Inv. banking & brokerage services

Source: Refinitiv

Market data

EPIC/TKR	**OCI**
Price (p)	**415**
12m high (p)	454
12m low (p)	291
Shares (m)	178.0
Mkt cap (£m)	739
NAV p/sh (Mar'22, p)	571
Disc. to NAV	27%
Country of listing	UK
Currency	GBP
Market	Main Market SFS

Description

Oakley Capital Investments (OCI) has generated market-beating returns from its concentrated, three-sector-focused portfolio of private equity (PE) investments via Oakley Capital (Oakley) PE funds. Oakley has a proven model for sourcing investments, and an excellent track record of identifying resilient value opportunities and delivering superior returns.

Company information

Chairman	Caroline Foulger
Ind. NED	R Lightowler, F Beck
NEDs	P Dubens, S Porter
Inv. Mgrs.	Oakley Capital
Contact	Steven Tredget

oci-investorrelations@oakleycapital.com

Key shareholders (31 Dec'21)

Peter Dubens/Directors	11%
Asset Value Investors	9%
Lombard Odier	8%
City of London IM, HL	6%
Sarasin	5%
Jon Wood & family, Fidelity, II	4%
Hawksmoor	3%

Diary

Jul'22	Trading update

Analyst

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OAKLEY CAPITAL INVESTMENTS LTD

Capital Markets Day 2022 – let the sun shine

On a wet day in May, OCI's CM Day was a ray of sunshine, explaining how it has delivered the impressive market- and peer-beating 19% NAV CAGR growth 2017-21 (6% 1Q'22), and why this growth should be sustainable going forward. At its core is an investment focus on structurally high-growth areas, combined with a unique proprietary network originating deals. Once a business has been acquired, value is added through business transformation (e.g. digitalisation), performance improvement, leadership development and buy-and-build strategies. Oakley Capital's expertise incrementally improves investee companies. Investors are buying into this sustainable, long-term model, not just the current attractive portfolio.

- **Current issues:** The CM introduction addressed how OCI will fund its commitments (cash + near-term realisations vs. long-term commitments), its prudent approach to valuations (largely kept at, or near, acquisition ratings until close to exit) and the multiple approaches being taken to address the high level of discount.

- **Sustained outperformance:** A key theme running throughout the session was sustained outperformance. 75% of recent NAV growth is driven by EBITDA growth. Funds III and IV are in the top 5% on Preqin performance benchmark data for realised assets, with IRRs over 50%. €665m has been deployed in 2021/22, funding future growth.

- **Valuation:** Against the March 2022 NAV, OCI trades at a 27% discount, despite its absolute (five-year CAGR 19% total NAV return) and relative performance. The 2021 total NAV return of 35% is significantly greater than the discount, with the latter reflecting the "icing on the cake", rather than the reason to buy, we believe. OCI yields 1.1%.

- **Risks:** While OCI's costs are slightly above-average, post-expense returns are still market-beating. Sentiment towards the global economic cycle is likely to be adverse, even though outperformance has been delivered in downturns. OCI's portfolio is concentrated, and we believe its permanent capital is right for private assets

- **Investment summary:** OCI provides investors with liquid access to the attractive private equity (PE) market, enhanced by Oakley's incremental origination and active management skills. Oakley Funds focuses on mid-market, tech-enabled European companies that operate in the technology, consumer and education sectors. This space provides structural growth, as well as opportunities for Oakley Capital to add operational, strategic and financial value to the business acquired. Accounting and governance appear conservative, with an average 50% uplift to carrying value in exit since inception. There are risks – primarily sentiment-driven – around costs and cyclicality, as well the liquidity and valuation of the underlying private assets.

Financial summary and valuation

Year-end Dec (£000)	2018	2019	2020	2021	2022E	2023E
Interest income	6,629	9,218	10,466	10,073	12,622	11,733
Realised gains	102,314	17,840	208,536	56,593	20,040	26,243
Unrealised gains	(23,877)	127,741	(133,086)	191,335	120,238	131,217
Total income	88,432	153,157	100,006	252,485	153,171	169,465
Costs	(6,434)	(17,888)	(7,620)	(3,751)	(10,000)	(10,000)
EPS (p)	40.0	66.3	47.9	138	82	92
NAV per share (£)	2.81	3.45	4.03	5.38	6.20	7.08
S/P disc. to NAV*	-38%	-22%	-29%	-22%	-33%	-42%
Investments (£m)	470	661	505	799	997	1,211
DPS (p)	4.5	4.5	4.5	4.5	4.5	4.5

**2018-21 year-end actual, 2022-23 forecast NAV on current s/p, Source: Hardman & Co Research*

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OCI summary and introduction

The Capital Markets (CM) Day started with some fund overview observations. Key takeaways were:

19% five-year NAV CAGR, driven by earnings growth in investee companies

- Sustained and resilient NAV growth – 19% CAGR 2017-21 (6% 1Q'22).
- Across Oakley Funds I-III, realised exits have seen an average multiple uplift from entry to exit of 60%. Fund III saw the greatest uplift, with the entry level 6.7x increasing to 15x on exit.
- EBITDA growth in investee companies (28% in the past 12 months) is a key driver to NAV growth (accounting for 75% of the recent increase).

Diversified and resilient portfolio

- Diversified and resilient portfolio, with:
  - largest investment just 17% of NAV;
  - 70% of NAV invested in companies delivering services digitally; and
  - 75% of the portfolio having recurring revenue streams.

Long-term commitments covered by cash and likely near-term realisations of investments already held for three years or more

- Of the £1bn outstanding commitments, cash covers £139m and £293m are not expected to be drawn, leaving £582m to be covered by realisations/refinancing. The average hold period at realisation has been four years, and £348m of the portfolio has now been held for at least three years. Recognising that the average uplift to carry value on exit since inception has been more than 50%, these holdings alone would nearly cover the commitments expected to be drawn over the next five years.

Valuation approach, and so the NAV, proven to be conservative

- In our note, *Proving the pudding: a sustainable growth model,* published on 16 March 2022, we highlighted that the average portfolio company EV/EBITDA valuation was 13.9x (FY'20 11.8x, FY'19 12.1x, FY'18 12.6x), giving an undemanding average PEG of 0.5x (1H'21 0.6x). The PEG ratio is down on the interim stage, and the rating is well below listed market ratings in sectors achieving growth at such levels. In the CM presentation, OCI emphasised that its approach to valuation is to largely keep the same rating as at acquisition through the first years of ownership, and only to increase the rating as an exit approaches. This is despite the improved business prospects, quality and growth that may be expected under Oakley's ownership, and explains why there is such an uplift on exit. It means the NAV on any given date is likely to be conservative.

Multiple actions to address discount

- The presentation also highlighted the multiple actions being taken and events that should help address the discount, notably i) returning cash via the buyback, ii) improved reporting (OCI winning best investment company Report and Accounts for the second year running), iii) the strong NAV performance, iv) realising the direct investments to focus on Oakley Capital Funds, v) moving to quarterly NAV reporting, and vi) breaking the £1bn NAV – so enhancing scale.

Further growth expected, despite market headwinds

- Further growth is expected with the strong investments in new funds noted above and 34 hires made since January 2021. None of the major headwinds in 2022 (supply chain insecurity, rising inflation and interest rates, geopolitical uncertainty) is expected to have dramatic effects on portfolio companies. Oakley Capital continues to invest for structural growth (demand for quality education, migration to the cloud, consumer shifting online), while the key competitive advantages to value creation (through business transformation – e.g. digitalisation), performance improvement, leadership development and buy-and-build strategies all remain intact.

Sector reviews

Education

We provided detailed review in February

We gave our detailed thoughts on OCI's education investments in our recent report, Educating on education, published on 9 February 2022. The key points from the OCI CM Day presentation were:

Brand value of being "Responsible Custodian" absolutely key

- Oakley Capital has built a sustainable competitive advantage in being a safe custodian for education assets in a market where both potential sellers of education assets and customers place an extremely high value on the quality and reputation of who is providing the education. This brand value of being a "Responsible Custodian" is hugely important in this market.
  - Evidencing this focus on quality, OCI noted that Ocean Technologies customers saw a 39% reduction in regulatory deficiencies, ICP Education has twice the market average number of sites rated outstanding and IU group had a 97% recommendation rate.

Education market growing strongly, and highly attractive, resilient income streams

- The market is growing, with education spending to reach $10tr by 2030, compared with less than $7tr in 2020 and just over $4tr in 2010. The spending is non-cyclical, has high barriers to entry, and is long-duration and non-discretionary for most consumers, making it highly resilient. The US Bureau of Labour Statistics data show that the price changes for education in that market indicate that education price rises have been faster than, for example, medical since 2000.

PE education market growing strongly

- The number is growing rapidly (globally 415 in 2021 deals vs. 158 in 2016), with European growth lagging behind that of the US. This should provide further upside opportunity in due course. The average size of deals has also been roughly doubling over this period.

Limited listed opportunities

- Despite the attractions, investors have limited access to education opportunities, with, for example, no constituents of the S&P 500 being present in that market, while there are 65 healthcare companies (making up 15% of the capitalisation).

Oakley Capital a leading player

- A third of Oakley Funds II and IV have been invested in education (a far higher proportion than other leading PE funds), Oakley Capital has done twice the number of deals of the next most active European fund, it has created two of the £1bn+ valued European education companies (out of just 15), and it was voted EducationInvestor Award investor of the year in 2019 and 2021.

CEO of IU Group gave case study highlighting opportunities

- The CEO of IU Group (OCI's largest investment, at 17% NAV) then gave a presentation. We believe the key takeaways were:
  - The scalable model can now deliver degrees at a marginal cost under €1,000, creating the opportunity to democratise education globally.
  - Two-year student growth has been 63%, driving similar revenue growth and 61% EBITDA growth.
  - The business is not only strong-growth and scalable but also high-margin (40%).
  - Further opportunities lie in vocational skills training (10,000 corporate relationships).

Technology

Technology been best-performing PE sector in past decade. Looking forward, many of the key drivers remain intact.

The technology section highlighted not only that technology had been the best-performing segment of PE over the past decade (54% of technology and software deals had delivered money-on-money returns of more than 2.5x, compared with 35% for all other PE deals), but also considered that many of these characteristics were sustainable themes going forward. In particular, it noted that the right technology businesses showed the following recurring traits, and were:

- mission critical;
- non-cyclical;
- capital light;
- generating predictable revenues;
- highly scalable; and
- driven by solid market tailwinds.

Adoption of new technologies also will drive growth. Oakley Capital focused in sub-sectors with fastest growth prospects.

The company also noted that, despite all the hype, the adoption of technology in a number of areas is still at a relatively early stage. The presentation cited a McKinsey report noting that software as a service (SaaS, or delivering applications over the internet), even in professional service firms, still accounts for only 38% of software spend, while it was only in 2020 that cloud infrastructure spend materially overtook on premises spend (TechCrunch as source). This is before a range of other new investments, such as artificial intelligence (AI) and next-level robotics, are adopted. Looking specifically at the areas in which Oakley Capital focuses, such as enterprise resource planning (ERP) software, e-commerce and cloud computing, the levels of adoption are even lower.

Oakley Capital valuation approaches in technology conservative

Unsurprisingly, the presentation also addressed the issue of valuation, noting that the average valuation of technology business in the Oakley Funds is 13.5x (slightly below the average for the portfolio as a whole) and still well below that of listed peer comparables. The usual Oakley Capital approach of largely keeping valuations close to acquisition levels until exit is approaching applies to this sector. It is worth noting that, while recent private market deals have been at lower multiples than in 2021, they are still above the levels of when most of the businesses were acquired (average EV/revenue multiples SaaS PE deals: 2018 4.8x, 2019 5.6x, 2020 5.7x, 2021 7.5x, 2022 6.8x).

Company CEO presentations re-emphasised business driver themes of structural growth and Oakley Capital business enhancement

There followed presentations by the CEOs of Grupo Primavera (business software in Iberia), TechInsights (the Bloomberg of the semiconductor market) and Seedtag (the leading contextual advertising platform in Europe Latam). These three businesses operate in very different markets, but what was interesting was drawing the common themes from them in terms of the value added to Oakley Capital investors (slide 77 of the presentation gave more details). We note:

- structural growth in the product areas;
- leadership support; and
- fast decision-making with scale and financial support, cited specifically by Grupo Primavera, which completed 12 deals and 30 in the plans.

Digital consumer

Focus on digital because of its far superior structural growth...

One of the core themes from the CM Day, with regard to the consumer investments, is the support Oakley Capital provides in transforming models from analogue to digital business models. This is driven by the superior growth available in such markets (the presentation cited ca.7x the growth in the digital economy vs. non-digital since 2010 for the US). The pandemic accelerated trends, with digital adoption in entertainment in the US increasing from ca.40% before COVID-19, to 64% currently, and doubling in groceries to 61%.

...but not all the same, so want to be in under-penetrated markets where you have scalable unit economics and can improve revenue quality

The presentation also emphasised that the trends are not uniform, with different changes in behaviour according to products, customer groups and age groups – so management needs to be acutely aware of its own customer bases and behaviour patterns. To this end, Oakley Capital has refined its investment approach to focus on:

- Structurally under-penetrated core markets – such as digital motor insurance in Italy (penetration 17% vs. UK 70%+), multi-brand vouchers (German spend per capita €2 vs. UK €8), estate agent online advertising (Spain 5% of revenue vs. UK 8%).
- Scalable unit economics, where profitable customer acquisition is the basis for sustainable growth, often supported by effective marketing. Being able to use the skills and experience of seeing how marketing works for one business and applying it to others is a key competitive advantage for a PE-backed business over a standalone entity, when it comes to marketing.
- Improving revenue quality should see a valuation uplift on exit. In Alessi, digital revenues doubled to 30% of total revenue in just four years, in Windstar, higher-margin branded products are expected to rise from 41% to 57% of revenues over four years, and, at Gymondo, one-year subscription revenues are expected to increase to 86% of revenues, from 66% in 2019.

Enhancing iconic brand business models

The presentations then focused on the investee companies demonstrating these traits. In addition to the digital element, there are two businesses that could be described as “iconic brands” – Alessi (Italian homeware) and Globe-Trotter (British luxury luggage). The core approaches of Oakley Capital in terms of adding value through business transformation (e.g. digitalisation), performance improvement and leadership development are all being applied to these businesses.

Even in challenging markets, there are opportunities

While the consumer sector is likely to face challenges with inflation and a potential downturn, it does not mean that there are not opportunities to find and then create value within specific sub-sectors and companies within the consumer space. The company reviews that followed highlighted again, in particular, how the companies’ business models could be enhanced under the Oakley Capital ownership. In previous notes, we have highlighted where a play book used in one country means that PE-backed business has a competitive advantage over standalone competitors. Similarly, acquisition skills, which are core for PE, give a competitive advantage for a build-and-buy strategy company such as Dexters.

Other issues

ESG

Managing both investee companies and at Oakley Capital

The ESG section gave an update on how ESG is being embedded into the due diligence ahead of deals being done (at the Oakley Capital level), with the companies through the onboarding processes, engagement and monitoring during ownership, and then through exit preparation. Additionally, at the Oakley Capital level, there are the appropriate internal training, reporting and committee structures now in place.

Director overview

Focus on quality of NAV, cash and investor concerns reflected in discount

The attending NED noted the three key areas of focus for the board: i) the quality of the NAV, including the high quality of the portfolio, multiple independent valuation reviews, etc., to ensure that confidence in the NAV is high; ii) a detailed review of cashflows, including all realisations with base cases and stress reviews; and iii) discount consideration, including managing investors' confidence in the NAV and improving this with greater transparency, more infrastructure and dealing with other investor concerns.

Q&A session

The Q&A session was slightly truncated, due to time pressures, but the key areas reviewed included:

Capital return

The key metric for the buyback is not the level of the discount but rather the level of commitments and outlook for cashflows. It is not an exact science, and the board will not commit to a specific number of shares over every quarter, but will rather keep it under a regular review as opportunities present themselves at any given time. In terms of the dividend, the group has paid a moderate dividend and would expect to continue to do so, but it is managed for capital growth, and that is what investors should primarily expect.

Cash management, commitments and loan facilities

Cashflows are reviewed in detail, and expected realisations and tolerance levels to them are a key consideration in any liquidity review. We also point readers to our detailed review of commitments in our note, *Proving the pudding: a sustainable growth model,* published on 16 March 2022.

The 28% average EBITDA growth in underlying companies is a simple average, but the weighted average is very similar.

Technology very mixed by sector

The impact of competition on new deals is mixed. There is more competition in the education space, with, for example, some new infrastructure funds now seeking to finance education assets, but no other fund has the Oakley Capital branding advantage, and Oakley Capital is continuing to buy at well below average market multiples for the sector (this is a theme it reports across its business, and is reflective of the unique entrepreneur network built up over the life of the business). Geographically, competition in Germany has increased but remains slightly below, say, UK levels and, by scale, mid and smaller deals (where Oakley Capital is focused) are seeing less competition than the largest deals. In Italy and Spain, penetration remains relatively low and, while there is competition, it remains below European average levels. In technology, it varies significantly among different sub-sectors.

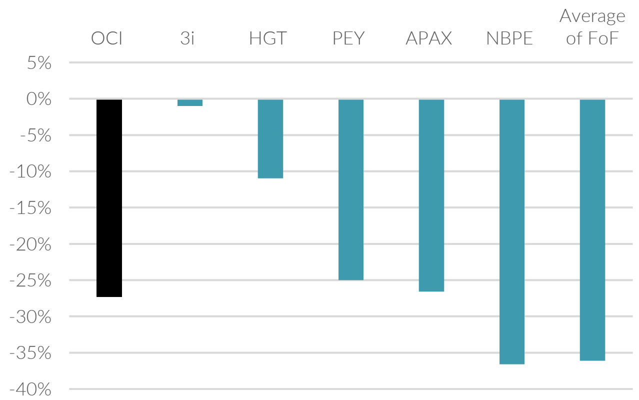
Valuation and financials

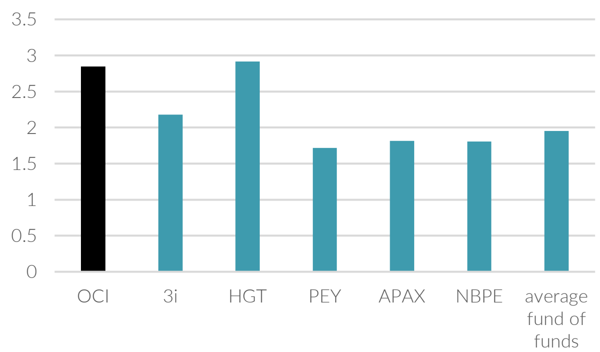
Valuation

OCI's discount appears anomalous with its market- and peer-beating, long-term performance

The charts below show the premium/discount ratings of OCI's closest competitors, together with their five-year total share price returns. Despite having a significantly better five-year return than 3i, OCI is trading at a 27% discount, while 3i is around NAV. There are, of course, differences in business models (although it may be argued that the six-year total return would reflect this), but perhaps the bigger anomaly lies in the comparison with Princess Private Equity and Apax, with OCI on a bigger discount, despite a visibly stronger medium-term performance. Taking an absolute rating perspective, it also appears anomalous that a company with a strong track record of growth and value-added should trade at any discount to NAV at all.

Discount to NAV and total return since January 2017 for OCI and peers





Source: Company websites, factsheets and presentations, LSE, Hardman & Co Research; priced at 16 March 2022

Financials

Our forecasts are unchanged.

Profit and loss summary

Year-end Dec (£000)	2016	2017	2018	2019	2020	2021	2022E	2023E
Interest income	11,637	7,722	6,629	9,218	10,466	10,073	12,622	11,733
Net realised gains at FV through P&L	8,545	23,991	102,314	17,840	208,536	56,593	20,040	26,243
Net unrealised gains/losses through P&L	46,196	20,316	(23,877)	127,741	(133,086)	191,335	120,238	131,217
Net foreign currency gains/(losses)	4,733	(839)	3,149	(2,715)	13,700	(5,787)	0	0
Other income	140	306	217	1,073	390	271	271	271
Total income	71,251	51,496	88,432	153,157	100,006	252,485	153,171	169,465
Costs	(4,519)	(6,571)	(6,434)	(17,888)	(7,620)	(3,751)	(10,000)	(10,000)
Operating profit	66,732	44,967	170,430	135,269	92,386	248,734	143,171	159,465
Interest expenses	(55)	0	0	0	0	0	0	0
Pre-tax profit	66,677	44,925	81,998	135,269	92,386	248,734	143,171	159,465
Tax	0	0	0	0	0	0	0	0
Attributable profit	66,677	44,925	81,998	135,269	92,386	248,734	143,171	159,465
Average no shares (000s)	189,901	203,859	204,804	204,113	192,707	179,600	174,599	173,600
EPS (£)	35.1	22.0	40.0	66.3	47.9	138.5	82.0	91.9
DPS (p)	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5

Source: OCI Report and Accounts, Hardman & Co Research

Balance sheet

@ 31 Dec (£000)	2016	2017	2018	2019	2020	2021	2022E	2023E
Non-current assets								
Oakley Funds	211,254	282,663	298,581	420,316	354,718	628,541	835,333	1,058,419
Co. investment Fund	0	26,280	41,789	74,984	0	0	0	0
Quoted	43,854	41,182	22,320	38,510	23,940	39,450	39,450	39,450
Other unquoted	0	0	0	0	0	0	0	0
Debt	85,761	69,502	107,059	127,156	126,466	130,667	121,775	112,883
Total investments	340,869	419,627	469,749	660,966	505,124	798,658	996,558	1,210,752
Current assets								
Cash and cash equivalents	106,509	117,836	107,888	48,866	223,090	163,178	100,989	57,911
Receivables	673	668	11	40	33	123	100	100
Total assets	448,051	538,131	577,648	709,872	728,247	961,959	1,097,647	1,268,763
Creditors	9,619	36,091	2,826	23,864	297	508	837	20,300
Net assets	438,432	502,040	574,822	686,008	727,950	961,451	1,096,810	1,248,463
NAV per share (£)	2.31	2.45	2.81	3.45	4.03	5.38	6.20	7.08

Source: OCI Report and Accounts, Hardman & Co Research

Cashflow

Year-end Dec (£000)	2016	2017	2018	2019	2020	2021	2022E	2023E
Purchase of portfolio investments	(178,228)	(167,047)	(165,302)	(127,265)	(95,983)	(120,227)	(200,000)	(200,000)
Sale of portfolio investments	173,554	167,773	158,712	90,005	332,595	80,949	155,000	155,000
Interest income	17,403	7,001	7,077	842	5,146	3,627	12,622	11,733
Expenses paid	(4,704)	(5,967)	(4,196)	(7,009)	(21,050)	(3,630)	(2,000)	(2,000)
Interest expense paid	(55)	(42)	(389)	0	0	0	0	0
Other income received	140	306	217	1,073	390	389	271	271
Net cash inflow/(outflow) from op. activities	8,110	2,024	(3,881)	(42,354)	221,098	(38,892)	(34,107)	(34,996)
Cashflows from financing activities								
New shares issued	0	0	0	0	0	0	0	0
Purchase/sale of shares into treasury	(1,854)	23,291	0	(4,737)	(51,894)	(7,151)	(20,000)	0
Dividends	0	(13,149)	(9,216)	(9,216)	(8,680)	(8,082)	(8,082)	(8,082)
Net cash inflow from financing activities	(1,854)	10,142	(9,216)	(13,953)	(60,574)	(15,233)	(28,082)	(8,082)
Net increase in cash and cash equivalents	6,256	12,166	(13,097)	(56,307)	160,524	(54,125)	(62,189)	(43,078)
Opening cash and cash equivalents	95,520	106,509	117,836	107,888	48,866	223,090	163,178	100,989
FX effects	4,733	(839)	3,149	(2,715)	13,700	(5,787)	0	0
Closing cash and cash equivalents	106,509	117,836	107,888	48,866	223,090	163,178	100,989	57,911

Source: OCI Report and Accounts, Hardman & Co Research

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