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Business

Private equity trusts are 'pregnant' with gains from their investments – this is our pick

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TRUST BARGAINS

Sales of trusts' holdings dropped off last year as buyers grew more cautious but could revive if interest rates fall and confidence returns

Read Questor's rules of investment before you follow our tips: telegraph.co.uk/go/questorrules

Many people think of investing as buying shares in companies listed on a stock exchange, but there is a parallel universe of investments in private companies.

Worldwide, there are 39,000 private equity funds that invest in start-ups or established companies, aiming to grow the businesses so they can be floated on the stock market or sold to a trade buyer or another investor. Most of these funds require big sums to invest. On the London Stock Exchange though, there are 40 private equity funds whose shares can be bought easily like any other through a stockbroker.

We tipped one, the specialist early-stage investor Augmentum Fintech, in December. However, these funds operate across a broad range of sectors and countries, investing in companies either directly or through other private equity funds.

The market is remarkably polarised. On the one hand is the giant 3i Group, whose £18bn portfolio accounts for nearly half of the £39bn in the sector. Its share price stands at a huge 31pc premium above asset value, reflecting strong investor demand after it trebled shareholders' money over the past five years. The other 39 funds are rather neglected, their shares consistently stuck below net asset value (NAV) despite impressive long-term performance. Although none comes close to 3i's incredible 776pc shareholder return over 10 years, the average private equity "fund of funds" hasn't done badly with gains of 232pc while the average direct private equity fund achieved 275pc. These figures compare well with global public stock markets and are much better than the FTSE All-Share index's return of 65pc.

Despite this, private equity funds apart from 3i stand at an average 24pc discount to NAV. There are several causes: painful memories of the 2008 global financial crisis; regulations that inflate these funds' charges; and suspicion of the three-to-six-month delay in valuing their assets.

The latter has led to fears that the funds could go over a "cliff edge" if their stakes in unquoted companies are written down in the challenging economic environment. City analysts believe this to be unlikely because private equity backed firms have continued to grow profits.

Private equity funds generate their returns by eventually selling stakes in their holdings, frequently on big uplifts to their previous valuation. Last year these "exits" dropped off as buyers grew more cautious, but they could revive if interest rates fall and confidence returns.

Analysts at the broker Stifel said this pause left many private equity funds "pregnant" with potential gains from investments made five or more years ago. "Assuming realisations at gains over previous valuations, this will help NAV growth" and lead to higher share prices, they said.

Oakley Capital Investments, a £1.2bn fund of funds tipped here in the past, is a popular analysts' choice on a 31pc discount and with a 206pc 10-year return to its name.

So is Pantheon International, another Questor tip. The £2.2bn portfolio of funds and companies languishes on a 34pc discount despite a £200m share buyback programme to boost shareholder returns and demonstrate confidence in its investments.

But Questor's favourite is NB Private Equity (NBPE), a £1bn investment company run by Neuberger Berman in New York, which has the pick of all the $120bn (£95bn) investments made by the group's private equity funds. Its top holding and best long-term performer is the 6pc invested in Action, the rapidly growing European discount retailer that has turbocharged 3i. By co-investing almost all its portfolio directly in 86 private firms with 53 external fund managers, NBPE avoids shareholders paying two sets of fund fees. As a result, its 1.9pc annual ongoing charge is lower than the 3.4pc average of its closest rivals.

It pays 3pc of assets in dividends each year, which, with the shares on a 28pc discount, puts them on a 4.7pc yield. Best of all, the maturity of the portfolio – 70pc of its investments date back to 2019 or earlier – increases the likelihood of disposals this year.

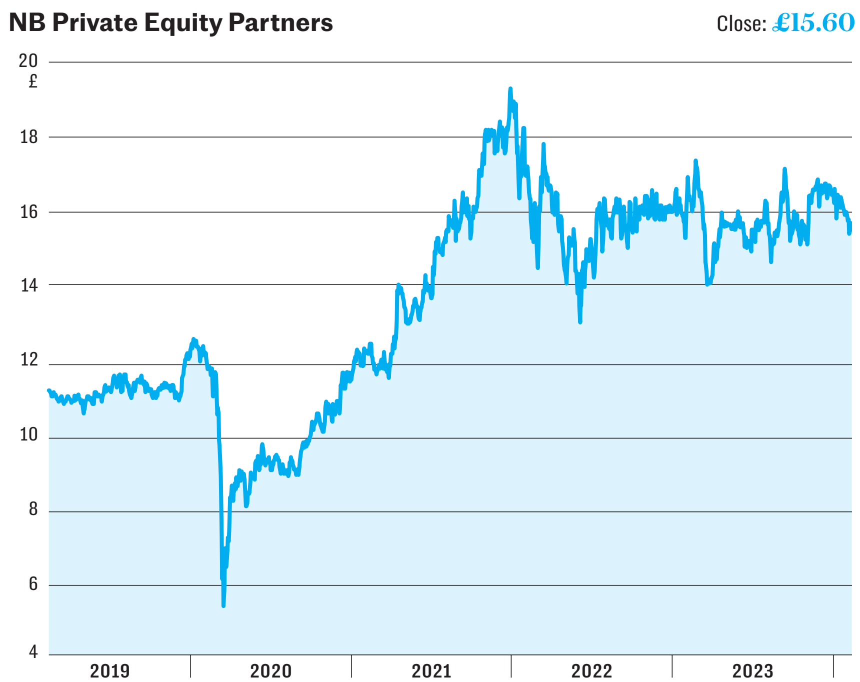
Although these may not be as profitable as in recent years, they could pep up performance, which has been modest in the past year but over five and 10 years has delivered shareholders gains of 74pc and 287pc after all fund fees. As the board steps up share buybacks, Paul Daggett, a Neuberger managing director, says NBPE is "well positioned". Questor agrees.

Questor says: buy
Ticker: NBPE
Share price at close: £15.60

NB Private Equity

BUY

Some 70pc of its investments date back to 2019 or earlier, increasing the likelihood of disposals this year



Key numbers

- **Market value: £721m**
- **Year of listing: 2009**
- **Discount: 29pc**
- **Ave discount over past year: 29pc**
- **Yield (Dec 2022): 4.7pc**
- **Most recent year's dividend: $0.94**
- **Gearing (Dec 2023): nil**
- **Annual charge (Dec 2023): 1.9pc**

'NBPE's 1.9pc annual ongoing charge is lower than the 3.4pc average of its closest rivals'