

## Investment Companies Daily

CLDN capital markets day, III realisations, JPEL NAV, FPEO credit facility, INPP acquisition, ERET redemption

- **Caledonia Investments** - On Friday, Caledonia hosted a capital markets day, which featured presentations from the managers of its four investment pools. More detailed descriptions of these presentations are in the note but in summary we saw this as a fitting book end to the strategic review process started in 2011. The presentations highlighted that Caledonia has come a long way during this time, now benefiting from a firmly embedded pool structure, with distinct resource allocated to each capital pool and clear lines of accountability.
- While we note that there is still some work to do at the margin, such as some legacy UK private equity investments remaining within the funds pool, and the income and growth pool still slightly below its target allocation, the broad shape of the portfolio looks to be as intended. The overall portfolio is now more concentrated but flatter (bar the income and growth pool constituents), with an attractive running yield of around 3%. This looks to be feeding through to some good near term performance. Stripping out the NAV uplifts from the recent sales of Oval and Amber Chemicals, the NAV return for H1 2014 (using Morningstar NAVs) would still have been 6.2%, against a flat FTSE All-Share.
- The presentation on the unquoted pool gave us further confidence that Caledonia's differentiated approach to private equity investments is likely to benefit its longer-term returns. The recent disposal activity has helped highlight this as a clear source of value, although the longer potential holding period which is central to Caledonia's approach means that it is hard to predict when further realisations may occur. Caledonia's shares currently trade on an 18.1% discount to our live NAV, which includes the potential valuation increase for JD.com as per the announcement on 19/06/14. We therefore continue to see Caledonia as an attractive opportunity and remain **Overweight**.
- **3i** yesterday announced the sale of Foster + Partners and today the refinancing of Amor. Foster is a top ten investment in which 3i held a minority stake. 3i invested in the architectural practice in 2007 and for a pre-GFC investment has made a respectable 1.8x money. The cash proceeds of £70m and deferred consideration of £40m (with interest) will result in a modest £2m uplift to the 31/3/14 carrying value. Amor, the market leader for previous jewellery in the lower priced end of the market has completed a refinancing. 3i will receive £21m of cash proceeds from this 2010 deal vs the £50m cost and the 31/3/14 valuation of £70m.
- Both transactions are indicative of the strong market for selling or

**See page 11 for analyst certification and important disclosures, including non-US analyst disclosures.**

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### UK Investment Companies

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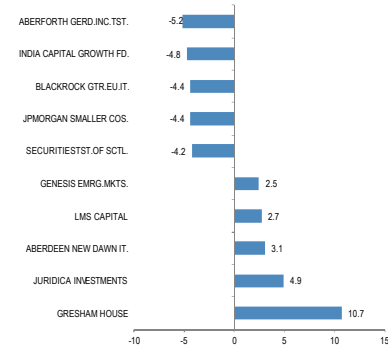
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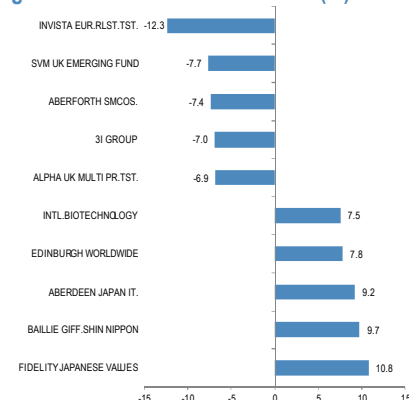
J.P. Morgan Securities plc

### Largest movers over the last week (%)



Source: Thomson Reuters Datastream

### Largest movers over the last month (%)



Source: Thomson Reuters Datastream

refinancing assets and no doubt lie behind the company's confidence in achieving realisation proceeds of a similar magnitude to last FY's £677m. Indeed, with just one quarter of the current FY gone, we estimate that realisation proceeds are running at about £315m, or £355m taking into account of the deferred consideration from Foster. Thus we think it reasonable that 3i can pay out 15pps for FY 14 (the 20p in FY13 was boosted by a large realisation carried over from the prior year) which implies a forward yield of around 3.7% at the current price. With a rather buoyant market for selling assets, the payout policy is a good discipline, in our view, as it will reduce 'cash drag' without gearing up the balance sheet to any great extent. The main challenges that 3i faces are to raise third party capital (it has recently done so in the CLO market) and to find attractive new investment opportunities without overpaying for them. Recent transactions have been of a proprietary nature and have all been bought for less than 8x. Our live NAV is currently 345p (ex the final and special dividends) to which the shares trade at a 17.2% premium. We believe the potential upside on Action alone can justify the premium to book value, but other supporting reasons to be more bullish include strong earnings growth (14% ex Action), a right-sized cost base, a lower net interest charge and the optionality inherent in the fund management operations. We remain **Overweight**.

- **F&C Private Equity** has entered into a new 5 year facility of £70m with RBS, comprising a €30m term loan from September 2014 and a £45m multi-currency revolver available immediately. The new rate will be significantly lower than the GRY on the zeros and the margin is less than that on the existing £50m facility due to mature in February 2016 that has now been cancelled. Covenants are similar.
- This looks to be a very positive outcome that provides certainty for the trust, enabling it to both repay its zero and continue to make new investments with the balance. While gearing will initially be quite high (it is currently 19% of NAV), strong cashflows should enable it to come down to a more sensible level. And there will be a meaningful reduction in the cost of funding.
- **J.P.Morgan Private Equity** (JPEL) reported an end May NAV of \$1.13 per share, up 1.8% over the month, reflecting the performance of Deutsche Annington (DA) and Placid Holdings, the latter a recent investment that generated strong revenue growth. With distributions of \$37.8m during the month the company was able to repay \$27.2m of its bank debt and end the month net cash positive (excluding the zeros). Following the partial exit from Deutsche Annington, JPEL now holds 1.8m shares, which represent around 14% of NAV.
- This was a good month for JPEL which has been able to deleverage, although it still has plans to reinvest before offering shareholders a realisation share class. Counting the zeros as debt - as we do - net leverage is an estimated 32% of NAV, which is still one of the highest in the sector. Marking currency, DA and the zeros to market we think the

current NAV is in the region of \$1.12 which although implying a headline discount of 31% at the current price, means that the discount on the equity base (i.e. including the zeros) is a more comparable 20.3%. We would require further evidence of the NAV being on an upwards trajectory before becoming more positive, and hence remain **Underweight**.

- **International Public Partnerships** (INPP) has acquired a 72% direct investment in the second phase of the Nottingham Building Schools for the Future (BSF) portfolio, increasing its stake to 82%. The consideration is £2.75m.
- **European Real Estate Investment Trust** announced that it will return approximately £6.4m (equivalent to 19.3p per share) on 10 July 2014 by way of a compulsory partial redemption of shares. The redemption will be affected at the estimated unaudited redemption NAV per share as at 30 June 2014 of 182p per share. The redemption will be made pro rata to holdings of shares on the register at the close of business on the record date, being 10 July 2014. On this basis 10.6% of the company's issued share capital would be redeemed.

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## Conventionals

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### Caledonia Investments – Capital markets day

On Friday, Caledonia hosted a capital markets day, which featured presentations from the managers of its four investment pools.

#### Quoted Pool

Mathew Masters presented on the quoted pool. He explained that Caledonia allocates directly to quoted investments as it has a proven ability to generate strong returns over the long periods of time. Just over 50% of the quoted portfolio has been held for over ten years, with the total shareholder return of holdings such as Close Brothers, AG Barr, Bristow and Polar Capital (while quoted) averaging 15% p.a., against a return objective for the pool of 10%. The aim is to invest in businesses of proven quality, ideally with compounding revenue lines and low financial leverage in order to capture the cash generation. The team (of four) behind the quoted pool operate a strong valuation discipline, attempting to select good entry points in order to invest with a margin of safety. A recent example is Rolls Royce, which was purchased following the profit warning.

#### Unquoted

Duncan Johnson presented on the unquoted pool. The unquoted pool strategy is to hold a portfolio of 8-10 equity investments constituting c.20-35% of Caledonia's NAV. The pool targets returns in excess of 15% p.a. Duncan explained that Caledonia has a genuinely differentiated product offering, generating proprietary deal flow. The key differentiator against the private equity market is Caledonia's longer term potential holding period of between seven and ten years. He described Caledonia's approach as 'hands with' rather than 'hands on' but willing to intervene where performance is adrift. Caledonia has the ability to optimise exit timing due to its permanent capital structure, with trade deals as the preferred exit route. Caledonia's approach is also differentiated by the lower level of financial risk taken, with only modest use of debt and alignment of interest through dividends.

The investment criteria are mid-market deals, in established businesses headquartered in the UK, with demand-led drivers to underpin growth, rather than businesses at 'inflection points'. Downside protection is provided through the deal structure (such as using preference equity for the acquisition of a minority stake in B&W) and business type. Caledonia's strong deal flow gives the team the confidence to wait for the right opportunities. In the year to 31/03/14, there were 220 opportunities presented to Caledonia, with 96 of these actively reviewed. Of these seven bids were made, with exclusivity achieved on two, which led to the acquisitions of Park Holidays and Choice Care Group.

#### Funds Pool

Eloise Fox presented on the funds pool. Eloise explained that the fund pool has a return target of 12.5%, with an allocation of 15-20% of Caledonia's NAV. The programme concentrates on Asia and North America as these are areas of the world where Caledonia finds it more difficult to invest directly. The North American private equity fund programme targets US lower mid-market funds, while the Asian programme covers a wider range of private equity funds. The private equity fund intended allocation has a broad 50:50 split between North America and Asia, although the current portfolio still includes legacy positions in UK private equity

funds, which means the actual portfolio is approximately split a third in each of these groups. The team's approach to selecting funds is sector agnostic but looking for mid market funds, with no venture capital funds as the returns are seen as too volatile. The quoted market funds also broadly allocate 50% between North America and Asia, with some exposure to global funds. The quoted funds are also chosen on a sector agnostic basis, but with concentrated value-biased portfolios across all cap sizes.

### Income & growth pool

Stephen Mitchell presented on the income & growth pool. This pool has a strategic target of 15-20% of Caledonia's NAV (currently 14%), with a yield target of 4.5-5%. The aim is to identify market leading companies, with growing cash generation underpinning their dividend growth. The portfolio should be value-biased, holding companies with a high return on invested capital, high dividend yields but with low financial gearing. Often these companies will have strong brands to act as a defensive feature. The portfolio is constructed using three yield tiers: *high yield*, with yields of over 5.5% (e.g. Zurich Insurance and Swedbank), which enhance the portfolio's overall yield and allow for the inclusion of 'growth' names; *core stocks* (e.g. Standard Life and SES), which yield 4-5.5%; and *growth stocks* (e.g. General Electric and Intel), which yield 3-4% and have an attractive and visible growth profile. The 3% yield in the latter tier is the dividend floor for the portfolio and helps enforce a strict sales discipline. In the three years since inception of the portfolio in March 2011, it delivered a NAV total return of 28.4%, against 24.8% from the MSCI World High Dividend Yield Index.

### J.P.Morgan View

- In our view, Caledonia's capital markets day serves as a fitting book end to the strategic review process started in 2011. The presentations highlighted that Caledonia has come a long way during this time, now benefiting from a firmly embedded pool structure, with distinct resource allocated to each capital pool and clear lines of accountability.
- While we note that there is still some work to do at the margin, such as some legacy UK private equity investments remaining within the funds pool, and the income and growth pool still slightly below its target allocation, the broad shape of the portfolio looks to be as intended. The overall portfolio is now more concentrated but flatter (bar the income and growth pool constituents), with an attractive running yield of around 3%. This looks to be feeding through to some good near term performance. Stripping out the NAV uplifts from the recent sales of Oval and Amber Chemicals, the NAV return for H1 2014 (using Morningstar NAVs) would still have been 6.2%, against a flat FTSE All-Share.
- The presentation on the unquoted pool gave us further confidence that Caledonia's differentiated approach to private equity investments is likely to benefit its longer-term returns. The recent disposal activity has helped highlight this as a clear source of value, although the longer potential holding period which is central to Caledonia's approach means that it is hard to predict when further realisations may occur. Caledonia's shares currently trade on an 18.1% discount to our live NAV (price 2219p @ 10.00), which includes the potential valuation increase for JD.com as per the announcement on 19/06/14. We therefore continue to see Caledonia as an attractive opportunity and remain **Overweight**.

## Private Equity

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### 3i – Realisation and refinancing

3i yesterday announced the sale of Foster + Partners and today the refinancing of Amor. Foster is a top ten investment in which 3i held a minority stake. 3i invested in the architectural practice in 2007 and for a pre-GFC investment has made a respectable 1.8x money. The cash proceeds of £70m and deferred consideration of £40m (with interest) will result in a modest £2m uplift to the 31/3/14 carrying value. Amor, the market leader for previous jewellery in the lower priced end of the market has completed a refinancing. 3i will receive £21m of cash proceeds from this 2010 deal vs the £50m cost and the 31/3/14 valuation of £70m.

#### J.P.Morgan View

- Both transactions are indicative of the strong market for selling or refinancing assets and no doubt lie behind the company's confidence in achieving realisation proceeds of a similar magnitude to last FY's £677m. Indeed, with just one quarter of the current FY gone, we estimate that realisation proceeds are running at about £315m, or £355m taking into account of the deferred consideration from Foster. Thus we think it reasonable that 3i can pay out 15pps for FY 14 (the 20p in FY13 was boosted by a large realisation carried over from the prior year) which implies a forward yield of around 3.7% at the current price of 403.8p (@10.00).
- With a rather buoyant market for selling assets the payout policy is a good discipline, in our view, as it will reduce 'cash drag' without gearing up the balance sheet to any great extent. The main challenges that 3i faces are to raise third party capital (it has recently done so in the CLO market) and to find attractive new investment opportunities without overpaying for them. Recent transactions have been of a proprietary nature and have all been bought for less than 8x.
- Our live NAV is currently 345p (ex the final and special dividends) to which the shares trade at a 17.2% premium. We believe the potential upside on Action alone can justify the premium to book value, but other supporting reasons to be more bullish include strong earnings growth (14% ex Action), a right-sized cost base, a lower net interest charge and the optionality inherent in the fund management operations. We remain **Overweight**.

### F&C Private Equity – New loan facility

The Board has entered into a new 5 year facility of £70m with RBS, comprising a €30m term loan from September 2014 and a £45m multi-currency revolver available immediately. The new rate will be significantly lower than the GRY on the zeros and the margin is less than that on the existing £50m facility due to mature in February 2016 that has now been cancelled. Covenants are similar.

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## J.P.Morgan Private Equity – May NAV

J.P.Morgan Private Equity (JPEL) reported an end May NAV of \$1.13 per share, up 1.8% over the month, reflecting the performance of Deutsche Annington (DA) and Placid Holdings, the latter a recent investment that generated strong revenue growth. With distributions of \$37.8m during the month the company was able to repay \$27.2m of its bank debt and end the month net cash positive (excluding the zeros). Following the partial exit from Deutsche Annington, JPEL now holds 1.8m shares, which represent around 14% of NAV.

### J.P.Morgan View

- This was a good month for JPEL which has been able to deleverage, although it still has plans to reinvest before offering shareholders a realisation share class. Counting the zeros as debt - as we do - net leverage is an estimated 32% of NAV, which is still one of the highest in the sector. Marking currency, DA and the zeros to market we think the current NAV is in the region of \$1.12 which although implying a headline discount of 31% at the current price of \$0.773 (@9.00), means that the discount on the equity base (i.e. including the zeros) is a more comparable 20.3%. We would require further evidence of the NAV being on an upwards trajectory before becoming more positive, and hence remain **Underweight**.

## Infrastructure

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### International Public Partnerships – Acquisition

International Public Partnerships (INPP) has acquired a 72% direct investment in the second phase of the Nottingham Building Schools for the Future (BSF) portfolio, increasing its stake to 82%. The consideration is £2.75m.

## Property

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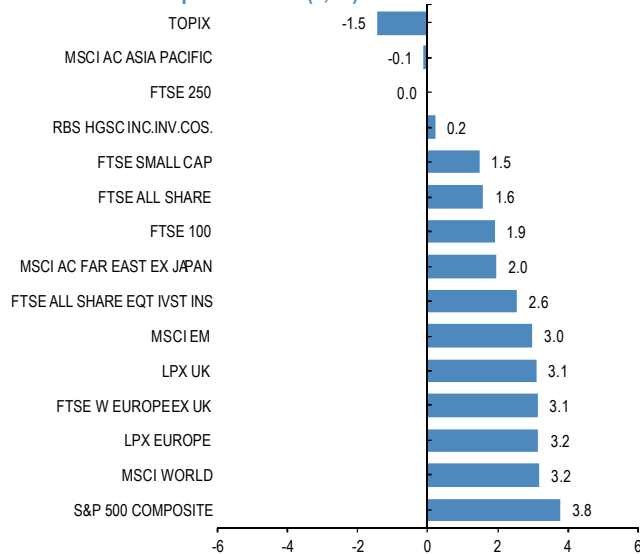
### European Real Estate Investment Trust – Return of capital

ERET announced that it will return approximately £6.4m (equivalent to 19.3p per share) on 10 July 2014 by way of a compulsory partial redemption of shares. The redemption will be effected at the estimated unaudited redemption NAV per share as at 30 June 2014 of 182p per share. The redemption will be made pro rata to holdings of shares on the register at the close of business on the record date, being 10 July 2014. On this basis, 10.6% of the company's issued share capital would be redeemed.



## Sector and market performance

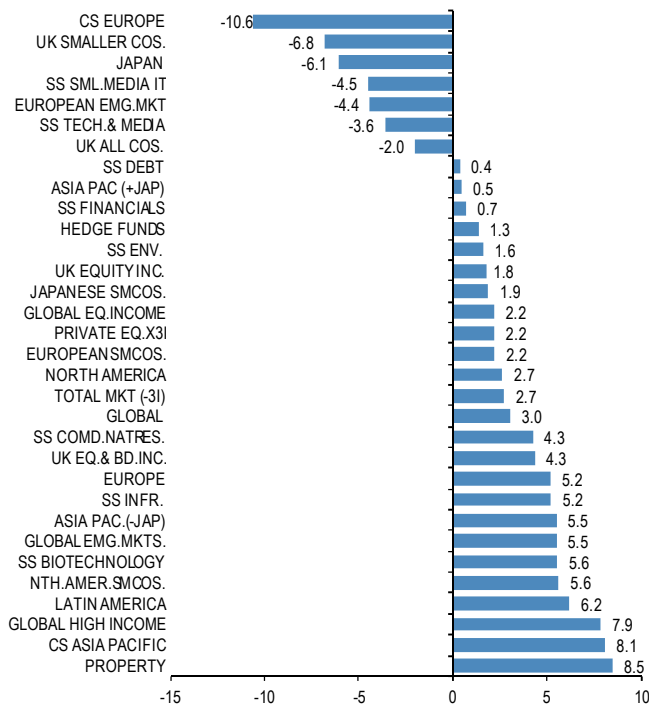
Year to date market performance (£, %)



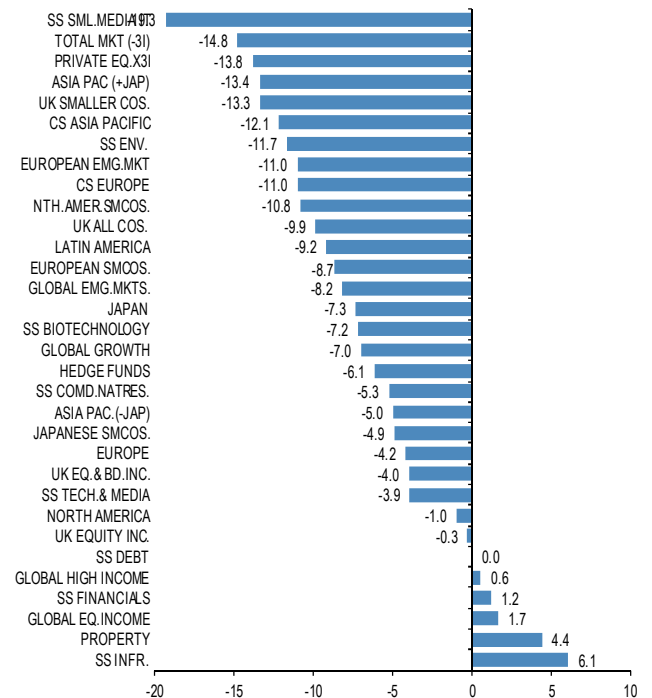
Investment Companies sector performance and discount (RHS)



Investment Companies sector price changes ytd (%)



Investment Companies sector discounts (%)



## Investment Companies Calendar

Company	Date	Details
City Merchants High Yield	03-Jul-14	Continuation resolution
Worldwide Healthcare	07-Jul-14	Continuation resolution
Martin Currie Pacific	10-Jul-14	Extraordinary General Meeting
Jupiter Green	11-Jul-14	Continuation resolution
Templeton Emerging Markets UK	17-Jul-14	Continuation resolution
Aurora	18-Jul-14	Continuation resolution
Montanaro UK Smaller Companies	31-Jul-14	Continuation resolution
Schroder UK Growth	07-Aug-14	Continuation resolution

Source: Morningstar

## Buybacks

Company	Type	Currency	Date	No of shares	Price	Value(£)	No. shares outstanding	(%)	Treasury?
Aberforth Smaller Companies	Ord	£	30 Jun	18,000	1043.20	187,776	95,364,792	0.02	
Acencia Debt Strategies	Ord	£	30 Jun	425,000	107.49	456,833	116,016,949	0.36	
BH Global GBP	Ord	£	30 Jun	30,000	1194.70	358,410	28,877,578	0.10	T
BH Macro EUR	Ord	€	30 Jun	579	19.05	9,243	5,766,145	0.01	T
BH Macro GBP	Ord	£	30 Jun	35,165	1892.41	665,466	41,341,649	0.08	T
BH Macro USD	Ord	\$	30 Jun	10,745	19.58	130,013	21,089,811	0.05	T
Boussard & Gavaudan EUR	Ord	€	30 Jun	8,100	14.21	96,456	35,408,940	0.02	T
Foreign & Colonial	Ord	£	30 Jun	125,000	378.20	472,750	566,677,016	0.02	
Herald	Ord	£	30 Jun	50,000	648.04	324,020	77,629,546	0.06	
Investors Capital A Share	Ord	£	30 Jun	500,000	97.00	485,000	122,854,847	0.41	T
Manchester & London	Ord	£	30 Jun	14,025	258.13	36,203	22,244,157	0.06	T
Monks	Ord	£	30 Jun	500,000	384.35	1,921,750	226,787,859	0.22	
Pantheon International	Red	£	30 Jun	100,000	1066.00	1,066,000	66,194,547	0.15	
Scottish Investment Trust	Red	£	30 Jun	25,000	589.00	147,250	108,909,926	0.02	
Threadneedle UK Select Trust	Red	£	30 Jun	1,731,856	183.00	3,169,296	22,459,914	7.16	T

Source: Morningstar

## Share Issues

Company	Type	Currency	Date	No of shares	Price	Value (£)	No. shares outstanding	(%)	Type
Baillie Gifford Shin Nippon	Ord	£	30 Jun	200,000	327.00	654,000	37,075,497	0.54	Allotment
City of London	Ord	£	30 Jun	150,000	379.60	569,400	284,809,868	0.05	Allotment
European Assets	Ord	£	30 Jun	25,000	953.50	238,375	20,679,332	0.12	Issue from treasury
Henderson Diversified Income	Ord	£	30 Jun	2,000,000	92.30	1,846,000	137,131,726	1.48	Allotment
Schroder Oriental Income	Ord	£	30 Jun	100,000	183.75	183,750	219,641,574	0.05	Allotment
Schroder Oriental Income	Ord	£	30 Jun	100,000	183.23	183,230	219,866,574	0.05	Allotment
Schroder Oriental Income	Ord	£	30 Jun	125,000	183.50	229,375	219,766,574	0.06	Allotment

Source: Morningstar

## Share notifications

Company	Type	Notifier	Date	Shares	%	Resulting shares	Resulting holding (%)
Alliance Trust	Ord	Garrett-Cox Katherine	30-Jun	57		1,793,932	0.32
Aurora	Ord	Barstow James	30-Jun	5,000		900,000	8.66
TwentyFour Income	Ord	Investec Wealth & Investment Ltd	30-Jun			4,402,200	1.65
TwentyFour Select Monthly Inc	Ord	Investec Wealth & Investment Ltd	30-Jun			4,402,200	3.95

Source: Morningstar

**Companies Discussed in This Report** (all prices in this report as of market close on 30 June 2014, unless otherwise indicated)

3i (III.L/402p/Overweight), Caledonia (CLDN.L/2225p/Overweight), F&C Private Equity (FPEO.L/221p/Underweight), International Public (INPP.L/133p/Neutral), JPMorgan Private Equity (JPEL.L//Underweight)

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**Important Disclosures**

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- **Market Maker/ Liquidity Provider:** J.P. Morgan Securities plc and/or an affiliate is a market maker and/or liquidity provider in Caledonia, F&C Private Equity, 3i, International Public, JPMorgan Private Equity.
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- **Client/Investment Banking:** J.P. Morgan currently has, or had within the past 12 months, the following company(ies) as investment banking clients: Caledonia, F&C Private Equity, 3i, JPMorgan Private Equity.
- **Client/Non-Investment Banking, Securities-Related:** J.P. Morgan currently has, or had within the past 12 months, the following company(ies) as clients, and the services provided were non-investment-banking, securities-related: Caledonia, F&C Private Equity, 3i, JPMorgan Private Equity.
- **Client/Non-Securities-Related:** J.P. Morgan currently has, or had within the past 12 months, the following company(ies) as clients, and the services provided were non-securities-related: 3i, JPMorgan Private Equity.
- **Investment Banking (past 12 months):** J.P. Morgan received in the past 12 months compensation from investment banking Caledonia, F&C Private Equity, 3i, JPMorgan Private Equity.
- **Investment Banking (next 3 months):** J.P. Morgan expects to receive, or intends to seek, compensation for investment banking services in the next three months from Caledonia, F&C Private Equity, 3i, JPMorgan Private Equity.
- **Non-Investment Banking Compensation:** J.P. Morgan has received compensation in the past 12 months for products or services other than investment banking from Caledonia, F&C Private Equity, 3i, JPMorgan Private Equity.
- **Broker:** J.P. Morgan Securities plc acts as Corporate Broker to Caledonia, JPMorgan Private Equity.

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**Explanation of Research Ratings:**

For Investment trusts and private equity companies, the following stock recommendation definitions apply: Overweight - the total return on the security is expected to outperform the sector\* by 5% or more over the next six months. Neutral - the total return on the security is not expected to outperform or underperform the sector\* by 5% or more over the next six months. Underweight - the total return on the security is expected to underperform the sector\* by 5% or more over the next six months. \*the sector comprises those securities covered by the analyst(s) where those securities would be included within the relevant AIC, Datastream or Morningstar sub-sectors.

For hedge funds the following stock recommendation definitions apply:

Overweight - the risk-adjusted total return on the security is expected to outperform the sector over the next six months. Neutral - the risk-adjusted total return on the security is not expected to outperform or underperform the sector over the next six months. Underweight - the risk-adjusted total return on the security is expected to underperform the sector over the next six months. \*the sector comprises those

securities covered by analyst(s) within the relevant J.P. Morgan Cazenove sub-sectors. The J.P. Morgan Cazenove sub-sectors are fund of funds (multi-manager) and single manager funds.

#### Research Ratings Distribution:

For investment trust and private equity companies, J.P. Morgan Cazenove research has 230 companies under coverage. 30% have been assigned an OVERWEIGHT rating. 51% of companies within this rating are investment banking clients of the firm. 57% have been assigned an NEUTRAL rating. 55% of companies within this rating are investment banking clients of the firm. 13% have been assigned an UNDERWEIGHT rating. 48% of companies within this rating are investment banking clients of the firm.

Following a systems upgrade on September 8, 2013, relevant to the Investment Trust research team we have amended our method of calculating ratings dispersion data.

#### RECOMMENDATION HISTORY

12 months recommendation changes for International Public;  
No changes in recommendation over the last 12 months.

12 months recommendation changes for Caledonia;  
No changes in recommendation over the last 12 months.

12 months recommendation changes for 3i;  
18 May 2014 Overweight

12 months recommendation changes for F&C Private Equity;  
30 Aug 2013 Underweight

12 months recommendation changes for JPMorgan Private Equity;  
No changes in recommendation over the last 12 months.

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