

Equity Investment Instruments



Source: Thomson Reuters, Company

Market data

EPIC/TKR	GHS
Price (p)	860
12m High (p)	1000
12m Low (p)	675
Shares (m)	3.688
Mkt Cap (£m)	32
EV (£m)	17
Free Float*	66%
Market	AIM

*As defined by AIM Rule 26

Description

GHS applies PE techniques to quoted investments to deliver long term superior returns. Its focus on small caps and value stocks may deliver a further cyclical recovery should these approaches be less out of favour.

Company information

Fund mgr	Tony Dalwood
Fund mgr	Graham Bird
Chairman	David Potter
Investment team	Pardip Khroud
Investment team	Jonathan Dighe
Investment team	Laurence Hulse

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Key shareholders (22 Feb 2016)

Gresham House	19.2%
M&G	11.7%
Majedie	10.0%
River and Mercantile AM	8.5%
Trium Capital Managers	5.7%
Smith and Williamson	4.7%
Credo Capital	3.3%
M Whitaker	3.1%

Next event

Weekly NAV 12th September

Analysts

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Gresham House Strategic PLC (GHS)

PE approach pumping up investment returns

PE has outperformed the stock market over most time horizons. GHS aims to do likewise by using PE techniques to generate 15% IRR p.a. long term. Detailed due diligence is undertaken on companies with strategic, management or operational change options. Other techniques include focus on cash generation, constructive management engagement and input from an experienced Investment Committee and Advisory Group, all mitigating risk. The manager has a strong track record implementing this strategy while at SVG. With the share trading at a 20% discount to NAV investors have a good entry point and the assets are quoted securities or cash (£15m). GHS's small cap, value focus may also see cyclical outperformance. It has beaten the FTSE small cap (ex IT) index by c6% over the last year.

- ▶ **Strategy:** Applying PE techniques to smaller quoted companies imposes a strict set of criteria designed to deliver enhanced performance. While this approach is relatively new to GHS (strategy adopted August 2015) there are established competitors which support its use and management has expertise in the field.
- ▶ **Investment Policy:** Target portfolio is 10 to 15 UK/European, mainly public companies. It will focus on companies below £250m market cap with an expected hold period of 3-5 years, seeking influential, block stakes (i.e. 10% to 25%). Borrowing limited to under 20% gross assets.
- ▶ **Valuation Anomaly:** The 20% discount rises to 38% if we strip out the residual cash. Its companies are valued at around half the FTSE All Share level and forecast to deliver twice the growth. In due course, GHS may have a good yield with the intention to distribute up to 50 per cent. of (initially tax free) realisation profits and has locked in £1.2m of gains half of which will be available for dividends (c15p p/sh). Its NAV rose from 985p on 17th June to 1,075p on 2 Sept.
- ▶ **Risks:** A concentrated portfolio is at risk from one company suffering unforeseen events. For historic reasons, GHS has c40% of the portfolio in IMI Mobile). PE returns while better than the market over the long term, can be volatile. Shares may be issued to fund growth.
- ▶ **Investment summary:** GHS uses an approach that has delivered superior long term returns. It is focussed in the small cap value area which also has over the long term outperformed the market. Pricing anomalies in the inefficient small cap market create opportunities to use PE techniques, especially when conditions are volatile / value investing out of fashion. The manager is aligned with shareholders (owning c20% of GHS. Recent team buying in the market.

Portfolio composition and key characteristics (2017E)

	Value £m 2nd Sept	% port 2nd Sept	EV:2017 EBITDA *	Free CF yld *	EBITDA G*	EPS G*
IMI Mobile (IMO)	15.6	39.3%	7.5	5%	10%	12%
BeHeard (BHRD)	2.2	5.5%	16.1	n/m	114%	82%
Quarto (QRT)	2.5	6.3%	6.3	13%	8%	5%
Northbridge (NBI)	2.0	5.0%	4.3	5%	63%	n/m
Miton (MGR)	1.5	3.8%	4.0	16%	46%	25%
Space&People (SAL)	<u>0.7</u>	<u>1.8%</u>	<u>3.0</u>	<u>25%</u>	<u>82%</u>	13%
Sum total / wgt'd avg	24.5	61.7%	7.5	12%	20%	
Cash and other assets	<u>15.2</u>	<u>38.3%</u>				
Total	39.7	100.0	** 5.5			

Source: Hardman & Co Research * house broker estimates **GHS reflecting cash /NAV discount

PE & small cap out-perform the market, value investing due a bounce

Quoted PE shares out-performed the market

LPEq, the (primarily UK) listed private equity association statistics indicate that on a 3 year view its members share prices have risen by c25% more than the FTSE All Share Index. Performance has been more volatile than the market but on a 5 year view the outperformance is still around 10%.

PE funds also out-performed the market

Looking at PE funds rather than the quoted shares, the British Private Equity and Venture Capital Association (BVCA and whose Chairman is a member of Gresham House Advisory Group) latest Performance measurement survey indicates that the 10 year IRR from private equity and venture capital funds was 14.9% (to end 2014) nearly double the FTSE All Share (7.6%). The 5-year performance was 11.5% against 8.7% in the FTSE All share. Since inception all funds IRR was 13.8%.

Small Cap out-performs the market over the long term

GHS invests in small cap companies. The UK Small-cap has performed well over the medium and long term with, for example, the FTSE small-cap (ex IT) delivering a total return of 59.2% vs 24.2% for the All Share from Dec 2012 to Dec 2015.

Value style investing due a recovery

GHS adopts a value investment philosophy. This style of investment is out of favour with the 10 year rolling relative performance of the MSCI World Value Index close to all times lows relative to the MSCI World growth index. In the past, there has been a strong recovery in value compared to growth after such an under-performance.

How GHS is adopting PE approaches to deliver superior returns

GHS adopts private equity techniques to investment appraisal and due diligence, along with active, constructive company engagement. It is the combination of all techniques, consistently applied, that should deliver superior returns.

Detailed analysis / due diligence

Many fund managers will claim to do detailed analysis. Relatively few will acquire independent market reports and engage sector specialist advisers as GHS did with its recent investment in NBI. Nor do they engage to such an extent with management teams and Boards over a longer time period. GHS adopts conservative estimates of the downside value of assets. GHS's downside analysis of that company not only valued certain oil tools and drilling equipment at zero, but they appointed a further expert adviser and direct market customer referencing.

Businesses with manageable change options

PE houses usually look for companies where there are catalysts for change, not just value opportunities. This may be internal management control (NBI cut staff 15% in 2015, QRT has increased earnings through operational improvement), acquisitions (QRT, BHRD) or balance sheet management (NBI) allowing future growth.

Focus on cash generation

Cash generation is a critical focus for PE houses. As can be seen by the table on the front page, the average free cash flow yield (based off house broker estimates) is c12% with most of the investments consistently yielding around this average.

Significantly higher levels of engagement with management on a partnership not confrontational basis

GHS aims to buy influential minority stakes of between 10-25%. With these holdings it intends to be actively engaged with management as they take the business through change. GHS's inter-action with Northbridge (NBI) included making presentations to management highlighting both strategic options and GHS's willingness to provide further capital. For NBI this has the benefit of a "free" strategic review and knowledge of the terms on which further funding may be available. GHS has also provided introductions for Non-Executive Directors to its investee companies.

Input from experienced Board of Advisers

The Investment committee includes Tom Teichman (30 years VC experience including start up investor in lastminute.com), Rupert Robinson (Former CEO and CIO of Schroders Private Bank) and Bruce Carnegie Brown (chairman of Moneysupermarket.com Group plc). Bruce is a NED of Santander UK plc and was previously a managing partner of 3i QPE plc, a managing director of JP Morgan and CEO of Marsh Ltd. Gresham House Plc's Strategic Advisory Group includes (i) Gareth Davis, Chairman of Wolseley, William Hill and DS Smith and former CEO of Imperial Tobacco and Senior Executive at Hanson. (ii) Alan Mackay Former Senior Partner and Head of Healthcare at 3i Group plc, Chairman of BVCA. (iii) Sir Roy Gardner Adviser to Credit Suisse, current Non-Executive Chairman of Serco, Senior Independent Director of William Hill Plc and NED of Willis Group Holdings Plc. These advisers not only bring great experience to bear on any investment decision, but also are a source of new business and specific expertise which may be required for the due diligence.

Fund Manager: Gresham House

The managers, Tony Dalwood and Graham Bird, highly experienced

GHS is managed by the Strategic Equity investment team within Gresham House Asset Management Ltd, a wholly owned subsidiary of Gresham House plc (www.greshamhouse.com, AIM GHE). Tony Dalwood established SVG Investment Managers and launched Strategic Equity Capital plc gaining direct experience in building businesses. His previous appointments include CEO of SVG Advisers, membership of the UK Investment Committee of UBS Phillips & Drew Fund Management, Chair of Downing Active Management Investment Committee and the Board of Schroders Private Equity Funds. Graham Bird spent 6 years as a senior executive at PayPoint plc, gaining direct experience of running a business. He was a fund manager and Head of Strategic Investment at SVG Investment Managers and a Director at JP Morgan Cazenove. Up to 50% of performance fees will be re-invested in the fund. There has been regular director purchases through the year.

In addition to 20% current ownership, the FM will re-invest up to 50% of performance fees.. there has also been regular director buying in the market

GHS trading at bigger discount than more established, larger peers

PE approach is well established

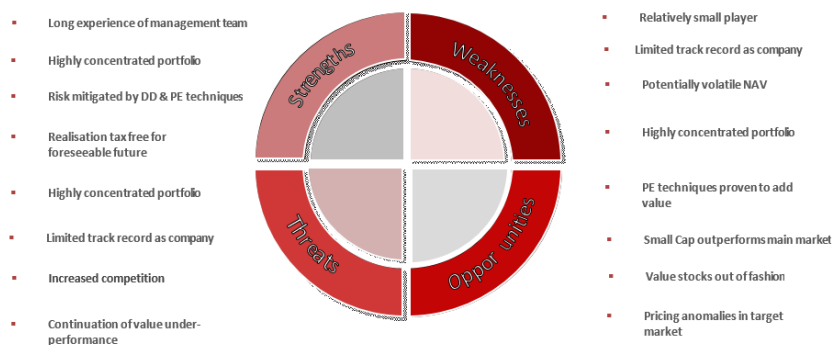
There are a number of quoted vehicles adopting a PE fundamental approach. It is recognised by investors with other investors in GHS in addition to those on page 1 including Henderson Global, Barclays Wealth, Rathbones, and Charles Stanley.

Peers premiums / discounts to NAV				
	Ticker	Market Cap (£M)	Latest NAV (P)	Discount to NAV (%)
Gresham House Strategic	GHS	32	1077	-20%
Strategic Equity Capital	SEC	137	218	-10%
Aurora	ARR	31	163	2%
Crystal Amber *	CRS	174	161	9%
North Atlantic Smaller Co IT *	NASCIT	359	2870	-14%
Marwyn Value Investors Ltd	MVI	121	213	-31%

*Source: Hardman & Co Research prices as at 5th September 2016 * latest monthly NAV early August.*

SWOT Analysis

SWOT analysis



Source: Hardman & Co Research

The portfolio

GHS's portfolio is given below. Since the new strategy started in August 2015, there has been one realisation (Castle Street) with a c40% gross IRR. The previous strategy generated £120m of trading (and therefore useable) tax losses which mean realisations should be tax free for the foreseeable future.

On 16th August 2016 GHS announced that GHAM had launched the SPE Fund LP which adds more firepower to GHS. The greater combined unit size across both GHS and the Fund LP means the investment team can look at larger deals than before.

Key portfolio features		
	Headline investment Case	Key drivers to higher share price
IMI Mobile	Poorly understood, lowly valued with strong growth prospects	Earnings growth, Cash generation, Potential for re-rating - currently less than 8x EBITDA
BeHeard	Buy & build, organic growth plus strong cash generation	Proven management team. Strong track record of value creation. Digital media consolidation via enhancing acquisitions
Quarto	Organic and acquisition growth at attractive valuations	Niche market exposure. Quarto can grow earnings through enhancing acquisitions and operational efficiencies. Highly cash generative; reducing debt
Northbridge	Recovery and growth, investing alongside management	De-leverage - strong cash generation and significant scope to reduce capex. Profit growth as margins recover to LT average. Attractive entry point (c 40% discount to realisable assets)
Miton	Significant operational gearing and improvement in ROCE	AUM and earnings growth. Cash generation and cost control. Strong balance sheet with scope to increase ROCE
Space and People	Recovery, margins and growth	Sales growth and recovery of EBIT margin. Highly cash generative. Continued contract wins and renewals. Decisive action taken on an underperforming business announced on 1 st July with trading statement

Source: Hardman & Co Research

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(Disclaimer Version 2 – Effective from August 2015)

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