connection CAPITAL

JANUARY 2019

THE REVIEW

Welcome

Recent research undertaken by Connection Capital suggests that over a quarter of our HNW investors are now allocating more than 20% of their investment portfolio to alternative assets.

It's hardly surprising that private investors are searching for broader diversification, enhanced returns and increased resilience.

After all, volatility buffeted public markets over the last six months of 2018 – with October particularly bruising for many – and long-term returns prospects for traditional assets, such as quoted equities and bonds, are declining. With plenty of political and economic headwinds still to resolve in 2019, diversification remains a good bet.

Investor appetite for alternative investments was reflected in the second half of 2018. We completed a record number of transactions including our fastest fund raise to date (short-term debt opportunity, Portland 88). More detail on investment activity between June and December 2018 is covered in the rest of this newsletter.

In other news, our private debt team has expanded its target investment size to £3-£10m, in response to market demand. This means even more UK SMEs can access our flexible alternative to traditional, sometimes, restrictive lenders.

Lastly, we welcomed Michael Coupland to the private equity team, who has joined to support our portfolio companies.

As ever, if you have any questions, please do get in touch.

Best regards

The Connection Capital team

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Wagamama exit

Deal Completions

Private Equity

Mode Print Solutions

MODE SOLUTIONS — Keeping it SIMPLE since 1995

In August 2018, Connection Capital clients invested £8.1m in the £20.5m management buyout at Mode Print Solutions. 'Mode' is a provider of managed print services to UK SMEs in London and the South East.

The company is fast growing and has a diversified client base, with long-term contracts and a high retention rate. Established in 1995, the company has been transformed since CEO Robert Clarke (profiled overleaf) joined in 2013.

As part of the deal, we introduced an experienced Non-Executive Chairman, Richard Cottrell, who has held senior roles at major print services companies and led multiple private equity-backed MBOs.

23.5 Degrees

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Starbucks franchisee 23.5 Degrees received follow-on funding of £3.6m from our clients to support its ambitious expansion plans in July 2018.

Since our clients' original £5.6m investment in 2015, the company has grown from 13 stores to 62, with the most recent opening in York in December. There is a strong pipeline of future sites and plans are for further store expansion throughout 2019.

Exit News

Wagamama

The popular Asian-themed restaurant has been sold to The Restaurant Group, the listed UK independent restaurants group, for an enterprise value of £559m.

The sale which was voted through in December has generated a gross return of 3.4x and is one of the largest ever private equity transactions in the UK casual dining space.

Wagamama continues to trade very strongly. In the year to 19 August 2018, the company generated revenue of £307m and Ebitda of £43m (post pre-opening costs).

Connection Capital clients invested in 2011 as part of co-invest with Duke Street Capital when the chain had 70 restaurants. Since then, Wagamama's network has grown into 133 restaurants in the UK, five in the US, and 58 franchise restaurants in 23 markets across Europe, the Middle East and New Zealand.

Private Debt

Torquay Leisure Hotels

Clients provided £3.5m of secured debt into the MBO of a multi-hotel and leisure resort in July.

Located on Devon's English Riviera coast, Torquay Leisure Hotels Limited comprises four semi-autonomous 3* hotels with a total of 421 bedrooms and 17 apartments on a seven-acre estate, with numerous bars and restaurants on site.

The facilities, which include eight ballrooms and bowling greens, provide the resort with a high level of forward bookings and repeat business and help to deliver an unusually high level of year-round occupancy.

Target net returns are 1.9-2.2x over five years.

Vanburgh Court

Connection Capital clients invested £2.3m, as part of an £8.3m secured loan, to fund the development of a new 117-home residential property, Vanburgh Court. Located in a prime commuter location in central Slough, the property will offer a mixture of reasonably priced but well-specified studio, one and two-bedroom apartments with communal landscaped areas.

This was a popular investment, backing an experienced developer with the site almost complete and over a third of the units already sold. The investment was made in partnership with ASK Partners, a specialist property finance business.

Portland 88

Clients took the opportunity to invest £2.6m in a secured debt deal to provide working capital and equity release to Barnett Developments Group Limited for Portland 88, a multi-unit new-build residential development in central Belfast.

The investment holding period of c.12 months, with a target net internal rate of return (IRR) of 17%, proved extremely attractive to clients looking to invest in residential property. As a result, this was our fastest fundraise to date with the deal fully subscribed within three days.

Alternative Funds

Connection Therium No2 LLP

We raised a total of £10m in the fourth litigation funding vehicle that we have offered to Connection Capital clients. Advised by Therium Capital Management, the vehicle backs commercial litigants and takes a share of the proceeds of successful claims. Target net returns are c2x.

This asset class remains extremely popular with our clients. Returns are completely uncorrelated with other asset classes and the wider economy, therefore it can provide improved diversification in an investment portfolio. Early distributions are also likely.

Blantyre Special Situations Fund 1

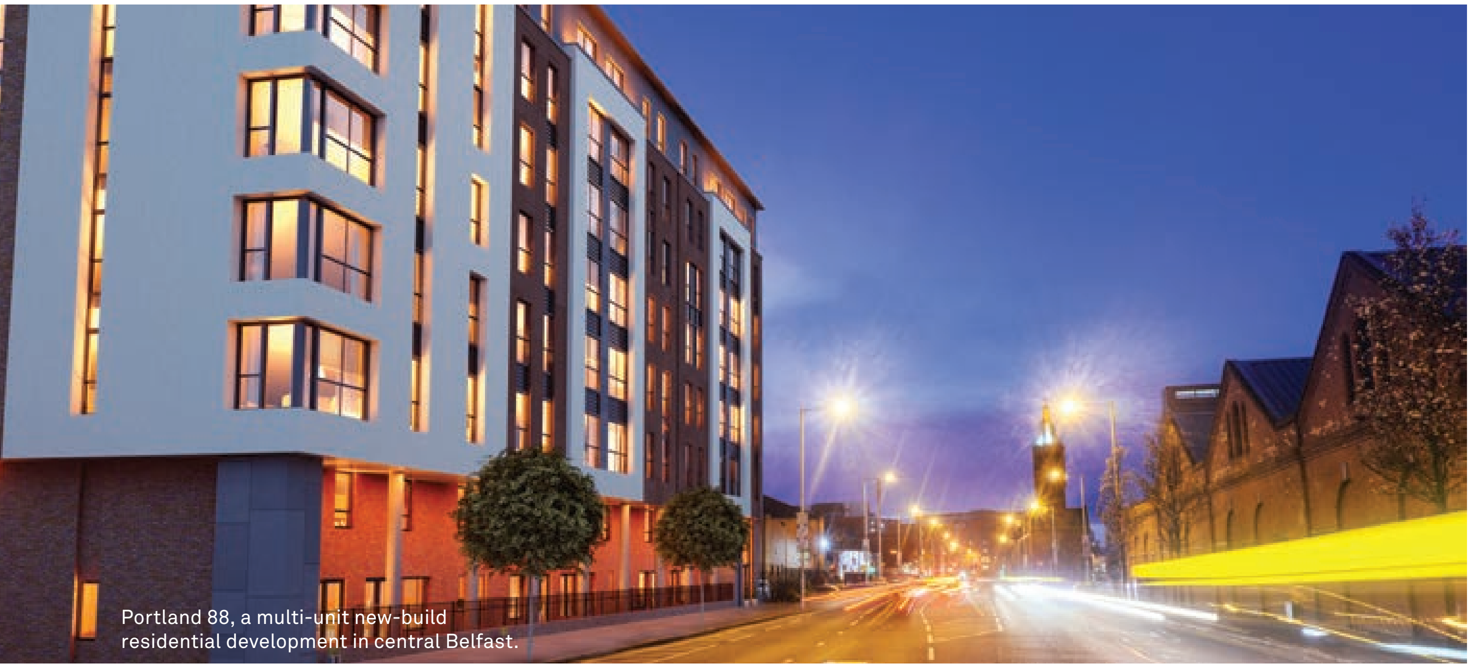
In September, our clients invested £3.8m in this fund offering access to a portfolio of distressed and special situation credit opportunities in Europe.

The fund manager, Blantyre Capital Management, is led by Mubashir Mukadam, former European Head of Special Situations at KKR. Target returns are 1.4-1.6x or 15% IRR.

Headway Investment Partners IV

In October, our clients committed to Headway Capital Partners' fourth fund. Headway invests in private equity 'secondaries'. This means purchasing 'primary' private equity investments, usually from forced sellers, which can mean attractive pricing and shorter holding periods than traditional primary investments.

The manager has a 14 year track record executing across this strategy and our clients invested £3.4m. Target net returns are 1.7-2.0x (15%-18% IRR).



Portland 88, a multi-unit new-build residential development in central Belfast.

Portfolio Highlights

Private Equity

The Light Cinemas
(Cinema operator)

In December, The Light Cinemas was featured in the Sunday Times Fast Track 100, a list of the UK's private companies with the fastest growing sales over the last three years.

The company aims to differentiate from mainstream multiplex offerings through a concept of 'sociable cinema': serving food and drink from local producers and becoming an active member of its community.

Since our clients' initial investment, sites have increased from three to ten. The next two sites will be Sittingbourne (late 2019) with Banbury to follow. A full pipeline exists for further sites.

Sleeperz Hotels
(Boutique budget hotel operator)

In July 2018, the 120 bed Sleeperz hotel in Dundee was opened as a cornerstone part of a £1bn waterfront development, which includes a brand new V&A museum. The company now operates four hotels, with a total of 407 bedrooms.

The Cardiff site has commenced construction on a 20 room expansion and the company has an active pipeline for new sites with several early stage discussions ongoing.

Tempcover
(Online insurance provider)

Our clients backed a £13.3m management buy-out of the UK's leading, direct to consumer, temporary insurance provider in December 2017.

The CEO, Alan Inskip, has featured prominently in the media over the Autumn challenging traditional insurers who have been quietly removing 'driver other vehicles' clauses from policies over the past few years. In addition, the business itself also recently won Employer of the Year at the Inspire Business Awards.

An improved website and user journey has been rolled out in recent weeks.

Rowan
(Goods re-seller)

Rowan is a re-seller of surplus goods that are left when a brand produces more stock than it can sell, for example when a promotional campaign ends. Customers include discount stores such as B&M, TK Maxx and Poundland.

Our clients invested £5m, taking a majority stake in the £50m turnover business in December 2017. Since then, management has been materially strengthened with addition of a Buying Director, Warehouse Manager, HR Manager and a Sales Director.

JCRA
(Financial risk advisor)

JCRA is the leading financial risk management advisory firm in the UK. Our clients backed a £13.6m MBO in August 2017.

JCRA expects its services to be in high demand in times of volatility. Rising interest rates from normalising monetary policy across the US, EU and UK, FX risks significant with US/China trade wars, Brexit and elements of emerging market turmoil, are all driving increased demand for its risk management and hedging services.

Iconx
(Key cutting machine manufacturer)

Iconx manufactures innovative key cutting machines that can scan and cut your key in under two minutes. Iconx has grown the installed machine base to over 500 machines across the UK and is now expanding internationally with the first four machines installed in France.

Further bolstering the value is the recent purchase of all the intellectual property associated with the key machines enabling the company to borrow more and accelerate the international expansion plans.

Carter Accommodation
(Temporary accommodation provider)

Since its MBO in 2015, Carter has grown turnover from £6.6m to £19.2m and increased its asset fleet from 3,000 to 7,000 cabins.

Alternative Funds

Stable Seed Fund

This fund invests in a diverse range of new and early-stage hedge funds operating specialist strategies. Investors take a share of revenue share from the underlying funds as well as investment gains from performance. This unique structure means investors will benefit from growth in the underlying funds' assets under management.

Connection Capital clients invested in January 2018 with further commitments made in August. The fund has made three seed investments since then and capital deployment is ahead of schedule.

Target net returns are 1.8-2.0x.

Permira Sigma IV

This fund invests in the equity/junior capital of collateralised loan obligations (CLOs) – vehicles which acquire participations in the senior loans of European corporates. These CLOs are actively managed by specialist credit managers and generate income from the yield on the underlying loans.

Our clients invested in September 2016. The fund currently has 45 underlying investments and is fully invested. The investment manager is continuing to actively reinvest capital and is regularly distributing interest to investors.

Private Debt

EPI
(Oil and gas consultancy)

EPI is a global leader in exploration services to the oil and gas industry. Services include seismic mapping and reservoir modelling.

The past six months have been positive as oil and gas exploration has increased and the sector continues to go through recovery. The business is on track to almost double its 2017 revenue.

Portfolio Company Management Profile

Robert Clarke, CEO, Mode Print Solutions

Career history: Robert's first job was cutting lettuces for Tesco aged 11. He was given the surplus to sell and keep the proceeds which he did by knocking on people's doors!

Inspired by hard-working people, especially those who have built their success up from scratch, Robert got his first finance director position aged just 29.

Having started his career at Waitrose and British Gas, learning how big businesses operate, he then decided that by working with small companies and entrepreneurs he could learn from their successes and mistakes.

That ethos has seen him pursue a varied career encompassing becoming financial controller for a London nightclub group, working for Nando's when it was still just a start-up, and spending 11 years as chef and restaurateur Marco Pierre White's right-hand man.

When he was approached to take over Mode in 2013, he jumped at the chance, keen to take the business to another level. This he has certainly done: net earnings have jumped eight-fold in that time.

His next challenge is recruiting for further growth.

Attracting the right people and training them well is key he says. Through initiatives like a team-building trip to Marbella, investing in his team is not just mission-critical, he sees real pay-off in making it fun too.

> "I connected straight away with the Connection Capital team, and my first impression was right – they've been true to their word all along."

Spotlight on the business

Name: Mode Print Solutions Limited ('Mode')

About the business: Mode provides hardware, software and remote and onsite support for printing needs to SMEs across London and the South East

Established: 1995

Connection Capital client investment: £8.1m into £20.5m MBO in 2018

Future plans: To double the business organically over the next 3-4 years

Our private debt offering has grown

Getting access to bank lending remains problematic even for many strong, successful SMEs. Since they're too small for the big debt funds to get involved with, there's real need for other options to fund growth ambitions or underpin on-going business development

In response to this continuing issue and greater appetite from the market, we've recently enhanced our private debt offering to UK SMEs. We will now fund financing requirements of £3-10m (up from £2-5m).

This will provide more small and medium-sized businesses with an alternative to bank lending or equity investment which can be tailored to fit their specific needs.

We will continue to target good quality, solid UK-based businesses. If the underlying credit is robust, and the company has either regular, dependable cash flow or strong assets, then we will consider the opportunity.

Connection Capital will consider applications for finance for any purpose, including equity release, growth capital, or acquisition funding. As well as conventional loans where businesses make regular repayments over a fixed period, it can also offer innovative structures which typically fall outside the remit or capabilities of traditional debt providers.

For example, loans which require a single final bullet payment, enabling cash generated to be deployed within the business e.g. to fund capex rather than using it to pay down debt, or 'cov-lite' opportunities, which are subject to less restrictive covenants than offered by other lenders.

Connection Capital aims to be the most flexible source of SME private debt in the market and we look forward to bringing you even more private debt investment opportunities in 2019.

Future-proofing value: why more SME owners are looking to unlock capital from their businesses

Claire Madden, Managing Partner, assesses how the political landscape is shaping business owners' financial planning – and why private capital could have an important role to play.

More and more these days, we are seeing the emergence of a hither-to relatively rare phenomenon: SME owners turning to "private capital" to help them unlock value from their businesses – without selling them. While the use of private capital to fund an MBO or to facilitate growth is well-established, this trend is not quite as common.

Why is this happening now and what are business owners hoping to gain by taking this course of action?

At first glance the answer to the "why now" question may seem obvious – with Brexit uncertainty still hanging over us, our imminent departure from the EU is often cited as the catch-all reason for most business decisions (or indecision) today. But the real reason, though indirectly related to Brexit, is more complex. Uncertainty over the future is the prevailing concern – but it's the risk of mid-to-long term government policy changes that's really rattling business owners.

Crystallising gains

The message we're hearing is that concerns over any future election of a strongly left-wing Labour government is the predominant motivating factor here.

The possibility of significant Capital Gains Tax (CGT) increases and doubts over the future of Entrepreneurs' Relief, as well as uncertainty over how broader economic conditions might impact business performance, are cited as key issues.

Given the current Conservative government's lack of majority and the on-going challenges of negotiating a suitable Brexit deal, the possibility of an early election before the end of the traditional five-year term cannot be ruled out. If that happens, Labour is likely to have higher earners and capital gains in its sights.

> "The risk of future government policy changes is rattling business owners."

It's perhaps little surprise then that we are seeing growing demand from business owners to crystallise some of the value they've built up without selling up entirely, while the economy is robust and the tax regime remains relatively favourable.

Keeping skin in the game

Then there's the issue of: how? Bank lending options remain limited, so there's a clear role for private capital providers to step in here, whether that involves making an equity investment or providing a mezzanine finance arrangement, to enable SME owners to realise some of the fruits of their labours. However, both options generally involve some dilution of the shareholder's equity stake.

We are very happy to consider both of these kinds of transactions, having launched our innovative specialist debt capital solution last year to complement our private equity offering. It's important to note however, that any deal must still leave SME owners with enough "skin in the game" to ensure they are incentivised to continue growing the business and are maximising its potential. Investors will be glad to hear that, structured appropriately, these transactions can be a win-win for all involved.

A trend to watch

There is no certainty as to whether a General Election will take place before 2022, nor to what the outcome will be, but concerns loom large that radical policy changes lie ahead, with major implications for tax bills and economic performance.

For those who do not want to relinquish their businesses, private capital can be an attractive option to realise some of the capital gains now at current rates, whilst still retaining control of their company. As a way to future-proof the value entrepreneurs have created, it makes a lot of sense, and this can open up some very attractive opportunities for investors too.

Definitely a growing trend to watch in the coming months ahead.

ASK Partners, Vanburgh Court

Don't miss out

Register at **www.connectioncapital.co.uk/client-registration-form** to view our investment opportunities

The Connection Capital Portfolio: Net Investor Returns

	Exited					
	Invested £000's	Proceeds (£000's)			Actual	
		Returned	Forecast	Total	IRR	MMx
Private Equity	13,147	23,299	0	23,299	19.4%	1.8x
Commercial Property	21,719	26,848	7,077	33,925	13.7%	1.6x
Alt Funds	4,700	6,040	0	6,040	9.5%	1.3x
Private Debt	6,373	8,709	0	8,709	15.7%	1.4x
Syndication	1,425	498	3,029*	3,527	13.2%	2.5x
Total	**47,363**	**65,394**	**10,107**	**75,500**	**15.1%**	**1.6x**

**Cash has now flowed to investors from the Wagamama exit.*

	Total (Exits and live portfolio)				
	Invested £000's	Proceeds (£000's)			Forecast MMx
		Returned	Forecast	Total	
Private Equity	109,538	29,500	171,276	200,777	1.8x
Commercial Property	41,529	27,834	35,782	63,616	1.5x
Alt Funds	65,090	14,645	99,416	114,061	1.8x
Private Debt	16,923	9,092	16,657	25,749	1.5x
Syndication	2,939	498	5,400	5,898	2.0x
Total	**236,019**	**81,570**	**328,531**	**410,101**	**1.7x**

Source: Connection Capital. Data accurate as at 30 September 2018. Contains forecast outcome of current portfolio and actual outcome of exited portfolio. Returns are net of all fees and carry.

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