



KENSINGTON PRIVATE EQUITY FUND

MANAGEMENT DISCUSSION AND ANALYSIS  
AND FINANCIAL STATEMENTS

FOR THE NINE MONTHS ENDED  
DECEMBER 31, 2016

February 15, 2017

*This management discussion and analysis of the Kensington Private Equity Fund contains financial highlights as well as the financial statements for the nine months ended December 31, 2016. You may obtain a copy of the financial statements, the annual information form, proxy voting policies and procedures, proxy voting disclosure record or portfolio disclosure at your request, and at no cost, by calling 416-362-9000 or toll-free at 1-855-362-9329, by writing to us at 95 St. Clair Avenue West, Suite 905, Toronto, Ontario, M4V 1N6, or by visiting our website at [www.kcpl.ca](http://www.kcpl.ca). Additional information relating to Kensington private Equity Fund is on SEDAR at [www.sedar.com](http://www.sedar.com).*

**KENSINGTON PRIVATE EQUITY FUND**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

Kensington Private Equity Fund (“KPEF”) is an investment trust established under the laws of the Province of Ontario. This Management Discussion and Analysis (“MD&A”) is being published for investors in KPEF in accordance with its governing Declaration of Trust and the regulatory requirements applicable to it as a Corporate Finance Issuer.

Kensington Capital Advisors Inc. (the “Manager” and “Trustee”) believes that investing in private equity will continue to offer the potential for attractive long-term returns that have historically outperformed public equity market returns. A well-planned private equity investment should reduce risk for traditional investment portfolios through diversification. The Manager provides investment advisory and portfolio management services to KPEF and is responsible for making all investment decisions.

**RECENT DEVELOPMENTS**

*Performance of the Kensington Private Equity Fund*

KPEF was created to provide investors with exposure to a diversified portfolio of private equity investments (“Underlying Investments”), including private equity funds and direct investments in private companies. By creating a hybrid private equity portfolio, the Manager believes investors will benefit from the potential for stronger returns from direct investments and the prudent risk management and diversification from investments in funds (“Underlying Funds”). This carefully managed hybrid portfolio strategy led to the following performance highlights during the nine-month period ended December 31, 2016:

- The Net Asset Value (NAV) of KPEF increased by approximately \$15.6 million, consisting of new subscriptions received from investors, net of distributions paid.
- The NAV per Unit was relatively unchanged during the period (-0.7%), determined on an internal rate of return basis based on the performance of Underlying Investments and taking into account the impact of other cash flows into and out of KPEF during the period (new subscriptions, conversions, distributions and redemptions of Units). The comparable return for the same period last year was 6.4%, and the return for the 12 months ended December 31, 2016 was 4.6%.
- KPEF completed three direct investments in White Swan Environmental Ltd., PaySimple Inc. and Walker Glass Inc. White Swan Environmental Ltd. is a private oilfield waste services company with operations in Northern Alberta. A co-investment with Providence Strategic Growth II LP, PaySimple Inc. is a rapidly growing SaaS and payments platform for small and medium-sized service-based businesses to manage the entire customer engagement processes. Walker Glass Inc. is a glass product company based in Montreal, Quebec, with sales throughout Eastern North America. KPEF also made commitments to three new Underlying Funds: Trivest Growth Investment Fund, Oncap IV LP and Providence Strategic Growth II LP.

For the nine-month period ended December 31, 2016, KPEF distributed \$9.7 million to Unitholders, representing \$1.95 per Unit. This level of distributions represents approximately 8.3% of current NAV, consistent with the track record of distributions from realized portfolio gains established by the Manager through the past several years. As the value of KPEF grows and gains are realized, the Manager continuously evaluates how much of these net realized gains will be returned as distribution to investors and how much will be re-invested into new opportunities. The Manager believes that the quality of investments in the KPEF portfolio remains promising and expects that a similar level of ongoing portfolio gains and distributions can continue, assuming no deterioration in broader economic and market conditions.

## *Overview of the Investment Environment*

In pursuing the KPEF investment strategy, the Manager evaluates broad economic developments as well as conditions specifically applicable to the private equity markets. Within the private equity markets, the Manager targets subsectors and geographic regions that it believes offer the best opportunities for strong returns as well as receptive markets for the sale of mature portfolio companies.

### *Economic Environment*

The protectionism that is growing in the developed world presents challenges and risks for companies that have spent decades developing international markets. The opportunities that arise from such changes in global sentiment may be long lasting if protectionism takes hold and lasts for a meaningful period of time. Identifying those opportunities and developing a plan to take advantage of them presents one of the more interesting puzzles that the Manager has seen in many years. A real opportunity is in products and services that face relatively little impact from protectionist policies. Most software products and productivity enhancing products and services fit this description. The point is that there are always opportunities. Within the Fund's portfolio, steps are being considered to mitigate the impact of protectionist policies. The uncertainty created by the current political environment is unsettling, and investors may see an extended period of public market volatility as a result. Alternative investments, including private equity, have provided significant diversification opportunities for portfolios seeking returns that are not tied to the public markets. The Manager continues to anticipate slow growth in the Canadian economy with somewhat stronger growth in the U.S. The Manager seeks opportunities that are unaffected by, and potentially that could benefit from the shifting political landscape.

### *Current Private Equity Market Conditions*

The Manager is seeing a steady flow of very interesting opportunities in the mid-market buyout, growth equity and venture capital sectors in Canada and the United States. The availability of money has driven pricing higher in many cases than the Manager believes to be a good investment. As a result, the Fund is not participating in investments at the pace of the market. There are, however, many cases where the relationships that the manager has are more important than the pricing and that is where the focus is for new investments. The sale of companies continues to be a high priority where the Manager's access to capital and acquisition opportunities has had a meaningful impact, and the opportunities to grow have slowed. In cases where the Fund is able to take advantage of the "easy money" environment, it is the manager's view that it should do so. The demographics of business owners continues to create a positive environment for new buyout opportunities. KPEF is focused on these areas, and the Manager expects to continue this focus in the year ahead.

One of the most reliable strategies for selecting private equity funds for investment is to back proven teams with strong financial track records as they raise new funds. Naturally, many of these managers see high investor demand, frequently leading them to limit access for new investors. The Manager is in a strong position to renew commitments to some of these selected high demand funds based on historical relationships developed over its 21-year investment history for the benefit of the KPEF portfolio.

The market remains open to sales of mature companies from private equity portfolios, as high quality businesses continue to be acquired by strategic and financial buyers at attractive prices. Public markets have become receptive to initial public offerings (IPOs) again and KPEF expects some IPO exits during the coming year. The Manager is also working on the sale of portfolio companies to strategic corporate buyers as a means of realizing gains.

The Manager remains confident that it can continue to source attractive opportunities for KPEF in the current market and believes that this pricing trend reinforces the importance of due diligence, discipline and a broad market perspective when investing in the private equity markets. The Manager has sought to maintain good liquidity in the KPEF portfolio in order to be in a position to capitalize on attractive opportunities.

As noted above, the Manager is capitalizing on the active venture capital and growth equity markets, and continues to see strong deal flow in those sectors.

## *Summary*

KPEF's portfolio has matured to the stage where the Manager expects to see a steady flow of exits from the sale of portfolio companies. The Manager expects that the frequency of exit transactions and the aggregate value received by KPEF from these exits will continue at a similar pace to its recent experience, as long as portfolio companies continue to perform and market conditions remain favourable.

The unique structure of KPEF provides for the reinvestment of capital from the sale of investments (unlike other private equity funds that typically return all capital to their investors) and the addition of new commitments from investors on an ongoing basis. This structure allows KPEF to continue to make new investments, year after year, as the Manager continuously renews the portfolio. As a result, the Manager believes now that the portfolio has reached this stage of maturity, KPEF is well positioned to continue to generate value for investors in the future.

The Manager does not expect to see dramatic economic improvements in the near term. Private equity investors can succeed in the current slow growth economy with interest rates remaining at historic lows where they have the capability and network for sourcing attractive investments, and the experience and skill set to enhance the company while it is part of the portfolio. With corporate buyers still under pressure to acquire growth in a slow economy, the Manager expects the exit market to remain healthy through the year ahead.

## **RESULTS OF OPERATIONS**

KPEF's investment objective is to maximize long-term total returns for Unitholders through distributions of net income and net realized capital gains from Underlying Investments, while managing risk through prudent diversification.

### *Current Portfolio of Underlying Investments*

The Manager maintains a portfolio of diversified private equity investments consisting of:

- investments in private equity funds to provide the diversification required to manage risk, combined with significant allocations to direct investments in companies to enhance returns;
- secondary investments to opportunistically take advantage of market dislocations;
- investments in the buyout sector, growth equity, venture capital and other sectors, in order to provide investors with access to different segments of the private equity market through a single investment in KPEF; and
- private equity investments located primarily in Canada and the U.S., allocated in a manner consistent with the Manager's expertise and its views on the most compelling investment regions and opportunities.

The investment strategy used to construct the portfolio of KPEF relies upon the Manager's proactive sourcing of proprietary deal flow and active management of the portfolio. This investment strategy is also designed to provide investors with access to private equity investments that would otherwise be unavailable to them, by capitalizing on the Manager's relationships with leading private equity fund managers, and from the scale achieved from combining their resources with other investors in KPEF.

As at December 31, 2016, KPEF held investments in 26 primary funds, 3 independent secondary fund portfolios, 17 direct investments, and 2 funds of funds. The Manager continues to review private equity investment opportunities on an ongoing basis in order to best achieve KPEF's investment objective.

In accordance with the Declaration of Trust governing KPEF, the Manager has the responsibility for establishing target portfolio weighting guidelines by geographic region, investment type and investment sector, with the expectation that the actual weightings will vary over time depending on market conditions and available opportunities, among other factors.

The target portfolio allocations and actual weightings at December 31, 2016 are set out below:

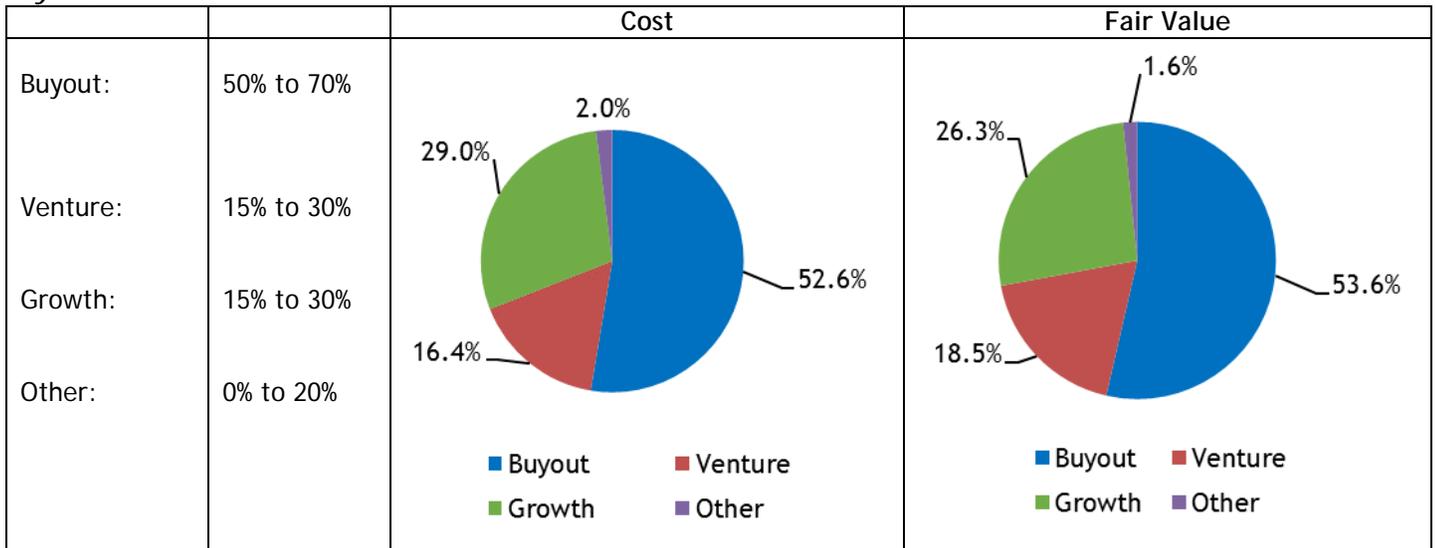
**By geographic region:**

		Cost	Fair Value
Canada:	33% to 66%	<p>3.5% 33.8% 62.7%</p> <p>■ United States ■ Canada ■ Rest of the world</p>	<p>1.6% 33.7% 64.7%</p> <p>■ United States ■ Canada ■ Rest of the world</p>
United States:	33% to 66%		
Rest of World:	0% to 10%		

**By investment type:**

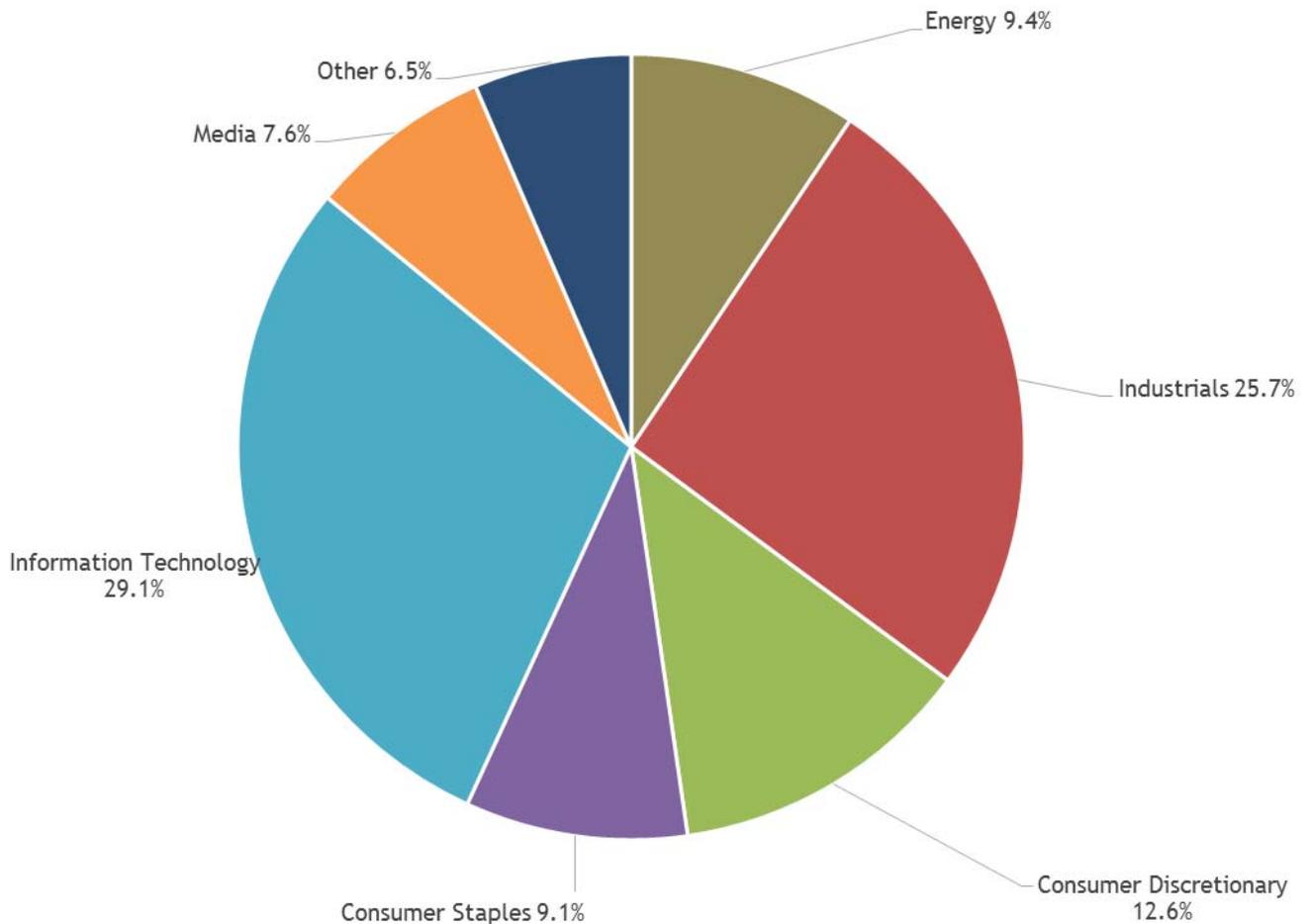
		Cost	Fair Value
Primary & Secondary Funds:	50% to 75%	<p>51.9% 48.1%</p> <p>■ Fund ■ Direct</p>	<p>49.6% 50.4%</p> <p>■ Fund ■ Direct</p>
Direct Investments:	25% to 51%		

*By sector:*



In addition to the 17 direct investments in private companies, the KPEF portfolio as of December 31, 2016, includes Underlying Investments in indirect investments in private companies through primary and secondary fund portfolios, and much smaller indirect investments in many additional private companies through the international fund of funds portfolio. These companies are diversified across multiple industry sectors, as set out in the chart below.

*KPEF Industry Weightings of Private Equity Investments (Fair Value)  
December 31, 2016*



## KPEF NET ASSET VALUE

### *Underlying Investments:*

As at December 31, 2016, KPEF held Underlying Investments in private equity totaling \$98.1 million representing 83.9% of the NAV. During the period, KPEF realized certain private equity investments, resulting in a shift from unrealized gains reported in prior periods to realized gains in the current period. Excluding the impact of net new subscriptions and distributions of \$16.2 million, the net asset value of Underlying Investments decreased by \$0.61 million during the period.

### *Liquid Investments:*

KPEF invests directly in Underlying Funds by committing and advancing capital as such amounts are drawn down by the respective managers of the Underlying Funds. Capital held by KPEF pending investment in private equity investments is invested in a variety of financial products (“Liquid Investments”) such as government securities, money market instruments and investment-grade securities, as well as listed securities of private equity funds and other securities consistent with the overall objectives of liquidity, capital preservation and an appropriate return.

As at December 31, 2016, KPEF held Liquid Investments totalling \$18.3 million, representing an increase of \$0.33 million over the \$18.0 million of Liquid Investments held at March 31, 2016. At December 31, 2016, Liquid Investments comprised 15.7% of the NAV. The Manager expects most of that liquidity to be used in the coming months as several investments that have been in due diligence and documentation are closed.

	December 31, 2016			March 31, 2016		
	Cost (CAD)	Estimated Fair Value (CAD)	% of Fund's Net Assets	Cost (CAD)	Estimated Fair Value (CAD)	% of Fund's Net Assets
Cash	4,007,842	4,007,842	3.4%	12,270,221	12,270,221	12.1%
Kensington Hedge Fund I *	13,773,575	14,340,129	12.3%	5,673,575	5,746,378	5.7%
	<b>17,781,417</b>	<b>18,347,971</b>	<b>15.7%</b>	<b>\$ 17,943,796</b>	<b>\$ 18,016,599</b>	<b>17.8%</b>

\* This fund is also managed by the Manager - see “Related Party Transactions”.

### *Management Expense Ratio:*

KPEF’s Management Expense Ratio (MER) is reported in accordance with applicable accounting standards and securities laws. The MER is based on total expenses for the stated period and is expressed as an annualized percentage of the net average assets during the period. The reported MER for KPEF includes expenses incurred by Underlying Funds. Unlike typical mutual fund expenses, the expenses incurred by these Underlying Funds will be recovered by KPEF prior to any such Underlying Fund’s managers earning a performance fee. The recoveries of these expenses will be recorded as portfolio gains at the appropriate times and will not be reflected in any adjustment to the MER at those times. The Manager has also calculated the unrecoverable portion of the MER during the relevant periods (“Unrecoverable MER”), as the reported MER less the amounts expected to be recovered from Underlying Funds as described above.

	For the Nine Months Ended December 31, 2016				Year Ended March 31, 2016			
	Class A Units	Class F Units	Class E Units	Class G Units	Class A Units	Class F Units	Class E Units	Class G Units
Net Asset Value	8,545,026	1,315,927	34,884,856	72,190,706	\$ 9,812,475	\$ 1,328,391	\$ 31,891,554	\$ 58,305,922
Units Outstanding	409,273	59,777	1,811,505	3,513,176	430,212	55,658	1,486,370	2,584,013
Management expense ratio %	3.96%	3.51%	5.81%	4.60%	4.40%	3.91%	5.70%	4.50%
Unrecoverable management expense ratio %	3.13%	2.66%	4.94%	3.72%	3.36%	2.86%	4.63%	3.44%

### Selected Financial Data:

The following table shows selected key financial information about KPEF and is intended to summarize the KPEF financial performance for the nine months ended December 31, 2016 as well as the last three years ended March 31, 2016, 2015 and 2014. The information is derived from the KPEF financial statements.

	For the nine months ended December 31, 2016				For the year ended March 31, 2016			
	Class A	Class F	Class E	Class G	Class A	Class F	Class E	Class G
	\$	\$	\$	\$	\$	\$	\$	\$
Total operating income	288,610	40,818	1,007,133	1,986,891	1,382,291	180,211	4,060,734	7,746,672
Total profit/(loss)	12,131	6,006	(409,110)	(216,763)	960,938	132,192	2,548,941	5,455,828
Total profit/(loss) attributable per-unit basis	0.03	0.10	(0.26)	(0.07)	2.21	2.47	2.00	2.34
Total net assets	8,545,026	1,315,927	34,884,856	72,190,706	9,812,475	1,328,391	31,891,554	58,305,922
Distributions declared and paid	1.95	1.95	1.95	1.95	1.32	1.32	1.32	1.32

	For the year ended March 31, 2015				For the year ended March 31, 2014			
	Class A	Class F	Class E	Class G	Class A	Class F	Class E	Class G
	\$	\$	\$	\$	\$	\$	\$	\$
Total operating income	2,201,287	242,059	4,455,149	9,264,895	1,834,674	172,931	2,752,636	7,029,651
Total profit/(loss)	1,785,055	203,408	3,307,787	7,222,946	1,388,439	134,505	2,110,005	5,694,643
Total profit/(loss) attributable per-unit basis	3.75	4.25	3.76	3.73	2.50	2.63	3.08	3.15
Total net assets	9,775,404	1,167,411	23,280,263	43,511,330	10,719,443	1,030,319	15,997,886	40,566,593
Distributions declared and paid	3.56	3.56	3.56	3.56	-	-	-	-

### KPEF UNITS ISSUED AND OUTSTANDING

As of December 31, 2016, KPEF had issued four classes of Units, Class A Units, Class F Units, Class E Units and Class G Units. As of December 31, 2016, KPEF had issued (net of redemptions and conversions) 409,273 Class A Units, 59,777 Class F Units, 1,811,505 Class E Units and 3,513,176 Class G Units for total net proceeds of \$117,896,262. The four classes of units are collectively and interchangeably referred to herein as the "Units". Holders of Units are collectively referred to herein as the "Unitholders". The Class E Units and Class G Units are currently available for subscription.

Units of KPEF are listed on FundSERV, under the symbol KEN 100 (Class A Units), KEN 105 (Class E Units), KEN 110 (Class F Units), and KEN 115 (Class G Units). Current NAV information is provided directly to investment accounts through Fundata.

All amounts stated throughout this report are in Canadian dollars unless otherwise noted.

### RELATED PARTY TRANSCATIONS

The KPEF investment portfolio includes investments in two funds managed by the Manager: KPEF has invested \$13,773,575 in Kensington Hedge Fund 1 and KPEF has committed \$23,850,000 to Kensington Venture Fund, LP, which will be drawn down by that fund over a 13-year period. As of December 31, 2016, the total amount funded by KPEF into Kensington Venture Fund was \$126,714. In each case, these related party investments have been structured to ensure there is no duplication of management fees paid by KPEF to the Manager.

### RISK FACTORS

KPEF is subject to a number of risks, including all of the risks described in the KPEF Offering Memorandum dated June 30, 2016.

## FORWARD LOOKING STATEMENTS

This document may contain forward-looking statements relating to anticipated future events, results, circumstances, performance or expectations that are not historical facts but instead represent the Manager's expectations regarding future events. By their nature, forward-looking statements must be based on assumptions and are subject to inherent risks and uncertainties. There is significant risk that predictions and other forward-looking statements will not prove to be accurate. Readers of this document are cautioned not to place undue reliance on forward-looking statements as a number of factors could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements. Actual results may differ materially from the Manager's expectations as projected in such forward-looking statements for a variety of reasons, including but not limited to market and general economic conditions, interest rates, foreign exchange rates, regulatory and statutory developments, the effects of competition in the geographic and business areas in which KPEF may invest and the risks detailed from time to time in KPEF's Offering Memorandum, Annual Information Form and other investor documentation. The foregoing list of factors is not exhaustive and when relying on forward-looking statements to make decisions with respect to investing in KPEF, investors and others should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Due to the potential impact of these factors, neither KPEF nor the Manager undertakes, and specifically disclaims, any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by applicable law.