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ICG Enterprise

ICGT continues to deliver consistently strong returns...

Update
06 July 2021

Summary

ICG Enterprise (ICGT) trust celebrates its 40th birthday this year, and five years since the move to ICG. In other ways too, 2021 is shaping up to be a banner year. Realisation activity is running at record levels, with £100m of cash received by the trust during Q1. Realisations have come at a 42% uplift to carrying value (35% average for past five years) and puts ICGT on track to deliver its 13th consecutive financial year of double-digit portfolio growth (net of management fees, but not including the effects of cash drag or FX changes).

ICGT sits in a unique place as regards the listed private equity (LPE) peer group in taking a hybrid approach to investing. The team describe their 'secret sauce' as blending the third-party funds portfolio (c. 50% of investments) with the 'high-conviction' portfolio. This represents investments over which the ICG team make a conscious decision to invest through ICG funds or through co-investments. Investments with third party managers drive co-investment opportunities, and enable diversification within the portfolio, without it becoming too concentrated.

Over time, ICG's team have added value through selecting top-tier managers in the fund portfolio, or through good company selection in the high-conviction portfolio. The combination has meant that ICGT has delivered consistently strong value creation for shareholders and, as we demonstrate in **Performance**, ICGT has outperformed UK and Global equities over five years on a NAV and share price basis.

ICGT's board aims to pay a total dividend (funded from capital) of at least 27p per share for the year ending 31 January 2022. This represents a 12.5% increase over the previous year, equivalent to a prospective yield of 2.5% on the current share price.

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Analyst's View

As we highlight in **Performance**, ICGT has produced strong and consistent NAV returns, and the **Discount** of 24% remains tantalisingly wide. We wonder what will draw more investors into what we view is an underappreciated niche. Large, successful institutions such as the Yale Endowment have long espoused significant allocations to private equity. We wonder when other investors might catch on? Even a slight move from generalist investors towards a 'Yale model' allocation could narrow discounts dramatically.

It is worth noting that ICGT's NAV returns have been achieved net of all management fees and other **Charges**, which to some look prohibitively high. There are no guarantees that historic outperformance will continue over the next five years. However, those who avoided ICGT five years ago because of the 'cost', have found the real cost has been missing out on what has been a strong period of outperformance of global equities.

We continue to believe that private equity-backed companies are in a better position than many of their listed comparators to deal with the aftermath of the pandemic and therefore justify a place in investment portfolios. Now that ICG have been at the helm for five years, their stamp on the portfolio is evident. ICGT offers a differentiated proposition, which over time as we discuss in **Discount**, could lead to the discount narrowing and justify a premium relative to peers.

BULL
Portfolio benefitting from being in 'sweet spot' un terms of concentration vs diversification, having delivered strong historic returns
Benefits of ICG starting to be felt in underlying portfolio (now 25% of total), with trust in good position re: deal flow and access to investments
ICGT carving out its own niche in the LPE sector offers the potential for a sustained discount narrowing relative to peers

BEAR
Private equity valuations lag markets, so precise level of discount is hard to determine
Gearing in underlying companies will magnify valuation movements
If sentiment towards risk assets changes, the discount may widen, potentially dramatically

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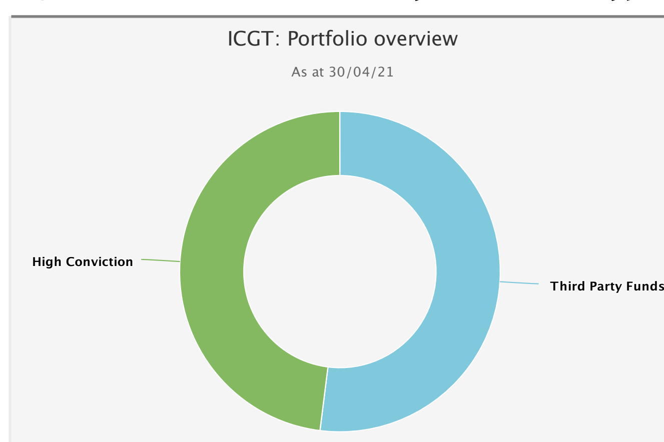
Portfolio

ICG Enterprise (ICGT) trust is celebrating its 40th year of existence this year, which in other ways too, is shaping up to be a banner year for the trust. In the recent Q1 NAV update, the team commented that realisation activity was running at record levels, with the highest ever quarter of realisation proceeds received by the trust (£100m). In the team's view, given these came at a 42% uplift to the previous carrying value, this puts ICGT in a good position to post its 13th consecutive year of double-digit portfolio growth. Local currency returns during the quarter were 3.4%, which translated into a sterling return of 2.2% (reflecting sterling's strength). Over the past five years, ICGT has delivered 15.8% per annum NAV total returns.

Realisations are a key part of the value accretion phase for private equity investments, where underlying companies' valuations are marked up to reflect not just earnings growth or a valuer's opinion, but to reflect an agreed transaction. Across the industry, private equity houses generally try to keep valuations conservative (although this is by no means guaranteed), reflecting the fact that these are illiquid investments, and as such should be valued at less than a willing buyer might be willing to pay at an indeterminate time in the future. This conservatism means that some investors view private equity NAVs as standing at a significant discount to 'true' value. The extreme approach was taken by Edward Bramson's Sherborne Investors, who took control of Electra Investment Trust in 2015 in order to wind it up and he successfully extracted significant value from where the published NAV stood and that subsequently realised. In the case of ICGT, evidence of this conservatism can be found in the five-year average uplift on sales of 35%. It is worth bearing in mind of course that not all investments are at the mature / ready for sale stage, and so we are not suggesting that the 'true' NAV is 35% higher than the current level. However, it does suggest that when combined with the current Discount to NAV that the shares trade, investors may have a significant margin of safety to the underlying value in the portfolio.

ICGT can be seen as a microcosm of the private equity industry, and the trust is not alone in seeing strong sales activity from the portfolio. That said, ICGT does sit in a unique place as regards the listed private equity (LPE) peer group, in that it takes a hybrid approach to investing. This means that the top holdings in the portfolio are significant enough to create meaningful growth when they are sold, yet the trust is diversified enough to have little specific company risk. The team describe their 'secret sauce' as blending the benefits of having access to the global network and investment opportunities provided by the wider ICG business (itself a direct investor in private companies) combined with the long history of the team behind ICGT as private equity fund investors. The key to the success of the strategy is the third-party funds portfolio (c. 50% of investments), in which the team aim to invest for the long term with top quartile managers around the world. The managers have long preferred investment opportunities which exhibit defensive growth characteristics, and to back more experienced, longer-established private-equity managers who invest in larger, more resilient buyouts. These investments and relationships with third party managers are critical in driving co-investment opportunities (which the wider ICG business helps evaluate) as well as investments with ICG's private equity funds, which have historically generated significantly higher returns than the fund portfolio, but have higher idiosyncratic risk. This part of the portfolio is called the High-Conviction investments, expected to be around 50% of the portfolio. We show the current breakdown in the chart below, which is not far from target.

Fig.1: Portfolio Breakdown - By Investment Type



Source: ICG

We understand the team continue to see the benefits of the wide range of relationships they have, evidence for which is seen in the 20+ co-investment opportunities the ICG team saw in the financial year ending January 2021. As one might expect the managers are highly selective in which ones they pursue, and this year have completed on two co-investments since the year end (31/01/2021). These are Ivanti (an IT security service provider) and Ameos (a provider of hospitals in German speaking Europe). Alongside two commitments to ICG funds, the team have also made two new commitments to third party funds, one of which is US based – continuing the pivot that ICGT is making towards the US. Five years ago, when the trust and the team moved to ICG, one of the strategic changes made was to actively target a higher exposure to the US, made possible by ICG's footprint and network in the US. This move has subsequently been highly accretive given the performance of US investments, and we would expect further investments here to be made given the US currently accounts for 40% of the portfolio (as at 30/04/2021).

Realisations and investments aside, private equity investing is a highly active investment strategy in which the sponsor (or manager) controls each company, sets the strategy and at times rolls their sleeves up to help drive

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value creation. It is this high degree of active management that we believe has been one of the contributors to private equity returns being so resilient during 2020. PE companies are well suited to having to deal with periods of change, with high quality management on the ground supported by depth of experience at the management house. Aside from many of ICGT's portfolio companies having relatively resilient business models, this is a key reason why we believe the trust performed so well during the volatile times of 2020. Over the longer term, ICG's team have also added value through stock picking – through selecting top-tier managers in the fund portfolio, or through good company selection in the high-conviction portfolio. The combination has meant that ICGT has delivered consistently strong value creation over the years on many metrics, which we show in the table below.

Value Creation

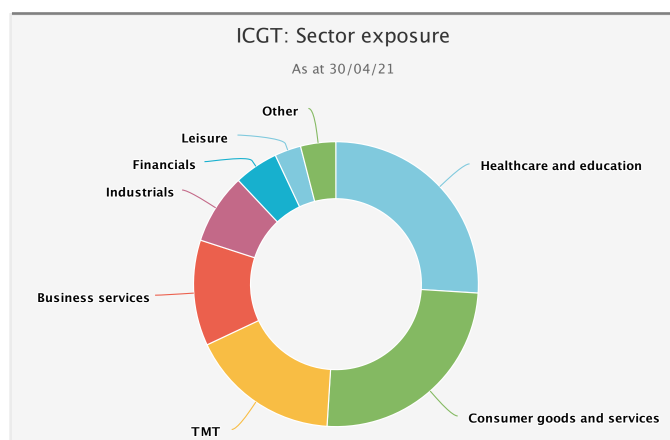
	Q1 2021	LAST 12 MONTHS	LAST 3 YEARS	LAST 5 YEARS
NAV per share total return	1.6%	29.8%	53.1%	108.7%
Average exit multiple to cost	3.9x	3.0x	2.4x	2.4x
Average exit valuation uplift	42%	38%	34%	35%

Source: ICG

Past performance is not a reliable indicator of future results

Delving into the underlying portfolio as it currently stands, the manager's long running interest in defensive growth companies (i.e. looking for companies with growth drivers which will still operate in difficult conditions) is evident in the sector breakdown below. Many of the companies that ICG is exposed to occupy niches within these sectors. What is clearly evident in the below is the different make-up the portfolio has when compared to many listed indices – the FTSE All-Share in particular which has significant exposure to energy, mining, and financials – all largely absent from ICGT's portfolio.

Fig.2: Sector Breakdown Of Portfolio



Source: ICG

We illustrate the top ten holdings in the table below. ICG's hybrid approach results in a portfolio with concentration that would not look out of place in a typical (listed) equity portfolio. The top ten make up c. 30% of the portfolio, the top 30 c. 46%, and the top 50 around 55%. With the third party fund portfolio consisting of many different fund interests, there is a relatively long 'tail', with a total of 240 companies making up 90% of the portfolio. The current largest position (8.2% of portfolio) is reflective of its success. PetSmart / Chewy was originally a co-investment made with BC Partners. Chewy is majority owned by Petsmart, which it demerged as a listed entity and the share price initially performed very strongly. Over Q1, Chewy's shares retreated but have since stabilised, although resulting in a negative contribution of 3.8% to NAV over the period. Observable in the table is the number of investments sponsored by ICG itself, part of a strategy to increase the percentage of the portfolio invested in high-conviction investments.

Top Ten Holdings

	MANAGER	YEAR OF INVESTMENT	% OF PORTFOLIO
PetSmart / Chewy	BC Partners	2015	8.2
DomusVi	ICG	2017	4.1
Minimax	ICG	2018	3.5
IRI	New Mountain	2018	2.4
Lead Home Solutions	Gridiron	2016	2.2
Visma	ICG	2020	2.2
DOC Generici	ICG	2019	2.2
Yudo	ICG	2017	2.0
Supporting Education Group	ICG	2014	1.9
Froneri	PAI	2019	1.8

Source: ICG, as at 30/04/2021

In our view, there are reasons to be optimistic on future NAV progress. Private equity funds are seeing no shortage of opportunities to realise assets, nor make new ones. As such, we don't see any obvious reasons why the strong momentum behind ICGT cannot continue. We continue to believe that private-equity-backed companies are in a better position than many of their listed comparators to deal with the aftermath of the pandemic, and hence fully justify a place in a long-term investment portfolio. In many cases, they are exposed to very different risks and growth drivers, and therefore offer a potentially useful complement to portfolios. Now that ICG has been at the helm for five years, its stamp on the portfolio is evident. As a result, ICGT offers a differentiated proposition, which over time as we discuss in **Discount**, could lead to the discount narrowing and justify a premium relative to peers.

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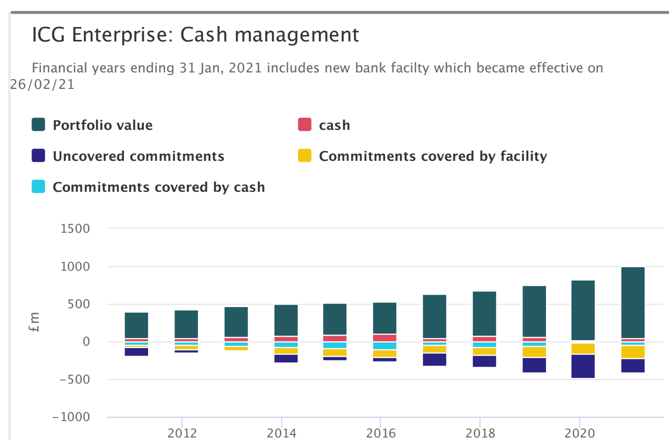
Gearing

IGCT is not currently geared in the traditional sense, and nor has it been for many years. However, many of the underlying companies make use of gearing as part of their capital structure, with the average net debt to EBITDA ratio of the portfolio at 4.3x (as at 31/01/2021). Despite ICGT not intending to use gearing at the trust level, it does have a borrowing facility of c. £174m. This is effectively used as an insurance policy for commitments and short-term working-capital purposes. Commitments to funds currently stand at £473m (as at 30/04/2021), of which we understand £87m is to funds which are outside of their investment period, meaning an effective commitment of £386m. Cash balances stood at £116m at 30/04/2021, meaning that cash and borrowing facilities make up 75% of likely commitments. Being 'over-committed' in this way, represents a form of gearing. However, given ICGT's capital is likely to be drawn over four to five years, this represents c. three years' worth of funding in the absence of any realisations from the portfolio. The adjusted commitment-cover ratio is broadly in line with the average for the trust's other fund-of-fund peers (excluding those in wind-up), which have an average commitment cover of 0.7x (according to data from JPMorgan Cazenove).

The balance sheet is represented graphically below, where we show over-commitments represented in dark blue. We think it noteworthy that the overcommitments have declined as a proportion, but do still represent an element of financial risk for the company. ICGT makes long term commitments to private equity funds, as well as making its own decisions on co-investments and secondary investments on a case-by-case basis. The timing of when these investments are made (and realisations as investments are sold) is difficult to predict given their illiquid nature and the way transactions occur. Fund commitments can be 'called' or drawn-down by managers at any point for them to make investments, and so it is important that ICGT always has a source of liquidity in order to meet these potential demands. As such,

Fig.3: Cash Management



Source: ICG Enterprise

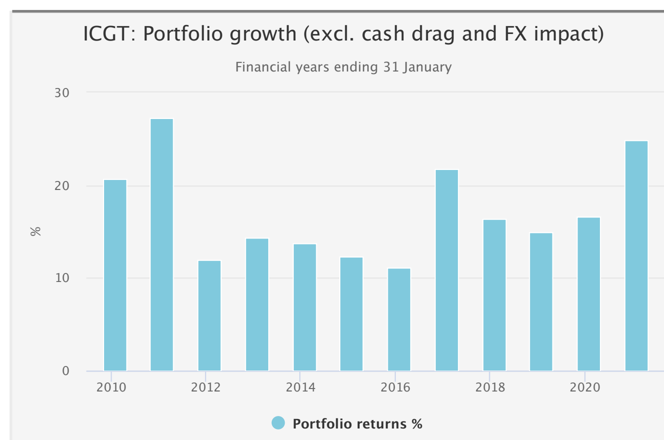
management of cash and running an element of over-commitment is critical in the manager's aim to keep ICGT as fully invested as possible, thereby avoiding a dilutive effect on returns from having cash on the balance sheet.

In the Q1 results announcement, cash had crept up to £116m, representing 12% of net assets. One of the motivators for the team moving to ICG in 2016 was that being a part of a larger group, they would have improved access to deal flow. The graph above shows that until more recently ICGT had become more fully invested, but exceptionally strong realisation activity that we note in **Portfolio**, has meant that cash has built up again. The team note a strong pipeline of potential deals for investment and so they are in a strong position to take advantage of opportunities.

Performance

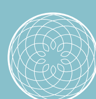
ICGT has developed a strong and consistent long term track record. In the graph below we show data provided by ICG, which shows it has delivered 12 consecutive years of double-digit portfolio growth (i.e. including management fees, but not including the effects of cash drag or FX changes). In our view, this shows the strength of the underlying 'engine' which drives portfolio growth, and is the main reason why we believe investors should be attracted to private equity in general, and ICGT in particular. As we discuss in **Discount**, the share price and discount to NAV can be volatile as sentiment ebbs and wanes, but this graph demonstrates the fundamental attractions of the value creation capability of private equity and the ICG team's ability to pick top-tier teams to invest with, but also pick attractive co-investment opportunities. NAV returns have been different to these figures because of the effect that cash drag (see **Gearing**) and foreign exchange fluctuations have had.

Fig.4: Underlying Portfolio Returns



Source: ICG

In our view, short term comparisons between listed private equity (LPE) trusts and listed markets don't make



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much sense. This is because private equity investments are typically made over long time frames and the value creation process typically only occurs after two years or more (and is only likely to be reflected in valuations after a certain period of time has elapsed in any event). A related point is that NAVs are calculated using relatively infrequent valuations released by different trusts at different times, which may mean that comparisons are using stale NAVs. That said, we understand that quarterly valuations are becoming more common within the industry, although some are still only performed six-monthly.

In the table below we show ICGT's NAV total return over various time frames, against peers and listed indices which may serve as a comparator. ICGT has delivered competitive returns, most especially since ICG became the manager. At the time of the move to ICG, the board highlighted a number of strategic changes designed to enhance long term returns. Amongst these was to increase the proportion invested in 'high-conviction' investments (see **Portfolio**) and also to target c. 50% invested in the US. Returns on the high conviction portfolio have generated local currency returns of 25% per annum over the past five years, compared to 15% for the third-party funds, and so one would hope that with the shift in strategy, the recent outperformance relative to Fund of Fund peers will continue. We note the strong performance too, relative to the MSCI ACWI over the past five years, and especially the FTSE All Share over all periods.

Nav Total Returns Over Various Time Frames Vs Comparators

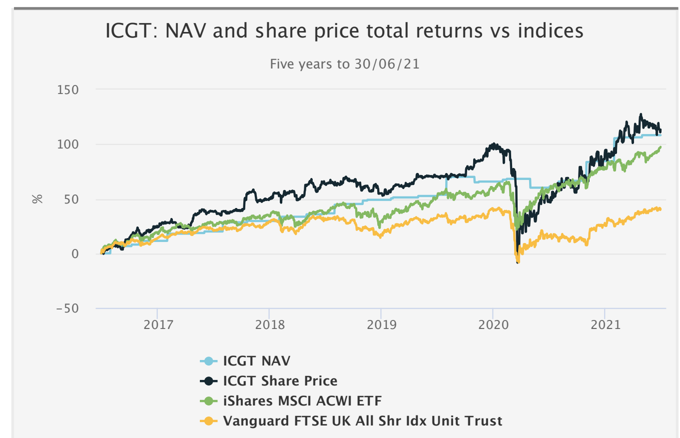
	3 YEAR %	5 YEAR %	10 YEAR %
ICG NAV	53.8	110.1	202.3
Fund of Funds weighted average	51.9	107.9	236
Single manager weighted average	48.1	142.8	267.2
MSCI ACWI £	44.1	101.9	208.5
FTSE All Share	9.2	45.6	95.8

Source: JPMorgan Cazenove, Datastream

Past performance is not a reliable indicator of future results

The graph below shows ICGT's NAV and share price returns against listed markets over the past five years. We note the strong outperformance but, as we discuss in **Discount**, listed private equity trusts tend to suffer inordinately in market corrections. 2020 was no different. However, as we note in **Portfolio**, the underlying portfolio is orientated to defensive growth companies, which meant that they proved resilient in what was a very challenging time. Earnings growth of the top 30 companies (excluding listed holdings such as Petsmart / Chewy) for the year to 31/01/2021 was 12% and EBITDA growth was 14%. This is clearly an impressive result given the background of the pandemic and the impact of lockdowns on businesses of all types. It is worth noting that these returns (and all performance statistics in this report) have been achieved net of all management fees and other **Charges**, which to some look prohibitively high. There are no guarantees that the same outperformance will be the case over the next five years but, in our view, those who avoided ICGT five years ago because of the 'cost', have found the real cost may have been felt as missing out on what has been a strong period of outperformance of global equities.

Fig.5: Five Year Total Returns



Source: Morningstar

Past performance is not a reliable indicator of future returns

Dividend

ICGT aims to provide shareholders with an attractive dividend as well as capital growth. As the graph below shows, since the 2017 financial year, shareholders have seen a significant increase in dividends being paid. In addition, the trust has moved to paying a quarterly dividend. At the time of the change, the board made an explicit target to pay a minimum dividend of 20p per share per annum, as well as growing it progressively. In the current financial year, the board has stated that it aims to pay a total of at least 27p per share for the year ending 31 January 2022. This represents a 12.5% increase over the previous year, and is equivalent to a prospective yield of 2.5% on the current share price (as at 02/07/2021).

ICGT's dividend is funded from capital, which has advantages and disadvantages. This method of returning capital diminishes the capital base of the company and could pose problems if the trust did not have sufficient liquidity on the balance sheet (as we discuss in **Gearing**, ICGT is very far from having this problem currently). On the plus side, we think it worth noting that the dividend is not subject to short-term headwinds that other dividend sources face. In some ways, paying a dividend from capital

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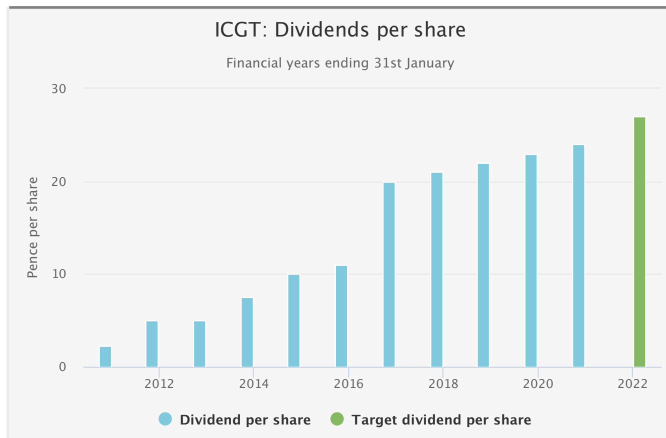
is akin to a buyback, but (as we discuss in **Discount**) shareholders need to reinvest this dividend in ICGT's shares to get the equivalent accretive 'uplift' in value that a buyback would deliver to NAV.

Fig.5: Dividends



Source: ICG Enterprise

Management

The team behind ICGT have expanded since the move to Intermediate Capital Group around four years ago. Oliver Gardey is the lead manager, who joined in Autumn 2019. Oliver has over 25 years' experience in the private-equity industry. For the past decade, he has been a partner at Pomona Capital, where he was a member of the global investment committee. He was previously a partner at both Adams Street and Rothschild/Five Arrows Capital.

Oliver is supported by ICG's team of five investment professionals, including Colm Walsh, who is a member of the investment committee (IC), having been part of the team for ten years (and who has over 15 years in total of PE experience); and Fiona Bell, who has been part of the team for 11 years (with 14 years' experience in private equity). The IC also contains Benoît Durteste (CEO and CIO of Intermediate Capital Group plc) and Andrew Hawkins (the head of Intermediate Capital Group's private-equity solutions division, which includes ICGT, and also the lead manager of its strategic equity strategy). The investment team at ICGT maintain an insight into Intermediate Capital Group's significant deal flow of potential fund investments, as well as secondary and co-investment opportunities. This is one of the significant benefits that ICGT offers as to why it moved to Intermediate Capital Group.

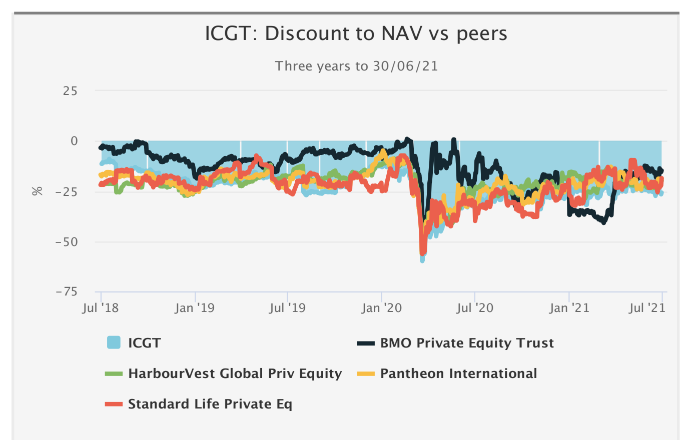
Discount

As the graph below demonstrates, ICGT trades on a wide discount to NAV. Over the past three years, the average discount it has traded at (according to Morningstar) is 23%.

The shares currently stand marginally wider than this, at 24%. Discernible in the graph too is the fact that at times the discount has been significantly narrower than this, but it has also been significantly wider. In our view, this encapsulates one of the difficulties for some investors in listed private equity – that share prices and discounts can be volatile. For long term investors this is likely an irritation, but it also presents an opportunity for those with confidence and patience to buy shares on a discount when presented. That said, given NAVs are published relatively infrequently, discounts may at times prove illusory. In our view, investors in listed private equity trusts should be investing because of anticipated NAV growth over the long term, and not on the basis the discount will narrow. That said, should the discount narrow, it does provide a good tailwind to returns. Our belief is that as ICGT increasingly differentiates itself from the fund of funds peer group, this could provide a catalyst for a sustainable premium rating relative to peers – rather than the current rating which is in-line with the peer group.

As it is, the current discount to NAV provides something of a margin for error should NAV progress not continue. For long term investors, as we discuss in **Portfolio**, we believe some additional comfort can be taken by investors in the typically conservative valuations that derive the NAV – evidenced by ICGT's historic 35% uplifts on valuations for companies sold. That said, investors should be aware that whatever 'value' appears to be on offer in terms of discounts will likely count for little should we enter a protracted down-phase in equity markets, given the likelihood that discounts will widen significantly, providing little insulation for investors.

Fig.6: Discount History



Source: Morningstar

As we highlight in **Performance**, ICGT has produced strong and consistent NAV returns over both the long and short term. We continue to believe that with momentum appearing to be behind the NAV since the last effective valuations (82% are 31/03/2021 valuations, and 18% as at 30/12/2021) there is a good chance that the current

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discount is conservative. With yet another strong year of performance under its belt (as we note, the team are on track to deliver their 13th consecutive year of double-digit portfolio growth in local currency terms), and discounts remain tantalisingly wide. We wonder what will draw more investors into what we view as an underappreciated, but highly attractive niche. Certainly large, highly professional and successful institutions such as the Yale Endowment have long espoused significant allocations to private equity (the latest target allocations for Yale is 17.5% in Buyout funds, and 23.5% Venture Capital). We wonder when other investors might catch on, given in our experience many investors currently consider a 'full' allocation to private equity as c. 5% of a total portfolio. Even if there is a slight move from generalist investors towards a 'Yale model', discounts could narrow dramatically and on a sustained basis.

Members of the board and management team have been active in buying shares over recent months, and historically ICGT has bought shares back opportunistically during 2020 which was highly accretive for remaining shareholders. However, there is no formal policy on buybacks. As we discuss in **Dividend**, the board has increased the dividend target for this year materially (+12.5% over last year) which represents a return of capital at NAV. Investors who re-invest this dividend at the current 24% discount level are generating a 'round-trip' increase in 'value' (as determined by NAV).

Charges

ICGT pays management fees to ICG of 1.4% of portfolio value and 0.5% of uncalled commitments. ICGT charges this fee only on qualifying assets, these being investments outside the funds managed by Graphite and ICG directly. This means an effective management fee of c. 1.1% of net assets of the trust, which we see as being reasonable, considering the highly active investment strategy.

In addition, the managers are entitled to participate in an incentive scheme, which requires a co-investment of 0.5% of investments made; they then receive 10% of any returns after an 8% hurdle, again excluding ICG and Graphite funds (which make up over 20% of the portfolio as at 30/04/2021). Unlike typical LTIP schemes which are prevalent in the listed market, this co-investment scheme requires that the team invest their post-tax earnings in each deal and creates long-term alignment of interests with shareholders by ensuring the managers invest in every underlying investment alongside ICGT (excluding post-2016 ICG and Graphite funds).

The most recently published KID RIY cost is 6.22%, which reflects 3.04% of performance fees both with respect to the underlying funds as well as at the trust level. These performance fees are non-recurring, and depend entirely on strong performance net of all underlying fees and incentives being delivered. Whilst high, they reflect active management in a difficult-to-access asset class. We also note that calculation methodologies across trusts vary significantly, with not all listed private equity trusts disclosing their full cost breakdown in the same way.

ESG

Responsible investing remains a key focus for ICG's investment team, with ESG considerations embedded across the business. The investment team work closely with ICG's ESG team to ensure that the investment programme is compatible with the wider business's ESG framework. ICGT's board has stated that it believes that the long-term success of the trust requires the effective management of both financial and non-financial measures, and fully endorses the increasing emphasis on responsible investment. It believes that companies that are successful in managing ESG risks, while embracing opportunities, will outperform over the long term.

Private-equity firms have an important part to play in being responsible investors. In some ways, private-equity managers have a stronger position than listed-company investors, given the control that they have over strategy and other matters. At the same time, private-equity managers (and the management of the companies they back) are heavily incentivised through financial performance, which could at times create a potential conflict. ICG seeks to manage and mitigate these conflicts through active and detailed due diligence on all high conviction and third-party fund commitments.

ICG as a business has been a signatory to the UN's Principles for Responsible Investment (PRI) since 2013, and we understand that almost all of the underlying managers through which ICGT accesses its investments are either signatories to PRI or have an ESG-policy framework. The team claim to engage actively with managers on ESG, although we believe that some reporting on these engagements (as well as reporting on progress made) would provide good colour for those who require more transparency on ESG. As such, it is clear that ESG is an important consideration for ICGT, but it may not meet the requirements for 'pure' ESG investors.

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