Item 5(b)

2nd March 2022

Glasgow City Council

Strathclyde Pension Fund Committee

Report by Richard McIndoe, Director of Strathclyde Pension Fund

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Direct Impact Portfolio (DIP)
Investment Proposal – Panoramic Fund 3

Purpose of Report:

To set out a proposal for an investment of £25m within DIP.

Recommendations:

The Committee is asked to **APPROVE** an investment of £25m in **Panoramic Fund 3** by DIP.

Ward No(s):	Citywide: ✓
Local member(s) advised: Yes ☐ No ☐	consulted: Yes ☐ No ☐

1 Background

1.1 Portfolio Establishment

In December 2009, the Strathclyde Pension Fund Committee agreed to establish a New Opportunities Portfolio (NOP) with a broad remit to invest in assets for which there was an attractive investment case but to which the current structure did not provide access.

1.2 Review

The NOP strategy has been subject to 3-yearly review. The most recent review was concluded in November 2021. This made no change to the objectives, structure, overall size parameters, risk and return parameters, or governance structure, but did result in an increase in the individual investment size parameters and a name change from the Direct Investment Portfolio to the Direct Impact Portfolio (DIP).

1.3 Implementation Framework

DIP investment proposals are assessed on their own merits within an agreed implementation framework based on SPF's overall risk-return objectives and specific DIP parameters. The framework agreed at the 2021 review is summarised below.

Direct Impact Portfolio (DIP)	
Objectives	Primary objective identical to overall SPF investment objective. Secondary objective of adding value through investments with a positive local, economic or ESG (environmental, social, governance) impact.
Strategy & Structure	In line with SPF risk-return framework but focused on the UK and the Equity, Long Term Enhanced Yield and Short Term Enhanced Yield asset categories.
Risk and Return	Portfolio benchmark return of **CPI +3% p.a.** Individual risk and return objectives for each investment.
Capacity	Target allocation of **5%** of total Fund (based on Net Asset Values). Range of **2.5**% to **7.5%** of total Fund.
Investment Size	Target: **£30m** to **£100m** Minimum: **£20m** Maximum: greater of **£250m** or **1%** of Total Fund Value
Decision Making	3 stage process with review and satisfactory due diligence by officers, followed by a presentation to the Sounding Board before a proposal is taken to Committee for approval subject to completion of legal documentation.
Monitoring	Includes individual investment reports, participation in advisory boards, and a quarterly DIP monitoring report which is reviewed by the Fund's Investment Advisory Panel.

The following proposal has been assessed using this framework and is considered appropriate for recommendation by the Sounding Board to the Committee.

2 New Investment Proposal

2.1 Key Terms

Name	Panoramic Fund 3
Investment vehicle	English Limited Partnership
Manager	Panoramic Growth Equity
Sector	Growth Capital
Investment objective	Investing in growth opportunities for Small & Medium Enterprise Companies ("SMEs").
Term	10 years
Target size	£75m (Hardcap £100m)
Proposed DIP investment	£25m
Target return	25% IRR (Net)

2.2 Investment Summary

Panoramic Growth Equity ("PGE") was founded in 2009 as a Glasgow-based asset manager specialising in growth opportunities for Small & Medium Enterprise Companies ("SMEs"). SPF invested £5m into PGE's first fund in 2010 and a further £15m in Fund 2 in 2015.

Fund 3 has a target raise of £75m and intends to invest across the UK with a particular focus on the following regions: Scotland, (focusing on the Central Belt of Glasgow and Edinburgh), Northern Ireland, (focusing on Belfast), Yorkshire (focusing on Leeds and Sheffield) East Midlands (focusing on Nottingham) South-West (focusing on the Bristol to Portsmouth corridor)

The target sector will be similar to previous funds albeit with an increase to the maximum investment size from £5 to £8m. The preferred target range is investments of £2m to £8m. The increase in the maximum size of any individual investment will allow the managers more flexibility e.g. instances where there may be requirements for follow-on funding. There will be no change to the underlying principles and fundamentals established for previous funds.

Investors in previous funds, including other LGPS funds are in the process of completing diligence and receiving authorisation for commitments to Fund 3.

Funds 1 and 2 have performed well returning a net IRR of 21%. As a consequence. Fund 3 will commence investing once Fund 2's Investment Period closes in April 2022.

An investment of £25m by DIP in Panoramic fund 3 is proposed.

More information on the investment manager is included in **Schedule 1.**

2.3 Investment Rationale

Panoramic is led by the three founding partners of its team and they will have responsibility for investing the Fund. They are supported by a team who have all worked with the partners for a number of years. All team members operate from Glasgow.

Since inception in 2010, the team has invested in 24 companies with a gross investment IRR of 38% (based on Q2/21 valuations). With Fund 1 exits to come and the Fund 2 portfolio continuing to mature well, overall performance since inception is expected to remain comfortably within the top quartile.

Panoramic is now seeking to build on this success by raising Fund 3. With the same team and investment strategy. 3 key aspects of Panoramic's approach are set out below.

Partner Led – strong returns are driven by the involvement of the partners in all investment activity. As a highly experienced partner group focussed solely on regional SMEs the team have the ability to work with founders to grow their businesses and help navigate the challenges faced to create a significant competitive advantage.

Regional Investment – London dominates the investment landscape across much of the private equity market. Panoramic's ethos has always been to seek out opportunities away from the masses across the regions. Panoramic has invested across many of the regions of the UK and has built strong and relevant networks to drive dealflow and value.

Structuring – Panoramic's investment model is tilted towards growing but profitable companies that need outside investment either to fund expansion, or to facilitate a change of ownership. Investment structures seek to generate equity returns whilst reducing investment risk. Downside protection is achieved through loan note or preferred equity structures, which bring the opportunity for running yield generation and debt repayment prior to exit. The success of seeking companies with strong cashflow is seen by the number of companies in Fund 2 where full strong returns have been achieved through cashflow alone before an equity exit event.

2.4 Risks

The main risks of the proposed investment in Panoramic fund 3 are considered to be as follows:

- Sourcing Opportunities
- Private Equity Risk
- Key Personnel

A summary of risks and key mitigants is contained in **Schedule 2**.

2.5 Projected Return

The target return for Fund 3 is an IRR of 25% (Net). This is appropriate for a portfolio of this nature.

2.6 Exit

The Fund has an investment term of 10 years although this may be extended with investors' agreement for up to 2 x 1 year extensions. The Fund has a 5 year investment period although it is expected that the funds will be deployed well within this time.

2.7 Fees

The management fee is typical of DIP's Growth Capital portfolio. The fee will be calculated on total commitments during the IP and on the invested capital thereafter, which is in line with market practice.

Carried interest provisions also apply. These are structured such that Panoramic require to perform strongly before they benefit under them.

The management fees and carried interest provisions are in line with growth capital market norms. It is anticipated that Panoramic will reach their £75m target fund raise.

2.8 ESG and Climate Change Impact

Panoramic was one of the first UK asset managers of any size to become a signatory to the United Nations Principles for Responsible Investing in 2009.

2.9 Investment Size and Cash Requirements

SPF Fund value at 31st December 2021	£28.633bn
DIP allocation (target 5% of main fund) NAV	£1,432m
Current DIP NAV	£1,174m
Headroom v NAV	**£ 258m**

2.10 Investment Strategy

The proposed investment falls within the Growth Capital sector and therefore the Fund's Equity allocation. Equity is a key area of investment focus for DIP.

Allocations following this investment, based on Fund values at 31st December 2021 and total DIP commitments to Growth/Venture Capital, would be as follows:

Growth/Venture Capital, £ in DIP	£233m
Growth/Venture Capital, % in DIP	13.1%
Growth/Venture Capital in DIP as % of Total Fund	0.81%
EQUITY, % Total Fund (target 52.5%)	60.6%

3 Policy and Resource Implications

Resource Implications:

Financial:	Investment of £25m to be drawn as required. Fee structure is in line with market.
Legal:	The investment will be subject to satisfactory completion of due diligence, including review and execution of appropriate legal documentation.
Personnel:	None.
Procurement:	None.
Council Strategic Plan:	Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality and Socio-Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2021-25? Please specify.	Equalities issues are addressed in the Fund's responsible investment policy.
What are the potential equality impacts as a result of this report?	No specific impact from this proposal.
Please highlight if the policy/proposal will help address socio-economic disadvantage.	No specific impact from this proposal.

Climate Impacts:

Does the proposal support any Climate Plan actions? Please specify:	Panoramic has been a signatory to the UNPRI (UN Principles of Responsible Investment) since 2009. This is consistent with Strathclyde Pension Fund's Climate Change strategy, which is being developed in line with Item 34 of the Council's Climate Action Plan.

What are the potential climate impacts as a result of this proposal?	No specific impact at this stage, but previous Panoramic funds include investment in solar panel supply and electric vehicle charging.
Will the proposal contribute to Glasgow's net zero carbon target?	No specific contribution from this proposal.
Privacy and Data Protection Impacts:	To be fully provided for in the legal documentation for the proposed investment.

4 Recommendations

The Committee is asked to **APPROVE** an investment of £25m in **Panoramic Fund 3** by DIP.

Schedule 1

Investment Manager: Panoramic Growth Equity

Stephen Campbell and David Wilson have worked together since 2001 with Malcolm Kpedekpo joining the team in early 2007. In total, they had completed 29 transactions (with an average investment size of £2m) prior to starting Panoramic. In 2009, the three partners set up Panoramic with a desire to create an independent fund management business solely focussed on investing in UK SMEs. The partners self-funded the period between leaving their prior roles and the closing of Fund 1 in March 2010. Fund 2 was successfully raised in 2015 (final close in 2016) by the same team. Across Fund 1 and Fund 2, this team have invested in 24 portfolio companies.

Investments have been targeted at growth and succession capital situations across a range of sectors. Equity capital supply into this market continues to be underserved and Fund 3 will seek to continue to capitalise on this opportunity to generate above average returns for LPs.

The Fund 3 investment strategy will be an evolution of that employed in Fund 2. Experience from Fund 2 supports an increase to the upper investment limit which would offer greater flexibility where previously, managers may have had to decline opportunities. The ‘sweet spot’ for investments will remain unchanged at £3 to 4m and the fund will be open to all sectors. Capital intensive and highly cyclical markets are typically avoided.

Schedule 2

Investment Specific Risks

Sourcing Opportunities

The ability to originate a pipeline of attractive opportunities in the lower mid-market segment of the UK market is a key factor in the potential success of the fund. Panoramic benefits from a steady flow of referrals from its network of contacts. There is no reason to believe this will not continue following the relative easing of the political uncertainty in the latter part of 2019. The combined experience of investing together in over 50 SMEs over the past 20 years and through several economic cycles makes this partnership group one of the most experienced in this part of the market.

Private Equity Risk

The proposed investment is into a PE fund, which operates in a relatively risky segment of the financial market with no guarantee of success. A PE fund would traditionally anticipate a number of outright investment losses, a larger number of moderately successful investments and one or two “stellar” investments, which combine to generate the blended / relatively high targeted return. The principal comfort in this regard is Panoramic’s track record in its previous 2 funds.

Key Personnel

The risk of over-reliance on key personnel is pertinent to any manager. The success of Panoramic has been built on a strong core team who have an experienced partner led team with over 20 years’ experience. There is sufficient strength and experience to deliver the strategy upon which the fund is predicated.

There will be 3 Key Persons, Stephen Campbell, David Wilson and Malcolm Kpedekpo who will be supported by other experienced managers.