

Strategic Equity Capital

Measured expansion on strong performance

Strategic Equity Capital's strong performance compared to both its rivals and comparable UK indices has increased in recent months as the table below shows. This good performance and inclusion in UK indices are fuelling demand for the trust, pushing up the premium. If, as we expect, shareholders approve, up to 20m new shares will become available from August. The manager is cognisant though to take in new cash only when it is needed, to avoid diluting future returns on the current portfolio for existing shareholders. We think this is a commendable stance.

Objective

Strategic Equity Capital ("SEC") invests in a relatively concentrated portfolio of quoted UK equities with the aim of generating an IRR of 15% per annum across an economic cycle. Stocks are evaluated using private equity techniques and the investment manager operates a policy of constructive engagement with companies in the portfolio, where appropriate.

| Year Ended | Share Price Total Return (%) | NAV Total Return (%) | FTSE Small Cap ex IT TR. (%) | FTSE All-Share ex IT TR (%) | IA UK Small Cap TR. (%) |
|------------|------------------------------|----------------------|------------------------------|-----------------------------|-------------------------|
| 30/06/11 | 82.3 | 55.5 | 27.0 | 28.6 | |
| 30/06/12 | (11.3) | (1.9) | (6.4) | (3.0) | |
| 30/06/13 | 29.2 | 25.9 | 38.6 | 17.9 | |
| 30/06/14 | 51.3 | 39.8 | 25.3 | 13.2 | |
| 30/06/15 | 48.3 | 26.0 | 8.4 | 2.4 | |

Source: Bloomberg, Morningstar and Marten & Co.

| | |
|---------------------------|-----------------|
| Sector | UK Smaller Co.s |
| Ticker | SEC |
| Base Currency | GBP |
| Price | 240.6 |
| NAV | 217.2 |
| Premium (Discount) | 10.8% |
| Yield % | 0.3% |

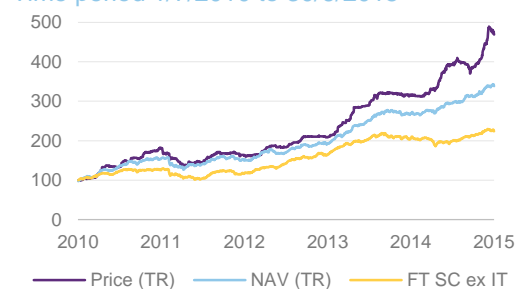
Share price and discount

Time period 1/7/2010 to 14/7/2015



Performance over five years

Time period 1/7/2010 to 30/6/2015



| | |
|---------------------------|------------------|
| Domicile | United Kingdom |
| Inception Date | 13 July 2005 |
| Manager | Stuart Widdowson |
| Market Cap (mlns) | 150.6 |
| Shares Outstanding | 62.6 |
| Trading Volume | 110,000 |
| Net Gearing | Nil |

Remarkable recent performance

Over the first half of 2015, SEC has delivered a return on net assets of 14.3% which compares favourably with the 11.9% return generated by the FTSE Small Cap. index (ex investment companies) and the 10.7% return by the average open-ended UK smaller companies fund (as represented by the IA UK Smaller Companies sector). This extends a long run of outperformance of both indices and competitors; over the past ten years the fund has made over 10% per annum more money for its shareholders.

We went into SEC's investment approach in some detail in our initiation note on the company, published in January. If you are not familiar with the company, this is worth a read.

Figures 1 & 2 illustrate SEC's top five contributors and detractors during H1 2015. The top contributor was specialist electronic component manufacturer E2V Technologies. E2V has been trading well and had a positive year end trading statement. The manager considers this has given the market some confidence that under the stewardship of Steve Blair (appointed March 2014) E2V's programme of self-help is working which has led to an improved rating for the stock.

4imprint is the second largest contributor. Whilst there has been no significant new news flow that can be pointed to in explaining 4imprint's strong performance, the company has been trading well and, in the manager's view, its significant scale is a major advantage over its competitors. 4imprint needs little in the way of working capital and in the manager's view has been able to invest cost effectively in its CRM systems and online strategy, which is driving an increasing market share.

Gooch & Housego (manufacturer of specialist optical components) is the third largest contributor. The manager continues to see strong growth potential for the stock. In his view the shift from components to subsystems is significant as it is significantly more cash generative.

Figure 1: Top five contributors – 6 months to 30 June 2015

| Company | Total return (%) | Contribution to return (bps) |
|------------------|------------------|------------------------------|
| E2V Technologies | 44.9 | 432 |
| 4imprint | 35.0 | 276 |
| Gooch & Housego | 32.2 | 168 |
| Wilmington | 19.4 | 164 |
| Clinigen | 18.1 | 129 |

Source: Strategic Equity Capital

In terms of detractors, Northbridge Industrial Services has made the largest negative contribution to portfolio return during H1 (this followed on from a strong performance during 2014 when Northbridge returned 49%). Northbridge sells and hires out loadbanks, transformers, generators, compressors and oil tools to a global customer base and has been affected by developments in the oil and gas sectors. A difficult end-market, coupled with significant M&A within its customer base, has seen sales fall significantly, which has been compounded by the company's borrowings so that earnings have collapsed. The manager considers that the fall has been overdone and that Northbridge offers a very good opportunity over a three to five year view.

Figure 2: Top five detractors – 6 months to 30 June 2015

| Company | Total return (%) | Contribution to return (bps) |
|---------------------------------|------------------|------------------------------|
| Northbridge Industrial Services | (47.8) | (57) |
| Goals Soccer Centres | (1.2) | (16) |
| Volution | (3.3) | (1) |
| CVS | (0.5) | (0) |
| IFG | (1.7) | 0 |

Source: Strategic Equity Capital

Issuing shares to meet demand

SEC's performance over both its rivals and comparable UK indices is attracting the attention of new investors. The company's recent inclusion within the FTSE All-Share Index has also triggered buying by index funds. Demand for the stock has pushed it to a premium but the proposed new share issuance should address this.

A meeting will be held on 31 July 2015 at which shareholders will be asked to approve the issue of up to 20m new shares on a non-pre-emptive basis. This will be followed up in early August with the publication of a prospectus.

If all 20m shares were issued today, the fund would be approaching £200m of net assets. The Board has said that it recognises that the Investment Manager's focused investment strategy in smaller companies has limited capacity. Sensibly, they say they will limit further issuance to ensure that the strategy is not compromised.

The manager is adamant that he will only support issues of shares where he has identified a use for the cash as he is keen not to dilute returns of existing shareholders. This does not mean that the fund's cash balance will not rise from here. Indeed he has indicated to us that he would be comfortable with a cash level of 15% in appropriate circumstance. We like this level of maturity and hope this approach means that the fund will maintain a premium rating relative to its peers in a more difficult market environment.

Previous research publications

Please see our initiation note of January 2015 for further details on SEC's investment strategy, engagement process, historic performance, discount, capital structure, fees, etc.

Figure 3: Marten & Co. previously published research on SEC

| Title | Note type | Date |
|--------------------------|------------|-----------------|
| Different, in a good way | Initiation | 27 January 2015 |

Source: Marten & Co.

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