EDISON

Princess Private Equity Holding

Initiation of coverage

Diversified global portfolio with high dividends

Investment companies

Princess Private Equity Holding (PEY) offers investors access to the private equity and debt expertise of global manager Partners Group ($74bn AUM), as well as selected co-investments with third-party managers. It has followed a direct investment strategy since 2011, when it refocused away from third-party funds of funds, and has seen solid NAV and share price performance over most periods of five years and shorter. Partners Group's differentiated global approach includes a highly selective process of deal sourcing (c 99% of potential investments are declined each year), and an in-house value creation team who can plan and implement initiatives to help investee companies achieve superior growth. PEY has a high dividend policy, targeting a payout of 5-8% of the opening NAV each year.

12 months ending	Share price (%)	NAV (%)	LPX Europe (%)	LPX Europe NAV (%)	MSCI World (%)	FTSE All-Share (%)
28/02/14	(4.8)	1.7	22.1	10.6	15.8	18.4
28/02/15	22.7	16.9	23.4	16.9	33.5	19.9
29/02/16	6.1	12.6	(5.9)	4.4	(7.6)	(13.7)
28/02/17	41.0	15.0	24.9	10.5	24.7	12.1
28/02/18	12.5	11.3	18.3	12.9	2.8	0.7

Source: Thomson Datastream. Note: All % on a total return basis in EUR.

Investment strategy: Direct, co-investment and debt

PEY aims to hold a diversified portfolio of 50-80 private equity investments, with the majority made directly by its investment adviser, Partners Group, as well as co-investments with other managers and direct senior or subordinated debt investments. A legacy portfolio of third-party funds is chiefly in realisation mode. Partners Group seeks controlling or majority positions in mainly mid-sized market-leading companies that are attractively priced versus history and peers. Through its industry value creation (IVC) team, it seeks to add value in investee companies through operational improvements, expansion and M&A.

Market outlook: Be selective amid high valuations

The global volume of private equity deals remains significantly below peak pre-financial crisis levels, but the exit environment has been robust and investment demand is strong, leading to record high levels of private equity 'dry powder'. The resulting competition for deals has pushed EV/EBITDA multiples for typical large-cap buyouts to near-record levels, but pockets of value may still be found further down the size spectrum, particularly for private equity teams that have a highly selective approach to investment and the expertise to effect operational change.

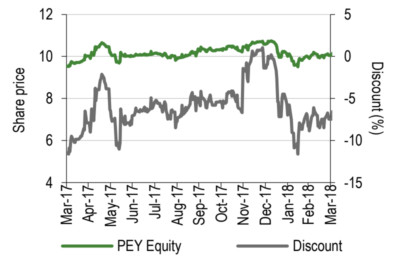
Valuation: Discount below historical and peer average

At 4 April 2018, PEY's shares traded at a 7.0% discount to the 28 February NAV. This was wider than the one-year average of 5.9%, but much narrower than longer-term averages, arguably reflecting the impact of the refocusing in 2011 from third-party funds to direct investments. While discounts have generally narrowed over the past year, PEY's current 7.0% is well below the 15.8% average for the AIC peer group, supported by a 5.5% dividend yield, among the highest in the sector.

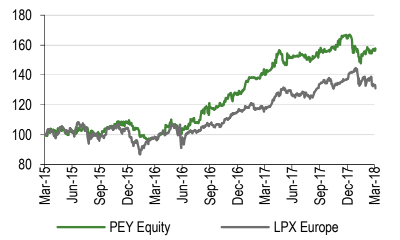
6 April 2018

Price	**€10.10**
Price (PEYS)	**882p**
Market cap	**€698m**
AUM	**€751m**
NAV*	€10.86
Discount to NAV	7.0%
*As at 28 February 2018.	
Yield	5.5%
Ordinary shares in issue	69.2m
Code	PEY/PEYS
Primary exchange	LSE
AIC sector	Private equity

Share price/discount performance



Three-year performance vs index



52-week high/low	€10.75	€9.50
NAV high/low	€10.95	€10.62

Gearing

Gross*	0.0%
Net liquidity*	15.0%
*As at 28 February 2018.	

Analysts

Sarah Godfrey +44 (0)20 3681 2519

Gavin Wood +44 (0)20 3681 2503

investmenttrusts@edisongroup.com

Edison profile page

Princess Private Equity Holding is a research client of Edison Investment Research Limited

Exhibit 1: Company at a glance

Investment objective and fund background

Princess Private Equity Holding is an investment holding company domiciled in Guernsey that invests in private equity and private debt. Its portfolio may include direct, primary and secondary fund investments. Princess aims to provide shareholders with long-term capital growth as well as an attractive dividend yield. The shares are traded on the Main Market of the London Stock Exchange.

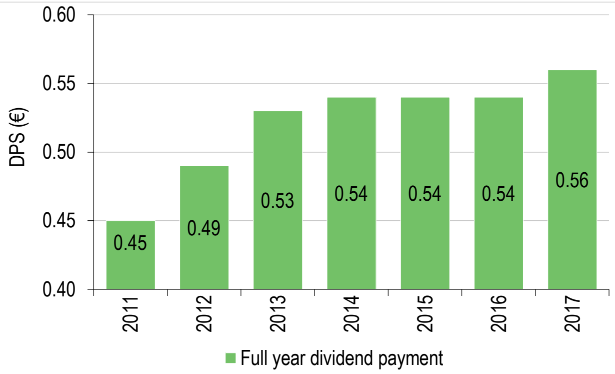
Recent developments

- 16 March 2018: Annual results for the year ended 31 December. NAV TR +11.2% and share price TR +29.6%. Performance was mainly driven by positive valuation movements (+16.2%), while currency was negative (-2.1%). Investments in the year totalled €117.2m and realisations were €191.1m.
- 23 January 2018: Sale of Trimco to Affinity Partners agreed for $520m, with proceeds for PEY of c €24m, a 3.4x return on the original investment.
- 15 January 2018: Sale of remaining shares in VAT Group.

Forthcoming		Capital structure		Fund details	
AGM	May 2018	Ongoing charges	1.78% (FY17)	Group	Partners Group
Interim results	August 2018	Net liquidity	15.0%	Manager	Team managed
Year end	31 December	Annual mgmt fee	1.5%	Address	Tudor House, PO Box 477, Guernsey, GY1 1BT
Dividend paid	June, December	Performance fee	See page 13		
Launch date	1999 (listed since 2006)	Company life	Indefinite	Phone	+44(0) 1481 711 690
Continuation vote	None	Loan facilities	€50m	Website	www.princess-privateequity.net

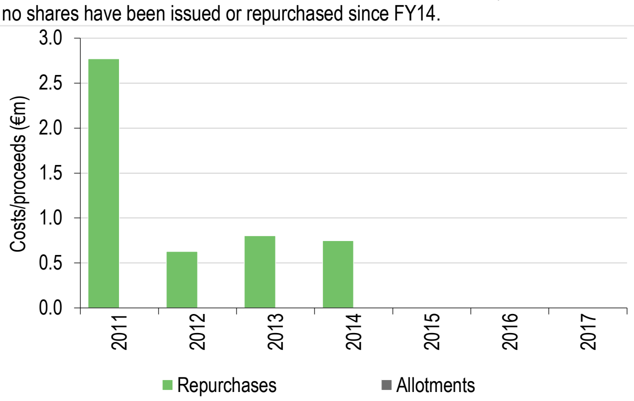
Dividend policy and history (financial years)

PEY intends to pay a total annual dividend equivalent to c 5-8% of NAV per share, paid in two instalments.

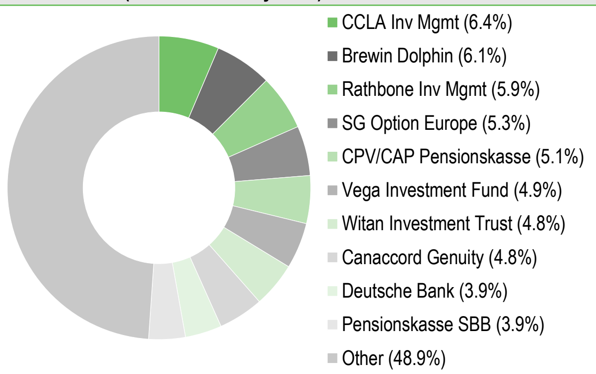


Share buyback policy and history (financial years)

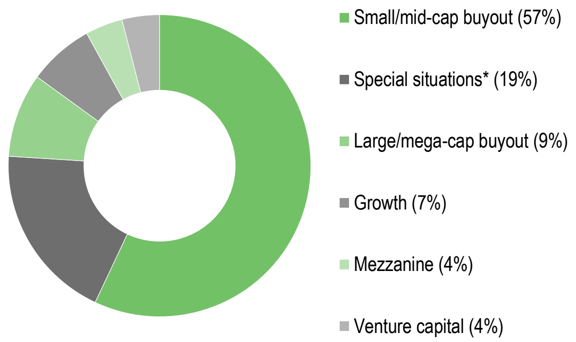
Under an authority granted in 2010, PEY's directors may buy back up to 14.99% of shares, or allot shares up to c 10% of the share capital, each year. However, no shares have been issued or repurchased since FY14.



Shareholder base (as at 13 February 2018)



Portfolio exposure by financing category (as at 28 February 2018)



Top 10 direct investments (as at 28 February 2018)

			% of NAV	
Company	**Region**	**Sector**	**28 February 2018**	**28 February 2017****
Action	Western Europe	Consumer discretionary	9.0	5.9
Permotio Intl Learning	Western Europe	Consumer discretionary	5.4	4.1
Form Technologies (formerly Dynacast)	North America	Materials	4.7	3.5
Foncia	Western Europe	Financials	3.0	3
KinderCare Education	North America	Consumer discretionary	2.9†	3.9
Trimco Intl***	Asia Pacific	Industrials	2.6	1.9
Fermaca	Rest of world	Energy	2.5	2.8
IDEMIA (formerly Oberthur - Morpho)	Western Europe	Information technology	2.1	N/A
Hofmann Menue Manufaktur	Western Europe	Consumer staples	2.1†	3.5
Global Blue	Western Europe	Financials	1.9	N/A
Top 10 (% of portfolio)			**36.2**	**40.4**

Source: Princess Private Equity Holding, Edison Investment Research, Bloomberg, Morningstar. Note: *Special situations includes first- and second-lien debt and infrastructure investments. **N/A where not in February 2017 top 10. ***Sale announced in January 2018. †Reduced as a result of partial realisation.

Fund profile: Diversified private equity and debt fund

Princess Private Equity Holding (PEY) is a Guernsey-registered investment company which began life in May 1999 when it raised $700m through the issue of a convertible bond, investing the proceeds in commitments to private equity partnerships (third-party funds). In December 2006, the convertible bond was converted into shares and the company listed on the Frankfurt Stock Exchange, changing its reporting currency from US dollars to euros. PEY gained an additional listing on the London Stock Exchange in November 2007 and in December 2012, it cancelled its Frankfurt listing and consolidated all trading activity in London. In September 2017 it introduced an additional sterling market quote (PEYS).

PEY's aim is to provide its shareholders with long-term ca pital growth and an attractive dividend yield by investing primarily in private equity, as well as private debt and, to a lesser extent, private infrastructure. Its investment adviser, Partners Group, is a Switzerland-headquartered global specialist in private market investment, with $74bn of assets under management. Having initially invested mainly through third-party funds, since 2011 PEY has focused on direct investments, principally those where Partners Group is the lead or co-lead investor, although it also enters into co-investments with other managers. A minority of the portfolio (c 18% at 28 February 2018) remains invested in third-party funds, which are mostly mature and in the process of returning capital to investors.

The fund has a policy of paying out 5-8% of its opening NAV each financial year as a dividend, paid in two instalments. It may use borrowing for short-term flexibility over the timing of investments, and has a loan facility for €50m (c 6.7% of NAV), which is currently undrawn as there are significant liquid resources (c €88m at 31 December 2017). Unlike many peers, PEY does not follow an overcommitment strategy.

The fund manager: Partners Group

The manager's view: Focus on value creation

With the global economy now entering its ninth consecutive year of low but steady growth, PEY's investment adviser, Partners Group, sees greater potential for a divergence from its base-case macroeconomic assumption of 'more of the same'. In particular, higher inflation and long-term bond yields could result from a combination of a tax-cut-driven increase in the US budget deficit and a faster pace of Fed rate rises, putting downward pressure on listed and private equity market valuations as 'risk-free' assets become relatively more attractive.

Against such a backdrop, and with pricing for private equity deals remaining at near-record levels, Partners Group focuses on identifying companies that are or can become leaders in their field and that operate in more defensive market segments yet can experience above-market growth rates as a result of transformative trends.

The high prices that investors are paying for private equity deals are connected with the amount of 'dry powder' available for investment (currently more than $1trn according to Preqin, with the majority seeking buyout deals). Felix Haldner, a director of PEY and a partner at Partners Group, explains that the manager has been capitalising on the excellent exit environment by crystallising a good portion of the value in more mature portfolio companies (c 30% of the opening portfolio value was realised in FY17). However, it takes a cautious and selective approach to buying at such elevated valuations, resulting in realisations outpacing investments in FY17.

In spite of the near-record pricing, Partners Group reports that it has still been able to find value in the market, in part because of the strength of its industry value creation team, which allows it to target companies where concerted value creation efforts are needed in order to achieve their potential. Specific areas of investment focus at present are specialisation and digitalisation (including digitally enabled manufacturing companies such as Form Technologies and service providers Idemia and MultiPlan); outsourcing (such as recent purchase Civica); and education, with a focus on early years (KinderCare and Guardian Early Learning Group) and international schools (such as Permotio International Learning, which operates the International Schools Partnership brand).

In terms of value drivers over the coming year, Haldner expects contributions from a number of the larger holdings, for example from the ongoing store rollout programme at discount retailer Action, revenue and EBITDA growth at Permotio as a result of M&A and new school openings, and merger synergies at Form Technologies (formerly Dynacast), which now has greater cross-selling opportunities as a result of its expanded customer base. M&A is set to continue to be a theme across the portfolio. Exits are expected to be mainly in the form of trade sales, with the IPO market likely to slow if equity market conditions continue to be more challenging on the back of volatility early in 2018.

Asset allocation

Investment strategy

PEY invests alongside other Partners Group funds and accounts in direct private equity transactions, mainly in the area of mid-cap buyouts, where Partners Group is the lead or co-lead investor. It also co-invests with other private equity managers (for example, top holding Action is an investment alongside 3i), as well as in private debt and, to a lesser extent, private infrastructure investments, overseen by Partners Group. The purpose of the strategy is to deliver long-term capital growth as well as an attractive dividend income, which is funded from a combination of capital and the interest generated by debt investments. PEY has focused primarily on direct investments since 2011 and its remaining mature third-party fund investments are largely in the process of returning capital. The portfolio is diversified, targeting direct holdings in 50-80 companies in order to reduce the volatility of cash flows compared with a more concentrated strategy.

For its direct private equity transactions, Partners Group aims to invest in companies with enterprise values (EVs) of €500m to €2bn. PEY invests in these deals both through Partners Group's direct programmes (its flagship limited partner funds, which are raised every three to four years) and as a co-investor. Partners Group seeks controlling or majority positions in investee companies, either as lead investor or co-lead with another private equity manager. The manager is a relative value investor and as such, investment opportunities should be attractively priced in a historical context and versus relevant peers, as well as offering meaningful top-line growth potential and/or being highly cash generative. To maximise the investment return prospects in the current environment of higher transaction prices, the manager targets companies it deems to have one or more of the following characteristics:

- **Platform companies**: those with strong management teams and infrastructure that can be expanded through add-on acquisitions at favourable valuations;
- **Category winners**: established companies with competitive advantages and differentiated product offerings, that are leaders within their market sub-segment in terms of market share or growth potential, with identifiable growth trends that can be exploited to increase profitability;
- **Defensive leaders:** niche leaders with strong defensive capabilities and high cash flow generation, where business strength can be exploited to develop resilient assets and value creation initiatives can provide the ability to deleverage quickly in uncertain environments.

By taking controlling or majority stakes in investee companies, Partners Group gains board representation and can use its dedicated industry value creation (IVC) team (see below) to help drive through initiatives to enable companies to reach their potential.

PEY co-invests alongside other leading private equity managers in order to add diversification to the portfolio without incurring an extra layer of fees, and as a flexible way to deploy capital that is not dependent on the investment schedule of Partners Group funds. Co-investments are selected to complement the direct investments in the portfolio.

The strategy for private debt investments is twofold: as an additional source of diversification and to boost returns on uninvested cash. The companies Partners Group lends to should have predictable revenues, sustainable margins, stable historical performance and a conservative capital structure. While first-lien senior loan investments (which are held primarily as a source of liquidity) may yield only c 3-4%, second-lien and mezzanine debt investments offer more equity-like returns with yields of c 7-13%. All the debt investments are floating rate, which is more favourable than fixed-rate lending in a rising interest rate environment.

The PEY strategy aims to keep a liquidity buffer of c 5% of net assets, held in cash and senior loans, which can be used if needed to fund dividend payments.

Investment process: Disciplined and highly selective

Partners Group has a highly selective approach to identifying direct private equity investments, with more than 99% of potential deals on average rejected each year. All of the firm's investment teams (covering direct and secondary private equity deals, debt, infrastructure and real estate, as well as the IVC team), along with an industry network including entrepreneurs, CEOs and board members, contribute to idea generation. Partners Group maintains a proprietary database of more than 7,000 private companies, which it can use to identify further targets. Each year, PEY's investment adviser screens around 1,000 deals on average (c 1,500 in FY17) to assess high-level company financials, investment and industry dynamics, market attractiveness, exit scenarios and return potential, and the potential for Partners Group to add value. Following this initial screening, potential deals (185 of 1,482 opportunities in FY17, although this 12.5% conversion rate was low compared to an average of c 20% for the past four years) undergo initial due diligence focusing on both quantitative and qualitative factors. The most promising deals (69 in FY17) are subjected to advanced due diligence, including detailed financial modelling; an in-depth analysis of the business and the relevant industry dynamics; legal terms & conditions and tax implications; and environmental, social and governance (ESG) factors. An investment thesis is constructed, including growth potential, an operational assessment by the IVC team and an exit strategy; and a 100-day plan is drafted for execution of the deal and implementation of value creation initiatives. The outcome of this process is a positive or negative investment recommendation. PEY made eight direct private equity investments (five Partners Group lead/co-lead and three co-investments) in FY17, broadly in line with historical averages.

Partners Group's flagship direct funds are raised every three to four years. PEY makes commitments to these funds and may also make direct 'top-up' investments alongside them. In addition to its flagship direct programmes, Partners Group runs a number of other programmes and separately managed accounts that also participate in direct investments. The allocation of investments across these various programmes is managed by Partners Group's portfolio management team and is separate to the investment process. Taking a top-down perspective, the portfolio management team determines a 'typical commitment size' for each programme. The typical commitment size represents the appetite each programme has for direct investments, and reflects its desired level of diversification. Deals are allocated across the programmes, including PEY, on a pro-rata basis based on their typical commitment size. No individual programme has priority and all are scaled back if the deal is not large enough to satisfy the total appetite. The same process is followed for co-investments with external managers, with PEY participating alongside other Partners Group-managed programmes. New private equity positions are typically 0.5-3.0% of PEY's NAV.

Investee companies are closely monitored by the manager via quarterly performance assessments, active engagement with stakeholders, board representation and the implementation and progress of value creation initiatives. Private equity investments are revalued quarterly by Partners Group (March, June, September and December), or more frequently if there are material changes that may impact the valuation of an investment.

Private debt investments may be made directly or through Partners Group programmes. First-lien senior loans are held mainly as a higher-yielding alternative to cash, while expected returns on second-lien and mezzanine debt are more similar to those from private equity investments.

The weighted average age of investments in the PEY portfolio at the end of FY17 was 3.7 years, with a typical holding period of three to five years. Where an exit from an investment comes as a result of an IPO, the manager will look to sell down the holding within one to two years, subject to any lock-ups, although it has discretion to continue to hold listed companies if there is an investment case to do so.

PEY does not intend to make any new commitments to third-party funds, preferring to focus on Partners Group programmes and co-investments with external managers, allowing the creation of a diversified portfolio without incurring an extra layer of fees.

While it invests globally, PEY hedges its currency exposure to help reduce the impact of fluctuating exchange rates (primarily $/€) on performance. Through instruments such as options and forward contracts, the fund reduces its US dollar exposure (from 33% to 13% after hedging at 31 December 2017) and increases its euro exposure (from 62% to 84%), in line with its reporting currency.

Industry value creation (IVC)

A key element of Partners Group's approach is its IVC team, a 23-strong in-house group of entrepreneurs and senior executives across six industry groups, who act as consultants to investee companies. The IVC team is involved in deal sourcing from the outset and where actionable steps to increase the value of the company cannot be identified, the investment opportunity is likely to be declined. PEY's manager comments that it is unusual to have such expertise in-house, particularly for managers focused on mid-sized companies. Many private equity houses prefer to use external management consultants. The IVC team identifies, initiates and assists with value creation initiatives, starting with a 100-day plan from the point of investment and drawing up a five-year roadmap. There are more than 200 IVC initiatives currently in progress in Partners Group's 2012 and 2016 direct private equity programmes (funds). As an example, value creation measures at current PEY investment KinderCare Education include: putting in place new childcare centre management systems to improve centre-level performance; building new optimised pricing models based on competitor analysis and local demographics; developing a new sales strategy targeting higher-margin areas such as back-up and corporate childcare; and exploring the opportunities for small-scale M&A in highly fragmented local markets.

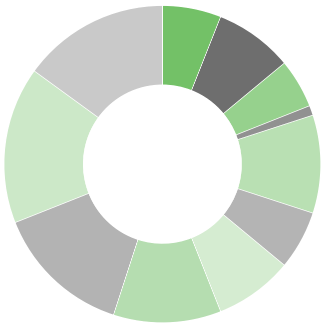
Financial resources and commitments

After a record year of realisations in FY17, PEY began the current financial year (to 31 December 2018) with a net liquidity (primarily cash) position of €88.3m (11.9% of NAV). It also has a €50m borrowing facility with Lloyds Bank, which is currently undrawn, equating to available resources of €138.3m. Unfunded commitments stood at €119.1m at the year-end, including c €50m to the Partners Group Direct Equity 2016 programme (still relatively early in its investment period), €14.8m to the 2012 programme, €2.1m to a 2011 mezzanine debt programme and €18.7m of commitments to single-line direct investments. There is a further €33.5m of unfunded commitments to third-party funds. However, with new third-party fund investments having ceased in 2011, most of these funds are now beyond their initial investment period. Partners Group has assessed that the €22.1m of commitments to pre-2007 vintages is unlikely to be called and the majority of the remaining €11.4m, if called, is likely to be accounted for by follow-on financing and fees.

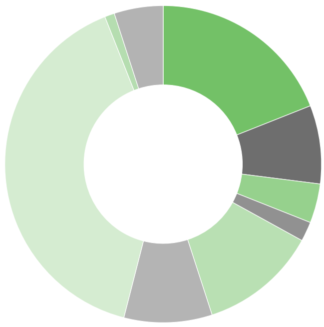
Excluding the borrowing facility and the commitments deemed unlikely to be called, PEY's outstanding commitments were equal to 1.1x its liquid resources at 31 December 2017. Including the €50m borrowing facility, outstanding commitments were 0.7x available resources. Many private equity managers follow an overcommitment strategy to reduce cash drag on money that has been committed to new programmes but is yet to be invested. PEY's strategy is instead to use senior loans to boost yields on short-term liquid resources, and co-investments and higher-yielding debt to even out the pace of investment.

Exhibit 2: Investments and unfunded commitments by vintage

Current portfolio by investment year (%)



Unfunded commitments by fund/programme vintage (%)

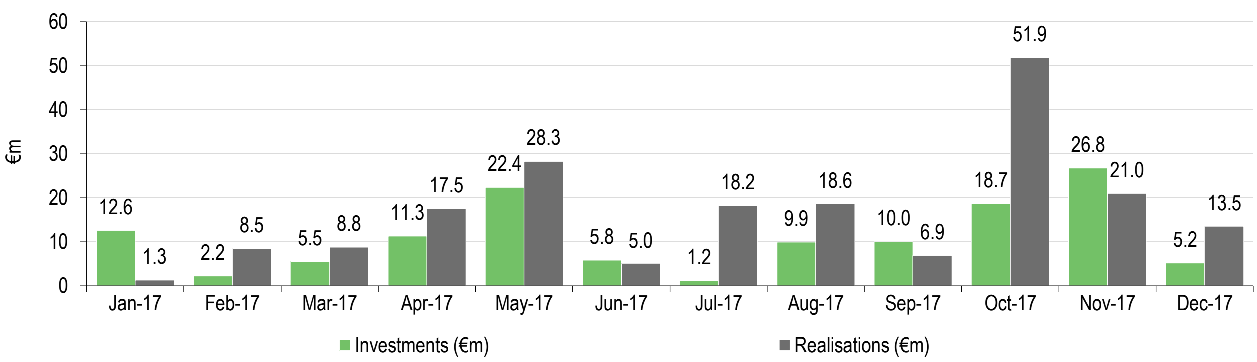


Source: Princess Private Equity Holding, Edison Investment Research. Data at end-December 2017.

Investments and realisations in FY17

The financial year ended 31 December 2017 was one of considerable activity for PEY in terms of both new (and add-on) investments and distributions. Realisations reached a record level of €191.1m, with the two principal drivers being the sale of shares in listed vacuum valve manufacturer VAT Group (the final proceeds of which were received in January 2018) and distributions from the legacy portfolio of third-party funds. Partners Group first invested in **VAT Group** in 2014 and helped to drive value creation initiatives including expansion into East Asian markets, the establishment of a manufacturing facility in Malaysia and the extension of after-sales services. The company listed on the SIX Swiss Exchange in April 2016 and, in line with its strategy of exiting investments after IPO, Partners Group had been selling down its stake in stages. Proceeds for PEY from the divestment of the company during the year came to €78.3m and in total the investment returned 6.0x the invested capital and generated an internal rate of return (IRR) of 74%. Exit multiples on other major divestments in FY17 were more modest, at between 1.3x and 2.7x.

Exhibit 3: Investments and realisations in FY17



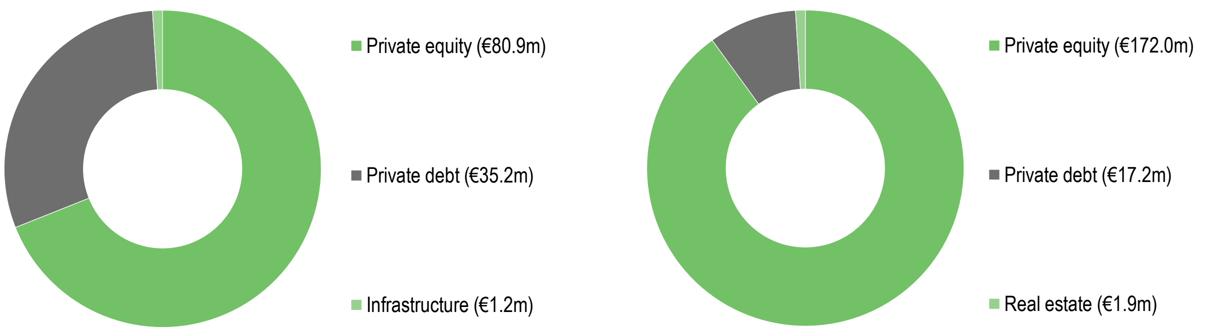
Source: Princess Private Equity Holding, Edison Investment Research

After VAT Group, the next-largest single exit was from the co-investment in speciality mineral company **Kerneos**, with a trade sale in July generating proceeds for PEY of €10.6m, 2.0x the invested capital. Distributions from the legacy third-party funds portfolio during the year totalled c €44m. The development of investments and distributions throughout the year is shown in Exhibit 3. Partners Group also agreed the sale of PEY's sixth-largest holding **Trimco**, a Hong Kong-based supplier of garment labels, tags and trimming products, in January 2018, with the transaction expected to complete in Q118.

New investments (see Recent investment activity, below) totalled €117.2m and were spread across direct investments with Partners Group, co-investments with other managers (c €25m across the year) and debt investments (with direct debt financing to companies outweighed by liquid loan investments made mainly for liquidity management purposes, following a strong period of realisations). The breakdowns of investments and realisations by type are shown in Exhibit 4.

Exhibit 4: Investments and realisations in FY17

New investments by type (€m) | **Realisations by type (€m)**



Source: Princess Private Equity Holding, Edison Investment Research

Recent investment activity

New investment activity in FY17 picked up in the second half of the year, with three of the year's eight largest new equity investments being made in the fourth quarter. In October 2017, PEY invested €12.3m in **Civica**, a UK-based software and outsourcing firm. Civica operates in the UK and internationally, mainly providing services to public-sector organisations such as UK local and national government, healthcare, fire services, police and schools. It has a market leading position in the UK as a software provider to the public sector and Partners Group sees the potential to create value through organic growth in the UK as a result of cross-selling and upselling; building on presence in markets such as Australia and New Zealand to accelerate international expansion; and seeking M&A opportunities in existing and adjacent sectors, both in the UK and internationally.

The next-largest investment, in November 2017, was €11.0m in **US Infrastructure Corporation (USIC)**. PEY's manager argues that under President Trump, there is the political will to invest in improvements in American infrastructure. USIC does not build infrastructure, but is highly geared to a pick-up in spending, as well as having been stable throughout the downturn because of the critical nature of its services. The company is the leading national provider of underground utility locating services for the outsourced '811' market. Under US law, before any excavations can take place on private or public land, a call must be made to 811, where operators then pass on details to location specialists like USIC to determine the location of utilities such as sewage pipes, gas mains and electricity cables. USIC is the leader in terms of both the size of its business and its service standards and Partners Group sees potential to create value through investing in the salesforce and IT infrastructure, expanding the legacy 'private locate' business and pursuing acquisitions.

Also in November 2017, PEY made a €10.3m equity co-investment in **CPA Global**, alongside US private equity firm Leonard Green & Partners. Partners Group had previously had a debt investment in the intellectual property software and service specialist, which has achieved double-digit EBITDA growth over the past five years, driven by consistent increases in the global stock of patents.

In April, PEY completed a €9.7m investment with Partners Group in **Cerba Healthcare**, a European medical laboratory services operator and the market leader in clinical pathology in France, with strong market positions in Belgium and Luxembourg. Partners Group sees potential for strong organic growth as well as a continuation of Cerba's successful track record of acquisitions.

In May 2017, PEY made a €9.0m co-investment with Advent International in the merger of French companies Oberthur and Morpho to create digital security and identification specialist **Idemia**, with a mix of complementary activities addressing the specific needs of five major industries (financial services, telecommunications, identity, security and internet of things).

Another co-investment, this time with Cinven and Bain Capital, was PEY's €6.2m investment in September 2017 in **Stada Arzneimittel**, a Germany-based branded over-the-counter and generic pharmaceutical manufacturer. PEY's manager sees potential for the company to capitalise on its strong market position to increase top-line growth and boost profitability.

In the third quarter of 2017, PEY participated in Partners Group-led investments in Philippines-based business process outsourcing provider **SPi Global** (€4.1m) and UK financial services firm **Key Retirement Group** (€3.4m). SPi Global specialises in the enrichment of published content for education, technical and research publishers, offering services such as digitalisation, database management and analytics. This is a highly fragmented market and as such, there is significant potential to add value by expanding into adjacent market segments and acquiring smaller competitors. Key Retirement Group is a market leader in the provision of specialist advice and financial products for individuals approaching or in retirement. Partners Group sees the opportunity to create value by improving adviser productivity through the use of technology, strengthening marketing capability and exploring cross-selling opportunities in non-retirement financial products.

Add-on investments totalling €12.4m were made during the year in existing portfolio companies including **Dynacast** (since renamed **Form Technologies**), **Permotio International Learning** and **Partners Group Pacific Restaurant Holdings** (all to fund acquisitions of complementary companies or additional sites); UK-based disability support provider **VoyageCare** (to strengthen the financial position and decrease borrowing costs); and Brazilian fruit and vegetable producer **Hortifruti**, where Partners Group's additional investment gave it a controlling stake.

The principal private debt investments during FY17 were c €5m each in French fresh food retailer **Prosol** and a European sports rights company, c €4m to support Advent in the acquisition of Morpho (merged with Oberthur to form Idemia) and a €2.3m mezzanine investment in **Caffè Nero**, as well as investments in liquid senior loans for cash management purposes.

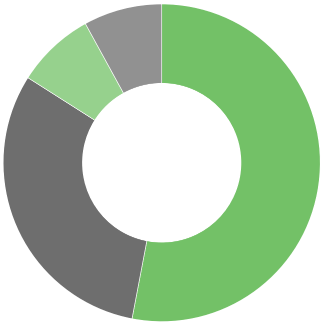
Current portfolio positioning

PEY's strategy is to hold 50-80 direct investments (including co-investments), although it also has a legacy portfolio of c 50 third-party fund investments (18% of the portfolio) that are largely in realisation mode. At 28 February 2018, the top 10 direct holdings accounted for 36.2% of the portfolio, which was a lower level of concentration than the 40.4% at 28 February 2017, largely owing to the divestment throughout the year of VAT Group, previously the largest holding. The top 50 direct investments accounted for c 70% of the total portfolio.

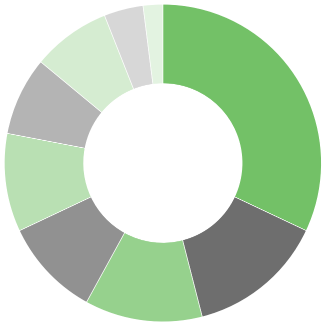
The PEY portfolio is broadly spread by geography (Exhibit 5, left-hand chart), with a tilt towards western Europe. Over the 12 months to 28 February 2018, the Europe exposure was unchanged, while rest of the world rose slightly (+1pp), and North American exposure fell by 1pp. Following the announced exit from Trimco (2.6% of the portfolio at 28 February 2018), the Asia Pacific exposure, which had been stable year-on-year, is expected to decline. Looking forward, PEY's manager sees significant opportunity in companies geared to infrastructure spending in the US (such as new investment USIC). In the UK, they prefer areas unaffected by Brexit negotiations, such as software services and applications. Business process outsourcing and specialist software are key focuses in Europe, where both the private and public sectors are undergoing cost rationalisation, while Asian and emerging markets investments are geared to the growth of the middle class, in areas such as personal health, education (particularly early years and English teaching) and e-commerce.

Exhibit 5: Investments by geography and sector

Investments by geography (%)



Investments by industry sector (%)



Source: Princess Private Equity Holding, Edison Investment Research. As at 28 February 2018 (geography)/31 December 2017 (sector).

Sector positioning (Exhibit 5, right-hand chart) reflects the thematic focuses, with consumer discretionary stocks (a sector that includes education as well as the more obvious shopping and leisure activities) making up nearly one-third of the portfolio at 31 December 2017, up 3pp year-on-year. Information technology was 4pp higher than a year earlier, in line with the digital transformation theme and boosted by new investments such as Civica. The major reduction over the 12 months was in industrials (-8pp), which is mainly attributable to the exit from VAT Group.

Exhibit 6: Portfolio by sponsor type (% unless stated)

	Portfolio end-December 2017	Portfolio end-December 2016	Change (pp)
Partners Group lead/co-lead	59.0	52.0	7.0
Funds	18.0	25.0	(7.0)
Debt	12.0	10.0	2.0
Co-investments	11.0	13.0	(2.0)
Total	**100**	**100**	

Source: Princess Private Equity Holding, Edison Investment Research

The proportion of the portfolio in direct investments rose over the 12 months to 28 February 2018 from 77% to 82% as the legacy funds continued to return cash. The PEY portfolio remains heavily biased towards buyout transactions (see Exhibit 1), with only two of the top 10 holdings (growth capital investment Permotio and infrastructure holding Fermaca) being outside this category.

Portfolio company valuations

As shown in Exhibit 7, the weighted average EV/EBITDA multiple (a valuation measure derived by dividing the enterprise value of a company by its earnings before interest, tax, depreciation and amortisation) for the 50 largest direct equity holdings in the PEY portfolio was 12.2x at the end of 2017. This compares with 11.2x at the end of 2016, although the higher multiple should be seen in the context of the rise in listed company valuation multiples over the same period. PEY's manager also stresses that strong EBITDA growth (+13.1% in FY17) means valuations still look reasonable. Partners Group's relative value approach, targeting companies that look reasonably priced relative to peers and their own history, aims to ensure the manager does not overpay for growth.

Exhibit 7: Valuation and performance metrics for direct portfolio in FY17

Valuation metrics		Performance metrics	
EV/EBITDA	12.2x	Revenue growth	11.7%
Net debt/EBITDA	4.7x	EBITDA growth	13.1%
Leverage	40.6%	Weighted average revenue	€1.1bn
Weighted average EV	€2.3bn		

Source: Princess Private Equity Holding, Edison Investment Research

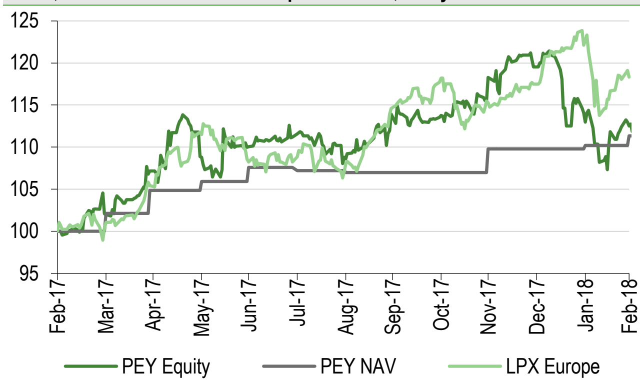
Debt levels have also risen over the 12 months, with the weighted average net debt/EBITDA multiple of the 50 largest direct equity holdings moving from 4.1x at 31 December 2016 to 4.7x at 31 December 2017. The rise was partly as a result of changes in the investment mix, and partly due to recapitalisations at KinderCare Education and Hoffman Menue Manufaktur, which, having deleveraged since PEY's initial investment, were able to refinance to release cash to investors. However, PEY's manager sees the current level as continuing to illustrate a disciplined approach to leverage, with the market average net debt/EBITDA multiple for leveraged buyouts in recent years having been consistently around 5.0x in both Europe and the US.

Performance: Strong absolute record since refocusing

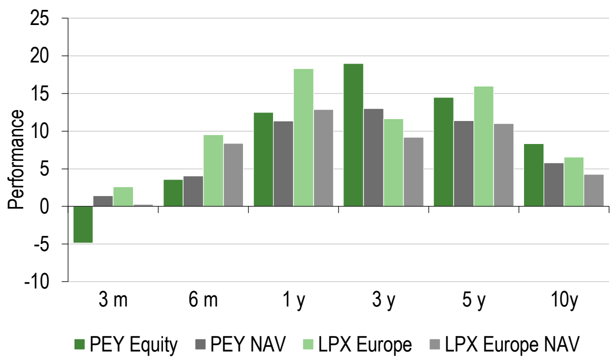
PEY's shares had a particularly strong year in 2017, before declining in January into February to post a one-year total return below that of the LPX Europe index of private equity funds (Exhibit 8). The NAV total return was also below the LPX Europe NAV total return over one year, but has matched or beaten the index NAV return over three, five and 10 years. Over the past five years (covering the period since the manager refocused on direct investments rather than third-party funds), PEY has produced an NAV total return of c 11% pa in euro terms, underperforming the MSCI World index but outperforming the UK FTSE All-Share (Exhibit 9). As shown in Exhibit 10, the NAV total return is well ahead of the LPX Europe NAV return over 10 years; although PEY underperformed the index for most of the period from 2012 to late 2014 while the portfolio was being repositioned (the sale of funds in the secondary market meant PEY had a high level of uninvested cash), it has largely outperformed since then.

Exhibit 8: Investment company performance to 28 February 2018 in euro terms

Price, NAV and index total return performance, one-year rebased



Price, NAV and index total return performance (%)



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

Exhibit 9: 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 LPX Europe	3.2	(7.3)	(5.4)	(4.9)	21.1	(6.1)	18.1
NAV relative to LPX Europe NAV	0.9	1.1	(4.0)	(1.4)	10.8	1.9	15.5
Price relative to MSCI World	1.7	(5.0)	(2.6)	9.4	42.1	7.4	(4.1)
NAV relative to MSCI World	3.1	1.3	(2.2)	8.3	21.8	(6.3)	(24.3)
Price relative to FTSE All-Share	4.0	(3.8)	0.2	11.7	72.8	42.3	37.7
NAV relative to FTSE All-Share	5.5	2.5	0.7	10.6	48.1	24.1	8.7

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-February 2018. Geometric calculation.

The main drivers of NAV performance in FY17 (to 31 December, in terms of absolute value created) largely came from among the top 10 holdings. The stake in listed vacuum valve manufacturer VAT Group (now fully exited) contributed a net €31.6m to performance, while discount retailer Action (+€23.3m) and Form Technologies (formerly Dynacast; +€10.8m largely as a result of merger synergies) also made double-digit contributions. Other top contributors included the following:

- €8.0m from Permotio International Learning (the only growth capital rather than buyout investment in the list);
- €7.3m from Trimco (sale announced post year-end, which will generate c €24m of proceeds);
- €6.4m from MultiPlan 2016 (a minority stake in the US healthcare cost management consultancy, which was retained after Partners Group sold its majority holding to Hellman & Friedman in 2016);
- €5.0m from KinderCare Education (partially divested during the year through a recapitalisation);
- €4.8m from Global Blue, a tourism shopping tax refund company; and
- €2.9m from French estate agent and property manager Foncia.

Only one of the 10 biggest value drivers in FY17 (Project Sun, -€3.8m) was negative. The company, which makes components for the solar power industry, was written down in value in Q417 as a result of ongoing operational difficulties.

Exhibit 10: NAV total return performance relative to LPX Europe index NAV over 10 years

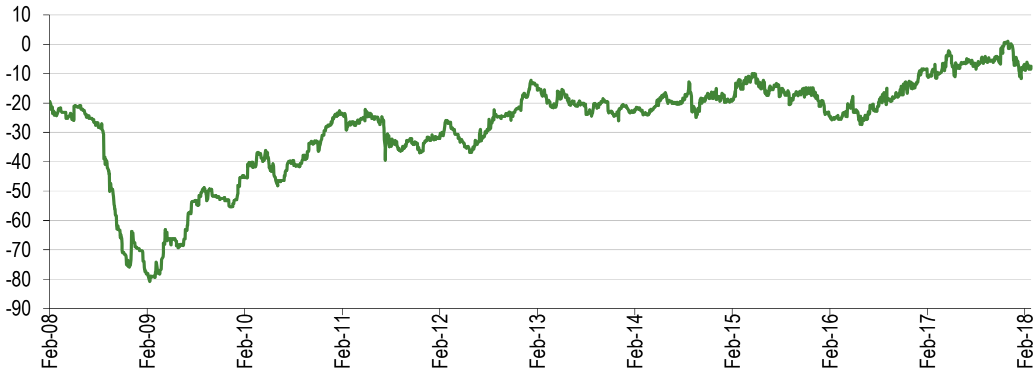
Source: Thomson Datastream, Edison Investment Research

Discount: Long-term narrowing trend

At 4 April 2018, PEY's shares traded at a 7.0% discount to net asset value. This is wider than the one-year average of 5.9%, but narrower than the three-, five- and 10-year averages of 13.5%, 16.1% and 27.5% respectively. Following a prolonged period of discount narrowing for most listed private equity funds from mid-2016, PEY briefly reached a premium of 1.0% in late December 2017. The recent equity market volatility saw discounts widen somewhat (PEY's was 11.6% in mid-February), although the current discount is still comfortably below the AIC Private Equity (excluding 3i) sector average of 15.8% at 4 April.

In common with most private equity funds launched before the global financial crisis, PEY saw a significant widening in its discount in 2008/9, reaching 80.8% as the stock market bottomed in March 2009. It has broadly been on a narrowing trend ever since, bolstered by the decision in October 2010 (when the discount was c 50%) to reposition the portfolio to focus more on direct investments, increasing portfolio transparency and reducing unfunded commitments. A share buyback authority was also granted in 2010, allowing for up to 14.99% of shares to be repurchased annually to manage a discount. However, the last time this was used to any significant extent was in 2011, when a little over half a million shares were bought back for a total of €3.2m.The board and management also view the dividend policy (aiming to pay out 5-8% of NAV each year) as a key factor in limiting the discount, as it gives visibility over the likely payout, as well as offering an attractive yield. Since the post-crisis resumption of dividend payments in May 2011, PEY's discount has narrowed from c 40% to par.

Exhibit 11: Share price discount to NAV over 10 years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

PEY is structured as a limited liability investment holding company, domiciled in Guernsey. Having cancelled its Frankfurt listing in December 2012, the company is now listed solely in London, with all the shares denominated in euros until the introduction of a second market quote in sterling (PEYS) in September 2017. There are 69.2m shares in issue. The board has the authority, renewed annually, to buy back up to 14.99% of the shares, or to allot new shares up to the equivalent of 10% of the issued share capital, in order to manage a discount or a premium. However, no shares have been issued or repurchased under this authority since FY14.

Borrowing is available via a €50m revolving multicurrency facility with Lloyds Bank, which if drawn would represent gross gearing of c 6.7% of NAV. The loan has an interest rate of 2.95pp above Libor or Euribor if the loan-to-value (LTV) ratio is less than 15%, or 3.25pp above if the LTV is more than 15% (subject to a maximum LTV of 25%), with a commitment fee of 0.90% on undrawn sums. The loan facility runs until December 2020 and is currently undrawn. At 31 December 2017, PEY had liquid resources of €88.3m (11.9% of NAV) in cash and senior loans.

Partners Group receives an annual management fee of 1.5% of NAV, paid quarterly in arrears. This has been standardised across the whole portfolio since the beginning of FY13 (previously the management fee levels were different for primary, secondary and direct investments). Incentive fees (performance fees) may be paid subject to certain conditions. There is a hurdle rate of 8% pa compound on both direct and secondary investments. If annualised returns are above this level, the investment manager receives incentive fees up to 10% of the excess return on secondary investments and up to 15% of the excess return on direct investments. These fees are calculated individually for each investment, rather than across the whole portfolio.

For FY17, Partners Group received management fees of €11.2m and incentive fees of €6.0m. We calculate PEY's ongoing charges for the year to be 1.78% excluding performance fees and 2.59% including performance fees (FY16: 1.64% and 3.51%).

Dividend policy and record

PEY has a long-standing policy of targeting annual dividends equivalent to 5-8% of NAV, paid annually in two instalments. While this is only a target and not a guarantee, it has been achieved in each of the last seven financial years (a range of 5.2% to 6.7% based on the NAV at the start of each year). For FY17, total dividends of €0.56 were paid (€0.28 each in June and December), an increase of 3.7% on the previous year and representing 5.3% of NAV. Dividends are declared in euros but, since the introduction of the sterling listing in September 2017, investors can elect to have their dividends paid in sterling. A dividend reinvestment plan is also available for investors who prefer to use the payment to buy further shares rather than receiving an income.

While the private debt investments in the portfolio provide a source of income to help support the dividend, the majority of the payout has historically been funded from distributable reserves. The manager focuses on cash flow rather than revenue cover, and in FY17, gross realisations in the portfolio covered the dividend by 4.9x. Based on the 4 April 2018 share price and the FY17 total dividend, PEY's shares currently yield 5.5%.

Peer group comparison

Exhibit 12 below shows PEY's performance in sterling terms alongside a peer group of mainly UK-listed private equity funds. The peers follow a variety of strategies, from wholly or largely direct to wholly or largely fund of funds, with some secondary and co-investments. Several of the peers may, like PEY, make debt as well as equity investments.

PEY's market capitalisation in sterling is a little above average. Its NAV total return performance in sterling terms is in line with or above average over one, three and five years and below average over 10 years. Its share price total return performance is below average over five years but broadly in line with or above average over one, three and 10 years. One of the peers (Deutsche Beteiligungs) trades on a substantial premium to net asset value because of the implied value of its own asset management business. Excluding this, PEY's 7.0% discount to NAV is much narrower than the 16.2% average for the group. Its dividend yield of 5.5% is the second-highest in the peer group.

Exhibit 12: Listed private equity investment companies peer group, as at 4 April 2018*

% unless stated	Country focus	Mkt cap £m	NAV TR 1 year	NAV TR 3 years	NAV TR 5 years	NAV TR 10 years	Price TR 1 year	Price TR 3 years	Price TR 5 years	Price TR 10 years	Premium/ (discount)	Dividend yield (%)
Princess Private Equity	**Global**	**609.9**	**13.0**	**76.4**	**77.1**	**104.8**	**16.6**	**105.4**	**102.2**	**158.0**	**(7.0)**	**5.5**
Apax Global Alpha	Global	663.0	5.5	--	--	--	(1.6)	--	--	--	(13.8)	6.2
Deutsche Beteiligungs AG	Europe	501.2	27.1	81.8	107.4	182.4	58.7	135.8	216.6	478.7	25.7	3.1
Electra Private Equity	UK	317.0	4.7	86.4	140.6	199.3	9.5	83.2	154.7	240.0	(25.7)	0.0
F&C Private Equity Trust	Global	266.2	5.5	44.1	70.3	95.2	14.7	68.4	110.9	130.8	2.6	3.9
HarbourVest Global Priv Equity	Global	947.2	3.4	48.4	89.4	184.3	1.2	43.8	130.1	162.9	(20.1)	0.0
HgCapital Trust	UK	658.8	20.6	70.4	77.7	151.4	13.7	73.5	78.0	161.3	(6.0)	2.6
ICG Enterprise Trust	UK	545.8	9.8	46.3	63.7	109.3	22.2	57.7	100.7	120.2	(13.4)	2.5
JPEL Private Equity	Global	229.1	1.7	51.5	63.2	42.6	4.0	83.2	141.3	34.4	(12.7)	0.0
Oakley Capital Investments	Europe	347.7	6.1	24.5	38.3	152.8	6.0	3.1	10.4	70.3	(30.1)	2.7
Pantheon International	Global	1,022.8	7.4	48.3	72.2	113.3	9.1	42.5	100.0	108.5	(13.7)	0.0
Standard Life Private Eq	Europe	492.0	13.8	67.5	92.3	80.2	18.9	81.3	102.5	78.8	(17.4)	3.9
Symphony International Hldg	APAC	274.2	8.8	30.5	36.1	160.0	(3.7)	52.5	80.0	151.0	(37.0)	4.4
Average		**528.8**	**9.8**	**56.3**	**77.3**	**131.3**	**13.0**	**69.2**	**110.6**	**157.9**	**(13.0)**	**2.7**
PEY rank in sector		**5**	**4**	**3**	**6**	**9**	**4**	**2**	**7**	**5**	**4**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance data to end-February 2018. TR=total return. All returns expressed in sterling terms.

The board

There are six non-executive directors on the board of PEY, four of whom are considered independent. Brian Human joined the board in 2003 and was appointed chairman in 2009. Originally from South Africa, he emigrated to the UK in 1973 and spent more than 40 years working in banking and finance. Richard Battey, chairman of the audit committee, became a director of PEY in 2009. A resident of Guernsey, he is a qualified chartered accountant and spent the majority of his professional career at investment management company Schroders. Fergus Dunlop also joined the board in 2009, having previously worked in institutional investment advice and sales. He has recently been appointed as a non-executive director of Partners Group (Guernsey), which provides administrative services to PEY, and is thus no longer considered an independent director. Henning von der Forst was appointed in 2012 and was previously chief investment officer of Nuernberger Insurance Group. Two new directors were appointed in 2017. Felix Haldner (August 2017) is a partner at Partners Group, with responsibility for strategic client development and public affairs. Because he is employed by PEY's investment manager, he is deemed non-independent. Stephen Le Page (September 2017) is a qualified chartered accountant and Guernsey resident who holds a number of other directorships. Urs Wietlisbach, a director and co-founder of Partners Group, who chairs its markets committee, resigned from the board of PEY in August 2017.

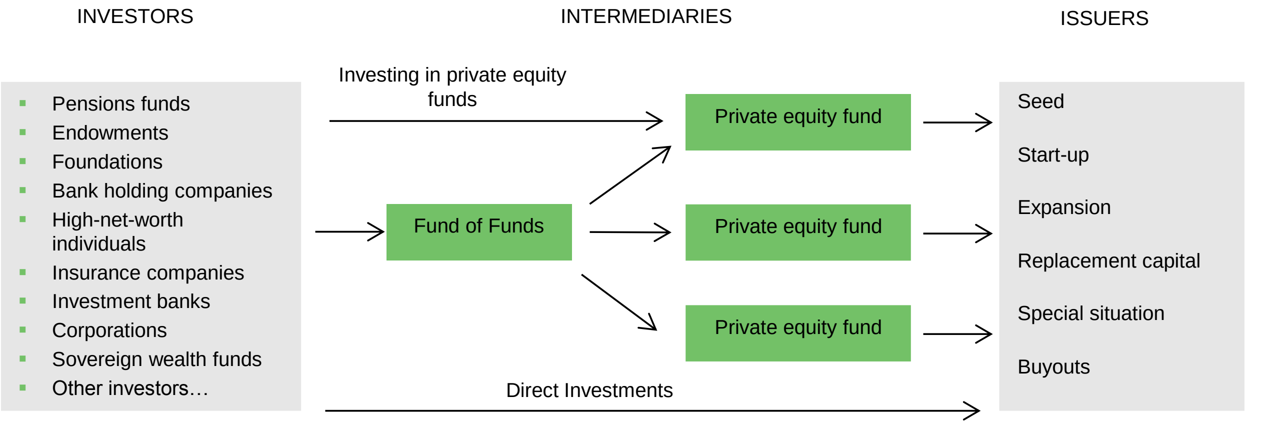
Appendix: Private markets background

Private equity is a form of funding that enables companies to access capital without seeking a stock market listing. Broadly, the finance available falls into three areas: venture capital, funding start-ups and early-stage companies; growth capital, to fund expansion; and buyout financing, which enables a change of ownership of an existing company, often taking it into the hands of its managers (management buyout). Private equity funding may also be used in situations such as replacement capital (for example, where a founding shareholder wishes to realise their investment), or cases such as rescuing and restructuring companies in financial distress. Private debt broadly refers to non-bank lending to private companies, often medium-sized or smaller firms that have limited access to capital markets, and may be used to fund growth, add-on acquisitions, or ongoing business activities.

Direct private equity investment is usually undertaken by specialist firms, which may offer expertise as well as investment, helping to refocus or restructure businesses through operational and/or board involvement. These firms, known as general partners (GPs), may structure portfolios of their investments as a fund, typically with a fixed life and containing a mix of investee companies. Such funds are usually structured as limited partnerships and the investors in them are known as limited partners (LPs). Sometimes private equity investments may be sold in the market rather than being held by the GP until maturity; this is known as a secondary investment.

In comparison to listed equities, private equity investments are relatively illiquid. Funds are committed to the GP for a set period of time, and may not all be drawn at the outset, so further funding commitments may be attached to an investment. In addition, underlying holdings are valued periodically, usually quarterly, so a time lag is inherent in the reported NAV of a listed private equity fund. The trade-off for illiquidity and relative lack of transparency is the greater growth potential of earlier-stage companies or those undergoing transformation, although equally, less established companies or those with a troubled history will carry a higher level of risk. While these risks cannot be mitigated entirely, investing via a listed private equity fund can give the smaller investor access to a more diversified portfolio and the benefit of a team of experienced investors selecting and monitoring the underlying holdings. The addition of private debt to a portfolio can boost returns on cash awaiting investment (as the interest charged is typically higher than on bank lending), with a balance of risk and reward available according to the position of the debt in the company's capital structure – from senior secured lending, which has the first call on a company's assets in the event of financial distress, to higher-yielding mezzanine finance, which shares characteristics with both equity and debt.

Exhibit 13: Private equity market schematic



Source: The CityUK, Federal Reserve Bank of Dallas, EVCA/Thomson Reuters/PricewaterhouseCoopers

The size of minimum investment required from an LP in an unlisted private equity fund puts these vehicles out of reach of most individual investors, although as shown in Exhibit 13 above, they may be accessed by pension funds and other institutional investors. Individual investors can access the asset class by investing in a listed private equity fund. Listed funds benefit from having a permanent pool of capital that allows the formation of a stable portfolio without the need to sell investments to meet redemption requests. The corollary to this is that when demand for such strategies is low, investors who wish to sell may have to settle for a price significantly below the underlying asset value, although the quoted share price gives visibility over the prevailing discount to NAV at which the investment can be traded. Listed private equity funds may make investments directly or in a portfolio of underlying funds (fund of funds); while PEY historically had more of a fund of funds approach, since 2011 it has focused increasingly on direct investments with Partners Group.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia