STIFEL

RIT Capital Partners – A calmer harbour, on an attractive discount

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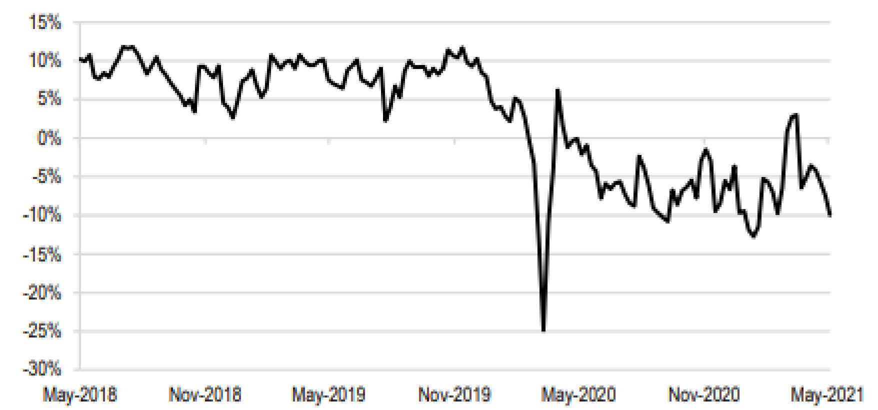
Summary

With global markets becoming jittery about the inflation and interest rate outlook, we think it may be worth taking a look at funds offering lower exposure to equities. RIT shares are trading on a high single-digit discount level, and we view this as a relatively attractive entry point. At times of weak stock markets, RIT is expected to deliver returns which decline less than equities, given its multi-asset portfolio. Over 2020, its listed equity exposure was 43% of NAV on average and at 31/03/21 long quoted equity positions accounted for 47% of NAV. We reiterate our Positive rating.

Key points

Figure 1: RIT Capital discount/premium (%) over three years to 18/05/21



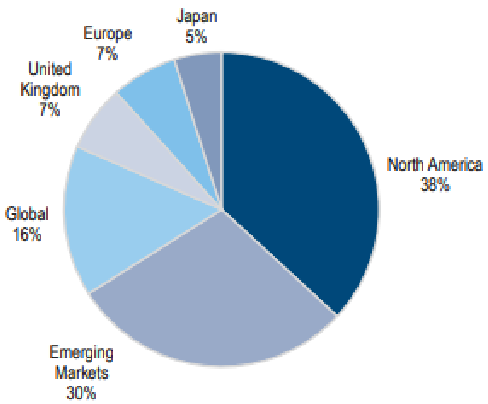
Source: Datastream

A multi-asset portfolio, offering some value: Prior to the stock market fall in March 2020, RIT had tended to trade on a significant premium to NAV and generally looked expensive. Over the past year, the share price trading range has typically been a 0% to 10% discount to NAV. The shares are trading on a high single-digit discount to NAV which we think is a relatively attractive entry point. It is worth noting that RIT has bought back shares in the past year, which may provide some comfort that the board proactively focuses on the discount when it is relatively wide. RIT's multi-asset approach dampens the upside and downside from equity market moves and with equity and bond markets becoming jittery about inflation in recent weeks, we think it is a good time to revisit RIT.

Current positioning: RIT provides exposure to a broad range of assets and offers a good alternative to traditional equity funds. The latest asset allocation is shown in Figure 3 overleaf. It has 47% in long quoted equity and also includes 10% in quoted equity managed on a hedged basis and 21% of NAV in Absolute Return & Credit. There is also 23% in private investments (including 17% in private equity funds and 6% in private direct investments), with a further 2% in real assets.

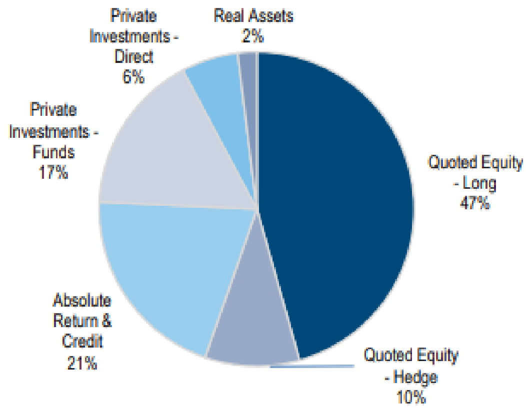
Correlation with equities: RIT says that since listing in 1988, it has participated in 73% of the market upside, but only 38% of the market declines. Per RIT, this has resulted in the NAV per share total return compounding at 11.2% per annum over this period, a meaningful outperformance of global equity markets.

Figure 2: RIT Capital geographic breakdown at 31/03/21



Liquidity, Borrowings & Currency -2%
Other -1%
Source: Company data

Figure 3: Asset allocation (% of portfolio) as 31/03/21



Net Liquidity / Borrowings / Other Assets -3%
Source Company data

Coupang IPO: On 12/03/21, RIT announced that Coupang, a South Korean e-commerce business had IPO'd on the New York Stock Exchange. This investment is held through a co-investment fund managed by an external general partner (GP). On the first day of trading (11 March), RIT said that based on the closing price of $49.25 per share, this represented a c.222% increase in the value of RIT's investment. This was equivalent to an increase in RIT's NAV of +195p or +8.4% per share. This meant that Coupang had become RIT's largest portfolio investment accounting for c.12% of NAV. This was an excellent outcome for RIT, which has been a long-term investor in private equity-backed businesses and has been able to generate some good uplifts on these investments over the years. However, RIT did not dispose of any shares at IPO and given lock-ins, it will be subject to volatility in the Coupang share price. At the 30/04/21 valuation point, the price of Coupang had declined by -15% from initial trading to $41.90 (vs NASDAQ up +6.2%). It had fallen further by 19/05/21 to a price of $37.25, with this reducing RIT's NAV by around -25p per share since its last published NAV of 2615p at 30/04/21. We estimate that Coupang is currently c.9% of RIT's NAV.

Recent performance: RIT has made a strong start to 2021, with the Coupang investment being a key contributor. The NAV at 31/12/20 was 2292p and it had risen to 2615p at 30/04/21, a +14.1% increase since the start of the year. This is after deducting an interim dividend of 17.625p. We estimate that the gain to NAV from Coupang over this period was c.+160p per share, with the remainder of the portfolio generating a gain of c.+180p (prior to the deduction of the 17.625p dividend). By way of comparison, the MSCI All Companies World Index (50% £) has risen by +7.5%

Figure 4: Performance attribution for year to 31/12/20 (% to NAV)

Quoted equity	+6.4
Private investments	+9.8
Absolute return & credit	+2.5
Real Assets	+0.5
Government Bonds & Rates	-0.1
Currency	-0.6
Total Investments	**+18.5**
Liquidity, Borrowings & Other	-2.1
Total	**+16.4**

Source Company data

2020 performance: Over 2020, RIT delivered an NAV total return of +16.4%, outperforming both its reference hurdles, i.e. 1) RPI plus 3.0% which measured +4.2%, and 2) MSCI All Companies World Index (ACWI) which returned +12.7%. This represented the ninth consecutive year of positive returns for the portfolio. A full attribution is shown in Figure 4; however, the private equity portfolio made the largest contribution to the return of +9.8% to NAV. The quoted equity portfolio also added +6.4% to the overall return, despite the portfolio only being 43% invested in equities over the year, on average. The absolute return and credit book finished the year positively and contributed +2.5% to the overall NAV. The returns were broadly distributed across managers and sub-strategies, with all key funds delivering a positive return.

<u>**Private Investments**</u>

In 2020, the private portfolio was the best performing segment of the RIT portfolio with a return of +9.8%. Coupang, discussed above, was the strongest contributor in the direct portfolio and was valued at £141m at 31/12/20, representing 3.9% of NAV. This was a significant increase from the 31/12/19 valuation point, when it was valued at £56.4m. RIT says over 2020, the Korean e-commerce giant experienced strong revenue growth and a consequent revaluation from the general partner (GP) of the fund with which RIT co-invested in this company.

Realisations: The portfolio also benefitted from realisations of two positions: CSL and Credit Karma. CSL was sold in the second half of the year at a sizeable uplift from its carrying value, and Credit Karma was taken over by Intuit with the transaction completing in December. These investments generated IRRs of 25% and 33%, respectively. The aggregate contribution from both exits represented just under 1% of NAV. The remainder of the portfolio saw modest uplifts driven by operational performance, with some investments facing headwinds from Covid-19. However, given the portfolio's tilt towards disruptive technologies, it also benefited from the acceleration in uptake of online activity. During 2020, RIT made further investments including: a technology-enabled US insurance company, a US online consumer financial platform as well as a cloud investment.

£93m of distributions; commitments £256m, 7% NAV: Realisations continued during 2020, with in excess of £93m of distributions from these funds. RIT made £145 million of new commitments over 2020 to a range of private funds – many of whom are US firms where RIT have existing and successful relationships, and often with a venture or growth bias. At 3/12/20, total outstanding commitments were £256m (31/12/19: £211m), equivalent to 7.1% of NAV.

Strategy: RIT's allocation to private investments often targets firms engaging in disruptive technologies in the US and Asia. They use their unique and extensive global network to invest either directly or indirectly through funds, with these allocations designed to allow us to capture pre-IPO value creation opportunities, which can be sizeable.

Dividend wholly uncovered

We view RIT's dividend as a return of capital, rather than a dividend that is financed through earnings. The 2020 dividend totalled 35.0p, and was wholly uncovered by earnings, given the revenue EPS was a loss of -0.8p (2019: 0.24x covered). For 2021, the board forecast a total dividend of 35.25p, an increase of +0.7% over the 35.0p in 2020, with this being slightly above the inflation rate in early 2021.

Manager's view on outlook

In the accounts to 31/12/20 published on 02/03/21, Ron Tabbouche, CIO, and Francesco Goedhuis, CEO, made the following comment with their views on markets:

"As for 2021, we believe that financial markets will continue to reflect the balance between the pandemic's impact, the roll out and efficacy of the vaccines, and government and central banks' policy responses. If there are challenges to the vaccination programme, we are likely to see meaningful market volatility, given the degree of optimism we feel is already embedded in many asset prices. On the other hand, a smooth path to broader immunity, may also pose a risk for stocks as it is likely to bring us closer to the potential resurgence of inflation. Here, the combination of record monetary and fiscal stimulus, with a post pandemic economic recovery could result in the transmission of asset price inflation to price rises in the real economy.

As investors seek to adjust to such a change, they are likely to demand an additional risk premium. And at a time when much of the invested capital is premised on sustained low-rates and a lack of inflation pressures, a shift in the perception of these, could have a sizeable impact.

Our approach in this regard is to use thoughtful portfolio construction and a security selection process focusing on assets with asymmetric outcomes. We are likely to continue with our modest quoted equity exposure and diversified themes, and have undertaken some de-risking of some of the more frothy areas where we see risks of overstaying our welcome. Ultimately we will seek to continue to reinforce our approach which worked so well in 2020 – namely our belief that robust performance can only be driven by a resilient focus on our long-term convictions, excellent sourcing of investments, and a combination of discipline and agility around our portfolio construction."

Recommendation & Key Positives & Negatives

Key Fund Positives & Negatives:

Positives:

1) Offers something different to many funds given multi-asset approach;
2) NAV has potential to outperform in weak equity markets; and
3) Private Equity portfolio (23% NAV) has historically had interesting investments and delivered good returns.

Negatives:

1) NAV reporting monthly i.e. infrequent and NAV is difficult to estimate day-to-day – this may be a factor influencing the discount;
2) Relatively high 'see-through' management costs at c.2% of NAV, taking into account external fund fees and performance fees; and

3) Complex incentive structure, including LTIP linked to share price.

Recommendation – Positive: Over the past year or so, RIT has lost its premium rating, with the shares typically having traded on a c.10% premium to NAV in 2018 and 2019, derating to a discount. We think the current high-single digit discount that the shares are estimated to be trading on is a relatively attractive entry point. The board have shown over the past year that they are prepared to use the share buyback facility at times and we think this should give investors some comfort around the risk of further significant discount widening. We do like the multi-asset strategy and think that in a scenario of any renewed weakness in markets, the share price should perform relatively well compared to long-only equity funds. We re-iterate our Positive recommendation.