Oakley Capital Investments

Update
14 November 2019

Summary

Oakley Capital Investments (OCI) has seen strong performance so far in 2019, with a NAV total return of 14% over the six months to 30 June. This has been driven by the rise in value of two investments in particular (Inspired and Time Out), but also by the average 31% EBITDA growth of the portfolio companies.

The portfolio is currently constituted of 15 investments. Oakley Capital (Oakley), the investment adviser, has expressed near-term optimism for much of the portfolio, but highlighted two companies with significant momentum: Career Partner Group (7% of NAV) and WebPros (8.8% of NAV). If their rapid growth metrics are maintained, these investments might be material contributors to OCI's continued NAV growth.

Alongside the strong portfolio performance, Oakley has reported an uptick in investment activity. Over the six months, the Oakley Funds have made five investments, amounting to OCI capital deployment of £85m. These investments were all within Oakley's favoured sectors (consumer, education and TMT) and types of company (mid-market, European, founder-led and market leaders). Also, the investments were acquired outside of auction processes, via complex transactions and often carve-outs.

In harnessing their network of proven business founders and entrepreneurs, the managers have been able to buy these businesses at attractive prices – with an average valuation multiple of 11.2x on an EV/EBITDA basis, compared to the peer group average of 13.4x (Source: Oakley Capital).

Whilst the adviser and OCI board are positive on prospects, OCI's share price discount to its NAV remains wide. Many of the corporate governance measures undertaken by the board to enhance shareholder value have been well received and may have contributed to the discount narrowing in the first half of 2019. However, the share price has lagged subsequent strong NAV growth and the discount has widened again. At 29%, OCI's discount (to the 30 June 2019 NAV) remains wide relative to its history and its peers.

Analyst's View

OCI is a differentiated growth opportunity, with a concentrated portfolio of direct private investments. The Oakley investment team continue to demonstrate that their approach delivers impressive NAV growth, with the last three and a half years proving particularly strong.

Underlying this, average EBITDA growth of the portfolio companies to June 2019 was 31%. This is clearly a very strong growth rate, and only marginally behind the 35% portfolio EBITDA growth HgCapital Trust (HGT) reported for the 12-month period to 30 June 2019 (the strongest trading figures it has ever reported). Comparing the valuation multiples of OCI and HGT, OCI's portfolio companies are currently valued at an average EV/EBITDA of 12x, whilst HGT's top 20 companies are valued at 19.5x.

Key Information:

As at	05/11/19
Price (p)	221
Discount (%)	-29.2
OCF (%)	0.81
Yield (%)	2.0
Gearing (%)	-15
Ticker	OCI
Turnover Ratio (%)	29.1
Shares (£)	204,399,936
Market cap (£)	451,723,859

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This valuation difference is stark, particularly in the context of the share price discounts each company trades at – HGT currently trades on an NAV discount of 3%, against OCI's 29% discount.

In our view, OCI represents an opportunity to invest in an asset class that is being overlooked by public market investors. In tandem with the discount to NAV, the opportunity for near-term realisations and refinancings from some of the fast-growing and maturing portfolio companies could provide near-term catalysts for the share price which would enhance our view that now is potentially an interesting time to look at an investment in OCI.

Analyst's View

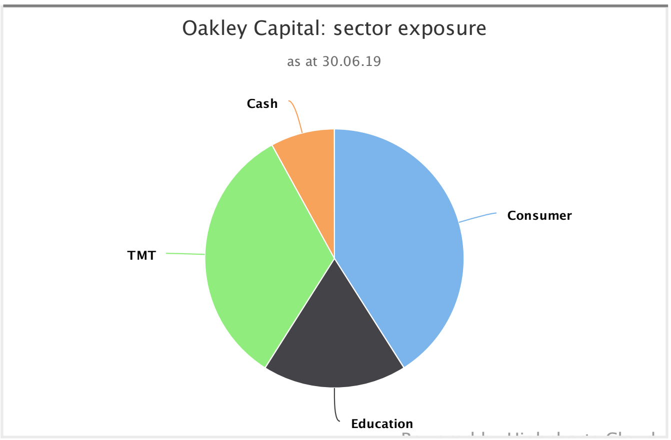
BULL	BEAR
Strong long-term NAV growth, driven by portfolio company performance	Concentrated portfolio returns can be materially impacted by an underperforming investment
Conservative valuations mean that realisations present a possible near-term catalyst for further NAV growth	Private companies offer limited liquidity, and returns can be lumpy
Shares trade on a 29% discount to NAV. A shift in perception towards OCI could accelerate shareholder returns	Private equity funds charge relatively high fees

Portfolio

Oakley Capital Investments (OCI) aims to deliver capital appreciation through investing in private companies. We believe it offers a rather different exposure to other trusts in the listed private equity sector because OCI's investment adviser, Oakley Capital, typically aims to be the first institutional investor in entrepreneurial businesses within the TMT, education and consumer sectors. The company has a strong preference for finding businesses outside the 'usual' private equity hunting grounds, which has latterly led it to what have so far proven to be rich pickings in Europe. The manager's investment style is influenced by the entrepreneurial background of the company's founder, but which has evolved into a more institutional approach to private equity investing. Over the years, Oakley has developed a wide network of proven business founders who help bring interesting but 'below the radar' growth opportunities.

The basic ethos of backing proven entrepreneurs, introduced through this extended network, ensures the portfolio has a very different feel to a traditional LBO (leveraged buyout) private equity strategy. Oakley's team of seven partners and 18 investment professionals currently have a portfolio of 15 UK and continental European 'mid-cap' companies with an enterprise value (at the time of investment) of between €100m and €400m. The team have proven that they rarely acquire assets already in the hands of private equity funds, with only one investment since 2008 so far acquired from a peer. Instead, Oakley looks to harness its network of proven business founders and entrepreneurs, many of whom it has backed in the past. The team pride themselves on their expertise in conducting long and intensive due diligence, enabling them to structure complex deals. Oakley Capital focuses on three sectors: consumer, education and TMT, and the current exposure of OCI's portfolio can be seen below.

Fig.1: Portfolio Overview

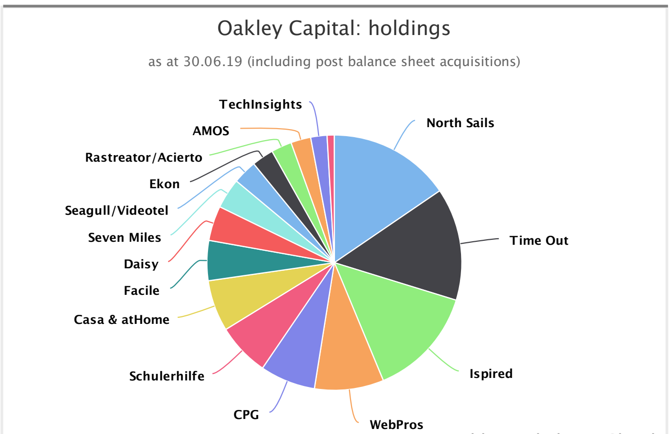


Source: Oakley Capital

As we discuss in the Returns section, Oakley has a track record of contributing to significant growth from underlying businesses, but also of achieving very profitable exits. Their combined track record (of a total of 17 realised investments since Oakley Capital was founded) shows a return of 3.1x on invested capital and a 47% gross IRR (before fees). The three-year compounded annual NAV growth rate for OCI is 17% to date. 2019 has so far seen an extension of this because over the first six months NAV growth has been 13%. This has been driven by two companies: Inspired (due to a partial sell-down at an 80% premium to book value) and Time Out (a listed holding where the share price increased by 60% in the wake of market openings). As the chart below shows, both of these investments remain significant holdings for OCI and we understand the managers remain excited about their prospects.

As well as Inspired and Time Out, other portfolio holdings also put in a strong showing over the first six months of this year in terms of earnings growth. Indeed, average EBITDA growth for the portfolio over the period was 31%. This is clearly a very strong growth rate, and only marginally behind HG Capital Trust's (HGT) portfolio EBITDA growth reported for the 12-month period to 30 June 2019 of 35% (the strongest trading figures they have ever reported). Comparing the valuation multiples of OCI and HGT, OCI has an average EV/EBITDA of 12x, whilst HGT's top 20 companies are valued at 19.5x. This valuation difference is stark, particularly in the context of the NAV discounts each company trades at - HGT currently trades on a discount of 3%, against OCI's 29% discount.

Fig.2: Portfolio Overview



Source: Oakley Capital

We went into some detail on various portfolio holdings in our previous note on OCI, which can be found here. However, two investments with bright prospects that are delivering strong growth and could be among the largest contributors to NAV growth in the near term are Career Partner Group (7.0% of NAV) and WebPros (8.8% of NAV). CPG is one of the fastest-growing private university groups in Germany, offering online and dual-study courses for people wishing to study for a degree. Oakley reports that in the year to date student registrations are up 70%, and with these increased revenues the company has been able to further accelerate its marketing spend. Following a successful buy-and-build strategy, WebPros is now the leading provider of hosting-control software that allows customers to administer every facet of their websites. Oakley reports that the group is currently held at a valuation of c.12x EV/EBITDA, despite the revenue predictability of its SaaS model and its EBITDA growth this year of c.60%.

OCI has a relatively low weighting to UK businesses, which is reflected in its currency exposure. As at 30 June 2019, 23% of assets are in GB pounds, 51% in Euros and 26% in US dollars. Currencies have therefore been a tailwind over the past few years, but should sterling appreciate, it is worth noting that this will be a headwind to performance. In terms of medium- to long-term prospects, 2019 has seen significant acquisition activity. Oakley has been unusually busy, having made transactions on five investments over the first half of the year, amounting to a capital deployment of £85m for OCI. These investments were all within Oakley's favoured sectors (Consumer, Education and TMT), types of company (mid-market, (European, founder led, market leaders) and acquired outside of auction processes (complex transaction and often carve outs). The average valuation multiple paid on these investments was 11.2x on an EV/EBITDA basis, compared to the peer group average of 13.4x (source: Oakley Capital). These investments should be the drivers of NAV growth in the medium to long term.

Oakley Funds - New Investments Signed During H1 2019

COMPANY	REGION	SECTOR	OCI LOOK-THROUGH EXPOSURE	DESCRIPTION
Rastreator /Acierto	Spain	Consumer	£17m	Spain's leading price-comparison websites
Ekon	Spain	Software	£18m	Leading local provider of Enterprise Resource Planning software
Seagull & Videotel	Norway /UK	Education	£20m	Market leader in global maritime e-learning
Alessi	Italy	Consumer	£6m	Leading high-end homeware design
Seven Miles	Germany	Consumer	£25m	Consumer tech company in multi-brand gift cards

Source:Oakley Capital

In our view, OCI represents an opportunity to invest in a sector that is being overlooked by public market investors. Attractive small- and mid-cap growth companies are remaining private or are being taken private by well-capitalised private equity funds, leaving retail investors with fewer opportunities to invest in the most dynamic and fast-growing businesses. In a strong seller's market the near-term opportunity for realisations amongst the portfolio companies could be a further catalyst for NAV growth- since inception Oakley has sold assets at an average of 26% above the prevailing book value.

Gearing

OCI was launched in 2007, and it avoided the problems some listed private equity trusts had during the financial crisis by not being financially overstretched. However, memories of this period have made OCI's board reluctant to arrange a debt facility up to now. We understand that the board continues to debate its merits, but so far OCI has maintained a cautious stance, with cash consistently held on the balance sheet. However, as the graph below shows, the net cash level (as a % of NAV) has been progressively reducing, and currently stands at 15%.

Without an overdraft facility, the trust needs to maintain a sufficient cash buffer to allow it to deploy capital in future deals. The timing of exits (another source of liquidity) is clearly very difficult to judge, and so the team at Oakley Capital clearly view the resulting 'cash drag' (where investment returns are diluted by having a material percentage of the NAV in cash, returning next to nothing) as a necessary evil – although it is worth noting that this is only an opportunity cost, and not a real one.

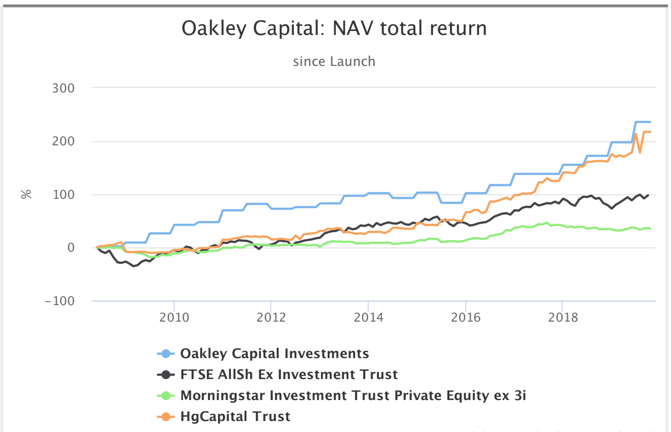
Fig.3: Gearing

Source: Morningstar

Returns

Since launch, OCI has delivered good NAV total returns relative to peers and equity indices. As the graph below illustrates, over this time period the company has outperformed even the perceived sector leader, HgCapital Trust.

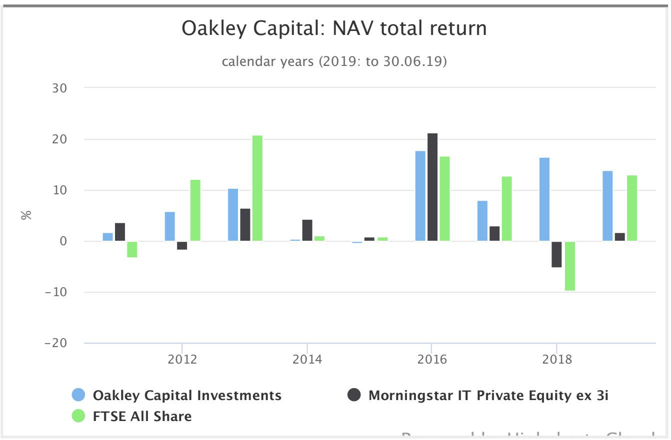
Fig.4: Nav Performance



Source: Morningstar

Over the ten years to the end of June 2019, OCI has delivered NAV total returns of 166.7%, compared to 113% for the FTSE All-Share over the same period. As the graph below shows, after a relatively fallow period in 2014 and 2015, the period since has shown a strong performance from the trust on a NAV basis relative to both the FTSE All-Share and Morningstar peer group average (ex 3i). Indeed, over the past three years the trust has been amongst the better performing trusts on a NAV and share price basis.

Fig.5: Calendar-Year Performance

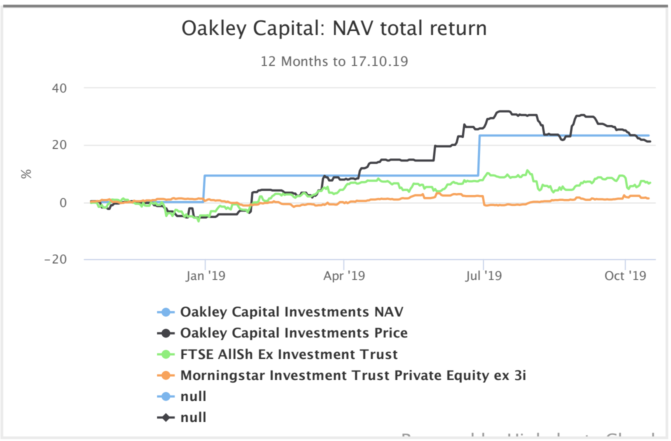


Source: Oakley Capital, Morningstar

Private equity investment returns are to some extent correlated to equity markets because valuation metrics are related to quoted comparator companies. On the other hand, Oakley-backed companies are in sectors underrepresented in the public markets, e.g. education, and tend to occupy specific niches, so it doesn't necessarily follow that valuation and performance pressures affecting global companies will feed through to Oakley portfolio valuations. We note that the strong NAV performance from 2016 onwards has been driven by earnings growth, rather than valuation expansion. The average EV/EBITDA multiple for the portfolio at June 2019 was 12x, which had fallen from 12.6x at the year end.

It is worth noting that with a concentrated portfolio like OCI's, valuation changes (positive or negative) can have a more material effect on overall performance, in contrast to a very diversified private equity fund made up of funds with hundreds or thousands of underlying companies. As we highlight in the Portfolio section, this means that if the current momentum behind CPG (7.0% of NAV) and WebPros (8.8%) is maintained, these companies could be material drivers of the NAV going forward. With the discount at 29%, any narrowing of this discount will act as an accelerant to shareholder returns. The graph below shows this in the context of the improved sentiment towards OCI in the first half of 2019, but given the discount has widened more recently, share price returns have come back since the summer.

Fig.6: 12 Month Performance



Source: Morningstar

Dividend

The board has paid a dividend of 4.5p per annum since the introduction of a dividend policy in December 2016. The dividend was part of a range of governance initiatives in response to shareholder feedback. At the current share price, the dividend represents a yield of 2%.

Several other LPE trusts also pay a dividend, in some cases yielding more than OCI. However, the company makes the point that given it invests a proportion of the portfolio as loans to some of the portfolio companies, it does receive a reasonable 'natural' income, and unlike peers does not pay the dividend solely out of capital. In the first six months of the year, OCI received £4.5m of interest income, against which £4.6m was paid in dividend. As such, the dividend can be seen to be nearly 98% covered by current income.

Management

Oakley Capital is the investment adviser to the company. It was founded by Peter Dubens in 2002 and he remains the managing partner. The team now constitutes seven investment partners (including Peter), who have a great depth of experience as well as access to a unique network accustomed to sourcing investment opportunities.

Peter's background is as an entrepreneur, having originally founded his thermochromic t-shirt business aged 18, which was subsequently sold. Peter has a long and impressive track record as an active investor, and within the public markets he has had notable success with Pipex and 365Media. He later decided to formalise his investing activities through Oakley Capital. Oakley Capital Investments (OCI), the AIM-listed investment company which invests in the Oakley Funds, was launched in 2007. Oakley Capital currently has assets of c.€3.1bn under its management. Oakley Fund IV closed its raise earlier in the year at €1.5bn, and OCI represents 27% of the new fund.

OCI board members own c. 8% of OCI, representing a significant increase since a year ago (c.1.2%). We understand that Peter Dubens has committed more than £100m to the Oakley Capital Funds, and his total holding in OCI is currently 7.3% of the company.

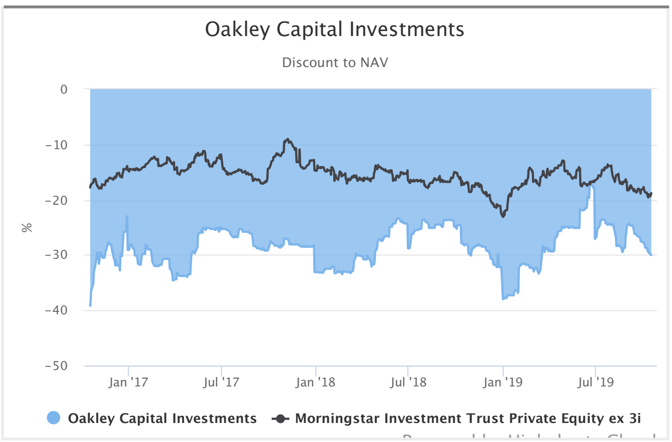
Discount

In common with many other listed private equity trusts, OCI's discount to NAV has been a constant feature of recent years. However, as the graph below shows, the company's discount remains significantly wider than its peers' discount. As we discuss in the Returns section, OCI's historic NAV progression has been amongst the strongest in the sector over the past three years, and therefore on a performance basis this seems unwarranted.

Recognising that the discount may be down to other factors, the board has focused on several measures to address this. In common with many other LPE vehicles, OCI pays a dividend which yields 2%. However, in contrast to its peers, this is largely covered by current income receipts from the debt investments made by the company. Most recently, the company moved from the AIM to the Specialist Fund Segment of the LSE's Main Market. The board has also undertaken other initiatives, including: reinitiating the share buyback programme; a refreshment and increase in independent board members; a commitment to never issue shares at a discount to NAV; greater disclosure of the economics of the company and the performance of the underlying portfolio companies; and investor meetings and capital markets days to improve liquidity and achieve a less concentrated share register.

Certainly, many of these corporate governance measures have been well received and will have contributed to the narrowing of the discount in the first half of 2019. However,

Fig.7: Discount To Nav



Source: Morningstar

the combination of a significant increase in NAV as well as a lot of share-buying interest being absorbed by high turnover in the share register (including the placement of Woodford Investment Management's 15% stake) has seen the discount widen again. At 29%, OCI's share price discount (to the 30 June 2019 NAV) remains wide relative to its history and peers.

Charges

Oakley Capital manages the investments made through the Oakley Funds, where OCI pays the same management fees that any other investor would. These are 'typical' for the private equity industry, and constitute 2% of commitments for a five-year period post-inception, and thereafter 2% on capital invested. Fees are not charged on the value of investments, and after the first five-year period has elapsed, fees are not charged on uninvested cash. OCI can also make investments outside these funds (co-investments), which are levied at 2% p.a. of the value of any such investments.

The managers are also entitled to a performance fee of 20% on returns over an 8% p.a. hurdle rate. In the case of the Oakley Funds, this is on the entirety of the fund. In the case of co-investments, performance fees are paid on a deal-by-deal basis. The OCI board signs off on each co-investment and negotiates an 'advisory fee' payable to the manager of each co-investment transaction. We understand that these typically have not exceeded 0.5% of the investment value but can be up to 2%. The latest KID RIY cost is 6.23% p.a.

ESG

Oakley Capital has viewed ESG as an important consideration for quite some years now, having been a signatory to the UN's PRI (Principles for Responsible Investment) since 2016. We understand that Oakley believes that ESG is key to protecting and creating long-term investment value beyond the standard drivers of compliance and risk management.

The managers do not negatively screen companies, but recognise that portfolio companies will have, to varying degrees, environmental, social and governance (ESG) impacts. They seek to work together with their investments to identify and apply good practice with regard to ESG matters.

When considering potential new investments, Oakley conducts an ESG risk assessment on the target company's sector, countries of operation and supply chain. The outputs of these risk assessments are included in the initial investment papers and are discussed with the investment committee. Once Oakley has invested in a company, the company's relative strengths and weaknesses are reviewed from an ESG perspective, and the team then work out where ESG efforts should be focused.

Oakley provides an example of this in practice, relating to North Sails. As a pioneer in the marine industry and in recognition of its close affiliation with the ocean, North Sails has developed an environmental mission to raise awareness of the issue of plastic pollution in the ocean, which is fully supported by Oakley. A number of major initiatives have been implemented across the group, including the appointment of a sustainability officer to lead North Sails' environmental initiative and form its policies. This initiative involves ensuring all locations around the globe adopt best practices to reduce plastic use as well as participating in regular beach clean-ups. North Sails is also increasing the portion of its apparel collection that is 'sustainable'.

Find out why our analysts believe now could be the time to consider OCI

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