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Oakley Capital Investments

OCI's capital markets day provided valuable insight into opportunity...

Summary

Update
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Oakley Capital Investments (OCI) has a unique feel when compared to the listed private equity peer group. Aside from a focus on education, consumer and technology sectors, the recent capital markets day emphasised the entrepreneurial roots of Oakley Capital as manager, but also demonstrated a growing institutional feel as the team has expanded (see **Management**).

Digital disruption and the opportunities it presents has long been a recurring theme in OCI. This placed OCI well at the beginning of 2020, and portfolio companies have clearly been nimble in adapting to the digital opportunities presented to them during lockdown. 53% of the portfolio by value had digital delivery models at the start of the year, which had risen to 76% by the end of 2020. This has helped ensure resilience and growth, with a NAV total return of 18% achieved for 2020 (see **Performance**).

Following the recent capital markets day, we discuss many of the exciting businesses investors in OCI are exposed to in **Portfolio**. Across the three specialist sectors that Oakley focusses on, the recurring themes from the capital markets day presentations were the strong operational performance during 2020 and into 2021, the exciting future growth potential, and also how entrepreneurial founders of businesses represent a key part of Oakley Capital's DNA. Oakley aim to continue to build on their track record of being the first institutional investors in growing companies and create "product" for other private equity firms to buy, as was the case with WebPros sold to CVC.

Over the past five years, OCI has delivered good NAV and share-price total returns relative to peers and equity indices. The next NAV as at 30 June 2021 (announcement due end of July) will give more colour.

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Analyst's View

OCI's strong balance sheet is a differentiator. It went into the market sell-off with net cash on the balance sheet of c. £250m, or 36% of estimated net assets. This put the trust in a strong position, and Oakley Capital has made a number of interesting investments since then, in what is a competitive market. We estimate that OCI now has net cash on the balance sheet of c. £162m, representing 22% of the estimated NAV.

Oakley's track record is strong – both in absolute terms, but also relative to peers, which we discuss in **Performance**. For investors who want a focused private-equity portfolio, we think OCI looks exposed to plenty of exciting growth drivers from its **Portfolio** of niche businesses that are leaders in their field.

It is perhaps in recognition of this fact that the **Discount** has narrowed considerably, which currently stands at 12% to Numis's adjusted NAV. However, we believe this is more than justified by the good long-term performance and the resilience exhibited by the portfolio during 2020. We believe that should OCI's strong performance continue along with the higher standards of governance and investor communication, OCI may be rewarded over time by a rating more in line with HgCapital (premium of 1%), rather than the wider peer group average. With OCI clearly offering a differentiated proposition, as well as the best liquidity position of the peer group, the shares should continue to attract interest.

BULL
Strong long-term NAV growth, driven by portfolio-company performance
Capital markets day highlighted the focus and expertise that gives Oakley Capital an edge in a competitive market
Shares trade on a 12% discount to Numis's NAV estimate, with 30 June NAV announcement as a potential catalyst for further appreciation

BEAR
Concentrated portfolio means that returns can be materially impacted by specific company performance
Private companies offer limited liquidity, and returns can be lumpy
Private-equity funds charge relatively high fees

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Portfolio

Oakley Capital Investments (OCI) is a differentiated listed private equity trust, which has a unique feel when compared to the peer group. Aside from the sector focus on education, consumer and technology, the recent OCI capital markets day emphasised the entrepreneurial roots of Oakley Capital as manager but also demonstrated a growing institutional feel as the team has expanded. For example, during 2021 the investment team has grown by c. 30% in number, with eleven investment partners in the business and a total of 64 personnel in the UK and Europe. That said, seems clear to us that the Oakley network of entrepreneurs and founders of investee companies, not to mention Oakley Capital's willingness to embrace complexity, represents a competitive advantage in an industry background that shows a fierce competition for deals. In this context, we believe it is noteworthy that OCI has recently announced two new platform investments which further develop the portfolio.

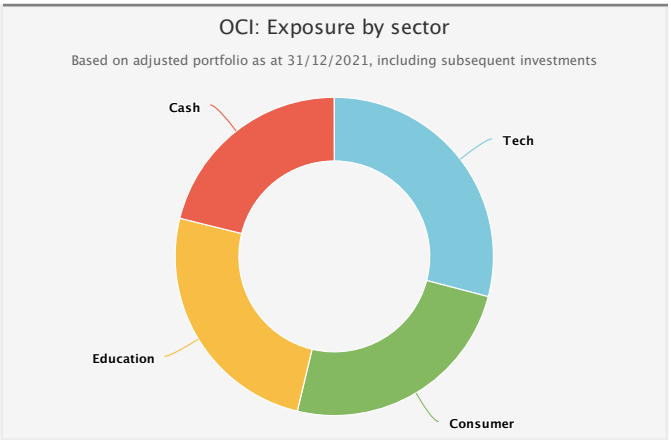
Oakley Capital has long been aware of the potential from digital disruption and the opportunities it presents to nimble businesses. They observe that during 2020 e-commerce penetration has been brought forward by ten years when compared to the prior trend. OCI's portfolio companies have been quick to adapt to the digital opportunities presented to them during lockdown. Having been well placed at the beginning of 2020 with 53% of the portfolio having had digital delivery models, by the end of the year this had risen to 76% (both figures by value, (source: Oakley Capital)). It is this fact that has helped ensure resilience and growth in the portfolio, resulting in a NAV total return of 18% during 2020 (see **Performance**).

At the same time, the operational resilience of companies exposed to technology and digital delivery means competition for investments that are technology-related is very competitive. In this regard, we think Oakley's investment approach helps. Aside from the deep sector knowledge and experience in their chosen sectors, Oakley looks to harness their network of proven business founders who help bring interesting but 'below the radar' growth opportunities to the firm. The team observed that they rarely acquire assets that are already in the hands of private-equity funds, with 85% of investments being the primary capital into a business and 75% of deals to date (since the formation of Oakley Capital) being proprietary (i.e. not contested). Oakley Capital typically aims to be the first institutional investor in the entrepreneurial businesses it backs.

Oakley Capital believe it is their proprietary sourcing network that enables them to find interesting investments at attractive valuations. But Oakley Capital also bring with them deep expertise which founder entrepreneurs see as a valuable aid to help with the next stage of growth. The current EV/EBITDA multiple of the portfolio (on a weighted average basis) is 11.2x, which is below the average European buyout deal multiple of 12.6x (and for Technology buyouts, 25x) (source: Pitchbook). We understand that Oakley does not factor in multiple expansion as part of their investment thesis and expect that EBITDA growth will be the main driver of NAV progression. That said, we would observe that depending on the exit, multiple expansion could be icing on the cake.

OCI's portfolio is currently relatively balanced by exposure to the three core sectors that Oakley Capital specialise in. We think it worth noting that within education, and perhaps to a slightly lesser extent consumer, there is still a significant bias towards digital delivery of the products or services that each company provides. For example, IU Group (previously Career Partner Group) is the largest holding in the portfolio and is a provider of online higher education and degrees. COVID-19 lockdowns have significantly increased demand, and at the recent Oakley capital markets day, we heard from the CEO who expressed an ambition to be the largest university globally through international growth. Having significant cash on the balance sheet leaves OCI with a lot of liquidity, allowing the managers to comfortably meet fund drawdowns and giving Oakley the flexibility to support existing portfolio companies and look to invest funds in their pipeline of deals.

Fig.1: Portfolio Overview

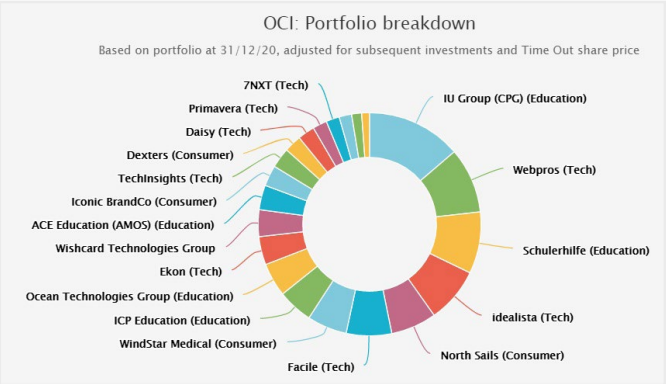


Source: Kepler Partners estimates

Overall, the portfolio is represented by 22 investments of which we estimate that the top ten make up c. 57% of NAV. As such, we would comment that relative to the wider LPE sector OCI's portfolio can be considered relatively concentrated. This means that investors in OCI's shares have higher specific risk, with each portfolio company capable of having a material impact on NAV progress. That said, the asymmetrical return profile of equity investment clearly applies, which is one of the reasons that OCI achieved such strong NAV returns during 2020 despite seven of the 17 portfolio companies being materially impacted by COVID-19. However, private equity investment returns can be uneven, and so we think that OCI must be considered a higher risk investment relative to more diversified peers. We illustrate the current portfolio based

on valuations as at 31/12/2020 (adjusted for acquisitions since then, and the share price of Time Out) in the graph below.

Fig.2: Portfolio Constituents (Estimated, Excl Cash)



Source: Oakley Capital, Kepler Partners

At the recent capital markets day, the investment team gave brief presentations on each company, grouped by sector. We provide a brief overview of the major holdings within each sector below. The presentations by the various teams – both within Oakley and the underlying management teams of investee companies, in our view, served to highlight the growth potential of this collection of niche businesses around Europe, but also that they all benefit from the experience of Oakley Capital's team in achieving their growth ambitions.

Technology

Oakley Capital has a long track record of successfully investing in digital businesses. The four main funds raised by Oakley Capital over time have had a majority of investments in "digital", being companies involved in web hosting, online price comparison, telecoms, online consumer, and software. The Oakley Capital team have experience and expertise in these areas and aim to bring this experience to bear in growing new investments to create significant value.

WebPros is the largest investment of the ten technology investments in the portfolio, which we estimate at 7% of NAV. WebPros has been a stellar investment for OCI over the years, having achieved a sale to CVC in 2019. Oakley Capital chose to reinvest alongside CVC when they bought the business, showing their confidence in the company. WebPros is the leading provider of hosting-control software that allows customers to administer every facet of their websites.

idealista is an online real estate classifieds platform in Southern Europe that represents c. 6% of NAV, and **Facile** is Italy's leading online price comparison website which represents 5% of NAV. Both of these investments (as well as **atHome**, 1% of NAV) have benefitted hugely from an acceleration of online habits in the lockdowns of last year. idealista has seen traffic to its site increase by 70% from pre-COVID-19 levels, and the team believe that the behavioural changes we have seen are here to stay. idealista represents a classic Oakley Capital investment, having been combined with another investment – **Casa** – and the combined entity puts the site in the number one spot for property in the Spanish and Italian markets. Facile is the number one price comparison site for insurance in Italy, but has huge growth potential with only 15% penetration, compared to the UK market's penetration of 80%. This clearly gives the management team a huge runway for growth, assuming the UK serves as an illustration of what is achievable once the Italian market has matured.

Consumer

As one might expect, OCI's consumer investments were hardest hit by the pandemic. However, Oakley Capital observe that as a result of the pandemic, consumers are changing the way they shop dramatically, with a significant increase in online transactions. This offers new growth opportunities, specifically enabling companies to establish direct relationships with the consumers of their products (and aided by social media such as Instagram).

OCI's largest investment in consumer is **Time Out**, a listed company which we estimate represents c. 10% of NAV following an improvement in its share price since 31/12/2020. The popular Time Out Market concept has been hit hard, but there remains optimism that the model will bounce back once restrictions are lifted and the company can benefit from pent-up demand in its location cities. Time Out's shares are up over 70% from the 31 December 2020 valuation point at the time of writing (60p, 25/06/2021).

North Sails represents c. 5% of NAV, although this doesn't include the debt provided to the company. This has undoubtedly been a troubled investment for Oakley Capital, and the pandemic has not helped. That said, we understand that the manufacturing side of the business is recovering to its pre-pandemic run rate and the lifestyle side is showing strong revenue and EBITDA growth in excess of historic levels. The team observed that valuation multiples for sports brands are significantly higher than the company is valued at, indicating that should earnings continue to improve, and an exit be achieved, an uplift to the current valuation is possible.

Windstar Medical is a relatively recent investment made in December 2020 and is a leading German over the counter healthcare platform, which distributes its own and partner's branded products. The team have a business plan to grow the company through organic initiatives

and a buy and build strategy. It is early days yet, but the team hope to launch a direct to consumer offering later this year, benefitting from changes in consumer habits. During the OCI capital markets day, we also heard from **Wishcard's** founder, who set up the German gift card and voucher company but recognised the need for a more professional team to enable the company to achieve its growth potential. He sees the Oakley team as having the necessary experience and has partnered with them to accelerate growth.

Education

Education is one of the largest global sectors, as measured by spend, and is expected to grow. Yet it is an immature market, which is highly fragmented and has very few listed comparables. At the same time, the managers note that it has attractive investment characteristics, including its non-cyclical nature, high barriers to entry and a high willingness by customers to pay. As a result, there has been an increasing number of private equity deals in the sector, and valuation multiples have been expanding. We understand that Oakley Capital is one of the most active investors in the education sector in Europe currently. The experience of the four education companies in the portfolio during the pandemic have proved the investment credentials of the sector. All of OCI's holdings have been highly resilient and delivered revenue and earnings growth during 2020.

IU Group (c. 10% of NAV) has seen growth in student numbers of 4.4x from 2017 to 2020 and has become the number one higher education provider in Germany by providing online degree courses. It has been a beneficiary of the uncertainty surrounding on-site education and reduced foreign student numbers coming to Europe for higher education, given many foreign students are still wishing to attain a qualification from a European institution. The company saw 100% growth in customers last year, with EBITDA up 80%. The company has refinanced, and returned the original investment back to investors, meaning that OCI's cost is zero for this investment. The company has huge ambitions to continue to grow and benefit from its dominant position in the market.

Ocean Technologies Group is the number one provider of remote maritime crew training globally, seen by most customers as essential for complying with regulations. Despite global trade reducing, and the cruise industry ceasing activity almost entirely, the requirement for training of staff has not stopped. Indeed, moving to the online provision of training helps customers save costs. Ocean serves an estimated 1m of the 1.6m ocean-going seafarers around the world, and so has a dominant position which the team are entrenching by making select bolt-on acquisitions. Revenue growth of 10% was achieved during 2020, demonstrating the recurring nature of revenues and strong customer retention.

Overall, across the three specialist sectors that Oakley Capital focusses on, the recurring themes from the capital markets day presentations were the strong performance during 2020 and into 2021, the exciting growth potential in the future, but also how entrepreneurial founders of businesses represent a key part of Oakley Capital's DNA. Members of this network have around €170m of capital invested in the Oakley Funds, and their continued engagement and support is a crucial part of the process. Oakley Capital aim to continue to build on their track record of being the first institutional investors in companies and create "product" for other private equity firms to buy, as was the case with WebPros and CVC. In this regard, aside from the expertise the team bring to help growth investee businesses, low entry multiples clearly help, such as a 7x valuation multiple for Contabo (October 2019), and Dexters 4x multiple (February 2021).

Gearing

OCI was launched in 2007 and as a result, was not financially overstretched in the financial crisis that followed. This meant it avoided the problems some listed private-equity trusts had during the financial crisis. That said, memories of this period have made OCI's board reluctant to arrange a debt facility. We understand that the board continues to debate its merits, but so far OCI has not employed gearing during its life, with cash consistently held on the balance sheet. OCI went into the market sell-off in Q1 2020 with net cash on the balance sheet of c. £250m, or 36% of NAV. This fortunate position left OCI with a lot of liquidity and enabled Oakley Capital to support existing investments as well as find other opportunities. Currently, we estimate that OCI has net cash on the balance sheet of c. £162m, representing 22% of the estimated NAV.

In the listed private equity sector, gearing can also be thought of in terms of the commitments made to the funds for investments that have not yet been made. OCI has outstanding commitments to Oakley funds of £440m. A majority of these is to Fund IV which closed in 2019, but also c. €70m remains committed to Oakley's new Origin Fund, which targets smaller (€10m to €50m equity tickets) transaction sizes than the main fund. Of the total commitments, only around £255m is likely to be drawn, giving an adjusted commitment cover of 63%. As such, when compared to the LPE peer group, OCI is relatively highly committed as a proportion of NAV but also has significant cash on the balance sheet. However, given the relatively young age of the two funds, we believe that it should be a realistic expectation that commitments will only be called over the next five years, and therefore OCI's finances will not be particularly pressed. Should

investments be made at a faster rate than one might expect, then the board clearly still has the option of arranging a debt facility – a feature which is relatively common across most of the other constituents of the listed private equity sector. As such, given the cash on the balance sheet, we do not believe that the commitment strategy is likely to present OCI with a financing problem for the foreseeable future.

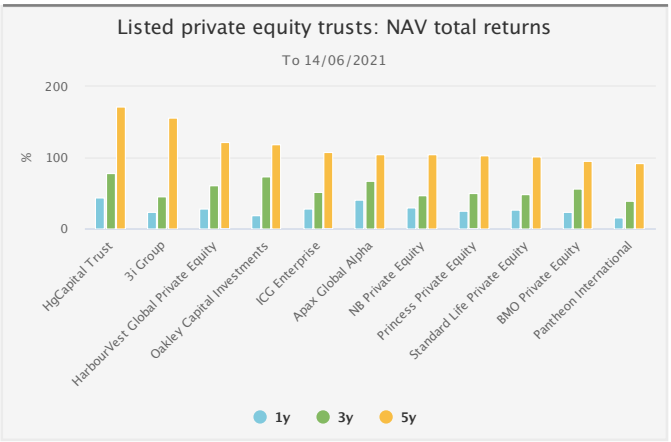
Performance

Oakley Capital has a track record of contributing to significant growth from underlying businesses, but also of achieving very profitable exits. The combined track record since inception shows a total of 17 realised investments since Oakley Capital was founded, which have delivered a return of 3.9x on invested capital and a 77% gross IRR (i.e. before fees). This is the engine which has driven OCI (as an investor in these funds) since IPO, although it is worth noting that as one might expect because of cash drag, the effect of fees and FX as well as other effects, NAV returns have not been this high. That said, on a comparative basis, OCI has been amongst the top performers in the sector in terms of NAV total returns.

We believe that the relatively narrow sector focus has enabled the team to deliver strong returns, not to mention the benefit to returns of partnering with founder entrepreneurs and being able to embrace complexity (see **Portfolio**). Oakley has a clear strategic focus in how it acquires businesses, which in a market with significant competition for deals, means that the process should be repeatable. For example, 85% of investments that the team have made have been 'primary' (i.e. not bought from other private equity managers). Perhaps more importantly, 75% of investments have been proprietary (i.e. uncontested). The Oakley network of entrepreneurs is key in bringing ideas to the team and has been an important driver of returns. In the graph below, we illustrate the peer group's NAV returns over various time frames but note that OCI's strong showing on a relative basis is despite having significant cash drag (nor employing any gearing), with low USD exposure (which has been a positive for HVPE) or having a narrow sectoral exposure (HgCapital).

As the graph below shows, over the past five years, OCI has delivered good NAV and share-price total returns relative to peers and equity indices. Clearly, with the NAV only being reported on a half-yearly basis (as opposed to HgCapital which has the latest NAV as at 31/03/2021), the next NAV as at 30 June 2021 (due to be announced at the end of July) will indicate how OCI has truly performed relative to peers and the benchmark. As we discuss in the **Portfolio section**, 70% of the portfolio now delivers products or services digitally, and 70% of the portfolio has subscription-based or recurring revenues. With average EBITDA growth across the portfolio of 20% during 2020, one might hope that this momentum has continued into 2021. 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 very diversified private-equity funds made up of funds with hundreds or thousands of underlying companies.

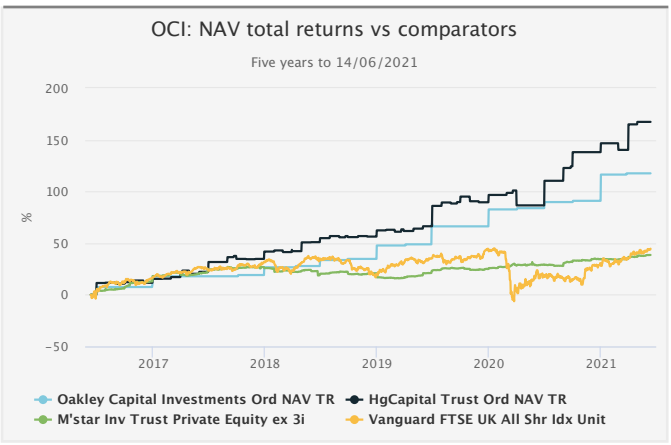
Fig.3: Sector Nav Total Return Performance



Source: Numis

Past performance is not a reliable indicator of future returns

Fig.4: Nav Performance



Source: Morningstar

Past performance is not a reliable indicator of future returns

Dividend

OCI's dividend policy is to pay a dividend of 4.5p per share each year. This was first introduced in December 2016, as part of a range of governance initiatives in response to shareholder feedback.

The dividend is paid in two equal instalments, in October and April each year. At the current share price, the 4.5p total dividend represents a yield of 1.3%.

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Management

Oakley Capital is the investment adviser to the company. It was founded by Peter Dubens in 2002 and he remains the managing partner. At the recent capital markets day, Oakley reported that the investment team has been expanded by 30% over the past year and the team now constitutes eleven investment partners (including Peter) who have a great depth of experience as well as access to a unique network accustomed to sourcing investment opportunities. Recent developments include the opening of a Milan office to complement the German and London investment offices. Oakley sees itself as a Western-European investor and has a particular focus (and track record) in three sectors: Technology, Consumer, and Education.

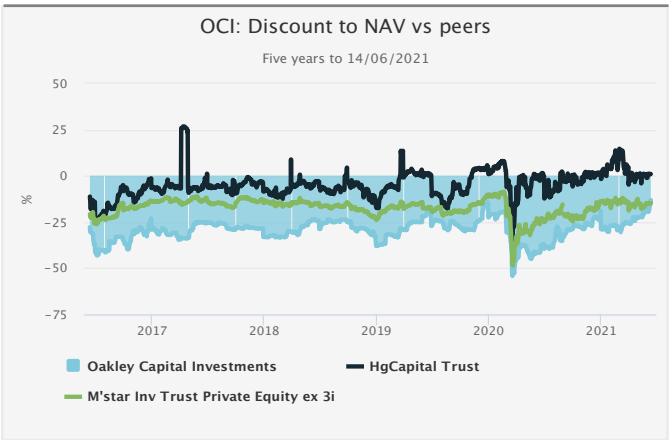
Peter Dubens' background is as an entrepreneur, having originally founded his thermochromic t-shirt business aged 18, which was subsequently sold. Peter has a long and impressive track record as an active investor, and within the public markets, he had notable success with Pipex and 365 Media. He later decided to formalise his investing activities through Oakley Capital. Oakley Capital Investments (OCI) is an AIM-listed investment company which invests in the Oakley Funds and was launched in 2007. Oakley Capital currently has assets of c. €4bn under its management. Oakley Fund IV closed its fundraising in 2019 at €1.5bn, and OCI represented 27% of the fund. More recently, OCI announced that it had committed €75m to the Oakley Origin Fund which will target lower-mid market deals and as a result smaller transaction sizes than Oakley's main fund.

OCI board members (which include Peter Dubens) and Oakley partners own c. 11% of OCI, representing a significant increase since 2018 (c. 1.2%). We understand that Peter has committed more than £100m to the Oakley Capital Funds, and his total holding in OCI is 18.8m shares, representing 10.4% of the company.

Discount

OCI has delivered good NAV returns relative to both the peer group and listed equities, as we discuss in **Performance**. That said, the shares have traded on a persistently wide discount – not just in absolute terms, but also relative to peers. Over the last five years, OCI's board and manager have been taking various shareholder-friendly steps to address it. As the graph below demonstrates, the market sell-off in Q1 2020 badly affected the discounts of listed private-equity trusts, and OCI was not insulated from this. However, over the past 12 months, the discount has been narrowing, with the company's annual capital markets day (held virtually) perhaps contributing to a further boost in demand for the shares. Relative to Numis's adjusted 31 December NAV (accounting for announcements made to 15/06/2021, currency changes and the share-price movement of Time Out), the share price trade at a discount of 12% (to an estimated NAV of 406p).

Fig.5: Discount To NAV



Source: Morningstar

Recent share price gains put the discount to NAV in line with the broad peer group (excluding 3i), but it remains considerably wider than HgCapital Trust, which we view as OCI's closest peer. That said, OCI reports its NAV every six months, and so most peer's discounts will reflect more up to date data. This is relevant in the context of what was a strong period for NAV growth by the peer group. OCI's portfolio is highly idiosyncratic, and therefore there is little direct read-across from the highly diversified listed private equity funds with heavy US exposure to OCI's portfolio. That said, as we discuss in **Portfolio**, the average EBITDA growth of OCI's investee companies was 20% over 2020, and so if this momentum has continued, one might hope for further NAV progression when OCI reports its 30 June 2021 NAV at the end of July. If this is the case, then the current discount of 13% may actually prove to have been wider.

Whilst the discount has narrowed considerably, we believe this is more than justified by the strong long-term performance track record of Oakley Capital, and the resilience exhibited by the portfolio during 2020. We believe that should OCI's strong performance continue along with the higher standards of governance and investor communication, OCI may be rewarded over time by a rating more in line with HgCapital (premium of 1%) rather than the wider peer group average. Whilst there remains the risk that the discount will widen out once again, the board do have powers to buy shares back to take advantage of mispricing, enhance shareholder returns and help support the shares. The last buyback activity undertaken by the board was in December 2020, which saw OCI repurchase and cancel £18m-worth of shares at a price of 257p. At the time, the discount was at a 26% level, meaning that this activity was highly accretive to NAV.

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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), currently, no fees are charged on direct 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%.

For the period ended 31 December 2020, the Company's ongoing charges (excluding performance fees) were calculated as 2.46% (2019: 2.57%) of NAV. The latest KID RIY cost is 7.06%, of which 0.11% is portfolio transaction costs, and 3.66% is historical carried interest and performance fees. Whilst this is undeniably high in absolute terms, the contribution to KID costs from historic performance fees is reflective of the strong performance from the portfolio.

ESG

Oakley Capital has embraced ESG for some years now, having been a signatory to the UN's PRI (Principles for Responsible Investment) since 2016. Oakley Capital states that incorporating ESG into their investment process as well as their investee businesses culture is a key way to protect and create long-term investment value beyond the standard drivers of compliance and risk management.

At the recent capital markets event, we heard from Oakley Capital's Head of Sustainability who explained that the team were implementing a strong and meaningful ESG agenda. The team are aiming to help influence change for the good, to benefit people, the planet and each investee company. This is being driven by the senior partners at Oakley Capital, who see it as their responsibility to set the moral compass, identifying and applying good practice with regard to ESG matters. Oakley Capital hope to be able to report metrics for each company going forward, and if they are successful, that the portfolio as a whole will show improvements as they have been achieved over time.

Being controlling investors in companies, private equity firms like Oakley Capital have the potential to meaningfully influence the direction of travel with regards to ESG. It is clear to us that Oakley Capital are committed to integrating ESG fully into their processes and their stewardship of companies over the period of their ownership. We look forward to seeing further reporting developments. In our view, successfully implementing ESG will enhance returns for OCI shareholders on a NAV basis, but also – given the amount of investor interest in ESG – could also help to contribute to a narrower discount over time.

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