NB Private Equity Partners

NBPE can hunker down until realisations improve...

Update
28 November 2024

Overview

NB Private Equity Partners (NBPE) has a number of unique and distinguishing features, which mark it apart from the wider listed private equity peer group. In this note, we discuss how the trust is positioned for the current environment, drawing on details provided by the annual capital markets event.

Realisation activity in the private equity world remains subdued. As a result, NBPE's managers have been very selective when considering investments, and the investment level is at the bottom of the target range (see **Gearing**). NBPE is purely focused on co-investing, which gives the managers a lot of control on when to deploy capital. In the context of the current environment this puts NBPE in a strong position. Many other trusts are seeing trust level gearing increase, with investments being made at a faster rate than realisations. This has prompted some managers to conduct secondary sales of chunks of their portfolios at a small discount to NAV. This isn't necessarily an issue, but NBPE is protected from the need to raise cash by (effectively) having no future investment commitments, and can sit tight and wait for the realisation environment to improve.

As we discuss in the **Portfolio section**, in a bearish scenario NBPE can hunker down, and future NAV growth will be driven by underlying portfolio company growth. In a bullish scenario, realisation activity starts to build up, driving valuation uplifts, and NBPE will see cash coming back onto the balance sheet. The managers and board then have a number of options, including new investments or pursuing buy-backs. In this scenario it is possible we could see a return to NAV growth and the discount narrowing.

Analysts:
William Heathcoat Amory
+44 (0)203 384 8795

Analyst's View

In either a bearish or bullish scenario for the private equity sector, we believe NBPE is in a resilient position in absolute and relative terms when compared to the peer group. Unarguably, NAV performance relative to quoted markets has been disappointing over the last two years (see **Performance section**). However, with an increasingly mature portfolio and resilient revenue and earnings growth from the underlying companies in the portfolio, the prospects of the performance gap between NBPE's share price and world equities narrowing in the short to medium term must be improving.

Longer term, we believe that NBPE's differentiated proposition means that if it delivers better long-term performance than peers, then it should trade at a consistent premium to peers. Currently the discount to NAV is c. 25%. As we highlight in the **Portfolio section**, the most obvious catalyst for this discount to narrow will be a return of investor appetites, which we believe will be driven by improved NAV growth, which itself is largely dependent on an improvement in realisations. Until then, NBPE has the balance sheet strength to wait. For those who take a long-term view, the current discount continues to be a potentially attractive entry point for investors wishing to access the private equity asset class, and NBPE's unique exposure to it.

BULL
Unique investment strategy, with returns driven by direct equity co-investments
Manager has a high degree of control over the timing of new investments and, therefore, also over the balance sheet
Wide discount in absolute terms

BEAR
Illiquid underlying holdings, which are themselves often geared
Deal activity in private equity markets generally may remain muted
Valuations of portfolio companies are performed quarterly

Portfolio

NB Private Equity Partners (NBPE) recently held its annual capital markets event, which provided a good opportunity to review the managers' take on the macro-economic environment and how it relates to the private equity sector, as well as drill down into some of the specifics of the portfolio. In our view, the session served to highlight the unique and distinguishing features of NBPE in the context of the London listed private equity sector. By way of a reminder, NBPE is purely focused on co-investments, by which private equity managers who are investing into a company bring other third parties into the deal as minority investors. These investments are therefore controlled by the private equity manager leading, or sponsoring the deal, but co-investors rank equally in terms of the economics.

Typically, co-investors are not charged management or performance fees on their investments, meaning this can be a potentially interesting and efficient way to capture the strong returns that private equity deals can deliver. That said, not all investments will necessarily be successful, and this is where NBPE, as a co-investor, benefits from having control over whether it makes an investment or not, as well as sizing investments. NBPE aims to make investments of c. $30m, which if achieved, represent a holding of between 2% and 3% of NAV. This results in a diversified portfolio, in which risks are managed, but allows strongly performing investments to 'move the dial'. In total, the portfolio currently consists of investments in 82 companies across 51 different private equity managers.

We show the top ten holdings in the table below, and note that in terms of shape, NBPE's portfolio concentration looks very much like a typical equity fund. Other than sizing, making investments in this way gives NBPE's managers a large degree of control on when to make investments. In the context of the current environment in the private equity industry, where realisation activity continues to be subdued, this puts NBPE in a strong position. Many other trusts are seeing trust level gearing increase as investments are being made at a faster rate than cash is being realised and returned to investors. This has prompted some managers to conduct secondary sales of parts of their portfolios at a small discount to NAV. In itself, this isn't necessarily an issue, but NBPE is protected from the need to raise cash by (effectively) having no future investment commitments, and having the managers in control of all investment decisions. NBPE can therefore sit tight and wait for the realisation environment to improve.

Notwithstanding the realisations from the portfolio that have been achieved this year (see **Performance section**), NBPE's portfolio is becoming increasingly mature. As at 31st August the average life of its investments was 5.1 years, which puts a good proportion of its portfolio at the point at which sponsors will theoretically be looking to realise investments. The capital markets day highlighted that of recent investment activity, NBPE has been shortening the expected life of new investments by making 'mid-life' co-investments. These are typically investments proactively sourced by NB's private markets team where the private equity sponsor is looking to make a transformative acquisition for a portfolio company, or looking to crystalise some of the return already generated by the investment and either return that capital back to other investors or re-invest the proceeds from a new fund. This provides the opportunity for NB to access an investment which is arguably de-risked (in that it is well known by the underlying PE manager), at an attractive valuation and at a potentially interesting point in terms of value creation.

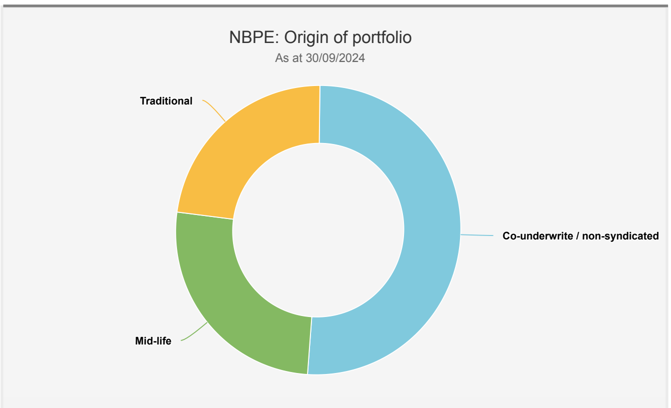
Top Ten Holdings As At 30/09/2024

	SECTOR	SPONSOR / GP	DESCRIPTION	% OF TOTAL
Action	Consumer	3i	European discount retailer	5.4
Osaic	Financial Services	Reverence Capital	Wealth management	4.9
Solenis	Industrials	Platinum Equity	Speciality chemicals	4.6
Beyond Trust	Technology	Francisco Partners	Cyber security	3.3
Branded Cities	Comms / Media	Shamrock Capital	Advertising	3.2
Monroe Engineering	Industrials	AEA Investments	Distributor	3.0
Not disclosed	Business Services	Undisclosed	Business services	2.9
True Potential	Financial Services	Cinven	Wealth management	2.8
Kroll	Financial Services	Further Global / Stone Point	Financial consultancy	2.5
Constellation Automotive	Business Services	TDR Capital	Vehicle remarketing services	2.4
Total				**35.0**

Source: NB

Of relevance given the increasingly mature portfolio, the expected time until realising these investments is considerably shorter than it would be for a 'new' co-investment. NBPE highlighted that three of its four new investments made this year are mid-life investments, being Benecon, Mariner and FDH Aero. The number of mid-life transactions the team have seen over the last couple of years have increased by about 90%, now accounting for 50–60% of deals the team are seeing across the platform. NB is increasingly seeing attractive mid-life opportunities on a bi-lateral basis, with no need to compete with other private equity investors on price.

Fig.1: Portfolio Breakdown



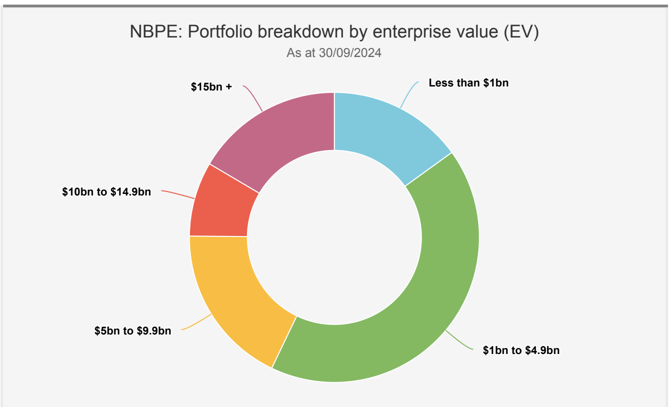
Source: NB

NBPE's capital markets event also highlighted the interesting niches that its investments occupy. For example, we heard a case study on Branded Cities, NBPE's fifth largest holding, and a portfolio company that represents 3.2% of NAV as at 30/09/2024. The investment was led by Shamrock Capital, a private equity manager that focuses exclusively on media, entertainment and communications. Branded Cities is the owner and operator of multiple next generation 'iconic' advertising billboards in North America. This company is unique in its offering, and we understand has the prime locations for advertising in the major US and Canadian cities. Unsurprisingly, Branded Cities was negatively impacted by Covid, but the backing of the sponsor and the expertise of that team has been instrumental in the company's performance.

We also heard about one of the newer investments NBPE has made, which completed in May 2024. FDH Aero is a global distributor of parts and consumables in the aerospace and defence sector. This was a mid-life investment, which NB had identified as an attractive business which Audax Group had first invested in in 2017. NB had previously registered interest in investing if the opportunity came up, and so with the company needing further equity funding for its roll-up strategy, NB was able to agree terms to invest on a bi-lateral (i.e. exclusive) basis. The team believe that this investment is a good example of the value that NB are able to bring to the table, in that they have a considerable pipeline of opportunities being brought to them every week, many of which are proprietary.

The majority of NBPE's companies are headquartered in North America (76%) which the team continue to regard as the best private equity market to be exposed to, in terms of deal activity and returns. We heard from several members of the NBPE team who believed that a second Trump presidency would be good for US businesses generally. In their view, whilst the picture is understandably rather unclear, any increase in antitrust regulations or scrutiny on corporate acquirors is likely to impact the largest companies the most. As the below chart illustrates, the majority of NBPE's exposure is to domestic companies that are below $5bn, which we view as the mid- to small-cap equivalent of the US private equity sector, by implication less in the cross-hairs of regulators. Being relatively small, these businesses tend to occupy niches, such as those we illustrate in the Branded Cities and FDH Aero examples above. Aside from being interesting businesses in their own right, we observe that these companies offer pure, or undiluted exposure to niche business areas that are unlikely to be found in quoted equity markets.

Fig.2: Portfolio Breakdown By Enterprise Value



Source: NB

As we discuss in the **Discount section**, NBPE's shares trade on a persistently wide discount. Whilst the investment trust sector as a whole is also trading on relatively wide discounts too, part of the reason for NBPE's discount may be caution on the part of investors with regard to the relatively slow realisation activity across the sector. In this context, NBPE may be in an advantageous position relative to many peers. In a bearish scenario, which sees realisation activity not recovering over the short to medium term, then NBPE can afford to hold onto its investments and use its balance sheet strength to support existing investments. In contrast to peers, NBPE can simply decide not to make new investments given it does not make new primary fund commitments, and so the board and manager are fully in control of the level of gearing. In this bearish scenario, if other trusts become more highly geared, NBPE would unlikely to be immune from discounts widening across the sector. In this scenario, buy-backs using any surplus capital that NBPE has available will become increasingly accretive. Therefore, NBPE could hunker down and future NAV growth will be driven by underlying earnings growth and accretive buy-backs.

In a bullish scenario, realisation activity starts to build up. Realisations are an important part of the private equity value creation cycle, given historically there have been material uplifts to valuations when a sale is made. NB accepts there will be lots of deals trying to get done if the environment improves, and some may not pan out, but it is the best quality companies that will get sold first. If realisation activity improves, then a higher percentage of NBPE's portfolio may see uplifts to their valuation on a sale, and NBPE will see cash coming back onto the balance sheet. The managers and board then have a number of options to consider, which include making new investments or making buy-backs. Inevitably, the path the board chooses will depend on the circumstances at the time. However, in this scenario we would envisage seeing strong NAV growth and the discount narrowing – either as investor appetites for NBPE shares increase, or as a result of the board funding accretive buy-backs.

In either scenario therefore, we believe NBPE looks to be a resilient position in absolute terms, and relative to the peer group.

Gearing

NBPE's board and managers have historically employed structural gearing to enhance long-term returns in the form of zero dividend preference shares, the last tranche of which were repaid on 30/10/2024. NBPE now only has a revolving credit facility with capacity for up to $300m (of which $90 million was drawn) and which extends to 2029. This credit facility allows the managers flexibility in being able to keep NBPE fully invested, given the board has a long-term target of being between 0% and 10% geared. As of 4th November including the most recent investment announced in Mariner, the gearing position was c. 102% invested, which reflects an element of caution from the managers, but also a desire to be in a position to take advantage of opportunities when they arise.

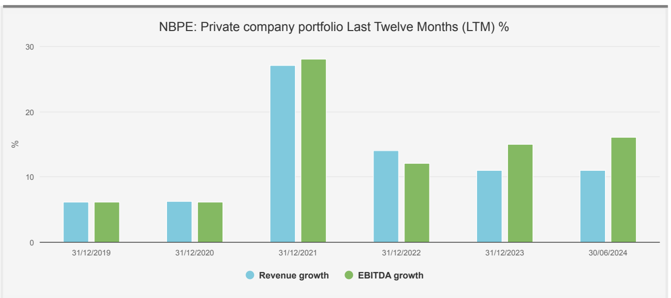
According to NB, total available pro-forma liquidity as of 4/11/2024, including undrawn credit facilities and cash is $269m, representing c. 21% of NAV. As we highlight in the **Portfolio section**, because NBPE is purely focused on co-investments, the manager and board have a large degree of balance-sheet control. This means that they are arguably in a strong position to wait for an improvement in realisation activity, without the worry that committed capital will continue to be called and gearing will rise. NBPE has a total of $33m of legacy outstanding commitments on an adjusted basis (adjusted for amounts the manager expects to be called), though this is well-covered by cash and NBPE's available credit facility.

Private equity-backed businesses usually employ higher leverage than public ones, and NBPE's portfolio companies are no different. On a look-through basis, NBPE's portfolio has a weighted average net debt-to-EBITDA ratio of 5.2x, meaning that, with the weighted average valuation multiple of 15.2x on an EV/EBITDA basis, borrowings make up roughly one-third of the overall capital structure (or c. 50% on a debt to equity basis). As we show in the table in the **Performance section**, this is higher than public markets, but broadly in line with underlying portfolios in the LPE peer group.

Performance

The private equity industry is currently experiencing the effects of a relatively protracted period of slow realisation activity. Part of this may be a pause for breath, following a frenetic period post-2020. However, the rapid rise in interest rates is likely to be the most obvious reason, necessitating a period of adjustment as higher debt costs get reflected in business models and expectations. It is important to note that the underlying health of private equity backed businesses appears not to have been materially affected, as reflected in the continued strong revenue and earnings growth reported by NBPE's portfolio, which we show in the graph below. We also note that in transactions being seen today by the team at NB, private equity sponsors are being conservative in their expectations for multiple expansion in valuations over their period of ownership. In fact, in aggregate we understand they expect a slight moderation of valuations, putting the emphasis on revenue and earnings growth as the key driver of expected returns. This is why, in our view, investors in the LPE space should be keeping an eye on underlying revenue and earnings growth as a key determinant of the long-term prospects for NAV returns.

Fig.3: Underlying Company Performance Metrics

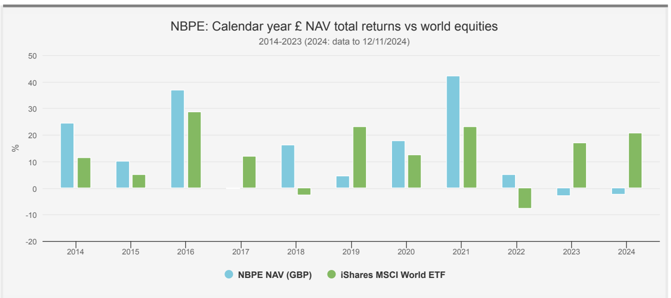


Source: NBPE

Past performance is not a reliable indicator of future results.

The result of the slowdown in activity can be seen in the modest calendar year returns over 2023 and to date in 2024. In contrast, quoted equity markets have roared away, and NBPE's NAV returns have trailed. It is worth noting that returns from the private company portfolio, on a constant currency basis have been better than these figures suggest, at +5.3% for 2023 and 4.4% for H1 2024 which is in line with other buyout funds on the NB platform. FX, fees and the value of quoted holdings have weighed on the NAV to deliver negative NAV total returns in GBP. Whilst disappointing, it is noteworthy that NBPE delivered strong NAV outperformance over the prior three years.

Fig.4: Calendar Year Performance

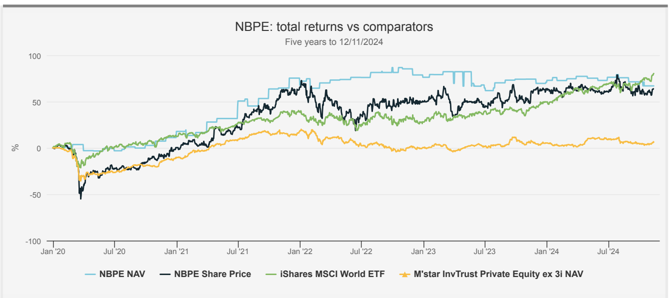


Source: Morningstar
Past performance is not a reliable indicator of future results.

The graph below shows that over five years, NBPE has been a strong performer, until recently having outperformed world equities on a NAV and share price basis. The graph shows the experience for sterling investors, who in addition to the strong underlying NAV performance, have benefitted from the strength of the US dollar over this period. As we highlight in the **Portfolio section**, we believe that the catalyst for better performance will come when realisation activity starts to improve. The year 2023 was a relatively slow year for private equity exits, with industry-wide deal volumes about 30% lower than in 2022, and about 45% lower than 2021 levels. NBPE bucked the industry trend, with 2023 representing a 42% increase relative to 2022, generating $171m of cash proceeds from 12 partial and full exits. For the nine months to 30 September 2024, full and partial sales have been achieved at a healthy 1.8x gross multiple of cost, and generated $160m. Whilst the 6% uplift to carrying value is lower than historical levels, realisations provide evidence to support investment valuations. NB believes that market activity has improved over the year, and there is an 'improved outlook for near-term exits'. We continue to believe that if interest rates fall, the realisation headwinds for NAV growth will turn into a tailwind, and higher deal activity could also provide a catalyst for improved sentiment towards NBPE's **Discount**.

NBPE's portfolio is increasingly mature, and private equity managers are increasingly helping to drive companies revenue and earnings growth through accretive M&A. For companies that are able to consolidate fragmented markets, this is an important driver of gaining scale and efficiencies, and therefore, value creation. If the portfolio's underlying growth continues to outpace public markets, this should give grounds for optimism irrespective of whether realisation activity levels recover.

Fig.5: Five-Year Performance

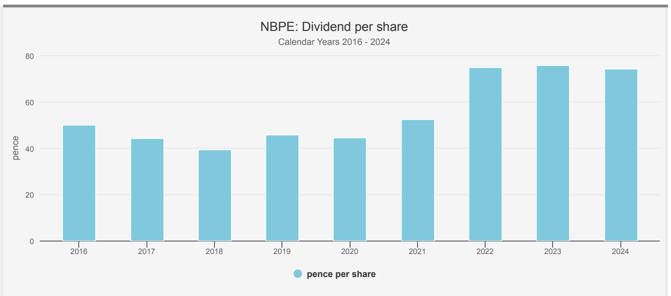


Source: Morningstar
Past performance is not a reliable indicator of future results.

Dividend

The board's policy is to pay a dividend that represents 3% of NAV or greater, and in this way NBPE has maintained or increased the annual dividend (in USD) for over ten years. Since inception, NBPE has paid a total of $360m of dividends to shareholders, and the semi-annual dividend has grown from $0.20 per share to $0.47 per share. The 2024 dividend of $0.94 represents a dividend yield of 4.8% when converted into GBP at the current share price. We show below the sterling dividends received by investors, which are converted from dollars at the time of the payment, so the actual amount received by shareholders varies with currency movements. In 2022, when the NAV declined over the year as a whole, the board chose to maintain the dividend level. The board also decided to maintain the dollar dividend amount paid in 2023, and because of dollar strength, the payout in pence rose. In 2024, USD weakness led the sterling dividend to fall slightly.

Fig.6: Sterling Dividends



Source: NBPE

Like most listed private equity trusts, NBPE's dividend can be viewed as a return of capital at NAV. With the discount to NAV remaining wide (as we discuss in the **Discount section**), the board has stated that, in its view, dividends will remain the primary method for returning capital to shareholders. We note that tax considerations aside, those shareholders who reinvest these dividends at a wide discount to NAV, effectively boost the net asset value of their holding in the same way that buy-backs would.

Management

The board sets the overall strategy and is ultimately responsible for the performance of NBPE, but the board has delegated NB to act as investment manager to execute day-to-day management and the investment strategy. The investment manager's senior professionals are responsible for the day-to-day management of the trust and, with respect to NBPE, management is led by Peter von Lehe and Paul Daggett, both managing directors at NB.

Peter and Paul are part of the private equity division of NB, a very large global investment business that manages over $125 billion of commitments in private equity strategies. The commitments made through the private equity platform give the team a greater level of access than many of their peers and NBPE leverages the power of the wider NB platform. NB aims to be a capital solutions provider for GP partners and not competition, able to leverage the significant resources of the team and wider asset management business.

Investment decisions are made by an investment committee that comprises 13 members, who have an average of 30 years of professional experience and have worked together for an average of more than 20 years. NB has more than 420 private market professionals, located across 12 global locations, with 90 individuals focused on co-investments. The team claim to have over 770+ active private equity fund relationships. In the managers' view, they see a very high proportion of deal flow from their private equity relationships and have positioned themselves as a capital solutions provider and strategic partner, who are often brought in very early on in the investment process to help cornerstone a deal. They achieve this because they are not seen as a competitor to private equity managers. Their large size and the speed with which decisions can be made, given their specialist teams, can be competitive advantages when sourcing and executing co-investments.

Discount

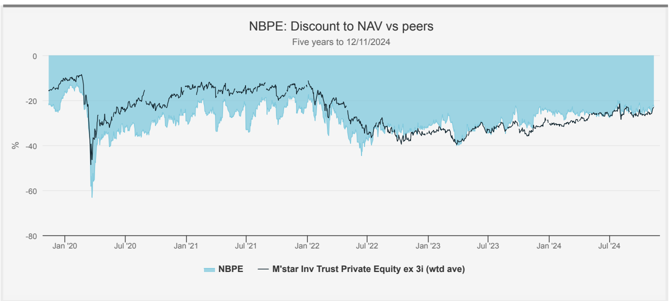
NBPE's discount to NAV has been persistent, an experience shared by the majority of the listed private equity peer group. Over the last five years, NBPE's average discount has been c. 28%, which is broadly in line with the Morningstar peer group average over the same period of c. 25%. Over the last five years we have seen the shares alternately trade on a relatively tight discount to NAV (in the low teens) towards the start of 2020. Then the market derated in 2020, and the discount widened dramatically, which is a recurring feature (and risk to be mindful of) with investment trusts which tend to be less liquid and therefore hit harder during market sell-offs. Since 2022, as the graph below shows, the discount has been on a largely narrowing trend, which has also been seen across the peer group.

Currently the discount to NAV is c. 25%. As we highlight in the **Portfolio section**, the most obvious catalyst for the discount to narrow further will be a return of investor appetites, which we believe will be driven by improved NAV growth, which itself is largely dependent on an improvement in realisations. Until then, NBPE has the balance sheet strength to wait. The board believes that performance is the main determinant of discounts, but at the margin will be opportunistic with their use of buy-backs, preferring the dividend as the main way to return capital to shareholders (see **Dividend section**). So far this year, compared to some peers, NBPE has been a less enthusiastic buyer of its own shares, having only bought shares back worth $5.4m at an average discount to NAV of 26%. With the relatively strong level of realisations seen over 2023, the board increased the amount of capital notionally allocated for buy-backs during 2024, but it is also worth remembering that this year the board has had to contend with the repayment of the last of NBPE's zero dividend preference shares, a form of structural gearing.

As the board has stated before, as part of the framework for considering buy-backs, the board considers NBPE's financial position, use and cost of leverage, the investment level relative to its target, and the vintage year diversification of the portfolio. The experience so far this year would suggest that the relatively low level of buy-backs has not held back the discount from narrowing. To some extent, a rising tide may have lifted all boats. Perhaps the changes to KID disclosures may also be helping. Long term, the board believes that continued strong relative NAV performance is a key determinant of attracting investors, and a consistently narrower discount. We understand that the board continues to focus on investor relations (IR), and that in their view NBPE's governance – with a fully independent board – should also be attractive, and over time lead to a narrower discount to NAV.

Fundamentally, we believe that the differentiated proposition that NBPE represents, means that if it delivers better long-term performance than peers, then it should trade at a consistent premium to peers. In the short term, lower interest rates, and higher realisation activity may be the catalysts for the discount to narrow. For those investors who take a long-term view, the current discount to NAV of 25% continues to be a potentially attractive entry point for investors wishing to access the private equity asset class, and NBPE's unique exposure to it.

Fig.7: Discount To NAV



Source: Morningstar

Charges

NBPE's differentiated approach to investing in private equity also confers significant fee advantages, relative to many listed private equity peers. By co-investing alongside third parties, NBPE can invest in deals largely free of management and performance fees payable to the underlying private equity sponsors. Fund-of-funds peers often pay two layers of management and performance fees on a proportion of their investments, typically 1.5% to 2% of committed capital and typically a carried interest fee of 20% of gains over an 8% hurdle. NBPE pays no management fees or carried interest to third parties on the vast majority of the direct equity portfolio.

NBPE's management fee is 1.5% p.a. on 'private equity fair value', i.e. investments, excluding cash, and is in line with that of most direct-investing LPE funds. NB is also entitled to a 7.5% performance fee on NAV gains over a 7.5% per annum hurdle, subject to a high-water mark. We note that this performance fee is lower than that of other direct-focused funds, although it is charged on unrealised gains. Directly investing managers typically only receive carry on realised gains. The trust's OCF for the year to the end of December 2023 was 1.94%.

The updated KID RIY figure is 0%. We note that the regulations around KID disclosures are changing. See **this article** for more information.

ESG

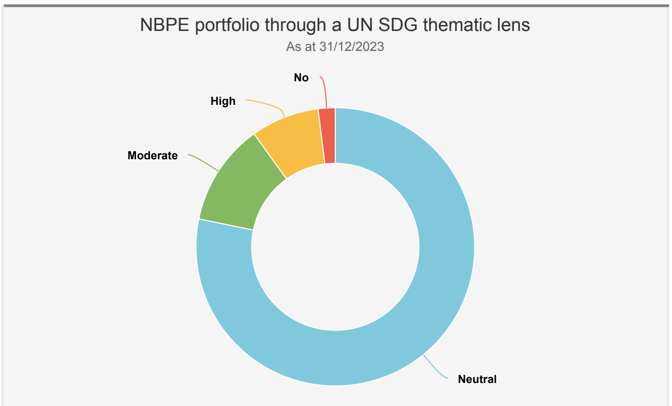
The team at NB believe that ESG is a fundamental part of investment risk and opportunity assessment. In August 2020, and updated in September 2023, NBPE's board implemented a responsible investment policy, which can be found **here**.

ESG factors are an integral part of the NB private equity team's due diligence process. As a co-investor, NB performs due diligence on each prospective investment and aims to ensure that the company and sponsor are managing ESG risks appropriately. The team also aim to monitor ESG risks during the time of any investment. The NB Private Markets investment team work closely with the dedicated ESG teams to support the implementation of industry best practices.

As a mark of the success of the team for their ESG efforts, in the 2023 UN PRI assessment, NB scored above the median of all reporting signatories and large investment management peers globally for their ESG integration efforts in every UN PRI reported category. NB achieved top scores in multiple categories including the Policy, Governance and Strategy category (formerly, Investment and Stewardship Policy) and the Indirect – Private Equity category. Alongside this, NB Private Markets received the British Private Equity & Venture Capital Association's Excellence in ESG Award (LP Category) for its commitment to fostering innovation of ESG objectives, engagement with private equity managers, and efforts related to ESG data and climate initiatives.

The team provided a breakdown of the directly invested portfolio as they currently see it, showing that overall, 19% of the portfolio has a positive potential from a UN Sustainable Development Goal (SDG) thematic perspective.

Fig.8: Portfolio Through A Sustainability Lens



Source: NB

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