# Strategic Equity Capital plc

Q4 Update 2018

# Risk considerations

***Risk Factors** for Strategic Equity Capital plc (the Company") – The general risk factors set out under the heading "D.1.Key Risks" of the Prospectus apply to the Company. In addition, potential investors should note the following factors:*

- There can be no guarantee that the investment objective of the Company will be achieved and neither capital nor income is guaranteed.
- You may not be able to sell your shares in the Company easily or you may have to sell at a price that significantly impacts on how much you get back.
- The share price may trade at a discount to the Net Asset Value of the Company.
- The amount that you have invested is not protected so in some unfavourable circumstances you could lose all of your investment.
- The Company may borrow money which can be used to make further investments (gearing). In a rising market, this "gearing" can magnify the gains or in a falling market, the losses on your investment.
- The Company invests in a smaller number of companies and sectors than the market, creating concentration risk.
- There is some liquidity risk, as a significant level of investment is made in companies too small for inclusion in the FTSE 250 Index. These are likely to have a low level of liquidity in some circumstances.
- The Company may invest in companies that are not listed or admitted to trading upon any recognised stock exchange. These investments can be riskier and may be illiquid and difficult to realise and more volatile than investments in larger, longer-established businesses.
- The performance of SEC will depend on the skill and expertise of the Investment Manager. The loss of key personnel could affect the performance of the Company.
- Stock market investments should be regarded as long term. The Company's strategy, and therefore level of risk, can change over time. Economic factors, such as interest rates, inflation and supply and demand can affect all investments. Tax rules can change and the value of any benefits will depend on personal circumstances.
- Charges and expenses are taken from capital and this increases the chances of the capital value falling

These are not all the risks of an investment in the Company. For a full list of the Company's risks, please see the Prospectus and Supplement to the Prospectus, in the section entitled "Risk Factors".

Investors should take advice from their own independent professional financial advisers before making an investment decision and are responsible for ascertaining any income tax or other tax consequences which may affect their acquisition of any investment.

You should remember that the value of investments and the income from them may go down as well as up and is not guaranteed, and investors may not get back the amount invested. Past performance cannot be relied on as a guide to future performance.

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**Risk considerations**:

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In addition, there is no guarantee that the market price of shares will fully reflect their underlying net asset value and it is not uncommon for the market price of such shares to trade at a substantial discount to their net asset value.

The unconstrained, long term philosophy and concentrated portfolios resulting from GVQIM's investment style can lead to periods of significant short term variances of performance relative to comparative indices. GVQIM believes that evaluating performance over rolling periods of no less than three years, as well as assessing risk taken to generate these returns, is most appropriate given the investment style and horizon. Properly executed, GVQIM believes that this investment style can generate attractive long term risk adjusted returns.

These are not all the risks of an investment in Strategic Equity Capital Plc shares ("Strategic Equity Capital" or "SEC"). Investors should take advice from their own independent, professional financial advisers before making an investment decision and are responsible for ascertaining any income tax or other tax consequences which may affect their acquisition of any investment.

Morningstar 10 Year Rating of ★★★★★ as at 31st December 2018
Money Observer: Rated Fund as at 31st December 2018

**Runner Up 2017 and 2016, Winner 2015, Highly Commended 2014:** Money Observer Trust Awards. Category: Best UK Equity Trust
**Highly Commended 2016, Winner 2015, Highly Commended 2014:** Moneywise Investment Trust Awards . Category: UK Smaller Companies
**Winner 2015 and 2014:** What Investment Trust Awards . Category: Best UK Investment Trust
**Winner 2015:** Investment Adviser 100 Club Awards . Category: UK Smaller Companies
**Winner 2015:** Grant Thornton Quoted Company Awards . Category: Fund Manager of the Year
**Winner 2014:** PLC Awards . Category: Fund Manager of the Year
**Winner 2014:** Investment Week, Investment Company of the Year Awards . Category: UK Smaller Companies
**Highly Commended 2012:** Money Observer Trust Awards . Category: Best UK Smaller Companies Trust
**Winner 2011:** Investment Trust Magazine. Category: Best Small Companies Trust

# Contents

# Q4 UPDATE 2018

# Executive summary

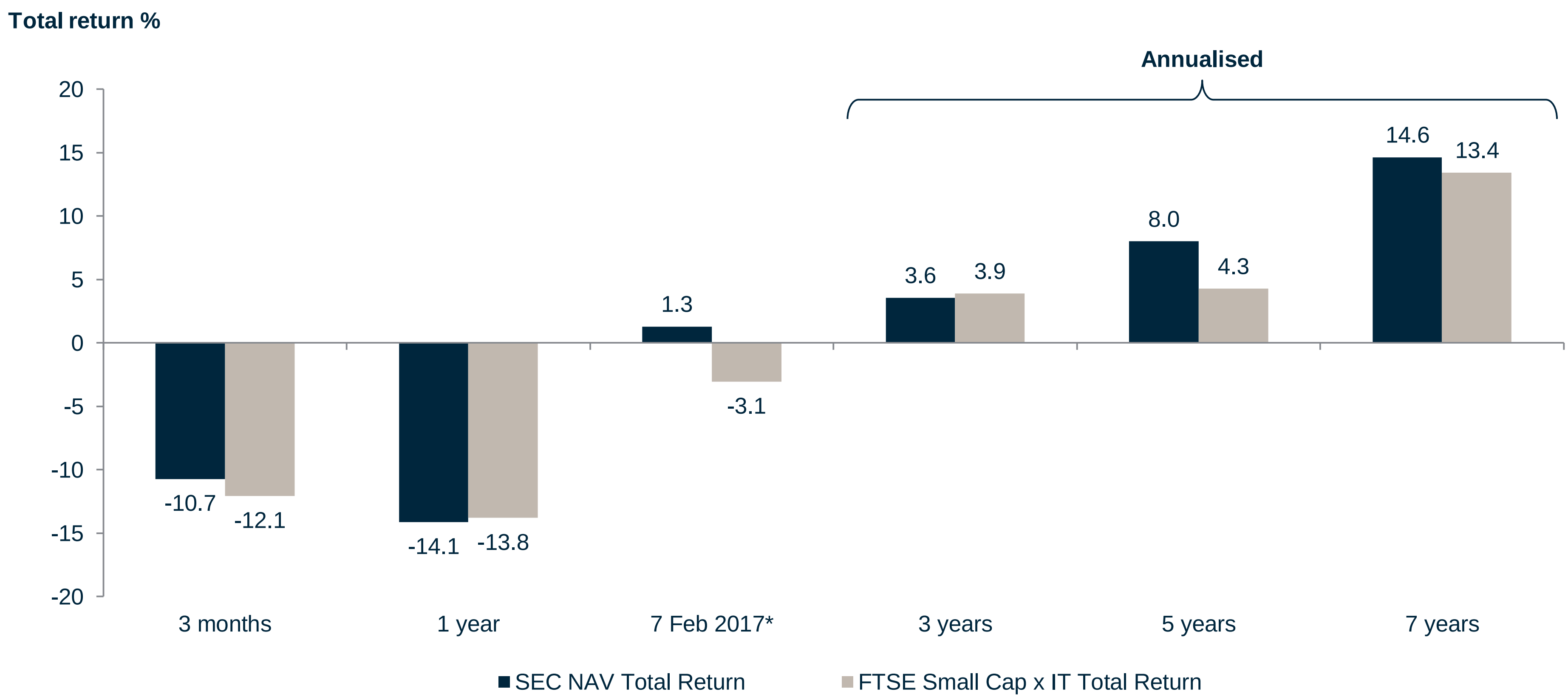
- Difficult quarter for global financial markets; net assets per share decreased by 10.7%. The FTSE Small Cap ex IT index (the "index"[1]) decreased by 12.1% and the FTSE AIM All Share index[1] decreased by 21.5%
- A confluence of global macro-economic concerns, alongside a lack of progress on the negotiation of the UK's withdrawal from the EU, were the backdrop to the weakest quarter for UK small caps in over seven years
- On a portfolio basis, there were encouraging operational and strategic developments (p9). We strongly believe these are not reflected in valuations. Despite all but one of the top ten holdings undergoing increases in their growth prospects, many have suffered indiscriminate de-ratings and are valued at multi-year lows (p11)
- Portfolio characteristics are very strong with broadly unchanged aggregate growth forecasts and financial strength. Portfolio de-rates to a GVQ cash yield of 11.4%, the highest (cheapest) since mid 2013
- It is possible that, over the near term, markets remain difficult owing to a continuation of themes from last year. However, with permanent capital and a portfolio of high quality, largely acyclical companies, with high international exposure, strong balance sheet positions[2] and with many at multi-year valuation lows, our outlook is decisively positive
- Managers bought shares during the quarter

**Sound operational progress of portfolio companies, however, widespread de-rating of UK equity markets impacted portfolio NAV. This creates a strong valuation opportunity**

As at 31st December 2018
1. On a total return basis 2. Portfolio companies, constituting 55% of the NAV of the invested portfolio, are forecast to have net cash balance sheets over the next twelve months
Source: GVQIM, PATAC, FactSet
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Fund performance

## SEC NAV performance against comparator index[1]




| Average Net Cash | 6.8% | 7.5% | 8.4% | 9.9% | 10.0% | 9.4% |
|---|---|---|---|---|---|---|

**Weak quarter for global markets. For reference, the Aim index declined 21.5%², reflecting a sell-off in 'momentum' stocks, which have performed strongly over recent years. Consistent process of the Trust over all time periods**

As at 31st December 2018. Source: Unaudited Bloomberg, PATAC, GVQIM. Notes: 1. Comparator index FTSE Small Cap ex Investment Trusts Total Return 2. On a total return basis
* Management change
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Q4 Attribution analysis

| Positive attribution (top five) | bps | GVQIM Comment |
|---|---|---|
| Proactis | 64 | Full year results with encouraging customer wins and high (86%) level of recurring revenue. Approach for European peer Basware at a premium valuation to Proactis |
| Ergomed | 17 | No significant news. Board changes with Head of Clinical Development stepping down and a new Non-Executive Director with a strong digital transformation background. Both in line with group strategy |
| Vintage | 7 | In distribution |
| Alliance Pharma | 4 | Launch of Xonvea for nausea in pregnancy in the UK |
| Oxford Metrics | 0 | Strong full year results with notable progress in Vicon. Company well positioned in a growing motion capture and measurement market niche. Special dividend announced |
| **Negative attribution (bottom five)** | **bps** | **GVQIM Comment** |
| Tribal | -114 | No significant news |
| Brooks Macdonald | -118 | Solid organic growth in the quarter to September. Continuing focus on operational efficiencies. Shares de-rate materially to the lowest valuation since its IPO in 2006 against a broader macro backdrop and concerns over growth outlook |
| Medica | -134 | No significant news |
| Equiniti | -213 | November trading statement with further upgrades to the upgraded interim results. Impressive client gains in the UK and initial wins post the completion of EQ US. Despite ongoing operational progress, shares de-rate on what we believe is a misperception of the business |
| Tyman | -231 | In line Q3 trading statement and CEO succession. Shares de-rate to a seven-year low valuation (PE of 7x) on concerns over the growth outlook in North America |

**Portfolio holdings caught up in the wider market de-rating despite no specific news or generally positive news. In many cases to multi-year low valuations**

As at 31st December 2018
Source: Attribution estimates based on FactSet Portfolio Analysis and GVQIM
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Significant quarterly news items

| Company | Recent News | Comment |
|---|---|---|
| **Proactis** | In line full year results, 86% of annualised revenue is recurring<br><br>European peer Basware receives 'conditional takeover offer'. Rumoured valuation of EV/Sales of 4.5x[1] | The approach for Basware is a further example of consolidation in the e-procurement industry<br><br>The rumoured valuation is a c.60%[2] premium to Proactis' rating, despite the target having a lower proportion of cloud based revenues and not generating meaningful profit or cash. We believe Proactis is a highly attractive strategic asset |
| **Equiniti** | November trading update saw a further increase to full year results expectations, following the upgrade at the July interim results | We believe the company is fundamentally mis-valued by the public market. The company is continuing to take share in the UK, improve margins through 'self-help' measures and has a multi-year opportunity to grow into the North American market |
| **4imprint** | November trading update with Board expecting results at the upper end of market forecasts. Full year forecasts are c.14%[3] higher than at the start of 2018 | 4imprint has been a holding since 2003. Following meetings with management and ongoing diligence, we have used weakness in the share price at points in 2017 and 2018 to add to our holding. We believe the company provides solid growth in operating cash flow, alongside a very high ROCE and prodigious cash generation |
| **IFG** | New management announced 3 year targets focusing on 'developing and optimising two strong and self-reliant businesses which will enhance [its] strategic optionality' | We remain highly engaged with the company as we believe the group consists of two high quality assets in structural growth areas with significant margin improvement potential<br>Improved IR through better London broker coverage and a primary listing in London could also improve the rating |
| **Oxford Metrics** | Positive full year results, particularly in Vicon. Remains on track to reach long term profit targets | Oxford Metrics has strong IP particularly around motion measurement and location based virtual reality (LBVR). This is becoming more widely adopted across entertainment, sports and life sciences. We believe the IP is extremely valuable |

Source: 1, 3 Bloomberg. 2. On an EV/Sales valuation metric

# Changes to top 10 holdings

GVQ INVESTMENT MANAGEMENT

### Top 10 Q3 2018

| Company | % of portfolio |
|---|---|
| Equiniti Group | 12.1 |
| Tribal Group | 8.4 |
| 4imprint Group | 8.1 |
| IFG Group | 8.1 |
| Tyman Group | 6.9 |
| EMIS Group | 6.7 |
| Wilmington | 6.4 |
| Medica | 6.1 |
| Clinigen Group | 5.5 |
| Proactis | 4.6 |

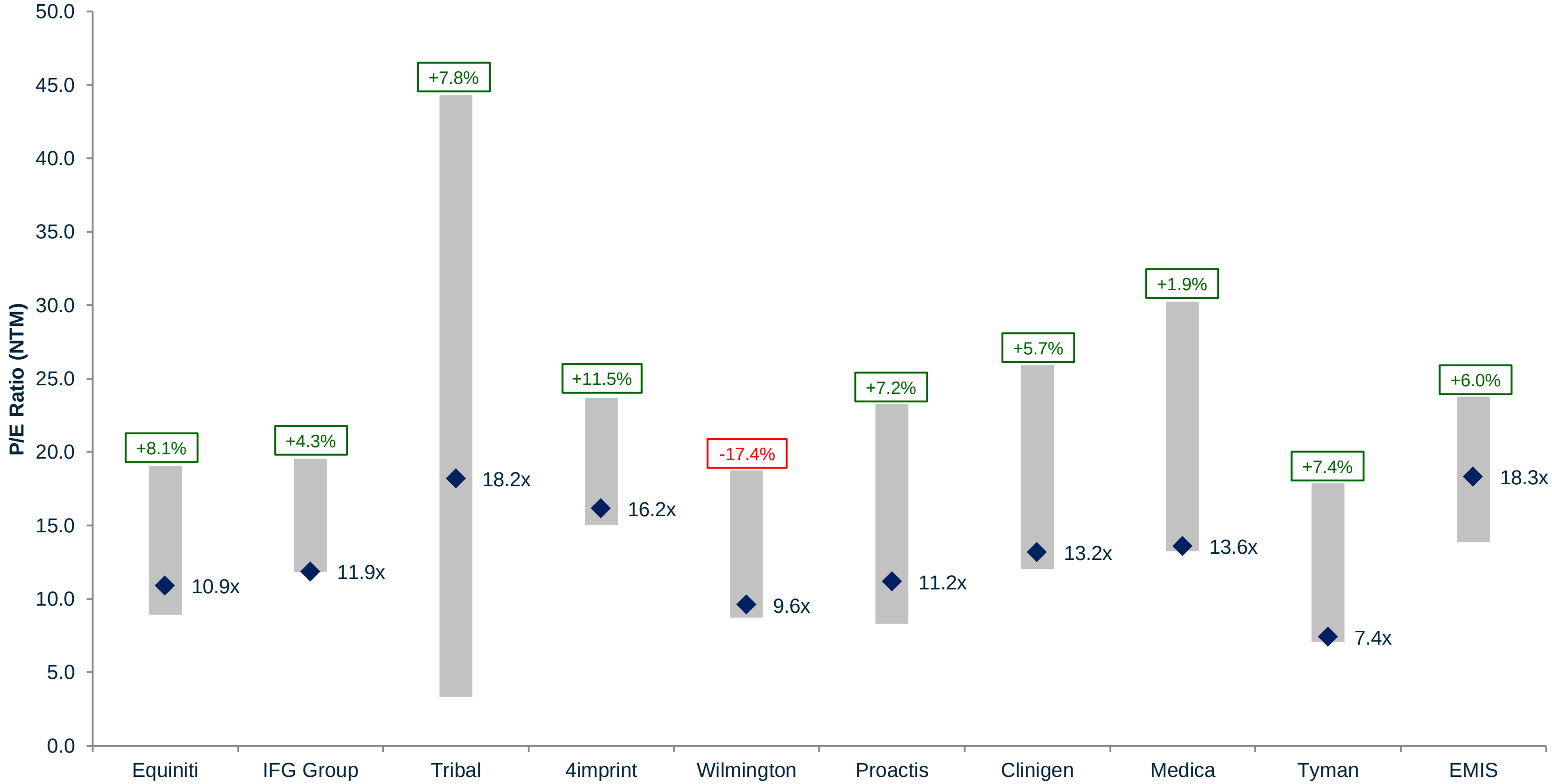
### Top 10 Q4 2018

| Company | % of portfolio |
|---|---|
| Equiniti Group | 12.1 |
| IFG Group | 8.8 |
| Tribal Group | 8.2 |
| 4imprint Group | 8.0 |
| Wilmington | 7.1 |
| Proactis | 5.9 |
| Clinigen Group | 5.7 |
| Medica | 5.4 |
| Tyman Group | 5.3 |
| EMIS Group | 5.1 |

**Capital deployed into existing holdings which suffered, in our view, indiscriminate de-ratings, plus two smaller, more recent investments. Funded through cash balance and partial realisations of holdings where ratings were less affected**

As at 31st December 2018
Source: PATAC, GVQIM
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Portfolio company progress and valuations provide confidence




The grey bars indicate the 5 year valuation range
The diamonds indicate the closing PE/Ratio (NTM) as at 31/12/2018
The figure in the box is the 6 month revision in forecast earnings for the following year. +ve indicates upgrades

**In the main, despite operational and strategic progress reflected in positive revisions to forecasts, portfolio holdings suffered from indiscriminate de-ratings and are valued at multi-year lows. As such, our outlook for the portfolio is positive**

As at 31st December 2018
Source: Factset, Liberum

# Top 10 holdings[1]

| Company | Sector | GVQIM Funds % of company | GVQIM CF yield[2] NTM[3] | Net debt/ EBITDA NTM[3] | Investment thesis |
|---|---|---|---|---|---|
| Equiniti Group | Support Services | >5% | 10.4% | 2.2x | Growth through demonstrable cross-sell and margin improvement through automation and offshoring and integration of WFSS acquisition; de-geaing; M&A |
| IFG Group | Financials | >5% | 15.8% | -1.9x | Structural growth; self-help in James Hay; M&A; strategic review; new mgmt team |
| Tribal Group | Technology | >5% | 9.4% | -1.5x | Delivery of operational improvements; new platform development; contract wins; M&A |
| 4imprint Group | Support Services | >3% | 8.3% | -0.4x | Continued US growth; new marketing strategy broadening addressable market; enhanced cash returns |
| Wilmington | Media | >5% | 13.1% | 1.4x | Organic growth and improved execution post-investments; de-gearing; M&A; New Chairman and CFO; portfolio review |
| Proactis | Technology | >5% | 10.8% | 1.1x | Organic growth and integration; M&A; cashflow |
| Clinigen Group | Healthcare | c.3% | 9.9% | 0.9x | Organic growth; degearing; development of technology platform and international presence |
| Medica | Technology | >5% | 10.3% | -0.4x | Organic growth; cashflow; expansion of offering; internationalisation |
| Tyman | Industrials | c.5% | 15.6% | 1.6x | Integration of acquisitions; self-help through automation and footprint rationalisation; de-gearing |
| EMIS Group | Technology | c.3% | 8.7% | -0.5x | Organic growth; operational restructuring; new CEO; balance sheet; M&A |

As at 31st December 2018. Source: GVQIM analysis and PATAC

Notes: 1. Top 10 holdings representing c.72% of NAV. 2. GVQIM cashflow yield: (12m forward Cash EBITDA minus maintenance capex)/(market capitalisation plus 12m forward net debt). 3. NTM: Next Twelve Months; negative number indicates net cash

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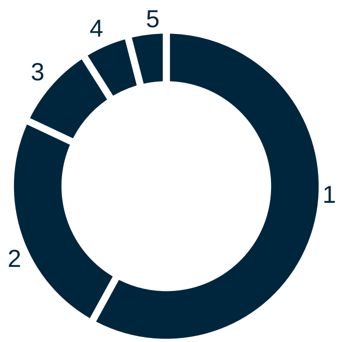
# International exposure of the portfolio




| End market sales | | | Portfolio Companies |
|---|---|---|---|
| 1 | UK | 58% | Equiniti, IFG Group, Tribal, EMIS, Medica, Harworth |
| 2 | North America | 24% | 4imprint, Tyman, Clinigen, Proactis |
| 3 | Europe | 9% | Clinigen, Proactis, Ergomed |
| 4 | Asia | 5% | Alliance Pharma, Oxford Metrics, Tribal |
| 5 | RoW | 4% | Tyman |

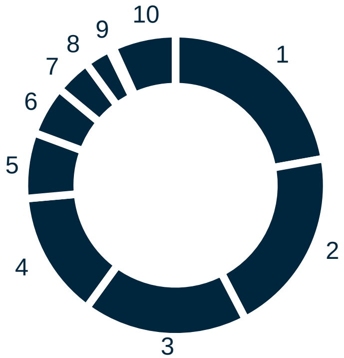
- A significant number of portfolio companies have greater international than domestic sales (e.g. 4imprint, Tyman, Clinigen, Proactis, Ergomed)
- Where portfolio companies have end market sales in the UK, these are not in 'consumer discretionary' sectors. There are no companies in the banking, housebuilding, retail or consumer discretionary industries
- UK exposure is largely in companies with long term, client-embedded, repeatable and often non-discretionary services (e.g. Equiniti, EMIS, Tribal, Medica)
- In addition, UK based companies have limited trading activities (imports and exports) and generally have international bases
- Exposure to Continental Europe is at its lowest level in recent history[1]

**Over 40% of portfolio company sales are international. Where companies are UK focused, these are not in consumer discretionary sectors, rather have less macro-exposed repeatable revenues based on long term established and embedded customer relationships**

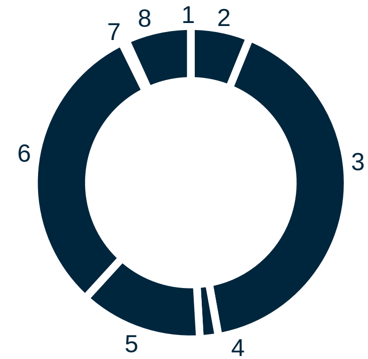
As at 31st December 2018
Source: Factset, company accounts, GVQIM
Notes. 1. In over 5 years

# Highly concentrated and unconstrained portfolio

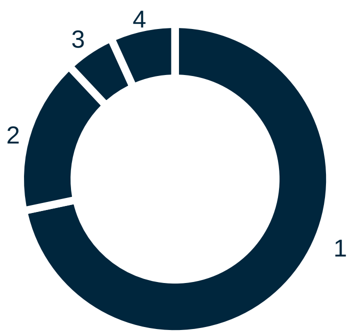
GVQ INVESTMENT MANAGEMENT



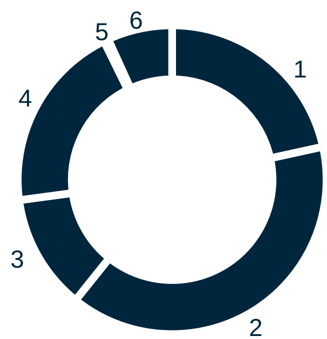

| Sector exposure by value | | |
|---|---|---|
| 1 | Technology – software & services | 22.2% |
| 2 | Support services | 20.1% |
| 3 | Healthcare | 17.7% |
| 4 | Financials | 13.6% |
| 5 | Media | 7.1% |
| 6 | Industrials | 5.3% |
| 7 | Property | 3.9% |
| 8 | Electronics | 2.8% |
| 9 | Unlisted | 0.5% |
| 10 | Net cash | 6.8% |




| Value by market cap band | | |
|---|---|---|
| 1 | <£50m | 0.0% |
| 2 | £50m - £100m | 6.1% |
| 3 | £100m - £200m | 41.0% |
| 4 | £200m - £300m | 1.9% |
| 5 | £300m - £500m | 12.7% |
| 6 | > £500m | 31.0% |
| 7 | Unlisted | 0.5% |
| 8 | Net cash | 6.8% |




| Concentration | | |
|---|---|---|
| 1 | Top 10 | 71.7% |
| 2 | Rank 11 - 15 | 16.3% |
| 3 | Smaller holdings | 5.2% |
| 4 | Net cash | 6.8% |




| Value by index membership | | | No. Holdings |
|---|---|---|---|
| 1 | FTSE Small Cap | 21.6% | 4 |
| 2 | Aim | 39.2% | 9 |
| 3 | FTSE 250 | 12.1% | 1 |
| 4 | Other[1] | 19.8% | 3 |
| 5 | Unlisted | 0.5% | 1 |
| 6 | Net cash | 6.8% | |

**A highly concentrated portfolio with <u>focus on smaller companies</u>. Believe this part of the market remains under-researched, accentuated by MiFID II, with good opportunities for active managers**

As at 31st December 2018
Source: GVQIM
Note: 1. "Other": UK listed companies which are not eligible for inclusion in indices either due to liquidity or dual listed with only standard list on the LSE, with market cap. of £150-£350m
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Portfolio valuation[1]

| | SEC weighted average | SEC median | FTSE UK Small Cap ex investment trusts |
|---|---|---|---|
| Number of securities | 16 | 16 | 159 |
| Market cap (£m) | 366 | 156 | 318 |
| Consensus EV/EBITDA FY1 | 9.5x | 8.1x | 6.2x |
| Consensus price earnings FY1 | 11.4x | 11.9x | 9.4x |
| Consensus FY1 earnings growth | 12.5% | 12.9% | 2.4% |
| Consensus dividend yield FY1 | 2.8% | 2.4% | 3.9% |
| Price/sales FY1 | 1.5x | 1.5x | 0.5x |
| Price/cash flow | 17.9x | 17.2x | 10.0x |
| GVQIM cash flow yield FY1[2] | 11.4% | 10.4% | - |
| Net Debt/EBITDA | -0.0x | -0.5x | 1.9x |
| Overseas sales as % | 45.4% | 49.3% | - |

**GVQ cash yield at highest level since July 2013 provides scope for significant potential re-rating. Traditional PE valuation incongruous with forecast growth profile**

As at 31st December 2018
Source: FactSet portfolio analysis, Bloomberg, FTSE Russell
Notes: 1. Harworth Estates & Vintage excluded from analysis. 2. GVQIM cash flow yield: (12m forward Cash EBITDA minus maintenance capex)/(market capitalisation plus 12m forward net debt)
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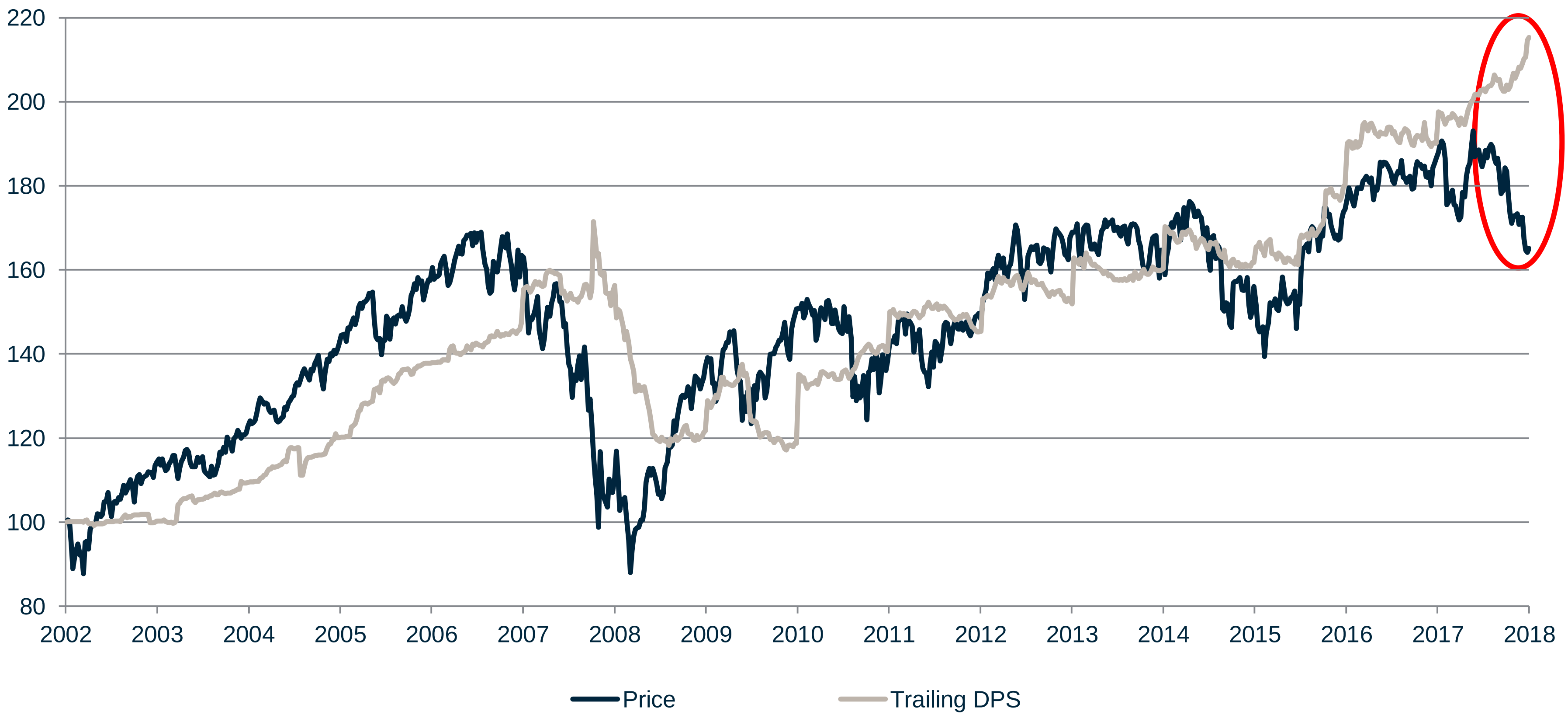
# Outlook

# Extreme bearishness around UK equities

## Price and trailing DPS of UK MSCI index over time




**Highly negative view of UK equities reflected in >£12bn of net outflows from UK funds since June 2016 and widespread 'underweight' allocation. Multi-year valuation opportunity or another 2008/9 economic crisis?**

Source: Bloomberg data, as at 31st December 2018. MSCI UK Index and dividends rebased to 100; Investment Association

# Bear market checklist

| | Start of Proper Bear Markets Mar-00 | Oct-07 | Now |
|---|---|---|---|
| **Global Equity Valuations** | | | |
| Trailing PE | 33 | 17 | 17 |
| Fwd PE | 24 | 14 | 14 |
| DY | 1.3 | 2.1 | 2.6 |
| CAPE | 48 | 30 | 23 |
| Global Equity Risk Premium | 1.0% | 3.3% | 3.3% |
| **US Yield Curve (10Y minus 2Y)** | -0.5 | 0.0 | 0.2 |
| **Sentiment** | | | |
| Global Analyst Bullishness (std dev) | 1.7 | 1.0 | 1.1 |
| US Panic Euphoria Model | 1.09 | 0.42 | -0.01 |
| Global Equity Fund Flows (3y as % of Mkt cap)[1] | 2.9% | 0.7% | 0.4% |
| **Corporate Behaviour** | | | |
| Global Capex Growth (YoY) | 8% (1999) | 11% (2007) | 8% (2018e)[2] |
| M&A (Previous 6m as % of Mkt cap) | 6.1% | 4.2% | 5.5%[2] |
| IPOs (Previous 12m as % of DM Mkt cap) | 0.70% | 0.40% | 0.2% |
| **Profitability** | | | |
| Global RoE | 12.2% | 16.1% | 12.8% |
| Global EPS ($, % from previous peak) | 35% | 117% | 9% |
| **Balance sheets / credit markets** | | | |
| Asset/Equity (US Financials) | 16x | 16x | 10x |
| Net Debt/EBITDA (US ex Fins) | 1.8x | 1.4x | 1.6x |
| US HY Bond Spread | 600bp | 600bp | 436bp |
| US IG Bond Spread | 175bp | 175bp | 140bp |
| **# of sell signals** | 17.5/18 | 13/18 | 3/18 to 5/18 |

Red = worrying, Amber = perhaps, White = not worrying

**Updated bear market checklist with only 3 out of 18 sell signals continues to support buying the dips**

As at 4th January 2019

Source: Citi Research

Note: 1. Consensus. 2. Whilst these indicators are at levels seen before previous bear markets, Citi requires a prolonged and sustained uptick before flagging them as warning signals

Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Market outlook and portfolio position

GVQ INVESTMENT MANAGEMENT

*GVQ commentary from Q3 2018 Update*

| Macro | Valuations | M&A | Debt/monetary tightening |
|---|---|---|---|

**Market**

| Macro | Valuations | M&A | Debt/monetary tightening |
|---|---|---|---|
| Significant uncertainty remains in the UK and global geopolitical system e.g. Russia, Syria, trade wars etc. | Pockets of small cap are trading at peak multiples often at a premium to precedent transactions | Number of UK inbound M&A transactions increased from 106 in Q118 to 182 in Q218<br>Preqin estimates over $1trn in Private Equity 'dry powder' at the end of Q3 2018 | Increasing inflationary expectations. Start of interest rate tightening cycle. |

**Portfolio position**

| Macro | Valuations | M&A | Debt/monetary tightening |
|---|---|---|---|
| Avoid 'macro' exposed sectors (e.g. housebuilders, consumer discretionary, resource companies) | Seek to avoid companies on peak multiples, above real world transactions<br>Cash flow based valuation metrics prioritised<br>Continued valuation discipline, both on entry and exit of portfolio positions | Process focuses on relevant trade and private equity transaction multiples<br>History of significant M&A in the portfolio (e.g. e2v, Servelec)<br>Portfolio consists of strategic and covetable assets with undervalued cash flow | Portfolio company balance sheets are very strong (>50% net cash[1])<br>Certain holdings (EQN, IFG) will be beneficiaries of increasing interest rates |

**Q4 Update**

| Macro | Valuations | M&A | Debt/monetary tightening |
|---|---|---|---|
| *Domestic cyclicals sold off in Q4. Whilst value exists, we will continue to be highly selective and avoid challenged sectors and low quality business models* | *Many highly rated growth / momentum stocks suffered sharp falls; the AIM market was off 22%! Even after this correction, many are still priced at 20x PE or higher…* | *Macro and market uncertainty led to lower M&A volumes over the quarter. Potential for opportunistic bids to emerge in 2019?* | *Widespread expectations for US and European monetary tightening have been tempered. Portfolio unlikely to be significantly impacted either way* |

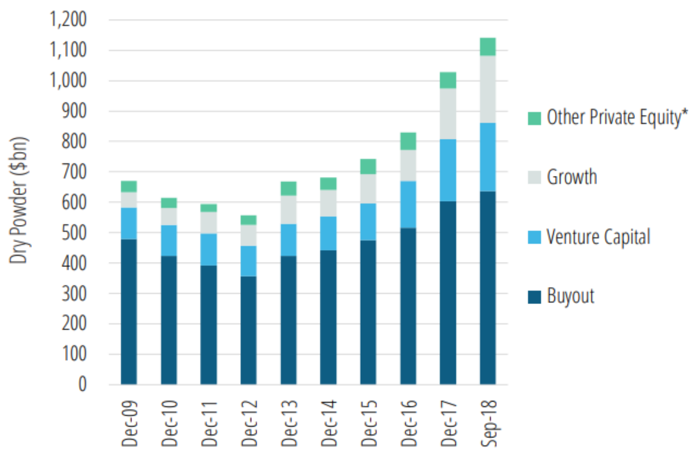
Source: GVQIM, Preqin, ONS

1. Portfolio companies, constituting 55% of the NAV of the invested portfolio, are forecast to have net cash balance sheets over the next twelve months

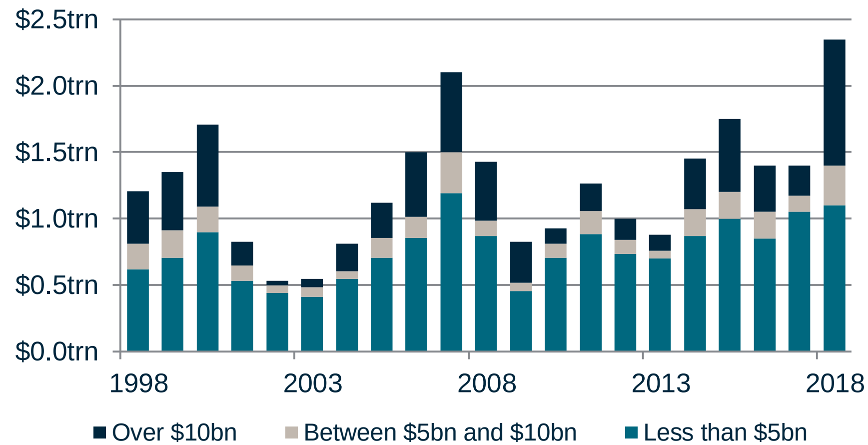
# Global private equity dry powder levels at record highs

GVQ INVESTMENT MANAGEMENT

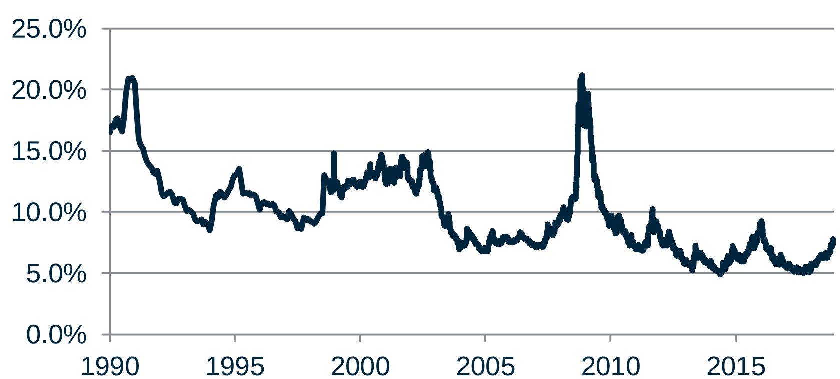
### Private Equity Dry Powder by Fund Type, 2009 - 2018



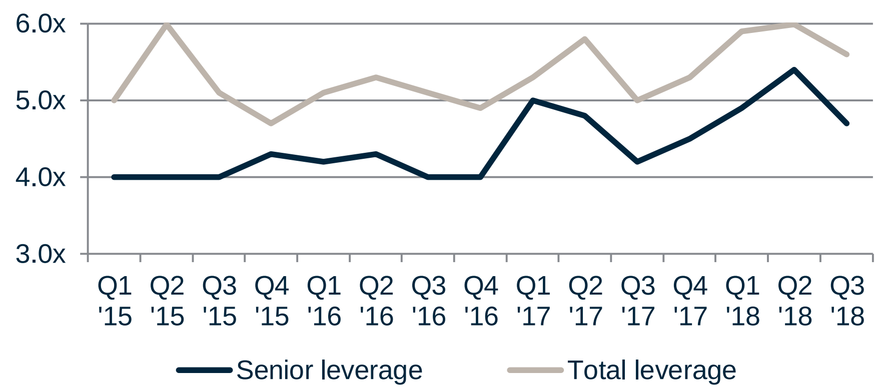

### Worldwide M&A volumes in H1, 1998 - 2018




### HY bond yields over time (Bloomberg global high yield bond index)




### Net debt / EBITDA of mid-market M&A deals




**The level of private equity dry powder (capital that has been raised, but not yet deployed) has continued to climb; global dealmaking hit an all-time record in H1 2018 at $2.5tn eclipsing the previous high set in H1 2007; the cost of debt remains both generationally low, and widely available**

Source: Preqin Private Equity Online, William Blair, Bloomberg, Thomson Reuters

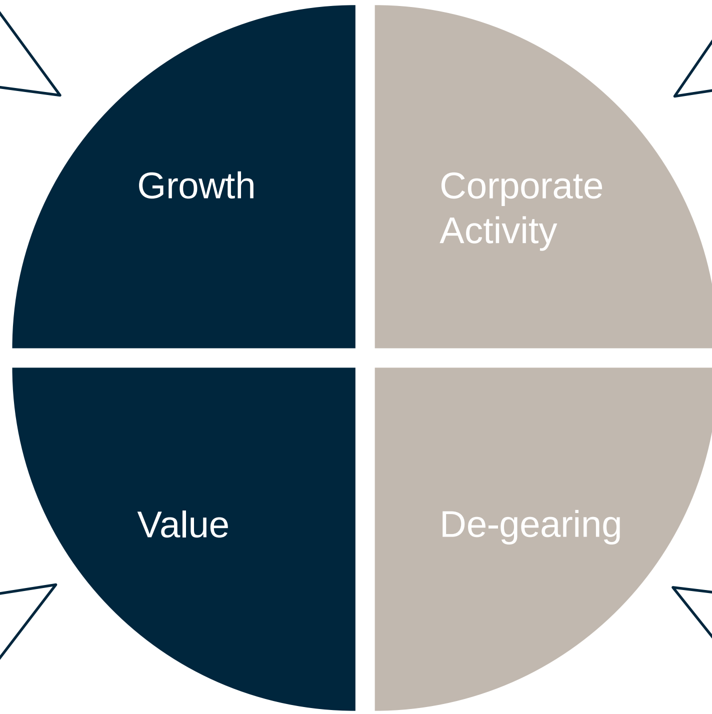
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Earnings growth, cashflow and M&A to drive returns

## SEC portfolio

- Double digit aggregate earnings growth for the portfolio
- Portfolio growth exceeds the market, despite portfolio's much lower financial gearing

- Private Equity 'dry powder' at record levels. Any resolution to UK uncertainty could see acquirers return
- Debt at generationally cheap levels
- Greater mispricing in small cap on reduced liquidity creates opportunity for long term opportunistic buyers




- SEC portfolio valuation is at attractive level; weighted average GVQ cash yield of 11.4%
- Portfolio valuation further supported by sum-of-the-parts analysis

- Portfolio de-gearing continues at mid single digits p.a.
- Balance sheet strength provides scope for enhanced returns
- Additional 2.8% dividend yield

**We continue to target double digit annualised returns from the portfolio over the medium term**

As at 31st December 2018
Source: GVQIM, Preqin

Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Conclusion

# Conclusion

- Challenging market conditions throughout the quarter as concerns regarding the health of the global economy and political uncertainty, both domestic and international, weighed heavily on markets. The FTSE Small Cap ex IT index[1] decreased by 12.1% and the FTSE AIM All Share index[1] decreased by 21.5%

- The portfolio was well positioned, in our view, heading into the quarter with a focus on attractively valued quality companies[2] with resilient earnings streams, multi-year structural growth drivers and exposure to international markets. Despite this, broad, arguably indiscriminate, de-rating across the market drove a decline in the Trust's NAV of 10.7%

- We remain cautiously optimistic
  - Cautious with respect to the global and domestic geopolitical and macroeconomic backdrop, which is likely to continue to be reflected in subdued and volatile market conditions
  - Optimistic with respect to portfolio holdings, many of which are trading at or near 5 year valuation lows and continue to make operational, strategic and financial progress. To illustrate this point, 9 of the Trust's top 10 holdings experienced positive earnings revisions over H2. Despite this the Portfolio now trades on a GVQ cash yield of 11.4%, the highest (cheapest) since mid 2013

- Permanent capital structure, net cash balance and in-house research capability enables the Trust to deploy capital opportunistically in quality companies that have been disproportionately de-rated to trade at a discount to intrinsic long term value. We will continue to be highly selective

- Reflecting this optimism, managers bought shares during the quarter

**We are cautiously optimistic; holdings continue to make fundamental progress that is not reflected in multi-year low valuations. Continued market uncertainty will likely present further opportunities to deploy capital**

As at 31st December 2018
1. On a total return basis 2. In the opinion of GVQIM
Source: GVQIM, PATAC, FactSet
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Appendix

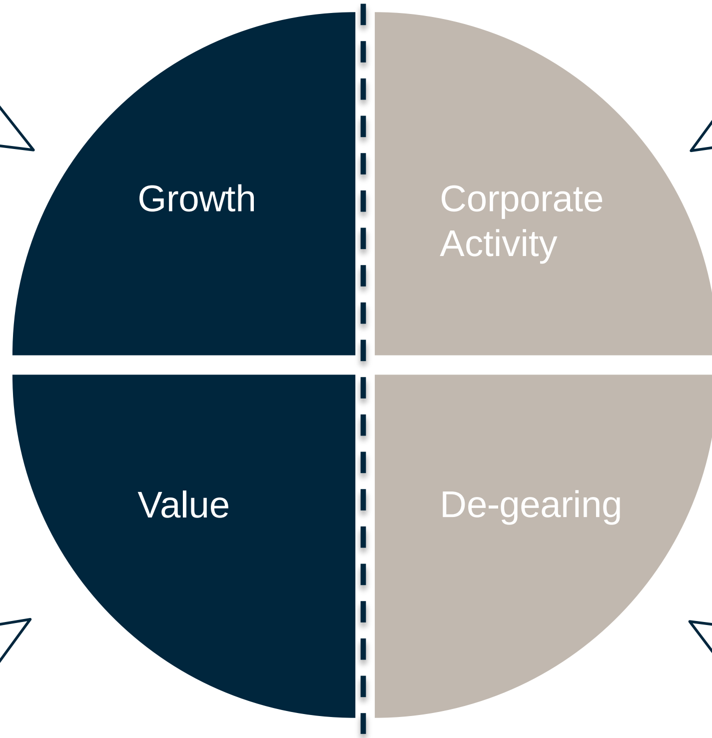
# How we identify value in potential investments

Main focus of most
**PUBLIC EQUITY INVESTORS**

Main focus of most
**PRIVATE EQUITY INVESTORS**

All investments undergo in-house, **prospective cash-flow and historic modelling**

Focus on growth in operating cash flow




All investments are valued using an in house **leveraged buy-out model**

Focus on recent relevant trade and private equity transaction multiples

All investments are valued using an in-house **re-rating model**

Focus on GVQ cash yield*

* Enterprise value to operating cash less maintenance capital expenditure

All investments are valued using an in-house **de-gearing model**

Focus on transfer of value from debt to equity holders over investment period

**We focus on four key drivers of shareholder value creation to maximise the chance of success**

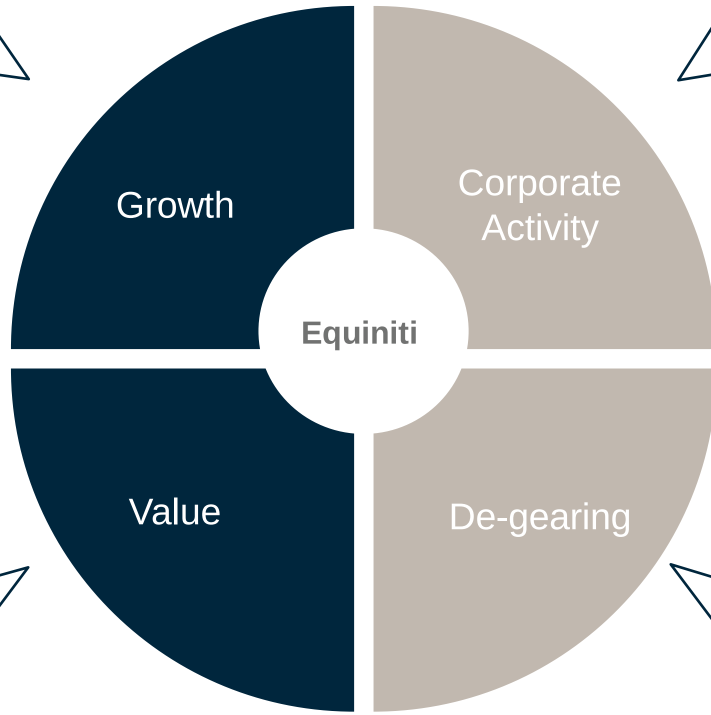
Source: GVQIM

# Equiniti – a reminder of the thesis

## Equiniti – a market leading specialist technology and business process outsourcer

- Customers include 70% of FTSE 100 companies and 70% of newly listed companies
- Opportunity to sell increasing suite of services into core customer base. Target mid-single digit organic growth p.a., consistent with recent history
- Integration of WFSS business and ongoing off-shoring of cost base provides further underpin to forecast double digit annual EPS growth before increase in base rates

- High value on the strength of cash flows and structural growth drivers to both PE and trade:
- Permira acquired Tricor for **15x EV/EBITDA** in October 2016,
- Link acquired CAS for **13x EV/EBITDA** in June 2017,
- Computershare acquired Equitex for **19x EV/EBITDA** in May 2018
- Equiniti trades on 8.2x EV/EBITDA[1]
- 'Bolt-on' M&A continues to provide growth opportunities into 'sticky' customer base




- Trades at discount to lower growth support services peers
- High single digit GVQ cash yield and below market PE (13.5x) for a stable highly cash generative business
- Acquisition of WFSS provides entry to world's largest capital market
- Implied impact of re-rating of low single digits p.a.

- Well invested business with low ongoing capex requirements
- Forecast to de-gear by c.0.5x of EBITDA p.a. representing c.6% of market capitalisation
- Forecast dividend yield of c.2.5% giving total prospective cash return of c.8.5% p.a.

**Equiniti is a high quality unique asset offering a rare combination of growth with cash flow in a stable industry and is trading at a discount to the market, peers and recent take-outs of comparable businesses**

Source: GVQIM
1. As at 31st December 2018

# Portfolio investment themes

### DIVERSIFIED PHARMA

Demographic and population changes increase need for treatments

Access to medicines. 80% of the world's population has limited or no access to right medicines

Diversified portfolios of pharmaceutical brands. Not dependent on binary outcomes

**Clinigen**
**Alliance Pharma**
**Ergomed**

### DIGITAL HEALTH

Digital maturity agenda; replacement of legacy IT systems with modern care management systems

Converged care agenda; integrated health journey to encourage a joined up approach to case management

Remote healthcare to address shortage of clinicians and improve patient care; 'Telemedicine'

**EMIS**
**Medica**

### REGULATION AND COMPLIANCE

Increasing compliance and regulatory burden

Need for information and reliable, auditable and cost effective technology driven solutions; 'RegTech'

Examples include MiFID II, financial crime and KYC

**Equiniti**
**Wilmington**
**Ergomed**

### PENSIONS AND SAVINGS

Increase in complexity and need to 'self-manage' investments and seek advice

Ageing populations with increased longevity of investments

**IFG**
**Brooks Macdonald**

### INFRASTRUCTURE AND BUILDING

US single family housing activity remains behind long term levels. 2.5 new homes per thousand inhabitants compared to c.60 year average of 4 new homes

Increasing demand for well-connected industrial and logistics space and regeneration of brownfield sites for housing development in the UK

**Tyman**
**Harworth**

**We target companies with strong positions in markets supported by long term structural growth**

Source: GVQIM, Clinigen, Liberum

Past performance is no guarantee of future performance and the value of investments can go down as well as up

# MiFID II could exacerbate a number of well documented issues in small cap markets

## Impact of MiFID II on Small Caps

- Decreasing resources (and therefore effectiveness) on the 'sell-side' for small caps. Limited traditional 'broking' of stocks
- Decrease in the dissemination of sell side research. Certain brokers no longer provide estimates to 3rd party compliers of consensus

- Heightened volatility on low volumes, and often in response to low level (or no) news flow. Prices potentially driven by retail investors?
- Pricing anomalies can take a long time to correct
- Price discovery is difficult; 'true' prices are opaque. Often little or no volume available at the price on the screen
- Greater vulnerability to opportunistic acquirers?

## Implications for SEC and Portfolio

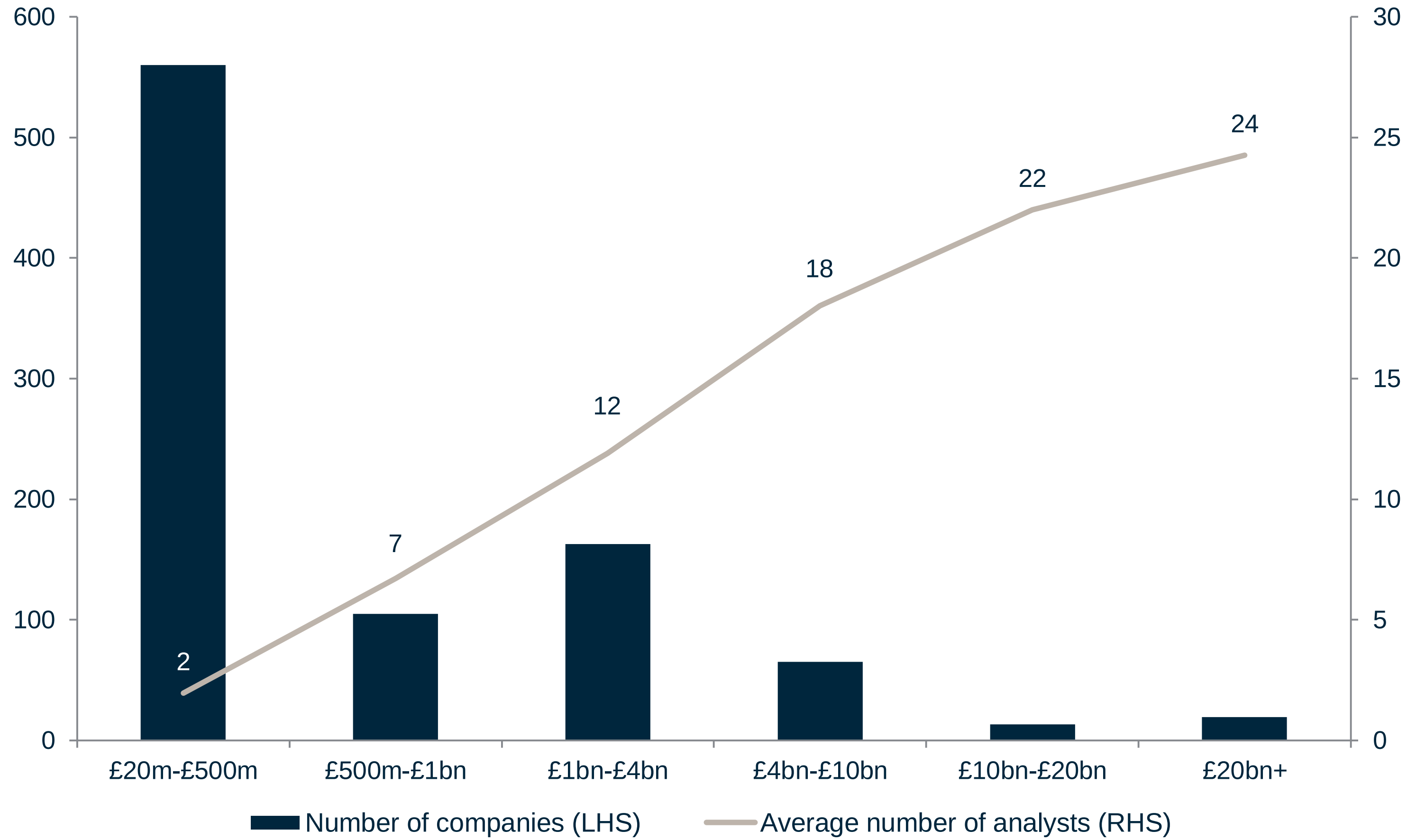
- For portfolio companies: Increasing importance of proper investor relations, corporate broking, market guidance and focus of the Board on shareholder value creation
- Our engagement approach: Proactive engagement with portfolio companies is essential
  - Chair / Board engagement or personnel change, e.g. **WIL**, **IFG**, **MGP**
  - Engagement with management to maximise financial and operating efficiency, e.g. **EMIS**, **WIL, IFG, PHD**
  - IR / broking / analyst introductions, e.g. **MGP**, **IFG**
  - Interactions with other shareholders to build consensus, and increase knowledge of the company, e.g. **EMIS**, **WIL, IFG, TYMN**
  - Sharing best IR practices, e.g. **IFG**, **MGP**, **WIL, PHD**
- Research implications: High value of GVQ proprietary research platform including primary research (e.g. customer / industry references, product demos, site visits), 6 member research committee and access to Industry Advisory Panel
- Investment opportunities: Permanent capital, cash balance and in-house research capability enables SEC to deploy capital opportunistically in quality companies that trade at a discount to intrinsic long term value

**We remain focused on the long term, fundamental, 'real world' valuation of businesses. We continue to invest on this basis, and are engaging proactively to ensure the potential of portfolio holdings is realised**

Source: GVQIM

Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Covering sell-side analysts by Market Capitalisation




**There are a large number of smaller companies with limited sell-side analyst research. We expect this to worsen as coverage becomes less economic post the changes resulting from MiFID II**

As at 31st March 2018
Data relates to the FTSE All Share ex-Investment Trusts
Source: Liberum
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# There are strict criteria for inclusion in our funds


**GVQIM's research process aims to identify high quality coveted assets with attractive cash flows**

Source: GVQIM
Note: 1. Growth at a reasonable price

Past performance is no guarantee of future performance and the value of investments can go down as well as up

# How we identify coveted assets

## We look for characteristics which GVQIM believes potential acquirers value highly

| Qualitative | Quantitative |
|---|---|
| • Niche market leaders<br>• Orderly end markets, with some growth<br>• Sustainable business model/franchise/uniqueness<br>• Overseas earnings<br>• Able to pass on price increases<br>• Intellectual property<br>• Operational know-how<br>• High barriers to entry | • High and/or improving ROCE<br>• Strong cash conversion<br>• Limited capex or working capital investment needed to finance growth<br>• Recurring revenues/profits/cashflows<br>• Ideally achieving, or has potential to achieve double digit operating profit margin<br>• Realisable surplus tangible fixed assets and/or working capital |

**We believe coveted assets retain value even in tough times, and are more likely to be acquired**

Source: GVQIM

# Our Black List screens out companies with fundamental business risks

## Operational

- Excessive reliance on a single product, customer, supplier or distributor
- The primary driver of profitability cannot be influenced by management (e.g. resources)
- Inherently low margins
- Structurally declining markets

## Financial

- Poor accounting systems or controls
- Weak cash flows – especially when reported profits look good!
- Excessive gearing

## Governance

- Controlling shareholder with misaligned interests
- Below average/deteriorating governance practices
- Stakeholders unwilling to engage constructively

**We have learnt what to avoid from previous experiences**

Source: GVQIM

# Research Committee ensures consistency of approach

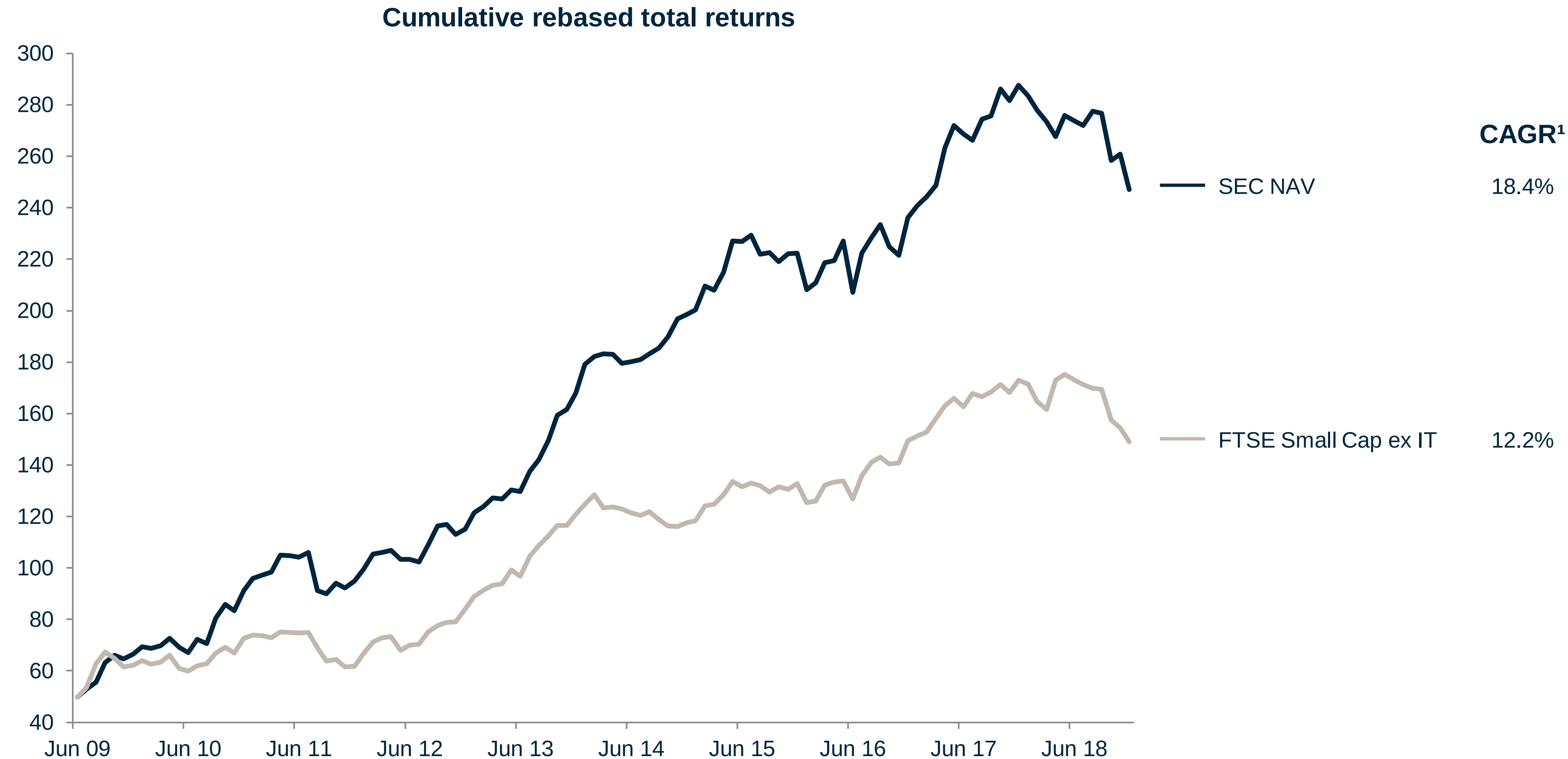
| | Idea generation | Investment Memorandum | Preliminary Investment Recommendation | Final Investment Recommendation | Monitoring & review |
|---|---|---|---|---|---|
| **Materials** | • Watch list<br>• M&A transactions<br>• Cash flow screen<br>• Yield screen<br>• Four drivers screen<br>• LBO screen<br>• Directors dealing | • Company description<br>• Investment thesis<br>• Cash flow model<br>• LBO model | • Company meeting<br>• Management analysis<br>• Stakeholder analysis<br>• Qualitative financial analysis<br>• Feasibility | • Counterparty analysis<br>• Due diligence verification<br>• Bespoke research<br>• Forensic accounting<br>• Management referencing | • Progress against original investment thesis<br>• Proposed changes to target price<br>• Changes to consensus estimates |
| **Debate** | • Are we focusing on the right stocks/sectors?<br>• What is happening in trade and private equity? | • Is there are credible case for investment?<br>• Does the company meet our basic criteria? | • Peer group review<br>• Work together to identify key due diligence questions and investment risks | • Have we properly answered all of the key questions? | • Automatic review against thesis every 12 months or earlier as required |
| **Output** | • New idea | • Initial Target Price | • Due diligence questions | • Final Target Price | • Watch list |

**Industrial Advisory Panel involvement**

**Multi-stage research process; fully documented and scrutinised using a variety of methods and people**

Source: GVQIM

# Long term track record




**Strong cumulative performance since process improvements in June 2009. No use of gearing or derivatives**

As at 31st December 2018
Source: Bloomberg, PATAC
Notes: Data rebased to SEC start NAV June 2009 1. CAGR: Compound Annual Growth Rate
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Performance

GVQ INVESTMENT MANAGEMENT

**Calendar Year annual performance**

| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|---|
| Share Price Total Return | -17.6% | 20.2% | -9.0% | 14.2% | 32.7% | 61.5% | 25.6% |
| NAV Total Return | -14.1% | 21.7% | 6.3% | 12.1% | 18.1% | 46.1% | 21.3% |
| FTSE Small Cap ex Investment Trusts Total Return | -13.8% | 15.6% | 12.5% | 13.0% | -2.7% | 43.9% | 36.3% |

**Established track record of successfully employing private equity techniques in the quoted market**

As at 31st December 2018
Source: GVQIM, PATAC, Bloomberg, Trustnet
Note: 1. Preliminary estimates based on Trustnet & Morningstar data
Past performance is no guarantee of future performance and the value of investments can go down as well as up

# Contact details

For further information regarding the SEC please contact the GVQ Investment Management marketing team below, or visit the Company's website: www.strategicequitycapital.com

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