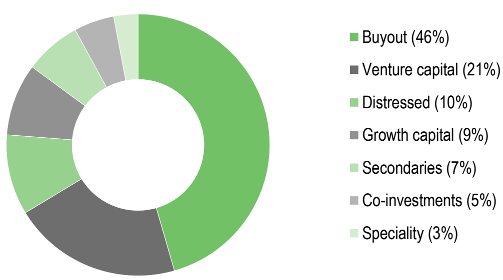
No significant buybacks have been made since 2011 although the board continues to have permission to buy back up to 14.99% of issued share capital.



Shareholder base (as at 30 Sep 2015)



Portfolio distribution (as at 30 Jun 2015)



Top 10 holdings (as at 30 September 2015)

Fund	Vintage	Strategy	Geography	Fair market value (FMV)	FMV/NAV (%)
Northzone VI	2010	VC	Europe	16.1	7.9
Lion Capital Fund III	2010	Buyout	Europe	12.0	5.9
Silver Lake Partners III	2007	Buyout	Global	11.3	5.6
Thomas H Lee Parallel Fund VI	2006	Buyout	US	10.3	5.1
HIG Bayside Debt & LBO Fund II	2008	Distressed	US	9.7	4.8
Rho Ventures VI	2008	VC	US	8.7	4.3
Apax 8 (A8 – A[Feeder])	2012	Growth capital	US	8.4	4.1
Tenaya Capital V	2007	VC	US	7.7	3.8
Pine Brook Capital Partners	2007	Growth capital	Global	7.0	3.5
MatlinPatterson Global Opportunities Partners III	2007	Distressed	Global	7.0	3.4
Top 10				**98.4**	**48.4**

Source: Aberdeen Private Equity Fund, Edison Investment Research.

Why a private equity fund of funds?

We discuss the private equity sector and its performance in the financial crisis in more detail in our 3 February 2015 initiation note. Listed private equity funds of funds benefit from having permanent capital, allowing them to invest for the long term without fear of redemptions forcing them to exit investments at a time when they might not be able to realise the full value of the asset. Access to a range of high-quality managers globally diversifies risk and brings exposure to investments, which would not normally be available to most retail investors. In addition, private equity funding does not come with the same burden of shareholder communication and mandatory announcements as a public listing, allowing company management to devote more effort to running the business and potentially making a better return on investment.

Market outlook: How do you follow a record year?

Bain's Global Private Equity Report 2015 shows that following record realisation of $450bn and near-record amounts of PE funds raised in 2014 at $499bn, there were $1.1tn of uncommitted PE funds globally (compared with Preqin's figure of $1.32tn after Q315). On the one hand this reflects the success of PE as an asset class since the financial crisis: low interest rates have helped companies and PE borrowers refinance debt; rising public markets have improved private valuations and enabled IPO exits; and improving corporate profits and growing confidence in the global economy have meant that trade exits have outstripped IPOs. On the other hand, the QE which helped fuel many of those factors has meant that more capital is looking for a home, raising asset prices and therefore investment holding periods. As APEF's chairman noted in the 2015 annual report, purchase multiples of new private equity buyouts hit 9.7x trailing earnings in 2014, making it harder to source investments. The managers themselves noted more recently that general partners (GPs) are raising larger funds than in the past, which may struggle to be invested at good prices with the result that GPs may end up going for deals which are bigger than they have experience of. This makes APEF potentially more attractive as risk is spread across 26 managers (and four co-investments) and APEF's own managers provide a layer of due diligence over that of the underlying funds.

Given the slowing global growth, particularly in emerging markets and Europe, the board and managers of APEF believe that "arguably within the investment life of some of our more recent commitments…we could see a return to more straitened times for private equity." With that in mind APEF will seek to make sure its underlying investments are prepared for harder times, with stronger balance sheets and business models.

Fund profile: Diversified global private equity exposure

Aberdeen Asset Management was appointed as manager on 19 November 2009 and simplified the investment approach in 2010 from being an alternative investment fund to a fund of private equity funds. The shares were consolidated into a single sterling-denominated class. In May 2013, Aberdeen Asset Management and SVG Capital entered into a three-year joint venture agreement, increasing the size of the private equity team and assets under management. Following Aberdeen's acquisition of Scottish Widows Investment Partners (SWIP, completed in April 2014), the JV was ended mutually a year early, in April 2015. Aberdeen has also recently (May 2015) acquired FLAG Capital, which is focused on venture capital in the small- to mid-cap space and based in Stanford, CT and Boston, MA. FLAG acquired Asia specialist Squadron Capital Advisors in 2012, a fund-of-funds based in Hong Kong. Squadron is in the process of relocating to Aberdeen's Hong Kong office and brings further Asian expertise to the private equity team. SWIP and FLAG will be fully integrated into Aberdeen.

For APEF, much less has changed: the private equity team at Aberdeen remains substantial at 42 professionals and the fund has two managers; Colin Burrow, formerly of SWIP, working alongside Alex Barr, who has managed the fund since Aberdeen's appointment in 2009. The fund seeks to hold a broadly diversified portfolio of investments by sector, geography, size and strategy. The majority of the portfolio is held in buyout, growth capital, distressed and venture capital sectors. No more than 20% of NAV, at the time of investment, can be held in any single investment.

The fund managers: Alex Barr and Colin Burrow

The managers' view: Cycle maturing with less risk this time

Alex Barr and Colin Burrow think that the private equity cycle is past its halfway point and given PE investment horizons, recent vintages may be held into more difficult economic times. In mitigation, despite strong deal flow and prices being higher than in the last few years, similar to levels seen in 2005-07, there is less leverage than before the financial crisis, so distress from any downturn would be less severe. Importantly, APEF is not heavily exposed to commodity (3.1%) or oil and gas (4.3%) industries, which rely on heavy initial capital outlay before making a return on investment, and which are therefore exposed not only to the commodity cycle, which has already turned, but also to wider economic factors. It also has limited exposure to other risky sectors like China (3%), and other ex-Japan Asia-Pacific countries (2.7%).

In line with the view expressed in the annual report, the managers see diminished deal flow this year, but think that the exit market is strong, especially for trade sales (although they anticipate a fickle IPO market as volatility has returned in the last quarter). Less money is being deployed in drawdowns and co-investments as well. However, good funds are raising money quickly with the caveat, noted above, that anecdotally some GPs are raising much bigger funds than they have in the past; perhaps testing the scope of their opportunities to invest. From APEF's point of view, an appetite for listed private equity seems to be returning to public markets.

Asset allocation

Investment process: Rigorous due diligence

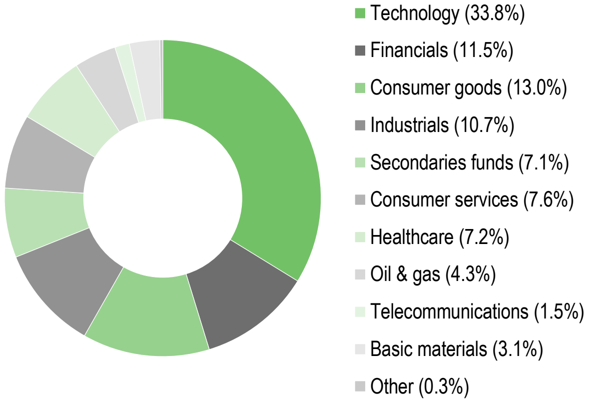
The investment process begins with top-down asset allocation based on a strategic view of the relative merits of different regions, stages of financing and investment type. The latter is affected to some extent by the number of opportunities the team can source; the acquisitions of FLAG and SWIP have added to the flow, particularly by bringing direct investment and Asian expertise. The global macroeconomic climate is formally reviewed at least once a year, but also forms part of all investment decisions and the team's view on the global economy is continually updated.

The managers' main task is to select private equity fund managers who will provide superior risk-adjusted returns over time compared to their peers. Each is rigorously assessed, including operational and legal due diligence, typically over three or four months. A detailed report on each potential manager is compiled and presented to the investment committee, which makes recommendations to the board for approval. Managers are also monitored post commitment, as are market conditions and their likely effects on individual funds. In a change to previous policy, the board has now given approval in principle to co-investment alongside GPs in whose funds APEF has not invested; previously co-investments were only made alongside investee managers.

Current portfolio positioning

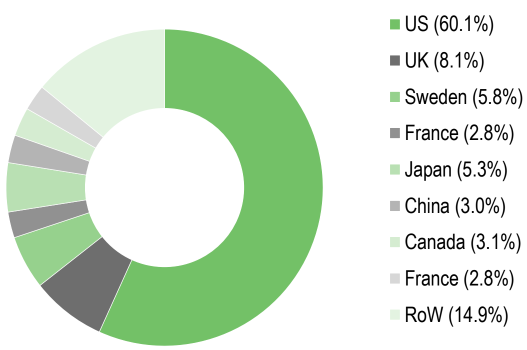
At 30 September 2015, the APEF portfolio consisted of 30 investments. Of these, the top ten make up 57.8% of total investments or 48.4% excluding the 17.3% cash weighting. The biggest regional exposure is to the US at 60.1% and the largest single holding is in Northzone VI, a Nordic-based venture capital fund. We note that Northzone has recently announced the sale of Avito, APEF's largest single underlying holding, valuing Northzone's stake at $155m and Avito at $2.7bn, making it Europe's biggest tech VC M&A deal to date. Technology is the heaviest sector weighting at 33.8% for several reasons: most private-equity funded start-ups are either pure tech companies or are tech-enabled, so venture capital strategies tend to have heavy tech weightings; technology is a key driver of growth in the global economy; and several underlying tech investments have performed well. The latter has had the effect of increasing the weighting, but as a result of putting pressure on limited partners (LPs) to exit successful investments as they grow in proportion to the rest of the portfolio, the strength of the exit market is one reason the tech weighting has fallen slightly in 2015.

Exhibit 2: Weighting by sector



Source: APEF, 30 June 2015

Exhibit 3: Weighting by geography



Source: APEF, 30 June 2015

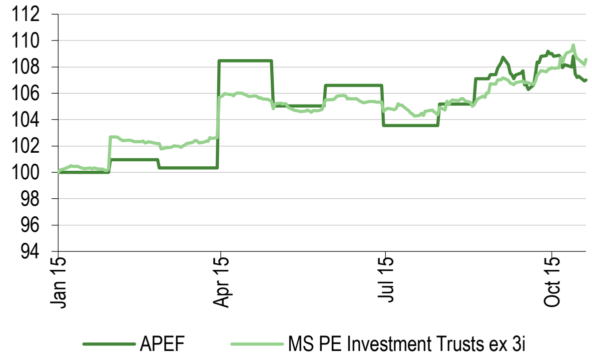
There has been a slight increase in the co-investments weighting, although the number of co-investments remains at four. Colin Burrow's background in direct investments should be an asset in this area. The four co-investments are: **Alain Afflelou** with Lion Capital, a French optical retailer with a franchise model. It has weathered a difficult French retail climate and performed well in Spain and Morocco as well; helped by proprietary software for optimising store locations and expansion into areas such as hearing aids; **Dell** with Silver Lake Partners, Dell's acquisition of EMC announced on 12 October will be the biggest transaction ever in the sector (see our TMT research team's commentary on the deal). Going private has allowed Michael Dell, CEO and founder, to focus on the business rather than shareholders and the investment is held up as an example of the advantages PE can have over public equity; **Hillman Group** with CCMP Capital, Hillman is a distributor of fixtures and fasteners to retailers in the US. The family business has benefited from external guidance and management and has opportunities in adjacent products such as plumbing. Greg Gluchowski was appointed CEO in August 2015 having led a division of Stanley Black and Decker, which was divested to Spectrum for $1.4bn in 2012; and **Via Mechanics** with Longreach. Longreach specialises in selling out-of-favour Japanese companies or their subsidiaries to Chinese or Korean buyers. Via Mechanics produces equipment for making printed circuit boards.

Performance: Shares lagging NAV

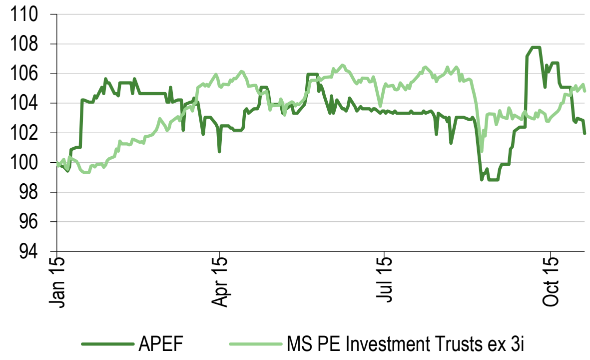
APEF's NAV total return of 7% in 2015 (to 20 October) has been in line with the wider sector although its share price has not reflected that move closely, as shown in Exhibit 4. While the record amount of funds raised over the last 21 months and in 2014 in particular implies a strong institutional appetite for private equity investments (no doubt driven in part by low interest rates and the strong recent exit environment), as the cycle matures, access to a portfolio diversified by stage of investment, geography and sector may become more attractive to investors. The intention to focus more on co-investments alongside managers on which the team has done their due diligence may also affect the market's view.

Exhibit 4: Investment trust performance to 20 October 2015

NAV total return performance, 2015 to 20 October 2015



Price total return performance 2015 to 20 October 2015



Source: Morningstar, Edison Investment Research

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

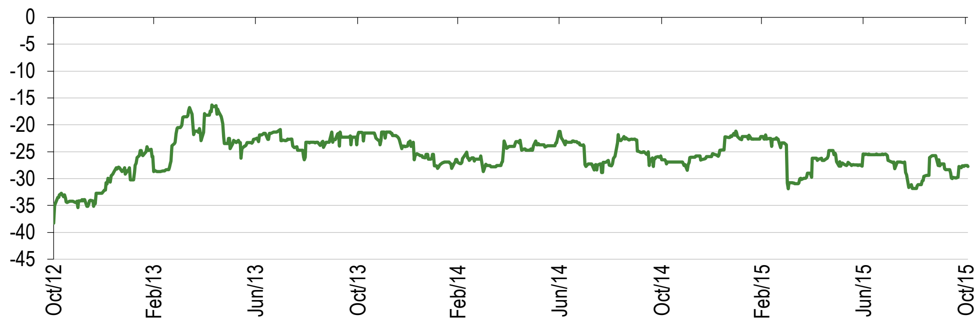
	One month	Three months	Six months	One year	Three years	Five years
Price relative to FTSE All Share index	-4.56	6.42	7.95	4.99	22.28	0.20
NAV relative to FTSE All Share index	-5.68	7.73	10.00	4.75	-3.64	
Price relative to LPX 50	-8.96	7.54	2.06	-17.00	-29.41	-65.28
NAV relative to LPX 50	-10.08	8.85	4.11	-17.24	-55.32	
Price relative to MSCI World index	-5.75	4.64	5.63	1.97	2.50	-23.56
NAV relative to MSCI World index	-6.87	5.95	7.68	1.73	-23.41	

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-June 2015. Geometric calculation.

Discount: Near two-year maximum

Currently standing at 27.6%, the discount to NAV is above the figure for the start of the year (25.3%) and above the one and three year averages (26.3% and 25.5% respectively). As noted earlier, there was a step down in the share price at the end of March at the time the end of the SVG JV was announced.

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



Source: Morningstar, Edison Investment Research.

APEF's board has historically been given permission to buy back up to 14.99% of the company's share capital as a means of managing the discount to NAV and seeks to renew the authority every year. The permission has not been exercised since 2011, when a tender offer of 41.7m shares was made, 24.7m being placed with new and existing shareholders and the remainder bought back by

APEF. The board prefers to address the discount by actively marketing the shares to encourage demand rather than by restricting supply. This approach is suitable for a private equity fund with substantial cash commitments and we believe purchases of shares in the market are unlikely in the near term.

Capital structure and fees

APEF is a conventional investment company with a single class of 109.1m ordinary voting shares in issue. The accounts are presented in US dollars because the majority of its holdings are dollar denominated. There is a three year £15m borrowing facility provided by Lloyds Bank, which is undrawn and the current cash position is approximately 17% of the portfolio. Formally, gearing should not exceed 25% of NAV, but in practice the fund is unlikely even to approach that and the facility is available in order to provide flexibility to meet commitments.

The stated management fee is 1.5% of NAV per share (0.75% on cash). The performance fee calculations were amended in FY15 and apply from the current financial year. They now incorporate a three year 8% per annum compound return hurdle rate meaning that three criteria must be met in any performance fee year: NAV must have risen by 8% in the performance fee year; NAV must exceed the high water mark (at which the performance fee was last paid); and the NAV must have risen 8% per annum compounded over the last three performance years.

The fee itself will be 10% of the NAV gain above the hurdle rate in the latest performance fee year. Total fees payable to the manager in any performance period will be capped at 3% (down from 4.99% previously).

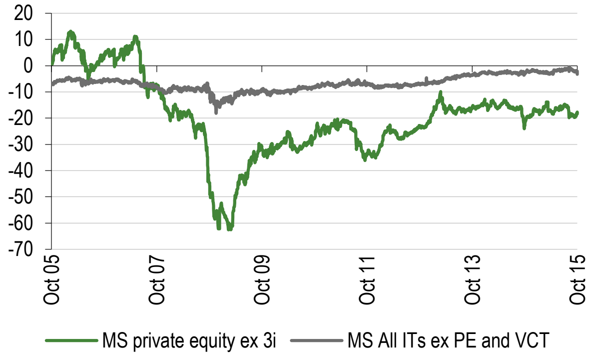
Dividend policy and record

In 2012, APEF adopted a dividend policy in of paying out 10% of non-recallable distributions it received each year to a minimum of 1p per share, regardless of distributions. There is no formal policy to grow the dividend. The company has paid four dividends so far: 2p per share in 2012, 2013 and 2014 and 2.2p in 2015. Dividends are declared in June and paid in September.

Peer group comparison

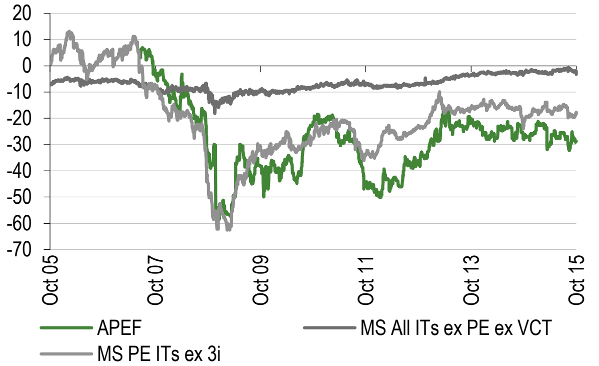
APEF's peer group is skewed greatly by 3i, which earns external management fees as well as being a fund in its own right and therefore trades at a considerable premium to NAV. Exhibit 7 compares the rest of the private equity sector to the wider investment trust universe. Private equity fell out of favour at the time of the financial crisis in 2007 and seems to have found a discount level in the 15% to 20% range, having previously traded at a premium.

Exhibit 7: Private equity discount vs all ITs



Source: Morningstar

Exhibit 8: APEF discount vs all ITs and PE ex 3i



Source: Morningstar

A further contrast can be seen between APEF and the rest of the PE investment trust sector where the discount gap has widened by another 10%. This started at the time of the European sovereign debt crisis and has since persisted. With continued NAV performance in line with the market, this gap could narrow again. One of the benefits of having a permanent capital vehicle is that a stable portfolio can be established without the need to sell investments to pay for redemptions. Conversely, shareholders wishing to exit the investment may have to sell at well below NAV.

Exhibit 9: Peer group comparison (private equity funds of funds)

% except where stated	Mkt cap £m	NAV TR 1Y	NAV TR 3Y	NAV TR 5Y	Ongoing charge	Perf fee	Discount (cum fair)	Net gearing	Yield	Sharpe ratio 1Y	Sharpe ratio 3Y
Aberdeen Private Equity	**97.4**	**7.3**	**23.5**	**49.7**	**2.0**	**Yes**	**-26.7**	**84.0**	**2.5**	**1**	**0.9**
F&C Private Equity Trust	159.9	9.1	26.2	53.0	1.4	Yes	-20.3	118.0	4.8	2.2	1.9
Graphite Enterprise Trust	439.3	5.7	27.5	54.7	1.4	No	-13.5	100.0	1.6	2	1.0
HarbourVest Global Private Equity	695.8	12.3	47.8	81.5	0.5	No	-19.2	95.0	0.0	2.5	2.1
JPMorgan PE	225.0	14.6	17.1	0.2	2.5	Yes	-17.4	112.0	0.0	2	1.0
NB Private Equity Partners	371.3	12.8	47.0	71.5	2.9	Yes	-18.7	124.0	4.1	2.1	2.1
Pantheon International	892.5	8.8	35.8	69.5	1.2	Yes	-14.3	92.0	0.0	1	1.4
SVG Capital	822.6	14.7	61.6	114.4	0.9	No	-20.0	89.0	0.0	1.4	1.5
Standard Life Euro PE	328.8	9.6	27.7	48.4	1.0	Yes	-21.7	100.0	2.4	2	1.6
Weighted average		**11.0**	**40.9**	**72.6**	**1.3**		**-17.9**	**98.3**	**2.9**	**2**	**1.6**
Selected stock average	**448.1**	**10.5**	**34.9**	**60.3**	**1.5**		**-19.1**	**101.6**	**1.7**	**2**	**1.5**
Rank		8	8	7	3		9	9	3	9	9
Count		9	9	9	9	9	9	9	9	9	9
Sector average (38 fds)	**366.0**	**0.8**	**12.9**	**27.6**	**6.8**		**-9.3**	**99.2**	**3.8**	**1**	**0.6**

Source: Morningstar, 30 September 2015, Edison Investment Research. Notes: TR = NAV 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 shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds, 100 = ungeared.

The board

The board is comprised of four independent non-executive directors including the chairman, Howard Myles. Myles joined the board in December 2009 and became chairman in September 2014. David Copperwaite became a director in June 2009 following a successful EGM requisition by a major shareholder, which resulted in changes to the fund's strategy and manager. Philip Hebson and David Staples joined in September and December of the same year. The directors have experience in fund management, corporate finance, banking and accountancy.

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