



STRATEGIC EQUITY CAPITAL PLC

Q4 Update 2016



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FE Crown Rating : 4 crown rating issued July 2016

Morningstar Rating™ for 3 and 5 Years: 5 star rating first issued October 2013

Money Observer: Rated Fund as at 31st March 2016

Runner Up 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

Q4 update 2016

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Q4 UPDATE 2016

Q4 2016 Executive summary

- Net assets per share increased by 1.2%¹ over the period, with net cash averaging 15.2% over Q4
- FTSE Smaller Companies ex Investment Trusts Index increased by 4.6% in Q4 2016. We estimate that the IA UK Smaller Companies sector increased by 4.2%¹
- Lack of exposure to resources stocks has contributed to the NAV lagging broader markets over the last year
- Net cash balance decreased from 17.0% to end the period at 11.2%
- Recommended bid for longstanding portfolio company E2V at a 48% premium from US trade peer Teledyne. Completion expected mid March 2017
- Forecast portfolio earnings growth continues to exceed the FTSE Smaller Companies Index, despite much lower financial gearing of the portfolio. Portfolio also less geared than equivalent AIM companies¹
- Portfolio rating has reduced both Year on Year and Quarter on Quarter. Rating even lower ex E2V and Tribal (former subject to agreed bid; latter on recovery multiple)
- We believe that there is significant earnings “self-help” within the portfolio, as well as companies which are trading on considerable discounts to precedent M&A multiples

Share price & discount

- Average discount of c.10.8%¹ over the quarter, ending the period at c.11.4%

As at 31st December 2016

Source: 1. Bloomberg; Capita; Factset; iii; Trustnet & GVQIM

Note: IA = Investment Association – UK Smaller Company OEICs

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

Q4 2016 Highlights

Investment highlights¹:

- Net assets per share increased by 1.2%, compared with the 4.6% rise in the FTSE Smaller Companies (ex investment trusts) index
- 11.2% net cash at the end of December reflects top up investments made in November and early December. >5% points of cash deployed
- Portfolio forward earnings growth marginally increased from 12.7% to 13.0% over the quarter. Portfolio p/e rating has reduced by 0.8x to 16.4x
- Takeover of E2V provides clean exit at a reasonable price. Excellent long term investment, which we have been highly engaged with. Cash will arrive in late March 2017
- Portfolio companies generally trading well. News flow limited but typically positive

Unaudited financial highlights¹:

- Net assets of 225.1p per share²
- Average discount in Q4 2016 was 10.8% compared to a discount of 7.5% in Q3 2016³

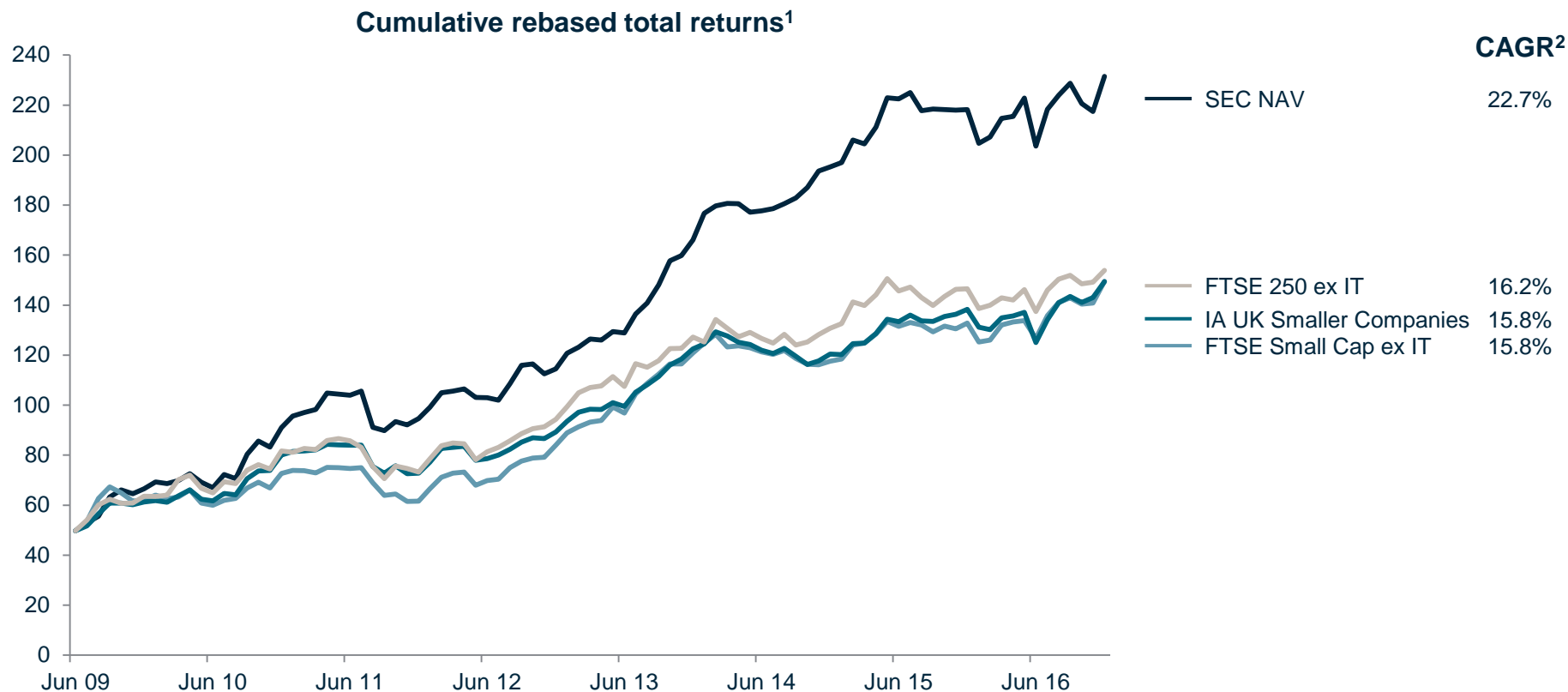
Net investment of c.5% points over the quarter in existing holdings. E2V takeover provides capital for 2017

As at 31st December 2016

Source: 1. Bloomberg, Capita, GVQIM. 2. NAV unaudited. 3. Bloomberg

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

Long term track record



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

As at 31st December 2016

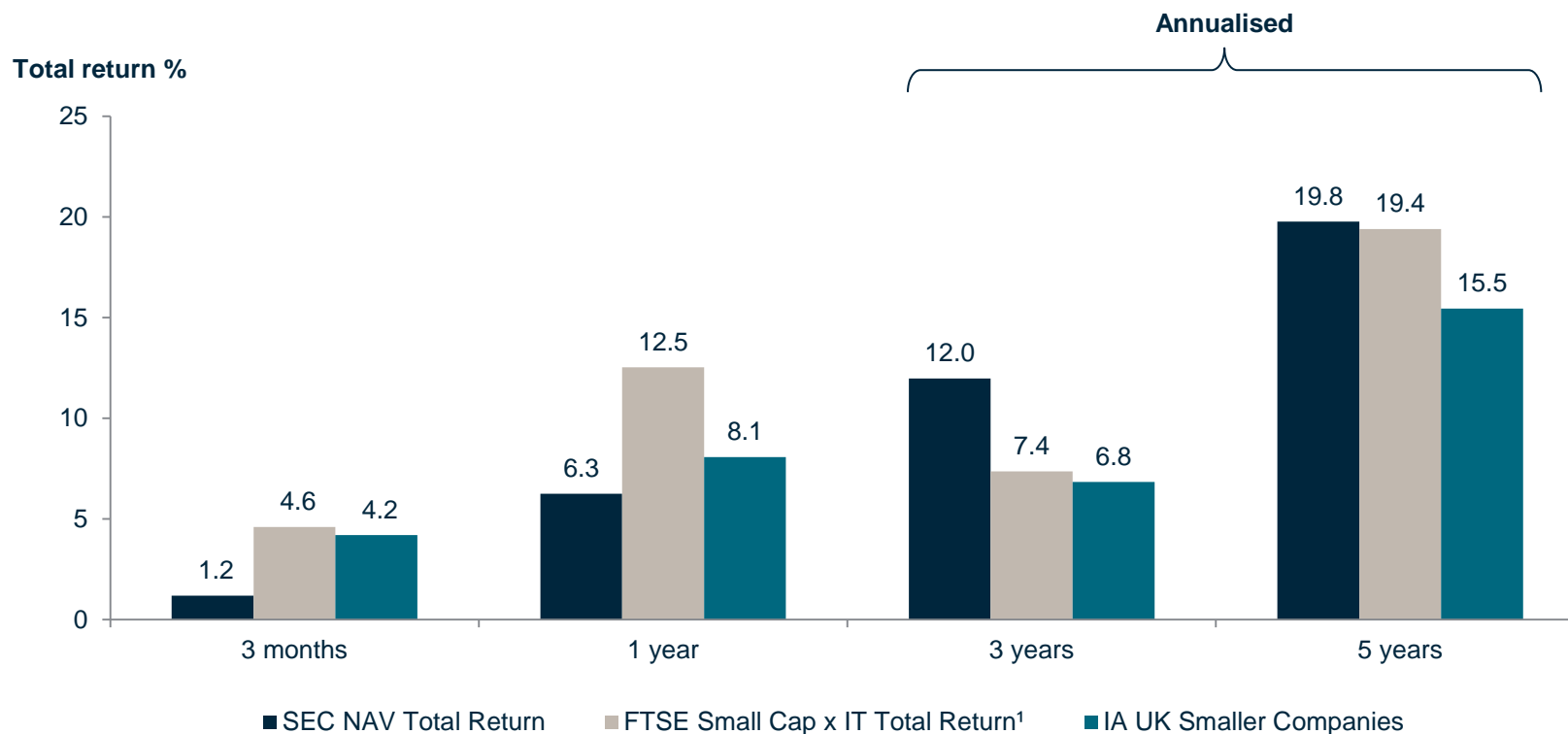
Source: IA; Bloomberg; Capita; iiii data

Note: 1. FTSE Small Cap, FTSE 250 and IA data rebased to SEC start NAV June 2009. 2. 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

Medium and long term outperformance

SEC NAV performance against comparator index¹ & IA Sector²



Average Net Cash	15.2%	12.7%	11.1%	9.8%
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Strong medium and long term annualised absolute and relative performance

As at 31st December 2016

Source: Unaudited Bloomberg; Capita; IA; GVQIM

Note: 1. Comparator index FTSE Small Cap ex Investment Trusts Total Return. 2. IA data aggregates performance of some 53 smaller company open ended funds
Past performance is no guarantee of future performance and the value of investments can go down as well as up

2016 small cap market returns were narrow

- Significant index impact from the resource sectors, and for the FTSE Small Cap ex Investment Trusts Index (“SMXX”), Melrose PLC
- The resource sectors do not fit our investment criteria – and we have never invested in these sector
- Following a very poor 2015 for the shares of mid cap resource companies, a number were
 - demoted from the FTSE250 to become very large weights in the SMXX from early 2016
 - included for the first time in the broader small cap index – the Numis Smaller Companies Index (“NSCI”)
- Extremely strong rebounds in the share prices of some of these companies had a disproportionate impact on the returns of the smaller companies indices. e.g.
 - SMXX – of the c.10.6%¹ capital return for the year (total return 12.5%), Mining and Oil & Gas sectors combined contributed more than 5.7% points – 54% of the total index return from sectors which began 2016 as c.10% weights³ in the SMXX index
 - NSCI - of the 11.1%² total index return in 2016, Mining and Industrial Metals & Mining delivered 4.2% points and 1.8% points, and total returns of 145% and 237% respectively. All other sectors delivered a return of 5.1% points of the 11.1% total return (46%), and began the year compromising 3.6% of the NSCI index by value
- In addition, Melrose, as a single stock, generated a very significant proportion of the 2016 SMXX annual return (c.2% points of the total SMXX annual return of 12.5%) over the three months it was a member of the SMXX index due to unusual circumstances

Q4 performance attribution

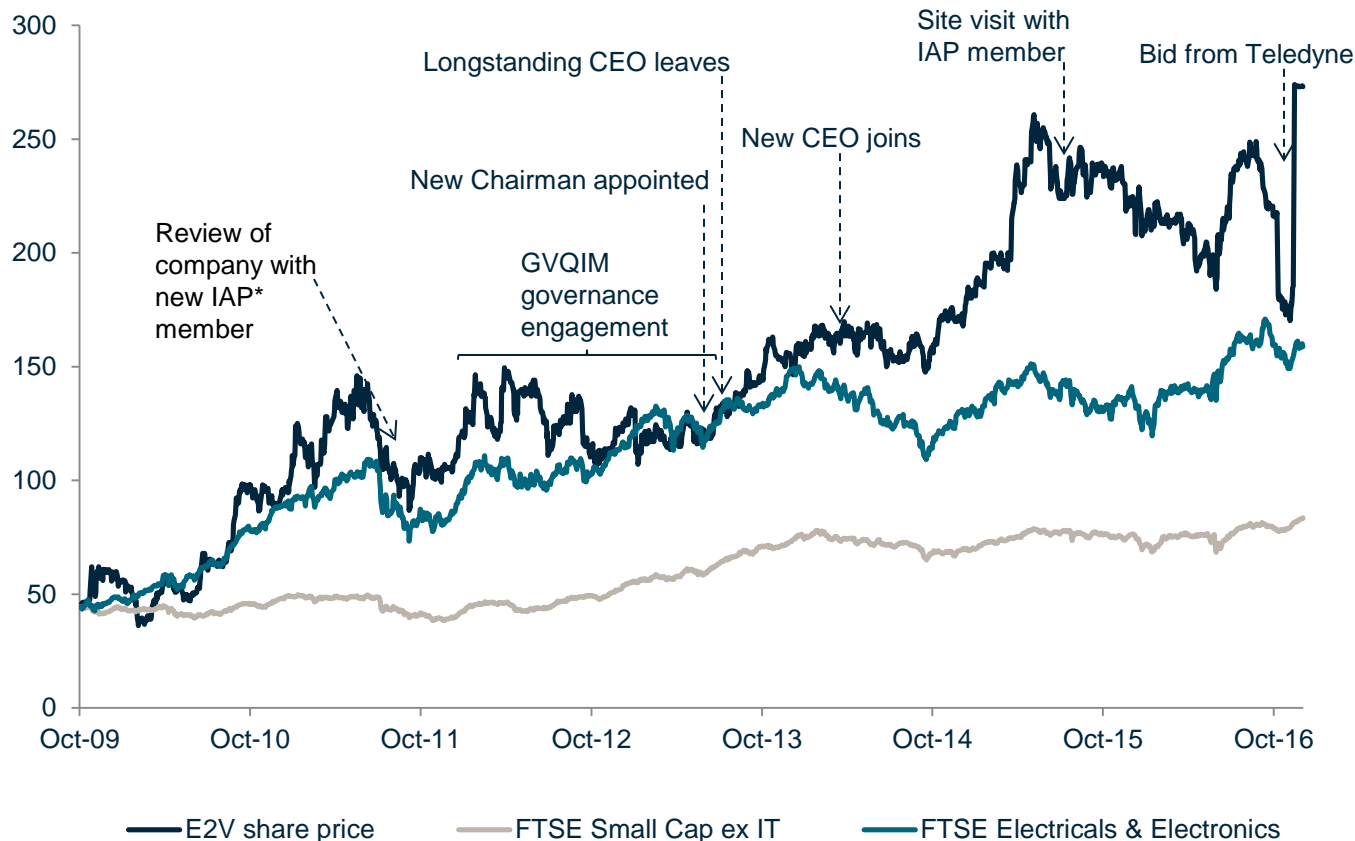
Company	Total return three months to 31 st December 2016 (%)	Contribution to return (bps)	GVQIM Comment
Top 5 contributors			
e2v Technologies	16.9%	156	Slightly weak interims followed by recommended bid approach
Wilmington	7.0%	56	In line Q1 trading statement
EMIS	2.8%	27	CEO retirement announced
Tribal	3.2%	22	US peer Jenzabar continues to purchase shares
Harworth Group	6.2%	16	Positive newsflow on site disposals
Bottom 5 contributors			
IFG Group	-6.3%	-43	Cut in base rates reduces interest income. CEO changes
Servelec Group	-3.6%	-29	Announces award of oil and gas automation contract
Goals Soccer	-4.9%	-26	No newsflow
Equiniti Group	-2.1%	-18	Shares depressed by share placing
Clinigen Group	-1.3%	-14	Shares were weak into the end of the year – forced seller?
Total	1.2%		Average net cash position 15.2%
FTSE Small Cap Ex IT	4.6%		

E2V realisation. Clinigen shares were very weak in the last few days of the year on no news

Case study – E2V Technologies

Share price

Share price performance since first SEC investment



- Initial investment thesis
 - Support balance sheet repair
 - High IP business, trading at trough sales, margins, rating
 - Operational upside
- Following review with new IAP member in late 2011, decision taken to lengthen investment horizon and engage:
 - Whilst good return made to date, the IAP member & SW concluded that the business was still underperforming its potential
 - New Chairman and CEO were appointed in 2013
- New CEO initiated a significant change process
 - Strategic focus/simplification
 - Significant people and culture change
 - Focus on customer
 - Operational improvement
- Attracted bid from longstanding suitor and trade peer Teledyne Technologies Inc

IRR of around 40% (no gearing) during hold of >7 years

We believe that fundamental research and corporate engagement have driven returns

As at 31st December 2016

Source: GVQIM, Bloomberg * Industrial Advisory Panel

Note: Capital return only. FTSE Small Cap ex IT and FTSE Electricals and Electronics sectors rebased to SEC's initial purchase price of E2V shares

Q4 saw purchases significantly exceed disposals

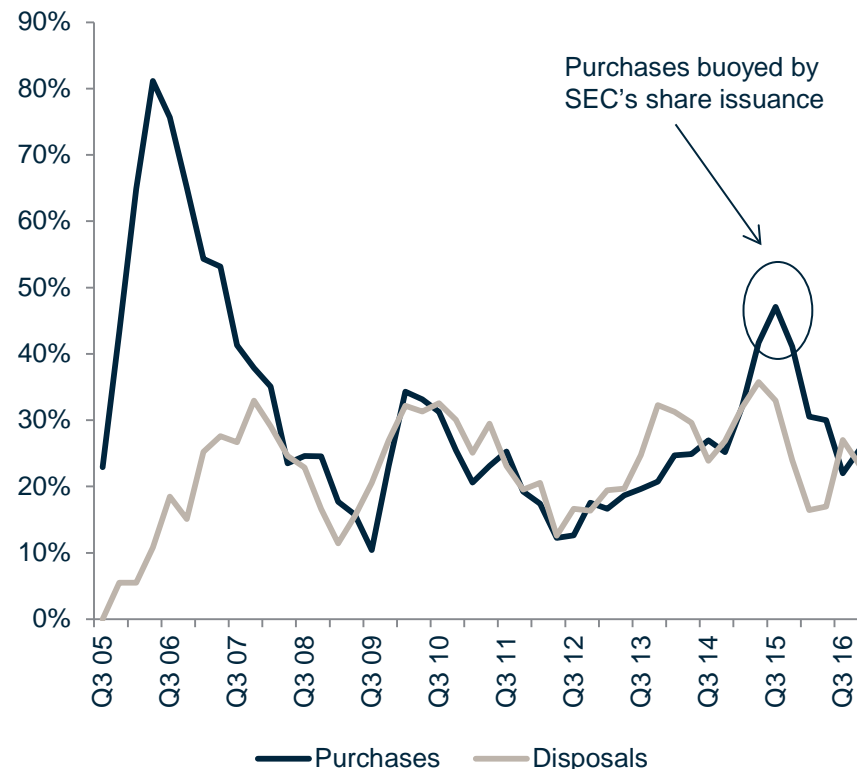
Investment highlights

- £8.5m purchases of existing holdings
- £4.3m additional investment in Equiniti, some of which was via institutional placing
- IFG (£1.1m), E2V (£0.8m – between interims and bid approach), Harworth (£0.8m), EMIS (£0.7m), Servelec (£0.7m)
- No new investments made

Realisation highlights

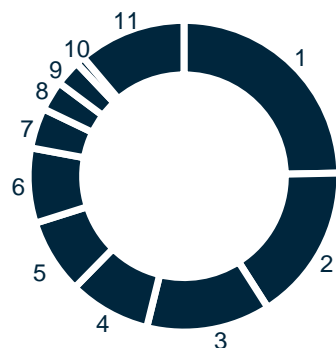
- £0.5m disposals
- Mainly continued profit taking in Gooch & Housego (£0.3m)

Moving annual total purchases and sales as % of NAV

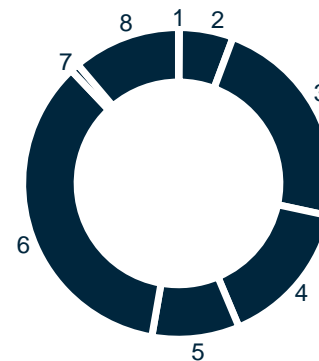


Investments mainly made during a period of weak share prices of portfolio companies in November and early December

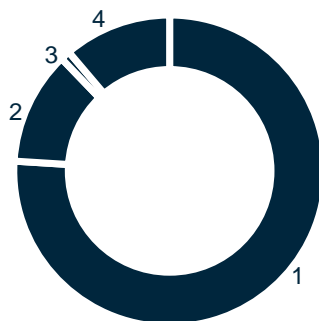
Highly concentrated and unconstrained portfolio



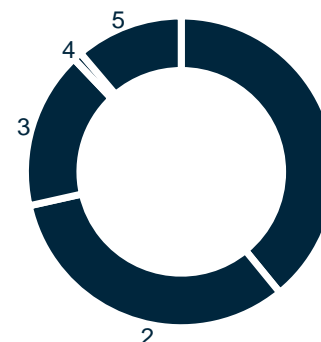
Sector exposure by value		
1	Technology – software & services	24.7%
2	Support Services	16.3%
3	Electronics	12.9%
4	Healthcare	8.5%
5	Media	7.8%
6	Financials	7.8%
7	Consumer Services	4.2%
8	Industrials	3.1%
9	Property	2.7%
10	Unlisted	0.9%
11	Net cash	11.2%



Value by market cap band		
1	<£50m	0.1%
2	£50m - £100m	5.6%
3	£100m - £200m	22.7%
4	£200m - £300m	15.3%
5	£300m - £500m	9.1%
6	> £500m	35.2%
7	Unlisted	0.9%
8	Net cash	11.2%



Concentration		
1	Top 10	76.0%
2	Rank 11 - 15	11.8%
3	Smaller holdings	1.0%
4	Net cash	11.2%



Value by index membership			No. Holdings
1	Small Cap	39.1%	5
2	Aim	32.4%	8
3	Other*	16.4%	3
4	Unlisted	0.9%	1
5	Net cash	11.2%	

E2V was 10.0% of the portfolio at the year end, a Top 10 holding & >£500m market cap

Will turn into cash in mid March 2017 due to the takeover

As at 31st December 2016

Source: GVQIM

Note: **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 – ex Harworth and Vintage

	Portfolio weighted average	Portfolio weighted median	FTSE UK Small Cap ex investment trusts	FTSE UK Small Cap ex investment trusts ex resources	FTSE AIM ex resources
Number of securities	15	15	149	138	603
Market capitalisation (£m)	401	489	327	326	101
Consensus EV/EBITDA FY1	10.4x	8.3x	6.5x*	7.3x*	11.2x
Consensus price earnings FY1	16.4x	16.2x	12.6x*	12.4x*	16.4x
Consensus FY1 earnings growth	13.0%	11.0%	11.8%*	10.9%*	12.9%
Consensus dividend yield FY1	2.4%	2.6%	3.1%*	3.7%*	2.4%
Price/book FY1	3.0x	2.8x	1.4x	n/a	n/a
Price/sales FY1	1.8x	2.0x	0.7x	n/a	n/a
Price/cash flow	14.4x	14.4x	n/a	n/a	n/a
Debt to EBITDA	0.1x	-0.1x	1.7x	1.6x	1.0x
GVQIM cash flow yield FY1 ¹	9.0%	9.1%	n/a	n/a	n/a
Overseas sales as %	40.3%	26.0%	n/a	n/a	n/a

Portfolio average metrics closer to AIM than FTSE Small Cap. Price to cashflow metrics look attractive

Portfolio ratings more attractive ex E2V (subject to bid premium) and Tribal (high p/e recovery rating)

As at 31st December 2016 for SEC; as at 1st January 2017 for Index data

Source: Factset portfolio analysis; Bloomberg; Peel Hunt; *Index is ex loss makers – i.e. valuation and yield is flattered. Harworth Estates & Vintage excluded from analysis

Note: 1. GVQIM cashflow yield: (12m forward Cash EBITDA minus maintenance capex)/(market capitalisation plus 12m forward net debt)

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Top 10 holdings¹

Company	Vintage	Sector	GVQIM Funds % of company	Return potential ²	Progress vs thesis	GVQIM CF yield ³ NTM ⁴	Net debt/ EBITDA NTM ⁴	12 month catalysts	Market leader ²
Equiniti	2016	Support Services	>5%	High	Ahead	9.5%	2.1x	Delivery of organic growth and cashflow. M&A? Becomes more broadly owned	Yes in niches
e2v technologies	2009	Electronics	>5%	N/A	In line	9.1%	-0.1x	N/A – recommended bid from Teledyne Inc	Yes - niche
Servelec	2013	Technology	>5%	Medium	Behind	9.8%	-0.2x	Work begins on oil & gas platform 2; clarity on prospects for healthcare market	Yes – UK niches
Clinigen	2014	Healthcare	>3%	Medium	Ahead	8.3%	0.4x	Article 31 for Cardioxane lifted. Delivery of organic growth	Yes – niche
Wilmington	2010	Media	>5%	Medium	In line	10.4%	0.8x	Overseas growth; de-gearing; M&A	Yes - niche
Tribal	2014	Support Services	>5%	High	Behind	4.0%	-0.8x	Update on improvement plan	Yes - UK
EMIS	2014	Technology	>3%	Medium	Ahead	8.3%	-0.4x	Traction in secondary care business	Yes – UK
4imprint	2006	Support Services	<3%	Medium	Ahead	7.4%	-0.5x	Continued US growth	Yes - US niche
IFG Group	2015	Financials	>5%	High	In line	12.2%	-2.2x	Initiatives to recover margin. In H2, cross sell of GIA and ISAs into SIPP client base	#2 in high end SIPPs
Goals Soccer	2012	Consumer Services	>5%	High	Behind	9.9%	1.5x	New pitch capex and soft comps drive recovery in L4L sales growth	Yes - UK

Equiniti most geared but due to de-gear materially

As at 31st December 2016. Source: GVQIM analysis; Capita

Note: 1. Top 10 holdings representing c.71% of NAV. 2. In the opinion of GVQIM. 3. GVQIM cashflow yield: (12m forward Cash EBITDA minus maintenance capex)/(market capitalisation plus 12m forward net debt). 4. NTM: Next Twelve Months

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Investment pipeline considerations

- Valuations seem polarised in the small cap market
 - Quality growth with momentum mostly expensive, or very expensive. De-ratings severe when news disappoints
 - Many “value” stocks cheap for a reason (e.g. contingent liabilities/non-earnings cash leakage)
 - Many stocks trade at, or above, precedent M&A multiples – less margin of error; less chance of M&A
 - Recovery situations can price in a good deal of recovery before certainty of delivery
- Liquidity remains low
 - Sub £400m market cap companies see either small retail buying/selling, or reasonably sizeable block trades
 - We have seen situations where:
 - a marginal change in buying/selling sentiment can have a disproportionate impact on pricing
 - spreads have widened materially
 - share prices are “stuck” – limited market making activity – “buyers and sellers stand-off”
 - even moderate overhangs/buying demand (in the case of the latter – particularly IHT qualifying AIM quoted companies) causing individual stock volatility which is often untradeable
 - Difficult to see a positive catalyst for better liquidity in 2018 with MIFID2 – **large stakes akin to a private investment!**
- Some interesting IPOs – but caution and significant DD required; little interesting secondary issuance
- We remain wary of investing in companies with material pension schemes and deficits, due to the potential poison pill this creates. This continues to limit the investable universe

We retain a preference for reasonably priced quality growth, with self-help. Ideally non-cyclicals

OUTLOOK

Outlook summary

- **Positives**

- Fall in Sterling is good for UK companies with overseas earnings
- Market volatility is likely to lead to more mispricing and opportunities
- M&A levels picked up notably in Q4 2016, with long awaited activity from overseas trade buyers
- US banking sector appears stable (and much better than EU)
- UK banks and UK corporates much better capitalised than in 2008

- **Negatives**

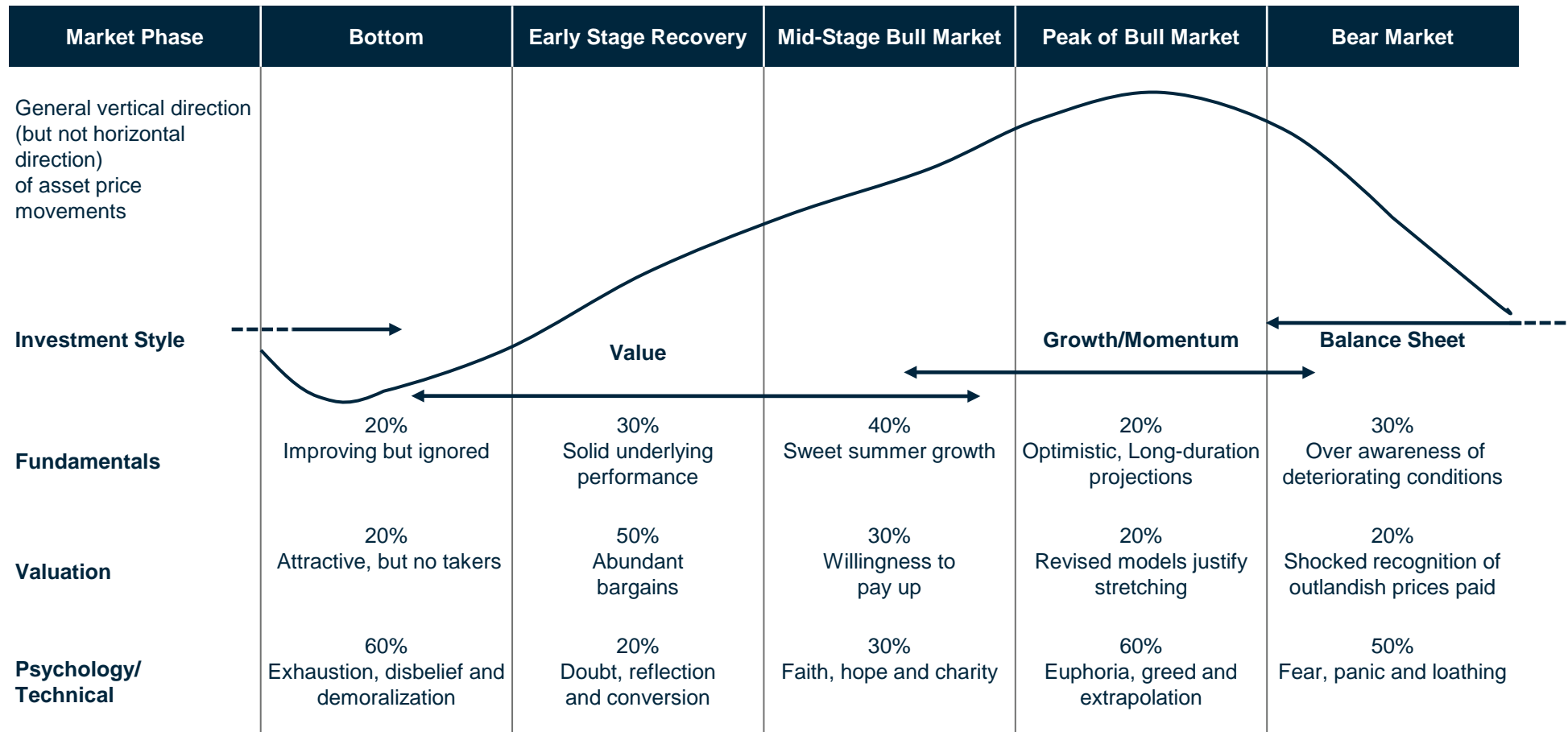
- Brexit impact, process and outcome is unclear, and will remain so for some time
- Global macro risks remain unresolved: Eurozone/EU; Chinese shadow banking & equity bubble; public sector indebtedness and persistent budget deficits
- Potential for a European Banking crisis
- Geopolitical risks remain e.g. Iraq/Syria/ISIL; North Korea; Russia; US President change
- Liquidity in companies <£400m market cap remains poor
- Aggressive re-rating (on low volumes) of some IHT qualifying AIM growth stocks – “crowded trades”

- **The big “known-unknowns”**

- How will equity ratings react if, as expected, US interest rates tighten
 - Bull case – “great rotation” – capital moves from bonds to equities
 - Bear case – all asset classes de-rate as the risk free rate rises
- Is this equity cycle prolonged due to QE, and we are mid cycle? Or are we in the final stages of a typical 8-9 year cycle?

Trying to time when the music stops is impossible. Supports selective investment approach, a strong balance sheet and being prepared for volatility

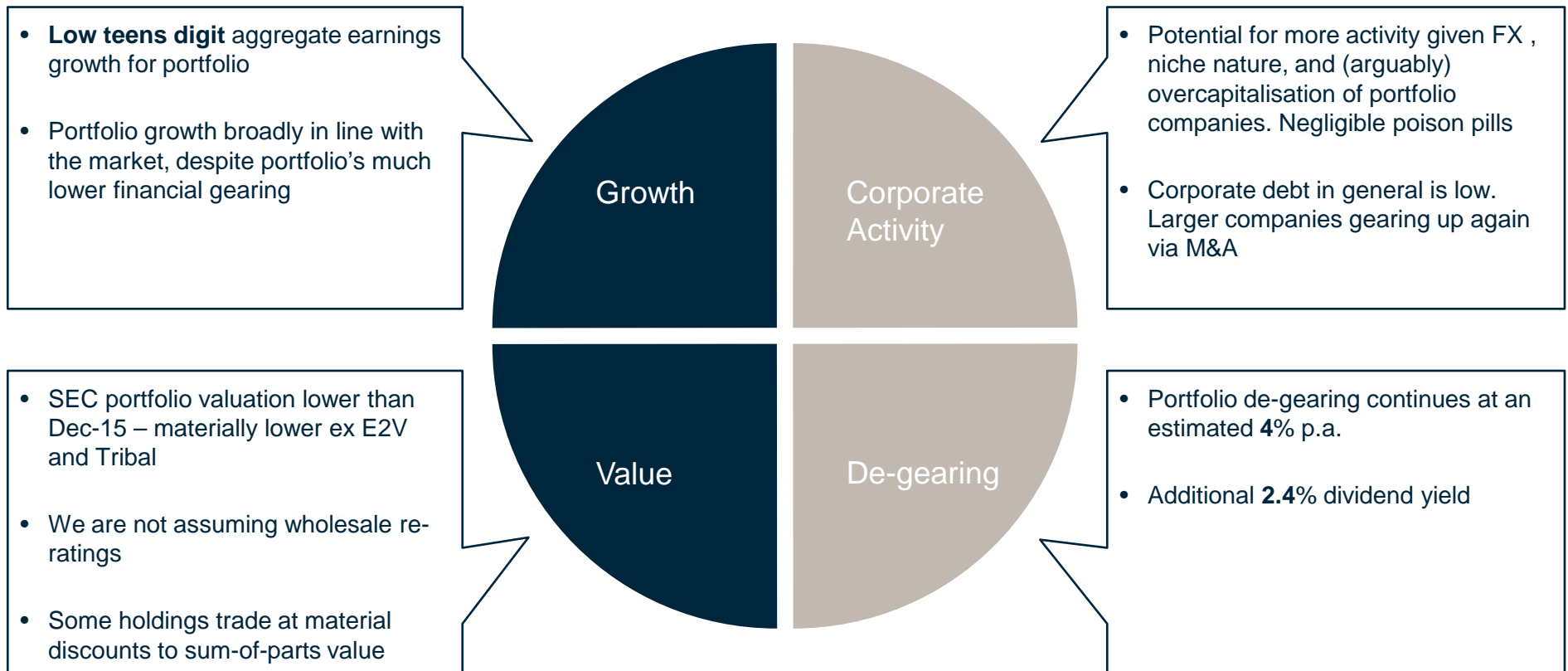
The investment cycle – where are markets now?



Does QE mean this equity cycle is longer/just different? How does slowing growth impact the cycle?

Earnings growth, cashflow and M&A to drive returns

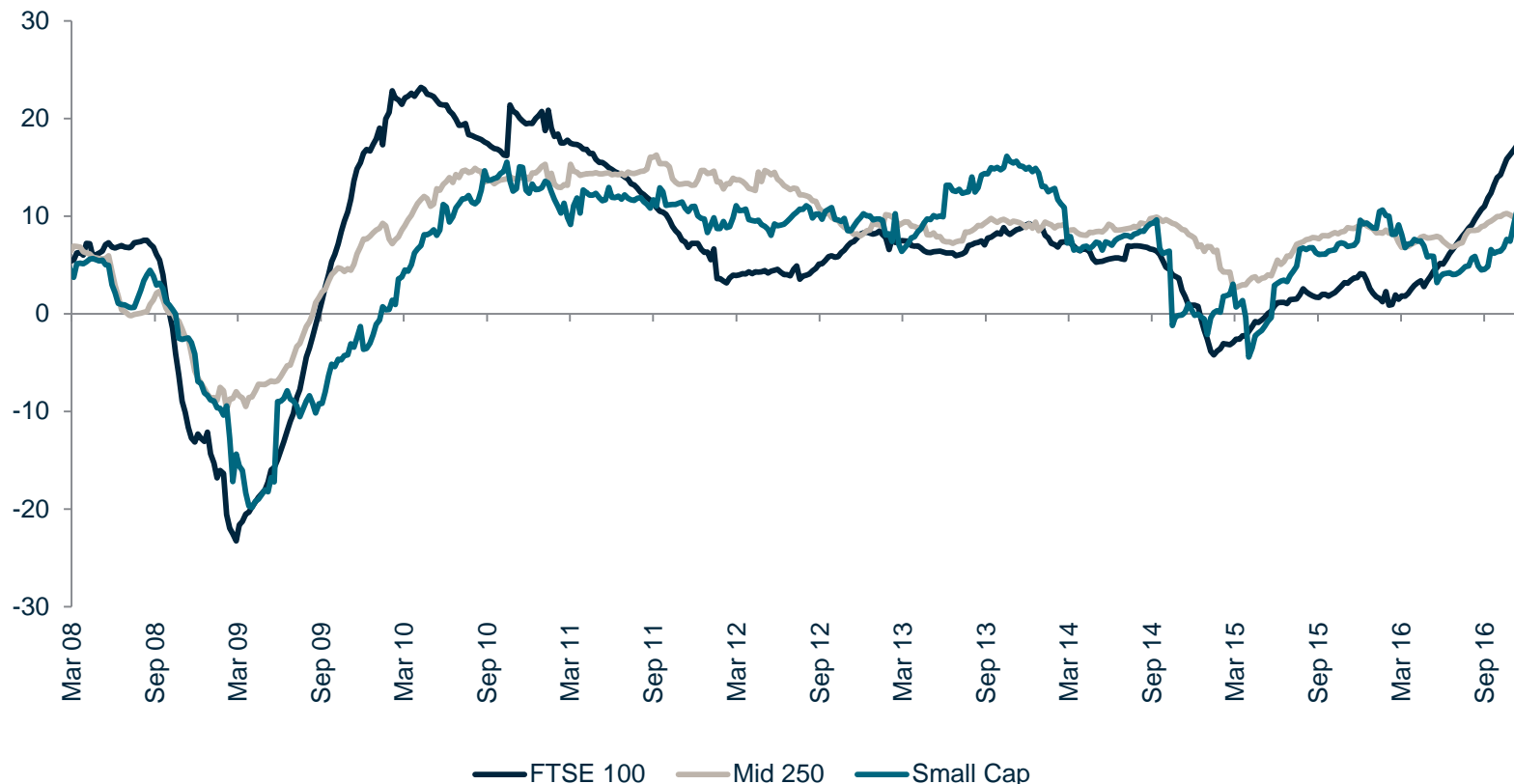
SEC portfolio



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

12-month forward EPS¹ growth projections

12m forward EPS growth by FTSE index ex investment trusts March 2008 to date²



FTSE All Share earnings projections have materially improved over the quarter, driven primarily by FTSE 100 companies, the principal beneficiaries of the on-going weakness of Sterling

As at 31st December 2016

Source: 1. EPS = earnings per share 2. Peel Hunt

Note: Index excludes loss makers

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How SEC's portfolio dynamics compare to the market

Valuation and growth metrics of key indices ex oil, miners and ex loss makers and non-dividend payers*

Index	Average market cap	12m forward p/e	12m forward eps growth	12m forward dividend yield	Growth & yield	PEG ratio	PE/(growth + yield)	Net debt/ EBITDA
FTSE 100	£16.4bn	14.6x	9.2%	3.8%	13.0%	1.6x	1.1x	1.6x
FTSE 250	£1.7bn	14.4x	10.1%	3.4%	14.5%	1.4x	1.0x	1.3x
FTSE Small Cap	£326m	12.4x	10.9%	3.7%	14.6%	1.1x	0.8x	1.6x
FTSE AIM	£101m	16.4x	12.8%	2.4%	15.2%	1.3x	1.1x	1.0x
SEC portfolio	£401m	16.4x	13.0%	2.4%	15.4%	1.3x	1.1x	0.1x
SEC portfolio ex E2V & Tribal	£403m	15.1x	12.2%	2.4%	14.6%	1.2x	1.0x	0.2x

FTSE100 growth rates may be buoyed by the depreciation of Sterling, given the level of overseas earnings
Portfolio metrics similar to FTSE AIM, ex debt, despite average company being 4x size (and more liquid?)

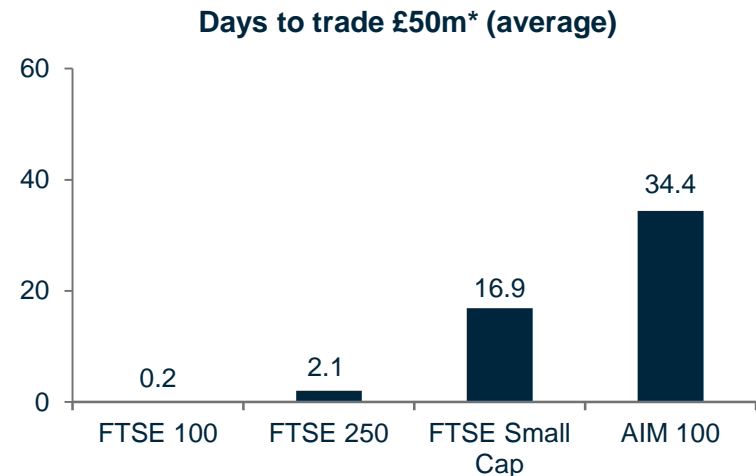
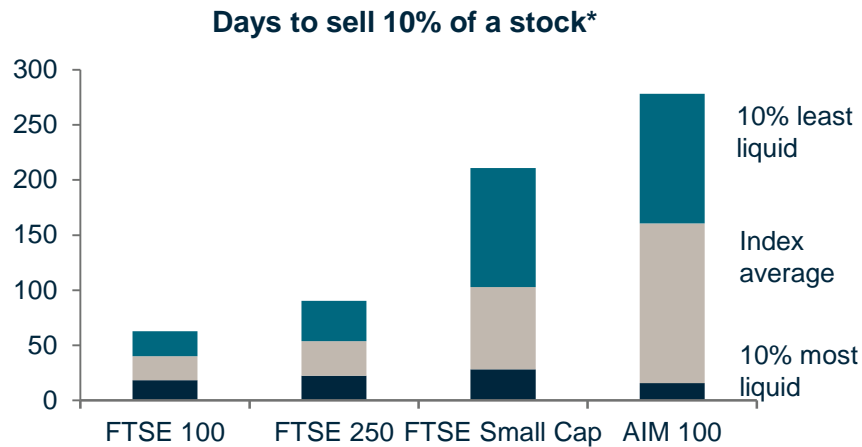
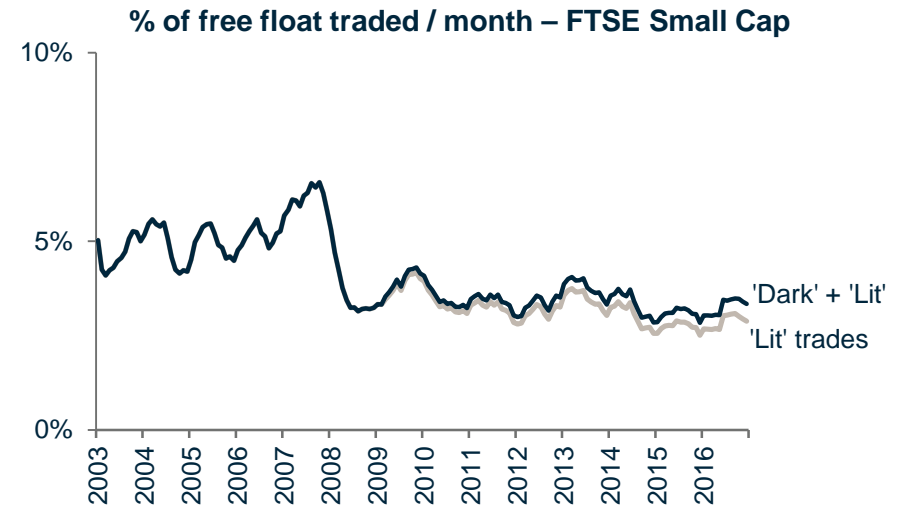
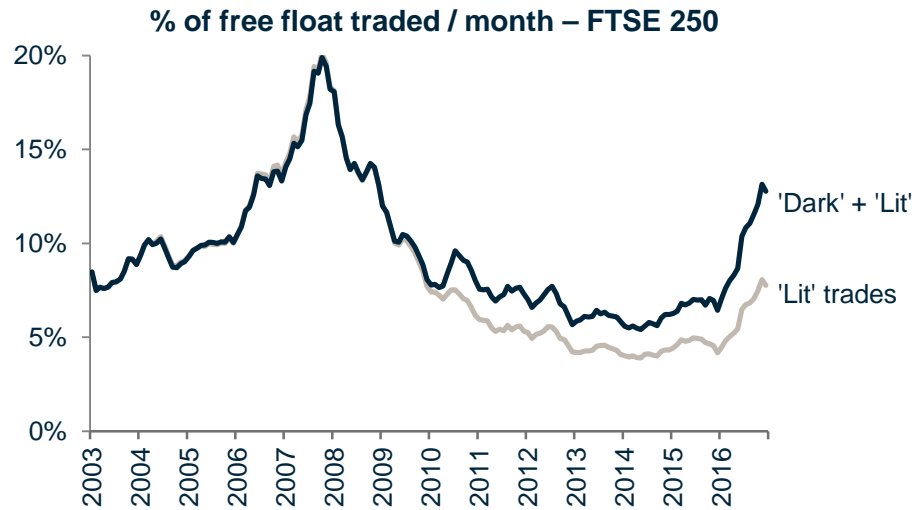
As at 31st December 2016 for SEC and index data from Peel Hunt

Source: Peel Hunt; Capita; Factset; GVQIM

Note: *Indices presented exclude resources, as well as non-dividend payers and loss makers

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FTSE Small Cap liquidity remains low



FTSE 250 liquidity almost 4x that of Small Cap – and unlike Small Cap is back to 2006/7 levels

As at 31st December 2016

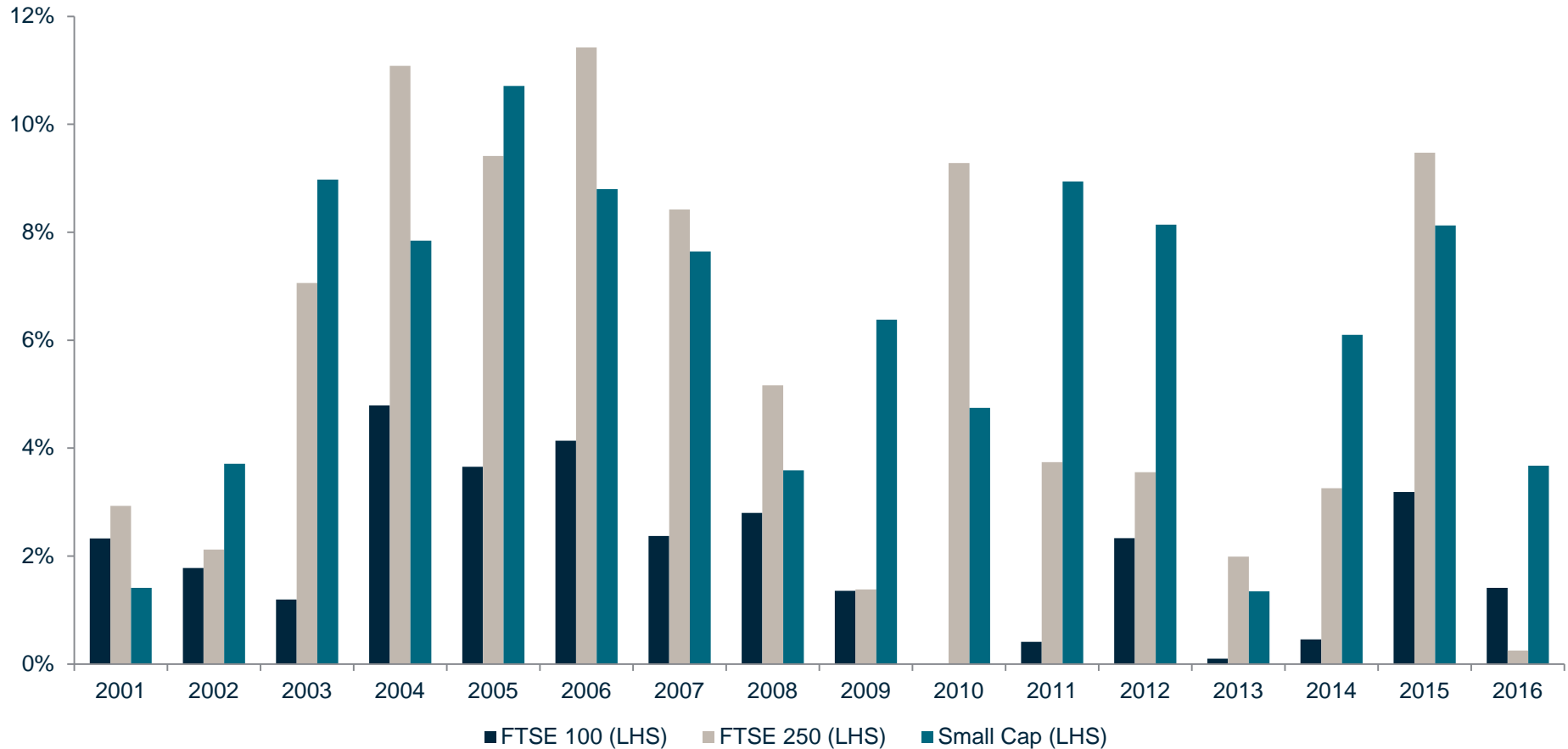
Source: Liberum, Bloomberg

Note: *Assuming 100% of daily volume

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

Small Cap M&A levels picked up materially in Q4

Value of acquisitions as % of index starting mkt cap



M&A still appears below trend. Notable bids from overseas trade buyers in Q4 2016

As at 31st December 2016

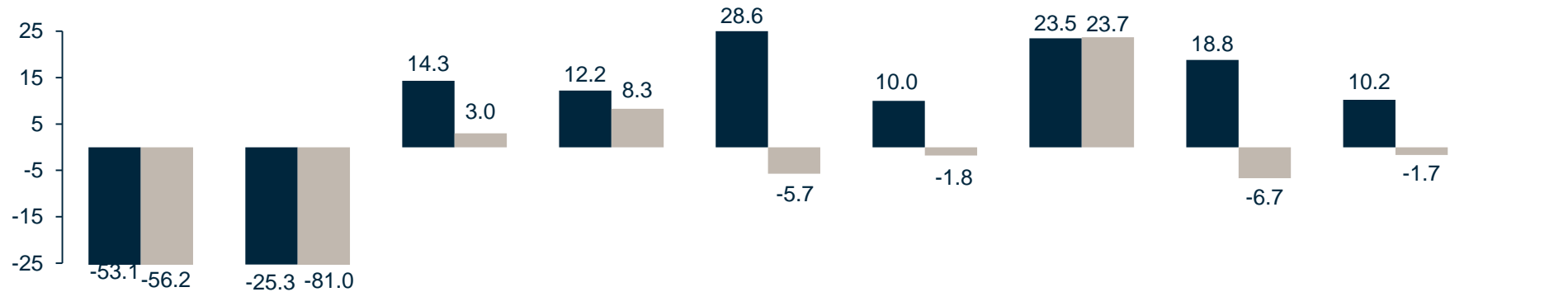
Source: Liberum

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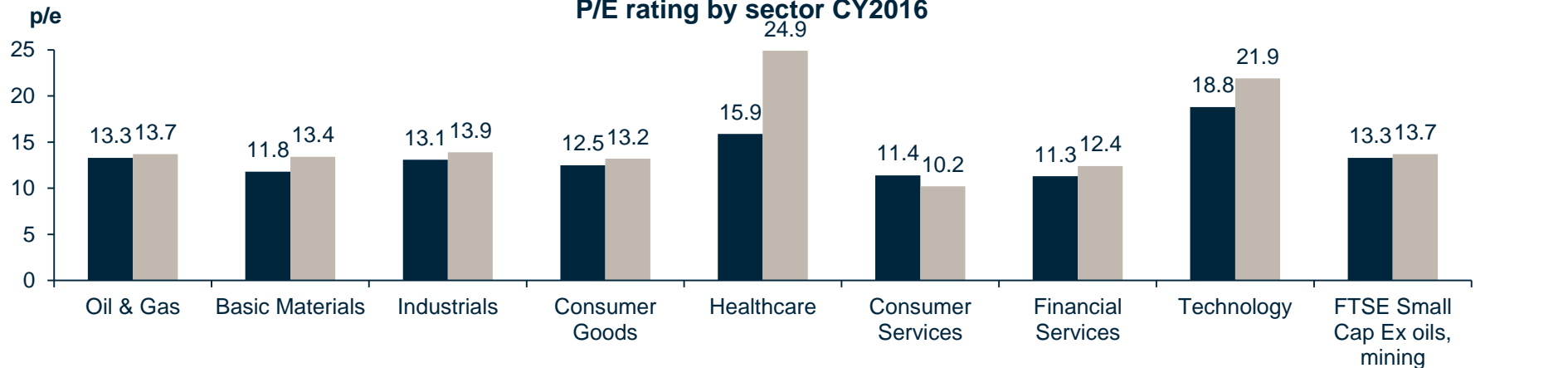
FTSE Small Cap Calendar Year 2016 downgrades

eps growth by sector CY2016

eps growth



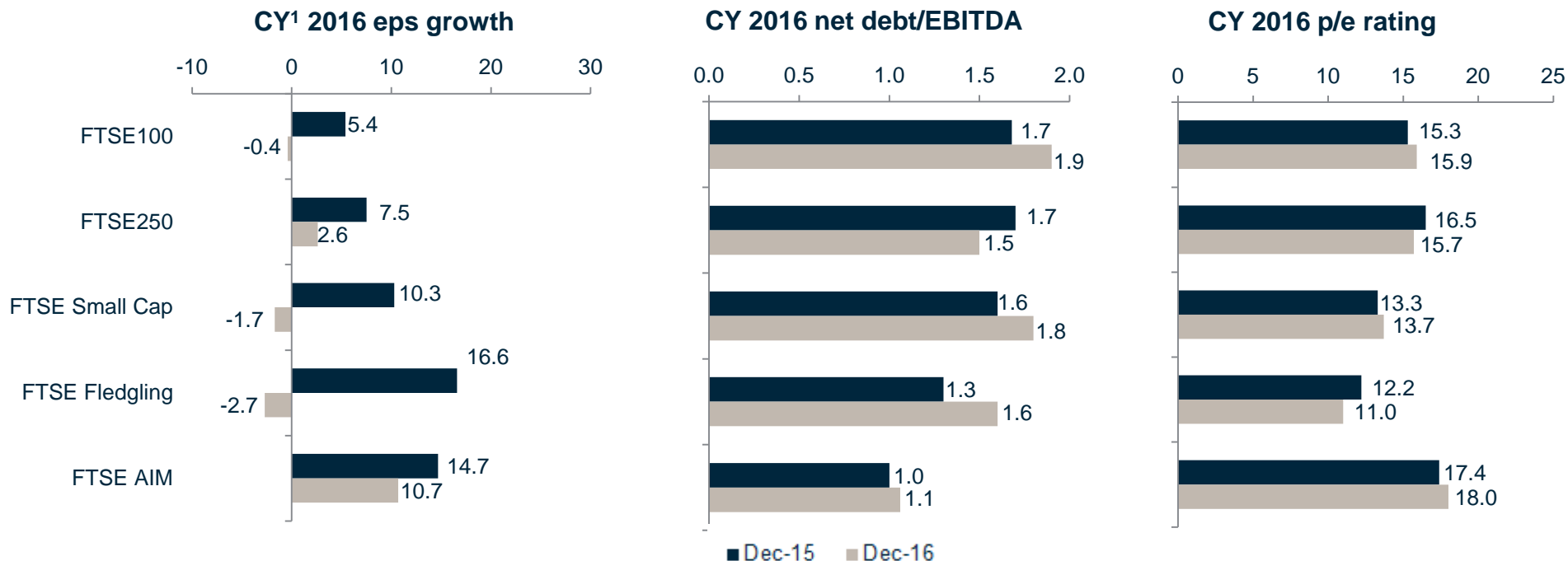
P/E rating by sector CY2016



Aggregate sector earnings disappointed again other than financial services

Only moderate market re-rating over the year

FTSE Indices data, ex resources and loss makers

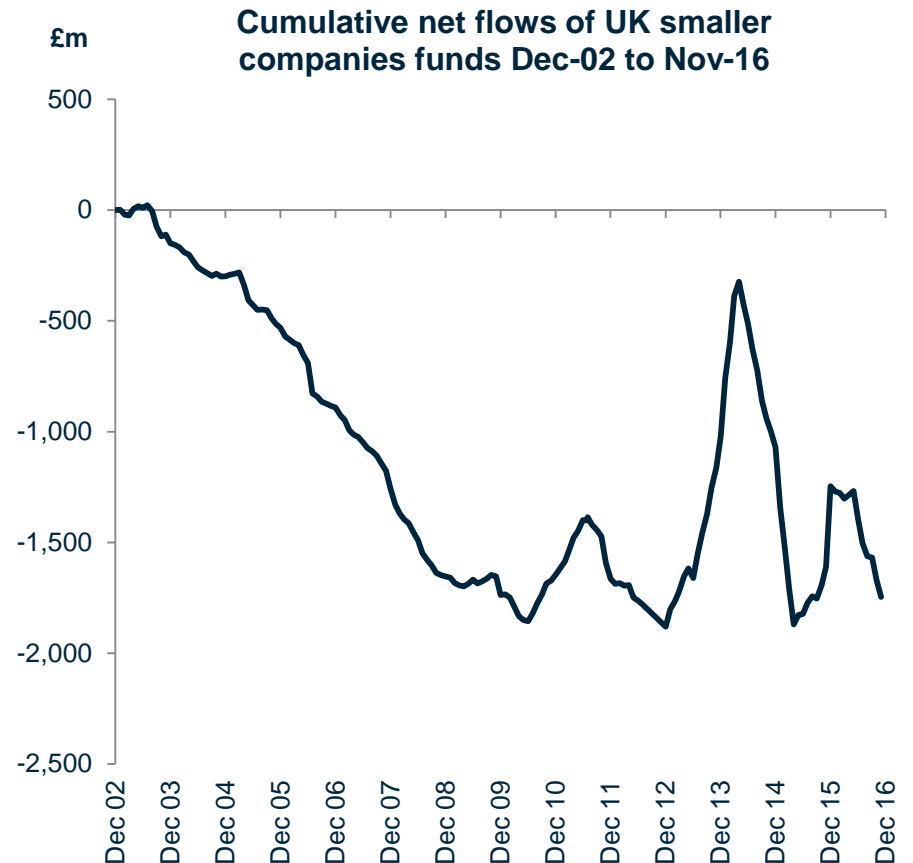
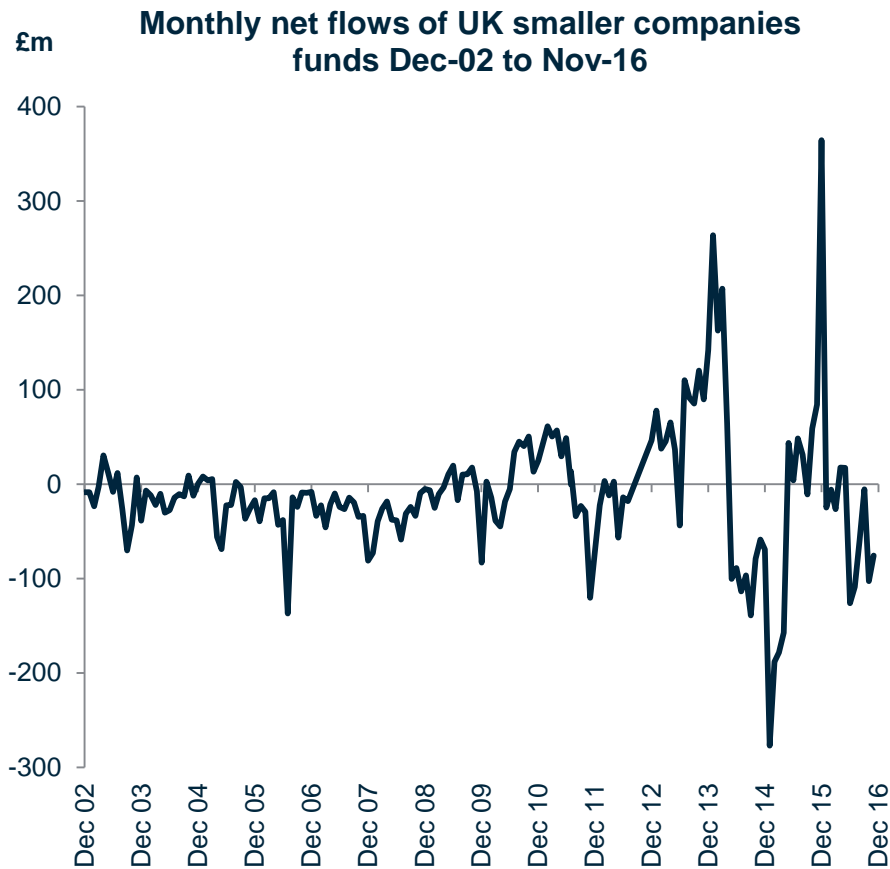


Implications

- Another year of aggregate earnings disappointments, combined with gearing exceeding expectations except the FTSE250, which also de-rated on an aggregate basis
- FTSE100 relative re-rating compared with the rest of the market, especially on an ungeared basis

General trend of companies gradually gearing up, despite aggregate earnings misses

UK Smaller Companies OEIC flows



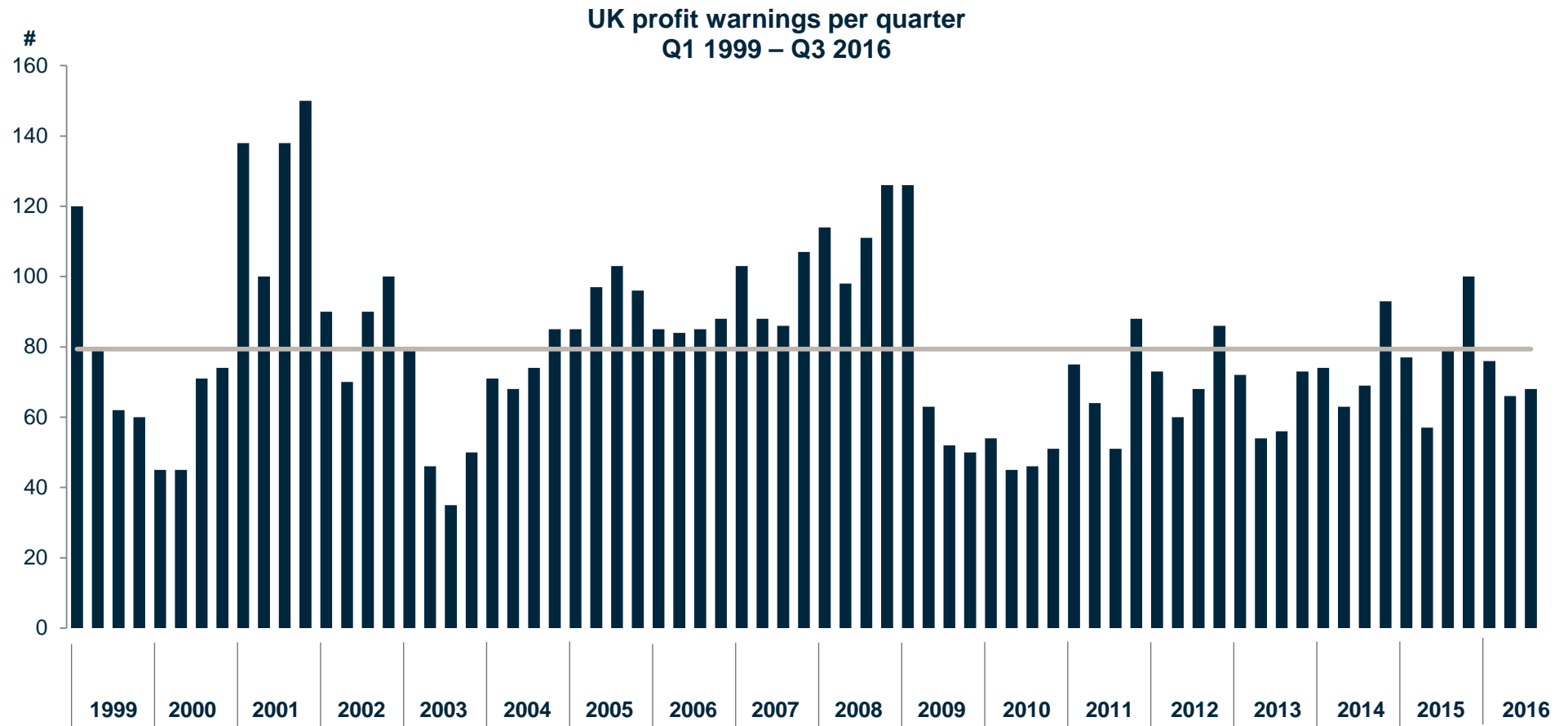
Outflows continued unabated through Q4

As at 30th November 2016

Source: Investment Association

Note: Total AUM in the IA UK Smaller Companies Sector in November 2016 was £12.0bn

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



Profit warnings were down marginally YoY in Q3

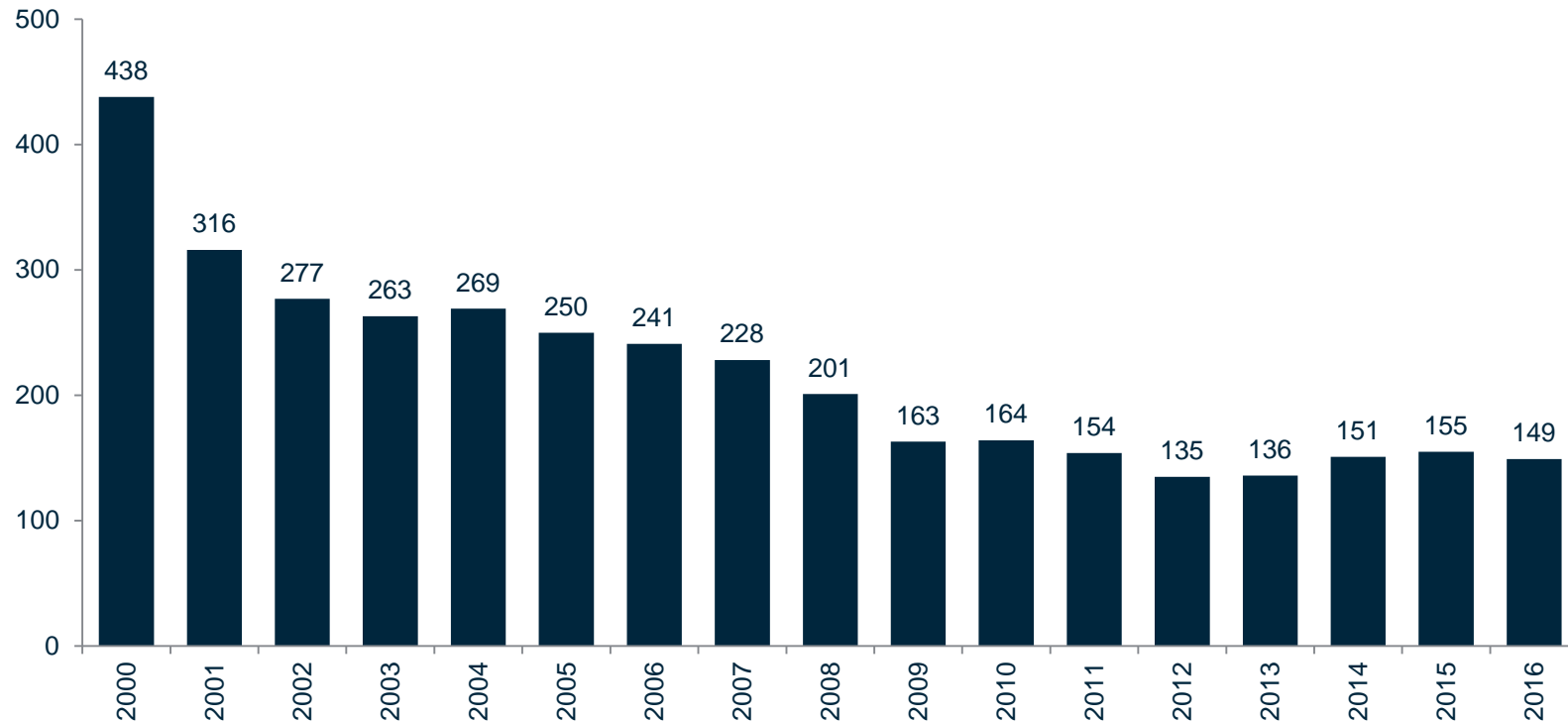
As at 31st December 2016

Source: Ernst & Young

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

Growth in number of smaller companies has paused

Constituents of the FTSE Small Cap ex Investment Trusts Index



**Number of constituents of smaller companies index remains well below the middle of the last cycle
Given buoyant market ratings, why is this so low? Perhaps more companies IPO and stay on AIM**

As at 31st December 2016

Source: Numis Securities; Bloomberg

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

APPENDIX

Calendar Year Annual performance¹

	2016	2015	2014	2013	2012	2011	2010	2009
Share Price Total Return	-1.6%	14.2%	32.6%	61.4%	25.6%	9.4%	35.1%	252.1%
NAV Total Return	6.3%	12.1%	18.0%	46.0%	21.3%	3.9%	37.1%	63.8%
FTSE Small Cap ex Investment Trusts Total Return	12.5%	13.0%	-2.7%	43.9%	36.3%	-15.2%	16.9%	57.7%
IA UK Smaller Companies	8.1% ²	14.7%	-1.7%	37.4%	22.5%	-9.0%	30.8%	50.1%

Share price return in 2016 impacted by the widening of the discount

As at 31st December 2016

Source: 1. GVQIM; Capita; Bloomberg; Trustnet. 2. 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

There are strict criteria for inclusion in our funds



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

How we identify coveted assets

We look for characteristics which GVQIM believes potential acquirers value highly

Qualitative	Quantitative
<ul style="list-style-type: none">• Niche market leaders• Orderly end markets, with some growth• Sustainable business model/franchise/uniqueness• Overseas earnings• Able to pass on price increases• Intellectual property• Operational know-how• High barriers to entry	<ul style="list-style-type: none">• High and/or improving ROCE• Strong cash conversion• Limited capex or working capital investment needed to finance growth• Recurring revenues/profits/cashflows• Ideally achieving, or has potential to achieve double digit operating profit margin• 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

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

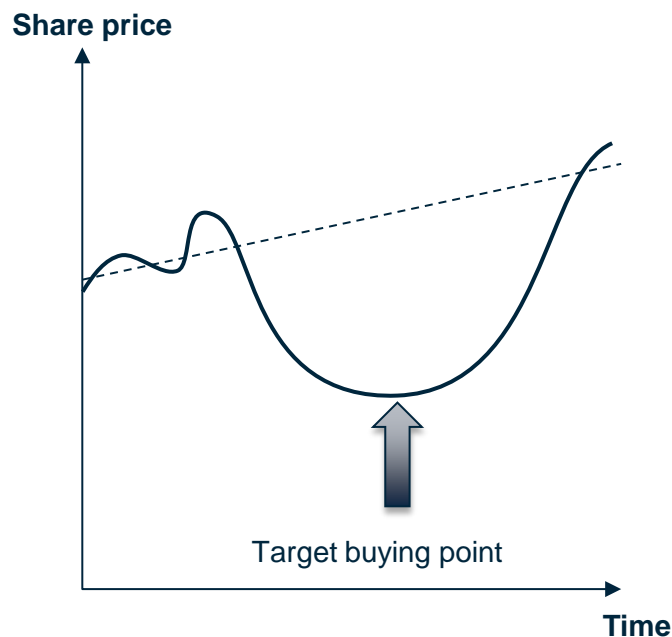
Governance

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

We have learnt what to avoid from previous experiences

Types of market purchases we consider

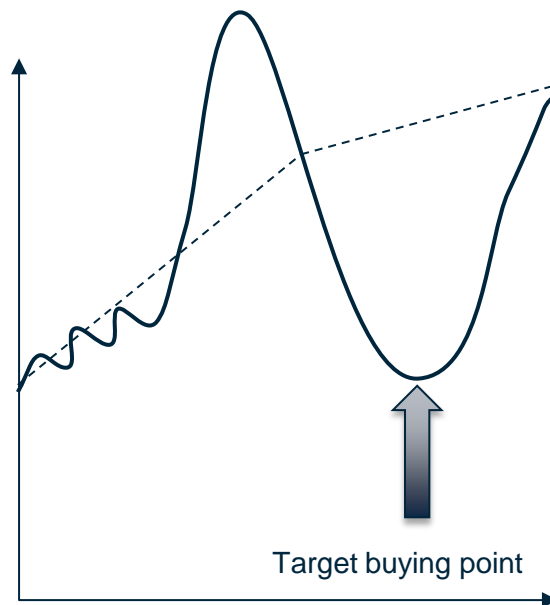
Self help



- Typically low growth businesses
- Some element of engagement required to stimulate performance improvement
- Long term investments

**Identified via deep research.
Require corporate engagement to
unlock value**

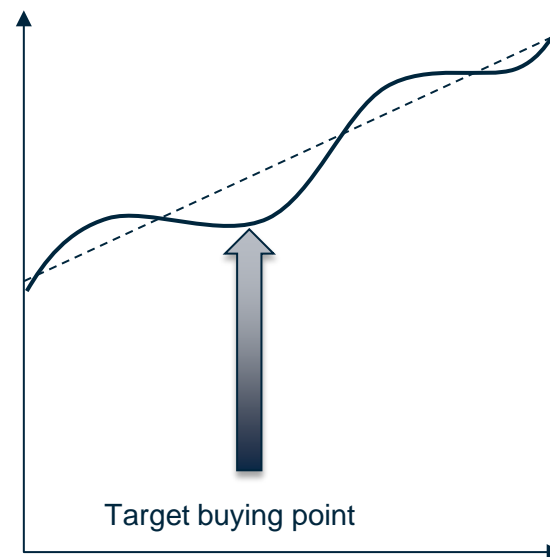
Broken growth



- Momentum stocks, which have gone wrong. Over rated transitions to under rated
- Base investment case attractive even assuming moderate growth
- Often attract corporate suitors

**Shunned by momentum investors.
Some interesting opportunities**

Quality GARP



- Quality, growing, high margin “value compounders”
- Temporary out of favour with investors -> opportunity to buy at a discount to fair value

**Became relatively over valued
in our opinion in late 2015**

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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