investors CHRONICLE alpha

27 September 2019

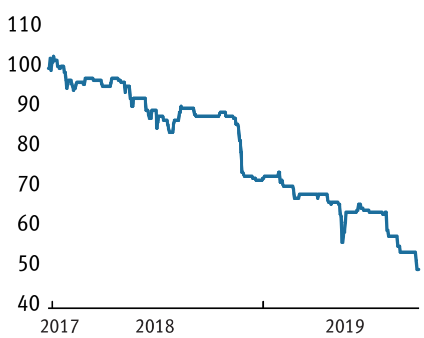
CIP Merchant Capital: A Ben Graham deep value buy

Even though net asset value per share has only declined by 4 per cent since the start of 2018, shares in this investment company have lost 46 per cent of their value in the period, creating a huge discount

CIP Merchant Capital (CIP)

Ticker	CIP
Current price (p)	50p
Target price (p)	72p
Market cap (£m)	£27.5m
52-week high (p)	90p
52-week low (p)	50p
Net cash (£m)	£24.4m (estimated at 23 Sep 2019)
Shares in issue (m)	55m
Financial year-end	31 Dec
Next event	2018 annual results in late Mar or early 2020
Company website	cipmerchantcapital.com

CIP Merchant Capital share price



Source: Bloomberg

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Simon Thompson's view:

It's a sensible approach to build in a 'margin of safety' into the price you are willing to pay for the equity of any company. The investment risk can be mitigated even further when the company is sitting on a cash pile to minimise the potential downside risk. In the case of **CIP Merchant Capital**, the value of cash on the balance sheet backs up 89 per cent of its market capitalisation, meaning that its investment portfolio is effectively being thrown into the price at 88 per cent below book value even though all bar one of its seven investee companies are listed on a major stock exchange. Moreover, as the company's investment manger puts the cash to work, then the huge share price discount to net asset value should narrow markedly assuming of course they invest wisely.

Bull points

- Cash accounts for 89 per cent of market capitalisation.
- Shares trading 45 per cent below net asset value, a deep discount to private equity peers.
- Equity and corporate bond portfolio in the price for 11p in the pound.
- Takeover potential for three investee companies.
- Investment Manager incentivised to generate strong investment returns.
- Stringent stock selection process carried out before any investment is made.
- Directors have significant shareholdings and have been buying at current levels.
- Net asset value per share has recovered in 2019.

Bear points

- Net asset value per share declined in 2018.
- High management charges.
- Small-cap liquidity discount.
- No guarantee that the investment manager will generate positive investment returns.
- Cash will only be fully invested by end of 2020, far later than originally planned.
- Largest investment accounts for 16 per cent of net asset value, and that company's share price is volatile

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In chapter seven of *The Intelligent Investor*, the seminal 1949 work of Benjamin Graham, a US investor and writer, the father of value investing explains: "If we assume that it is the habit of the market to overvalue common stocks which have been showing excellent growth or are glamorous for some other reason, it is logical to expect that it will undervalue – relatively, at least – companies that are out of favour because of unsatisfactory developments of a temporary nature. This may be set down as a fundamental law of the stock market, and it suggests an investment approach that should be both conservative and promising."

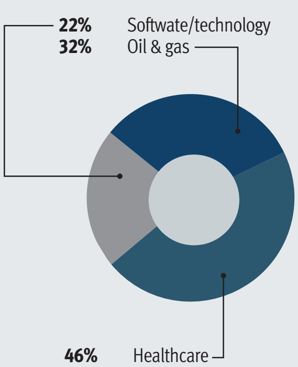
How do we know whether the "unsatisfactory developments" are indeed "temporary"? Mr Graham's approach was to focus on the balance sheet, and specifically the net current assets – stocks, debtors and cash less any creditors. He believed that a bargain share is one where net current assets less all prior obligations – such as creditors falling due after one year, deferred taxation and provisions for liabilities and other charges – exceeds the market value of the company by at least 50 per cent. Mr Graham's theory was that a strong balance sheet will usually see a company through any short-term difficulties; he called it his "margin for safety".

In a nut shell, that's what's on offer at **CIP Merchant Capital (CIP)**, a Guernsey-based closed investment company that is taking a private equity style performance-focused approach to investing in predominantly listed equities.

CIP Merchant Capital listed its shares, at 100p, on the Alternative Investment Market (Aim) in December 2017, when it raised £52.4m (95.3p a share) net of £2.6m (4.7p a share) listing costs. Since then the company's investment manager has created a £25.8m (47p) portfolio across seven different investee companies. It retains an estimated cash pile worth £24.4m (44.4p), implying a live net asset value (NAV) per share of almost 91p, after deducting the company's estimated third quarter operating costs of around £360,000 (0.6p). However, the company's share price has headed south and is trading at an all-time low of 50p, or 45 per cent below NAV per share.

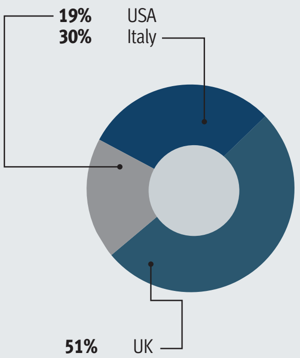
This means that the combined £50.2m value of cash and the investment portfolio exceeds CIP Merchant Capital's market capitalisation of £27.5m by 82 per cent, thus creating the "margin of safety" Mr Graham desired. Moreover, strip out the £24.4m cash pile from the company's market capitalisation and CIP Merchant Capital's £25.8m investment portfolio is effectively in the price for £3.1m, or 88 per cent less than book value. That's even though six of the seven investments are listed on a major exchange and include stakes in **Orthofix Medical (NSQ: OFIX)**, a $1bn

CIP Merchant Capital portfolio composition by industry



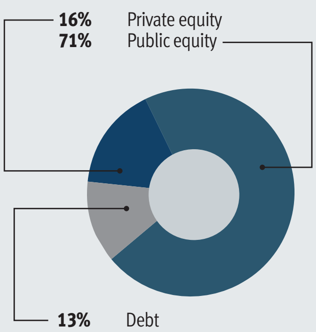
Source: CIP Merchant Capital London Stock Exchange filings

CIP Merchant Capital portfolio composition by country



Source: CIP Merchant Capital London Stock Exchange filings

CIP Merchant Capital portfolio composition by security



Source: CIP Merchant Capital London Stock Exchange filings

market capitalisation Nasdaq quoted medical devices company, and FTSE Aim 50 constituent **CareTech (CTH)**, a heavily asset backed provider of social care services. CIP Merchant Capital's investment manager, Merchant Capital, an affiliate of Continental Investment Partners, would need to invest the cash disastrously for investors buying at the current level not to make a decent return.

Reasons for chronic share price underperformance

Two directors of CIP Merchant Capital, Marco Fumagalli and Carlo Sgarbi, are the sole shareholders of Continental Investment Partners. They don't draw any salary from their position on the company's board, but under the investment management agreement between CIP Merchant Capital and Merchant Capital, Mr. Sgarbi earns a management fee of 2 per cent of CIP Merchant Capital's net asset value, paid quarterly in arrears. That's £1m a year of annual fee income which is admittedly high given that half the total portfolio is still in cash 21 months after the company's IPO.

The fact that it took far longer to make investments, partly due to the volatile equity market conditions last year which made CIP Merchant Capital's investment manager more cautious in its approach, may have unsettled investors as the company has annual operating costs of around £1.4m, including the £1m annual management fee paid to Merchant Capital.

Indeed, investment manager Carlo Sgarbi commented in the company's 2018 annual results that: "The prolonged market uncertainties, especially the Brexit negotiations, give us reason to believe that it is prudent and in shareholders' best interests to wait, where applicable, until negative news affects the share price of a potential investment instead of investing too early before potential negative macroeconomic impacts are experienced by such targets. Accordingly, given this prudent approach to investing, the company is not yet fully invested and it is now unclear as to how long this will take." Latest guidance is for the portfolio to be fully invested by the end of 2020, or three years after the IPO.

Investors may also have been unsettled by the loss reported in CIP Merchant Capital's 2018 annual accounts which was released in early April this year. The company reported a £4.4m pre-tax loss after taking £3m of unrealised losses on its portfolio, the vast majority relating to its largest investment: **Coro Energy (COR)**, an Aim-traded Southeast Asian focused upstream oil and gas company. The value of the stake halved after CIP Merchant Capital invested £6m acquiring 150.7m shares from a £14m placing of Coro shares at 4p in April 2018, which gave it a 21 per cent stake in the £22m market capitalisation company (the current stake is 19 per cent, after further share issues by Coro). That paper loss reduced CIP Merchant Capital's NAV per share from 95.2p, post the IPO in December 2017, to 87.2p at the end of 2018, and will have been a contributing factor behind the investment company's own share price slide.

CIP Merchant Capital (Aim:CIP)

Ord Price: 50p **Market Value:** £27.5m
Touch: 48.4-51p **12-Month High:** 90p **Low:** 50p
Discount to NAV: -45% **Dividend yield:** nil
Net Asset Value**: 91.5p **Net Cash:** £24.4m

15 months to 31 Dec	Net asset value (p)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2018	87	-4.4	-8.0	nil
% change	–	–	–	–

Normal market size: 2,000 SETSqx
** Net asset value and net cash at 23 September 2019 calculated after taking into account investments made since 31 August 2019
Source: CIP Merchant Capital Annual Report, London Stock Exchange

However, it's worth pointing out that Coro's share price has bounced back by 33 per cent from its December 2018 closing lows of 2.25p. The £6m investment CIP Merchant Capital made is now worth around £4.4m, one reason for the recovery in its live NAV per share to around 91p. The company also holds Coro call warrants which have a carrying value of around £400,000. There is potential for a further recovery in the Coro investment, too (see section on Coro on page 18).

It's also worth flagging both Mr Fumagalli and Mr Sgarbi have been backing their ability to create value for shareholders. They added to their combined 2m shareholding in late May this year, investing £688,000 by purchasing 1.23m shares at 56p each to take their aggregate holding to 3.23m shares, or 5.88 per cent of the 55m shares in issue. Their shareholdings in CIP Merchant Capital are held through a company, Goldfinch SA, which is owned in equal proportions between the two directors. They were not the only ones buying as seven weeks ago 65 year old chairman Adrian Collins made a maiden purchase of 50,000 shares at 65p, to give himself 0.09 per cent of the issued share capital.

These are strong signals that not only do the insiders believe there is value in the shares, but the cautious approach in investing the company's cash is justified, and that the portfolio will ultimately deliver positive returns for shareholders. Also, Mr Fumagalli and Mr Sgarbi have an added incentive to deliver superior investment returns because Merchant Capital has a 'carried interest'. It is entitled to 20 per cent of the net realised cash profits from investments made once CIP Merchant Capital has received an aggregate annualised 5 per cent realised return, made during the relevant investment period and for the subsequent 24-month 'follow-on' period.

Importantly, the investment mandate they are pursuing is sensible, even if deployment of the IPO proceeds has been sluggish.

Investment mandate

The investment objective is to generate risk-adjusted returns through investment in equity and equity-related products, principally through capital growth, and seek exits within 12 to 60 months. The Investment Managers will seek to achieve this by targeting companies that are undervalued and could benefit from strategic, operational or management initiatives, achieved through a private equity style investment philosophy.

The Investment Manager has a mandate to invest primarily in equity and equity-linked securities, as well as debt, convertible debt and other financial instruments with equity characteristics. It targets companies that typically have at least two or more of the following characteristics:

- Potential to achieve a superior risk adjusted return with a medium/long-term target internal rate of return (IRR) of 20 per cent.
- Cash-generative, or expected to generate cash, within a reasonable investment horizon.
- Attractive management track record.
- Strong fundamentals.
- Potential for liquidity or exit within an identified time frame.
- Investee company to have a competitive advantage.

CIP Merchant Capital will consider investments in a number of industries and sectors, particularly those in which the directors and the Investment Manager have the necessary expertise to be able to identify and manage the opportunity. Investments will predominantly be in the following industries: oil and gas; healthcare; pharmaceutical; and real estate.

Typically, companies listed on a western European stock exchange (with a predominant focus on the London Stock Exchange), with a market capitalisation of less than £500m are targeted. Specifically, CIP Merchant Capital is focused on sub-£200m market capitalisation companies and is aiming to create a portfolio of around 10 companies when fully invested. The primary reasons for targeting this segment of the market is because many small and mid-cap companies quoted on western European stock exchanges suffer from a lack of liquidity and access to capital, and there is a lack of interest from institutional investors in under-capitalised companies, too.

To manage investment risk, the following parameters apply:

- Maximum investment in/or exposure to any single investee company will be no more than 20 per cent of NAV.

- Investments in/or exposure to unlisted/unquoted companies will be limited to, in aggregate, 30 per cent of NAV.

- Maximum investment in/or exposure to any investee company or fund that itself invests in a portfolio of investments will not exceed 10 per cent of NAV.

- Investments concentrated in any one sector or industry shall not exceed 50 per cent of NAV.

- CIP may take on borrowings of up to 30 per cent of NAV at the time the borrowings are incurred.

Investment process

Once an investment has been identified, the Investment Manager will carry out peer-group analysis; financial, commercial, technical and legal due diligence; internal and commissioned third party research; management referencing and analysis of their track records; and consider potential exit scenarios. As part of this approach, the following areas are considered:

- **Time horizon:** The Investment Manager's private equity approach is focused on the medium to long term, typically ranging from three to five years. This approach to investment focuses on intrinsic value rather than short-term opportunistic gains.

- **Fundamental analysis:** A bottom-up fundamental analysis of a potential investee company is carried out by the investment manager, starting with detailed insights into the relevant industries and sectors, typically including in-depth research into customers, suppliers, distributors, competitors and former employees. The process includes a thorough assessment of the potential investee company's management and its effectiveness in deploying capital and resources.

- **Value-oriented investments:** The approach is to look for asymmetric return distributions that also provide a margin of safety. The asymmetry analysis is based in part on the presence of reliable cash flows, or the ability to create value enhancement for shareholders in the short to medium term in respect of companies in the natural resources sector. It is not dependent on the potential investee company being expected to achieve high levels of growth.

■ **Strategy and governance:** Typically, private equity investors control the boards of their portfolio companies and are activist investors who seek to influence their strategy and governance. The Investment Manager will prepare detailed asset-by-asset valuation analysis and seek to develop value-enhancement plans with the management of investee companies. Additionally, where appropriate, the Investment Manager will seek to join the boards and/or nomination committees of its investee companies in order to support the delivery of such plans.

The portfolio

CIP Merchant Capital's current market capitalisation implies that there is little value in its investment portfolio. This is clearly not the case as the portfolio includes liquid investments and investee companies which have real takeover potential.

CIP Merchant Capital portfolio breakdown (prices at 23 September 2019)

Holding	Asset class	Sector	Net asset value
Alkemy	Listed equity	Software/Technology	£3.45m
Brave Bison	Listed equity	Software/Technology	£0.71m
CareTech	Listed equity	Healthcare	£3.48m
Coro Energy	Listed equity	Oil & Gas	£4.40m
Coro Energy	Listed warrants	Oil & Gas	£0.44m
Coro Energy	Eurobond	Oil & Gas	£3.18m
Happy Friends	Unlisted	Healthcare	£3.98m
Orthofix Medical	Listed equity	Healthcare	£4.67m
Proactis	Listed equity	Software/Technology	£1.47m
Total			**£25.78m**

Cash and short dated government bonds	£24.40m
Estimated operating costs Q3 2019	-£0.36m
Net asset value	£49.82m
Shares in issue	55.0m
Net asset value per share	90.6p

Source: CIP Merchant Capital RNS filings. Quoted investments priced at latest market prices on London Stock Exchange, Nasdaq (Orthofix Medical) and Luxembourg MTF Market (Coro Energy Eurobond). Unlisted assets valued at 30 June 2019. Allowance made in operating costs for Merchant Capital third quarter management fee and group operating costs for third quarter of 2019.

Investment management team

The investment management team is led by 55-year old **Mr Sgarbi**. He has over two decades experience in investment banking including being appointed Head of Debt Capital Markets for Banca IMI – the investment bank of Intesa Sanpaolo, a leading Italian banking group – as well as Global Head of Fixed Income and Derivatives during his time at the bank. From 2007 to 2013, he was responsible for managing all investment activities within a Swiss family office. In 2013, he co-founded Continental Investment Partners along with Mr Fumagalli.

Mr Fumagalli's track-record also includes being Global Partner at the private equity firm, 3i Group, where he managed investments in both private and listed companies. From 2010 to 2013, the 49-year old was responsible for managing the private equity activities within the same Swiss family office as Mr. Sgarbi, before co-founding Continental Investment Partners. He is a non-executive director of Aim-traded companies **Sound Energy (SOU)**, **Echo Energy (ECHO)** and **Cora Energy (CORO)**.

The other member of the investment management team is **Marcello Nesta**, an Investment Manager responsible for private equity and real estate activities. Mr Nesta began his career at SAI Investimenti SGR, the Real Estate investment manager of Italian insurer UnipolSai. In 2011, he joined a financial advisory firm in Switzerland, where he advised small and medium sized enterprises (SMEs) in raising debt and equity capital as well as alternative investments.

Main board directors

Importantly, the other members of CIP Merchant Capital's board who are responsible for sanctioning investment decisions have relevant industry expertise.

Chairman Adrian Collins has worked in the fund management business for over 37 years, a large part of which was at Gartmore Investment Management where latterly he was managing director. He is chairman of Liontrust Asset Management and is also on the boards of Bahamas Petroleum (BPC), City Natural Resources High Yield Trust, CQS New City High Yield Fund and a number of other companies.

Non-executive director John Falla trained with Ernst & Young in London before moving to their Corporate Finance Department. On returning to Guernsey he worked for an international bank, before joining the Channel Islands Stock Exchange as a member of the Market Authority. In 2000, Mr Falla joined the Edmond de Rothschild Group in Guernsey and provided corporate finance advice to clients including institutions with significant property interests. He was also a director of a number of Edmond de Rothschild Group operating and investment companies.

The other **non-executive director** is 56-year old **Robert King** who is also a non-executive director of a number of open and closed ended investment funds (OEICs) including Chenavari Capital Solutions and Weiss Korea Opportunities Fund. He has worked in the offshore finance industry since 1986, specialising in administration and structuring of offshore OEICs.

CIP Merchant Capital major shareholders and liquidity

The top six shareholders in CIP Merchant Capital control 38.76 per cent of the issued share capital and this includes the 5.88 per cent shareholding of Goldfinch, the vehicle used by co-founders Mr Fumagalli and Mr Sgarbi to hold their shares.

Despite the small numbers of institutions on the share registrar above the 3 per cent threshold (they are only obliged to disclose their interests to the London Stock Exchange when holdings exceed this level), there has been some interesting buying this year. Notably, Nassau based Ecostone Fund and Horbit Small-Cap Opportunities Fund have popped up on the share registrar. Their stakes are 3.32 per cent and 3.27 per cent, respectively.

Importantly, the shares are readily tradable in bargain sizes above the London Stock Exchange minimum of 2,000 shares, and on a relatively tight bid-offer spread of 53p to 55p. Indeed, there was one trade at the mid-market price of 54p on Friday, 20 September.

CIP Merchant Capital major shareholders

Name	Number of shares	Percentage
Efg Bank	5,000,000	9.09%
Corporation Financiere Europeene SA	5,000,000	9.09%
Spartan Fund Ltd SAC	4,460,000	8.11%
Goldfinch SA*	3,231,527	5.88%
Ecostone Fund Ltd	1,828,000	3.32%
Horbit Small Cap Opportunities Fund Ltd	1,799,000	3.27%
Total		**38.76%**

Source: Company

Peer group comparison

Clearly, you need to factor in some small-cap liquidity discount for CIP Merchant Capital, the lack of track record and absence of a dividend when comparing the company to its private equity peers. However, on any basis, the current rating is extreme.

The shares not only trade on a 45 per cent discount to the last reported NAV – almost double the peer group average discount – but the actual discount is even wider once you consider that 80 per cent of the company's market capitalisation is in cash. Effectively, this means the investment portfolio is in the price for 88 per cent below book value. This is even more extreme than the rating on LMS Capital, another small-cap private equity company and one that I featured in my Alpha Report.

By way of comparison, I estimate that LMS's proforma NAV has increased by six per cent from £59.1m to £62.7m (77.7p per share) since 30 June 2019, of which the quoted investments and proforma net cash accounts for £35m (43.4p per share). To put LMS's valuation anomaly into perspective, the company only has a market capitalisation of £44m, implying that the company's UK and US quoted and fund investments - which have a combined value of £30m - are in the price for a miserly £9m after making a few small balance sheet adjustments. That's plainly an absurd valuation once you consider the portfolio breakdown, a point I made in my recent analysis ('Exploit LMS's 'margin of safety', 15 August 2019).

The bottom line is even if CIP Merchant Capital's shares only re-rate back towards the average share price discount to NAV of the company's peer group then this still implies 44 per cent share price upside from the current depressed level.

Private equity peer group analysis

Company	Market capitalisation	Premium/ discount	Dividend yield	Percentage NAV return	
				Year-to-date	3-year
3i Group	£10,913m	30.1%	3.1%	10.1%	88.6%
Apax Global Alpha	£764m	-15.8%	5.8%	13.3%	44.3%
Augmentum Fintech	£126m	-1.5%	0.0%	5.4%	na
Better Capital 2009	£17m	-38.5%	0.0%	na	-23.5%
Better Capital 2012	£24m	-52.1%	0.0%	na	-40.1%
CIP Merchant Capital	£27m	-45.0%	0.0%	5.2%	na
Draper Esprit	£548m	-11.3%	0.0%	na	na
Dunedin Enterprise Investment	£71m	-14.2%	0.6%	3.3%	46.9%
Electra Private Equity	£131m	-33.1%	0.0%	-39.2%	-8.3%
EPE Special Opportunities	£58m	-29.1%	0.0%	29.3%	30.7%
HgCapital Trust	£932m	-4.8%	2.1%	15.2%	68.8%
JZ Capital Partners	£379m	-40.4%	0.0%	5.1%	3.4%
LMS Capital PLC	£44m	-29.5%	0.0%	-1.9%	-16.7%
NB Private Equity Partners	£564m	-20.6%	3.9%	10.1%	85.8%
Oakley Capital Investments	£472m	-27.6%	2.0%	14.1%	56.6%
Princess Private Equity	£587m	-17.4%	5.9%	9.9%	27.3%
Average		-21.9%	1.5%	6.1%	28.0%

Source: Liberum Capital (20 September 2019); Investors Chronicle (LMS Capital and CIP Merchant Capital)

Target price

Pricing anomalies in the small-cap space are all too common. A lack of broker and institutional coverage, and liquidity discounts make this a fertile hunting ground as the depressed valuations of both LMS Capital and CIP Merchant Capital clearly highlight.

Moreover, there is realistic potential for NAV upside from CIP Merchant Capital's investment portfolio. Catalysts include the possibility of bid activity for CareTech, Proactis and Brave Bison; scope for a re-rating of Alkemy when it moves up from AIM Italia to STAR segment of Borsa Italiana's Main Market (MTA); and potential for positive and well received results from Coro Energy's drilling programme.

In the circumstances, I can see material upside to my short-term target price of 72p, based on the share price discount to NAV narrowing to 20 per cent, in line with its private equity peers and a far more appropriate discount given CIP Merchant Capital's high cash levels. **Buy**.

Risk assessment

There are always risk factors to consider before making any investment and there are several to consider here:

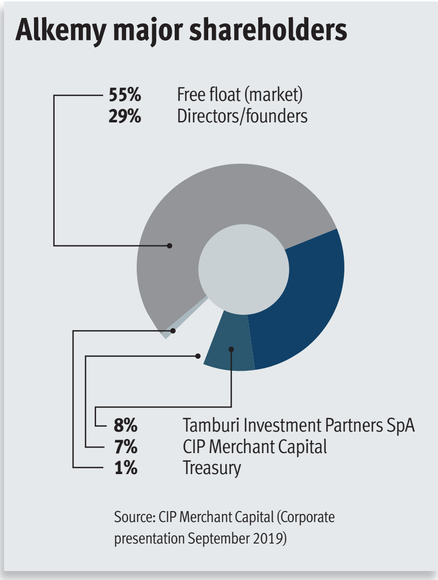
- **Investment strategy:** The opportunities are actively sourced by the investment manager through its network of contacts and through a proactive identification of target investments through its proprietary database. However, there is no guarantee that the investment manager will be able to successfully identify appropriate investment targets.

- **Market uncertainty:** The investment manager has adopted a cautious approach in light of the uncertainty about the outcome of the Brexit negotiations, the deterioration of the macroeconomic indicators across the globe and the exacerbation of international tensions between the US and China. This has meant that the cash raised from the IPO will take longer than anticipated to invest. As a result shareholders are paying out £1m in annual investment management fees even though half the portfolio is in low yielding cash or high grade short-dated UK and European Investment Bank government bonds. I have taken into account the likelihood that the company will now not be fully invested until the end of 2020 when making this recommendation.

- **Concentration of portfolio risk:** With only seven companies in the portfolio, there is greater company specific concentration of risk. Indeed, the largest investment in Coro Energy accounts for 16 per cent of NAV. Arguably, this is the most speculative investment, too, as there can be no guarantee that it will create value. That said, it's effectively in the price for free given that the combined value of CIP Merchant Capital's proforma cash pile of £24.4m and its most liquid investments – CareTech (£3.5m) and Orthofix Medical (£4.67m) – already exceed its market capitalisation of £29.7m by 10 per cent.

■ **Currency risk:** A proportion of the portfolio is invested in investments denominated in a foreign currency and movement in exchange rates can significantly affect their sterling value. The investment manager does not normally hedge against foreign currency movements affecting the value of the investment portfolio, but takes account of this risk when making investment decisions. In the scenario of sterling rallying against the Euro and US dollar post Brexit or in the event of Article 50 being revoked, then this could have a detrimental impact on the sterling value of the company's overseas investments (Orthofix Medical, Alkemy and Happy Friends) which account for 24 per cent of NAV.

■ **Credit risk:** The company is exposed to material credit risk on its cash and cash equivalents and investments. Failure of the transaction counterparty to perform their obligations under the financial instruments may lead to a financial loss.



Appendix: CIP Merchant Capital portfolio holdings

Alkemy S.p.A

Market: IPO in December 2017 on Aim Italia and progressing with move to STAR segment of Borsa, Italiana's Main Market (MTA)

Ticker: AILK

Country: Italy

Industry: Software/Technology

Corporate website: alkemy.com

First investment date: July 2018

Transaction: On market purchase of shares

Market capitalisation: €57.2m

CIP Merchant Capital shareholding: £3.45m

CIP Merchant Capital equity interest: 6.95 per cent

Strategy: Active approach

Activity: Milan-based digital marketing company Alkemy S.p.A. designs and implements data analytics, customer relationship management (CRM) and integrated channel (website, mobile and social media) solutions for clients' business-to-business (B2B) and business-to-consumer (B2C) activities.

Alkemy is growing fast: average revenue per client has almost doubled from €160,000 in 2014 to €303,000 in 2018. The company boasts a 100 per cent retention rate on top accounts and has a diversified base of around 200 clients which underpins a strong order back log.

Rationale for investment

1. Double-digit growth both through organic growth and aggressive mergers & acquisition strategy.

2. High standing and cross-industry client base, with high loyalty and room for cross-selling.

3. Plan to move from Aim Italia to the STAR segment of

Borsa Italiana's Main Market MTA.

4. Trading at a discount to peers and potential for a re-rating.

5. Valuation. In 2018, Alkemy increased both revenue and operating profit by two thirds to €71.6m and €4.8m, respectively. It ended the financial year with net debt of €10.7m, implying an enterprise value of €66m. Cash profit increased by 58 per cent to €6.2m. Alkemy is valued on an historic enterprise value to cash profit multiple of 10 and significantly less assuming it delivers on analysts' consensus 2019 revenue estimate of €94m and maintains profit margins.

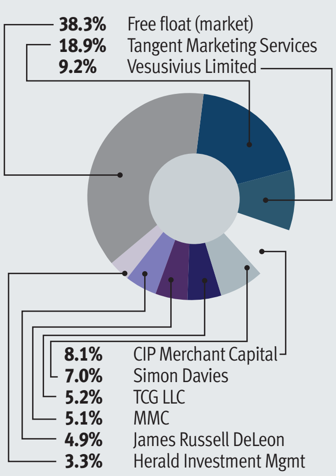
Recent developments

July 2019: Acquisition of an initial 20 per cent stake of Design Group Italia, an internationally accredited innovation & design consultancy company with 50 years of experience and operating across offices in Milan, Reykjavik, New York and Palo Alto.

August 2019: Financial results for first half of 2019. Revenue increased by 53 per cent to €41.7m year-on-year, cash profit increased by 42 per cent to €2.7m and net operating income rose by 33 per cent to €1.7m.

Brave Bison

Brave Bison major shareholders



Source: CIP Merchant Capital (Corporate presentation September 2019)

Market: Aim, London Stock Exchange

Ticker: BBSN

Country: UK

Industry: Software/Technology

Corporate website: bravebison.io

First investment date: June 2019, follow on investments in August and September 2019

Transaction: On market purchase of shares

Market capitalisation: £8.7m

CIP Merchant Capital shareholding: £707,000

CIP Merchant Capital equity interest: 8.1 per cent

Strategy: Opportunistic

Activity: Brave Bison works with brands, creators and platforms to create, distribute and monetise video and derives its revenue from advertising and fee based services. It has identified three pillars to its service offering: Strategy, Origination and Distribution.

The company has a substantial network of social media influencers and a growing number of brand-safe and targeted owned and operated channels for advertisers. Unlike many of its competitors (TV production companies and digital agencies), Brave Bison can offer all these elements as a one-stop shop or as individual services. The company derives advertising revenue from its portfolio of owned and operated channels. Fee based services are primarily consultancy services around social media strategy, content creation and audience development.

Brave Bison has benefited from the development by Facebook of its ‘Ad Breaks’ programme, the ability for short ads to be included in eligible videos to drive monetisation. It developed into the biggest publisher on Facebook in terms of views, and has the single biggest Facebook page in the world with VTRND. However, Brave Bison’s share price collapsed earlier this year, mainly due to Facebook’s policies which require the company to demonetise its pages.

As a result, Brave Bison has taken swift action to rebrand its four biggest Facebook pages: Super Crafty, VTRND, Blunt Kommunity and Daily Viral Stories. This has given the pages their own identities to meet Facebook’s new requirements, as well as increasing the amount of exclusive and original content the company uploads. Around 80 per cent of licensed content is now commissioned and the contribution to advertising from non-Facebook pages accounts for 35 per cent of total advertising revenue. Also, as part of the new strategy to deliver sustainable and solid revenue streams, the company is publishing more content on alternative platforms to Facebook such as Instagram, Snapchat and Youtube.

The new strategy appears to be working. YouTube revenue is being driven by the company’s largest clients PGA Tour, Tennis Australia, Lev Group Media European Tour and new client World Chase Tag; Snapchat is enjoying success with VTRND and revenue from advertising has been above expectations; and Asia Pacific revenue growth is being driven by branded content campaigns for large clients including All Nippon Airlines, Lego, Jaguar Landrover and British American Tobacco. In the first half of

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2019, revenue from non-Facebook platforms increased by a third and fee-based work surged by 76 per cent to £3.6m of the company's total revenue of £10.1m, a reflection of growth in Asia Pacific branded content.

Brave Bison appointed a new chief executive in April, has moved both London based teams into one new location, and implemented new processes around licensing, creating content and commissioning content for Brave Bison's brands.

Rationale for investment

1. Growth potential. Brave Bison retains net cash of £3.9m, a sum that backs up 44 per cent of its market capitalisation. This means that the business is effectively being valued at £4.8m, or on a single digit multiple of annualised cash profit. This valuation fails to acknowledge the company's growth potential from its market leadership, with the benefits of the operating leverage still to be exploited.

2. Attractive valuation. The digital company recently turned profitable. In the first half to 30 June 2019, Brave Bison trebled its underlying cash profit to £0.25m on 9 per cent higher revenue of £10.1m. The performance was driven by growth in fee-based services, primarily from Asia Pacific branded content, despite advertising revenue being impacted by de-monetisation of Facebook pages and adopting the social media giant's new policies.

3. Geographic potential. Brave Bison may be a minnow of the stock market, and well under the radar, but it offers a global footprint and potential to tap into Asia Pacific growth.

CareTech

Market: Aim, London Stock Exchange

Ticker: CTH

Country: UK

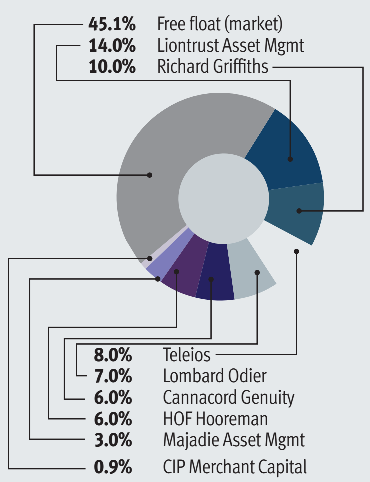
Industry: Healthcare

Corporate website: caretech-uk.com

First investment date: April 2019

Transaction: On market purchase of shares

CareTech major shareholders



Source: CIP Merchant Capital (Corporate presentation September 2019)

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Market capitalisation: £395m

CIP Merchant Capital shareholding: £3.48m

CIP Merchant Capital equity interest: 0.9 per cent

Strategy: Opportunistic

Activity: Founded in 1993, CareTech is a leading provider of specialist social care and education services, supporting around 4,500 adults and children with a wide range of complex needs in more than 550 residential facilities and specialist schools around the UK.

The company listed on Aim in October 2005, and has grown substantially since then. In October 2018, CareTech made its largest acquisition to date, the £278m takeover of rival Cambrian. Excluding the contribution from Cambrian, CareTech's like-for-like revenue increased by 12 per cent to £98m in the six months to 31 March 2019, to lift cash profit by 4 per cent to £20.5m, on a margin of 20.9 per cent. Cambrian delivered a cash profit margin of 13.2 per cent, up by 2.3 percentage points in the six month period, and this is before CareTech unlocks synergies from the acquisition.

A key feature of the business is its strong cash generation which is underpinned by high and stable occupancy rates (93 per cent on the 5,000 beds in the £600m property portfolio). In the latest six month trading period, Cambian and CareTech reported 100 and 97 per cent cash profit to cash conversion rates, respectively. The robust cash generation underpins a progressive dividend policy with surplus cash being invested back into the business to fund organic growth.

Rationale for investment

1. The company has a solid, steadily growing business. Net borrowings of £293m represent less than half the £600m (conservative) book value of CareTech's property estate. Balance sheet gearing was 89 per cent at 31 March 2019, with annual interest payments easily covered by the company's cash flow.

2. CareTech's management capabilities may unlock further value from Cambian's operation.

3. Potential takeover target for international player seeking to enter the market or increase its market share. Analysts expect CareTech's cash profits to rise (from £71m on revenue of £390m, in the 12 months to 30 September 2019) to £82m on revenue of £426m in the 2019/20 financial year, when a full

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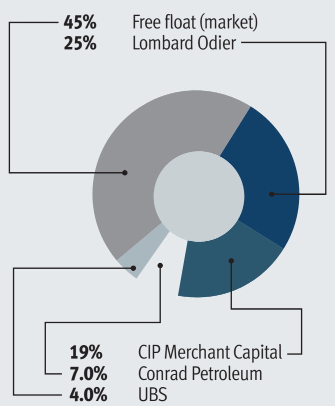
12-month contribution and synergy benefits from the Cambrian acquisition will be seen. Factor in net debt and CareTech's enterprise value of £685m equates to only 8.3 times forward cash profit estimates for the 2019/20 financial year.

4. CareTech owns a substantial real estate portfolio, and has potential to release hundreds of millions pounds of additional cash through further ground rent transactions. In January 2019, CareTech completed a ground rent transaction with funds managed by Alpha Real Capital at a net initial yield of 2.85 per cent. This transaction builds on the company's previous transaction with Alpha in February 2016. Under the terms of the agreement, the freehold interest in 24 CareTech properties were transferred to Alpha in exchange for £31m in cash and security of tenure, with a 150-year lease term returning to CareTech a virtual freehold interest in each property. The commencing annual rent of £1m per annum rises with the Retail Price Index (RPI) on a yearly basis. The properties are located across England and Scotland, representing less than 8 per cent of the aggregate number of freehold properties owned by CareTech.

Coro Energy major shareholders



Source: CIP Merchant Capital (Corporate presentation September 2019)

Coro Energy

Market: Aim, London Stock Exchange

Ticker: CORO

Country: UK

Industry: Oil & Gas

Website: coroenergyplc.com

First investment and follow on investments: April 2018 (£6m purchase of 150.68m shares at 4p); April 2019 (€3.44m investment in €22.5m Eurobond issue maturing in April 2022, paying a 5 per cent annual coupon and issued at 85 per cent of par value); call warrants on 85.2m Coro shares with exercise price of 4p and expiring in April 2022.

Transaction: Acquisition of equity interest in April 2018 placing, bond subscription in April 2019

Market capitalisation: £22.1m

CIP Merchant Capital equity shareholding: £4.4m

CIP Merchant Capital equity interest: 19 per cent

CIP Merchant Capital Eurobond shareholding: £3.18m

CIP Merchant Capital Eurobond interest: 15 per cent

CIP Merchant Capital call warrants holding: £0.44m

Strategy: Active management adopting private equity approach and seat on the Coro board.

Rationale for investment

1. Strategy of expansion in geography with untapped resources.

2. Target market population growth trends will create shortages of gas production.

3. Coro chief executive has track record of building and selling a portfolio of assets in South East Asia.

Investment case

CIP Merchant Capital's largest investment is in Aim-traded Coro Energy, a South East Asian upstream oil and gas company that is developing a business focused on finding and commercialising oil and gas resources of a scale and style which suit a mid-cap independent exploration and production company.

The region possesses some of the world's fastest developing economies where demand for gas currently significantly outstrips supply and is supportive of commensurate growth in energy demand. The growth strategy is being targeted on high-graded countries, such as Indonesia, Malaysia and Vietnam where there is significant 'yet to find' hydrocarbon resources as well as numerous fallow discoveries which represent opportunities for commercialisation and development for independent players such as Coro.

In February 2019, Coro announced its second transaction in Indonesia, the acquisition of a 15 per cent working interest in the Duyung production sharing contract (PSC), offshore West Natuna Indonesia, which contains the Mako gas field. The Mako gas field has been independently reviewed by Gaffney, Cline & Associates who ascribed gross 2C (contingent) resources of 276bn cubic feet (48.78m barrels of oil equivalent (boe)) of recoverable dry gas, and gross 3C (contingent) resources of 392bn cubic ft (69.3m boe) of additional field upside.

Following the Duyung acquisition, the Indonesian

Minister of Energy and Mineral Resources approved the Plan of Development for the Mako field, which is a key milestone towards monetising the Mako gas. Coro is fully funded to cover its share of estimated $19m drilling costs on a fully tested basis including rig mobilisation and de-mobilisation.

It's not the only gas prospect with potential as Coro is acquiring a 42.5 per cent working interest in the Bulu PSC, located 65km offshore East Java, which contains the Lengo gas field.

Of course, nothing is certain in oil and gas exploration, but clearly CIP Merchant Capital's Investment Managers see considerable upside to have invested around £9m of the £52.4m cash raised in the company's IPO by taking an equity stake in Coro in April 2018, and subsequently investing €3.44m (£3m) in Coro's Eurobond issue in April 2019.

Happy Friends (7 Star S.r.l.)

Market: Private company

Country: Italy

Industry: Healthcare

Corporate website: happy-friends.it

First investment date: December 2018

Transaction: Share capital increase and shareholder loan

CIP Merchant Capital investment including shareholder loan: £3.98m

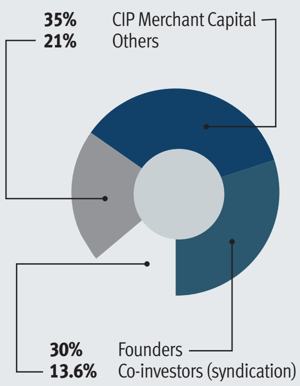
CIP Merchant Capital equity interest: 35.4 per cent

Strategy: Active approach, seat on board

History: In December 2018, CIP Merchant Capital invested €6.1m (£5.4m) in 7Star S.r.l , an Italian company that commenced operations in 2017 when it operated one veterinary hospital, under the brand Happy Friends, in Lombardy, North Italy.

The investment is being used to finance the expansion of 7Star's operations through the opening of further veterinary hospitals and clinics in northern Italy (a second veterinary hospital has since opened in Brescia). The founders of 7Star, Chicco Reggiani and Christian La Monaca,

Happy Friends major shareholders



Source: CIP Merchant Capital (Corporate presentation September 2019) were previously behind CareDent Italia, which undertook a roll-out of dental clinics throughout Italy, before being acquired in 2016.

CIP Merchant Capital initially invested €2.6m to acquire an equity stake of 49 per cent, and provided an interest free shareholder loan of €3.5m at the same time. In June 2019, the company completed a €1.7m syndication of its investment, which reduced its equity stake to €1.88m and its interest in the €3.5m interest free loan to €2.53m. Importantly, the stake and loan were both syndicated to co-investors at the same valuation that CIP Merchant Capital invested at last December. The CIP's retained 35.4 per cent equity stake and the shareholder loan, are in the books for close to £4m.

Rationale for investment

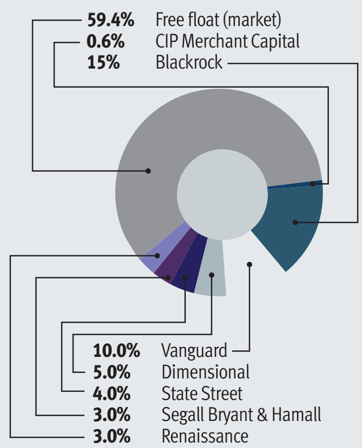
1. Attractive market with structural growth due to increasingly smaller families and humanisation of pets.

2. Fragmented market in Italy, while structurally concentrating industry in other European countries, including the UK.

3. Strong Private Equity appetite within the sector.

Orthofix Medical

Orthofix Medical major shareholders



Source: CIP Merchant Capital (Corporate presentation September 2019)

Market: Nasdaq

Ticker: OFIX

Country: USA

Industry: Healthcare

Corporate website: ir.orthofix.com

First investment date: July 2018

Transaction: On market purchase of shares

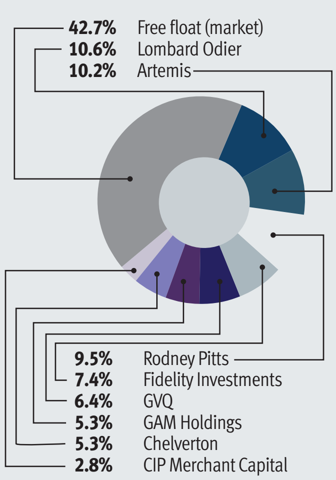
Market capitalisation: $978m

CIP Merchant Capital shareholding: £4.67m

CIP Merchant Capital equity interest: 0.6 per cent

Strategy: Passive approach

Proactis major shareholders



Source: CIP Merchant Capital (Corporate presentation September 2019)

Orthofix Medical Inc. is a diversified, global medical device company focused on improving patients' lives by providing superior reconstruction and regenerative orthopedic and spine solutions to physicians worldwide.

Rationale for investment

1. Global company with growing sales and cash profits.

2. Market leading position in its niche.

3. Healthy financial structure.

4. Significant upside potential from: accelerating revenue growth; margin expansion; premium paid by larger players from the acquisition of Orthofix's business units or in delisting process.

Recent developments
In August 2019, Orthofix released second quarter results which revealed net sales had increased by 3.9 per cent compared to the prior year (5 per cent on a constant currency basis), although there was some weakness in cash profit due to costs of marketing a new cervical disc generation product. However, the new product had already generated $0.5m sales since June when Orthofix commenced marketing it.

The succession plan for the group chief executive was announced, too. A seasoned orthopaedic and spine executive will replace the current chief executive on 1 November 2019.

Importantly, management reiterated its guidance for 2019 which suggests cash profits in the range $86m to $89m on revenue of $472m to $477m. The company has net cash of $52m and untapped credit facilities of $125m, so its enterprise value of $928m equates to 10 times 2019 cash profit estimates.

Proactis

Market: Aim, London Stock Exchange

Ticker: PHD

Country: UK

Industry: Software/Technology

Corporate website: proactis.com

First investment date: July 2019

Transaction: On market purchase of shares

Market capitalisation: £50m

CIP Merchant Capital shareholding: £1.47m

CIP Merchant Capital equity interest: 2.94 per cent

Strategy: Opportunistic

At the end of July, Proactis, a global procurement software provider, announced that it had received a preliminary unsolicited approach from a US-based investor with regard to making an offer for the company. It also received a number of preliminary unsolicited expressions of interest from other parties.

This followed interim results for the six months ended 31 January 2019 (announced on 29 April 2019) which outlined the conclusions of an operational review and the new strategy management would focus on. This included improving the company's financial position which has led the dividend being axed.

In the circumstances, it's hardly surprising that predators have been circling as Proactis' management team, led by a new chief executive and finance director, have considerable work to do to improve the company's operational performance. Although that's what they will be focused on, they are also exploring the strategic options that the unsolicited expressions of interest could present.

That's good news for CIP Merchant Capital, which by my reckoning picked up 2.5m shares at a cost of £842,000 during the month of July before the bid approach was announced. It has subsequently invested £144,000 by purchasing a further 300,000 shares at 48p to give it a 2.94 per cent equity stake worth £1.47m, and a paper profit close to £500,000.

Rationale for investment:

1. Proactis' share price declined significantly in the first half of 2019 following the announcement of a lower level of client retention, and deterioration in the pipeline of business for the company's US and European operations. The business has potential to be fixed by the new management team.

2. Proactis' software as a service (SaaS) model ensures stable recurring revenue and high margins.

3. Should the turnaround not work, there is potential for a trade buyer to emerge.

Quantifying upside potential

If a bidder does emerge, then it's likely that a take-out price will be at a premium to the current Proactis market capitalisation of £50m. That's because after factoring in the company's last reported net debt of £39.2m, its enterprise value of £89m equates to only 10 times the £8.9m operating profit that house broker finnCap was forecasting (prior to the company entering a bid situation, so forecasts have since been suspended) for the financial year to 31 July 2019. This forecast was based on annual revenue of £53.5m.

Furthermore, with the benefit of self-help measures, analysts at the brokerage firm expected Proactis to be able to increase operating profit to around £10m on flat revenue in the 2019/20 financial year. This offers an enticement for bidders to step in now at the low point, refinance Proactis' over-geared balance sheet, and then benefit from the operational and margin improvements.

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