Kepler Trust Intelligence

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Oakley Capital Investments

Update
26 March 2019

Summary

Oakley Capital Investments (OCI) is an AIM listed investment company and is one of the few remaining directly investing listed private equity funds. It makes the majority of its investments through the Oakley Capital Funds, but on a case by case basis has latitude to invest directly in equity or debt in the portfolio companies.

Oakley Capital aims to deliver long term capital appreciation by backing business operators to grow their companies in three main sectors: Consumer, Education and TMT. The team typically target majority stakes in profitable companies with an EBITDA range of £10m to £50m. They are often the first institutional capital in a business, helping proven entrepreneurs professionalise their companies and achieve the next leg of growth.

The basic ethos of backing proven operators, introduced through Oakley Capital's extended network, has a different feel to a traditional LBO (leveraged buyout) private equity strategy. Certainly, the way Oakley source investments, in complex transactions often without having to participate in auctions (26 of 27 investments have been primary deals), means they are not usually competing with other private equity players.

In 90% of cases the management/business owners they back remain with their companies for the life of the investment, whereas the average for the private equity industry is c. 50%. Many of these business owners invest their subsequent returns with Oakley. To date they have committed over €80m to the Oakley Funds. Overall, the portfolio currently represents investments in eleven growth opportunities. In the recent trading update, the company reported that average EBITDA growth from the portfolio had been 39% for 2018, considerably faster than wider listed equity indices.

Over ten years, OCI has been the third best performer of the remaining listed private equity funds (i.e. excluding Electra) on a NAV total return basis, according to data from Numis. Over this period, the company has delivered NAV total returns of 172% against Numis' average for the LPE peer group of 102%, representing strong outperformance over the longer term. Returns of 46% over the past three years have also been good in absolute terms and relative to the FTSE All Share over the same period.

In 2016 the board introduced a dividend, paying 4.5p per year, equivalent to a yield on the current share price of 2.3%. In the last financial year (to 31st December 2018), the company received gross interest income of £6.8m, against which the dividend cost around £9.2m. As such, the dividend can be seen to be 74% covered by current income.

A material discount has not always been a feature of OCI. However, the discount reached historically wide levels in 2016; the shares trading 40% below NAV. Recognising that the discount may be down to other factors, the board have focused on closing the discount and have undertaken a number of initiatives, including a

As at	22/03/2019
Price (p)	198
Discount (%)	-29.6
OCF (%)	1.07
Yield (%)	1.6
Turnover Ratio (%)	29.9
Ticker	OCI
Gearing (%)	-17
Shares	204,399,936
NAV per share	281
NAV (£m)	575
Divi per share (p)	4.5
Market cap (£)	404,711,873

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commitment to never issues shares at a discount to NAV, greater disclosure of the economics of the company and the performance of the underlying portfolio companies, investor meetings and capital markets days, and retaining a share buy-back policy. We understand they are also reviewing the AIM listing. At the current time, the shares trade on 33% discount to the 281p NAV per share, which remains considerably wider than listed private equity peers.

Portfolio

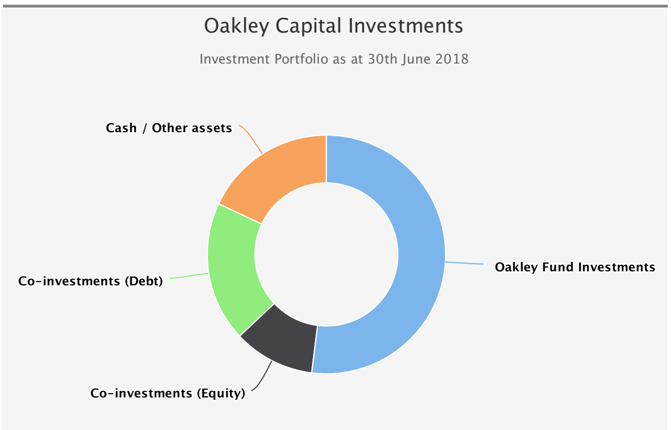
OCI's investment adviser, Oakley Capital, aims to deliver capital appreciation through investing in private companies. Oakley have a slightly different approach than "typical" private equity investors. The team target majority stakes in mid-market profitable growth companies with an EBITDA range of £10m to £50m. They are often the first institutional capital in a business, helping proven entrepreneurs professionalise their companies and achieve the next leg of growth. Oakley focus their efforts in three main sectors: Consumer, Education and TMT, all areas in which Oakley have a track record of contributing to significant growth and achieving profitable exits.

The underlying funds through which OCI make the majority of its investments, target returns of 25% per annum before fees and a blended gross multiple of three times their investments. The life of each underlying fund is expected to be approximately 10 years, which includes a five-year investment period from the date of final closing. OCI has recently made a €400m commitment to Oakley's latest Fund IV raise, which is speculated will attract commitments in excess of €1.2bn.

The basic ethos of backing entrepreneurs, introduced through Oakley Captial's extended network, has a different feel to a traditional LBO (leveraged buyout) private equity strategy. The team of seven partners and 12 investment professionals look to invest in UK and continental European "mid-cap" companies with an enterprise value of between £60m and £300m. They have a focus on western European countries and lean on their growing "family" or network of entrepreneurs and managers. The network, and Peter Dubens' reputation mean that the team do not rely on auctions to source investments. Additionally, the team have expertise in conducting long term and intensive due diligence, enabling them to structure complex deals such as the "carve out" of Plesk (now WebPros) – a software business that Oakley bought from a larger business (Parallels Group) in May 2017. The manager's investment style is influenced by the entrepreneurial background of its founder, that has evolved into a more institutional approach to private equity investing.

The company makes its investments through the Oakley Funds, but on a case by case basis has latitude to re-invest or remain invested in companies after the funds have sold. This might be a situation where an Oakley Fund can no longer make a follow-on investment or has to sell at the end of the fund's life. In every case, the OCI board, which is independent of the investment adviser, has overall control of the final investment decision based on the recommendations of the manager. Currently two equity co-investments are held in OCI - Time Out and Inspired – which together represent £64m, or 11% of the portfolio as at 31st Dec 2018. Overall, the portfolio currently constitutes investments in 11 companies. In three cases – Daisy, Time Out and North Sails - the company has investments in the equity as well as debt. Overall, we understand that the company's NAV has the following currency exposure: 60% Euros, 25% Sterling and 15% US Dollars.

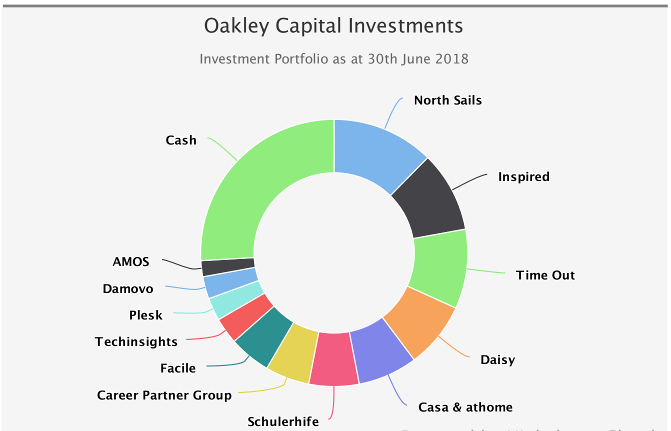
Fig.1: Portfolio Overview



Source: Oakley Capital

We recently met with the investment manager to discuss some of the most recently acquired portfolio companies, which illustrate the Oakley approach to investing. Each offers exposure to one of the three sectors in which Oakley targets investments, and each illustrates the entrepreneur led approach that they prefer. These investments made up the bulk of the £110m invested by OCI in 2018, being the acquisitions of Career Partner Group (CPG) and Facile and the purchase of c-Panel by WebPros.

Fig.2: Investments



Source: Oakley Capital

Facile (5.0% of portfolio, investment valued at £29m as at 31st Dec 2018)

Within the consumer sector, Facile is an Italian online price comparison business which the manager likens to Money Supermarket or Compare the Market, helping users find the most attractive car insurance deals. Oakley bought into the company in 2014 (Fund II) following their success with a similar German business called Verivox (sold during 2018 and owned through Fund I & Fund II). Oakley invested having been impressed with the management team and bought into the still young business in a deal which gave Oakley a controlling stake enabling them to provide strategic direction, professionalise the business and help expand the offering. At the time over 90% of revenues were from car insurance, which has been diversified such that it now constitutes around two-thirds. New areas of business include energy, internet provision, loans and mortgages. The managers tell us that the company is growing at around 30% a year, and now has an over 70% market share in car insurance (up from 67% at purchase).

Oakley point out that in 2014, at the time of investment, only c.10% of car insurance switches took place online. Now it's around 15% and still a fraction of the online switching in the UK which stands at c.80%. Recognising that the company needed further significant capital to continue to grow, Oakley agreed, in 2018, to sell Fund II's majority stake to EQT, whilst in turn investing via Fund III to acquire a 20% stake in the business. OCI therefore crystallised a large gain and de-risked the investment (by reducing the size) as well as retaining an exposure to the future growth of a business that the managers remain confident of. In the same way that the Facile investment came through the team's experience with Verivox, Facile itself has led the managers to another investment made in Fund III and which features in OCI's portfolio. Casa & atHome are the equivalents of Zoopla in Italy and Rightmove in Luxembourg.Oakley invested by backing the existing management team to buy the two companies as a carve out from their parent. Oakley secured the deal by being the only bidder for the combined group, which clearly fitted the strategic logic and appealed to the existing management.

Career Partner Group (7.9% of portfolio, investment valued at £45.6m as at 31st Dec 2018)

An example in the Education sector is Career Partner Group (CPG), in which Oakley Fund III acquired a stake in early 2018. CPG is one of the fastest growing private university groups in Germany, offering on-line courses for people wishing to study for a degree. Oakley's investment came about following a successful investment in Inspired (a "buy and build" strategy backed by Oakley to create a global group of premium private schools), and the team set about looking for other education business. Their search led them to CPG, which was a relatively small part of a US business called Apollo Education Group that was experiencing severe difficulties with the main part of their business in the US. Having been identified by the team, Oakley approached Sven Schütt offering to help develop a business plan and back him in a management buy-out. As a result there was no competitive process, and Oakley was able to buy a majority stake in the business. CPG has performed strongly under the newly rejuvenated management team, growing EBITDA by 70% over the past year. Oakley believe that the visibility and predictability of the revenue stream enables them to have a major barrier to entry to competitors, in both marketing and enabling CPG to develop sophisticated analytics to identify and provide courses that suit changing demand.

WebPros (12.4% of portfolio, investment valued at £71.5m as at 31st Dec 2018)

The third sector on which Oakley focuses is TMT where the team, in particular Peter Dubens, have a track record of hugely successful investments. One current investment is the WebPros Group, which primarily comprises investments in two software businesses – one headquartered in Switzerland (Plesk) and the other in the US (cPanel). The investment has all the hallmarks of an Oakley deal; the business faces the hosting industry that Oakley know well (from former successful investments in Host Europe and intergenia); it was made possible by close working relationships with founder entrepreneurs; the acquisition of Plesk was a complex carve out; and the company benefits from a "sticky" recurring revenue profile. Both businesses offer a "software as a service" (SaaS), which enables hosted web users to configure their servers and control their websites. In total, the business supports 2,500 hosting partners, operates on 750k servers supporting 32 million users. Oakley recognised that whilst continuing to develop its products Plesk had not been run commercially as a stand-alone business and consequently there was a significant opportunity to improve its operating performance. The Oakley team are helping the companies in both locations professionalise their infrastructure and improve their go to market approach. Oakley believe that WebPros Group has a defensive business model, strong cash generation and substantial scope for growth.

Co-investments

Aside from capital commited to the Oakley Funds, OCI has 30% of its NAV invested in co-investments, of which around two-thirds (£107m) is through debt instruments, which have so far generated an IRR of 11% pa. The equity co-investments are currently direct stakes in Inspired and Time Out. Inspired is one of the world's fastest growing premium private school groups. Oakley initially invested in the group in Fund I in July 2013. Since then, Inspired has expanded through acquisition and greenfield development across Africa, Europe, Australia and South America, educating over 31,000 students across 42 premium schools and 5 early learning centres. Due to the increasing global demand for high-quality education, paired with the expanding middle classes in developing countries, the K-12 (Kindergarten to Year 12) market is growing in both emerging and developed markets. This presents a great buy and build opportunity for Inspired, allowing them to further develop their market position.

Oakley invested in Time Out in 2010 and has worked closely with management on its successful print to digital transformation and the expansion of the Time Out Market concept. Time Out Market brings the best of the city together under one roof: its best restaurants, bars and cultural experiences, based on Time Out's editorial curation. Time Out floated in 2016 at 150p with Oakley Fund I and OCI retaining 57% of the equity. Whilst investors wait for the company to generate profits, driven by the Markets roll out which begins in 2019, the share price has since retreated to the current level of 85p. This is 20% above the 31st December level, when Time Out corresponded to around 11% of NAV (including the debt investment).

Overall, the portfolio represents investments in high quality growth opportunities across three broad sectors. In the recent trading update, the company reported that average EBITDA growth from the portfolio had been in excess of 30% for 2018, considerably faster than wider listed equity indices. We break down the full portfolio by company and respective 2018 sales/EBITDA figures in the table below.

Gearing

Optimising the amount of invested capital is a key part of managing a private equity portfolio. The illiquid nature of private equity investments, and the lumpy nature of deals, means that managers have to tread the fine line of being invested enough so as not to suffer "cash drag" (where investment returns are diluted by having a material percentage of the NAV in cash, returning next to nothing), but avoiding not having enough capital to deploy in future deals that the fund is committed to. The financial crisis in 2008 caused angst and woe for several listed private equity trusts, several of which had to dilute shareholders by launching rescue rights issues and permanently destroying capital.

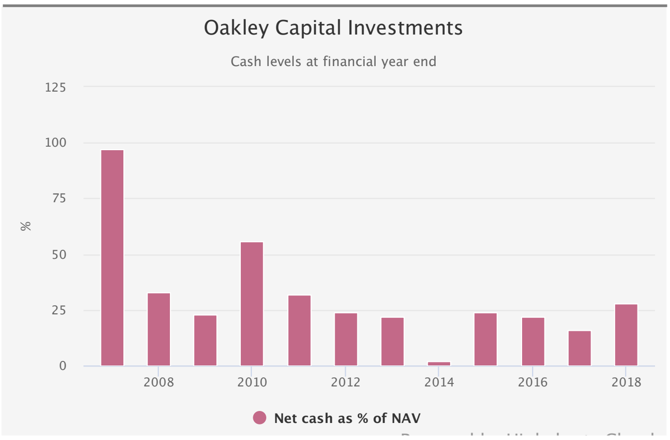
OCI was launched in 2007 and it avoided these problems, but memories of the experience suffered by others has meant that the board has hitherto been reluctant to engage with banks and arrange a debt facility. At the current time, we understand that the board continue to debate the merits of a modest facility. Certainly, OCI saves money by not having such an arrangement. The board caused some controversy when they issued new shares at a discount to NAV in 2015 to raise capital for co-investments. It then also sold shares out of treasury in 2017 (at around the same level of discount that it bought them back). Whilst these actions were dilutive to existing shareholders (and may in part be responsible for the discount to the peer group that OCI trades at now) the board have committed to not issue shares or sell stock out of treasury at a discount to NAV from now on. As the graph below shows, OCI has consistently held cash on the balance sheet which will have diluted NAV returns from a strongly performing portfolio.

Portfolio Investments As 31St December 2018

COMPANY	INITIAL INVESTMENT	SECTOR	REGION	DESCRIPTION	SALES (2018)	EBITDA GROWTH (2018)
Time Out	2010	Consumer	Global	Media & Entertainment	£48m	44%
North Sails	2014	Consumer	Global	Maritime Manufacturing	$228m	12%
Inspired	2014	Education	Global	K12 private schools	€264m	46%
Daisy	2015	TMT	UK	Telecoms	£684	31%
Casa & atHome	2017	Consumer	Italy & Lux	Property Classifieds	€38m	90%
Webpros	2017	TMT	Switzerland	Software/Hosting	$114m	22%
TechInsights	2017	TMT	Canada	Technology Intelligence	$53m	10%
Schülerhilfe	2017	Education	Germany	Private Tutoring	€79m	12%
AMOS	2017	Education	France	Higher Education	€18m	44%
CPG	2018	Education	Germany	Higher Education	€82m	85%
Facile	2018	Consumer	Italy	Price Comparison	€88m	36%

Source: Oakley Capital

Fig.3: Cash Level At 31St Dec Each Year



Source: Oakley Capital

Returns

Over ten years, OCI has been the third best performer of the remaining listed private equity funds on a NAV basis, according to data from Numis. Over this period, the company has delivered NAV total returns of 172% to 31st December 2018. The average for the wider direct and fund-of-funds peer group over the same period (according to data from Numis) is c.102%, representing strong outperformance over the longer term.

As the table below shows, the performance over shorter time frames is also strong in relative terms. As we illustrate in the calendar year graph below, OCI suffered some weak (albeit still positive) returns in 2014 and 2015 which were negatively affected by the company issuing equity at a discount to NAV, diluting returns for existing shareholders. The board have undertaken not to repeat this going forward. Returns of 46% over the past three years have also been good in absolute terms and particularly relative to the FTSE All Share over the same period.

Nav Total Returns Relative To Listed Private Equity Sector (To 31St Dec 2018)

	OCI NAV TOTAL RETURN	NUMIS LPE AVERAGE (EX ELECTRA) – NAV TOTAL RETURN	FTSE ALL SHARE
One year	16%	4.40%	-9.50%
Three years	46%	65.00%	19.50%
Five years	47%	83.30%	22.10%
Ten years	172%	102.40%	138.30%

Source: Oakley Capital, Numis

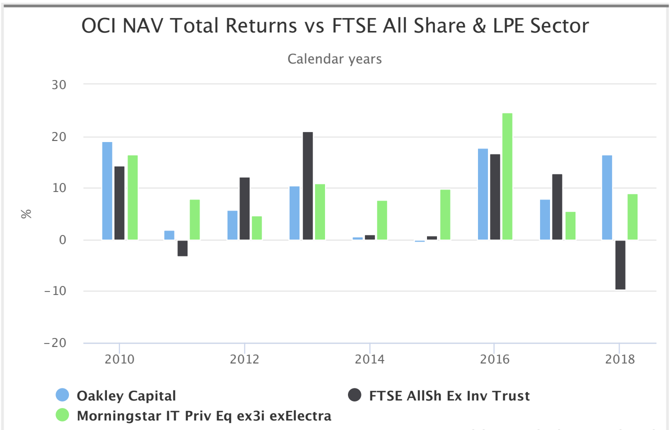
Private equity investment returns are correlated to equity markets. At the most basic level, valuations metrics (which typically occur half yearly) are related to quoted comparator companies. All things being equal therefore, if equity market valuations fall on a sustained basis, then valuations for OCI's portfolio will also fall. It should be noted however that many of Oakley's portfolio companies do not have listed peers, especially amongst their Education investments, so its NAV performance should be less correlated. If earnings grow faster than valuations fall, then the net effect will represent positive valuation growth. However, typically the greatest driver of private equity returns are realisations, where the manager achieves a sale and the full value of an investment can be captured.

OCI recently published its full year results to December 2018, in which it announced an NAV per share growth of 15% to 281p. The key drivers of this growth were:

- Portfolio company revaluations (+29p), driven by average portfolio company EBITDA growth of 39%,
- Realisations (+14p) of four portfolio companies (Parship Elite, Verivox, Facile and Damovo), which generated a combined gross money multiple of 4.0x and returned £114.8 million to OCI. The realisations were achieved at a combined 36% premium to the 2017 year-end book value

This NAV growth was achieved despite an adverse contribution from Time Out (which is listed), whose share price nearly halved in the period impacting the NAV per share by -18p (although it has recovered by c 20% since then). It is worth with this in mind noting that with a concentrated portfolio like OCI's, valuation changes (positive or negative) can have more material effect on overall performance, in contrast to a very diversified private equity fund of funds, which may have many hundreds or in some cases thousands of underlying companies.

Fig.4: Calendar Year Performance



Source: Oakley Capital, Morningstar

Dividend

The board of OCI announced in December 2016 that they would commence paying a dividend of 2.25p half yearly, amounting to 4.5p per annum. This policy remains in place, and the board continues to pay the same 4.5p rate during the current financial year. At the current share price, this represents a yield of 2.3%.

Several other LPE trusts pay a dividend, in some cases yielding more than OCI. However, in some cases OCI makes debt investments alongside equity investments in companies which typically attract high interest rates. We note that in the last financial year (to 30th December 2018), the company received gross interest income of £6.8m, against which the dividend cost around £9.2m. As such, the dividend can be seen to be 74% 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 depth of experience and access to a unique network used to source investment opportunities.

Peter's background is as an entrepreneur, having originally founded his thermochromic t-shirts business aged 18, which was subsequently sold. Peter has a long and impressive track record as an active investor. Within the public markets he has had notable success with Pipex and 365Media. He 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 under management of c. £1.6bn at current valuations, of which OCI represents 44%.

OCI board members own c. 5% of OCI, representing a significant increase over a year ago (c 1.2%). We understand that Peter Dubens has committed more than £100m to the Oakley Capital Funds, and has been increasing his stake in OCI, recently buying shares at 188p, bringing his total holding to 4.7% of the company.

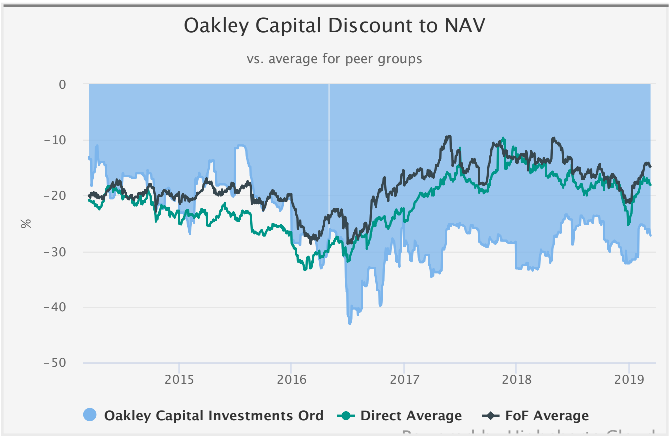
Discount

Discounts between NAV per share and share price have been a permanent feature for listed private equity trusts for much of the last ten years. However, as the graph below shows, a material discount has not always been a feature of OCI. However, the discount widened to historically high levels in 2016, resulting in the shares trading 40% below the NAV per share. The discount remains considerably wider than listed private equity peers. As previously referenced, however, OCI's historic NAV progression has been amongst the strongest in the sector.

Recognising that the discount may be down to other factors, the board have focused on measures to try to close it. In common with many other LPE vehicles, OCI is now paying a dividend. As we touch on in the dividend section, last year this was 74% covered by interest receipts from the debt investments made by the company. The board have also undertaken other initiatives including: a commitment to never issues shares at a discount to NAV, greater disclosure of the economics of the company and the performance of the underlying portfolio companies, investor meetings and capital markets days to improve liquidity and achieve a less concentrated share register, and retaining a share buy-back policy. We also understand they are currently reviewing the AIM listing.

Although significantly more diverse than a single listed operating company, directly investing (single manager) private equity trusts may be more volatile in terms of their NAV to fund of fund peers, thanks to more concentrated portfolios. This (and because of a disappointing performance from some of them) have meant that they have historically attracted wider discounts than the PE fund of funds. This difference has narrowed during 2018. At 33%, OCI's discount (to the 31st December 2018 NAV) remains wide relative to its history and peers.

Fig.5: Discount To Nav



Source: Morningstar

Charges

Oakley Capital makes the majority of its investments through 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% on 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 also makes investments outside these funds (co-investments) which are levied at 2% pa of the value of any such investments.

The managers are also entitled to a performance fee of 20% on returns over an 8% pa 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 sign off on each co-investment and negotiate an "advisory fee" payable to the manager on each co-investment transaction. We understand that these are typically c 0.5% of the investment value but can be up to 2%. The latest KID RIY cost is 6.23% pa.

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