Flash update: Oakley Capital

Oakley Capital (OCI) trades on a 28% discount despite the majority of its portfolio companies showing resilience to COVID...

Update
07 October 2020

Oakley Capital Investments (OCI) invests in the funds managed by Oakley Capital (Oakley), it has delivered a 16% annualised total NAV return over the last 5 years and this growth has continued in the face of COVID-19, driven by the accelerated digitisation of the economy. Despite this OCI's shares trade on a wide 28% discount to its NAV per share.

Oakley is a private equity manager established in 2002 in order to partner high growth, founder led private companies. Its focus is mid-market European companies within the technology, education and consumer space. Their origination advantage is achieved through a strong network of business founders who they back repeatedly and who have subsequently invested in the Oakley Funds themselves. The underlying portfolio companies are typically tech-enabled, with digital business models, such that the majority have proven resilient to the unique challenges posted by COVID-19, as reported in the interim results (published in early September). We revisit the investment case.

Recent portfolio activity

OCI has recently announced another sale of one of its investments at a 50% uplift to the value, adding 7p per share (or 2%) to NAV. Casa, an online classifieds portal in Italy, is a classic Oakley investment – a specialist business which is tech-enabled and has a subscription model and strong growth trajectory. The sale of Casa, together with the partial sale of its sister business atHome earlier this year (in which Oakley has retained a minority stake), takes the gross return on investment to date from Casa and atHome to 2x, and represents a c. 23% IRR so far. Clearly, further upside is potentially available from the minority stake retained in atHome.

Oakley first invested in the business in 2017. Under Oakley's ownership, Casa significantly expanded its customer base: it now services over 14,000 real estate agents and has over one million property listings on its website. The relatively speedy exit and attractive returns generated by the Oakley team bring the rest of the OCI portfolio into focus. As many observers have said, the onset of COVID-19 has brought consumers' online habits forward by as much as four years. It is therefore perhaps not surprising that companies previously expected to benefit from this structural growth trend have done very well indeed during lockdown.

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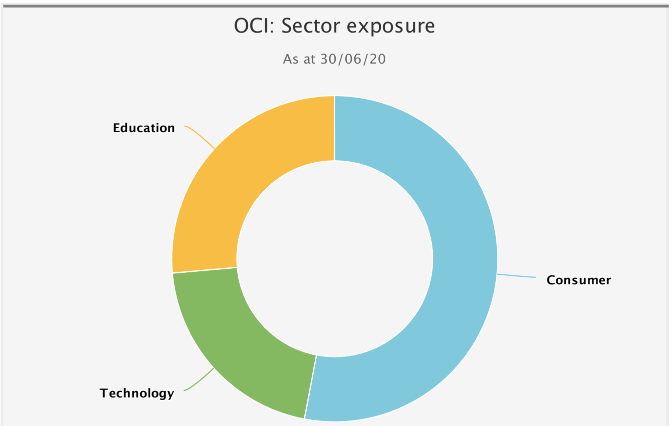
BULL
Top quartile returns to date and an underlying portfolio seems to be proving resilient
High cash balances provide reassurance for investors, and opportunities for managers
Shares continue to trade on a wide discount to NAV, with potential catalysts on the near-term horizon in the form of a possible revaluation upwards at year end

BEAR
Concentrated portfolio means returns can be materially affected by negative performance in any underlying company
Private companies offer limited liquidity, and returns can be lumpy
Private equity funds charge relatively high fees, although OCI's net of fees returns have still outperformed listed indices

Resilience of underlying portfolio

This dynamic could prove of benefit to OCI's underlying portfolio, which focusses on the technology, education and consumer sectors. Within each of these sectors, Oakley typically likes to invest in businesses which are founder-led, but which more importantly have an element of technology that enables them to deliver their product or service digitally (ideally with a subscription element). As such, when the managers updated investors recently (after the interim results – accessible **here**), the team stated that 12 out of their 15 companies are forecast to meet or beat their budget for 2020, or have returned to budgeted run rates in H2. These are clearly not the 'usual' consumer businesses which have seen their prospects dim with the onset of COVID-19.

Fig.1: Sector Breakdown



Source: Oakley Capital

In our view, the fact that the majority of the companies in the portfolio seem to be putting in a strong operating performance despite the current circumstances shows the portfolio to be of a high quality. Within the portfolio, valuations appear not to be stretched. Overall, the portfolio is valued at an average EV/EBITDA multiple of 11.8x. This multiple compares to that of HgCapital Trust (HGT), which reported recently that its portfolio (top 20 holdings) was valued at 20.6x as at 30/06/2020. Clearly HGT might be considered even more 'tech'-heavy and it has exposure to different sectors, but this does highlight a big valuation gap between portfolios, and suggests that OCI's is potentially more conservative.

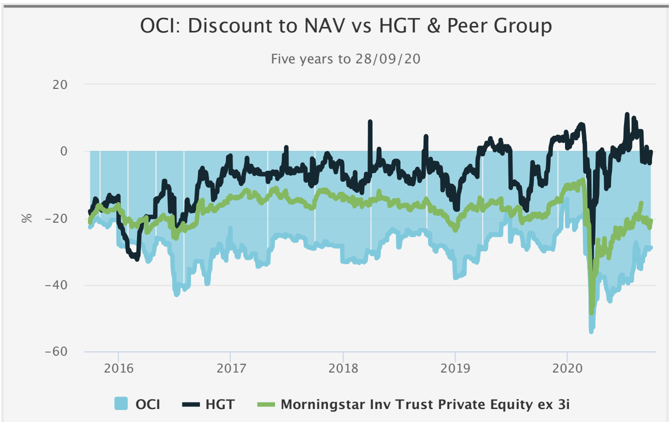
With Oakley having reported that 23% of OCI's portfolio is trading is unimpacted or benefitting from COVID-19, and that 27% is reporting only "some short-term disruption", there is clear potential for these companies to continue to drive OCI's NAV. OCI's managers revalue the portfolio twice a year, on 31 December and 30 June. However, we understand that four of the five companies that outperformed in the first half (WebPros, Ocean Technologies Group, Seven Miles and Contabo) were all acquired in the last 12 months, and Oakley's policy is that its valuations remain at cost for the first 12 months. As such, any performance from these companies above budget has not been reflected in the NAV at this stage. Should the reassuring trends referred to by OCI's manager continue, further NAV progress may be reported at the end of January. CPG is the other company which, with 'uninterrupted' trading, is a meaningful holding at c. 8.8% of NAV. It was revalued upwards at the end of June 2020, but given how significant it is in terms of the overall portfolio, its performance will likely have a strong influence on NAV.

The investments which have not fared so well from COVID-19 are all pre-2017 vintage investments, and probably feature in commentators' minds more than they are represented in the portfolio. The three companies which have been negatively impacted (Time Out, North Sails and Iconic Brand Co) amount to c. 28% of NAV, but half of this exposure (14%) is represented by a loan made to North Sails. This clearly has a different risk profile to equity, and so we think it fair to say that the NAV exposure, which is subject to periodic revaluations, is significantly weighted towards those businesses which appear to be in a strong position. On average portfolio companies have reported continued growth to earnings, with EBITDA growth of 17.5% reported for the 12 months to June 2020 providing a solid underpinning for the NAV.

Discount

Despite the strong showing from the majority of the portfolio in the adverse conditions seen this year, OCI's discount remains wide in absolute terms, but also relative to peers. In particular, HGT – which represents a similar, directly investing listed private equity trust with a focus on technology companies – continues to trade at a significant premium to peers (and currently, in absolute terms). The graph below illustrates that this has not always been so.

Fig.2: Discount To NAV



Source: Morningstar

Reasons behind the discount to NAV and peers

Looking at OCI's discount in isolation might suggest that the trust's balance sheet is in some way threatened, or perhaps that historically OCI hasn't delivered the returns that peers have. Looking at the bald numbers, neither of these scenarios is in our view plausible. Firstly, OCI's balance sheet is strong. Thanks to some well-timed realisations that completed in early 2020, OCI had cash of £261m at 30/06/2020 compared to net assets of £692m, representing 38% of NAV. According to our calculations, if we add proceeds from Casa cash since then, and adjust for buybacks, cash as a percentage of NAV is now nearer 36%.

OCI makes its investments through the Oakley Funds to which it commits capital in the ordinary way. OCI has around £514m of commitments to funds which are expected to be drawn. This clearly outweighs the cash available on the balance sheet, but we believe that given OCI is so central to Oakley Capital as a business, should realisations dry up (reducing cash coming in), it would seem unlikely that the manager would continue to draw capital and leave OCI in stretched circumstances. Certainly OCI has plenty of firepower to make investments in the immediate term. One such investment, announced as we publish this note, is to 7NXT – a business which Oakley hope to help scale into the growing online fitness and health market. The size of the investment has not yet been disclosed.

On performance, OCI has delivered sector- leading returns in recent years, but also good returns relative to the peer group over five years. In the table below we illustrate the strong relative performance relative to the peer group (we include only those trusts which are not in wind-up).

NAV Performance Relative To Peer Group

PERIOD	EQUIVALENT	NAV TOTAL RETURN (%)	RANK OUT OF TEN PEERS	MEDIAN TOTAL RETURN %
Since 30 June 2019	One year	14.9	2	6.9
Since 30 June 2017	Three years	41.0	3	33.3
Since 30 June 2015	Five years	90.1	4	85.5

Source: Morningstar, Kepler Partners LLP

After accounting for the share price movement of Time Out (-11% since 30 June as at 29/09/2020), buybacks of £16m worth of shares at between a 30% - 36% discount to NAV, as well as the realisation of Casa and exchange rate movements since the end of June, we estimate that OCI's NAV is now 363p. The discount of 28% compares to HgCapital Trust's premium of 4% and the average discount for the peer group ex 3iof 12.1% (according to Numis).

Conclusion

If OCI's top-quartile performance continues, the experience of HgCapital Trust might suggest that the discount on OCI might behave in similar way. Until then, any further buybacks that the board makes (they have a further c. 7m shares of a buyback programme to make) will be highly accretive. We see the next NAV update, due to be published in late January and which will show data as at 31 December 2020, as a key catalyst for investors to watch for. Clearly, any realisations that the manager is able to make before then should also be additive – since inception, realisations have been achieved at an average uplift to the most recent valuation of 34%. We understand Oakley has a strong pipeline of potential investments, as well as a successful track record of originating investments outside of formal processes. Oakley aims to be the first private equity investor in founder-led businesses, and has a wide network of entrepreneurs who introduce the manager to opportunities. With significant cash on the balance sheet, OCI is well placed.

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