



HARDMAN&CO.



# Investment Companies

Understanding the deepest discounts

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# Executive summary

At Hardman and Co, we try to answer the questions of why to invest in a company and what the risks are in doing so. For many investors, simply having a deep discount to NAV is a good enough answer to the first question. However, investors need to appreciate the risks and, in particular, the reasons why the shares are at a discount. Having understood those risks, investors need to be convinced that there is a catalyst for change on the part of the manager and how long (if at all) it will take for market sentiment to reflect this in a lower discount. In this report, we examine the companies with the largest discounts and review those very issues.

Our key conclusion are as follows.

Multiple factors compound discount for the companies in this report

- ▶ The largest discounts reflect the compounding effects of multiple factors at play. Indeed, for every company in this report, we have identified more than one issue. While one factor, such as legacy performance, may be the major influence, the discount is materially worsened where other factors, such as corporate governance, play a role. Addressing all the issues is likely to materially accelerate discount reduction.

Legacy issues may have been addressed but investors need convincing

- ▶ In each case where we have identified legacy issues as a factor, the company has either “gone back to basics” or fundamentally restructured – so the outlook is fundamentally different from when the legacy event occurred. As the real risk has changed, the issue for investors is confidence that the manager can improve sentiment and convince potential buyers it will be different going forward.

Other risks include i) asset liquidity, ii) cyclical, iii) competition, iv) regulation

- ▶ There is some correlation between stress-test scenarios disclosed in the Key Information Documents (KIDS), i.e. a prospective share price performance risk measure, and the level of the discount. We caution against over-reliance on this, given the nature of the calculation, and note the many exemptions to this rule. We do believe that some discounts are driven by prospective risks, rather than historical ones. We have identified the following factors: i) illiquid assets; ii) sensitivity of returns to macro drivers, including the cycle; iii) competitive pressures; and iv) regulation. We believe many of these are at least partially built into the valuation of assets.

Company-specific risks in concentration and key staff, which are part of investment case

- ▶ We have identified a range of other prospective issues, including concentration and diversity risk, and key staff dependency. In the main, we believe these reflect the underlying business model of the company and are unlikely to change. While a deterrent to some potential investors, they are also the reason why many of the buyers bought the company in the first place.

Where accounting is driven by assumptions, key considerations are realised prices against last valuation – shows management conservatism

- ▶ We note that the accounting valuation for some of the businesses is driven by assumptions. There are some notable exceptions, such as where the assets are entirely, or nearly entirely, valued off liquid market prices, but several of the companies in this report have illiquid assets valued using models. We believe the key test here is what have been the realised prices relative to recent valuations. This is indicative of management conservatism. It does not mean that future assets will be sold at book, but it is a good indication that there is a cushion should market conditions worsen. It also requires a several disposals to prove consistency in approach.

## Understanding the Deepest Discounts

On average, fees higher for companies in this report than for market. However, no correlation between fees and discounts for companies within this report.	<ul style="list-style-type: none"> <li>▶ On fees, we note that every company covered in this report has KID-disclosed fee levels that are above the average for investment companies (ICs) as a whole (on average, 3x market levels). However, we also note that there is no correlation between fees and discounts among these companies. KID disclosure is also far from perfect (including, for example, debt financing costs). In addition, we note that the type of asset often requires a higher cost to be managed effectively and gives investors diversified risk. The fees must be considered in the light of risk-adjusted returns, as we believe investors are willing to pay for businesses with a long track record of higher returns, given their superior net return. Overall, we conclude that high fees, in isolation, are unlikely to drive the biggest discounts.</li> </ul>
Corporate governance an important issue. We estimate non-voting structure could add 5%-10% to discount levels.	<ul style="list-style-type: none"> <li>▶ We believe corporate governance is an important issue for several companies in our report. In particular, we note situations where the public shareholders do not have controlling votes. We appreciate that, for the companies/management, this could provide further assurance of committed long-term capital, allowing them greater flexibility for conviction investments. However, we note that non-voting shares typically trade at a discount to voting shares. Our analysis indicates that this could account for 5%-10% discounts, compounding the effect of other issues.</li> </ul>
Major shareholders and related party transactions also important	<ul style="list-style-type: none"> <li>▶ We also note that major shareholding and related party transactions may have an influence on sentiment, liquidity and potential buybacks – and so on the level of discount.</li> </ul>
Fewer than half the companies in this report used buy-backs in past year	<ul style="list-style-type: none"> <li>▶ We note that fewer than half of the companies in this report have used buy-back discount-management techniques over the past year. The approaches have varied from single tender offers all the way through to daily dealings. We believe the boards are balancing the obvious advantages of such techniques with the facts that buybacks also i) may not be the best use of capital, ii) worsen expense ratios and leverage, iii) restrict further investments, and iv) send confusing messages to investors and staff. Clearly, the balance is driven by the level of discount.</li> </ul>
Anecdotally, size important (especially sub- £100m market capitalisation), but no correlation for companies in this report	<ul style="list-style-type: none"> <li>▶ We have also considered, and largely dismissed, a range of other factors, such as: <ul style="list-style-type: none"> <li>○ <b>Size:</b> Anecdotally, ICs under £100m face greater hurdles, convincing investors of their story. However, we found no correlation between market capitalisation, average deal size or shares traded and the level of discount. We also note that the largest nominal discount is ca.£1bn in a company whose assets are largely valued off liquid market prices.</li> <li>○ <b>Gearing:</b> We note that only a few of the companies in this report have any gearing and only two have debt/preference shares in excess of 80% of equity. More than half have zero leverage. There could, of course, be further gearing within the investments (and this may especially be a factor for private equity) but, at the IC level, we do not believe this is a material factor.</li> <li>○ <b>Comparison with accounting NAV:</b> We note that comparison with an accounting NAV may not be the most appropriate valuation measure, that the KID disclosure may not be helpful, and that sector classification can be issue. We do not believe that these factors are material drivers for all of the ICs' discounts, though.</li> </ul> </li> </ul>
Only modest gearing in these companies, although likely to be further gearing in underlying investments	
Discount to NAV not always best measure when business more of a trading company than investment company	
Companies in wind down have very specific features	<ul style="list-style-type: none"> <li>▶ We believe that companies in wind down/harvesting/realisation mode face specific issues around the realisable value of the assets and the likely costs of closure, which can lead to material discounts to NAV. We think these companies should be considered as a specific sub-set given their unique characteristics.</li> </ul>

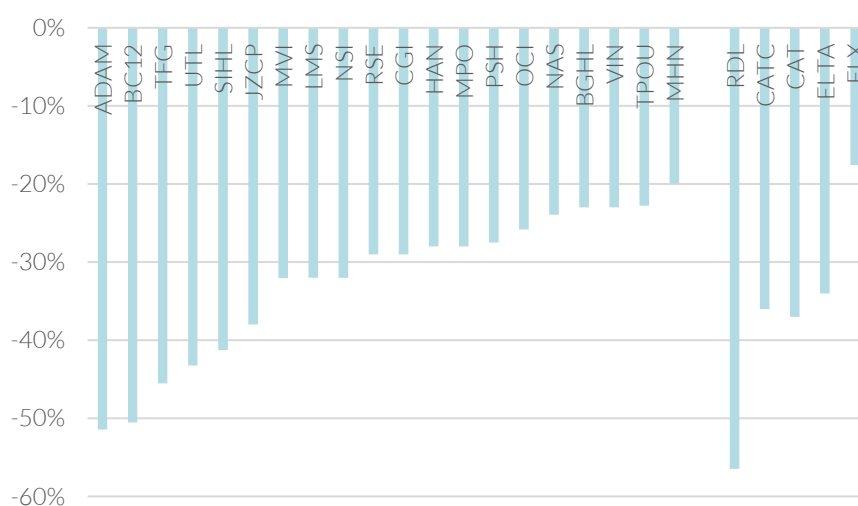
## Understanding the Deepest Discounts

### Communication hugely important

- For many of the ICs, the investment story has become complicated by the factors above, and historical investors may have suffered the double whammy of falling NAVs and widening discounts. Convincing new investors that it is worthwhile getting to know the details can be challenging. Investors may take time to be persuaded by managers' statements alone. By their nature, some of the issues are complex, and often it is helpful to make cross-party comparisons, which may not be appropriate for only one company. We believe that companies devoting resources to communicating what has been done to the broadest possible audience may be expected to see the reduction in discount significantly accelerated.

The table below shows the discounts for ICs with total assets exceeding £50m. Details of each company, its portfolio and core characteristics are shown in Appendix 1.

**Discounts for ICs with gross assets >£50m (%)**



Source: Company Report and Accounts, Hardman & Co Research

## Understanding the Deepest Discounts

Summary of issues driving discounts	
Issue	Tickers for companies most affected
<b>Historical risk: legacy issues</b>	
Performance, corporate governance, strategic change	ADAM, LMS, MHN, PSH
Other legacy issues (including historically high discount)	CGI, HAN, JZCP, OCI, TFG, VIN
<b>Prospective risk</b>	
Share performance risk (KID stress scenario >60%)	ADAM, BC12, HAN MHN, MPO, NAS PSH, RSE, SIHL, TPOU, MHN
Volatility	
Asset illiquidity	ADAM, BC12, BGHL, JZCP, LMS, MPO, MVI, OCI, RSE, SIHL, TFG, VIN
Cyclicality	ADAM, BC12, JZCP, LMS, MPO, MVI, OCI, RSE, SIHL,
Competition impacting re-investment returns	ADAM, BC12, JZCP, LMS, SIHL,
Regulatory risk	Mixed
Concentration risk by number of assets	ADAM, BC12, HAN, LMS, MVI, MHN, MPO NAS, OCI, PSH, RSE, UTL
Diversity risk by asset classes	HAN, JZCP, MHN, NSI, TFG, UTL
Key staff	JZCP, PSH, TPOU
<b>Accounting</b>	
Assumption-driven valuation	ADAM, BC12, JZCP, LMS, MPO, OCI, RSE, SIHL, TFG, VIN,
Where accounting rules are not helpful	Businesses whose underlying rationale is more operational than investment
<b>Fees</b>	
	ADAM, BGHL, JZCP, LMS, MPO, OCI, PSH, TFG, TPOU, VIN,
<b>Corporate governance</b>	
Majority shareholders (top 2 > 50%).	ADAM, HAN LMS, MVI, NSI, UTL
Voting structure	PSH, TFG
Related party transactions	ADAM, NAS
Discount management (programmes executed in past year)	ADAM, JZCP, MVI NAS, PSH, TPOU, TFG, UTL,
<b>Other factors to consider</b>	
Gearing (debt/prefs. > 80% NAV)	MPO, UTL
Size (under £100m mkt cap)	ADAM, BC12, LMS, MHN, MPO, MVI, NSI
Where NAV is the wrong approach	Businesses which are really trading rather than investments
KID disclosure	ALL
Sector classification	NAS
<b>Complexity of story</b>	<b>ALL</b>

Source: Hardman & Co Research

# Historical risk: legacy issues

## Summary

Degree to which legacy issues will impact on discount depends on i) cause of loss, ii) duration of loss, iii) scale of loss, iv) what has changed since, v) churn in shareholder register

We believe investors focus on risk with both a forward-looking perspective and also in the rear-view mirror. The degree to which legacy issues continue to affect the current level of discount will depend on the following.

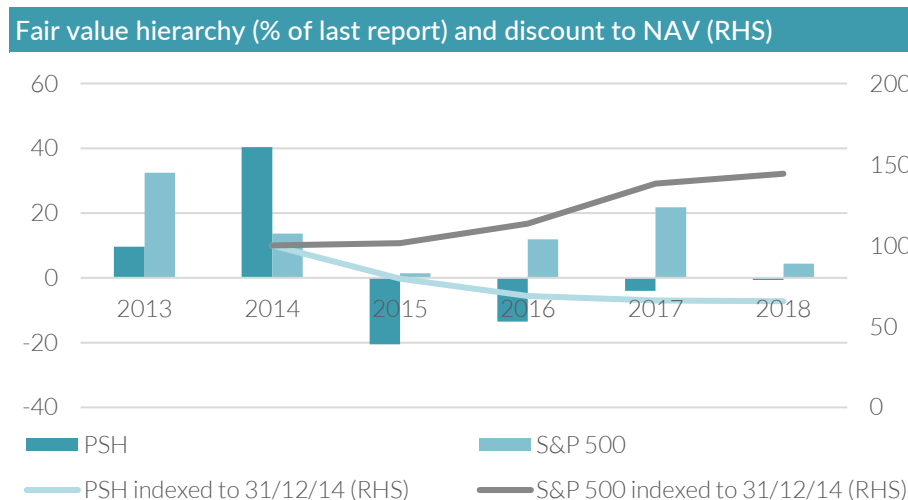
- ▶ The nature of the loss event, and in particular to what extent it was driven by current management action. In many cases, the loss event diverted off the core approach/ principles of the business that may have been re-imposed more recently. Investors need to be convinced that this is the case.
- ▶ The duration of the loss event before corrective action was taken.
- ▶ The scale of the share price correction. Investors will have seen not only a falling NAV but their losses will also have been compounded by a larger discount to NAV.
- ▶ The corporate actions that have been taken post the event.
- ▶ The churn in shareholder register. If there remain significant numbers of shareholders who have suffered the loss, and have been scared by it, there may be more sellers into future share price rallies

## Performance: case study PSH

PSH discount ca.£1bn for business where NAV is market price-driven (and so “clean”), the shares are liquid, and long-term performance has been excellent

We see some element re voting structure and a concentrated portfolio, but main driver is poor performance in 2015-17

Pershing Square Holding’s (PSH’s) market capitalisation is ca.£3bn, but it trades at a discount of 28% to NAV. It has delivered a 40% year-to-date (YTD) to April NAV accretion in 2019 but the discount has been stable – the widest in the company’s history. As we note in the section on accounting below, the NAV is market price-driven and not assumption-driven (89% of assets are on a level 1 accounting basis and have open and liquid markets, with the residual 11% on level 2 where there are significant observable inputs). The shares are highly liquid (66 million shares traded on the LSE alone in the year to end-March 2019). So what is driving the discount? We estimate that ca.5%-10% may be attributable to the voting structure (see section on corporate governance below) – and it is a highly concentrated portfolio – but there remains a huge nominal discount, which we believe relates to historical performance under a different investment regime.



Source: Company Report and Accounts, Hardman & Co Research



## Understanding the Deepest Discounts

Loss from investments undertaken away from core principles, and, as a long-term investor, positions held over extended period, despite further losses

Changes since i) return to core investing principles, with performance in 2019 YTD 40%, ii) improved corporate governance, iii) tender offer, iv) quarterly dividend

Stellar 2019 performance, given exit option to investors pre-loss, but also led to profit-taking by recent investors

OCI has changed several aspects of its corporate governance, which, over time, has seen the discount partially reduce

As can be seen in the chart above, after a strong 2014 (returns 3x S&P 500), PSH reported significantly weaker returns in 2015 through 2017. PSH's approach had been well established, since it started private funds in 2004, but it has highly concentrated portfolios. Just two positions drove the 2015-17 performance. Closer examination shows that the business had diverted from its historical and successful investment philosophy. One situation was a significant short, while PSH primarily had been long, and the other was where there was a trusted management team, rather than one where PSH would go in with its own form of activism. As a long-term investor, PSH held its positions for an extended period, and the losses were significant. Investors on the share register before this time would have seen not only a significant NAV reduction but also a much-widened discount.

Since then, the group has:

- ▶ delivered a stellar start to 2019 (YTD to end-April +40%);
- ▶ focused its investment style back to its core approach, which had delivered significant outperformance against the S&P since 2004;
- ▶ transformed its board, with two new non-executives recently joining;
- ▶ undertaken a \$300m tender offer and removed ownership limits – allowing management and affiliates of the group to increase their holding (now over 20%); and
- ▶ introduced a quarterly dividend.

Despite these actions, the discount remains at historically high levels. We believe this reflects the facts that i) investors who may have suffered through 2015-17 have sold into the 2019 recovery with a rising share price reducing historical losses, and ii) newer investors who have taken profits have achieved very significant short-term gains. The business message we take from this is that it takes time for legacy issues to be over-turned when losses have been significant and extended. A spectacular performance in the short term may see profit-taking opportunities, rather than be sufficient to re-establish management credibility.

## Corporate governance: case study OCI

We note that OCI (current discount 26%) had a number of corporate governance issues, where the outlook is now very different from the past. There has been some progress, with the discount falling from 33% at end-2017 to the current level of 26%. These include:

- ▶ A perceived lack of clarity over the relationship between OCI and other Oakley Capital managed funds. In particular, ca.20% of OCI was at one stage in Time Out, whose value fell by half. While the value was falling, there may have been the perception that OCI was co-investing in the poor performers, while the Oakley Capital funds kept the best. Such a perception may have also reflected the historical position, where Oakley partners were significant investors in the fund but not in OCI. Management believes that Time Out will now start to show operational improvements, which will drive a rising valuation and disprove this point, and it now owns 5% of the stock, more visibly aligning its interest with shareholders.
- ▶ Placing the shares at a discount to NAV (stopped in 2017).
- ▶ A new NED appointment to board (most recently Stewart Porter in September 2019), improving board independence.



## Understanding the Deepest Discounts

- Disclosure has improved, with the 2018 results presentation being 46 pages-long, and the report and accounts has doubled in length over 2017. We understand that OCI commenced an investor communication programme in 2017 and, in the last 18 months, has met with more prospective investors than in the previous eight years. OCI has also opened its doors to sponsored research.

A change from realisation to re-investment can take time

## Strategic changes: case study LMS

An example of a business that has undergone a major strategic change is LMS. On 27 July 2016, the company announced a change in its investment policy, from a realisation policy to a new policy focused predominantly on private equity. It also appointed a new manager (Gresham House), and made significant tender offers in both August 2016 and August 2017, as it disposed of assets. The sale of some residual assets took some time, with the company only generating material cash resources in 2H'18. At end-2018, it held £17m in cash (current market capitalisation £41m, latest NAV £60m, resulting in an implied discount to non-cash items of ca.45%, rather than the headline 32%). We believe investors are waiting for evidence of deal flow before giving greater credit for the strategy.

Need to establish good track record from start, with clear investment process

## New business launch: case study MHN

MHN management will acknowledge that, when the company was originally launched, there was perhaps too much focus on the logistics of establishing the business and rather less on the management of assets. A clear investment objective had been created (investing in businesses, and delivering or benefiting from the efficient use of energy and resources), but the actual asset management was significantly outsourced. This led to investments being made that would not be undertaken with the investment process having been in-sourced. Performance has subsequently improved, but there remains the legacy sentiment around the original performance.

"it's always been at discount and always will be" sentiment may see discount for a while, but we do not believe that, in isolation, this can sustain discounts over the long term

## Other legacy issues

Anecdotally, one issue for private equity houses and some specific stocks (e.g. CGI, TFG) is the perception that they have always traded at a discount and therefore will continue to do so. We note a number of reports that make comparisons between the current rating and the average historical level of discount, but we are sceptical of this argument, in isolation, being a cause for sustained discounts over the long run. We acknowledge that investors may take more time to be convinced as to what are the real risks when there has been a large historical discount but, over time, we believe the value will out. By way of example, we note the performance of RIT Capital Partners, which, for most of 2009-14, traded at a discount to NAV (average year-end discount 4.2%), but which has since traded at a premium (average premium 6.9%).

RIT premium/discount to NAV (%)										
Year-end Dec	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Premium/discount	-5.0	-8.3	+1.4	-5.0	-9.0	-5.8	+6.9	+9.0	+6.7	+4.9

Source: Company report and accounts, Hardman & Co Research,

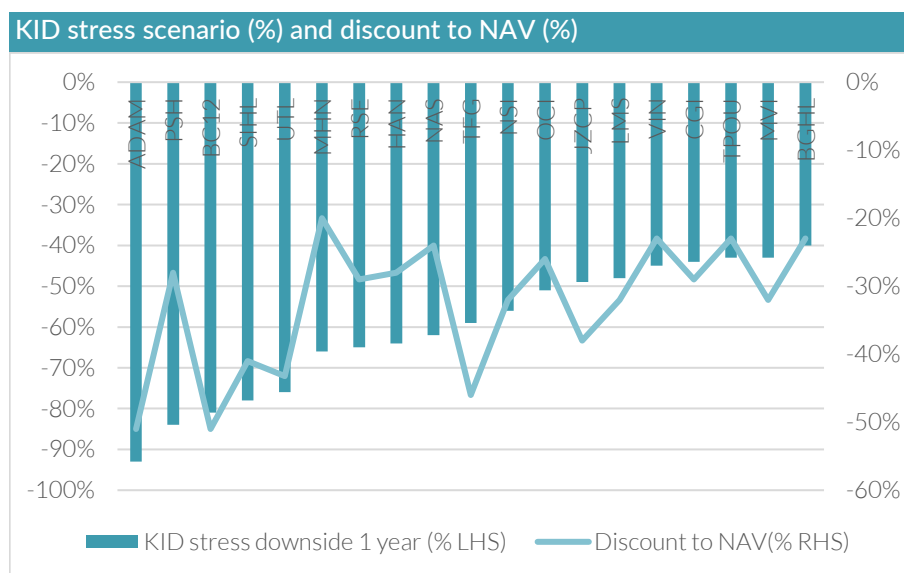
## Prospective risk

Where a fund has seen a challenging underlying market or one that is perceived as challenging/uncertain, there will be a higher discount than for more stable businesses. For example, if there were insurance events implying that catastrophe risk claims would be made, CAT Re-insurance Opportunities Fund would be likely to fall and a higher-than-average discount applied to reflect continued uncertainty. In the section below, we examine issues that could drive this risk and what investors should look for to project it.

## KID stress-test share price risk

In our group, higher stress test losses broadly see higher discounts

We share many companies' concerns about the direct comparability of KID disclosure. Noting that the scenario tests are based off historical share price movements and not likely NAV changes, it may nonetheless give an indication of how investors may consider prospective risk. The table below suggests broad indications that those with the highest stress downturns are trading at the highest discounts.



Source: Company, Hardman & Co Research

Not a clear relationship, as some companies with large stress downside trade at premia

We caution against over-reliance on this correlation, though. The correlation coefficient, at 0.59, is not statistically significant. We also note that several of the companies in our recent debt IC review, which are trading at a premium to NAV, also have significant stress downsides (e.g. RMDL: stress scenario -54%, premium to NAV 4%, GCP Asset-Backed stress scenario -54%, premium to NAV 7%).

## Cyclical risk

Cyclical stocks may trade at discount when economy likely to turn, as future value of assets may be less than current value

A further consideration in terms of outlook can be the perceived sensitivity of the company to macroeconomic cyclical. Private equity business accounts for 24 (i.e. 5%) of the 457 IC instruments listed by the AIC but, in this report, they account for six of the 25 instruments (i.e. 24% of the total, 29% excluding ICs in wind down mode). One factor driving this may be their perceived sensitivity to the economic cycle. We noted in our *debt investment company review*, published on 25 February 2019, that debt ICs, which may also be considered as cyclical, on average trade at only a small discount to NAV (then 4%, now 3%). We believe other considerations, in addition to cyclical, come into play, and these include issues like gearing in the underlying investments (not that gearing at the IC level is low – see section on other issues below). We note that OCI and MVI both believe their portfolios are defensive/non-cyclical

## Understanding the Deepest Discounts

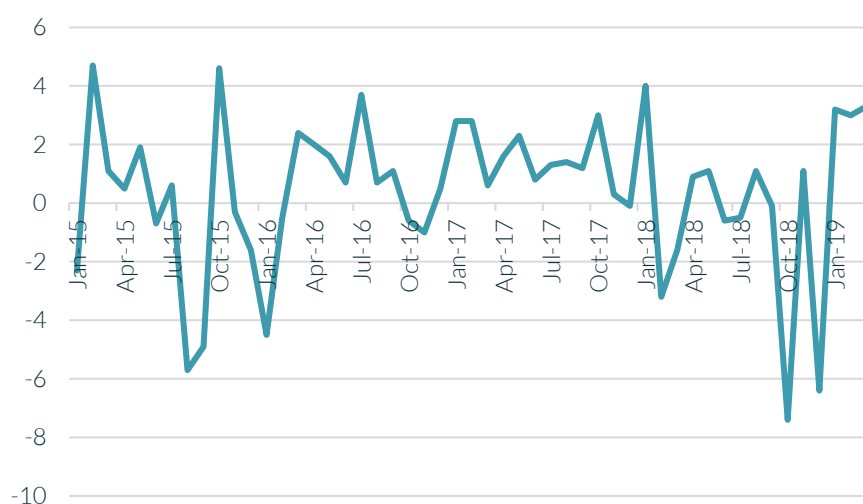
(and MVI notes very low gearing in its underlying investments). The largest PE company (3i) trades at a premium, but we still believe that, for smaller players, there may be sector cyclical sensitivity. This may be addressed by further communication of their own specific portfolios' outlook.

## Volatility risk

Monthly volatility may be unwelcome

Company-specific volatility may also be factor. We note that, in just four of the 51 months from January 2015 to March 2019, Third Point Offshore Investors delivered a return of under  $\pm 0.5\%$ . In contrast, it has had 18 months where its performance has been more than  $\pm 2\%$  in the month.

Monthly return Third Point Offshore Investors (%)



Source: Company, Hardman & Co Research

## Asset illiquidity risk

Illiquid assets harder to value, and uncertainty over their value leads to a discount

While consideration of the liquidity of the asset should be included in its valuation, investors are likely to require a bigger discount with illiquid assets, as the likely bid-offer spreads in a forced sale are likely to be much wider than for liquid assets, and this may not be captured in the ongoing valuation calculation.

## Competition impacting re-investment returns

May be some concerns about re-investment opportunities and returns when a sector is seen as highly competitive

A further consideration on future performance is the degree to which returns may be under pressure because of intensified competition. In practice, this will impact on re-investment risk, rather than returns from historical investments, and thus the speed at which a portfolio churns will be an important consideration. We note, by way of example, the comment in SIHL's 2018 report and accounts: "We have paid out attractive dividends in recent years because the deals we were seeing were overpriced and returning excess capital to shareholders seemed the prudent thing to do." These conditions can change – indeed, the 2018 report and accounts went on to say that the conditions had changed in Asia – but investors need to be convinced that the change is real. Investors need to understand the market positioning of each company. While there has been press coverage of competition in the private equity market overall, OCI reports that, in its chosen niches, market conditions remain good.

## Understanding the Deepest Discounts

Increased competition may be positive for the current NAV (if it bids up asset prices). However, if investors are worried that the IC will not be able to re-invest and so go into realisation mode, any discount is likely to increase.

### Regulatory risk

Regulatory risk may be on assets or the company itself

Regulatory risk, including government policy changes on issues such as nationalisation of utility assets, may apply to the underlying assets or the vehicle itself. One factor underlying the discount at CATCo Reinsurance Opportunities Fund Ltd could be the ongoing US and Bermuda government enquiries into loss reserves recorded in late 2017 and early 2018 by Markel CATCo Investment Management Ltd ("Markel CATCo"), the company's investment manager, and its subsidiaries. While the company states that "the internal review, which was conducted by outside counsel, found no evidence that Markel CATCo personnel acted in bad faith in exercising business judgment in the setting of reserves and making related disclosures during late 2017 and early 2018," investors may consider that an ongoing review of this type introduces an uncertainty that requires a discount. The business is now in run-off.

### Concentration risk by number of investments

Highly concentrated portfolios have advantages of specialism, but isolated situations can then have dramatic impact on performance

We see a highly concentrated portfolio as both a positive and negative.

- ▶ On the upside, focus in a narrow field is likely to enhance core competency in that field. In our report, [\*debt investment company review\*](#), we noted that specialist lenders were at a below-average discount and were delivering lower yields than the average debt investment company.
- ▶ On the downside, concentration within a few assets or on one asset class clearly means that any adverse movement in just one or two names can materially affect overall performance.

### Diversity risk by asset classes

Diversity can also be a risk:

- Investors do not know where to place the investment
- Investors can achieve their own diversity if they want to
- Need to ensure investment skills appropriate for each asset

Somewhat ironically, we can also see diversity as being a risk. In particular, where there is a diverse portfolio, it becomes harder for investors to allocate the company into an appropriate bucket. A lack of portfolio focus is especially important, unless the asset manager has significant resources to be deployed across a broad range of assets. We also believe that investors can achieve their own diversity, so that any business claiming this as an advantage needs to prove why there is incremental benefit by the company being diversified.

Some companies are obvious candidates to suffer from diversity risk. Companies in the AIC "Flexible Investments" sub-sector account for a disproportionately high number of companies in this report (HAN, JZCP, NSI, TFG, UTL). We would also argue that a company may have a clear investment vision, but the execution of this vision then creates diversity. For example, MHN is clearly focused on investing in businesses, and delivering or benefiting from the efficient use of energy and resources. The execution of this strategy has led to major investments in such diverse companies as Airbus through to Alphabet, and we believe investors may question the degree to which a small team can appreciate all the investment nuances of such a broad range of companies.

Diversity risk by asset class should be reduced where a company either has the scale to have resources to identify specific issues (e.g. TFG) or where the number of positions is very limited, and so there is more time available for each investment (such as MHN).

Key staff dependency creates operational risk but also, potentially, sentiment risk

### Key staff risk

Again, having a star manager is a benefit when times are good, but can be a detriment when not. The Woodford Patient Capital Trust moved from a ca.15% premium to NAV in summer 2015 to broad parity in mid-2017 and to a near 20% discount in March 2019. During this period, the NAV itself was broadly flat, and it was only the rating that changed dramatically. Sentiment to the star manager can be hugely important.

## Accounting

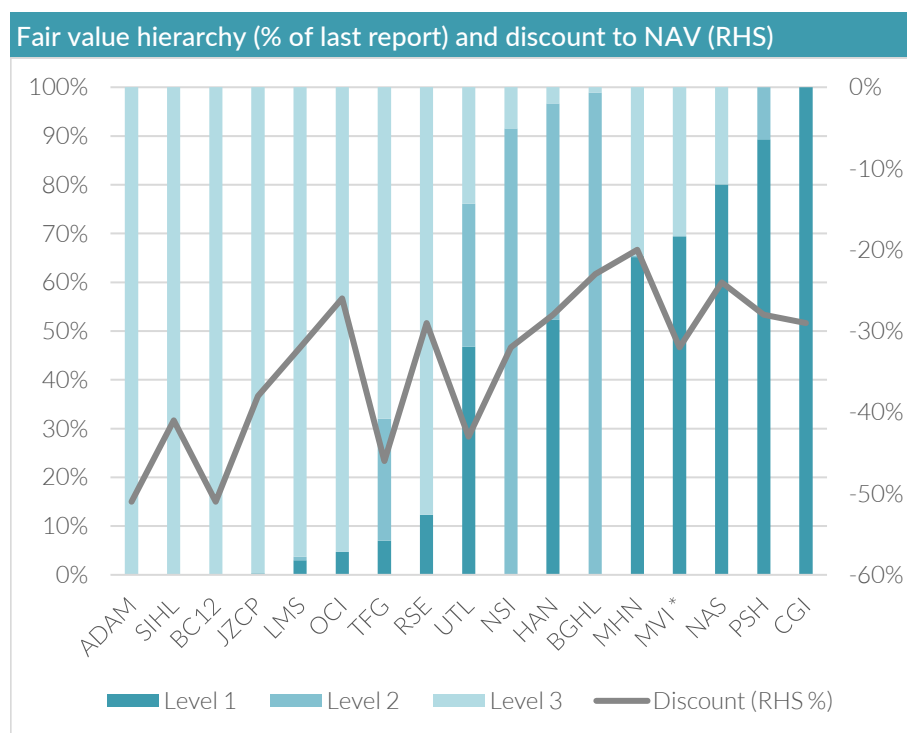
The key issue here is whether investors actually believe that the NAV, as reported, is a realistic reflection of the realisable value of the assets. Where there is no market price, and so judgement plays a more material part of valuation, we believe the market is more likely to apply a material discount.

## Assumption-driven valuation

One measure of external verification is the fair value hierarchy disclosed under IFRS 13 (Level 1, Level 2 and Level 3):

- ▶ Level 1 – quoted prices in active markets for identical investments that BGHL has the ability to access.
- ▶ Level 2 – valuations based on other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment spreads, credit risk, etc.) or quoted prices from inactive exchanges. Forward contracts are valued primarily based on market observable inputs, such as a share price or forward foreign currency curves at the balance sheet date.
- ▶ Level 3 – valuations based on significant unobservable inputs (including a company's own assumptions in determining the fair value of investments).

The chart below indicates this disclosure. Among the companies in this report, there are many with 100%, or close to 100%, Level 3 valued assets (i.e. assumption-driven), but only a few whose assets are either fully or nearly fully priced off quoted market prices in active markets. There is a slight, but not statistically significant, correlation between the proportion of Level 1 accounting and the level of discount, suggesting that investors gain some comfort from market-driven prices.



Source: Company Report and Accounts (\*MVI on look-through basis. In the accounts, the holding in the Master Fund (which holds the assets) is treated as a Level 3 investment, even though the majority of underlying assets are based off market prices), Hardman & Co Research

## Understanding the Deepest Discounts

Where level 3 used, we recommend investors consider realised prices that have been compared with valuation

May not reflect achievable prices if market conditions change, but does show management conservatism

Each company whose valuations are based off a company's own assumptions asserts the external verification of the values by auditors and other third parties. We believe one key question is 'what is the actual sale value of assets relative to their book value pre-sale?' We note, for example, that OCI's four exits in 2018 were at a 36% premium to the book value. Over the life of the OCI fund, the average premium at exit is 25%. Similarly, slide 21 of [JZCP's 8 May 2019 results presentation](#) shows an average accounting NAV discount to exit price of ca.20%, and we believe this is not an uncommon track record among listed PE peers.

This question's value is in establishing management conservatism. When used to forecast the realisable value, we need to bear in mind that sales conditions may not continue at the same level in the future.

It is also worth noting that an IC holding assets in a Master Fund may level 3 account for them, even if the underlying assets are mainly marked to a liquid market. This applies to MVI, which, in its accounts (page 36) reports 100% of financial assets at level 3 accounting, but all of MVI's underlying portfolio companies, except one, are publicly listed companies, and so are valued based on their market share price. Over two-thirds of the value is in businesses with liquid markets, which would be treated as level 1 if they were invested in directly.

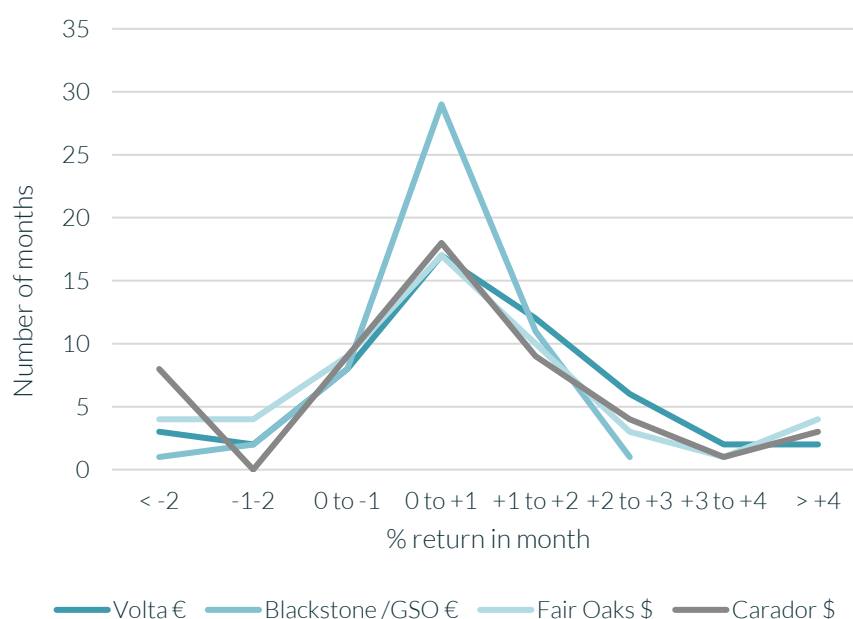
## Impact of mark-to-model or mark-to-market

Investors need to clearly understand how the basis of accounting impacts the valuation of the fund. Some of the key considerations include the following.

Merits in both approaches

We see merits in both marking to market and marking to model. The latter better reflects the expected long-term cashflows that the investment company may expect to earn. It is free from the potentially extreme sentiment-driven price movements that create unnecessary and unrealistic NAV volatility. However, such an approach does not reflect the likely value of assets if the investment company becomes a forced seller.

**CLO companies: number of months with different returns over past five years**



Source: Company Factsheets, Hardman & Co Research



## Understanding the Deepest Discounts

Mark-to-market companies likely to see more volatility

NAV returns on marking to model are likely to be significantly less volatile than returns on marking to market. Taking the CLO funds by way of example, Blackstone GSO is the only one that marks to model and, as can be seen in the chart below, it has had twice the number of months when it has delivered monthly returns in the range of 0%-1% compared with the other CLO companies. It does not have the same outliers, so in periods when markets are scared and writing down assets, its NAV does not show the same drop as those marking to market. Also, in periods when markets are scared, its discount to NAV may be expected to rise relative to peers (as its NAV will not have fallen to the same degree). We believe the current relative discount is illustrative of this.

Statutory accounts for mark-to-market companies need adjusting to see real dividend cover

## Where accounting rules are not helpful

The statutory accounts for some companies are not helpful in that they mix volatile, mark-to-market capital movements into the income statement. This creates not only a lack of visibility for each company but also makes comparisons between companies less robust. It may, therefore, be appropriate to consider creating adjusted accounts that strip out these anomalies, and get a better perspective of the underlying profitability and dividend cover.

We would typically strip out i) unrealised gains/losses, ii) FX movements and iii) net gain of IR derivatives, and adjust management fees to the new level of profitability

By way of example, on page 41 of our report on Volta, Delivering the structured finance opportunity, published on 5 September 2018, we outlined the adjustments we made to get a clearer view. We stripped out i) unrealised gains/losses, ii) FX movements and iii) net gain of IR derivatives. We left in realised gains, which, although volatile, have been converted into cash, and some capital gains may be expected to form part of the normal course of business. We also backdated the current management fee structure and adjusted it to the new level of profitability. We believe that, after these adjustments, investors have a much clearer view on the real extent to which the dividend is covered.

### Impact of Hardman & Co adjustments on Volta Finance dividend cover, 2014-20E

€	2014	2015	2016	2017	2018E	2019E	2020E
Dividend	0.60	0.62	0.62	0.62	0.62	0.62	0.62
Statutory EPS	1.22	1.31	0.34	1.06	0.62	0.90	0.92
<b>Statutory div. cover (x)</b>	<b>2.0</b>	<b>2.1</b>	<b>0.5</b>	<b>1.7</b>	<b>1.0</b>	<b>1.5</b>	<b>1.5</b>
Hardman & Co adj. EPS	0.82	0.98	0.80	0.77	0.84	0.90	0.92
<b>Hardman &amp; Co div. cover (x)</b>	<b>1.36</b>	<b>1.58</b>	<b>1.29</b>	<b>1.24</b>	<b>1.36</b>	<b>1.45</b>	<b>1.49</b>

Source: Hardman & Co Research, Volta Finance

FX accounting may not be helpful

In our report on debt ICs, *Diving deep finds you the treasure*, published 25 February 2019, we also considered how leasing accounting was not helpful to investors. Investors should also be aware that accounting for foreign exchange for leasing companies leads to distortions when comparing NAV. We consider that there is an artificial variance, as the accounting does not capture all cashflows at the same exchange rate (see leasing section in this report for more detail). The effect can be highly significant. By way of example, the Amedeo Air Four Plus (ticker: AA4) September 2018 interim accounts reported that the group saw a £116m unrealised foreign exchange loss. This can be compared with:

- ▶ a £110m unrealised gain in the prior year comparative;
- ▶ post-finance-cost, pre-tax profits of £33m; or
- ▶ period-end net assets of £593m.

## Understanding the Deepest Discounts

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### MPO adjusted NAV 30% above accounting

We also note that the basis of accounting can make dramatic differences. Taking MPO as an example, under IFRS rules, its stated NAV was \$143m at 31 December 2018, but its adjusted NAV, where all properties were fair valued by independent professional valuation firms, was \$188m. The discount on the adjusted basis is 28% while, on the IFRS basis, it is just 14%, and below the threshold for this report.

## Understanding the Deepest Discounts

### Fees

Average fees for companies in this report  
ca.3x market average, but:

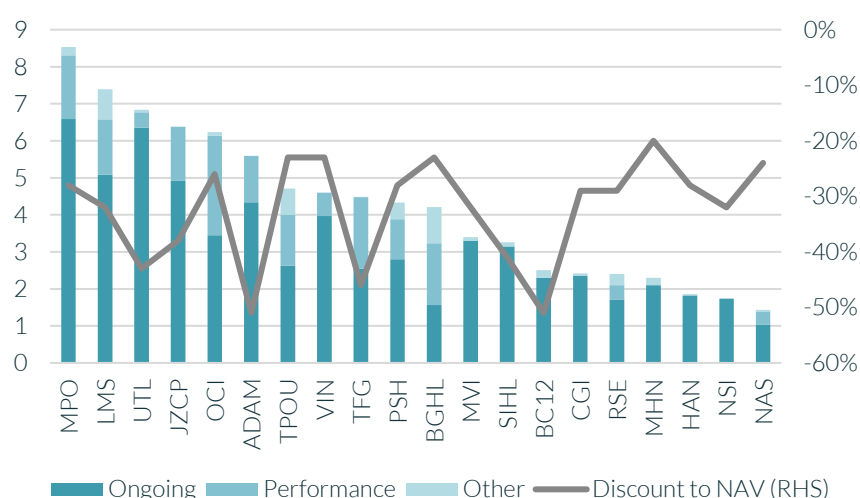
- No correlation between fees and discounts for the companies within this report
- Need to be considered against risk-adjusted returns

Our conclusion: fees alone not a key driver to discounts for companies in this report

For some investors, the level of fees is hugely important. The average ongoing fees disclosed in their KIDS by the continuing companies in this report is 3.1%, which compares with an average for all ICS of just over 1%, we believe. The underlying message is that the highest discount companies do have higher fees.

We understand that, in the institutional market, there has been some focus on the KID cost disclosure, making it an important element of sensitivity. In the table below, we therefore show the KID-disclosed costs and discount level. Investors should be aware that the KID disclosure on fees is not what many people may understand it to be. For example, UTL reports an ongoing fee cost of 6.35% in its KID, but this is significantly due to i) including the financing cost of its preference shares, and ii) the fact that it charges fees on gross assets while the KID disclosure apportions costs to net asset. As a geared business, UTL's costs appear much higher on the KID basis than the 0.5% of gross assets actually charged.

Impact of ongoing, performance and other fees on investment returns (%), and discount to NAV (%)



Source: Company KIDS, Hardman & Co Research

We note the following.

- Fees should be considered in the light of returns, not simply at the gross fee level. Investors should be more willing to pay higher fees where they are confident that even more superior returns will be earned.
- The correlation co-efficients between total/ongoing charges and levels of discounts are -0.172 and -0.186, respectively. Within the companies in this report, there is thus no correlation between the discount to NAV and fees, and this can be seen visually in the chart above.
- Many of the businesses in this report offer investors exposure to underlying assets that are not correlated to returns they may expect on, say, equity or debt portfolios. The nature of the underlying asset is more complex, and thus incurs higher costs, but this may be a necessary cost to achieve the diversity of portfolio that it can create.

Accessing assets not correlated with equity/fixed income indices has a value for investors, and fees may be necessary to get this benefit

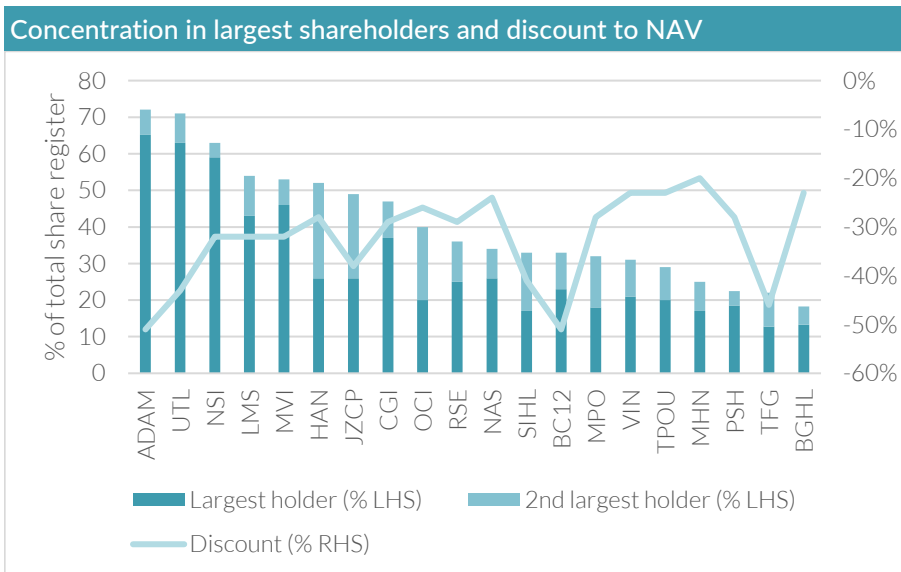
Our conclusion is that higher fees, in isolation, are not the driver to the level of discount.

## Corporate governance

### Majority shareholders

Many of the ICs with deepest discounts are those with significant shareholder concentration

Majority shareholders create potential control issues, and this reduces liquidity. It can also mean that buy-back options are severely constrained – if not impossible. These are all issues that may deter potential new investors. However, we would also argue that, where the largest holders are management and so there is clear alignment between them and other shareholders, this should be less of an issue.



Source: Company website, Hardman & Co Research

### Voting structure

Some of the largest nominal discounts (PSH, TFG) are with companies where public shareholders do not have voting control. In both cases, there is significant management financial alignment with shareholders.

Examples of companies with control outside the quoted shareholders include two of the largest companies in this report – PSH and TFG. There are obvious disadvantages in such structures, but also some upside. Being free from short-term market sentiment means these companies can take long-term conviction positions to add value. In principal, this is the same as the permanent capital offered by close-ended ICs, and we estimate that close-ended funds have added, on average, 1.4% p.a. to returns over the long term over open-ended ICs.

These structures are common where managements have material financial interests that are closely related with those of investors. Taking TFG as an example, while the quoted shares do not carry votes, management investment in the business is equivalent to 27% of the company; in PSH's case, it is in excess of 20%. We believe that there is a clear alignment between the interests of non-voting shareholders and managements, and so investors should not be unduly concerned by the voting structure.

Investors need to understand details of structure. In PSH's case, the independent 50.1% vote holder is legally obliged to act in interests of shareholders and sees public vote in advance

It is also worth digging into the detail of the PSH voting structure. The VoteCo share plays a role in maintaining PSH's status as a Passive Foreign Investment Company from a U.S. perspective. We understand that the VoteCo corporate documents require its directors to vote the share in the best interests of shareholders as a whole, and that VoteCo directors see the results of the public shareholder votes before making their decisions. While it is still possible for VoteCo to go the other way, its directors would have to do so while adhering to their responsibility to vote the shares in the interests of all shareholders. By way of specific example, a change of manager

## Understanding the Deepest Discounts

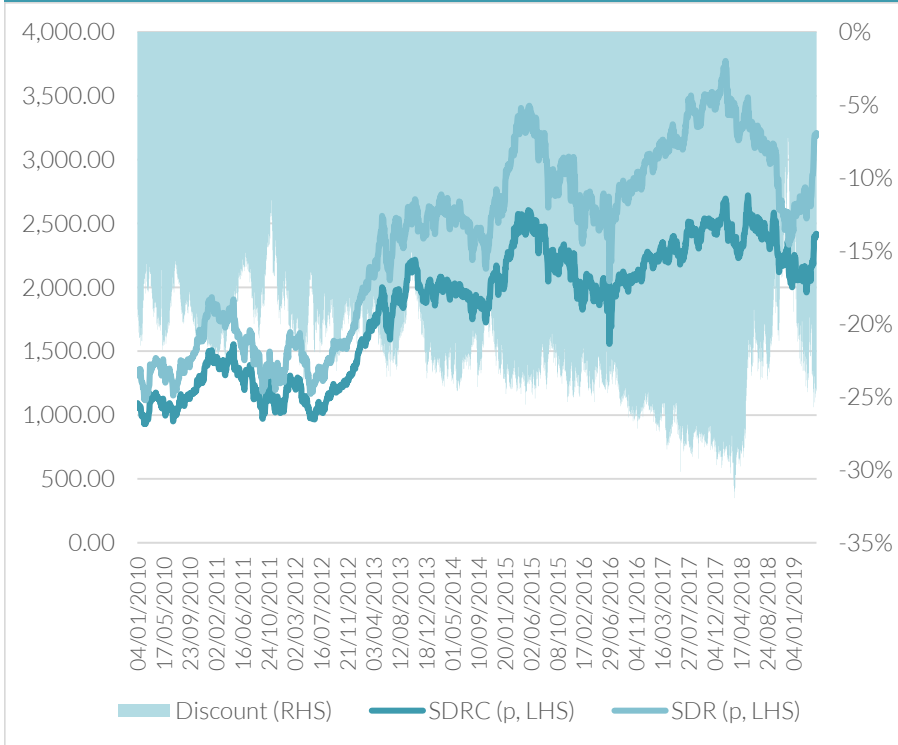
requires two-thirds' shareholder approval of all shareholders (including VoteCo) and two-thirds' shareholder approval of public shareholders. If this "super-majority" of public shareholders have stated they want to change manager, we believe it would be a high risk for the directors of VoteCo to vote against. Management characterises the spirit of the structure as ensuring compliance with the regulatory environment, rather than a control mechanism to protect its own incumbency. Knowing the detail that VoteCo's own rules require it to vote in shareholder interests, and the fact they know public shareholder votes in advance, means that there is a high hurdle for them to vote against the public shareholders. This supports the management's characterisation and significantly reduces (even though it does not completely eliminate) the probability that public shareholders' decisions will not be followed.

We also note that HarbourVest Global Private equity enfranchised its shares when it moved to the main FTSE listing in autumn 2015. At the time, the discount to NAV ranged from 12% to 20%. There was a small improvement in discount over the period (which may also have been associated with being main-market-listed) but it reversed within a few months. The current discount is ca.17%. It is, of course, impossible to say what the rating would have been had the old voting structure been maintained but, in this case, enfranchisement did not lead to a visible change in the discount.

Schroders non-voting shares traded at 22% discount to voting shares since 2010. Given management alignment, we believe much smaller discount is relevant for PSH and TFG.

Given the scale of the businesses whose public shares are non-controlling, we have considered another large UK company with non-voting shares to try to quantify the effect of any discount. We note that, since the start of 2010, Schroders non-voting shares have traded at an average discount of 22% to the voting shares, with the range of discount being 6% to 32%. Given the financial alignment of managements in both PSH and TFG, we would expect the effect to be much smaller than this. We also note that PSH historically traded on a much smaller discount, even when it had the same voting structure. This suggests to us that the voting structure may account for a discount in the range of 5% to 10% for these companies.

**Schroders voting & non-voting share price (p) and discount of the non-voters (%)**



Source: Company website, Hardman & Co Research

Related party transactions may be best option financially, but likely to raise questions

## Related party transactions

The presence of material related parties in complex transactions may achieve the best financial result for the investment company but may also lead to questions. We note, for example ADAM's [\*release of 15 June 2018\*](#), where the company stated, "On 15 September 2017, ADAM announced the disposal of the GP Interest to Fortune for cash consideration of US\$15.6 million. The GP Interest was transferred to Fortune at that time with the cash consideration due within 120 days. ....Payment was delayed and on 27 April 2018 the Company announced that it had been notified by Fortune that, as a result of a change in the identity of the principal investor in a fundraising being undertaken by Fortune, it was no longer in a position to complete the acquisition of the GP Interest on the agreed terms". It went on to say, "The revised terms, contained in a deed of amendment to the original sale and purchase agreement, involve a cash payment to be made by Fortune to the Company of US\$3 million", and "Due to Fortune being managed by affiliates of Adamas Asset Management (HK) Limited, which also manages the Company's largest shareholder, Elypsis Solutions Limited, the Disposal is classified as a related party transaction under the AIM Rules."

Discount can be helped by buy-backs, but this can create liquidity issues, worsen expense ratios and send mixed messages re growth prospects

## Discount management

There are a number of tools that can be used to manage the discount. Many companies have policies that allow them to buy back shares if the discount is above a certain level for a specified time. Others use intermittent tender offers. We believe the key considerations are as follows.

On the upside:

- ▶ It creates a buyer for the shares. The immediate effect of a large tender offer may be more effective in removing potentially bulky sellers. If future offers are expected, it may also mean that such sellers do not continually drip shares into the market. Where there are likely to be a larger number of small-sized sellers, an ongoing programme may be more effective.
- ▶ The liquidity provided by buy-backs may encourage buyers, as it provides them with an exit route without disrupting the market price.
- ▶ It may be perceived as putting a cap on the discount, which the market might then close itself.
- ▶ It is "fairer" to all shareholders. A seller may arise for specific reasons (such as death, divorce or liquidity calls) and, by keeping the discount tightly controlled, such sellers do not lose out to discount variability.
- ▶ Where the discount is large, the returns on the cash used in the buy-back may be above the levels targeted in the investment company.

On the downside:

- ▶ It could create liquidity problems. We note, for example, that, in the NSI report and accounts, "The Directors review regularly the level of discount; however; given the investor base of the Company, the Board is very restricted in its ability to influence the discount to net asset value." With a 59% majority shareholder and a small trading volume, buy-backs of any scale are simply not practical.
- ▶ The capital can be better deployed in the fund.
- ▶ By shrinking the business, it worsens the total expense ratio, and increases leverage where there is debt.

## Understanding the Deepest Discounts

- ▶ It sends a very mixed message, to investors especially, if the company later comes back to the market for further equity funding.
- ▶ It can also send a very mixed message to staff. We note that, in its results call, JZCP, when announcing a buy-back and debt repayment plans, very clearly outlined why it would not be shrinking the business by still originating assets but placing them in a different vehicle.
- ▶ Active buy-back programmes may reduce the likely return of capital by way of dividends, and thus benefit capital investors over income ones.

PSH noted direct example where deploying cash in investments yielded more than a buy-back at a 15% discount

We note, for example, the PSH comment in its 2018 Report and Accounts, "The potential accretion to NAV per share from such a purchase would be small relative to the return that we believe could be earned by investing the capital in an existing or newly identified investment ... For example, in July of last year, PSH invested \$495 million in Starbucks at an average price of \$51.30 per share. To date, the Starbucks purchase has increased NAV by 476 basis points. Had we instead used the same \$495 million to complete a second self-tender for PSH shares would have created an immediate 236 basis point increase in NAV, the benefit would have stopped there. The accretion in NAV would have been less than half the 476 basis points increase in NAV created by the Starbucks acquisition, which had the additional benefit of reducing, rather than increasing, our leverage."

Fewer than half the companies have had active programmes in past year

We note that the companies in this report have undertaken a range of buy-backs over the past year, ranging from significant one-off tender offers through to moderate one-off purchases and ongoing/daily programmes. Fewer than half the companies have had active programmes.

### Company approaches to buy-backs over the past 12 months

Approach	Companies
Significant tender offers/one-off buybacks	PSH, TFG
Moderate one-off purchases	ADAM, NAS, OCI, UTL
Ongoing/daily programmes	JZCP, MVI, TPOU
None during past year	MPO, LMS, RSE, NSI, CGI, HAN, ELX VIN, BGHL, BC12, SIHL, MHN

Source: Companies, Thomson Reuters, Hardman & Co Research



# Other factors to consider

## Gearing

Anecdotally, investors do not like gearing in ICs, except where the asset class is very clearly low-risk

Gearing acceptable, we believe, if structured so that company cannot be driven into position of being forced seller of assets

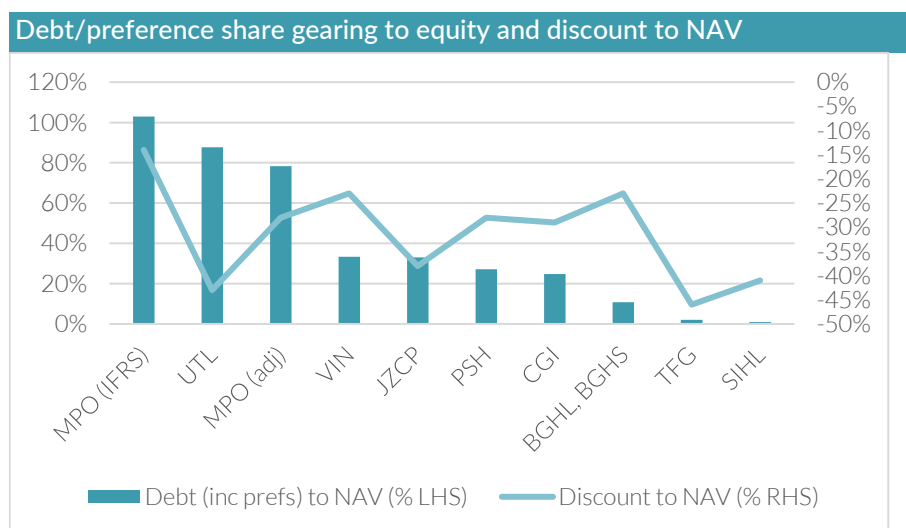
Gearing sensitive to performance – PSH debt as percentage of equity gearing will be down 40% YTD

We note the potential for ICs to gear up returns through leverage in the fund. Anecdotal evidence is that investors are cautious about structural gearing, unless the assets are perceived as being extremely low-risk (for example, Real Estate Credit Investments is trading at a 6% premium to NAV, with debt financing at 40% of NAV). We believe that JZCP is sensitive to this issue. In its 8 May 2018 results, it announced, *inter alia*, a plan to repay \$100m debt, and that its goal was to redeem its preference shares and unsecured loan stock on maturity in two to three years. In order to conserve cash for these strategic initiatives (and a \$100m buy-back programme), it will be investing in fewer new deals or investing a smaller percentage in each new deal.

While we acknowledge the impact on sentiment, we are, in principle, not opposed to gearing, but we believe it should be carefully managed and with consideration, as we suggest below.

- ▶ Does the principal repayment pattern create liquidity strains that could see the business become a forced seller of assets? In this regard, the principal cashflows from this need to be considered in the light of other cashflows generated by the business and its other financing options.
- ▶ To what extent are there covenants that could also drive the business into being a forced seller of assets? We note, for example, that one of the reasons UTL has chosen the Z preference share option is because it is a covenant free. While such funding may be a little more expensive than bank debt, it comes with fewer constraints.
- ▶ To what extent is the debt permanent? Again, taking UTL as an example, gearing has fallen from ca.160% five years ago to 88% at end-2018, to ca.70% now.

The companies with gearing at the investment company level are detailed below. These figures have been taken from the last report and accounts. Where there has been a significant performance (e.g. PSH 40% YTD), the gearing level would be smaller, and we understand that UTL is now under 70%. JZCP's announcement will lead to much-reduced gearing in due course. Overall, we believe that gearing at the investment company level is a very specific company and sentiment risk issue.



Source: Latest company financial report, Hardman & Co Research

## Understanding the Deepest Discounts

Investors may also look to gearing in underlying investments

We noted earlier the high percentage of private equity companies within this report. The degree to which there is gearing in the underlying investments could be, in part, an explanation for this. Unlike traditional PE strategies, we note that MVI's underlying portfolio companies typically have low leverage (2.0x net debt/EBITDA, on average).

Where business more operational, NAV not right measure

## Where NAV is the wrong approach

We note that, until recently, Burford Capital was a "Non-Equity Investment Instrument" (it is now classified on the LSE as a Speciality Finance business in the Financial Services sector). In the past, GLIF went through the same transition. While comparisons may be appropriate for businesses that are solely making investments, if the underlying business is more of a trading business, a discount to NAV is not the right measure. We also note that ADAM is now classified as a Speciality Finance business on the LSE, although it is still an AIC member. In addition, we note that the accounting methodology used may create a very different discount (see MPO in the section on accounting).

NAV disclosure may not be that timely

We note that timing may also affect the appropriateness of using the discount to NAV as a valuation measure. While some of the companies in this report announce NAVs daily, others, such as ADAM and BC12, are much less current.

Issues around KID disclosure. Given companies in this report typically have further issues, this may compound discounts.

## KID disclosure

In line with many other ICs, the KID disclosure is not helpful to companies with the features we have outlined in our report. In particular, we note that the stress scenario is based off historical share price movements and, as such, is not forward-looking, especially when a business has seen a material change in strategy/execution. Somewhat ironically, a sharp upward revision in a share price, due to good NAV performance, would be likely to see a higher stress-case scenario. The calculation of fees for KIDS includes finance costs, without there being any benefit in the KID from the income that gearing may generate.

## Sector classification

We note that the sector to which an IC is allocated may affect potential buyers' appetite and pools of capital. For example, North Atlantic Smaller Companies' largest holdings are all in the UK, but it is classified as "North American Smaller Companies".

## Size

Anecdotally, £100m critical market capitalisation to get investors' attention. Our analysis does not, however, show a correlation for companies in this report.

Size may be viewed as a factor potentially deterring investors who perceive that they may not get a good return for the work spent on looking at the company. Anecdotally, we have been repeatedly told that £100m is a critical market capitalisation in terms of grabbing broader investor attention (although one much larger company also considered size an issue). We note the following.

- ▶ Within the companies in this report, there is no correlation between the size of the company and the discount to NAV (see top chart, next page). Despite its near £6bn market capitalisation, Pershing Holdings trades at a 28% discount to NAV, against the average 33% for the companies featured in this report, and Tetragon Financial is at a 46% discount, despite being a £0.9bn company.
- ▶ The market capitalisation is not correlated to the average LSE deal size nor the proportion of the company traded (bottom two charts, next page). Some of the larger players have multiple listings with further liquidity on other exchanges.

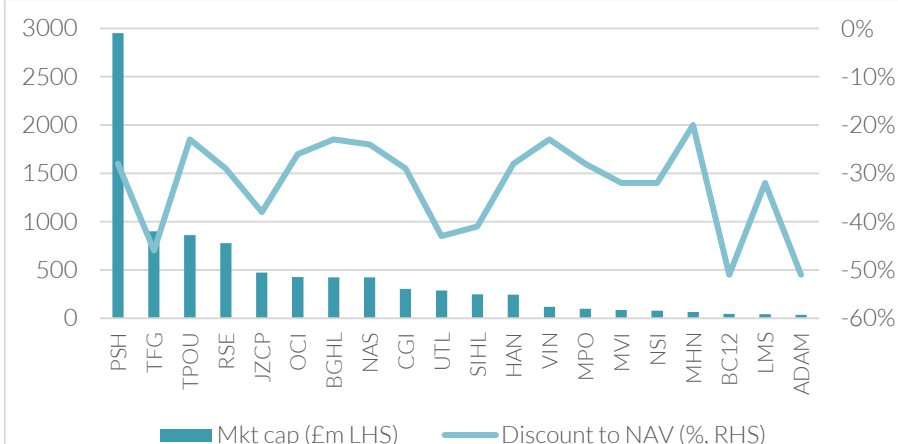
## Understanding the Deepest Discounts

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We believe the combination of anecdotal evidence and trading means that size may be an issue when there are other considerations causing the discount but, in itself, it is not a key driver to discount levels.

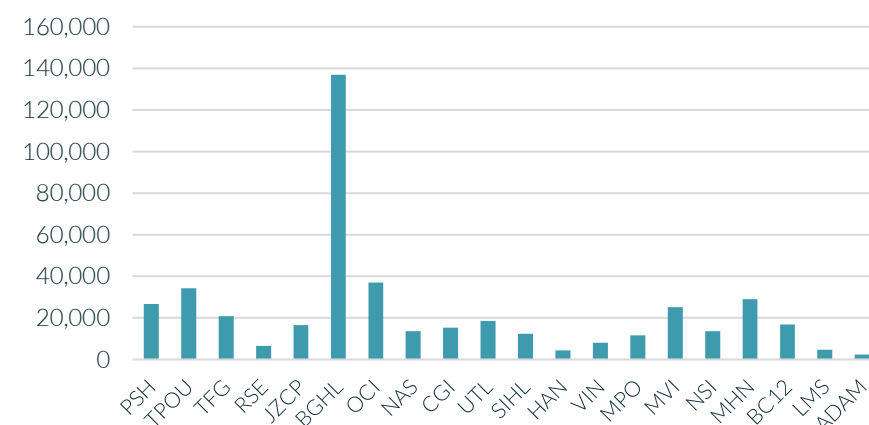
## Understanding the Deepest Discounts

### Market capitalisation and discount to NAV



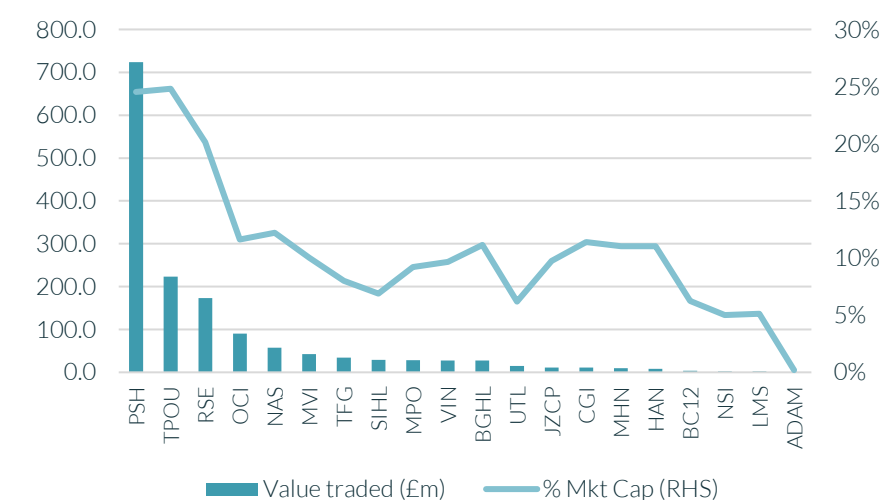
Source: LSE, Companies, Hardman & Co Research

### Average trade size, April 2018 to March 2019 (£)



Source: LSE, Hardman & Co Research

### Value traded and value as % current market capitalisation (LSE only), April 2018 to March 2019



Source: LSE (note Some of the larger players have multiple listings with further liquidity on other exchanges), Hardman & Co Research

## Complexity of story

Danger some companies may fall into the 'too difficult to understand so ignore' bucket

Most effective when i) problem acknowledged, ii) company says what has been done about it, and iii) communication to existing and new shareholders

Portfolios diversified across different assets/risks

Comparisons may help when market leader at huge premium

Need to explain why legacy issues in past

Accounting may need explaining

There are 420 ICs quoted in London. Investors generally use ICs to get exposure to a particular asset class or theme. Ideas that come with a lot of baggage and need explaining can easily fall into the 'too difficult to understand so ignore' bucket. Thus communication becomes very important where the underlying story is complicated by any of the issues identified elsewhere in this report. Ineffective communication alone may thus deter a cohort of potential investors.

We believe the key features of effective communication are:

- ▶ Acknowledgement of the issues, clarity on what has been done about them, and which factors are likely to mean they should reduce over time. With, say, legacy issues, it is putting what happened in the past into the context of future performance.
- ▶ Increased granularity of disclosure, with hard facts in the areas of most concern. We note, for example, that PSH had a 58 slide deck for its February 2019 meetings.
- ▶ Communication with existing shareholders and also accessing potential new investor bases, and opinion formers such as the press. Excluding BGHL, the average deal size for companies in this report was ca.£17,000, meaning that, on an ongoing basis, getting information to high-net-worth individuals, PCBs and wealth managers is very important.

In addition to company-specific issues, we believe there are some themes that apply to a range of companies:

- ▶ The AIC flexible investment sector has an average discount that is three to four times the average for ICs as a whole, and around a third of the highest discount ICs in this report are in this AIC sub-sector. One of the companies with the highest discounts, UTL (43%), has investments ranging from technology through to gold mining, with a huge geographical split. Tetragon (discount 46%) has investments from private equity in asset managers through to event-driven equities, real estate and bank loans. The key issue for ICs in this space is to explain the competitive advantage they gain from the flexible mandate and why investors get a better return from investing in a single company when they could choose from specialists in each area.
- ▶ Private equity also accounts for a disproportionate number of companies in this report. This is despite the market leader (3i) trading at 1,069p, against a last reported NAV of 802p (i.e. a 33% premium). Most of the issues (*inter alia* cyclicalities, historical discounts levels, valuation, gearing, fees) could equally apply to 3i, and so part of the communication issue is comparative. Investors need to be convinced that the reason they are willing to pay a premium for 3i also applies to the companies in this report.
- ▶ Legacy issues – where a business is very different today from how it was in the past, the implications from these changes need to be understood. Communicating what has been done to change the historical outlook is hugely important.
- ▶ We detailed in the section on accounting above how accounting complexity is a factor in making the story easy or hard to sell. While the accounting may be complex, we believe the underlying business issues can be made much simpler. Again, some hard facts (such as actual realised prices compared with last valuation) can go a significant way towards mitigating investor concerns.

## Appendix 1: company summaries

### Adamas Finance Asia (now classified on LSE as Speciality Finance but still in AIC)

Issue	Comment
Ticker/Market Cap	ADAM/\$46m (£36m)
Website	<a href="http://www.adamasfinance.com">http://www.adamasfinance.com</a>
Company description	<p>"Adamas Finance Asia (ADAM.LN) is an AIM-quoted company targeting the delivery of income and capital gain from a diversified portfolio of pan-Asian investments in the Small and Medium-Sized Enterprise (SME) Sector. ADAM is agnostic in both the sectors and geographies it invests in, enabling the company to seek the best SME investment opportunities from across Asia and provide investors with a broad exposure to this growing market. The company views sectors such as healthcare and life sciences, energy and resources, internet and technology and property as especially attractive since they can offer exposure to rapidly expanding consumer-driven industries in Asia.</p> <p>Its investment manager, Harmony Capital Investors Limited, appointed in 2017, has a dedicated team with real Asian expertise; focused on sourcing compelling SME investment opportunities throughout the region since its founding in 2005."</p>
Latest NAV	\$95m end-June 2018
Market Cap 7 May 2019	\$46m
Discount	51%
Volatility	Low
Return	NAV +17% June 18 on June 17 (appointment of current manager)*
Major shareholders	Elypsis Solutions Limited 65.2%, CASIL Clearing Limited 6.9%, Barry Lau 5.1%
AIC sector	Private Equity
KID	
Costs	Ongoing costs 4.34% + performance fees 1.25%
Risk level	6
Stress scenario	-93%
Discount factors	Legacy performance, KID stress-test illiquid assets, cyclicity, concentration risk, assumption-driven valuation, fees, majority shareholders, related party transaction, size, timing of NAV

Source: Company, \*company presentation May 2019, Hardman & Co Research

### Better Capital 2012

Issue	Comment
Ticker/Market Cap	BC12/£46m
Website	<a href="http://www.bettercapital.gg/">http://www.bettercapital.gg/</a>
Company description	<p>"Better Capital PCC Limited is a limited liability, closed ended investment company, which was incorporated on 24 November 2009 in Guernsey and which, by special resolution of its members, converted to a protected cell company on 11th January 2012. It has an unlimited life ..... The Better Capital 2012 Cell will seek to invest in a portfolio of businesses (through BECAP 12 Fund LP) which have significant operating issues and may have associated financial distress, with a primary focus on investments in businesses which have significant activities with the United Kingdom or Ireland. Investments include Everest and Spicers-Office Team".</p>
Latest NAV	£58m, 19.2p per share 30 September 2018
Share price 7 May 2019	9.5p
Discount	51%
Volatility	Low
Return	n/m
Major shareholders	Jonathan Moulton 23%, Progressive Capital Partners 10%, Overseas Asset Mgt. 9%, CG AM 3%*
AIC sector	Private Equity
KID	
Costs	Ongoing costs 2.30%
Risk level	5
Stress scenario	-81%
Discount factors	KID stress test, illiquid assets, cyclicity, competition, concentration risk, assumption-driven valuation, size, timing of NAV

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Understanding the Deepest Discounts

### Boussard & Gavaudan Holding Limited

Issue	Comment
Ticker/Market Cap	BGHL, BGHS/£424m
Website	<a href="http://www.bgholdingltd.com">www.bgholdingltd.com</a>
Company description	"BGHL seeks to achieve long-term appreciation of its assets through multi alternative investment strategies by investing in BG Fund, a sub-fund of BG Umbrella Fund Plc, also managed by BGIM. BG Master Fund ICAV is an opportunistic Europe-focused multi-strategy fund which aims primarily at arbitraging instruments with non-linear pay-offs in special situations. Over time, BGHL may undertake direct investments other than BG Fund that are identified by the Investment Manager. The Company has received the approval of the Guernsey Financial Services Commission and the States of Guernsey Policy Council. It is also registered with the Dutch Authority for the Financial Markets ("AFM") as a collective investment scheme."
Latest NAV	€21.8255/£19.5778 6 May 2019
Share price 7 May 2019	€16.90, £15.40
Discount	23%
Volatility	Medium 14 months since start 2016 shown +/- >1%
Return	2019 YTD end-March 0.11%, 2018 -6.15%, 2017 5.87%, 2016 7.22%, 2015 15.65%
Major shareholders	Boussard 13%, Kempen Capital 5%, OMERS Administration Corporation 5%, M&G 4%, CE Joseph 3%, Premier AM 3%*
AIC sector	Hedge Funds
KID	
Costs	1.56% ongoing, 1.67% performance and 0.98% portfolio transaction
Risk level	4
Stress scenario	-40%
Discount factors	Illiquid assets, fees

Source: Company, \* Thomson Reuters, Hardman & Co Research

### Canadian General Investments

Issue	Comment
Ticker/Market Cap	CGI, CAN/\$541m (£304m)
Website	<a href="http://www.mmmainvestments.com/closed-end-funds/overview">http://www.mmmainvestments.com/closed-end-funds/overview</a>
Company description	"A closed-end equity fund focused on medium to long-term capital appreciation and dividends in Canadian corporations, Canadian General Investments, Limited (CGI) was established in 1930 and has been managed since 1956 by Morgan Meighen & Associates. Sector exposures include IT 24% NAV, Materials 20%, Industrials 17%, Consumer Discretionary 17%, Financials 12%, with the largest holdings being Shopiy (7%), Air Canada (6%)."
Latest NAV	C\$36.82 6 May 2019
Share price 7 May 2019	C\$26.0
Discount	29%
Volatility	Medium, Daily P/L with assets priced off liquid market prices
Return	2018 -10.9%, 2017 21.5%, 2016 18.2%, 2015 -7.2%, 2014 8.4%
Major shareholders	Morgan Meighen & associates 37%, Catherine and Maxwell Meighen Foundation 10%, New Annan Investments 5%*
AIC sector	North America
KID	
Costs	2.36%
Risk level	5
Stress scenario	-44%
Discount factors	Legacy – long history of discount

Source: Company, \*Thomson Reuters, Hardman & Co Research



## Understanding the Deepest Discounts

Hansa Trust	
Issue	Comment
Ticker/Market Cap	HAN, HANA (A Non-Voting shares)/£244m
Website	<a href="https://www.hansatrust.com/">https://www.hansatrust.com/</a>
Company description	<p>"The Portfolio: The objective of Hansa Trust is to achieve growth of shareholder value, from a concentrated, long-term, non-index correlated portfolio of unusual investments, which would not normally be available for investment to individual investors.</p> <p>Stock Selection: Our focus is to identify, invest in and monitor well managed companies with good growth prospects being fully aware that their underlying strategies may take time to come to fruition.</p> <p>Risk: We believe the risk that Hansa Trust shareholders run is that they do not make money and do not regard short-term volatility as a risk for long-term shareholders.</p> <p>Key Performance Indicators: The Board considers that the use of a single benchmark won't always offer shareholders the relevance and the clarity needed with regard to the performance of their Company. Therefore the Board considers the following KPIs when assessing the performance of the Company: UK CPI, MSCI ACWI TR GBP and FTSE Gilts All Stock TR.</p> <p>Dividends: We regard dividends as an important part of the return that shareholders enjoy, the dividends that are payable to shareholders will depend on the make-up of the portfolio as we strive to maximize shareholder value. As such dividends may fluctuate but over the long term, we would expect the dividend to grow."</p>
Latest NAV	1427.67p (cum inc), 1427.51 (exc inc) 2 May 2019
Share price 7 May 2019	1035p
Discount	28%
Volatility	Medium
Return	Company has generated a 25.5% Total Return over the five years since March 2014
Major shareholders	William Salomon 26%, Nomolas Ltd 26%, Alliance Trust 5%, Brooks MacDonald AM 4%*
AIC sector	Flexible Investment
KID	
Costs	1.82%
Risk level	5
Stress scenario	-64%
Discount Factors	Legacy other, KID stress test, Illiquid assets, diversity risk by asset class, majority shareholders

Source: Company, \*Thomson Reuters, Hardman & Co Research

JZ Capital Partners	
Issue	Comment
Ticker/Market Cap	JZCP, JZCZ, JZCC/£472m
Website	<a href="http://www.jzcp.com">http://www.jzcp.com</a>
Company description	<p>"JZ Capital Partners ("JZCP") ...seeks to provide shareholders with a return by investing selectively in US and European microcap companies and US real estate JZCP receives investment advice from Jordan/Zalaznick Advisers, Inc. ("JZAI") which is led by David Zalaznick and Jay Jordan. ...JZCP is incorporated in Guernsey and is an authorised closed-ended investment scheme pursuant to the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (as amended) and the Authorised Closed-Ended Investment Schemes Rules 2008. It is listed on the Specialist Fund Segment of the London Stock Exchange.</p> <p>David Zalaznick and Jay Jordan attribute JZCP's success to its competitive strengths: (i) A unique focus on US and European microcap companies and US real estate (ii) The flexibility to invest throughout market cycles (iii) A strategy of working with the existing management of companies to enhance growth (iv) A proprietary network of intermediaries to find investment opportunities rather than participating in auctions (v) A long-term, value-orientated approach."</p>
Latest NAV	\$10.02 per share 31 March 2019
Share price 7 May 2019	£4.72 (\$6.20)
Discount	38%
Volatility	Low, NAV broadly flat from February 2016
Return	NAV broadly flat on Feb 2017 and 2016
Major shareholders	Edgewater Funds 23%, John Jordan 13%, David Zalaznick 13%, Leucadia Fin Corp 10%, Abrams Capital Mgt. 10%, Arnhold LLC 6%, Finepoint Capital 5.5%*
AIC sector	Flexible Investment
KID	
Costs	Ongoing 4.93% + performance fees 1.45%
Risk level	3
Stress scenario	-48.5%
Discount factors	Legacy, other, illiquid assets, cyclicalities, competition, diversity risk by asset class, key staff, assumption-driven valuation, fees

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Understanding the Deepest Discounts

LMS Capital	
Issue	Comment
Ticker/Market Cap	LMS/£41m
Website	<a href="http://privateassets.greshamhouse.com/funds/lms-capital-plc/">http://privateassets.greshamhouse.com/funds/lms-capital-plc/</a>
Company description	<p>"LMS Capital plc is a listed private equity investment company managed by Gresham House Asset Management (GHAM). Its focus is predominantly on direct investment at the smaller end of the UK private equity market. The investment objective is to achieve absolute total returns over the medium to long term, principally through capital gains and supplemented with the generation of a longer-term income yield. The fund targets a return on equity, after running costs, of between 12% and 15% per annum over the long term." "Its focus is predominantly on direct investment at the smaller end of the UK private equity market below £50 million enterprise value where the manager believes there to be significant market inefficiencies which create opportunities for superior long-term returns and where they can leverage the experience of the investment team. .... A disciplined investment process has been established with a newly formed Investment Committee. The short-term focus is on maximising the value of existing holdings, with the ability where growth prospects are clear, to preserve and support value creation. As investments are recycled, the fund will be able to gain exposure to alternative investment opportunities and illiquid assets through access to the Gresham House group and network to invest directly via co-investment. Our team have a proven track record in asset management, private equity and public markets. As a result of changes to the investment policy implemented in 2016, the fund is now focused predominantly on investment in private assets, with emphasis on private equity."</p>
Latest NAV	73.8p end-March 2019
Share price 7 May 2019	50.4p
Discount	32%
Volatility	High 1Q'18 -6.8%, 2Q'18 +6%, 3Q'18 -1.1%, 4Q'18 -4.4%
Return	GHAM appointed August 2016. NAV total return was minus 6.6% and its share price total return was positive 5.6% for the year-ended 31 December 2018
Major shareholders	Rayne Family Holding 42.8%, Charles Stanley & Co Ltd 10.7%, Armstrong Investment Management LLP 5.9%, Rath Dhu Limited 5.3%, Schroders plc 3.6%, UBS AG 2.9%
AIC sector	Private Equity
KID	
Costs	5.08% ongoing + Performance fees 1.5%, entry costs 0.5%, Transaction costs 0.31%
Risk level	5 years
Stress scenario	-47.7%
Discount factors	Legacy strategy change, illiquid assets, cyclicity, competition, concentrated portfolio, assumption-driven valuation, shareholder concentration, fees, size

Source: Company, Hardman & Co Research

Macau Property Opportunities	
Issue	Comment
Ticker/Market Cap	MPO/£100m
Website	<a href="https://mpofund.com/">https://mpofund.com/</a>
Company description	<p>"Macau Property Opportunities Fund Limited (MPO) is a closed-end investment company registered in Guernsey, and the only quoted property fund dedicated to investing in Macau, the world's largest gaming market and the sole city in China in which gaming has been legalised. Launched in 2006 and listed on the London Stock Exchange, MPO targets strategic property investment and development opportunities in Macau. MPO is managed by Sniper Capital Limited, an Asia-based property investment manager with a proven track record in fund management and investment advisory."</p>
Latest NAV	\$2.94, 225p 31 Mar 2019
Share price 7 May 2019	162.5p
Discount	28%
Volatility	Medium – typical quarterly change in NAV in 2018 ca.4%, 2018 ca.1%, 2016 3%-10%
Return	Adj. NAV (p) end-2018 239p, 2017 250p, 2016 245p, 2015 218p, 2014 302p
Major shareholders	Sniper Investments Limited 18%, Lazard Asset Management LLC 14%, Universities Superannuation Scheme 14%, Ironsides Partners LLC 7%, Apollo Multi Asset Management 4%, Miton Asset Management 4%, Rathbone Investment Management 4%, FIL Investment International 4%
AIC sector	Property Direct - Asia Pacific
KID	
Costs	6.59% ongoing + Performance fees 1.72%, transaction costs 0.22% p.a.
Risk level	6
Stress scenario	n/m
Discount factors	KID stress test, Illiquid assets, cyclicity, concentrated portfolio, assumption-driven valuation fees, gearing, size

Source: Company, Hardman & Co Research

## Understanding the Deepest Discounts

Marwyn Value Investors	
Issue	Comment
Ticker/Market Cap	MVI (ordinary), MVIR (realisation shares)/£86m
Website	<a href="http://www.marwynvalue.com/">http://www.marwynvalue.com/</a>
Company description	<p>"With a growing portfolio of European small and mid-cap businesses, we're adept at spotting big opportunities in sectors going through big changes.. Acquisition is just the first step on the journey. That's why we don't simply invest in businesses, but also in the talented people who run them. We identify experienced, industry-leading management teams to build and grow businesses – not just for the first year, but through ongoing support, active participation and collaborative involvement. Working together, we improve operations, re-focus strategy, streamline revenue/cost models and plan smart, organic M&amp;A activity. That's how we build success. We start small but think big. Our focus is mid-cap UK, European and North American headquartered businesses, with a target enterprise value of £150 million to £1.5 billion. We see opportunity in change. We target companies in industries that are being galvanised by major structural change or dislocation, which we believe offer significant growth potential. Our "Buy-and-Build" strategy hinges on acquiring meaningful equity stakes in these companies via publicly-listed, sector-specific acquisition vehicles. Why use public markets? It gives us an efficient, liquid source of capital throughout an investment's lifecycle, and helps us to deploy our exit strategy most effectively – at the best possible time, terms and price. We are sector agnostic. The diverse array of industries we have invested in to date reflect our sector-agnostic and entrepreneurial approach to investment."</p>
Latest NAV	183.594p 18 April 2019, MVIR £1.89048 18 April 2019
Share price 7 May 2019	125.5p, MVIR 170p
Discount	32%, MVIR 10%
Volatility	Medium
Return	Ordinary shares 158% NAV total return from 23 February 2006 to end-March 2019. Share price broadly flat on 1 year view. Yield ca. 7.4%.
Major shareholders	Invesco AM 46%, Armstrong Investments 7%, Insight IM 6%, Marwyn IM 6%, Lazard AM 5%, Barclays Wealth 5%, GLG partners 4%*
AIC sector	Private Equity
KID	
Costs	3.3% ongoing
Risk level	4
Stress scenario	-43%
Discount factors	Illiquid assets, cyclical, concentrated portfolio, shareholder concentration, fees, size

Source: Company, \*Thomson Reuters, Hardman & Co Research

Menhaden	
Issue	Comment
Ticker/Market Cap	MHN/£64m
Website	<a href="http://www.menhaden.com">www.menhaden.com</a>
Company description	<p>"The Company's investment objective is to generate long-term shareholder returns, predominantly in the form of capital growth, by investing in businesses and opportunities, irrespective of their size, location or stage of development, delivering or benefiting from the efficient use of energy and resources. Whilst the intention is to pursue an active, non-benchmarked total return strategy, the Company will be cognisant of the positioning of its Portfolio against the MSCI World Total Return Index (in Sterling). Accordingly, the Menhaden Team will take notice of the returns of that index with a view to outperforming it over the long term." The largest investments are X-ELIO * (19.1% total assets), Airbus (11.0%), CGE Investments (10.7%), Safran (10.1%), Alphabet (9.8%), Brookfield Renewable Energy (5.6%), Union Pacific Railway (4.7%), Calvin Capital (4.7%), Canadian Pacific Railway (4.6%), Terraform Power (4.0%).</p>
Latest NAV	100.05p 31 March 2019
Share price 7 May 2019	80.5p
Discount	20%
Volatility	High
Return	NAV 10% YTD, 14% 1 year, 28% 3 years, 2.5% since inception
Major shareholders	Cavenham Private Equity and Directs 17%, Generali AM 8%, Kendall family investments 6%, AachenMunchener Versicherung 5%, Santino Global 4%, Grantham Foundation 3%, Rathbones IM 3%, Ravenscroft IM 3%*
AIC sector	Sector Specialist: Environmental
KID	
Costs	Ongoing 2.1%, transaction costs 0.2%
Risk level	4
Stress scenario	-66%
Discount factors	Legacy issue – performance, KID stress test, concentrated portfolio, diversity risk mitigated by few positions, size

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Understanding the Deepest Discounts

New Star Investment Trust	
Issue	Comment
Ticker/Market Cap	NSI/£77m
Website	<a href="http://www.nsitplc.com/">http://www.nsitplc.com/</a>
Company description	"The Company's investment policy is to allocate assets to global investment opportunities through investment in equity, bond, commodity, real estate, currency and other markets. The company's assets may have significant weightings to any one asset class or market, including cash. The Company invests in pooled investment vehicles, exchange-traded funds, futures, options and limited partnerships. The Company may also invest up to 15% of its net assets in direct investments in relevant markets."
Latest NAV	158.92p (cum inc), 157.23 (exc inc) 31 April 2019
Share price 7 May 2019	108.5p
Discount	32%
Volatility	Low
Return	The total return in the six months to end-December 2018 was -4.63%, +5.4% in prior year
Major shareholders	John Duffield 59%, Michael Astor 4%, Miton AM 4%, Armstrong Investments 3%*
AIC sector	Flexible Investment
KID	
Costs	1.74%
Risk level	3
Stress scenario	-56%
Discount factors	Diversity risk by asset class, majority shareholders, size

Source: Company, \*Thomson Reuters, Hardman & Co Research

North Atlantic Smaller Companies	
Issue	Comment
Ticker/Market Cap	NAS/£423m
Website	<a href="https://www.electraequity.com">https://www.electraequity.com</a>
Company description	"The objective of the Company is to provide capital appreciation through investment in a portfolio of smaller companies principally based in countries bordering the North Atlantic Ocean." The largest holdings are all UK companies and include Oryx International Growth Fund Limited (Listed 11% portfolio), Polar Capital Holdings plc (AIM 8.3%), Ten Entertainment Group PLC (Listed 7.1%), MJ Gleeson plc (Listed 7%), EKF Diagnostics Holdings plc (AIM 6%), Bioquell PLC (Listed 3.7%), Harwood Private Equity Fund IV LP (Unquoted 3%), Trident Private Equity Fund III LP (Unquoted 2.9%), Sherwood Holdings Limited (Unquoted 2.8%), Odyssean investment Trust Plc (Listed 2.5%)
Latest NAV	3,864.06p basic net asset value per share (excluding current period revenue) under the equity accounting method The unaudited basic net asset value per share (excluding current period revenue) under IFRS 10 was 3,774.92p, 31 March 2019
Share price 7 May	2950p
Discount	24%
Volatility	Medium (1 year price range 2,630p to 3,076p)
Return	In past year to 6 May 2019, the share price has risen from 2,739p to 2,950p, (over three years up from 2,330p)
Major shareholders	Christopher Mills 26%, CG Asset Management 8%, Merian Global Investors 5%, Rathbone IM 5%, Butterfield AM 5%, Quilter Investors 5%*
AIC sector	North American Smaller Companies
KID	
Costs	Ongoing 1.24%, performance fees 0.27%
Risk level	4
Stress scenario	-62%
Discount factors	KID stress test, concentration risk (top 5 holdings 39.4%), related parties' disclosure 2 May 2019, sector classification

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Understanding the Deepest Discounts

### Oakley Capital Investments

Issue	Comment
Ticker/Market Cap	OCI/£427m
Website	<a href="https://oakleycapitalinvestments.com">https://oakleycapitalinvestments.com</a>
Company description	"OCI provides access to the out performance of a focused portfolio of fast growing private companies. It has achieved its top tier returns through its investment in the Oakley Capital Funds. These are Europe-focused Private Equity Funds that aim to build portfolios of high-growth, medium-sized companies, primarily in TMT, Consumer and Education."
Latest NAV	574.8m 281p per share 31 December 2018
Share price 7 May 2019	209p
Discount	26%
Volatility	Medium 1 year price range 172p to 209p (3 year 163.5p to 2,010p)
Return	Total NAV return in 2018 16%, 3 years 47%
Major shareholders	Invesco AM 20%, Woodford IM 20%, Asset Value 11%, Sarasin Partners 6%, FIL 6%, Peter Dubens 5%, Rothschild WM 4%, RBC trust 4%, Jupiter AM 4%*
AIC sector	Private Equity
KID	
Costs	Ongoing 3,45%, Incidental 2.69%
Risk level	4
Stress scenario	-51%
Discount factors	Legacy issues – other, Illiquid assets, cyclical (sentiment), concentration risk (top 5 69% NAV), assumption-driven valuation, fees,

Source: Company, \*Thomson Reuters, Hardman & Co Research

### Pershing Square Holding

Issue	Comment
Ticker/Market Cap	PSH, PSHD/£2,951m
Website	<a href="http://www.pershingsquareholdings.com">www.pershingsquareholdings.com</a>
Company description	"Pershing Square Holdings, Ltd. ("PSH") (LN:PSH) (LN:PSHD) (NA:PSH) is an investment holding company structured as a closed-ended fund that makes concentrated investments in publicly traded, principally North American-domiciled, companies. PSH's objective is to maximize its long-term compound annual rate of growth in intrinsic value per share. SH has appointed Pershing Square Capital Management, L.P. ("PSCM," the "Investment Manager" or "Pershing Square"), as its investment manager." "Our strategy is to acquire smaller pieces of superb businesses over which we have substantial influence, rather than controlling interests in lower quality businesses. "Pershing Square Holdings has assembled one of the highest quality collections of "subsidiaries" in the world. Businesses like Restaurant Brands, Hilton, Starbucks, ADP, Chipotle, Howard Hughes, United Technologies, Lowe's, Fannie Mae and Freddie Mac, each have high returns on capital, very long-term growth trajectories, wide competitive moats, unique and irreplaceable brands and/or other assets."
Latest NAV	\$24.06/£18.45 30 April 2019
Share price 7 May 2019	£13.34
Discount	28%
Volatility	High
Return	40.0% YTD 2019, -0.7% 2018, -4.0% 2017, -13.5% 2016, -20.5% 2015, +40.4% 2014
Major shareholders	William Ackman 18.5%, Quilter Investors 4%*
AIC sector	Hedge Funds
KID	
Costs	Ongoing 2.8%, Performance fees 1.08%
Risk level	5
Stress scenario	-84%
Discount factors	Legacy issues – performance, KID stress test, concentration risk, key staff, voting structure, fees

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Understanding the Deepest Discounts

Riverstone Energy	
Issue	Comment
Ticker/Market Cap	RSE/£778
Website	<a href="http://www.riverstonerel.com/">http://www.riverstonerel.com/</a>
Company description	"Riverstone Energy Limited is a closed-ended investment company listed on the London Stock Exchange under the symbol RSE, which invests exclusively in the global energy industry, with a particular focus on the exploration and production and midstream sectors."
Latest NAV	\$1,431m, \$17.91 per share end-December 2018
Share price 7 May 2019	975p
Discount	29%
Volatility	Medium
Return	Share price fallen over past year from 1,256p to 975p
Major shareholders	Alaska Permanent Fund Corporation 25%, Kendall Family 11%, Riverstone Holdings 9%, Quilter Investors 8%, Asset Value 5%, Robert McNair 4%, Stephen Orenstein 3%*
AIC sector	Sector Specialist: Commodities & Natural Resources
KID	
Costs	1.7% ongoing + performance fees 0.4%
Risk level	5 years
Stress scenario	-65%
Discount factors	KID stress test, illiquid assets, cyclicity, concentration risk, assumption-driven valuation

Source: Company, \*Thomson Reuters, Hardman & Co Research

Symphony International Holdings	
Issue	Comment
Ticker/Market Cap	SIHL/\$318m, £247m
Website	<a href="http://www.symphonyasia.com/">http://www.symphonyasia.com/</a>
Company description	"We provide opportunities for investors to gain exposure to the region's rapidly expanding markets by investing in companies in particular high-growth sectors - primarily healthcare, hospitality, lifestyle and branded real estate - which will benefit from the rising disposable incomes of Asia's increasing, and increasingly aspirational, population. Our team is led by Anil Thadani, who founded one of Asia's first private equity businesses and has been investing in the region for more than 30 years. Our business is structured as a permanent capital vehicle to enable us, where necessary, to take a long-term view of our investments. In contrast to traditional private equity funds, our decisions on investing and divesting are not, therefore, influenced by restricted life-cycles. In addition, our structure gives investors more flexibility: it enables them to liquidate or, indeed, add to their positions whenever they choose. Typically, we invest in transactions that involve growth capital for later-stage development and expansion, management buy-outs/buy-ins, restructurings and special situations. Where we see a special opportunity, we may also invest a smaller portion of our investment capital in earlier-stage businesses. In addition, and unlike most private equity businesses, we invest in real estate development: we develop projects designed to appeal to the evolving lifestyles of Asia's increasingly wealthy demographic."
Latest NAV	\$541m (\$1.0554 per share) 31 March 2019
Share price 7 May 2019	\$0.62
Discount	41%
Volatility	Medium
Return	The share price has fallen from \$0.86 to \$0.63 over the past year (3 years ago \$0.70). NAV per share fell 13.3% (excl. dividend in 2018)
Major shareholders	Asset Value Investors 16%, Anil Thadani 17%, Sunil Chandiramani 6%, Symphony IM 4%*
AIC sector	Private Equity
KID	
Costs	3.15% ongoing
Risk level	5
Stress scenario	-78%
Discount factors	KID stress test, cyclicity, illiquid assets, competition, assumption-driven valuation, fees

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Understanding the Deepest Discounts

Tetragon Financial Group	
Issue	Comment
Ticker/Market Cap	TFG NA, TFG LN, TFGS LN/TGONF (OTC Markets, Pink)/£900m
Website	<a href="https://www.tetragoninv.com/">https://www.tetragoninv.com/</a>
Company description	<p>"Tetragon is a closed-ended investment company that invests in a broad range of assets, including bank loans, real estate, equities, credit, convertible bonds, private equity stakes in asset managers, infrastructure and TFG Asset Management, a diversified alternative asset management business. Where appropriate, through TFG Asset Management, Tetragon seeks to own all, or a portion, of asset management companies with which it invests in order to enhance the returns achieved on its capital. Tetragon's investment objective is to generate distributable income and capital appreciation. It aims to provide stable returns to investors across various credit, equity, interest rate, inflation and real estate cycles. The company is traded on Euronext in Amsterdam N.V. and on the Specialist Fund Segment of the main market of the London Stock Exchange.</p> <p>TFG Asset Management (TFGAM) comprises: (i) LCM Asset Management – a CLO asset management company. (ii) The GreenOak Real Estate joint venture – a real estate-focused principal investing, lending and advisory firm. (iii) Polygon Global Partners – a manager of open-ended hedge fund and private equity vehicles across a number of strategies. (iv) Equitix – an integrated core infrastructure asset management and primary project platform. (v) Hawke's Point – an asset management company focused on mining finance that seeks to provide capital to companies in the mining and resource sectors. (vi) Tetragon Credit Income Partners (TCIP) – the holding company of the general partner entities of two private equity vehicles focusing on CLO investments, including majority stakes in CLO equity tranches. (vii) TCI Capital Management LLC (TCICM) – a CLO loan management business Assets under management for TFGAM as of 31 December 2018 totalled approximately \$28.1 billion."</p>
Latest NAV	\$2,238m (\$23.87 per share) 31 March Factsheet
Share price 7 May 2019	\$12.78
Discount	46%
Volatility	Medium (share price low to high in past 12 months \$11.5 to \$13.2)
Return	NAV per share return: 2018 10.3%, 2017 9.0%, 2016 8.5%, 2015 16.0%, 2014 8.1%, 10-year 13.2%, 11.2% since IPO in 2005
Major shareholders (% excluding treasury shares)	Directors 17%, Other employees 9%, OMERS Administration Group 9%, Fortress Investments 9%, Goldman Sachs AM 8%, Omega Overseas partners 6%, Asset Value 6%, Danica Pension 5%
AIC sector	Flexible Investment
KID	
Costs	2.55% ongoing costs + performance fees 1.93%
Risk level	4
Stress scenario	-59%
Discount Factors	Other legacy issues, illiquid assets, diversity by asset class, assumption-driven valuation, voting structure, fees

Source: Company, Hardman & Co Research

Third Point Offshore Investments	
Issue	Comment
Ticker/Market Cap	TPOU, TPOS/£859m
Website	<a href="http://www.thirdpointoffshore.com">www.thirdpointoffshore.com</a>
Company description	<p>"Third Point Offshore Investors Limited ("TPOIL") is the London-listed, closed-end fund managed by Daniel S. Loeb's Third Point LLC. TPOIL offers investors a unique opportunity to gain direct exposure to Daniel S. Loeb's opportunistic investment strategy. TPOIL maintains all investment holdings present in Third Point's primary investment strategy. TPOIL's objective is to provide shareholders with long term, attractive risk-adjusted returns, using the investment skills and expertise of Daniel S. Loeb and the Master Fund's wider portfolio team. The Master Fund pursues an opportunistic investment approach based on event-driven fundamental value analysis across the capital structure."</p>
Latest NAV	\$19.31 30 April 2019
Share price 7 May 2019	\$14.85
Discount	23%
Volatility	High
Return	YTD 12%, 2018 -10.9%, 2017 +18.9%, 2016 6.1%, 2015 -2.6%, 2014 +6.5%
Major shareholders	Third Point LLC 20%, Clearbridge LLC 9%, Asset Value 9%*
AIC sector	Hedge Funds
KID	
Costs	Ongoing 2.63%, Performance fees 1.37%, Transaction 0.71%
Risk level	3
Stress scenario	-43%
Discount factors	Volatility, key staff, fees

Source: Company, , \*Thomson Reuters, Hardman & Co Research



## Understanding the Deepest Discounts

UIL	
Issue	Comment
Ticker / Market Cap	UTL/£175m
Website	<a href="http://www.uil.limited">www.uil.limited</a>
Company description	“Our investment objective is to maximise shareholder returns by identifying and investing in investments worldwide where the underlying value is not reflected in the market share price. UIL Limited (formerly Utilico Investments Limited and Utilico Limited) is an exempted closed-end Bermuda incorporated investment company, established as a successor to Utilico Investment Trust plc. The investment approach is to seek to invest in undervalued investments. This perceived undervaluation may arise from any number of factors, including technological change, market motivation, prospective financial, engineering opportunities, competition, management underperformance or shareholder apathy. UIL has the flexibility to make investments in a wide range of sectors and markets.” Gearing based off the AIC definition was 69% at end-March 2019. The largest sector split of investments were Technology (28.2%), Financial Services (22.5%), Gold Mining (13.8%), Resources (8.5%). Geographically, Australia was 24.6%, Other Gold Mining 13.8%, Bermuda 13.2%, UK 13.0%, Europe ex UK 12.6 %. Manager is ICM Investment Management.
Latest NAV	349.08p (cum inc), 347.2p (exc inc) NAV RNS 30 April 2019
Share price 7 May 2019	197p
Discount	43%
Volatility	Medium share price high to low in past year (199p to 158p), share price doubled in 2016
Return	NAV total return 18.7% in year to June 2018 to 292p; on course for similar return in year to June 2019
Major shareholders	General Provincial Life Pension Fund, Ltd. 63%, Permanent Mutual, Ltd. 8%, Brooks Macdonald Asset Management Ltd 3%*
AIC sector	Flexible Investments
KID	
Costs	6.35% ongoing, 0.42% performance, 0.07% transaction
Risk level	5
Stress scenario	-76%
Discount factors	KID stress test, concentrated portfolio (top 5 holdings 72% portfolio), diversified by asset class, major shareholders, gearing, fees

Source: Company, \*Thomson Reuters, Hardman & Co Research

Value and Income	
Issue	Comment
Ticker/Market Cap	VIN/£118m
Website	<a href="https://www.olim.co.uk/investment-products/value-and-income-trust/">https://www.olim.co.uk/investment-products/value-and-income-trust/</a>
Company description	“The Company's objective is to provide shareholders with long-term returns in excess of the FTSE All-Share Index by investing in higher yielding, less fashionable areas of the UK commercial property and quoted equity markets, particularly in medium and smaller sized companies. The Company will pursue its investment objective by investing primarily in quoted UK equities, UK commercial property and cash or near cash securities.” In recent years, around two-thirds of the portfolio has been in equities and one-third in commercial property. Of the equities, the largest reported positions were in Beazley, Unilever, Halma, BP & L&G. Manager is OLIM Investment Managers.
Latest NAV	337.63p (debt at par), 318.73 (debt at fair value) 30 April 2019
Share price 7 May 2019	259p
Discount	23%
Volatility	Medium (share price 246p to 278p over past year)
Return	NAV total return in 2018 -1.6% and 9.3% over three years, dividends up 3.6% (31 <sup>st</sup> consecutive year of increase)
Major shareholders	M Oakeshott 21%, Alliance Trust 10%*
AIC sector	UK Equity Income
KID	
Costs	Ongoing 3.97%, transaction costs 0.63%
Risk level	4
Stress scenario	-45%
Discount factors	Legacy other, some illiquid assets, some assumption-driven valuation, fees

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Appendix 2: realisation phase

We believe the ICs that are in realisation/harvesting phase offer very specific opportunities but that they require a considerable investment of time before potential new buyers can become comfortable with the real valuation of the assets. When a business is put into wind down, the economics change, and there are a number of uncertainties introduced into the valuation, including i) in a wind down situation, the business is a known and maybe forced seller of assets, making the actual realisable value uncertain, ii) there will also be uncertainty over the eventual costs of closure, and iii) there will be fewer buyers, given the complexity of the story, and sellers may want to crystallise their cash ahead of final termination.

CATCo Reinsurance Opportunities	
Issue	Comment
Ticker/Market Cap	CAT, CATC/£219m
Website	<a href="http://www.catcoreopsfund.com/">http://www.catcoreopsfund.com/</a>
Company description	"The investment objective of the Company is to give its shareholders the opportunity to participate in the returns from investments linked to catastrophe reinsurance risks, principally by investing in fully collateralised reinsurance contracts but also via a variety of insurance-based investments, including insurance-linked swaps and industry loss warranties, insurance-linked securities as well as other financial instruments. The Company will target an internal rate of return in excess of LIBOR plus 12 percent to 15 percent per annum including a distribution by way of dividend in respect of each Fiscal Year, of an amount equal to LIBOR plus 5 percent of the Net Asset Value at the end of each Fiscal Year. The Master Fund intends to spread investment risk by seeking exposure to several non-correlated risk categories which limits the amount of capital at risk with respect to a single catastrophic event."
Latest NAV	\$0.33 (ordinary) \$0.6069 (C shares) 31 March 2019
Share price 7 May 2019	\$0.21 Ordinary, \$0.38 C shares
Discount	38% for both
Major shareholders	Quilter Investors 19%, Aberdeen AM 13%, FIL 12%, Baillie Gifford 7%, Schroder IM 7%, Architas MM 5%, Aberdeen Asset Investments 4%, West Yorkshire Pension Fund 3%*
AIC sector	Sector Specialist: Insurance & Reinsurance Strategies
KID	
Costs	n/m
Risk level	n/m
Stress scenario	n/m
Discount factors	Put in run-off from 30 June 2019

Source: Company, \*Thomson Reuters, Hardman & Co Research

Electra Private Equity	
Issue	Comment
Ticker/Market Cap	ELTA/£133m
Website	<a href="https://www.electraequity.com">https://www.electraequity.com</a>
Company description	"On 4 October 2018, the Board announced the outcome of the third phase of its strategic review. The Board announced that it considered that each of the remaining corporate investments represented an opportunity for value creation within an acceptable timeframe but had decided that the concentration of the portfolio and the structural inefficiency in reinvesting in a listed private equity vehicle with a significant market discount to NAV made it inappropriate to seek to do this within the existing investment objective and policy of the Company. The Board therefore concluded, and recommended, that it is in the best interests of shareholders to conduct a managed wind-down of the portfolio over a period of time, allowing optimisation of returns, the return of cash to shareholders, and ultimately the winding up of the Company."
Latest NAV	527p 30 September 2018)
Share price 7 May 2019	347
Discount	34%
Major shareholders	Sherborne Investors Management (Guernsey) LLP and its associates 30%, Prudential 10%, Witan IT 10%, FIL 5%, Insight IM 4%, Aviva investors 3%*
AIC sector	Private Equity
KID	
Costs	Ongoing 1.95%,
Risk level	5
Stress scenario	-79%
Discount factors	Wind down

Source: Company, \*Thomson Reuters, Hardman & Co Research

EL Oro	
Issue	Comment
Ticker/Market Cap	ELX/£39m

## Understanding the Deepest Discounts

Website	<a href="http://www.eloro.co.uk/">http://www.eloro.co.uk/</a>
Company description	"The El Oro Group holds discrete portfolios which are segmented and managed along distinctly different lines and investment styles: (i). the UK portfolio is predominantly an income portfolio that focuses on stocks in relatively mature sectors (e.g. some, but not all, brewing, utility and mining stocks) which are typically characterised by high yields; and (ii). the Guernsey portfolio holds stocks selected in pursuit of a blended value / growth investment style which seek to identify companies with good growth prospects that have not yet been fully priced by the market."
Latest NAV	75.2p per share, 31 March 2019 (incl. cash of 44.1p per share)
Share price 7 May 2019	62p
Discount	18%
Major shareholders	S Kumaramangalam 10%, E Houston 10%, C Parish 9%, C Zegos 7%*
AIC sector	Sector Specialist: Commodities & Natural Resources
KID	
Costs	Ongoing 3.63%, Transaction costs 0.69%
Risk level	4
Stress scenario	-37%
Discount factors	Voluntary winding-up and reconstruction of the company with rollover options into JPMorgan Elect plc ("JPME")

Source: Company, \*Thomson Reuters, Hardman & Co Research

RDL Realisation	
Issue	Comment
Ticker/Market Cap	RDL/£60m
Website	<a href="https://rdlrealisationplc.co.uk/">https://rdlrealisationplc.co.uk/</a>
Company description	"...effecting a Managed Wind-Down with a view to realising all of the Investments in a manner that achieves a balance between maximising the value received from Investments and making timely returns to Shareholders. The Company may sell its Investments either to co-investors in the relevant Investment or to third parties, but in all cases with the objective of achieving the best available price in a reasonable timescale. As part of the realisation process, the Company may also exchange existing Debt Instruments issued by any Direct Lending Platform for equity securities in such Direct Lending Platform where, in the reasonable opinion of the Board, the Company is unlikely to be able to otherwise realise such Debt Instruments or will only be able to realise them at a material discount to the outstanding principle balance of that Debt Instrument."
Latest NAV	\$10.95 per share (£8.59 cum inc), \$11.51 (£9.02 exc inc) 30 November 2018
Share price 7 May 2019	374p
Discount	56%
Major shareholders	LIM Advisors 26%, Oaktree CM 19%, Invesco AM 12%, Almitas Capital 6%, Garraway 6%, Artemis 4%, Close Bros 3%*
AIC sector	Sector Specialist: Debt
KID	
Costs	6% ongoing and 2% portfolio transaction
Risk level	5
Stress scenario	-70%
Discount factors	Wind down

Source: Company, \*Thomson Reuters, Hardman & Co Research

## Appendix 3: Hardman & Co tick-sheets

Hardman & Co: questions for high-discount ICs	
Issue	Management response
<b>Historical risk: legacy issues</b>	
What has changed in investment process since loss event?	
What is the proof new strategy has worked previously/is working now?	
Evidence corporate governance has changed?	
What will change historically high discount rate?	
<b>Prospective risk</b>	
Why is the KID stress-test scenario not an appropriate measure for prospective risk?	
How do you manage monthly volatility, and is it important?	
What is the impact of asset illiquidity on likely forced sale price?	
How much illiquidity is built into valuation?	
What is the exposure of the assets to economic cyclicality?	
How is competition impacting on re-investment returns?	
To what extent may regulatory/government changes impact on future asset values?	
What is the proportion of assets in top 5 holdings?	
How do you manage investments across different assets classes?	
What is the advantage in holding your diversified company, rather than holding specialists in each asset class?	
How do you manage key staff dependency?	
<b>Accounting</b>	
What have been average realised prices against most recent assumption-based valuations?	
Where are accounting rules not helpful in understanding real value of the company?	
How do you justify current level of fees?	
<b>Corporate governance</b>	
Are there any implications from the shareholding structure?	
What discount do you think arises from the voting structure?	
Why have any related party transactions been in best interests of shareholders?	
What level of discount would you consider a buy-back to be effective?	
How would you manage a buy-back programme, and why in that way?	
<b>Other factors to consider</b>	
Can you prove the debt will never drive the company into being a forced seller of assets?	
Is size important, and what can be done about it?	
Is the discount to NAV the right valuation metric?	
Where is the KID disclosure weak?	
Is the sector classification right?	
What have you done to better communicate the story?	

Source: Hardman & Co Research

KID disclos



### About the author

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*Mark Thomas is an analyst in the Financial Stocks and Investment Companies team at Hardman & Co.*

*He has nearly 30 years' experience in Financial Services. He leveraged his 10 years' direct industry experience within NatWest Group to give investors a better understanding of the business models of the companies he followed. His general business analysis is supplemented with specific experience in balance sheet management, derivatives, tax, pension and accounting issues (invited member of FIAG), combined with considerable board-level liaison across all sizes of companies. He spent more than 10 years as a highly-rated sell-side analyst, primarily with the financial specialists Fox Pitt Kelton and Keefe Bruyette & Woods. His coverage extended beyond banks to a range of financial companies, after which he spent six years with the sponsored research house Edison.*

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