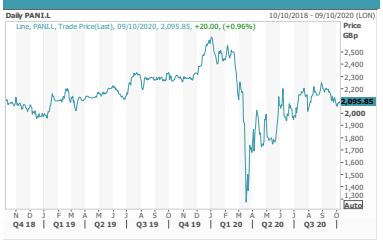
Closed-Ended Investment Funds



Source: Refinitiv

Market data

EPIC/TKR	**PIN**
Price (p)	**2,080**
12m High (p)	2,620
12m Low (p)	1,274
Shares (m)	54.089
Mkt Cap (£m)	1,125
NAV p/sh (p, Jun)	2,846.2
Disc. to NAV	27%
Market	Premium equity closed-ended inv. funds

Description

The investment objective of Pantheon International Plc (PIP) is to maximise capital growth by investing in a diversified portfolio of private equity (PE) funds and directly in private companies.

Company information

Chairman	Sir Laurie Magnus
Aud. Cte. Chr.	David Melvin
Sen. Ind. Dir.	Susannah Nicklin
NEDs	John Burgess, John Singer, Mary Ann Sieghart, Dame Sue Owen
Inv. Mgr.	Pantheon
Manager	Helen Steers
Contact	Vicki Bradley
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Key shareholders, 31 May 2020

Quilter	9.40%
USS	8.15%
Esperides SA Sicav-SIF	5.75%
East Riding of Yorkshire Cl	4.70%
APG Asset Mgt.	4.44%
Investec Wealth	4.37%
Private Syndicate Pty	3.76%
Brewin Dolphin	3.45%

Diary

Mid-Oct	Sep NAV

Analyst

Mark Thomas 020 7194 7622
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PANTHEON INTERNATIONAL PLC

Returns, resilience and responsibility

The long-term messages remain unchanged from our 6 September 2019 initiation, *11.9% average annual NAV growth since 1987*: i) PIP's investors get liquid access to the whole private equity (PE) market, ii) PE-backed companies, on average, deliver superior growth than quoted ones, iii) PIP is investing in the right parts of the PE market, iv) PIP benefits from being part of the Pantheon family, and v) PIP benefits from a structured asset selection process. We believe the "real" NAV is above "book" NAV and that its downturn resilience has been proven again in 2020. PIP's ESG credentials are market-leading and well-established.

- **Returns:** PIP delivers market-beating returns by selecting PE managers who add real value to their underlying portfolio companies, and by selecting direct investment opportunities in PE-backed companies. PIP's whole market mandate means it can select the best opportunities.
- **Resilience:** PIP's outlook confidence is driven by i) more than 40 years' PE experience, gathered through different economic cycles, ii) a conservative stance, including limiting debt, iii) a bias to the IT/healthcare sectors, iv) permanent capital and strong liquidity, v) a collegial culture, and vi) a track record of outperformance.
- **Valuation:** PIP shares trade at a 27% discount to NAV, despite their long-term outperformance. We believe the "real" NAV is likely to be above the book value on the accounting date, given the consistent uplift to carrying value achieved on exits. PIP re-invests returns for superior capital growth and pays no dividend.
- **Risks:** We note i) sentiment to the economic cycle (NAV rose every year in the 1990s' recession, and in FY'20), ii) adverse sentiment to illiquid and unquoted investments (PIP has permanent capital and proven exit uplifts), and iii) sentiment to the sustained discount could be an issue. Short term, there can be forex volatility.
- **Investment summary:** PIP is in an attractive market, can pick the best part of that market and has competitive operational advantages. Its manager selection, deal selection and portfolio structuring have added value. This has delivered 11.5% annual NAV growth since inception. Corporate governance is strong, and the NAV is conservatively valued. Investors get liquid access to the whole PE market. There are risks around the cycle, and illiquid and unquoted underlying assets, but the current discount appears an anomaly against historical returns.

Financial summary and valuation

Year-end May (£000)	2017	2018	2019	2020	2021E	2022E
Gains on investments	201,198	149,778	204,473	72,264	174,996	200,249
Investment income	17,436	15,504	13,222	11,198	11,218	17,115
Inv. Manager's fee	-12,659	-15,020	-16,584	-17,674	-18,500	-19,500
Other expenses	-1,783	-3,270	-573	-2,449	-1,500	-1,500
Int. payable/similar exps.	-1,791	-1,950	-2,386	-2,223	-2,223	-2,223
Return before taxation	204,790	131,947	194,918	62,294	163,990	194,141
NAV per share (p)	2,190	2,415	2,771	2,883	3,183	3,539
S/P discount to NAV	-18%	-17%	-20%	-28%	-35%	-41%
Investments	1,224	1,275	1,450	1,496	1,712	1,893
Equity issued in year	-26	-3,546	-500	0	0	0

Source: Hardman & Co Research

Important information

Owing to legal restrictions, the information in this document is not available to any person who is a "restricted person" (as defined below) or to any person who is physically present in "restricted countries" (as defined below), and it is available only to persons who are "relevant persons" (as defined below) for UK regulatory purposes.

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- any partnership or corporation organised or incorporated under the laws of "restricted countries";
- any estate of which any executor or administrator is a "restricted person";
- any trust of which any trustee is a "restricted person";
- any agency or branch of a foreign entity located in "restricted countries";
- any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a "restricted country";
- any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organised, incorporated, or (if an individual) resident in "restricted countries"; and
- any partnership or corporation, if:

  1. organised or incorporated under the laws of any foreign jurisdiction; and

  2. formed by a "restricted person", principally for the purpose of investing in securities not registered under the U.S. Securities Act, unless it is organised or incorporated, and owned, by accredited investors (as defined in the rules of the U.S. Securities and Exchange Commission), who are not natural persons, estates or trusts.

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Summary of key attractions/risks

PIP's post-cost returns ca.1.5x post-cost MSCI World/ FTSE All-Share returns since inception in 1987

Since inception in 1987 to end-August 2020, PIP has delivered 11.5% average annual NAV growth. After all costs, this is a ca.4% annual outperformance compared with benchmark indices over this period and ca.1.5x the market level of returns (FTSE All-Share Total Return 7.0%, MSCI 8.1%). The outperformance reflects:

Returns generated from being in an attractive market, picking the best bits of that market, being part of bigger Pantheon family, and a structured, proven manager selection process

- The PE process adds value, with multiple operational, strategic, financial, cultural and expertise levers to generate superior returns.
- PIP's flexible, global mandate means it can exploit whichever sub-segments offer the most value in this attractive market. It manages deal sizes, the vintage and nature of investment, and sector exposures to optimise returns.
- Pantheon, the Manager, controls risk tightly. While the mandate is flexible, the portfolio is diversified, moderating extreme return volatility.
- Being part of the Pantheon family brings economies of scale, deal access, a broad relationship network, experience and expertise, along with strong corporate governance, including a visibly independent board.
- As a fund investor and co-investor, manager selection is key. We outlined, in our initiation note, PIP's sophisticated process to choose underlying managers.

Accounting NAV likely to be conservative

We also detailed, in *our September 2019 initiation*, why the accounting NAV is conservative, noting that there is no incentive for the PE fund managers or PIP to inflate valuations. In addition, checks and balances are in place, the valuation ratings are in line with peers and there has been a consistent uplift to book value on exit (28% FY'20).

Gives investors liquid access to illiquid market, capital growth, controlled downside

PIP's model gives investors liquid, quoted shares that access the entire illiquid PE market. Other attractions include i) the capital growth story, with no tax leakage, ii) professional management of PE exposure, and iii) the KID (Key Information Document) stress-test shows lower downside risk than is the case for PIP's peers.

Appropriate gearing and liquidity

Gearing in PIP, in its funds and in underlying companies, appears appropriate. Liquidity is managed, and PIP has lower over-commitment than its peers. PE is a resource-intensive business, but this is more than compensated for by higher returns. PIP's costs are around one tenth of the returns earned by investors.

Business sensitive to economic cycle but still grew NAV every year throughout early 1990s' recession. NAV based off premium ratings for premium growth. Assets illiquid and unquoted, but PIP unlikely to be forced seller.

An economic downturn will affect the operating performance of both PIP itself and the underlying companies. It is likely to reduce valuation ratings, and sentiment will be affected by perceived gearing. However, despite these challenges, PIP grew its NAV every year through the 1990s' recession, and again in FY'20. We note that the valuation rating on underlying companies (12.7x March 2020) was at a 2% premium to the MSCI World index, but revenue and EBITDA growth has been massively ahead. While PIP has illiquid, unquoted assets, its permanent capital and liquidity management mean that it is unlikely to be a forced seller at distressed prices.

ESG strong and adopted early

We detail below why PIP's ESG policies are market-leading and the fact they have been established for many years. PIP uses technology to track underlying company compliance, and actively engages with the PE manager when a breach is reported.

Discount in line with peers but anomalous with performance

PIP's discount is in line with that of its peers. However, the absolute level of 27% appears anomalous with market-beating returns generated over the long run. In 57% of years since 1988, PIP has delivered a return of 10%-30%, and with just two years of negative performance.

Returns

PE an attractive market

PIP gives investors access to the whole PE market, and so it is important to consider how PE adds value to its underlying companies. The table below summarises our views of the process of value creation. The key considerations for investors are:

- there are multiple levers to enhance value; and
- the value creation is sustainable, being driven by the model and process.

Techniques used in PE market to create value

Stage	Process
Strategy	
Transforming strategy	PE creates flexibility to adopt a new business model, repositioning a business within its sector, diversifying its markets and implementing a credible growth strategy. PE managers' broader market knowledge may bring insights unavailable to the standalone entity.
Capital expenditure	PE can provide the necessary financial resources to support business growth objectives.
Accretive mergers and acquisitions	Growing scale, increasing sales and operational capabilities, improving a company's position within an industry and releasing synergies to unlock growth. PE backers can also help target company sourcing, due diligence and integration.
Managed for exit	Part of a PE manager's skill is expertise in achieving a high-value sale. We believe that an incremental aspect to this is that the businesses are being actively managed, with the expectation that there will be corporate action. By grooming such businesses for sale and knowing potential buyers, there is inherent value creation. We note that, in the public markets, a trade sale would typically be at a premium of 25%-30% to the pre-sale price.
Long-term focus	Compared with public companies, a PE-backed company can focus on long-term performance without the distraction of meeting short-term expectations. We believe the PE managers exert appropriate controls to ensure that there is oversight, and that this long-term focus does not become an excuse for short-term underperformance.
Performance enhancement	
Operational improvements	PE can generate superior top-line growth and margin expansion, helping to develop new products, geographies, enhanced sales force effectiveness, process optimisation and the use of technology. PE sector knowledge allows the transfer of best practice in a way that a small business cannot.
Strengthening management	Making new hires and adding industry specialists who bring fresh perspectives and the expertise that can drive the business further forward. Membership of Board and Advisory Committees is an option. The alignment of financial interests, and strategic optionality, may see the "best" possible talent attracted.
Active management of capital structures/finances	Using banking and debt relationships developed across a PE manager's platform can optimise funding. Additionally, PE managers bring significant financial and capital markets expertise to the businesses in which they invest – a skill base the underlying company may not have on its own account.
Valuation opportunity	
Lower target valuations	Many private company valuations are lower than listed ones, creating an arbitrage opportunity whereby PE companies can buy private companies and transform them over time into listed ones.
Fishing in bigger pool	The pool of companies PE can target is deeper and broader than the quoted market. Some market practitioners believe there are five times as many private company opportunities as listed ones.
Due diligence in PE process	The PE process itself involves extensive due diligence, often with inside management information. The depth of investigation is typically more than would be seen for most public companies – although this requires significant resourcing. PE managers are typically sector-focused and have detailed knowledge of potential investee companies' competitive landscapes.
Corporate governance	
Governance and responsible investing	We believe that, through investing responsibly and considering ESG issues at all stages of the investment cycle, PE is able to manage ESG risks to generate long-term sustainable returns. PE has the resources to consider such issues when a standalone company may not.
Manager/shareholder alignment	Managers' and shareholders' interests are closely aligned through common ownership at all levels of the investment chain. The underlying company managements typically are incentivised with share-based performance incentives. The PE manager's performance fee is typically paid only once the fund has achieved a hurdle return (market-wide typically 8% p.a.).

Source: Hardman & Co Research

PIP's added value

PIP adds value to this attractive market by:

PIP's whole market mandate means it can pick the best bits – currently middle-market and growth

A further factor driving outperformance is that PIP's flexible mandate means it can invest in the whole PE market and select which elements are likely to add the most value. The current portfolio has a bias to the middle-market and growth, where i) there are fewer competitive pressures, ii) gearing is lower, iii) there are more options for value-enhancing acquisitions, iv) there are more potential economies of scale, and v) there is a wider range of exit options.

PIP invests in primary (new funds) and secondary (established funds) funds, and co-invests directly in companies – this flexibility adds value

Having access to all stages of PE investments, and a flexible mandate to exploit them, is important to managing the portfolio. Secondary investments give quicker payback, and early fees will have been paid, incur material due diligence costs and may offer good entry pricing. While growing strongly, the market is still modest (ca.5% overall PE market). Co-investment opportunities are available because of Pantheon's primary relationships and market presence, and they potentially add value, as there are typically very low or no fees associated with such investments. Recent returns at PIP from co-investments have been accretive to overall returns. Primary deals give access to managers whose funds may not trade, and smaller niche funds are more likely to open up profitable co-investment opportunities, but create financial inflexibility and have longer paybacks.

Vintage management important

Other aspects of portfolio management are important. These include managing the vintage, as older investments typically earn lower returns but generate cash. Newer investments have lower cash generation, incur fees before income is generated, are a constraint on financial flexibility and have assets whose value can be increased by the PE techniques noted above. PIP actively manages the vintage of its book – most notably a one-off exercise segregating the returns from oldest (slowest-growing) assets into a separate Asset Linked Note (ALN), which was issued to a single shareholder in October 2017. The main, remaining portfolio should grow faster as a consequence of this segregation

Portfolio diversified by name, geography and economic sector

We note that PIP has a diversified portfolio by type of investment, geography stage, underlying manager and economic sector. This diversification has been a considerable factor in delivering the distribution of returns, with over three quarters of years generating in excess of 5% NAV growth. Exposures are actively managed, and we noted in our September 2019 initiation that increasing caution about the macroeconomic outlook saw exposure to the "consumer" sector fall significantly in FY'19.

Pantheon, as Manager, has scale, expertise, market knowledge, contacts and track record

Being part of the Pantheon family adds further value, with i) economies of scale, including technology, risk control, market knowledge and information flows, ii) a team with huge experience, very importantly through multiple economic cycles, and iii) access to deals at all stages of investment. This has delivered a track record that has not only beaten market indices, but also is generally better than the company's immediate fund of fund peers (especially over the long term) and better than average compared with direct-investing PE-quoted vehicles, while offering a lower risk profile.

Fund manager selection is key, and Pantheon's approach is structured and not dependent on one individual

As a fund investor and co-investor, manager selection is key. We believe it is also important to understand how this has been achieved and, to do this, investors need to understand Pantheon's investment process. We have detailed below why we believe it is tailored to the investment type and, critically, is process-driven, rather than single-individual-driven. The performance is driven by Pantheon's competitive advantages and is not dependent on individuals, and so should prove more sustainable.

Robust corporate governance

In terms of good corporate governance, we note that the directors have appropriate market knowledge, experience of a range of economic conditions and clear independence from the Manager. PIP's independence from Pantheon is characterised by clear policies overseen by an independent board.

"Real" NAV above accounting NAV, as evidenced by i) no incentive for PE managers to inflate performance, ii) spread of managers gives automatic sense check, iii) valuations of underlying businesses in line with peers, iv) using Pantheon's experience, v) usual independent checks and balances

The focus on what is the "real" NAV has never been greater. Valuing private companies in public funds has always involved a degree of management judgement. Accordingly, we believe that investors should focus on i) there are no incentives – indeed maybe dis-incentives – for the PE managers who provide the valuations to inflate them, ii) the spread of managers gives a sense check, as the same underlying company may be held in multiple funds, iii) valuations relative to other PE houses are not over-stretching, iv) Pantheon's experienced team has been through all trading conditions, and v) there are the usual independent checks and balances, including auditors.

Resilience in downturns

Why PE market is resilient in downturns

PE's outperformance in downturns does not come about by accident but reflects core aspects of the model

Looking at a downturn scenario, the advantages of the PE market we outlined above are arguably even greater. We believe the critical factors are i) access to committed capital, ii) strategic optionality, iii) operational, financial and strategic expertise, and iv) PE funds last at least 10 years. If managers want to earn performance fees or launch new funds, they have to manage their portfolios well through the cycle. Recent changes (including cov-lite documentation, diversity in funding, committed capital, increased communication and management information, and defensive positioning) mean the sector should also be more resilient than it was in the past.

Access to committed capital and creditors' knowledge of this support important factors

PE-backed companies have greater, and faster, access to committed capital than non-PE-backed ones. "Dry powder" (committed funding to PE which has not yet been drawn down) is at record nominal levels, reinforcing this advantage (see page 12 of the *Bain Global PE report 2020* for more details). Knowledge of this support means suppliers and other finance providers feel they are less at risk, and so they can be less aggressive in managing their cashflows with PE-backed companies. Confidence can be critical in uncertain times, and PE backing gives a competitive advantage in this in downturns.

Strategic optionality both acquisitive and organic

Access to capital gives more strategic optionality for PE-backed companies. This may fund acquisitions that, in a downturn, are likely to be less expensive and also more readily available (weaker competitors may see exit as an option, or looking for a stronger parent or larger business may dispose of non-core businesses to strengthen the group balance sheets). Importantly, the optionality from committed capital also allows investment for greater organic growth, which can be even more important in challenging conditions. This complements PE's operational support. By way of example, we note the Popov and Roosenboom (2009) study cited in the May 2013 report, *Exploring the impact of private equity on economic growth in Europe*, that €1 of PE finance can be up to nine times more effective than €1 of non-PE finance in delivering innovations, as measured by patents granted.

PE backers may provide expertise in downturns to help investee companies operationally and strategically, and to manage their finances

In downturns, PE managers can assist their investee companies with targeted expertise that may not be available to the standalone entity. *Inter alia*, PE backers may provide:

- operational expertise, which may include i) advice on procurement and managing supply chains, ii) demand management, including go-to-market strategies and managing key customer relationships, iii) implementing digital tools and processes, iv) talent management and recruitment, and v) operating best practices, including ESG;
- financial expertise, which may include i) working capital and liquidity management, ii) treasury skills in managing greater volatility in currencies, input prices, etc, iii) relationships and "buying-power" with banks, for whom a PE backer with skills in structuring debt is an attractive partner, and iv) planning and stress scenario testing;
- strategic expertise, which may include i) wider awareness of market opportunities, including mergers and acquisitions, or ii) leveraging experience in one area/geography across others – particularly relevant in COVID-19 environment.

We believe these supports are real, not theoretical. On page 16 of our recent *initiation note on Oakley Capital*, we gave practical examples of how these measures

benefited Oakley's investee companies through COVID-19. For Oakley, its support included structuring and managing a public equity for one of its companies.

Manager alignment

As PE funds for last at least 10 years, if managers want to earn performance fees or launch new funds, they have to manage through the cycle. The April 2020 McKinsey & Company report, *Lessons for private equity from the last downturn,* noted that those managers with value creation teams not only outperformed but also raised more capital afterwards. We believe this alignment results in i) adopting a long-term focus for investments, ii) having resources in place, so that they are never forced sellers at distressed prices, but rather can manage the time of sale to optimise returns, and iii) building expertise to manage through downturns. The long-term focus of PE investors may be in marked contrast to public businesses for whom meeting the next quarter's results is important to the share price. The agency cost from listed businesses looking to the short term may include deferred investment, incentivising short-term revenue production or chasing the latest, "hot" sector theme. This analysis saw how banks, which had been out of favour for "bullet-proofing" their balance sheets by restricting lending in 2005-06, were under such pressure that they started to chase lending volumes, just as they were going into the global financial crisis (GFC). A PE-backed business would not be under such short-term pressure.

Recent changes support resilience

In addition to these structural factors, there are several market developments that should enhance the PE market's resilience to a downturn. These include:

Expertise has been built at PE manager level

- Expertise can be provided not only to investee companies but is also important at the PE manager level. One recent feature of PE has been an investment by managers in their own resources. The Ernst and Young March 2020 report, *Why private equity can endure the next economic downturn,* noted that PE firms have 30% more operating partners than they had just five years ago. Pantheon International highlighted, in its recent results, that PE manager expertise had materially increased in advance of COVID-19, as managers prepared for a downturn. The April 2020 McKinsey & Company's study, *Lessons for private equity from the last downturn,* highlighted the scale of outperformance by those firms with "value-creation" teams against those without.

Cov-Lite documentation

- Cov-lite documentation should reduce the probability of default. Cov-lite documentation may allow weak companies to trade through to a recovery, when, in the past, they would not. A bank contact of ours recently reported that the enforceability of documentation was currently lower than in the GFC. We explored this in some detail in our *12 May 2020 note on Volta Finance*. Where gearing has been increased in a PE deal, cov-lite impacts are especially important.

Diverse and sophisticated funding sources

- Diversity in funding. The growth in private debt capital markets, as well as in public ones, has meant that the support to investee companies from sophisticated PE treasury teams is even more valuable. These teams have established relationships with financers, which can be invaluable in managing liquidity in a downturn. We do not see a potential debt refinancing cliff, as was the perception in the GFC[1].

Better communication and management information

- Communication and management information. One consistent theme from every PE listed vehicle is the speed and depth with which they are communicating, not only with investee companies, but also with a range of other stakeholders, including shareholders. Technology has facilitated a quantum league improvement in management information, allowing the rapid transfer of experience from one geographical region, which experienced COVID-19 early, to countries that experienced it later.

[1] Ernst and Young note refers to €570bn of PE loans perceived as needing re-financing in GFC

- Committed capital – as noted above the "dry powder" is at record nominal levels.
- Investor sophistication – we believe the experience of PE managers, PE investors and financers is very important in terms of managing in a downside. It is noticeable that the discount to NAV this time around widened significantly less than in the GFC.

Defensive positioning by sectors

- Defensive positioning. Every quoted PE company has, in recent times, been emphasising the defensiveness of its portfolio and the importance of sectors such as technology and healthcare. Since the beginning of 2018, for example, PE firms have invested US$181bn into tech – more than double the amount invested into retail and energy combined.[2] This investment has also been more focused on the defensive elements of technology, especially enterprise software [3]. A Boston Consulting Group report noted that 84% of the top-10 PE house average share of deal value in 2016-18 was in defensive sectors (against 75% in 2005-07).

Evidence of PE market resilience

In looking for supporting evidence that the whole PE market is more resilient than PE-backed companies, we cite a number of research pieces from academics.

Stanford report noted resilience

In a piece called Private equity firms show resilience in a downturn, Stanford scholar Shai Bernstein noted, in September 2017, "the decline in investment for private equity-backed firms was significantly smaller than the comparable firms. Specifically, we found that in the years leading to the crisis, both the private equity-backed firms and the control group followed a very similar trend in terms of investments. But this trend diverged in 2008, at the onset of the financial crisis, when the decline in investment among private equity-backed firms was much smaller. Moreover, we found that private equity-backed firms increased their assets more rapidly relative to the control group, and also enhanced their market share during the crisis."

Reasons given include long-term horizon and "dry powder" capital built ahead of downturn

The reasons given were "I think there were a couple of reasons that allowed private equity-backed companies to gain better access to financing resources, and, as a consequence, invest more and grow more rapidly relative to their peers. First, the longer time horizon of the private equity firms' funds (average fund life is 10 years) allowed the private equity investors to support their portfolio companies during the crisis. Moreover, the private equity firms themselves still had capital available to deploy – capital they had raised before the crisis. Consistent with this notion, we indeed found that private equity firms with more "dry powder," or non-deployed capital, at the onset of the crisis were more able to alleviate financing constraints of their portfolio companies during the crisis."

Academics from Leeds/Nottingham universities reached similar conclusion, with PE-backed companies showing stronger performance than quoted companies

Similarly, in a 2011 piece called Private Equity Portfolio Company Performance Through The Recession, academics from Leeds and Nottingham universities noted "Private equity-backed buyouts show a stronger economic performance in the period before and during the recent recession than a matched sample of private companies and listed companies. Private equity-backed buyouts show a higher return on assets, sufficient ability to cover the interest payments on their debt and higher gross margin in the recession period than before it. Growth in value added and profit is stronger than for listed companies during the recession period. Growth in turnover and employment remains positive for the PE-backed buyout sample. ….. The results imply almost 14% higher productivity and 5% higher return on assets (ROA) during the recession than matched private companies and listed companies.". A September 2020 Invest Europe report (entitled "Private Equity at Work : Employment & job

[2] P14 https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/private-equity/private-equity-pdfs/ey-why-private-equity-can-endure-the-next-economic-downturn.pdf?download

[3] See p30 of https://www.bain.com/globalassets/noindex/2020/bain_report_private_equity_report_2020.pdf

creation across Europe") showed the positive relationship between PE and employment in good times too.

PIP has incrementally reduced risk

As we noted in our September 2019 initiation, Pantheon has employed, for some time, a rigorous set of policies to limit company-specific downside and so further reduce risk beyond that of the PE market as a whole. Some of these policies and practices include:

Stress-tests

- Internal stress-tests (reflecting assumptions that are either in line or worse than market conditions seen in the GFC) across the portfolio, reviewing multiple scenarios to ensure appropriate management of the portfolio in the event of a downturn, while, at the same time, positioning it to maximise capital growth. Pantheon's deal teams' "base-case" scenarios for co-investments typically reflect more conservative hair-cutting of underlying managers' projections.

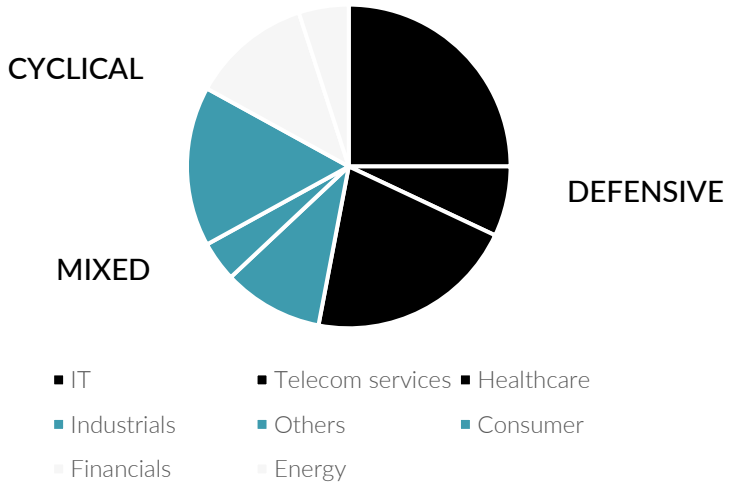
Manager due diligence and selection

- A holistic approach is taken in the due diligence of a manager, reviewing a host of quantitative and qualitative measures that provide a well-researched view of the prospects for a manager's next fund. This helps Pantheon assess how well-placed the manager is to generate consistent returns through the cycle.

Sector focus

- Managing sector exposure. The chart below shows the FY'20 sector exposure categorised by us by risk to a macroeconomic downturn. As can be seen, defensive sectors are the most prevalent. Sector exposures evolve over time (see section, *Portfolio summary*, below), and there has been growth in the defensive sectors over the past five years (using out categorisation, defensive is 53% in FY'20, against 42% in FY'15)

Sector exposure with cyclicality highlighted



Source: Hardman & Co Research

Defensive sub-sectors in higher-risk sectors

- Managing sub-sector exposure defensively. Many of the sector classifications are extremely broad and, while a sector may be perceived as cyclical, sub-sectors within it are not. Pantheon has picked managers who have weighted their portfolios in riskier sectors to more defensive sub-sectors, and in underlying companies with predictable revenues and cash-generative business models with high barriers to entry. An example of this is an ice-cream manufacturer, which is classified as "consumer", but is in the "consumer staples" sub-sector. The same argument applies to a co-investment in a toilet roll and tissue paper manufacturer. The consumer sector also includes education, which

PIP regards, and some peers report, as a separate (defensive) sector, and consumer services, which includes ecommerce.

Multiple levers to add value give downside protection

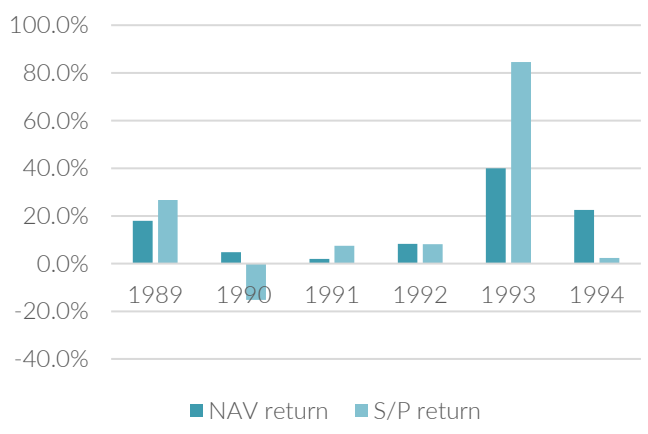
- Overweight areas of the PE market, where there may be more levers to create value and so offset downturn pressures. These include mid-market and growth sub-sectors, which typically have i) lower entry multiples, ii) higher organic growth rates, iii) more operational options to help businesses to grow bottom-line profit, iv) more opportunities for acquisitions of sufficient scale to make a difference, and v) greater numbers of exit options.
- A conservative approach to undrawn commitments, which also saw an increase to the size of the undrawn credit facility in 2020.

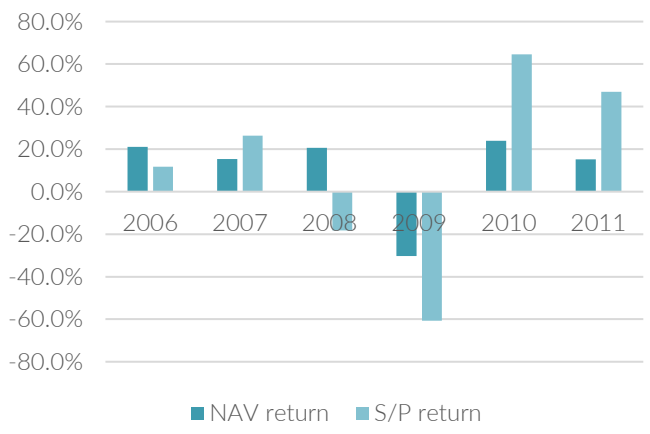
Evidence of PIP's downside resilience

NAV grew every year in early 1990s' recession

Given the recent market turmoil, we thought it might be helpful to summarise our comments from pages 42-45 of our *initiation report*, where we looked at how PIP had performed in various downside scenarios. We note that, in the early 1990s' recession, PIP reported NAV accretion every year. Compared with the financial crisis, PIP is now much more liquid, and so much less likely to be a forced seller of assets at distressed prices. We also highlighted the academic research, which showed not only that PE-backed companies continued to outperform quoted ones in a recession but also explained this outperformance. The better management, and especially having committed financial backing, meant PE-backed businesses could take advantage of such conditions. We detail more recent resilience in the COVID-19 section on the next page.

Annual NAV and share price performance (%) in early 1990s' recession (left-hand graph) and financial crisis (right-hand graph)





Source: PIP Report and Accounts, Hardman & Co Research

Economic cycle affects operational performance of underlying companies, and PIP affected by greater leverage and reduced valuation ratings. On the upside, cov-lite reduces risk of default being triggered (especially at larger end of market), underlying company EBITDA grew through the financial crisis, and re-investment opportunities arise.

A downturn has several potential impacts: i) weaker operational performance in the underlying companies – we note that, in 2009, revenue growth was significantly ahead of benchmark averages, and the underlying companies still produced, on average, a 7% increase in EBITDA – and, while these rates were slower than pre-crisis, they were still positive growth performances; ii) it would affect PIP's own operational parameters – the distribution rate fell by three quarters (from 39% of the opening portfolio in FY'07 to 11% in FY'09/10), and the call rate nearly halved (from 37% of outstanding calls in FY'07 to 16% in FY'10); iii) there is a higher risk of default where companies have more leverage (for PIP, we note that mid-market gearing levels are stable – in the larger buyout space, higher leverage is partially offset by increased cov-lite documentation, reducing the probability of default); iv) the EBITDA rating applied to underlying companies is likely to fall with market falls, reducing the NAV; and v) there are likely to be many more attractively priced re-investment opportunities.

COVID-19

PIP's results are to end-May and were based primarily off the Manager's valuations as at March 2020, i.e. the trough of the initial market's response to the crisis. Valuation losses were 127.5p for the quarter to May 2020 (4.4% of the December-based NAV). August saw a 121.4p valuation gain in the month, primarily because the valuation basis moved predominantly from 31 March to 30 June. The one year's performance is now -3.5%, against the FTSE All-Share's -12.6%.

Before the crisis

PIP's PE managers much better prepared for current crisis than during GFC

Before the crisis, PIP's managers i) fundraised while "times were good", amassing significant war chests over the past few years, ii) used strong exit conditions to sell portfolio companies, iii) built internal resources, adding operational, sector and capital markets expertise (this was especially noted as a differentiator from the GFC, with the skills PE managers now have to respond to shock events), iv) improved portfolio companies' financial positions and strengthened capital structures, v) prepared extreme "downside cases" and stress-tested recession scenarios based off GFC experiences, and vi) invested in businesses with multiple levers for value creation, and increased buy and build activity.

PIP itself was conservatively positioned

PIP itself i) steered the portfolio towards more resilient sectors, such as IT, healthcare and consumer companies with durable demand (leisure and hospitality are a minimal portion of the book – see section, *Portfolio summary*, below), ii) biased investment to "overweight" mid-market and growth, with its lower entry multiples, higher growth rates, more levers to help businesses to grow, and more routes to exit, iii) applied tighter filters on new investments – for example, Pantheon's "base-case" scenarios reflect a more conservative view than the underlying manager's projections, and iv) managed the balance sheet, with a conservative approach to undrawn commitments (see section below), and prepared an increased undrawn credit facility (now £300m, vs. £175m pre-crisis).

During the crisis

Rapid engagement by underlying mangers with their investments. Valuation and activity down but early signs of recovery

The PE managers increased contact with portfolio company management and conducted a rapid assessment of portfolio company issues, challenges and opportunities, which resulted in a detailed classification of investments into low-/medium-/high-impact categories. 1Q'20 portfolio valuations were down, as PE managers took account of lower public market comparables. New deal activity has, as expected, slowed (secondary market volumes are back to 2016 levels), and as buyers and sellers try to work out what the real risks are, as well as the new valuation levels.

Pantheon increased dialogue. Conservatism shown with its "Manager's Provision".

Pantheon itself has increased the dialogue with managers, shareholders and the PIP board. It carried out a detailed assessment of the impact, uniquely introducing a "Manager's Provision", so that its March NAV gave a truer impression of the real value of the investments. It is typical of the conservative nature of the Company that, when actual valuations were received, they were above the level PIP had used.

Benefits of PE apparent

PE outperforms in a downturn. Investee companies benefit from access to capital and significant expertise/knowledge transfer.

COVID-19 has reconfirmed the benefits of PE ownership. Investee companies have much more certain access to capital – to shore up balance sheets but also to take acquisition opportunities as they arise. PE backers have provided expertise and market oversights, especially to smaller and mid-sized companies – so they can much better evaluate impacts on supply chains, site closures and human resource implications. With many PE businesses being global, their insights from early experiences of previous epidemics, lockdowns and re-openings can be invaluable to companies in the later stages of a crisis.

Responsibility

PIP's approach to ESG

PIP overlays the ESG approach of its managers with an incremental set of policies and approaches that are detailed on pages 26-29 of the *2020 Report and Accounts*. Pantheon has an established in-house ESG Committee – comprised of senior individuals from its investment, risk and investor relations teams – which sets the ESG strategy and policy under which client capital, including that of PIP, is managed. It adopts the six principles of the UN Principles for Responsible Investment (UNPRI) and these underpin PIP's ESG strategy. These are:

UNPRI signatory in 2007

- Incorporating ESG issues into the investment analysis and decision-making processes. In 2007, Pantheon was one of the first PE signatories to the UNPRI and, in 2020, was awarded an A+ by UNPRI for PE. Pantheon has served on UNPRI's Private Equity Advisory Council since 2017.

PE managers graded on traffic light system

- Being active owners and incorporating ESG issues into ownership policies and practices. For fund investments, each PE manager is rated green, amber or red, based on a variety of factors. Those ranked amber or red are typically lacking in some critical aspect of ESG – for example, not having a formal ESG policy in place, no ESG reporting mechanism, or no designated senior person overseeing ESG incorporation. Over time, there has been a steady progression of managers to the green rating. At end-FY'20, the majority of the 13 primary commitments made by PIP had a green rating, with the remainder receiving an amber rating. Over three-quarters of the managers now have a formal process in place to engage with their portfolio companies on ESG issues.

RepRisk monitors underlying company and triggers reviews if potential breaches of policy. In FY'20, less than 1% of companies had such reviews, and all take appropriate action where needed.

- Seeking appropriate disclosure on ESG issues by the entities in which PIP invests. In addition to reporting by the manager, PIP uses RepRisk, a third-party news information service that has been fully integrated into Pantheon's pre- and post-monitoring processes since 2017. This system hunts across news reports and social media to identify where any underlying investee company is reported as potentially breaching ESG guidelines. PIP then contacts the PE manager to further understand more about the background, assess the accuracy and reporting of the incident and to find out how the manager plans to address the issue, or the steps that might already have been taken. During 2020, incidents in companies accounting for less than 1% of PIP's NAV required follow-up with the relevant PE manager, and, in all the cases, Pantheon was satisfied that the correct action had been taken where necessary and that the issue did not betray systematic underlying process issues.

- Promoting acceptance and implementation of the Principles within the investment industry.

- Working together with the PE managers to enhance PIP's effectiveness in implementing the Principles.

- Reporting on activities and progress towards implementing the Principles.

Additionally, Pantheon is a signatory to the Global Investor Statement on Climate Change, which was facilitated by the UN Environment Programme Finance Initiative Climate Change Working Group.

Pantheon has a long-established Global Diversity Committee to co-ordinate its initiatives to drive forward best practices and policies on diversity and inclusion. It is a signatory to the UK Government's Women in Finance Charter, which commits to

a pre-set target of gender diversity. Helen Steers, a Partner at Pantheon and manager of PIP, is one of the co-founders of Level 20 (www.level20.org), whose aim is to inspire women to join and succeed in the PE industry. In addition, three of the seven Directors on PIP's board are female, as are 45% of the investment team heads. Overall, 39% of the workforce are from non-white ethnic backgrounds and, as part of the due diligence process, PE managers are questioned about diversity in the teams in which they invest.

PIP's own corporate governance

Independent, experienced board

Directors have appropriate market knowledge, experience of a range of economic conditions, and clear independence from the manager

We detailed the biographies of the board at the end of our initiation report (it has been strengthened with the appointment of Dame Sue Owen and Mary Ann Sieghart since – see PIP's website for their biographies). We believe they demonstrate the key objectives investors should be looking for in a board, including:

- relevant experience of PIP's markets;
- current experience in comparable companies, from which PIP's performance and controls can be effectively compared;
- experience of adverse market conditions;
- independence from the fund manager – this applies to business dealings, but we also believe the PIP board has the character that would challenge the manager when required; and
- board diversity – three of the seven directors are female, exceeding the Hampton-Alexander Review target of 33% female representation on boards.

Investors will note, from pages 89-94 of the 2020 Report and Accounts, that the auditors i) test the effectiveness of PIP's valuation controls, including its sampling of underlying companies, and ii) look at the accuracy of management assumptions and verify the sample underlying companies' own accounts.

Corporate governance

PIP's risk controls are independent function

Further consideration in good corporate governance includes the independence of risk, compliance and allocation functions within Pantheon. Management advises that:

- There is a rigorous allocation process that governs the allocation of investment opportunities across individual Pantheon clients, which is independently overseen by an Allocation Committee to ensure investments are allocated consistently and fairly to clients.
- PIP originates investments that are across the spectrum of primary, secondary and co-investments, whereas Pantheon's other funds are typically focused on one of each of these investment types. As a result, it is difficult to compare returns between PIP and Pantheon's other vehicles directly, but, for each investment type, returns are broadly comparable. There is no evidence that PIP has been advantaged or disadvantaged relative to other Pantheon funds.
- Pantheon's risk management function is headed by the Chief Risk Officer, who reports to the Partnership Board and is a partner on the Risk Committee. The risk team is an independent function within Pantheon, with oversight of all risk management functions (including operational and investment risk).

- We understand that, twice a year, the PIP board receives a transparent report of allocations across the group.
- Pantheon staff declare potential conflicts of interest and excuse themselves from any decision-making process.
- The PIP board can attend the Pantheon Investor Advisory Committee, which convenes every six months and which also reviews potential conflicts of interest.

We understand that ca.1% of the total PIP portfolio is in Pantheon-run funds, but no new commitments to Pantheon funds have been made in over a decade.

Disclosure

An important element of good governance is the quality of disclosure and how willing the company is to be open with stakeholders. We believe PIP is very open in this regard, and its adoption of independent research is just one example of this.

PE market ESG credentials in a downturn

Social – jobs retained in downturn as companies with strong backing are more likely to survive

The key social aspect from PE resilience is the fact that companies with strong backing are more likely to survive a recession, and so employees will still be employed and taxes paid. While somewhat dated, the May 2013 report, *Exploring the impact of private equity on economic growth in Europe,* prepared for the EVCA (now Invest Europe), on pages 41-42, cited a number of academic pieces indicating that the potential survival rates were 5%-50% better under PE ownership. The research on employment levels (page 43) does not look explicitly at downturns.

Looking beyond downturns, Invest Europe, in September 2020, produced a piece of research entitled *Private Equity at Work : Employment & job creation across Europe*. The conclusion we found most striking was that, excluding the effects of M&A, in 2018, the rate of job creation was 5.5%, five times the European job creation average. This report negates the perception that PE is a "slash and burn"-driven sector.

Improving investee company governance with long-term focus, allowing cross-cycle management of business

As we outlined above, one lever PE uses to deliver outperformance is improving the governance within the investee companies. A PE shareholder is likely to be more actively engaged with the investee company management than are most public shareholders. There should be less room for pet projects and less tolerance of extended underperformance with such active engagement. The communication between a PE manager and an investee company is not driven by the formulaic requirements of publicly-listed companies. Perhaps, most importantly, for considering a downturn scenario, PE businesses are managed for the long term, matching the long duration of their mandates. Investee companies can thus be run for the long term, including cross-economic cycles, rather than meeting short-term performance goals.

FY'20 key performance indicators

NAV waterfall chart

Valuation gains in FY'20, despite being based on March 2020 – trough of market's COVID-19 response

The table below shows the percentage increase in NAV over the financial periods going back to FY'13. Valuation gains in FY'20 were positive, despite being based off March 2020, when the markets were at their trough in terms of COVID-19. Expenses and taxes continue to be consistently at 1.5% of NAV.

NAV bridge (% NAV)

Financial period	Valuation gain	Investment income	FX	Buybacks	Expenses and taxes	Total
FY'13	7.0	1.8	3.6	1.2	-2.0	11.6
FY'14	11.9	1.5	-10.1	0.5	-1.4	2.4
FY'15	8.0	1.7	4.0	0.3	-1.7	12.3
FY'16	4.5	1.2	17.2	1.1	-1.7	22.3
FY'17	13.9	1.5	3.2	0	-1.7	16.9
FY'18	13.5	1.2	-2.2	0.1	-2.3	10.3
FY'19	11.0	0.8	4.5	0	-1.6	14.7
FY'20	3.2	0.7	1.6	0	-1.5	4.0
Average	9.1	1.1	2.7	0.4	-1.5	11.8

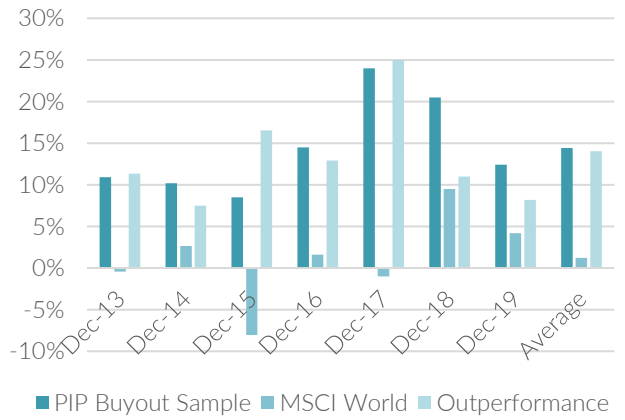
Source: PIP Report and Accounts, Hardman & Co Research

Growth multiples in underlying businesses

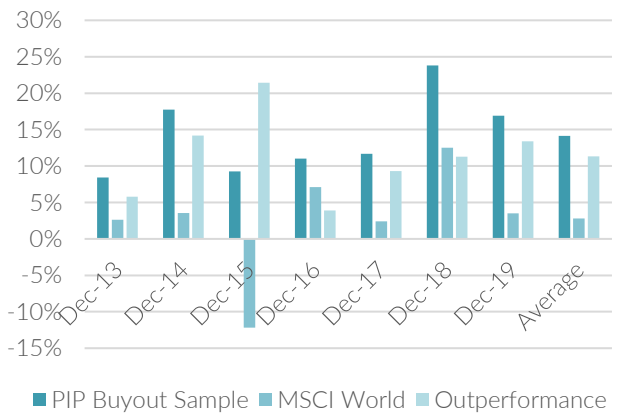
PE and PIP add value, as evidenced by consistent superior revenue and EBITDA growth. FY'20 continued this trend.

The key driver to sustained outperformance is that PE, and PIP's activities in PE, add value to the underlying companies. One metric for this is the growth in both revenue and EBITDA. The charts below show the medium-term trend for both compared with the MSCI Index. Outperformance has continued in FY'20, with revenue growth of 12%, against that for the MSCI of 4%. The EBITDA growth shows outperformance (FY'20 17%, against market 4%), and has been on an accelerated trend. The business message is that PIP's underlying companies are delivering faster growth than the market. These numbers are pre-COVID-19 but, as we detailed in the section above, if anything, we expect even more outperformance in the downturn.

Revenue growth in underlying companies (%)



EBITDA growth in underlying companies (%)



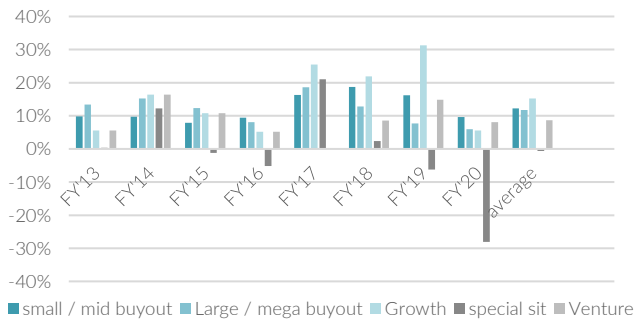
Source: PIP Report and Accounts, Hardman & Co Research

Valuation gains well-spread

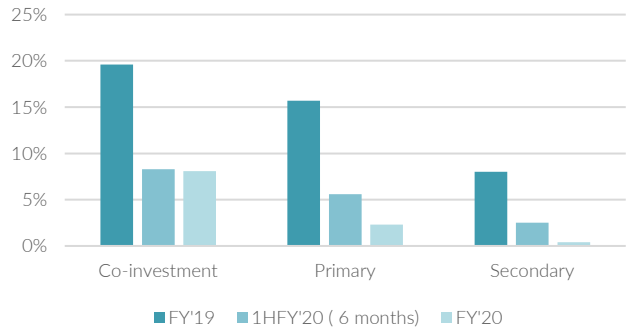
Valuation gains best in small and medium buyouts and venture. Co-investments not only best-performing type but also most resilient.

The charts below look at valuation gains by stage and by the type of investment (disclosure on the latter has been made only relatively recently). The messages from FY'20 are i) valuation gains in small and medium buyouts of 9.6%, just 2.6% below the average since FY'13, and in venture of 8.1%, against the average of 8.7%, ii) large and mega buyouts and ca.6.0% growth still delivered (historical average 11.8%), and iii) a significant reduction in special situations (FY'20 -28.1%, after fall of 6.3% in 1HFY'20). This performance was driven by the energy sector (9% portfolio March 2019, 5% March 2020), which, in the first half, saw a small number of company-specific markdowns and, in the second half, the more general impact of weaker energy prices. Valuation gains by type have again shown co-investment as being the best-performing type. Interestingly, it is also the most resilient to a downturn, with no material reduction in 2HFY'20.

Valuation gains by stage (%)



Valuation gains by type (%)



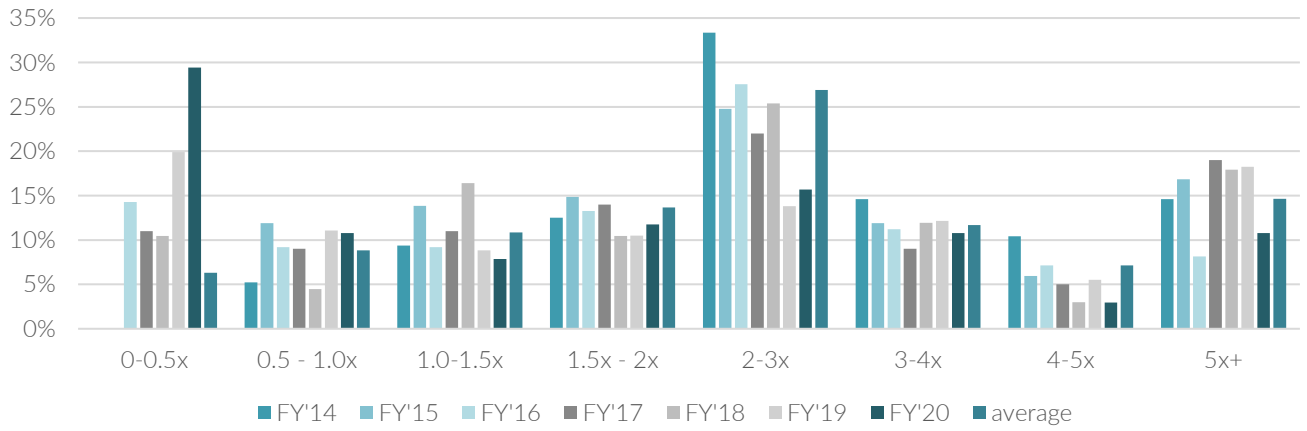
Source: PIP Report and Accounts and interim results, Hardman & Co Research

Exit multiples and realisation proceeds to cost multiple

Average exit multiple of 2.5x cost consistent with past. Distribution of exit multiples also stable, as is uplift to carry value of book.

The chart below looks at the long-term track record of the cost multiple on exit. As can be seen, in any given period, there will be elements of volatility. However, taking the portfolio as a whole, there has been a remarkable stability and, in FY'20, we saw the same again, with an average multiple of 2.5x cost.

Exit realisation as multiple of cost (% by number)

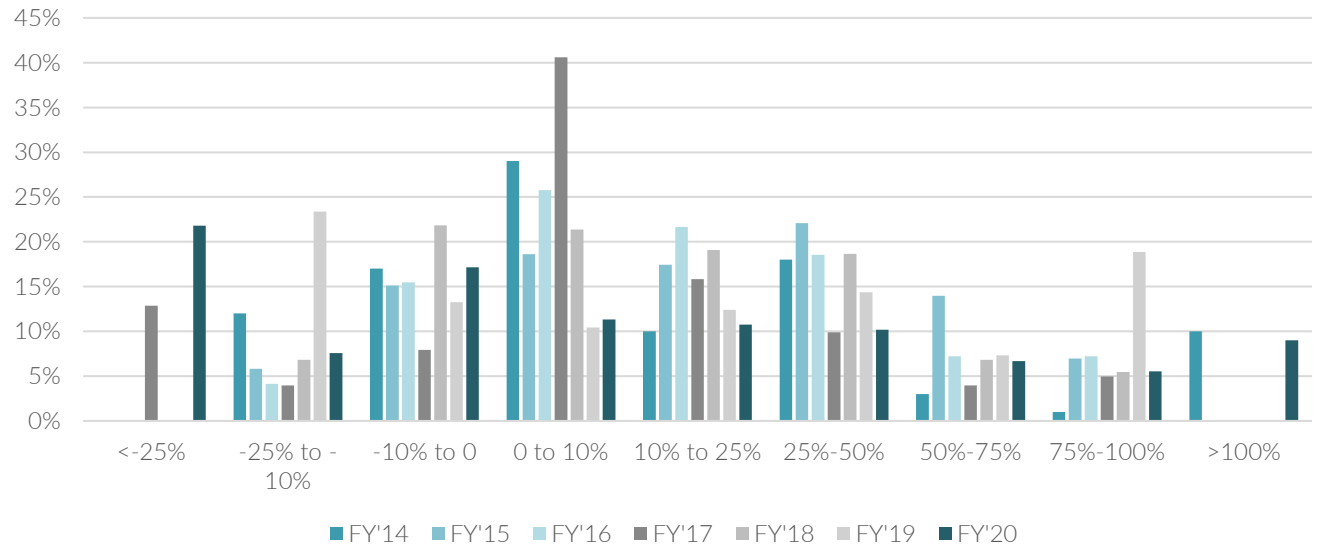


Source: PIP Report and Accounts, Hardman & Co Research

Average 28% uplift on exit

The average uplift to the book value (12 months prior to exit to eliminate any exit premium built in) was 28%. As we detailed in our initiation note, taking account of the expected EBITDA growth over the period, this scale of uplift gives some comfort that the underlying valuation is a realistic view of the companies. The chart below shows the distribution by scale of uplift.

Percentage of exits by the uplift on book value on exit



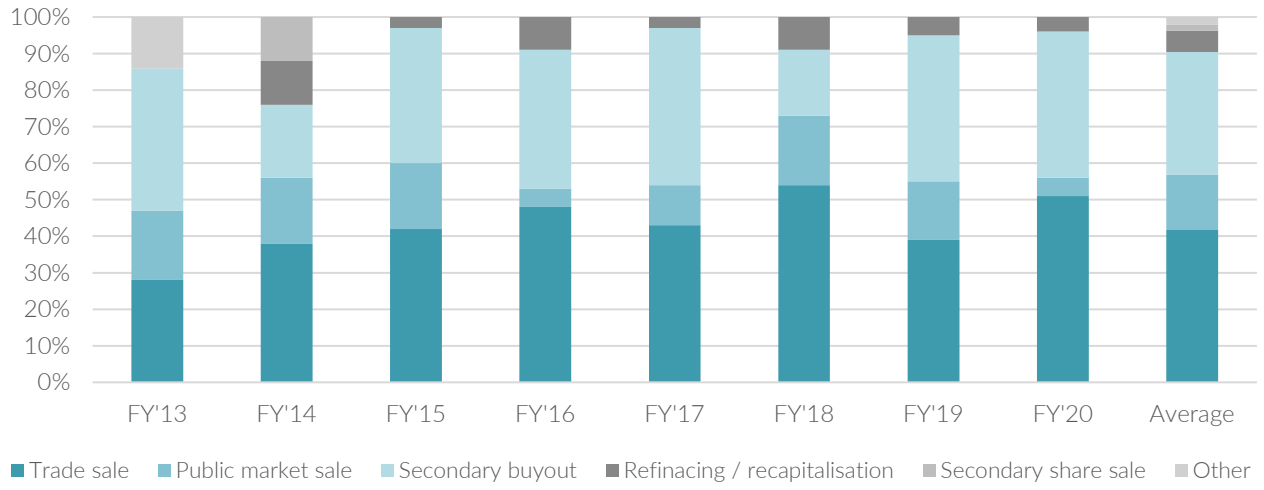
Source: PIP Report and Accounts, Hardman & Co Research

Exit by type of realisation

IPOs make up only a small proportion of exits (5% in FY'20)

The chart below shows the method of realisation over time. The key messages are that trade sales and secondary buyouts (i.e. sale to other PE houses) are each more than twice as important as public market sales. What we saw in FY'20 was a further extension of this trend, with secondary buyouts accounting for 40% of disposals (long-run average 34%), trade sales 51% (42%) and IPOs just 5% (15%).

Exit realisation by type (%)



Source: PIP Report and Accounts, Hardman & Co Research

Debt/valuation analysis

Debt to EBITDA multiples rising in large deals, but these are a reducing part of PIP book, and cov-lite documentation reduces probability of default. Debt gearing more stable for smaller deals.

PIP provides the data based off a sample covering just over half of its buyout book. From these, we can establish both debt and valuation multiples. The key messages are:

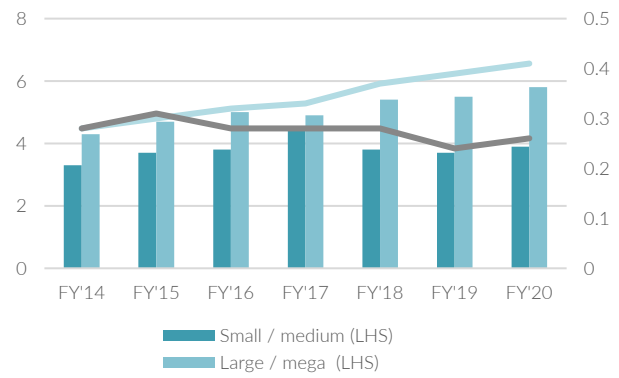
- In terms of debt, there has been a long-term, gently rising trend in the large/mega buyout books. However, these have been a falling proportion of the book (26% FY'20 vs. 31% FY'15). We also note that the cov-lite documentation is especially prevalent in this part of the market, and means that the probability of default should be lower. In 2HFY'20, there was a small debt to EBITDA reduction on 1H'19 (5.8x vs. 5.9x).

- The debt multiples in the small/medium buyout books have been broadly stable, a trend that has continued in FY'20 (at debt to EBITDA of 3.9x) and remains below the 2017 level (4.5x).

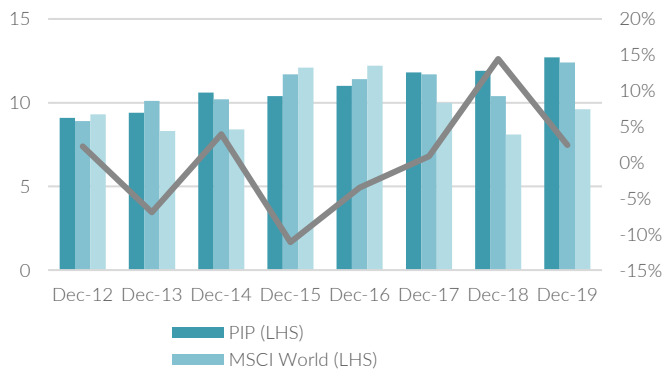
Rise in EBITDA valuation multiples reflects mix changes. Premium to MSCI World fallen from 14% to 2% December 2019 on 2018.

- In terms of valuation, there has been a trend of steadily rising average multiples of PIP's underlying companies (December 2019 EV/EBITDA 12.7x, up from 11.9x at end-2018), driven primarily by mix, with little change on a like-for-like basis for individual companies/sectors. The chart in the *Portfolio summary* later in this report shows the rise in some higher-rated sectors, such as IT and healthcare, and a reduction in industrials. The rating applied to PIP's companies moved to a premium to the MSCI World index at the end of 2017, but this premium reduced significantly in the recent results (from 14% at December 2018 to just 2% at December 2019).

Debt/EBITDA multiples (x, LHS; % book, RHS)



Valuation multiple (x EBITDA, LHS) & premium to MSCI (RHS)



Source: PIP Report and Accounts, Hardman & Co Research

Liquidity management

Focus on liquidity has never been higher. As in the rest of the industry, PIP's commitments are multi-year, but some investors have a tendency to consider these against current liquidity. This may be over-prudent, as it implicitly assumes that all commitments will be drawn (and many are not) and that no investments will be realised (and realisations tend to broadly follow a related pattern to calls on commitments, not least reflecting that a significant proportion of exits from PE Fund 1 are secondary buyout acquisitions from PE Fund 2).

23% of undrawn commitments are from 2013 or older, and so outside "normal investment" period

Noting this, PIP had total undrawn commitments of £541m in FY'20 (May 2019 £521m). 23% of these are from 2013 or older and, generally, after year six, the only drawings are to fund follow-on investments into existing portfolio companies, or to pay expenses, i.e. calls by these funds tend to slow dramatically. For its liquidity planning purposes, PIP (we believe conservatively) assumes that all these lines will be drawn.

Taking a "doomsday" scenario approach, if we assume no realisations at all, but that 80% of undrawn commitments will still be called (a very conservative approach, given the relationship between the two), the drawings of ca.£432m are completely covered by May 2020 cash of £121m and £310m of undrawn financing lines. This is an extreme scenario, which is highly unlikely to occur, but serves to illustrate the strength of the company's financial position.

Overcommitment policy much lower than peers

The table below shows that, relative to peers, PIP is very conservative in managing over-commitment.

Breakdown of components of over-commitment for PIP and peers (£m)

	PIP	ICGT	BPET	HVPE	SLPE
Date	May'20	Apr'20	Jun'20	Aug'20 ($m)	Mar'20
Total undrawn commitments	**521**	**451**	**141**	**1,674**	**451**
Cash	121	49	2	103	75
Undrawn credit line	310	115	30 E	480	100
Available funding	**431**	**164**	**32**	**583**	**175**
Over-commitment	**90**	**287**	**109**	**1,091**	**276**
As % NAV	5%	38%	38%	48%	42%

Source: PIP Report and Accounts, presentations and factsheets, Hardman & Co Research. BPET's facilities are £75m + €25m, against which, at June, it had £64.9m drawn.

Outlook

Early signs of pick-up

Clearly, there is uncertainty as to the outlook, given that the final impact of COVID-19 remains unknown. There are early signs of increased activity, with a more acquisitive stance in its managers (a view derived from the fact that PIP's manager, Pantheon, is on around 450 advisory boards). The August Factsheet showed that most of the losses in the period to March had been re-couped, when valuations moved forward to a June underlying basis. However, these green shoots could be killed by a short frost.

Range of opportunities in medium term

Over time, we believe there will be good opportunities, from i) companies needing the access to capital that PE provides, ii) weaker companies throwing in the towel, iii) weaker groups selling non-core businesses to strengthen their core balance sheets, iv) investee companies wanting funding for organic market-share growth, where weaker competitors have failed, and v) growth areas, such as digital medical appointments, needing incremental finance. Strategically, PIP advises that it is focused on direct co-investments and secondary deals, where there is much more visibility on underlying assets than in the primary market.

PIP has competitive advantage in secondary market

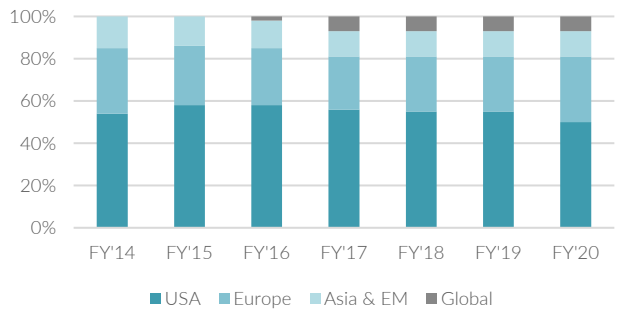
In the secondary market, PIP has very recently seen more activity. We believe it is uniquely placed to take advantage of them, given i) that it has deep relationships with PE managers, with whom PIP has done almost $14bn of deals since 1988, ii) its long experience in this market, iii) its scale, iv) its strong financial position, and v) its expertise, so that even complex deals can be concluded rapidly. Overall, it expects significant discounts to remain a feature of the secondary market for some years (discounts of 10%-15% remained prevalent through 2010-12), making it an attractive option.

With its results, PIP reported that co-investment deal flow appeared to have picked up, but that the overall market activity level remained relatively muted. As with PE commitment generally, there is caution in the price discovery process, due to the evolving impact of COVID 19. There is a specific co-investment opportunity where PE managers may look to extend their fund life but, again, we see this as an evolving opportunity, rather than a near-term surge.

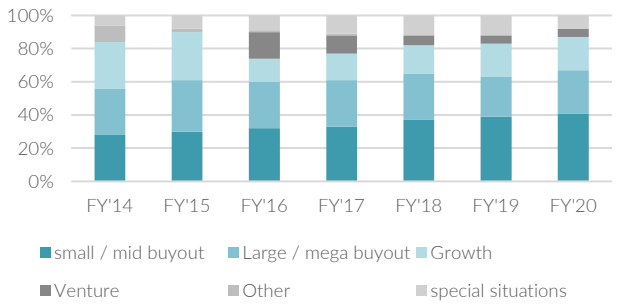
Portfolio summary

The charts below show some of the trends in the portfolio. In FY'20, there has been a continuation of trends, rather than anything dramatic, which is not surprising given the long-term nature of PIP's investments.

Geographical mix of assets (%)

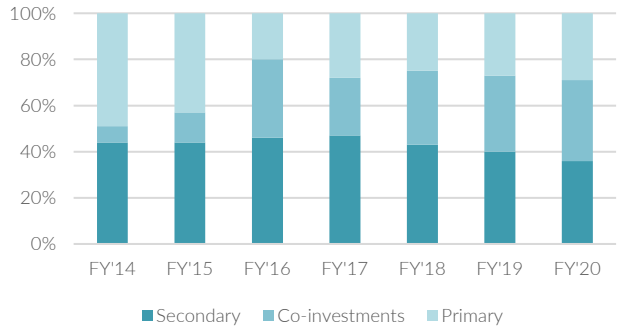


Mix by fund stage of investment (%)

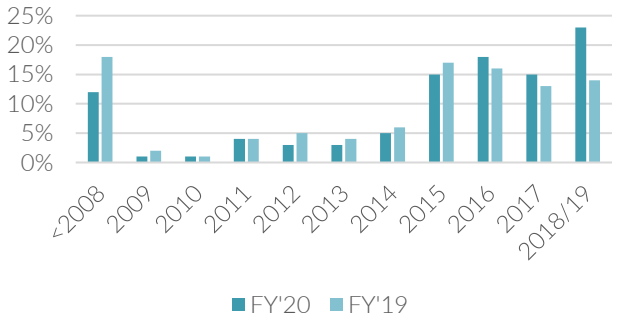


Source: PIP Report and Accounts, Hardman & Co Research

Mix of investments by type (%)

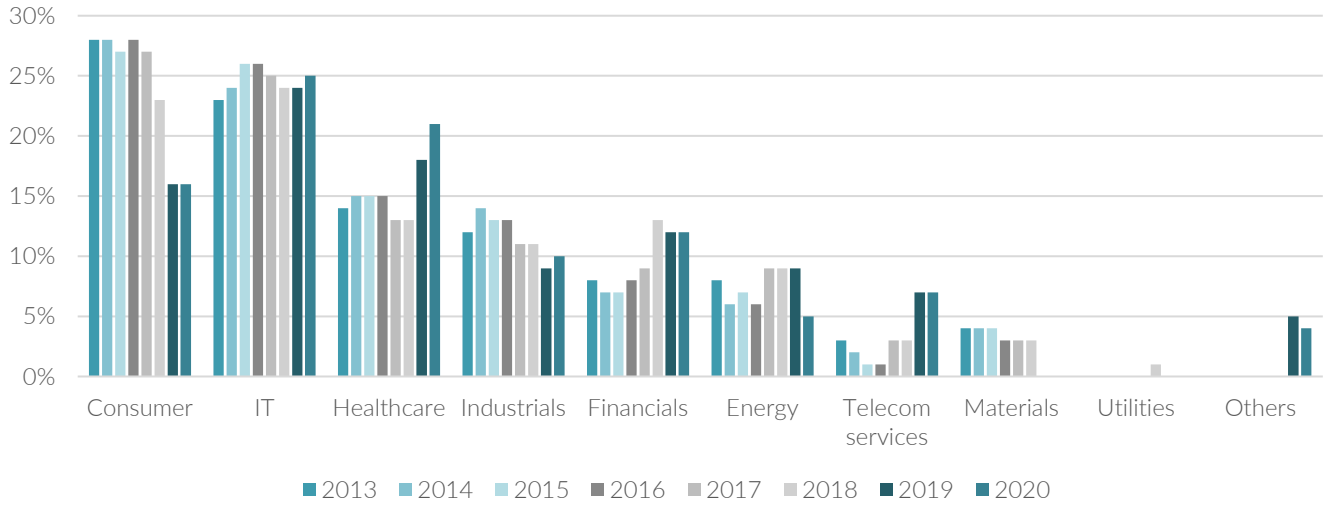


Mix by fund maturity of investment (%)



Source: PIP Report and Accounts, Hardman & Co Research

Sectoral mix of investments (%)

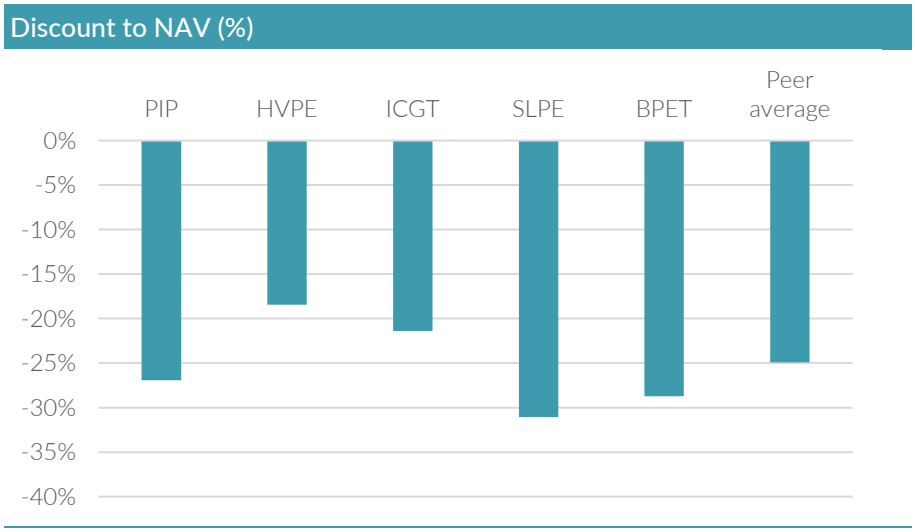


Source: PIP Report and Accounts, Hardman & Co Research

Valuation

Discount to NAV 27%

PIP and its peers continue to trade at a considerable discount to NAV, bearing in mind the long-term track record of outperformance.



Source: Latest company factsheets on websites, priced at 9 October 2020, Hardman & Co Research

Triggers for a re-rating

Key triggers for re-rating include continued performance, better market understanding of risk and reward in model, and more comfort that impact on NAV of any economic downside scenario will not be as adverse as feared

PIP and its peers have traded at a range of discounts to NAV for a considerable time. While investors have been rewarded by market-beating strong NAV growth driving the share price, it is also worth noting that there are a number of potential triggers that could deliver incremental returns by closing the 27% discount. These include:

- Market concerns about illiquid/unquoted stocks moderating as the Woodford effect becomes more historical. We do not believe this issue will go away quickly – not least as there may be regulatory changes to fund holdings of illiquid assets. However, we do expect a steady moderation in its intensity from here.
- We have stated that the discount appears anomalous. In this case, one key consideration will be communication. We note that PIP has become increasingly active in its investor engagement, *inter alia*, paying for sponsored research, hosting a capital markets day to better inform the market, building a new and engaging website and launching a LinkedIn page.
- Further delivery of consistently strong performance, in line with historical experience, through an economic downturn.
- The discount to NAV has widened significantly in the recent turmoil. Part of this is because it will take a little time for the NAV to reflect the falling market ratings, but we believe part is also due to worse-than-average sentiment to PE in such conditions. A normalisation of sentiment may lead to a discount reduction.

Financials

Our 2021 forecast NAV is unchanged. We have seen a modest reduction to gains, Investment Manager fees, costs and interest payable, but nothing material.

Profit and loss (£000)

Year-end May	2019			2020			2021E		
	Revenue	Capital	Total	Revenue	Capital	Total	Revenue	Capital	Total
Gains on investments at FV through P&L		204,473	204,473		72,264	72,264		174,996	174,996
ALN losses on fin. liab. at FV through P&L	-1,229	-8,815	-10,044	-502	277	-225	0	0	0
Currency (losses)/gains on cash & debt		6,810	6,810	0	1,403	1,403	0	0	0
Investment income	13,222		13,222	11,198	0	11,198	11,218	0	11,218
Investment Manager's fee	-16,584		-16,584	-17,674		-17,674	-18,500		-18,500
Other expenses	-5	-568	-573	-730	-1,719	-2,449	-500	-1,000	-1,500
Return before finance costs and taxation	-4,596	201,900	197,304	-7,708	72,225	64,517	-7,782	173,996	166,213
Interest payable and similar expenses	-2,386		-2,386	-2,223	0	-2,223	-2,223	0	-2,223
Return on ordinary activities before taxation	-6,982	201,900	194,918	-9,931	72,225	62,294	-10,005	173,996	163,990
Taxation	-2,594		-2,594	-1,616		-1,616	-1,616		-1,616
Return on ordinary activities after tax	-9,576	201,900	192,324	-11,547	72,225	60,678	-11,621	173,996	162,374

Source: PIP Report and Accounts, Hardman & Co Research

Balance sheet (£000)

@ 31 May	2015	2016	2017	2018	2019	2020	2021E	2022E
Investments at fair val. through P&L	862,029	1,071,876	1,224,142	1,274,737	1,449,634	1,495,689	1,711,530	1,892,623
Current assets								
Debtors	1,805	3,654	1,661	3,891	3,222	1,259	1,259	1,259
Cash and cash equivalents	137,483	115,522	167,252	162,292	142,773	130,091	61,625	58,056
Total assets	1,001,317	1,191,052	1,393,055	1,440,920	1,595,629	1,627,038	1,774,413	1,951,938
Current liabilities								
Creditors	1,253	3,938	5,522	19,046	4,682	10,030	10,030	10,030
Long-term liabilities								
Asset-Linked Loan (ALN)				115,110	92,359	57,743	42,743	27,743
Net assets	1,000,064	1,187,114	1,387,533	1,306,764	1,498,588	1,559,266	1,721,640	1,914,165
NAV per share (p)	1,532	1,874	2,190	2,415	2,771	2,883	3,183	3,539

Source: PIP Report and Accounts, Hardman & Co Research

Cashflow (£000)

Year-end May	2015	2016	2017	2018	2019	2020	2021E	2022E
Investment income received	14,855	11,664	17,105	13,619	12,818	10,356	11,218	17,115
Deposits and other income	60	159	343	830	1,359	952	1,000	1,000
Investment management fees paid	-9,876	-11,011	-12,506	-14,969	-16,401	-17,623	-18,500	-19,500
Other fees/cash payments	-1,727	-2,155	-1,867	-6,309	-17	-3,868	-3,751	-3,751
Withholding tax deducted	-1,437	-1,985	-4,257	-10,483	-3,407	-1,776	-1,616	-1,616
Net cash inflow/(outflow) from operating activities	1,875	-3,328	-1,182	-17,312	-5,648	-11,958	-11,649	-6,752
Cashflow from investing activities								
Purchase of investments	-171,799	-263,203	-251,181	-254,426	-285,326	-239,251	-340,000	-415,303
Disposals of investments	225,971	244,540	303,131	351,335	313,330	267,126	300,000	435,303
Net cash outflow from investing activities	54,172	-18,663	51,950	96,909	28,004	27,875	-40,000	20,000
Cashflows from financing activities								
ALN repayments	0	0	0	-77,152	-44,909	-28,023	-15,000	-15,000
Share buybacks	-6,872	0	0	-3,546	-500	0	0	0
Redeemable share buybacks	-4,389	-22,022	-26	0	0	0	0	0
Loan commitment and arrangement fees paid	-1,953	-992	-1,378	-1,577	-3,286	-1,816	-1,816	-1,816
Finance costs paid for deferred pay't transaction	0	0	-182	0	0	0	0	0
Net cash inflow from financing activities	-13,214	-23,014	-1,586	-82,275	-48,695	-29,839	-16,816	-16,816
Net increase in cash and cash equivalents	42,833	-45,005	49,182	-2,678	-26,339	-13,923	-68,465	-3,568
Opening cash and cash equivalents	88,346	137,483	115,522	167,252	162,292	142,773	130,091	61,625
FX effects	6,304	23,044	2,548	-2,282	6,820	1,241	0	0
Closing cash and cash equivalents	137,483	115,522	167,252	162,292	142,773	130,091	61,625	58,056

Source: PIP Report and Accounts, Hardman & Co Research

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