

Dunedin Enterprise Investment Trust

Realisations in prospect

Dunedin Enterprise Investment Trust (DNE) is a private equity investment specialist differentiated from peers by its focus on UK lower mid-market buyouts. While recent performance has been muted with no significant sale transactions in the last two years, the current maturity of the portfolio and favourable market conditions raise expectations for near-term realisations. As well as the potential valuation uplift from portfolio exits adding to returns, there is the prospect of share buybacks and special dividends to distribute capital gains to shareholders.

12 months ending	Total share price return (%)	Total NAV return (%)	FTSE Small Cap ex Inv. Trsts. (%)	UK Private Equity ex-3i NAV (%)	FTSE All-Share ex Inv. Trsts. (%)
30/06/11	40.7	22.4	24.6	28.2	25.7
30/06/12	(5.6)	11.8	(6.4)	1.0	(3.0)
30/06/13	31.1	(4.2)	38.6	6.7	17.9
30/06/14	5.3	(2.6)	25.3	1.3	13.2
30/06/15	(24.2)	1.0	8.4	1.4	2.4

Note: Twelve-month rolling discrete total return performance up to last published NAV.

Results for six months to 30 June 2015

DNE delivered a muted -0.1% NAV total return for the six months to 30 June 2015 with valuation gains and reductions broadly offsetting which masked positive developments at a number of portfolio companies. Gains came from increased valuation multiples being applied to companies continuing to perform well or showing sustained improvement in earnings, while the most significant reductions primarily reflected the lower oil price, which affected two companies in particular. New investments of £10.6m included £4.9m in construction consulting services provider Blackrock Programme Management and £2.6m in two investments through Spanish fund Realza, while realisations totalled £3.0m.

Outlook: Realisations in prospect

DNE's lack of major realisations since 2013 makes this a key focus for both management and investors. DNE has a mature portfolio and management views the prospects for exiting investments as favourable, suggesting the potential for the pace of realisations to pick up in the near term. Historically, management reports typical valuation uplifts of c 20% on the sale of investments and this indicates the potential for significant valuation gains to be realised as mature investments are exited. DNE has a policy of distributing at least 50% of capital gains so realisations could be followed by a tender offer or special dividends. Management expects DNE's £20.5m available funds, together with potential realisations, will be sufficient to meet the likely take-up of commitments.

Valuation: Scope for discount to narrow

DNE's share price discount to NAV has widened substantially from c 15% in July 2014 reflecting its weaker performance than peers, compounded by additional selling pressure as a consequence of DNE shares leaving the FTSE All-Share index at the June 2015 rebalancing due to the fall in its market cap. Currently standing at 36%, there is scope for the discount to narrow significantly on announcements signalling successful disposals or strengthening NAV.

Investment trusts

5 October 2015

Price 329p
Market cap £68m
AUM £105m

NAV* 505.4p
Discount to NAV 35.6%

*As at 30 June 2015.

Yield 1.5%
Ordinary shares in issue 20.6m
Code DNE
Primary exchange LSE
AIC sector Private Equity

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low 385.1p 308.3p

NAV high/low 515.5p 501.7p

Gearing

Gross 0.0%
Net cash* 0.5%

*As at 30 June 2015.

Analysts

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Exhibit 1: Trust at a glance

Investment objective and fund background

DNE aims to achieve substantial long-term growth in its assets, with a return on equity of over 8%. The trust mainly invests in UK lower mid-market management buyouts with an enterprise value of £20m to £100m aiming to partner with management to build better businesses. The strategy was amended in 2011 to focus on this area and the remaining third-party European managed fund investments are being reduced over time.

Recent developments

- 28 August 2015: H115 results – NAV total return -0.1%; £3.0m realisations and £10.6m new investment.
- 1 June 2015: Angela Lane appointed as a non-executive director.
- 13 May 2015: Q115 update – NAV total return 1.0%; £2.1m realisations and £8.7m new investment.

Forthcoming

AGM	May 2016
Preliminary results	March 2016
Year end	31 December
Dividend paid	May
Launch date	1974
Continuation vote	No

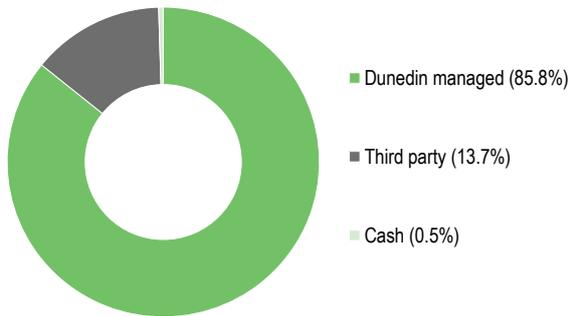
Capital structure

Ongoing charges	2.9%
Net cash	0.5%
Annual mgmt fee	N/A
Performance fee	N/A
Trust life	Indefinite
Loan facilities	£20m

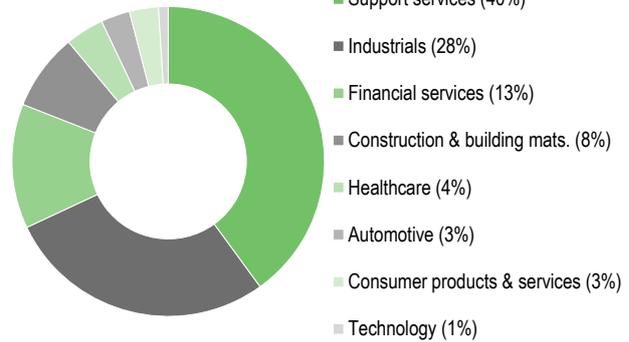
Fund details

Group	Dunedin Enterprise
Managers	Dunedin LLP
Address	Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EN
Phone	+41 131 225 6699
Website	www.dunedinenterprise.com

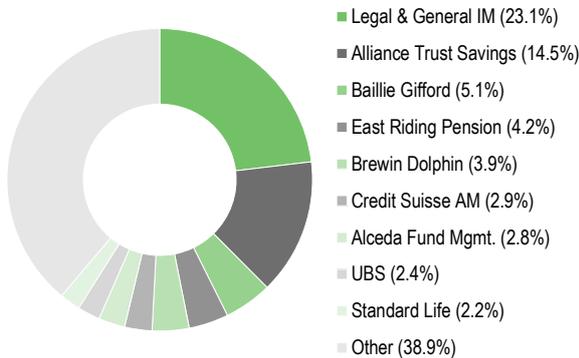
Funds under management (as at 30 June 2015)



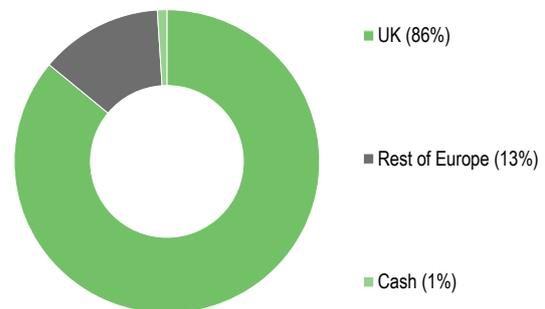
Sector breakdown (as at 30 June 2015)



Shareholder base (as at 10 September 2015)

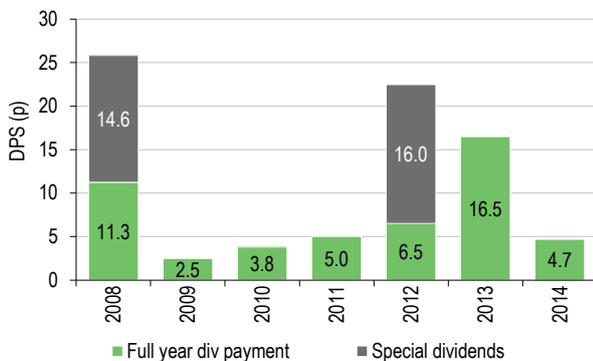


Geographic split of investments (as at 30 June 2015)



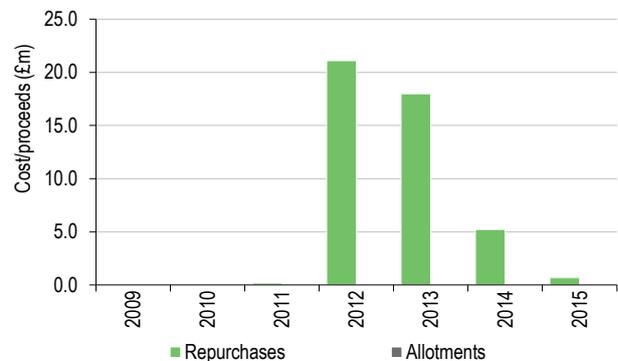
Dividend history

DNE pays an annual dividend in May relating to the prior financial year. Special dividends are used to distribute capital gains in addition to tender offers.



Share buyback history

DNE has annually renewed authority to repurchase up to 14.99% of shares in issue. Tender offers to return capital gains were made in 2012, 2013 and 2014.

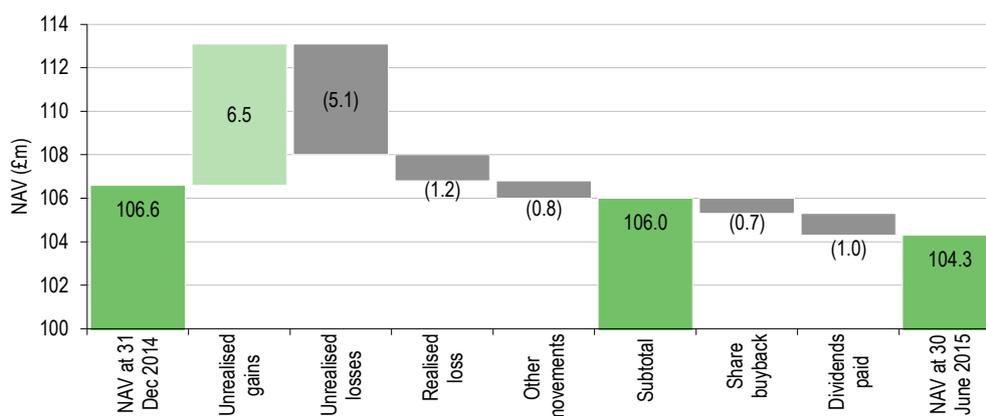


Source: Dunedin Enterprise Investment Trust, Edison Investment Research, Morningstar

Muted performance in six months to 30 June 2015

As would be expected for a small-cap private equity portfolio, DNE delivered a differentiated performance in the six months to 30 June 2015 with an NAV total return of -0.1% compared with 11.9% and 3.0% returns for the FTSE Small-Cap ex-IT and FTSE All-Share ex-IT indices. Overall, performance in H115 was similar to 2014 with portfolio valuation gains and reductions broadly offsetting each other (see Exhibit 2), but different drivers influenced NAV movements. Gains came from higher-valuation multiples being applied to companies continuing to perform well or showing sustained improvement in earnings, while the most notable reductions primarily reflected the effect of a sustained lower oil price on two investments rather than more company-specific developments.

Exhibit 2: DNE's NAV progression during H115



Source: Dunedin Enterprise Investment Trust, Edison Investment Research

Exhibit 3 shows a more detailed analysis of NAV movements during the first half of 2015, highlighting the most significant valuation movements for individual investments. Valuation gains and losses largely offset over the period, leaving Dunedin-managed fund investments £0.4m higher, while third-party managed fund investments declined by £0.2m.

Exhibit 3: NAV movement attribution for six months to 30 June 2015

£m	Q115	Q215	H115	£m	Q115	Q215	H115
Dunedin-managed direct investments				Other factors			
CitySprint	3.0	0.3	3.3	Share buyback	0.0	(0.7)	(0.7)
Hawksford	-	1.6	1.6	Dividend	0.0	(1.0)	(1.0)
Kee Safety	0.5	0.3	0.8	Other movements	(0.4)	(0.4)	(0.8)
U-POL	-	0.3	0.3	Total other factors (2)	(0.4)	(2.1)	(2.5)
Pyroguard	-	0.2	0.2	Total NAV change (1+2)	1.0	(3.3)	(2.3)
Formaplex	-	(0.3)	(0.3)	Opening NAV	106.6	107.6	106.6
Steeper	-	(0.4)	(0.4)	Closing NAV	107.6	104.3	104.3
Weldex	-	(0.4)	(0.4)				
Premier Hytemp	(0.6)	(0.4)	(1.0)				
EV Offshore	(0.7)	(1.9)	(2.6)				
Sub-total	2.2	(0.7)	1.5				
Other	(0.8)	(0.3)	(1.1)				
Total Dunedin funds	1.4	(1.0)	0.4				
Third party funds	-	(0.2)	(0.2)				
Total portfolio NAV (1)	1.4	(1.2)	0.2				

Source: Dunedin Enterprise Investment Trust, Edison Investment Research

Three of DNE's larger holdings saw the greatest valuation gains:

- **CitySprint**, the UK's leading same-day delivery service network, saw maintainable earnings increase by 18% during 2014, both through organic growth and acquisitions. The business has continued to perform well in 2015 pushing earnings higher and, in July 2015, the company completed its 20th acquisition since Dunedin first acquired a stake in December 2010. The

EBITDA multiple has been increased from 8.0x to 9.0x to reflect the company's increasing scale, lifting the valuation of DNE's holding to £22.3m, representing 21.3% of NAV.

- **Hawksford**, a leading independent fiduciary services provider in the Channel Islands, saw lower fee levels affect profitability in 2014 and DNE reduced the multiple used to value its holding. Business has improved in 2015 and the EBITDA multiple has been increased from 7.0x to 8.0x, which compares with recent sector transaction multiples of 9-10x. Lower net debt has also helped to lift the valuation to £10.4m, making it the second largest portfolio holding.
- **Kee Safety**, a global market-leading provider of safety systems and personal hazard protection products, increased its maintainable earnings by 12% during 2014, justifying the change of valuation from a cost to an earnings basis. Earnings growth of 10% was achieved in H115 resulting from both organic growth and acquisitions, with continued investment to generate future growth. Six acquisitions have been completed since Dunedin first invested in December 2013. Higher earnings pushed the valuation up to £8.2m, with the EBITDA multiple held at 9.0x.

The sustained lower oil price led to valuation reductions for two portfolio companies:

- **EV Offshore**, a leading provider of high-performance video cameras for well diagnostics, traded strongly following investment in June 2014, supporting the valuation moving from a cost to an earnings basis. Although it operates in a growing niche, primarily supplying the production side of the industry, and so less affected by the fall in oil price, trading weakened in early 2015. Although business has improved in recent months, maintainable earnings expectations have been lowered, reducing the valuation to £5.8m, with the EBITDA multiple maintained at 9.5x.
- **Premier Hytemp**, a provider of engineered steel, nickel alloys and machined components to the oil and gas industry, has been most affected by the oil price fall due to its dependence on exploration expenditure. While lower demand from key customers led to DNE writing down its investment to asset sale valuation in 2013, reduced demand and lower margins following the oil price fall in late 2014 have seen the valuation reduced by a further £1.0m to £3.6m.

Valuation multiples and debt profile

Primarily due to the higher multiples used to value CitySprint and Hawksford, the weighted average EV/EBITDA multiple for DNE's portfolio increased from 7.6x at end December 2014 to 7.9x at end June 2015. EBITDA multiples range from 5.5x for Pyroguard (formerly CGI) to 9.5x for EV Offshore.

Although the proportion of companies with net debt higher than 2.0x has increased from 59% at end December 2014 to 63% at end June 2015, no companies have net debt above 3.0x EBITDA (previously 10%), and over the six months the weighted average net debt/EBITDA multiple has declined from 2.2x to 2.1x. 37% of portfolio companies' debt matures in 2017 and 41% in later years, which suggests that appropriate medium-term financing is in place across the portfolio and that growth prospects should not be constrained by debt repayments.

New investments and realisations

New investments totalled £10.6m in H115, with £7.8m drawn down by DNE-managed funds and £2.8m by European third-party managed funds Innova/5 and Realza Capital. In March 2015, a £4.9m new investment was made in Blackrock Programme Management, a provider of consulting services to large, international construction projects, and follow-on investments were made in Red (£1.5m) and Steeper (£0.3m). Realza made new investments in packaging finishes provider, Litalsa (£1.4m) and premium tomato producer, Cualin Quality (£1.2m). Management fees of £1.1m were drawn by DNE funds, while the European funds drew down £0.2m to cover expenses.

Realisations totalled £3.0m in H115, with £1.7m received from Enrich following the successful outcome of the court case against the vendor. Innova returned £1.0m after the partial realisation of its investment in Polish internet portal company, Wirtualna Polska at IPO, while Realza distributed £0.3m due to strong cash generation by investee company, GTT.

Outlook

While DNE's rate of new investment has been relatively steady over the last few years, the lack of major portfolio exits since the sale of Practice Plan in 2013 means that realisations are now a key focus for management and investors. DNE has a mature portfolio and management views the prospects for exiting investments as favourable, suggesting scope for the pace of realisations to pick up in the near term. The seasonality of private equity activity makes December/January the likely timing across the industry for closing transactions currently being negotiated, with March/April and June being the other seasonal peaks.

Historically, management reports typical valuation uplifts of c 20% on the sale of investments and this indicates the potential for significant valuation gains to be realised as mature investments are exited. DNE has a policy of distributing at least 50% of capital gains so realisations will create the prospect of a tender offer being announced to buy back shares, as well as the possibility of special dividends.

DNE management has not given a recent update on the prospect of divesting its European fund investments. While it indicated earlier in 2015 that there was further value to be realised from these holdings, the secondary market for Spanish funds such as Realza has been relatively strong recently, which could encourage DNE to review its plans later in the year.

Maturing portfolio

A low pace of realisations from the DNE-managed portfolio during 2014 and 2015 has seen a notable maturing of DNE's portfolio. While investments held for more than five years represented 38% of its portfolio value at end June 2015, DNE's largest investment CitySprint has been held since December 2010, as has U-POL. These two holdings represented 26% of the portfolio and would bring investments held longer than five years to over 60% by end 2015 based on current valuations; this would be the highest level in the last 10 years.

Cash and commitments

During H115, DNE's outstanding commitments reduced by £7.6m and total funding declined by £9.4m, with £1.7m distributed to shareholders in addition to fund drawdowns. While unfunded commitments have increased from £33.9m to £35.7m during the six months, DNE expects only up to 80% (c £45m) of the total £56.2m outstanding commitments to be drawn down. The largest commitment is £36.0m to Dunedin Buyout Fund III, with drawdowns expected to be spread over the remaining investment period to December 2017. Management expects that the £20.5m in available funds, together with potential realisations, will be sufficient to meet the likely take-up of commitments.

Discount: Scope for narrowing

DNE's share price discount to NAV narrowed from over 35% to below 25% between September and October 2012 and remained at a similar level, averaging 22% over the subsequent two years. During the second half of 2014 and first half of 2015, DNE's discount widened from c 15% to c 40%, which partly reflects the lacklustre overall performance during this period, with investment writedowns largely offsetting valuation gains across the portfolio. The widening of the discount was compounded by additional selling pressure on the shares as a consequence of DNE leaving the FTSE All-Share index at the June 2015 rebalancing. The fall in its market cap means that DNE no longer qualifies for inclusion in the index. Currently standing at 36%, there is scope for the discount to narrow significantly once NAV performance improves, with the announcement of portfolio realisations seeming likely to act as a catalyst.

Peer group comparison

Exhibit 4 shows a comparison of DNE with a peer group of UK-focused funds selected from the AIC private equity sector, which has 41 constituents. DNE's NAV total return has lagged the selected peer group and broader private equity sector over one, three, five and 10 years, which may be seen partly as a reflection of the relative maturity of DNE's portfolio, as well as the differentiated returns that can be provided by a small-cap private equity portfolio. DNE's lower than average returns appear to be fully reflected in DNE's wider than average share price discount to NAV. Its smaller fund size contributes to its 2.89% ongoing charge, which captures all the DNE fund fees, being higher than average. DNE's 1.5% dividend yield is a further reflection of the relatively low number of realisations over the last year.

Exhibit 4: Private equity closed-ended peer group as at 30 June 2015

% unless stated	Market cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Discount (ex-par)	Ongoing charge	Net gearing	Dividend yield (%)
Dunedin Enterprise	67.1	1.0	(5.9)	28.8	45.6	(35.6)	2.89	101	1.5
Electra Private Equity	1,169.6	20.7	47.4	87.5	246.2	(9.8)	2.96	111	3.1
Graphite Enterprise Trust	415.2	0.3	22.9	60.6	114.9	(17.9)	1.35	100	1.7
HgCapital Trust	395.8	3.0	15.1	46.5	168.6	(17.1)	2.46	87	3.0
Selected peers average	511.9	6.2	19.9	55.8	143.8	(20.1)	2.42	100	2.3
Sector median	108.2	5.4	17.6	44.6	84.1	(20.2)	2.24	97	2.9

Source: Dunedin Enterprise Investment Trust, Morningstar, Edison Investment Research. Note: TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. Market cap and discount as at 1 October 2015.

The board

Angela Lane was appointed as a director in June 2015, enlarging the board to five independent directors. She spent 18 years working in private equity at 3i where she was a partner in the growth capital business managing the UK portfolio. The other board members are Duncan Budge (appointed director April 2012, chairman May 2014), Liz Airey (appointed 2005), Brian Finlayson (appointed 2007), Federico Marescotti (appointed 2009).

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