

# Dunedin Enterprise Investment Trust

## UK buyout market expected to strengthen in 2015

For the first nine months of 2014, Dunedin Enterprise Investment Trust (DNE) reported a modestly lower NAV. Two portfolio companies saw significant valuation uplifts driven by strong earnings growth, but these were offset by a net NAV reduction across other holdings. Disappointing developments at two companies in particular have been addressed, with one company sold during the period. Most portfolio companies are forecasting higher profits for 2014 and the manager reports a number of potential investments currently being considered, with the UK buyout market expected to strengthen in 2015 after a relatively quiet period.

12 months ending	Share price return	NAV return	FTSE Small Cap ex Inv. Trusts	LPX United Kingdom	FTSE All-Share ex Inv. Trusts
31/10/11	(0.6)	21.9	(6.9)	(0.9)	0.7
31/10/12	53.8	4.5	22.4	17.4	9.9
31/10/13	1.6	0.5	47.8	32.3	22.8
31/10/14	(10.2)	(2.8)	(0.1)	4.6	0.9

Source: Datastream. Note: All % total return. LPX index is for listed PE funds.

## Results for nine months to 30 September 2014

DNE recorded a -2.1% NAV total return for the first nine months of 2014, which compares with the FTSE Small Cap Index's -1.8% return. In the reported £11.6m NAV decline, a tender offer and dividend payments absorbed £8.9m. The most significant unrealised valuation movements were £4.0m and £3.0m increases at Weldex and CitySprint and a £3.7m reduction at Red Commerce. The investment in Trustmarque was sold, realising a £2.7m loss. Investments of £13.2m were made, including £5.9m in EV Offshore, a new addition to the portfolio in June 2014.

## Outlook

The manager reports that the majority of portfolio companies are forecasting higher EBITDA in 2014. There could be some risk to these forecasts from softening global growth expectations, but specific circumstances and management initiatives are likely to be key factors affecting growth. The manager expects a stronger UK buyout market in 2015 and reports that a number of new investment opportunities are currently under consideration. While DNE has a total of £66.4m in undrawn commitments, the manager expects only around £44m to be drawn down. DNE has a £20m credit facility, in addition to cash of £9m and prospective realisations to fund these commitments.

## Valuation

The average earnings multiple applied to DNE's managed portfolio increased from 7.1x EBITDA at end 2013 to 7.5x at 30 September 2014, primarily affected by new investments as well as a re-rating of CitySprint, the largest portfolio holding. Having narrowed to 16% in July 2014, DNE's share price discount to NAV has recently widened to a two-year low of close to 30%. This suggests scope for the discount to narrow markedly as sentiment improves.

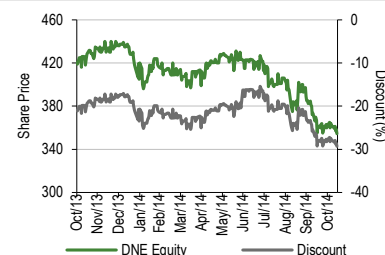
## Investment trusts

18 November 2014

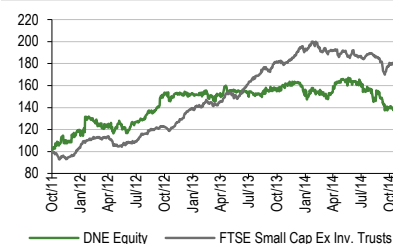
<b>Price</b>	<b>355p</b>
<b>Market cap</b>	<b>£74m</b>
<b>AUM</b>	<b>£105m</b>

NAV	501.7p
Discount to NAV	29.3%
Yield	4.6%
Ordinary shares in issue	20.9m
Code	DNE
Primary exchange	LSE
AIC sector	Private Equity

## Share price/discount to NAV



## Three-year cumulative perf. graph



52-week high/low	440.0p	354.5p
NAV* high/low	542.1p	501.4p

\*Excluding income.

## Gearing

Gross	0.0%
Net cash	9.0%

## Analysts

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### Exhibit 1: Dunedin Enterprise Investment Trust at a glance

#### Investment objective and fund background

Dunedin Enterprise Investment Trust 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 with the aim of partnering 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 news

- 7 November 2014: Q3 IMS – NAV total return -0.6% in three months to 30 September 2014; Trustmarque investment sold; £3.5m new investments.
- 28 August 2014: Interim results – NAV total return -1.7% in six months to 30 June 2014; £2.3m realisations and £9.8m new investment in the half year.
- 25 June 2014: £5.9m investment in EV Offshore announced.
- 15 May 2014: £5.2m returned to shareholders through tender offer.

#### Forthcoming announcements/catalysts

AGM	May 2015
Preliminary results	March 2015
Year end	December
Next dividend	May 2015
Launch date	1974
Wind-up	N/A

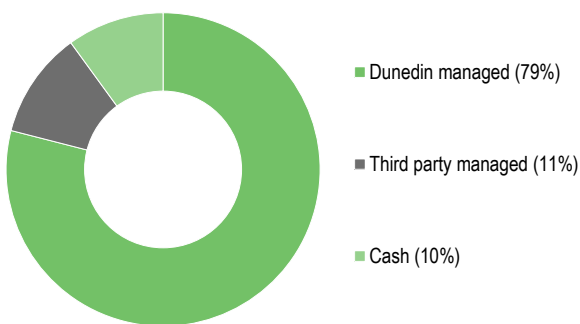
#### Capital structure

Ongoing charges	2.8%
Net cash	9.0%
Annual management fee	N/A
Performance fee	N/A
Trust life	Unlimited
Loan facilities	£20m

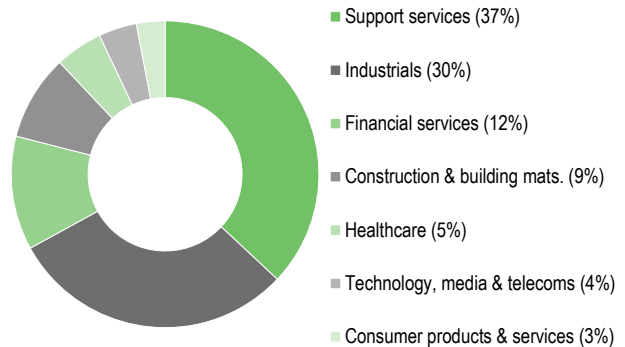
#### Fund details

Group	Dunedin Enterprise
Manager	Dunedin LLP
Address	Saltire Court, 20 Castle Terrace, Edinburgh
Phone	+44 131 225 6699
Website	www.dunedinenterprise.com

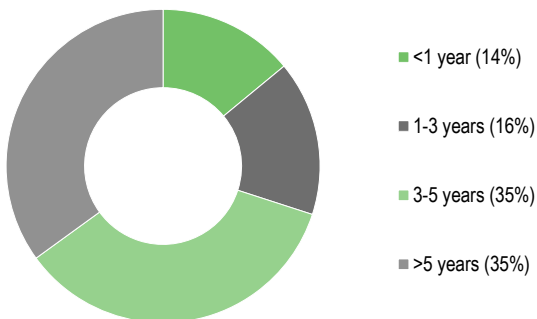
#### Funds under management (as at 30 June 2014)



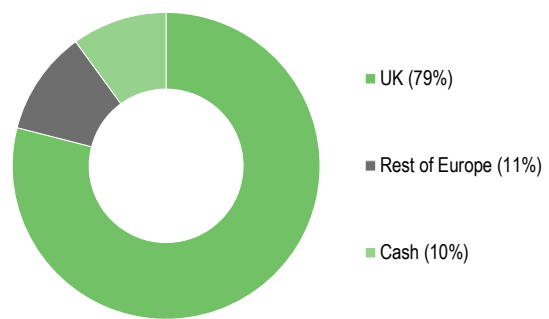
#### Sector breakdown (as at 30 June 2014)



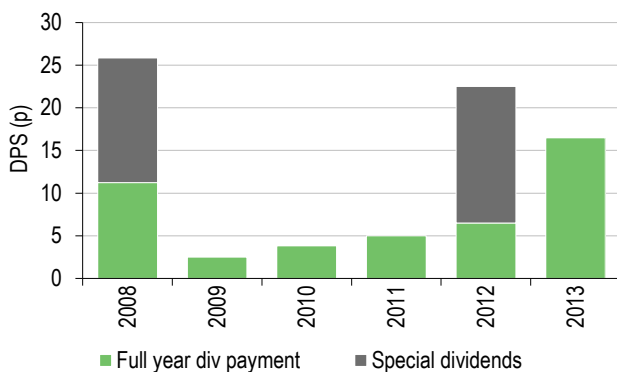
#### Age of investment (as at 30 June 2014)



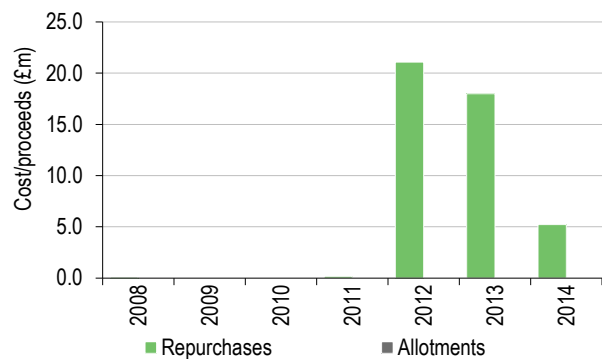
#### Geographic split of investments (as at 30 June 2014)



#### Dividend history



#### Share buyback history



Source: Dunedin Enterprise Investment Trust, Edison Investment Research

## First nine months 2014 performance

DNE's -2.1% NAV total return in the nine months to September 2014 compares with the -1.8% and 0.5% returns of the FTSE Small Cap ex-IT and FTSE All-Share ex-IT indices, which have both seen more muted performances in 2014 compared with the previous two years. Exhibit 2 shows an analysis of the movement in DNE's NAV, with value gains and reductions broadly offsetting and distributions to shareholders through tender offer and dividend payments equivalent to c 75% of the £11.6m decline in reported NAV.

**Exhibit 2: NAV movement attribution for nine months to 30 September 2014**

£m	H114	Q314	9m14	£m	H114	Q314	9m14
<b>Dunedin-managed direct investments</b>				<b>Other factors</b>			
Weldex	2.2	1.8	4.0	Tender offer	(5.2)	0.0	(5.2)
CitySprint	1.4	1.6	3.0	Dividend	(3.6)	0.0	(3.6)
Enrich	1.8	0.0	1.8	Other movements	(0.7)	0.0	(0.7)
RSL Steeper	0.6	0.0	0.6	<b>Total other factors (2)</b>	<b>(9.5)</b>	<b>0.0</b>	<b>(9.5)</b>
Hawksford	0.0	(1.2)	(1.2)				
U-POL	(0.7)	(1.0)	(1.7)	<b>Total NAV change (1+2)</b>	<b>(10.9)</b>	<b>(0.7)</b>	<b>(11.6)</b>
Trustmarque	(3.0)	0.3	(2.7)				
Red Commerce	(2.5)	(1.2)	(3.7)	Opening NAV	116.3	105.4	116.3
<b>Sub-total</b>	<b>(0.2)</b>	<b>0.3</b>	<b>0.1</b>	Closing NAV	105.4	104.7	104.7
Other investments	(0.3)	(0.4)	(0.7)				
<b>Total Dunedin funds</b>	<b>(0.5)</b>	<b>(0.1)</b>	<b>(0.6)</b>				
Third-party funds	(0.9)	(0.6)	(1.5)				
<b>Total portfolio NAV (1)</b>	<b>(1.4)</b>	<b>(0.7)</b>	<b>(2.1)</b>				

Source: Dunedin Enterprise Investment Trust, Edison Investment Research

Exhibit 2 shows the breakdown of valuation movements in the Dunedin-managed portfolio. The most significant valuation movements in the six months were:

- the valuation of crawler crane hire company **Weldex** has returned to an earnings basis from a net assets basis as the business has seen a sustainable earnings uplift with the construction sector cycle turning;
- same-day delivery service network **CitySprint** continues to perform well, generating growth both organically and through acquisitions. In addition to higher sustainable earnings, the valuation has benefited from a re-rating to 8.0x EBITDA, together with a reduction in bank debt;
- maintainable profit forecasts at global SAP solutions provider **Red Commerce** were reassessed by the recently appointed new executive team with expected lower margins in the contract division and lower activity in the permanent division; and
- a change in revenue recognition accounting at software management services provider **Trustmarque** resulted in a material reduction in maintainable earnings and a funding shortfall. In September 2014, Trustmarque was acquired by Liberata UK and DNE sold its entire 12.2% stake in the business, in which it had invested a total of £4.3m since June 2013. DNE acknowledges the disappointing outcome and has refocused the application and effectiveness of its due diligence procedures. This was incorporated into the due diligence process that was undertaken for its latest investment in EV Offshore.

## Additions and disposals

During the first nine months of 2014, DNE made total investments of £13.2m. The largest was a new investment of £5.9m to support the management buyout of EV Offshore, a manufacturer and supplier of high-performance, ruggedised video cameras used to diagnose and analyse problems in oil and gas wells. DNE is attracted to the strong market position the company enjoys supported by its technology and experience. The investment should help EV Offshore to continue its international

expansion. A further £1.3m was invested in Hawksford, enabling it to acquire Singapore-based corporate services provider Janus Corporate Solutions. This is the fifth acquisition by Hawksford since Dunedin made its initial investment in October 2008. Drawdowns totalling £1.8m were made by Dunedin to cover management fees.

The Polish and Spanish private equity funds Innova/5 and Realza Capital drew down £4.3m, investing £3.9m in three new investments and £0.4m was drawn to meet management expenses and operating costs. DNE realised a total of £1.7m from Innova/5 and Realza Capital. The intention remains to realise these fund investments, but DNE is prepared to be patient to achieve full value. Realisations of £2.2m from DNE's own portfolio took total realisations to £3.9m.

## Commitments versus cash

£5.2m was returned to shareholders under a tender offer in May 2014 for 5% of the issued share capital at 475p per share equating to a 10% discount to reported NAV at end 2013. The 2013 final dividend of 16.5p per share totalling £3.6m was also paid in May 2014. These distributions, which absorbed £8.9m together with net investments of £9.4m, accounted for the majority of the £18.5m decline in DNE's cash from £27.9m to £9.4m at 30 September 2014. DNE's commitments at end September 2014 totalled £66.4m, while cash and a revolving credit facility of just under £30m left an unfunded commitment of £37m. Management is comfortable with this given the likely 70% take-up of commitments, potential realisations and expectation that Dunedin Buyout Fund III commitments will be spread over the next four years.

## Outlook

The majority of portfolio companies are budgeting increased profits in 2014. The stability of the domestic UK economic environment should help underpin these expectations, but the recent lowering of the IMF's European and global growth projections does suggest some downside risk. The environment for deals was relatively quiet in the first nine months, but the manager highlights that a number of potential investment opportunities are currently being considered and expects the UK market for exits will be strong in 2015; this would be positive given the relative maturity of DNE's portfolio. Graphite Enterprise Trust noted in its recent results announcement that, although the current environment for new investment remains more challenging than that for realisations, a large number of potential investments are currently being reviewed and it expects other private equity managers to be experiencing a similar flow of new opportunities. Dunedin also benefits from an established network in the UK mid-market, enabling it to seek opportunities through approaching vendors directly ahead of a sale process being initiated, as demonstrated by its investment in EV Offshore.

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