Souter Investments

# Investment Review

October 2019

# About Souter Investments

Souter Investments is the family investment office of the Souter family, and one of the UK's leading family investment offices specialising in private equity.

Sir Brian Souter co-founded Stagecoach Group plc as a start-up in 1980. Stagecoach floated in 1993 and is listed in the FTSE 250. Sir Brian is Chairman of the company having stepped down from his role as Chief Executive Officer six years ago.

## Sector agnostic, flexible investment approach

Although many assume that we focus on investing in the transport sector, our investment activity reflects a far broader, sector agnostic approach. Transport forms only a part of our activity, and we have made many more investments in other sectors such as industrials, financial services, business services, healthcare, oil and gas services, consumer products, telecoms and technology. Our ethical views mean that we do not invest in companies involved in alcohol, gambling, tobacco, armaments or payday type loans.

As a first-generation entrepreneur led family investment office, we have not raised funds from third parties and only invest on our own account. This means that we are not constrained by fund rules, specific investment hold periods or restrictive investment criteria; we can therefore invest in whatever form and for whatever period makes sense.

We typically deploy equity cheques between £2 million and £30 million.

## WE CAN:

- Invest across a variety of transactions, including buy-outs, buy-ins, growth capital, cash out, buy and build, turnarounds, disposal of non-core assets and balance sheet recapitalisations;
- Use a variety of investment structures;
- Take majority or minority positions;
- Provide management expertise and resource as appropriate, either directly or via our extensive network; and,
- Be flexible in our hold period.

Most of our investments are buy-outs or acquisitions of established corporations, but we also back earlier stage growth businesses. Some of the companies in our portfolio are very recognisable, others are less well known to the general public despite being market leaders in their chosen fields. We do not generally invest in start-ups or pre-revenue companies.

We like to lead deals but are equally comfortable working with co-investment partners; we have led around half of the deals we have completed. We will participate in auction processes but are highly selective.

Our approach remains to employ high standards of professional diligence and rigour in selecting, executing and managing our investments, but we also benefit from an entrepreneurial owner. As a result, Souter Investments' decision-making process is quick, and we can take a flexible approach.

## PRIVATE EQUITY FOCUS

When Souter Investments was founded in 2006 more than two thirds of Sir Brian's portfolio was represented by Stagecoach with the remainder invested in a large and diverse number of managed funds, and a smaller portfolio of unquoted and property investments.

Today the balance is very different. Our primary focus is on unquoted private equity investments, and whilst Stagecoach is still a major part of the portfolio it now only represents 23% of total assets.

We have invested in over 50 unquoted companies and currently have significant investments in over 25 businesses, acting both as a lead investor and as a co-investor with other financial sponsors. Our investee companies are typically UK-based or headquartered, but we have made investments as far afield as New Zealand, Turkey, South America, Finland and Poland. Our companies often have an international footprint.

## OUR TEAM

The Souter Investments team encompasses a mix of investment professionals and support staff based in Edinburgh.

Managing Director Andy Macfie is a co-founder of Souter Investments and has more than 33 years' experience of investing in unquoted companies.

Investment Directors John Berthinussen and Calum Cusiter joined Souter Investments in 2008 having previously been involved in unquoted and property investments. They are joined by three more investment executives, Maurice Shamash, Stuart Callion and Scott Mackenzie who have now been with us for between four and six years.

If you have an investment opportunity you think might meet our criteria, please contact us at:

**info@souterinvestments.com**

**0131 225 7688**

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**68-70 George Street**
**Edinburgh EH2 2LR**

You can keep up to date with our activities and sign-up to receive our news updates at **www.souterinvestments.com**

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# Preface

## Sir Brian Souter

This is our fourth triennial Investment Review and covers the period from the formation of Souter Investments in December 2006 to March 2019.

As before, the purpose of this document is to provide an insight into:

- Our investment strategy, approach and criteria;
- The breadth, depth and diversity of our portfolio; and,
- Our performance.

We hope that you find it interesting and useful.

## ECONOMIC BACKGROUND

**In our last Investment Review in 2016, I predicted that we would likely avoid a serious recession in the UK, but that the major economies would continue to stagger forward, and markets would remain volatile.** I also indicated that I was cautious regarding the near-term investment outlook, with global economies likely to struggle to generate above average economic growth over the next two to three years.

This forecast was reasonably accurate though quoted investment returns have been better than I anticipated mainly due to continuing low interest rates and quantitative easing.

However, it does appear that storm clouds are gathering, and I am less confident about the next few years, especially since central banks have fewer instruments available to combat a recession. Global interest rates continue to be incredibly low by historical standards with many countries able to sell bonds with negative interest rates. Quantitative easing, introduced following the 2008 Global Financial Crisis, has also pushed up asset values. These policies, designed to avoid a global recession and deflation, have failed to increase economic growth and inflation back to levels which would allow governments to revert to more normal monetary policy conditions by increasing interest rates and withdrawing the QE stimulus.

Many economic commentators think that the UK is on the brink of a recession. The curve plotting the difference between yields on two-year and ten year US treasury notes recently inverted with longer term yields falling below short term yields. This inversion has preceded every US recession in the past 50 years, albeit with a varying lag time sometimes measured in years. The global economy remains fragile and there is a justifiable concern that we are in danger of being caught by the phenomenon dubbed "Japanification"; the battle against deflation and anaemic growth which Japan has faced in the last 30 years.

Reflecting on my comments in our last Investment Review, it is disappointing to note how little progress has been made in the last three years. Sterling fell immediately after the EU referendum in 2016 and I expressed confidence that with strong political leadership, the UK should be able to negotiate a satisfactory associate relationship with the EU, deliver Brexit and resume a strong growth profile.

The UK government has now negotiated a 585-page Withdrawal Agreement together with a Backstop arrangement which has been unable to get parliament's support. Brexit has claimed another Prime Minister. The recent European elections resulted in the two main political parties obtaining only 23% of the vote in aggregate. We live in strange times and it is almost impossible to predict with any confidence what the result of the next couple of months will be and indeed what impact this will have on the UK economy.

The political and economic background will continue to present challenges for investors and for companies, but it will also provide opportunities. We have in the past benefited from investing through the economic cycle, and we will continue this approach looking for interesting opportunities across several different sectors.

## PERFORMANCE

**We have taken the decision again this year to report Souter Investments' performance in isolation, excluding the contribution of Stagecoach Group plc. This better reflects the performance of the family investment office.**

*I am proud of what we have achieved at Souter Investments over the last twelve years, especially considering the prevailing macro-economic backdrop and investment climate.*

Our total portfolio, excluding Stagecoach, increased in value by 9% per annum over the 12 years ended March 2019. This compares against a 5% annual return on UK quoted equities over the same period. Although this does not sound like much of a

*A major beneficiary of Souter Investments' performance has been The Souter Charitable Trust. My wife Betty and I have always been keen to donate funds to charitable causes.*

difference, the compounding effect of this difference means that our portfolio is 55% higher in value than had we invested solely in the UK stock market.

This performance is especially encouraging given it is calculated post Souter Investments' running costs, and all corporation, capital gains and income tax paid. The performance of our unquoted investment portfolio, where the majority of our capital and efforts are now deployed, has been particularly pleasing, generating an IRR of 18%.

Following the successful sale of several of our unquoted investments over the last couple of years we now hold record levels of cash and liquid investments available to deploy into the right situations. This is great news, providing us with plenty of dry powder for future investments, but it will take time to deploy these funds in investments generating higher returns and therefore even I would accept that generating the same returns as we have achieved in the last twelve years will be a challenge.

## SOUTER CHARITABLE TRUST

A major beneficiary of Souter Investments' performance has been The Souter Charitable Trust. My wife Betty and I have always been keen to donate funds to charitable causes. We founded The Souter Charitable Trust in 1992 with the objective of assisting projects engaged in the relief of human suffering in the UK and overseas, particularly, but not exclusively, those promoting spiritual welfare.

In the thirteen years ended June 2019, the Trust has awarded more than 13,000 grants totalling over £98m. It currently has a net asset value of £26m. Annual running costs of the Trust amount to less than £50,000 representing 0.2% of assets. The Souter family provide nearly all the funds to the Trust, with donations in the period exceeding £65m.

Further details can be found at:
www.soutercharitabletrust.org.uk

## SUMMARY

I am proud of what we have achieved at Souter Investments over the last twelve years, especially considering the prevailing macro-economic backdrop and investment climate.

The portfolio is in a healthy state and I am confident that we will see many interesting investment opportunities in the future and continue to generate superior returns.

Sir Brian Souter

SIR BRIAN SOUTER

# Investment Review

Andy Macfie

When we launched Souter Investments in December 2006, our vision was to create a professional but entrepreneurial family investment office.

The overriding purpose of Souter Investments was to build a diversified investment portfolio that would generate healthy returns over the long-term, be resilient to economic downturns and fund charitable donations.

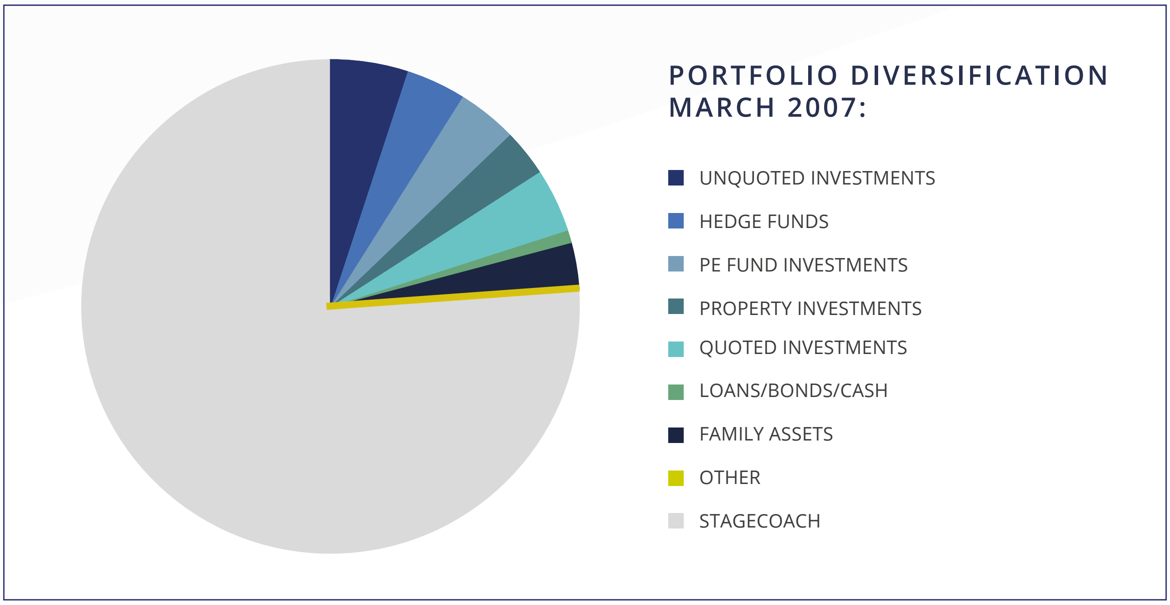
## INVESTMENT GOALS

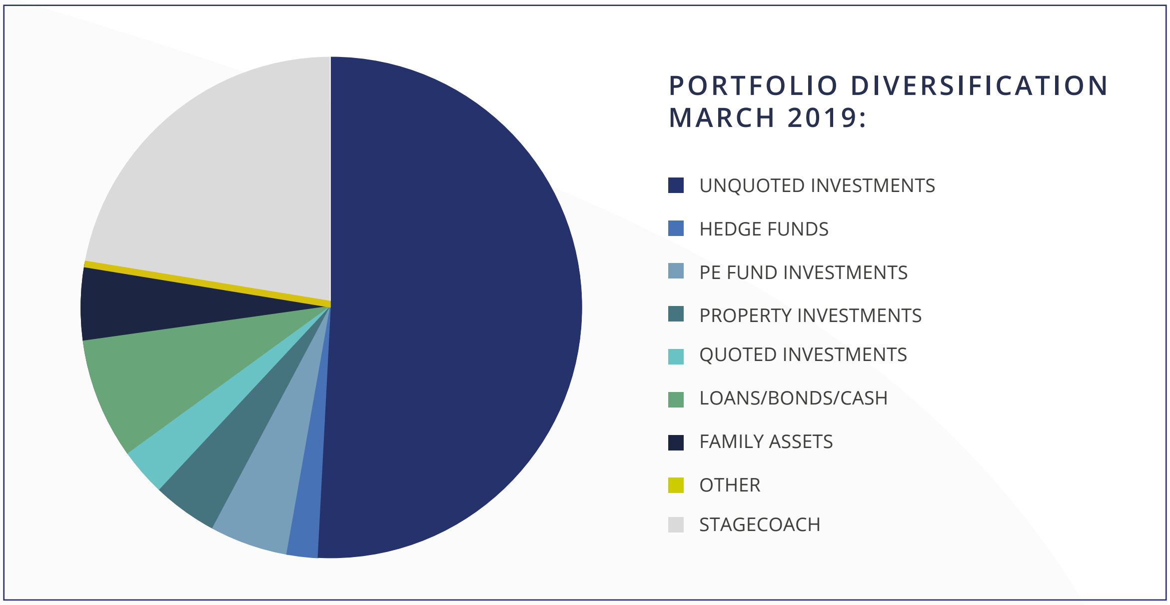
That purpose is still appropriate today and we have set about achieving it by pursuing several investment goals:

### 1. CREATE A DIVERSIFIED PORTFOLIO

Create a diversified portfolio, whilst retaining Stagecoach Group as a core holding of the portfolio, targeting private equity opportunities but also making highly selective and limited allocations to other asset classes, such as private equity funds, listed equities and property.

Through the targeting of unquoted investments and the release of capital from Stagecoach we have seen a significant increase in the portfolio's diversification. We have invested more than £350m in direct unquoted investments in the last twelve years, and the proportion of the total portfolio invested in direct private equity has increased from 5% to 52%.



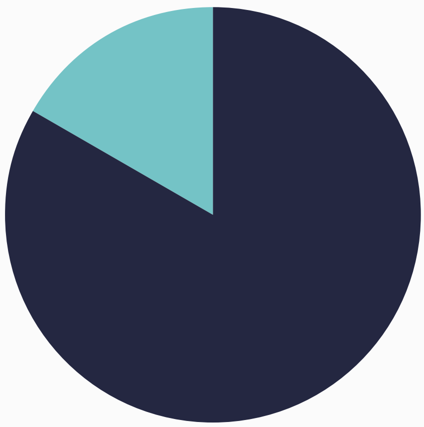




A diversified portfolio reduces risk but makes exceptional performance more difficult to achieve. It is therefore important to make good picks, read the markets and be versatile.

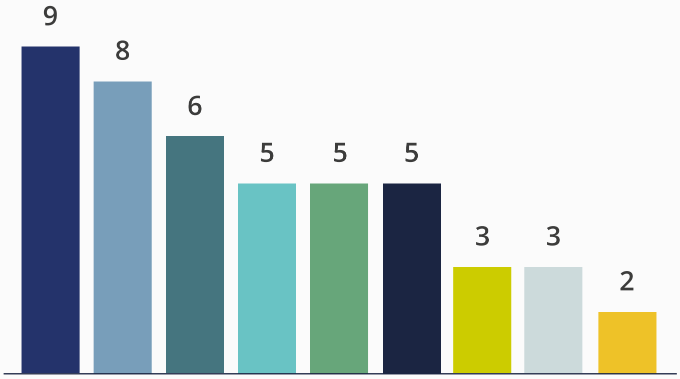
We had more than 25 unquoted investments in the portfolio at March 2019, with an invested cost of more than £200m. Our diversified portfolio spanned companies involved in industrials, financial services, consumer products, business services, oil and gas services, telecoms, healthcare, technology, property and transport.

## OUR PORTFOLIO IS DIVERSIFIED BY SECTOR

A sector agnostic generalist investor...

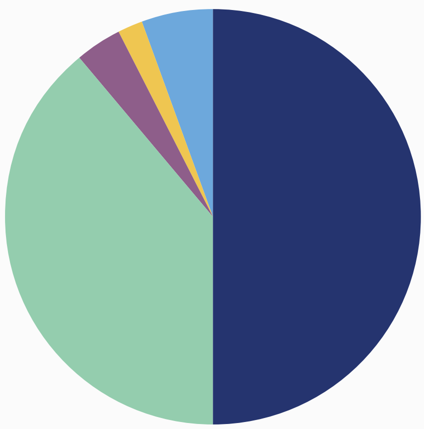



...writing general private equity deals across a variety of sectors

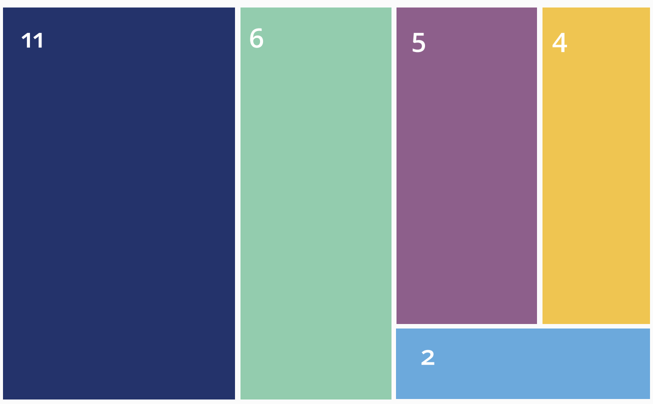



## WE HAVE FLEXIBILITY IN THE TYPE OF DEALS WE DO

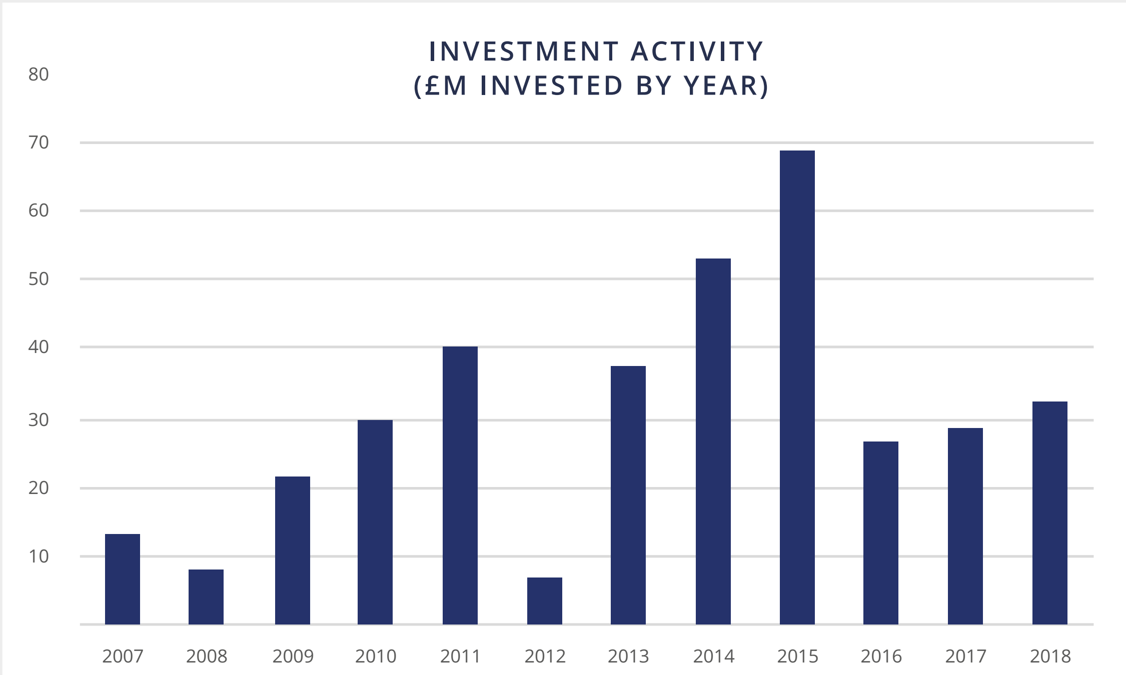
Buy-outs and Growth Capital are in the majority...




...and we participate in many different types of mature company acquisitions or buy-outs



We have increased our investment activity significantly over the life of Souter Investments, though activity levels can vary year to year as we maintain our discipline when looking for attractive unquoted investments and spend time on managing and selling existing investments.




## 2. MAINTAIN AN OPPORTUNISTIC INVESTMENT APPROACH

Maintain an opportunistic investment approach, so as well as our focus of direct private equity investing, we can invest in selected listed stocks and stock market index tracker funds, in a very limited number of private equity funds, and in commercial and residential property situations, focussing on areas where we have an angle and/or where we have experience and knowledge.

Although our appetite for third party managed funds is limited, we have made a small number of commitments to our existing private equity fund managers where we know the fund manager well and recent performance has been good.

In addition, we have invested in a limited number of property opportunities in Scotland where we know the market well.

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We are pleased to have achieved the objectives set out for Souter Investments at the start of the journey. This is particularly encouraging given how difficult the economic and investment environment has been; we started the period with the Global Financial Crisis, the effects of which are still with us, and we now face the consequences of the Brexit vote and a potential economic slowdown.

It has certainly been an interesting period during which to invest.

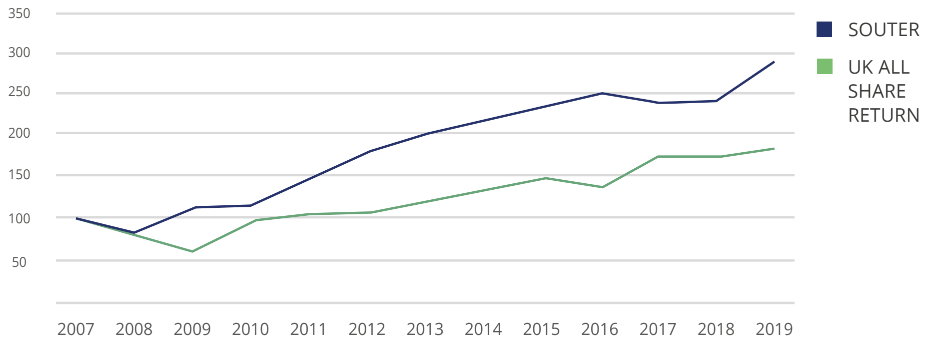
INVESTMENT REVIEW

## PERFORMANCE SINCE LAST REVIEW

We are very pleased with the 9% annualised return over the twelve-year period, which is stated after all tax payments and Souter Investments' running costs but before Souter Charitable Trust payments.

Our performance compares well against UK equities, which generated an annual return of 5% per annum (see figure below):

### SOUTER INVESTMENTS NET ASSET GROWTH COMPARED AGAINST UK ALL SHARE RETURNS INDEXED (2007= 100) YEARS ENDED MARCH




The contribution to this outperformance from our investments in the direct unquoted space is significant. Our returns on this asset class were 18% per annum[1] over the twelve-year period, and higher still on realised investments at 25% per annum, an average money multiple of 2.6x times. This is particularly encouraging and justifies the change in strategy to focus on direct unquoted investments when Souter Investments was formed in late 2006.

As highlighted above, the proportion of the original 2006 Souter Investments portfolio invested in higher return direct unquoted investments was relatively low and the proportion of other, typically lower return investments, including commercial property, listed stocks, hedge and private equity funds, was relatively high. Returns from these other investment classes supressed the total portfolio return over the period, especially given the poor performance in the first three years 2007-2010 as the Global Financial Crisis took hold.

Despite some of the headwinds identified by Sir Brian earlier, we believe that the portfolio is of a high quality and expect our unquoted returns to continue to be strong benefitting from the maturity of the portfolio, an increase in investee company profits, execution of growth plans, implementation of turnarounds, and the achievement of exits. Our valuations are typically conservative with realised proceeds normally exceeding pre-disposal valuations by 23%.

We are grateful to the management teams of all these companies and wish them, and their respective acquirers, continued success in the future.

As Sir Brian would say, however, not all our investments have been 'double yolkers' (or, more conventionally put, successes). Certain of our companies have struggled to achieve growth plans or increase profitability, however, through a diversified portfolio, getting more picks right than wrong and working hard to maximise recovery on poorer performing assets, we have ended up in a net positive position.

Andy Macfie

ANDY MACFIE

*1 Realised and unrealised investments, net of all provisions, at Souter Investments assessment of fair value, with all cash flows assumed at end of relevant financial year*

# Our Private Equity Activities

Souter Investments in numbers

## SINCE INCEPTION:

12
12 years

55
55 investments

27
27 realisations

50%
50% deals Souter lead

4½
Average hold period 4½ years

15
Longest hold 15 years

18%
Realised and unrealised IRR 18% per annum

25%
Realised IRR 25% per annum

## CURRENT PORTFOLIO

>25 COMPANIES

>£200M IN INVESTED CAPITAL

>17,000 EMPLOYEES

>£1.8BN COMBINED TURNOVER

# Portfolio

You can find out more information about our portfolio companies at www.souterinvestments.com/portfolio.

## EXISTING INVESTMENTS

### Business to Consumer

CONSUMER GOODS:

HEALTHCARE:

TELECOMS:

LEGAL SERVICES:

FINANCIAL SERVICES:

TRANSPORT:

### Business to Business

INFORMATION AND INSIGHT:

PLANT HIRE:

PACKAGING:

RECRUITMENT:

OIL AND GAS SERVICES:

FINANCIAL SERVICES:

TRANSPORT:

PROPERTY:

# EXITS

## Business to Consumer

MANUFACTURING:

PUBLISHING:

PROPERTY:

CONSUMER GOODS:

FINANCIAL SERVICES:

TRANSPORT:

## Business to Business

MANUFACTURING:

OIL & GAS SERVICES:

BUSINESS SERVICES:

FINANCIAL SERVICES:

TELECOMS:

HEALTHCARE:

PORTFOLIO

# NEW INVESTMENTS

We see, on average, over 300 deals per annum and invest in a very select few. The below table shows the companies we have invested into since our previous Investment Review.

## Oil and Gas Services

### Ashtead Technology

Provides fully integrated equipment solutions including rental equipment, equipment sales, calibration, repair and maintenance, offshore personnel and bespoke engineered solutions.

### Coretrax

An independent wellbore clean-up and abandonment specialist to the oil & gas industry.

### TWMA

A global provider of integrated drilling and environmental solutions to the onshore and offshore oil and gas industry.

## Financial Services

### DivideBuy

A FinTech company which offers interest free credit to customers through selected online and offline retailers.

### Eaton Gate

A managing general agent in the insurance sector which manages all key aspects of writing insurance on behalf of the ultimate underwriter.

### Payen

An internet Payment Services Provider and alternative payments provider to enterprise customers in industries with complex payment requirements.

## Business Services

### DMC Canotec

A provider of printer and document management services.

### Potensis

Provides temporary and permanent recruitment services to the residential housebuilding, social housing and commercial construction sectors.

## Telecoms

### Broadway Partners

A wireless internet services provider, pioneering the commercial use of line of sight radio and TV WhiteSpace radio to connect remote rural and underserved communities.

## Technology

### CoachHire.com, Kura Education, Kura Corporate

A leading provider of technology-led solutions to the education, corporate and leisure sectors, specialising in the procurement, management and delivery of passenger transport services, including vehicle tracking and passenger safeguarding solutions.

## Consumer

### Pet Network International

A leading group of pet supplies retailers in South East Europe.

PORTFOLIO

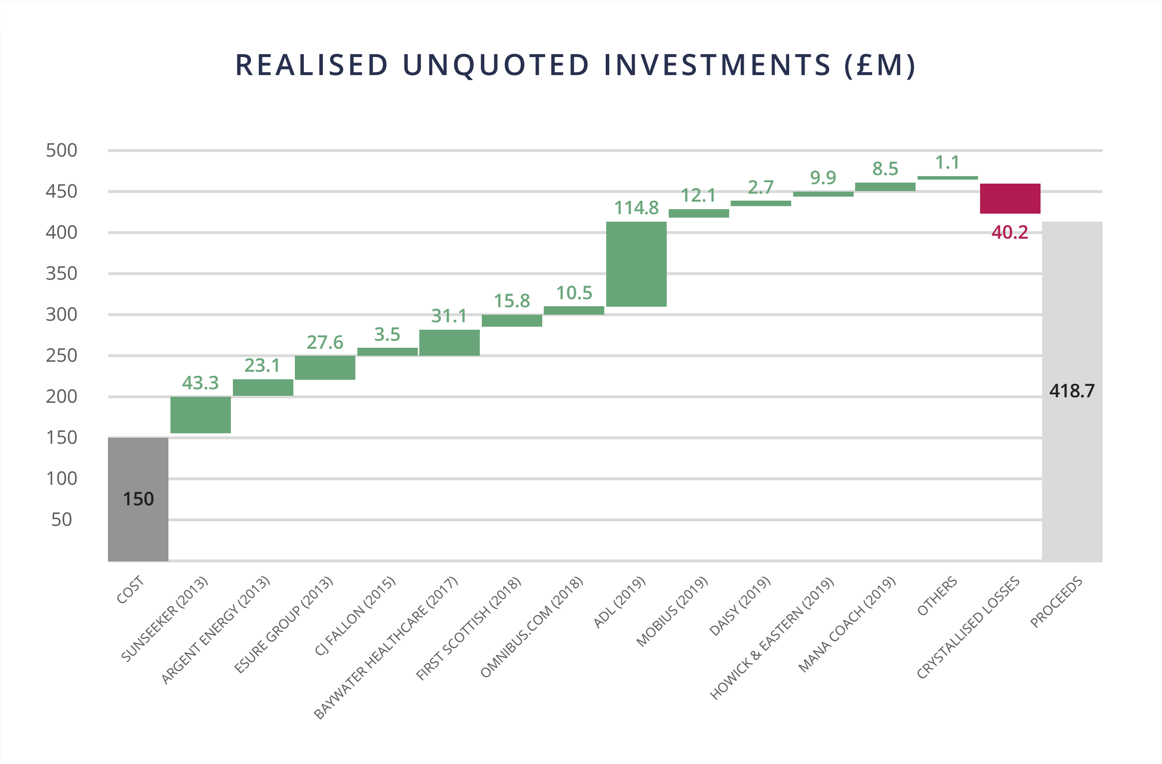
We welcome these companies and their management teams to the Souter Investments portfolio.

In addition, we supported many of our existing portfolio companies with additional funding to, for example, accelerate organic growth, make investments or complete acquisitions.

## PRIVATE EQUITY DIVESTMENTS

Unlike many private equity funds, we have no external pressure to realise sales of our investments within specific time periods and so have a flexible exit horizon. We can hold some assets for longer periods, although ideally, we like to receive income and/or a return of capital in these situations.

Set out below is a summary of the returns generated from our more successful exits.




*Note – Includes post 31 March 2019 disposals of ADL (completed May 2019), Mobius Life (expected to complete in September 2019 following receipt of regulatory approval), and our New Zealand bus businesses Howick and Eastern Buses and Mana Coach Services (which have been sold subject to regulatory consents).*

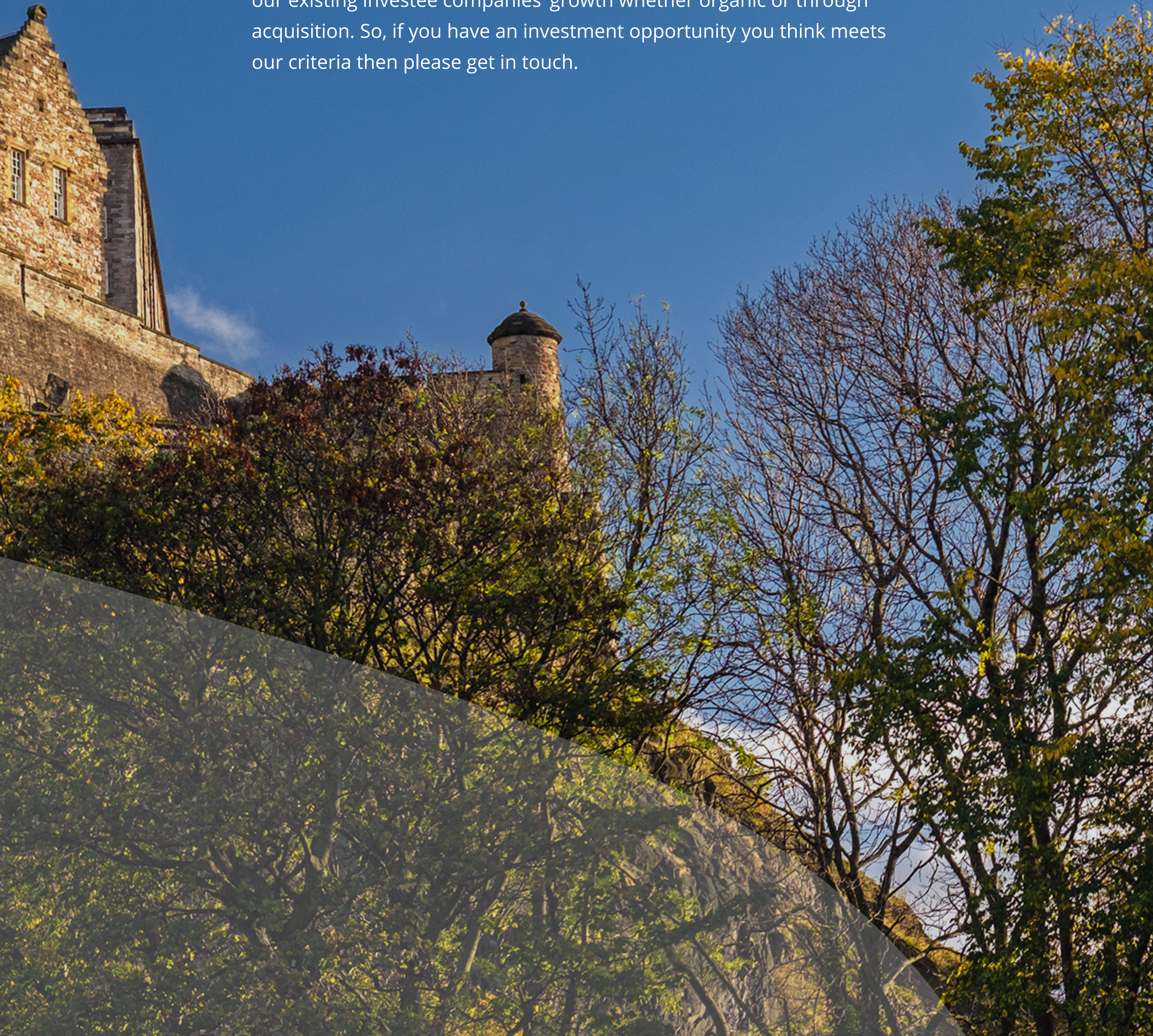
Acquirers of our businesses have been a mix of strategic corporate buyers and financial sponsors. We have seen an increase in interest from international corporates who find UK headquartered businesses attractive, especially those from North American and Europe.

We are grateful to the management teams of all these companies and wish them, and their respective acquirers, continued success in the future.

## OUTLOOK

Souter Investments has been very active and grown strongly since it was formed in 2006. Whilst there is always much to do to ensure our portfolio remains healthy, and we are definitely not complacent, we do believe we have acquired some attractive assets which are well placed to continue to grow strongly in the years to come.

We have enjoyed exceptional deal flow in recent years and have significant capital available, both for new investments and to support our existing investee companies' growth whether organic or through acquisition. So, if you have an investment opportunity you think meets our criteria then please get in touch.



## EDINBURGH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