



Oakley Capital Investments

OCI, trading on a broader discount, is approaching an important NAV update/capital markets event...

Summary

Update
14 July 2020

Oakley Capital Investments (OCI) differs from other trusts in the AIC's listed private-equity sector, as its investment adviser Oakley Capital typically aims to be the first institutional investor in the entrepreneurial businesses it backs, giving OCI's portfolio a very different feel.

OCI has historically seen strong performance delivered from a portfolio focussed on the technology, education and consumer sectors. A number of profitable realisations made recently meant that OCI went into the market sell-off with net cash on the balance sheet of c. £250m, or 36% of estimated net assets. This fortunate position leaves OCI with a lot of liquidity as Oakley looks to invest funds during a period of significant opportunity.

Notwithstanding OCI's strong cash position, the COVID-19 crisis left the shares trading on a very wide discount to NAV. Based on Numis's adjusted 31 December NAV, the current discount is 37%. As an expression of how wide the discount is, balance-sheet cash equates to 58% of the current share price.

Within the portfolio there will be winners, and likely also losers, from the economic slowdown. We expect more information with the end June NAV, released at the end of July. At the end of March, Oakley Capital noted that 70% of portfolio companies operate a subscription-based or recurring-revenue business model, and 65% of portfolio companies either deliver products or services digitally, or have the ability to shift to digital delivery in a short time frame. As such, despite the uncertainty, many of the companies within the OCI portfolio may have benefitted from recent events, or could be in a position to bounce back strongly.

Analyst's View

OCI has suffered a significant de-rating. The next potential catalyst for a reversal will come with the half-year NAV to June, due to be announced at the end of July. Adjusting for cash on the balance sheet, investors today are buying OCI's investment portfolio on a discount of 57% to the 31 December 2019 valuation.

Longer term, Oakley's track record is strong. For investors who want a focussed private-equity portfolio, OCI has delivered excellent returns – especially over the last three years, which we illustrate in **Performance**. At the same time, the shares trade on a significantly wider discount than those of peers.

As we discuss in the **Portfolio section**, several of OCI's companies are likely to have benefitted from the lockdown, although some were undoubtedly negatively affected. That said, the OCI portfolio has potential to provide resilience during the disruption.

OCI has the best liquidity position of the entire sector, yet trades on one of the widest discounts.

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BULL

Strong long-term NAV growth, driven by portfolio-company performance

Cash representing 58% of current share price (and 36% of estimated NAV) means manager has a lot of flexibility

Shares trade on a 37% discount to NAV, with several potential catalysts on the horizon

BEAR

Concentrated portfolio returns can be materially impacted by

Private companies offer limited liquidity, and returns can be lumpy

Private-equity funds charge relatively high fees



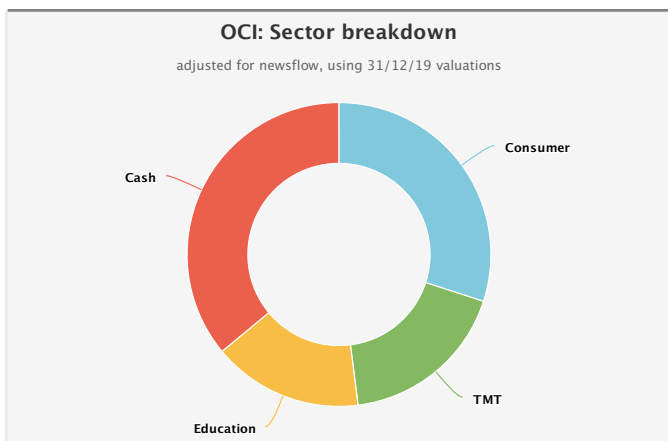
Portfolio

Oakley Capital Investments (OCI) differs from the other trusts in the AIC's listed private-equity sector in that its investment adviser Oakley Capital typically aims to be the first institutional investor in the entrepreneurial businesses it backs. This gives the portfolio a very different feel to those of the rest of its peers.

Oakley Capital typically sources investments outside of the 'usual' private-equity hunting grounds. Over the years, Oakley has developed a wide network of proven business founders who help bring interesting but 'below the radar' growth opportunities to the firm. The team observe that they rarely acquire assets that are already in the hands of private-equity funds, with only one investment since 2008 so far having been acquired from a peer. OCI's most recent investment – Globe-Trotter, the British luxury-luggage brand – is a case in point. OCI acquired the company from entrepreneur Toshiyasu Takubo. Mr Takubo, who has developed the brand significantly in the Japanese market, will retain a minority stake in the company.

Oakley Capital focusses on the technology, education and consumer sectors, which shows up in the portfolio breakdown we show below. The team had been taking advantage of strong underlying performance and a previously buoyant market for technology companies by crystallising several investments at strong IRRs. For example, WebPros was sold at the end of 2019 for a significant increase in the carrying value, generating a gross IRR on the investment of 152%. OCI reinvested in WebPros through Fund IV alongside new owner CVC, and we estimate WebPros currently represents c. 6% of NAV. More recently, Inspired was also sold (in April), at a 25% uplift to the end-of-December valuation. We estimate that these sales leave OCI with net cash on the balance sheet of c. £250m, or 36% of estimated NAV (using valuations as at 31 December 2019, but adjusted for subsequent news-flow and FX movements, as well as an updated share price for holding Time Out).

Fig.1: Sector Overview

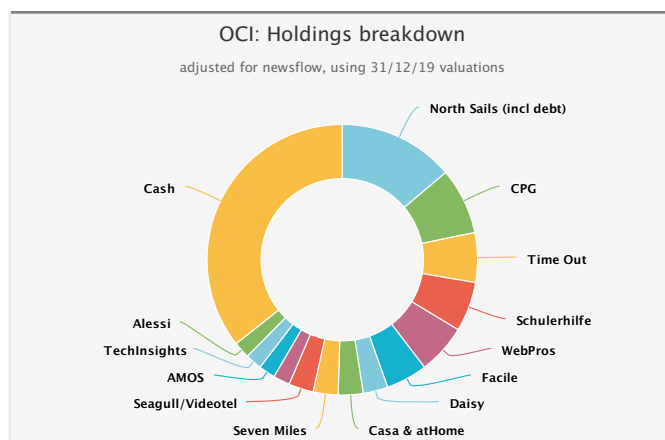


Source: Kepler Partners estimates

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 during a period of significant opportunity. One transaction that OCI has already participated in was a debt-for-equity swap for Time Out, a long-term holding that IPO'd in 2016. As we discuss in the Discount section, OCI's discount has widened out significantly since the start of the COVID-19-induced sell-off. At 36% of estimated NAV, OCI has the best liquidity position of the entire sector, yet trades on one of the widest discounts.

In this section we review the portfolio in the context of the lockdown and economic slowdown. At the end of March, OCI provided an update on the trading performance of the portfolio. The managers observed that 70% of the portfolio companies operate a subscription-based or recurring-revenue business model, which in their view made them less vulnerable to temporary declines in customer demand. Additionally, 65% of the portfolio companies either deliver products or services digitally or have the ability to shift to digital delivery in a short time frame. As such, while one might imagine there will be an impact on trading, the OCI portfolio has the potential to provide resilience during the disruption.

Fig.2: Portfolio Constituents (Estimated)



Source: Oakley Capital, Kepler Partners

Below we review OCI's top five holdings' likely trading performance since the pandemic hit; together, we estimate these holdings constitute 40% of NAV. OCI's largest investment is **North Sails** at c. 14%, of which two-thirds of the exposure is debt provided to the company. Unless this debt is impaired, this means that only the equity exposure is subject to revaluation (c. 5% of NAV). The group is a manufacturer of high-performance sailing and sportswear products. The lockdowns and economic slowdown are likely having a significant impact on the company's operations. However, with the America's Cup (and associated build-up) in New Zealand in Q1 next year, the company had been looking forward to strong trading over this period. The business might be expected to have



had lower activity so far this year, but with no indication that such a major event will be curtailed, we would hope that it will act as a catalyst towards getting back to (at the very least) a new normal.

Career Partner Group (CPG) at c. 8% might be considered a significant beneficiary of the near-term 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. CPG is Germany's number-one provider of online degree courses. In the same way that Zoom is likely to benefit from wider acceptance of videoconferences over the long term, the same phenomenon might possibly be beneficial to CPG. In the same way, we imagine that **Schülerhilfe's** (and also **AMOS's**) teaching operations will have been migrated online, and once the lockdowns have ended, would imagine that their businesses should return to normal. Schülerhilfe represents c. 6% of NAV, and AMOS 2%.

Time Out is listed, and so its travails are well understood by the market. Given the share-price decline since the OCI's last factsheet, we estimate it constitutes 6% of NAV. Trading at the popular Time Out Market concept has clearly been hit hard. The announced equity fundraising that OCI participated in recently (a debt-for-equity swap) should, we understand, give the business breathing room for a further two years. However, given the concept is essentially 'open air' (or at least, significantly more so than typical city-centre restaurants), and as lockdown restrictions are being relaxed, it might be imagined that Time Out Market should be amongst the first to benefit from pent-up demand in its location cities.

Finally, **WebPros** is now a smaller position in the portfolio than it has been historically, which we estimate at 6%. WebPros has been a stellar investment for Oakley, and the managers chose to reinvest alongside CVC when they bought the business – announced in December 2019. WebPros is the leading provider of hosting-control software that allows customers to administer every facet of their websites. It is hard to imagine that the pandemic would have affected the business much at all, and so we expect it to not be a meaningful detractor in the end-of-June NAV announcement.

Within the rest of the portfolio there are clearly a variety of different businesses, each of which will have had a unique experience of the economic slowdown. There will be winners, and there will likely be losers. However, we believe that despite the uncertainty, many of the companies within the OCI portfolio will have benefitted from recent events or look set to be in a position to bounce back strongly. Overall, we understand that the combined equity exposure of the direct-to-consumer investments – potentially the area most badly impacted by lockdown – is relatively small at 11% of NAV. As such, even in a worst-

case scenario in terms of valuations, the impact on the overall portfolio could be relatively limited, more so for investors when you consider the discount that OCI's shares currently trade at.

OCI has outstanding commitments to Oakley funds of £497m. A large part of this (£313m) is to Fund IV, which closed in 2019, and €75m has very recently been committed to Oakley's new Origin Fund, which is targeting smaller transaction sizes than the main fund. As we discuss in the Gearing section, whilst OCI is one of the most highly committed of the trusts in the peer group, we believe that it is a realistic expectation that capital will only be called gradually over time. This therefore should not present OCI with a financing problem – especially in the context of its current cash on the balance sheet of c. £250m, or 36% of estimated NAV.

As we discuss in the **Performance section**, 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 of a total of 17 realised investments since Oakley Capital was founded shows a return of 3.6x on invested capital and a 48% gross IRR (before fees). Aside from the high cash balances available to help weather the current crisis, there seems no reason to believe that over the longer term the managers will not continue to deliver impressive returns for investors.

Gearing

OCI was launched in 2007, and it avoided the problems some listed private-equity trusts had during the financial crisis by not being financially overstretched. However, memories of this period have made OCI's board reluctant to arrange a debt facility up to now. We understand that the board continues to debate its merits, but so far OCI has maintained a cautious stance, with cash consistently held on the balance sheet. Currently, we estimate that OCI has cash on the balance sheet of c. £250m, representing 36% of estimated NAV.

OCI has outstanding commitments to Oakley funds of £497m. A very large part of these (£313m) is to Fund IV, which closed in 2019, but also €75m has recently been committed to Oakley's new Origin Fund which will deploy the same investment strategy but targets smaller transaction sizes (€10m to €50m equity tickets) than the main fund. Whilst clearly relatively highly committed, we believe that it should be a realistic expectation that commitments will only be called over the next five years, and therefore the company'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,



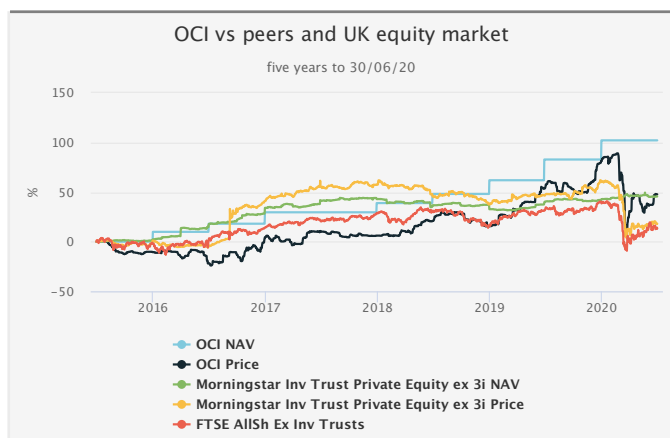
given the cash on the balance sheet, the commitment strategy doesn't seem likely to present OCI with a financing problem for the foreseeable future.

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 of a total of 17 realised investments since Oakley Capital was founded shows a return of 3.6x on invested capital and a 48% gross IRR (before fees).

Investors in OCI have not achieved such high returns on an NAV basis because of a number of factors, including cash drag and the effect of fees. However, 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, the next NAV as at 30 June 2020 (due to be announced at the end of July) will indicate how OCI has truly performed relative to peers and the benchmark. We think it noteworthy that even despite the recent de-rating to a discount of 37%, over five years the shares have outperformed those of the LPE peer group.

Fig.3: NAV Performance



Source: Morningstar

As we discuss in the **Portfolio section**, several of OCI's companies are likely to have benefitted from the lockdown, although some were undoubtedly negatively affected. The end-of-June NAV (announced in late July) is likely to provide more colour. 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. At the end of last year, the very direct linkage of the NAV to portfolio activity was illustrated by the sale of WebPros to CVC, which resulted in an uplift of 29p per share, or 9.1% from the June 2019 NAV. Clearly, this was a highly successful result for OCI, and we would

caution that such strong results from investments are the exception rather than the rule, but it does show how strongly performing businesses can properly influence returns for OCI shareholders.

Dividend

OCI has paid a dividend of 4.5p per annum since the introduction of a dividend policy in December 2016. The dividend was part of a range of governance initiatives in response to shareholder feedback. At the current share price, this 4.5p dividend represents a yield of 2.1%.

Management

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

Peter's background is as an entrepreneur, having originally founded his thermochromic t-shirt business aged 18, which was subsequently sold. Peter has a long and impressive track record as an active investor, and within the public markets he has had notable success with Pipex and 365 Media. He later decided to formalise his investing activities through Oakley Capital. Oakley Capital Investments (OCI), the AIM-listed investment company which invests in the Oakley Funds, was launched in 2007. Oakley Capital currently has assets of c. €3bn under its management. Oakley Fund IV closed its fundraising in 2019 at €1.5bn, and OCI represents 27% of the new fund. More recently, OCI announced that it had committed €75m to the Oakley Origin Fund which will target deals with smaller transaction sizes than Oakley's main fund.

OCI board members (which include Peter Dubens) and Oakley partners own c. 10% 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 17.6m shares, representing 9% of the company before the latest share buy-back was announced (but not yet transacted) on 18/06/20.

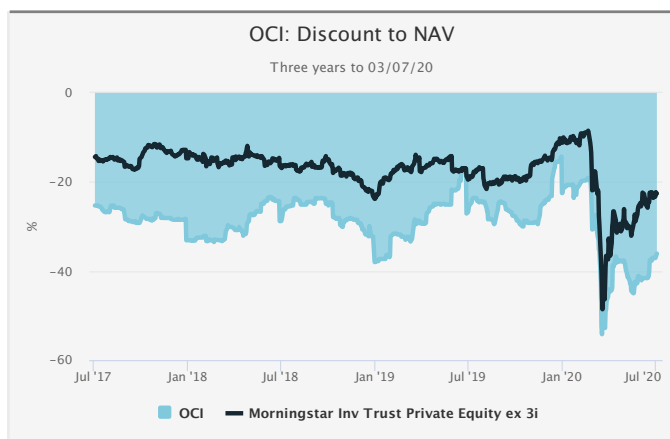
Discount

The market sell-off in February and March this year badly affected the discounts of listed private-equity trusts, and OCI was not insulated from this. As the graph below shows, following a strong period of performance, during 2019 OCI's discount narrowed closer towards the sector average.



However, the market's response to the COVID-19 crisis left the company trading once again on a very wide discount to the most recently published NAV. Latterly the share price has recovered somewhat, but based on Numis's adjusted 31 December NAV (accounting for announcements made to date, and the share-price movement of Time Out) the discount is 37% (to an estimated NAV of 346.8p).

Fig.4: Discount To NAV



Source: Morningstar

As we have discussed in our previous note on OCI ([found here](#)), the board has made a number of shareholder-friendly changes to help narrow the discount. It is possible that the market is worried about the extent of the commitments that OCI has made. However, as we discuss in the [Gearing section](#), the cash on the balance sheet means that for the foreseeable future it seems unlikely that OCI will find itself financially stretched.

There are two potential barriers to further widening of the discount. Firstly, c. £250m of cash on the balance sheet represents 58% of the current share price. If one takes this into account, investors today are buying OCI's investments on a discount of 57% to their 31 December 2019 valuation. This is clearly a significant margin for safety on the downside – even if one takes a relatively pessimistic view on valuations post-COVID.

Secondly, the managers' track record of outperformance is strong. For investors who want a focussed private-equity portfolio, perhaps representing higher risk but a higher return potential than one of the very diversified funds of funds does, there is a relatively narrow cadre of directly investing listed private-equity trusts from which to choose. The table below shows that OCI has performed ahead of peers over the past three years, and over five years is very much in line with the average, yet it trades on a significantly wider discount.

In the meantime, it is clear that the board views the discount as attractive. Aside from board members buying shares themselves, the company has announced in mid-June that it will be making purchases of up to 5m ordinary shares for cancellation. This comes on the back of buy-back activity in March which saw OCI repurchase and cancel £3m-worth of shares at a price of 159p. At this level, buybacks are highly accretive to NAV, but also signal to shareholders that the board is actively seeking to prevent the discount widening too far.

Charges

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

The managers are also entitled to a performance fee of 20% on returns over an 8% p.a. hurdle rate. In the case of the Oakley Funds, this is on the entirety of the fund. In the case of co-investments, performance fees are paid on a deal-by-deal basis. The OCI board signs off on each

Discount And Nav Performance Relative To Selected Peers

TRUST	PREMIUM/ (DISCOUNT) %	ONE-YEAR NAV PERFORMANCE %	THREE-YEAR NAV PERFORMANCE %	FIVE-YEAR NAV PERFORMANCE %
3i Group	5.3	-4.9	42.5	155.3
Apax Global Alpha	-16.6	-3.0	24.7	67.6
HgCapital	-1.3	0.1	41.4	105.9
Oakley Capital Investments	-36.9	10.6	55.9	102.0
Princess Private Equity	-16.5	2.9	25.8	104.4
AVERAGE	-13.2	1.1	38.1	107.0

Source: Numis



co-investment and negotiates an ‘advisory fee’ payable to the manager of each co-investment transaction. We understand that these typically have not exceeded 0.5% of the investment value but can be up to 2%. The latest KID RIY cost is 6.95%, of which 0.14% is portfolio transaction costs, and 2.81% is historical carried interest (performance fee).

ESG

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

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

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



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