15 March 2023

HARDMAN&CO.

OAKLEY CAPITAL INVESTMENTS LTD

2022: NAV returns driven by EBITDA growth

The *January trading statement* announced NAV (662p per share), total NAV return (24%), NAV growth driven by EBITDA growth (65%), modest multiple expansion (35%), investments (£271m), realisations (£244m), available finance, including cash (£210m), and commitments (£929m). The *detailed results announcement* highlighted i) 2022 exits, on average, 70% above carrying value, ii) 22% investee company average earnings growth, iii) weighted average EV/EBITDA of 15.9x, below listed market levels, iii) a PEG ratio of 0.7x, and iv) >75% of deals were uncontested. Oakley adds value to its companies in all economic environments. Its five-year share price total return (196%) is the best out of all *the AIC* investment companies.

- **Robust valuation:** *Inter alia*, this report reviews why we believe investors can trust the current valuation. Putting aside independent checks and balances, the bottom line is that other investors pay more for the assets than the level at which Oakley values them (uplifts on exit), and there is no incentive for Oakley to inflate the valuation.

- **Sustained outperformance:** OCI's five-year NAV total return CAGR to December 2022 was 23%. It is focused on structural growth sectors and subsectors with proven economic resilience. Oakley's operational, strategic and financial support is incrementally more valuable in a downturn than in good times, when rising tides lift all boats.

- **Valuation:** Against the December 2022 NAV, OCI trades at a 32% discount, despite its absolute (five-year CAGR 23% total NAV return) and relative performance. Any one-off closing of the discount is the "icing on the cake", rather than the reason to buy (the long-term NAV CAGR). We expect a stable 4.5p dividend (yield 1.0%).

- **Risks:** While OCI's costs are slightly above-average, post-expense returns are still market-beating. Sentiment towards the global economic cycle is likely to be adverse, even though outperformance has been delivered in downturns. OCI's portfolio is concentrated, and we believe its permanent capital is right for private assets.

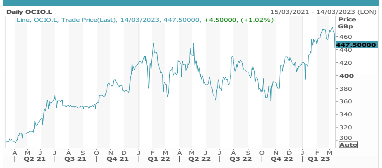
- **Investment summary:** OCI provides investors with liquid access to the attractive PE market, enhanced by Oakley's incremental origination and active management skills. Oakley Funds focus on mid-market, profitable, tech-enabled European companies that operate in the technology, consumer and education sectors. This space provides structural growth, as well as opportunities for Oakley Capital to add operational, strategic and financial value to the businesses acquired. Accounting and governance appear conservative, with an average 54% uplift to carrying value on exit since inception. There are risks – primarily sentiment-driven – around costs and cyclicality, as well the liquidity and valuation of the underlying private assets.

Financial summary and valuation

Year-end Dec (£000)	2018	2019	2020	2021	2022	2023E
Interest income	6,629	9,218	10,466	10,073	14,467	18,658
Realised gains	102,314	17,840	208,536	56,593	139,297	27,032
Unrealised gains	(23,877)	127,741	(133,086)	191,335	74,473	135,159
Total income	88,432	153,157	100,006	252,485	229,979	181,402
Costs	(6,434)	(17,888)	(7,620)	(3,751)	(7,019)	(7,019)
EPS (p)	40.0	66.3	47.9	138	126	99
NAV per share (£)	2.81	3.45	4.03	5.38	6.62	7.56
S/P disc. to NAV*	38%	22%	29%	22%	-37%	-41%
Investments (£m)	470	661	505	799	1,061	1,287
DPS (p)	4.5	4.5	4.5	4.5	4.5	4.5

**2018-22 year-end actual, 2023 forecast NAV on current s/p; Source: Hardman & Co Research*

Inv. banking & brokerage services



Source: Refinitiv

Market data

EPIC/TKR	**OCI**
Price (p)	**447.5**
12m high (p)	475
12m low (p)	355
Shares (m)	176.4
Mkt cap (£m)	789
NAV p/sh (Dec '22, p)	662p
Disc. to NAV	-32%
Country/Ccy	UK/GBP
Market	Main Market SFS

Description

Oakley Capital Investments (OCI) has generated market-beating returns from its concentrated, three-sector-focused portfolio of private equity (PE) investments via Oakley Capital (Oakley) PE funds. Oakley has a proven model for sourcing investments, and an excellent track record of identifying resilient value opportunities and delivering superior returns.

Company information

Chairman	Caroline Foulger
Ind. NED	R Lightowler, F Beck
NEDs	P Dubens, S Porter
Inv. Mgrs.	Oakley Capital
Contact	Steven Tredget

oci-investorrelations@oakleycapital.com

Key shareholders (Dec'22)

Peter Dubens/Directors	11.2%
Asset Value Investors	9.6%
Lombard Odier	6.9%
City of London IM, HL	6.0%
Hawksmoor	5.2%
Jon Wood & family	4.5%
Fidelity, II	7.8%

Diary

26 April	1Q'23 NAV update
10 May	Cap. Markets day
26 July	2Q'23 NAV update

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Shares in OCI are traded on the Specialist Fund Segment of the main market of the London Stock Exchange and are intended for institutional, professional, professionally advised and knowledgeable investors primarily seeking exposure to private mid-market UK and Western European businesses through investment in the Oakley Capital Private Equity Funds (or successor Funds) and: (a) who understand and are willing to assume the potential risks of capital loss associated with investments in such companies, (b) who understand the illiquid nature of private equity compared to other asset classes, (c) for whom an investment in OCI's shares would be of a long-term nature constituting part of a diversified portfolio, and (d) who understand, or who have been advised of, the potential risk from investing in companies admitted to the Specialist Fund Segment.

OCI is not subject to the UK City Code on Takeover and Mergers.

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2022 results summary

OCI announced, in its January trading statement, i) NAV per share of 662p and NAV of £1,167m, ii) a total NAV return per share of 24% (128p), iii) £271m in new investments (£239m in 2H), iv) a £244m share of sale proceeds, and v) year-end available finance of £210m, against £929m commitments (in excess of £200m of this is forecast not to be drawn, and the remainder is expected to be drawn over the next five years). Of the realised and unrealised portfolio value uplift in the year, 65% of the increase was driven by EBITDA growth, and 35% as a result of multiple expansion, driven primarily by exits.

With the results, we learnt that…

With the more detailed results announced, on 9 March 2023, we further learnt that:

…average portfolio company EBITDA growth was 22%…

- NAV growth was driven by earnings growth, with weighted average portfolio company YoY EBITDA growth of 22% (2021: 30%). This increase reflects the choice of sector, the tech-enabled business models, and the value added by the Oakley Capital team and entrepreneur network.

…average EV/EBITDA was up modestly, at 15.9x (PEG of 0.7x)…

- The weighted average portfolio company EV/EBITDA valuation was 15.9x (2021: 15.3x), giving an undemanding average PEG of 0.7x (2021: 0.5x).

… as before, EBITDA growth was a key driver to value creation…

- The portfolio value increase was 65%, driven by EBITDA growth, and 35% by multiple expansion, broadly consistent with prior periods.
- Across five exits, the average uplift to carrying value was ca.70%

…>75% of deals were uncontested…

- OCI's network introductions mean that more than 75% of deals are uncontested.

…digital delivery remains dominant…

….and debt/EBITDA has remained broadly stable

- Average net debt/EBITDA was 4.3x, a level that has been remarkably consistent over time (2021: 4.2x, 2020: 4.6x).
- The key company drivers of the NAV movement were, again, i) IU Group (+64p, after +38p in 1H'22) – with an increase in global student intake – now ca.100k, ii) Contabo (+26p) – sale of business agreed at ca.105% premium to book value, iii) Grupo Primavera (+21p, vs. +8p in 1H'22 – strategic combination of business with Cegid, and iv) foreign exchange (+29p, vs. +19p in 1H'22) – +5% change in EUR:GBP.
- OCI had £110m in cash at end-December 2022, equal to 9% of NAV. Additionally, it has agreed a £100m facility with major lenders to increase the company's flexibility and liquidity. This liquidity is against outstanding commitments of £929m, which may be drawn over the next five years.
- The outlook comment was "*The prevailing macroeconomic environment is likely to have an impact on portfolio company trading in 2023. However, resilient earnings growth, and demand for Oakley's attractive assets, are expected to continue driving NAV growth in the year ahead:*
    - *The portfolio of 26 European businesses continues to profit from long-term megatrends, including the shift to online solutions by businesses and consumers, and the growing, global demand for quality, accessible education.*
    - *The companies typically benefit from being both digitally disruptive and having recurring revenue streams. This results in predictable and stable cashflows that can grow by taking market share, rather than by relying on market growth.*

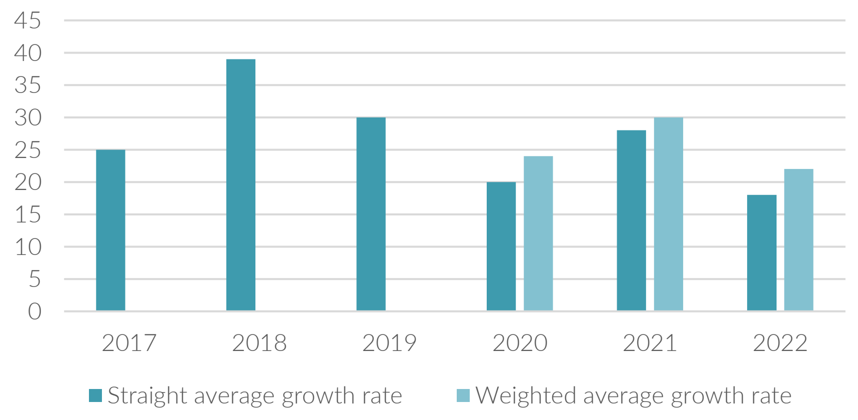
- *Continued liquidity and anticipated future exits, as a result of growing demand for investee companies, will enable OCI to take full advantage of the investment adviser's origination strategy and pipeline".*

Theme 1: value-added growth

EBITDA growth at underlying companies 22%

The chart below shows the EBITDA growth of OCI's investee companies over the past six years. The 22% weighted average growth in 2022 also came despite all the macroeconomic pressures, the noise around COVID-19 and a challenging comparative year. Investors should understand that the value added by Oakley includes operational support, which is likely to accelerate revenue and EBITDA. The timing of the sales of mature businesses (only once exits are completed, not just announced, does Oakley exclude them from EBITDA growth) and the acquisition of new ones (which generally have yet to fully benefit from the earnings enhancement) will affect growth numbers.

Underlying average EBITDA growth of OCI's investee companies, 2017-22 (%)



Source: OCI, Hardman & Co Research

How the growth is delivered

Understanding EBITDA growth in underlying companies core to understanding OCI

The core to understanding how OCI was able to deliver such a strong NAV return, even in uncertain times, lies in appreciating how its underlying businesses deliver their EBITDA growth. We believe the reasons include:

- Oakley Capital has focused on areas with structural growth prospects, such as business migration to cloud, the consumer shift online and the growing demand for quality, accessible learning. The market is continually evolving, and Oakley Capital continuously researches and taps new niche markets, such as business outsourcing and tech-enabled services – as demonstrated by its recent acquisition of Phenna Group.
- It has tech-enabled businesses, accessing superior growth with scalable models and downside resilience.
- Oakley Capital provides active operational, strategic and financial support to its investee companies. In particular, Oakley Capital adds value by improving the quality of earnings, digitalisation, leadership development (including assembling entire new management teams, as well as recruiting for critical roles, such as sales, marketing, technology and finance), marketing, and facilitating and executing buy-and-build strategies.
- Specifically on digitalisation, Oakley works with management teams to leverage digital tools and skills in order to meaningfully enhance the way in which a company does business, from migrating its services online to launching new e-

commerce channels. Improving the quality and predictability of earnings by shifting sales to a software as a service (SaaS) or recurring revenue model can have a meaningful impact on valuations. Today, over 70% of Oakley's current portfolio is digital/tech-enabled.

- OCI's entrepreneurial network, origination platform continues to grow, and its entrepreneurial ethos helps attract new deals. It is worth highlighting that each of its recent four platform deals — Vice Golf, Affinitas, Phenna Group and vLex — were led by business founders who chose to partner with Oakley, in part because of its entrepreneurial heritage.
- The inherent value created by Oakley Capital in its companies is then recognised by other (usually blue-chip, international, institutional investors) buyers who pay significant premiums above carrying values when Oakley Capital chooses to exit. These effects are about micro opportunities in specific companies, not the macro outlook, as well as tapping opportunities to invest behind enduring megatrends that are less affected by the economic cycle.

EBITDA growth main driver to NAV

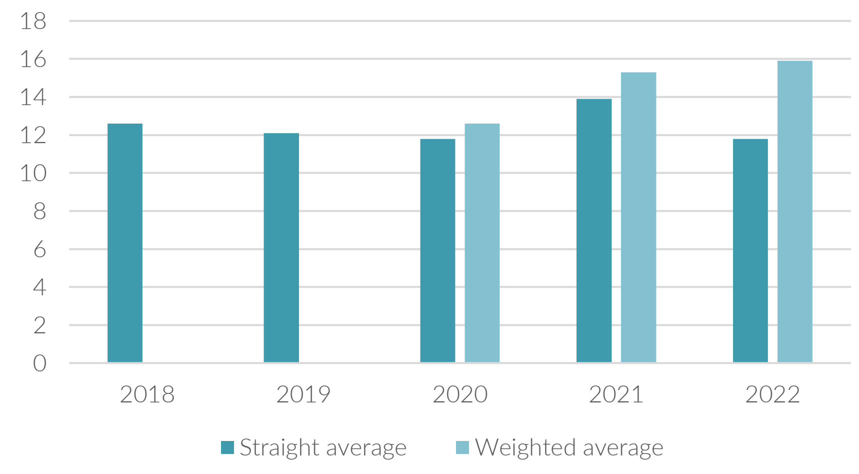
Key driver to value creation is EBITDA growth

In recent reporting periods, Oakley has consistently attributed the significant majority of the NAV uplift to earnings growth, rather than ratings increases. In 2022, this continued, with 65% (2021: 76%) of the NAV increase attributed to EBITDA growth. In 2022, uplifts on exit were the main driver to the multiple expansion – a feature seen in prior years.

Broadly stable ratings over time, and well below current market ratings for growth sectors in which Oakley invests

As noted, the overall weighted average 2022 EV/EBITDA was 15.9x (2021: 15.3x). As the chart below shows, there has been broad stability in the ratio, despite all the market volatility and noting the high-growth sectors in which OCI operates. The 15.9x multiple is somewhat above the current P/E ratios for the European markets as a whole (12.7x)[1], but it is in line with the MSCI World Index (15.9x) and well below the ratings given to the growth sectors in which Oakley invests (European tech average: 22x)[2].

EV/EBITDA, 2018-22 (x)



Note: To better reflect the increasingly diverse weighting of each investee company within the portfolio, OCI now reports metrics using a weighted average based on its look through fair value in the underlying investments. Source: OCI, Hardman & Co Research

[1] Source: Refinitiv
[2] Source: Refinitiv

PEG of 0.7x undemanding

PEG ratio consistently well below 1x

A PEG ratio (price earnings divided by growth) of 0.7x is undemanding. The portfolio investments of Oakley Funds – and so of OCI – have, for some time, been focused on businesses with a strong digital presence, and, as at December 2022, over 70% of revenues were digital/tech-enabled, despite new (less-modernised) businesses constantly being added to the portfolio. Oakley Capital has a track record of helping analogue businesses to digitise by launching ecommerce channels or using data analytics to support decision-making. Tech-enabled businesses not only have economies of scale but, typically, can access faster growth and new markets, and show considerable downside resilience, often having recurring, sticky revenues.

EBITDA growth main contributor to realised returns

EBITDA growth drove 48% of realised returns, vs. 15% for multiple expansion

In its presentation, OCI highlighted that the contribution that EBITDA growth makes is nearly half the realised return gains, followed by multiple expansion and bolt-on M&A (Oakley's 40 investee companies have, since inception, done over 130 deals). Gearing has contributed just 2%. OCI's strategy is not about buying poor companies at cheap multiples, but rather about buying good businesses with the potential to be improved further.

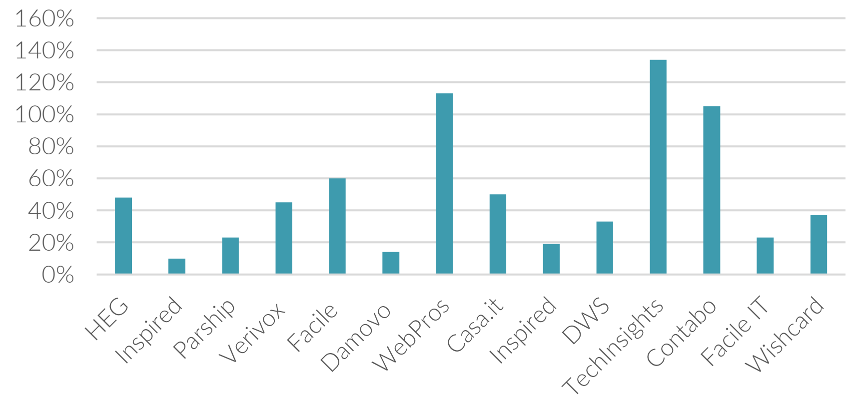
Theme 2: current NAV is real

Realisations above carrying value show others willing to pay more than book value

Buyers paying, on average, 54% more than that at which Oakley has valued its companies, implying conservative approach to valuation

With a concentrated portfolio, the uplift in any period is potentially distorted by the law of small numbers. Since formation, the average exit premium has averaged 54% above book. We show, in the chart below, the reported uplift for a number of companies to show the distribution of outcomes (both Contabo and FacileIT being 2022 events). The key message is that, when the assets are being converted into cash, there have been consistent uplifts to the book value.

Uplift to carrying value on exit, in chronological order (%)



Source: OCI, Hardman & Co Research

Limited uplift in ratings until exit is visible

There is therefore a strong J curve effect, with ratings uplifts being seen only as exits approach

Ratings not being moved significantly by market movements in intervening periods

At its 2022 Capital Markets day, OCI highlighted its approach to valuations, noting that, in the initial periods of ownership, the rating is held largely at the acquisition price. This is despite the considerable evidence that its acquisitions are at below-peer levels (2022 average entry multiple was 13.6x, vs. portfolio average of 15.9x). As value is added through Oakley ownership, there is a very limited uplift in ratings, and it is only as an exit approaches that any rating improvement is seen. On exit, there is then a significant valuation increase. The external empirical support that this is the approach being adopted can be seen in uplifts on exits, as noted above.

OCI in growth sectors, but not reflected in ratings

Present in markets with structural growth

Oakley is focused in just three sectors – technology, education and consumer – but, importantly, within these sectors, it targets subsectors and businesses that have structural growth opportunities. These are driven by socioeconomic trends across a range of factors, including:

- the accelerating shift to online for consumers;
- businesses migrating onto the cloud; and

- increasing global demand for quality education and learning (see our note, *Educating on education,* published on 9 February 2022).

However, this is not reflected in the ratings.

No incentive to inflate valuations

Performance fees paid on exit, not interim NAV – so no incentive to inflate

There is no financial incentive for Oakley to inflate the NAV, as performance fees are not paid on the NAV, but on the value generated on realisation. If interim valuations were over-inflated, the manager's reputation would be damaged by having to then write down on realisation.

Independent basis of valuations

Independent checks include deal ratings, rather than dependence on market price, independent auditors/board, prices paid by independent buyers on exit

The valuations have multiple layers of independent checks:

- Many of the investments do not have ready market peers, and, like many others in the PE space, Oakley Capital's ratings are driven by entry and peer deal valuations, rather than market multiples. This may create a sensitivity to deal activity, rather than the market rating – so, for example, the rating on IU Group was increased on the 2021 re-financings, as new investors bought into that group, rather than being driven by any change in market peers.
- For the year-end 2022, 11 companies (42% of the portfolio by value) saw third-party or corporate actions driving the multiple. After months of due diligence by other PE sponsors, a level of detail not available in public markets, they have been willing to pay a premium to carry values.
- This independence of the market is also overlaid by the usual independent checks of a listed vehicle, including the audit process with external auditors and the independent board. In recent years, OCI has taken considerable steps to reinforce the latter.
- A further independent check is the secondary market. OCI helps coordinate the sales of Oakley Funds, as general partners seek liquidity, and so it can see the price at which its funds are traded. It is currently a seller's markets (average discounts marketwide are 10-20% to NAV), but Oakley Funds' sales have been in the range of a 0-10% discount.
- For us, though, the ultimate independent check is what a third party will pay for an asset – so the uplift on exit is the ultimate independent check.

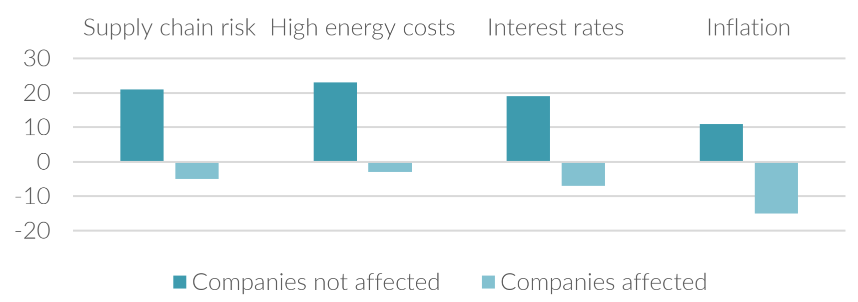
Theme 3: resilience of NAV

Near-term pressures

Inflation only risk likely to be adverse for OCI companies, but several could gain

In its results presentation, OCI detailed the number of companies exposed to the current economic environment. As can be seen in the chart below, the majority of companies are unaffected by most of the pressures, with inflation being the most significant factor. Even with inflation risk, OCI highlights that i) many of its investments offer low-cost options for its customers, helped by 70% delivering digitally, ii) it has price comparison companies in the portfolio that should gain market share, and iii) many of its companies have pricing power. EBITDA growth has already slowed from 2021 (noting that year's growth was helped by the ending of many pandemic lockdowns), and, in our view, slower growth should be expected. However, the differential over listed companies will remain, and, indeed, in downturn scenarios, the average outperformance gap may be expected to widen.

Number of OCI's investee companies affected by economic environment factors



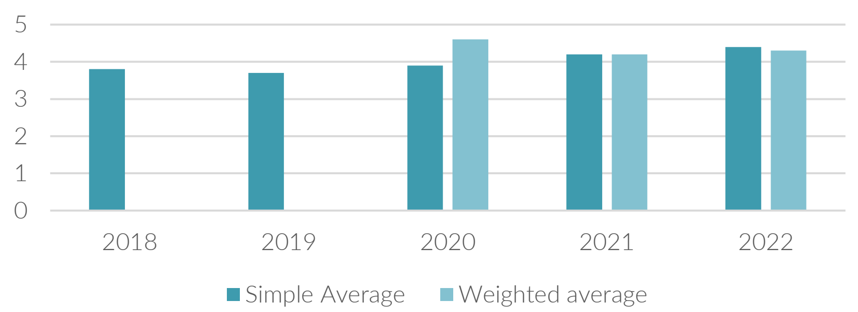
Source: OCI, Hardman & Co Research

Net debt/EBITDA stable

Net debt/EBITDA very stable over time

The chart below shows the average net debt/EBITDA for OCI's portfolio companies. We would characterise this as very stable over time, with the modest rise in 2022 reflecting bolt-on deals in that year and normal refinancing in a period when markets were anticipating rising interest rates. Oakley does not believe that there is any meaningful, fundamental trend in the debt metrics – a view with which we concur. Going into a downturn, this level of debt appears very manageable, and it is well below the PE average of 6-7x.

OCI's investee company average net debt/EBITDA, 2018-22 (x)



Source: OCI, Hardman & Co Research

Strong liquidity without over-commitment

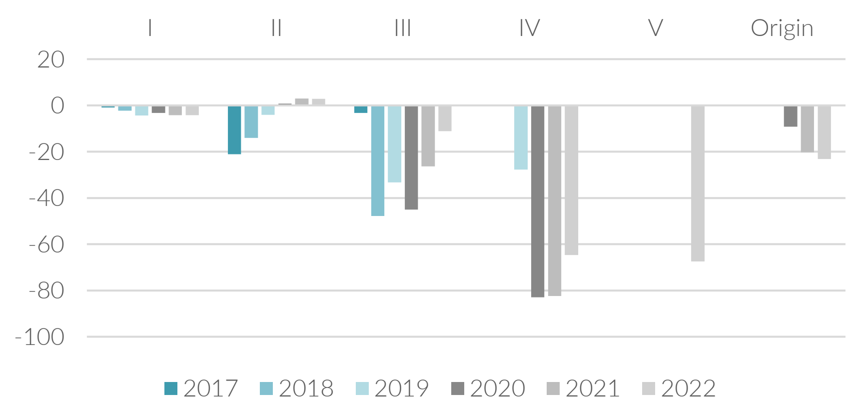
Commitments expected to be drawn over several years

Outstanding commitments at December 2022 were £929m, against £404m at end-2021, with the increase due primarily to the £608m outstanding commitment to new Fund V. Of the total amount, £200m is not expected to be drawn, with the balance expected to be drawn over the next five years. At the end of December, OCI had £110m of existing cash, and had an unused credit line of £100m (i.e. £210m of liquidity). With £550m of investments held for more than three years (at end-December) and which could be considered as being in the harvesting stage, realisations may be expected. Given the uplifts that have been recognised at exit, proceeds are likely to exceed the book value.

OCI's liquidity needs to include its share of debt at Oakley Funds

Oakley Funds has already drawn down on standing debt facilities to make investments, and, in due course, it will ask investors, including OCI, for capital in order to repay this debt. This is standard market practice, and is designed to smooth out so-called capital calls for investors. OCI discloses its share of other assets and liabilities in each Oakley fund. These now total a net liability of £168m, against £130m at end-2021. The other liabilities include £67.5m at Fund V and £64.7m at Fund IV, £23.2m at the Origin Fund (nil) and £11.1m in Fund III, reflecting their relative stage of development.

OCI's share of each Oakley Capital Funds' other assets and liabilities (£m)



Source: OCI, Hardman & Co Research

Fund debt is normal course of business, and reflects deployment of capital at optimal time

It gears returns for OCI shareholders, and will reduce perceived cash drag

When the Oakley Capital Fund makes the call on OCI, it will reduce both cash and outstanding commitments. From our perspective, the key points are as follows: i) historically, capital deployed immediately after a crisis has generated some of the best-performing PE cohorts, and so the deployment of funds made in 2020/21, as reflected by the higher fund gearing, was likely to be a good thing; ii) borrowing at the fund level increases the long-term returns for OCI's investors; iii) some borrowing is always likely to be present at the fund level; iv) Oakley Capital controls the calls from the funds, and it would be improbable that it would do anything to stretch OCI's financial position; and v) the cash at the OCI level will be perceived as a drag on performance until it is deployed (as Oakley Funds makes the calls on OCI, and so reduces cash levels, this perceived drag will reduce).

Portfolio

Broad balance across sectors at 1H'22

The details of the portfolio are given below. In considering movements, there a range of moving parts, including new investments (such as bolt-on deals), refinancing, partial disposals, currency moves, etc. We highlighted the key business drivers affecting OCI's overall NAV earlier (IU Group's global student intake). The consumer businesses, to varying degrees, have suffered from the economic outlook, most notably Windstar Medical. This also affected the listed Time Out.

The key message now is the broad balance between sectors. Oakley advises that the restructuring within North Sails may be expected within the next year, when a debt refinancing looks likely. As a listed entity, the issue for Time Out is that the market price needs to approach a level that Oakley considers reflects the value it ascribes to the business (which, not unsurprisingly, it does not disclose).

Key metrics for portfolio companies, as at December 2022 (£m)

Company	Dec'21 valn.	Jun'22 valn.	Dec'22 valn
Technology			
CEGID (combined with Grupo Primavera)	43.2	62.2	110.0
Phenna	0	0	72.7
WebPros	61.6	63.6	69.7
TechInsights	58.4	37.2	39.8
Contabo	13.7	60.1	34,5
Seedtag	8.7	10.9	9.7
Daisy Group	7.5	8.8	8.9
vLex	0	0	8.8
ECOMMERCE ONE	5.9	6.1	6.8
Total	**199**	**249**	**361**
Consumer			
Idealista	58.3	60.3	59.7
Facile	43.2	53.2	45.6
North Sails	35.5	41.8	34.0
Dexters	29.2	29.2	27.5
Iconic BrandCo	20.3	20.2	22.9
Windstar Medical	31.4	33.3	21.5
Time Out	33.1	28.0	21.2
Vice Golf	n/a	11.0	13.2
7NXT	9.7	10.8	8.9
atHome	7.9	8.3	8.6
Wishcard Technologies Grp	38.7	49.6	7.5
Total	**307**	**346**	**271**
Education			
IU Group	131.2	198.1	243.5
Schülerhilfe	46.1	53.0	58.9
Ocean Technologies	38.5	43.1	45.6
Bright Stars	27.0	33.8	36.8
ACE Education	9.5	11.0	13.8
Affinitas Education	n/a	8.3	11.2
Total	**252**	**347**	**410**
Direct			
Time Out Equity	39.4	33.4	25.3
Time Out Debt	0	0	5.2
North Sails direct debt	69.3	74.3	77.9
North Sails Apparel Direct debt	54.3	65.1	69.2
Total	**163**	**180**	**178**

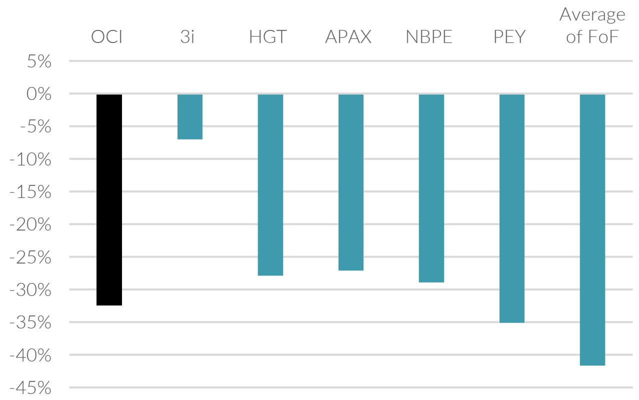
Source: OCI, Hardman and Co Research

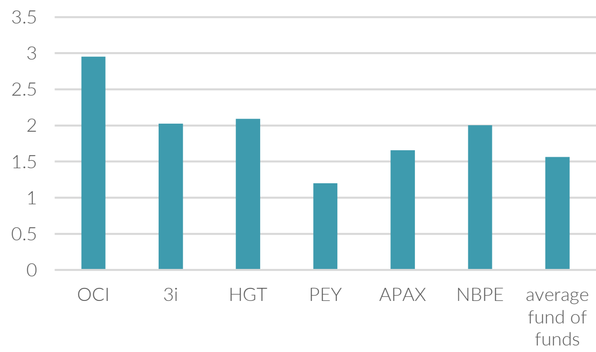
Valuation and financials

OCI's discount appears anomalous with its market- and peer-beating, long-term performance

The charts below show the premium/discount ratings of OCI's closest competitors, together with their five-year total share price returns. Despite having a better five-year return than 3i, OCI is trading at a 32% discount, while 3i is trading around NAV. There are, of course, differences in business models (although it may be argued that the five-year total return would reflect this). Taking an absolute rating perspective, it also appears anomalous that a company with a strong track record of growth and value-added should trade at any discount to NAV at all.

Discount to NAV and five-year total share return indexed to 100 for OCI and peers (%)





Source: LSE, Refinitiv, Hardman & Co Research; priced at 14 March 2023

Our estimates are unchanged.

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