Strategic Equity Capital

Interim Management Statement 31 March 2011

This interim management statement, issued in accordance with the UK Listing Authority's disclosure and transparency rules, relates to the period from 1 January to 31 March 2011.

Investment highlights

- Net assets per share increase by 7.9%, outperforming the FTSE Smaller Companies ex Investment Trusts index by 7.6%.
- Portfolio companies continue to deliver strong operating performances.
- Continued rotation from mature fairly valued investments into new attractively priced opportunities.

Financial highlights

- Net assets of 97.64p per share.
- Discount narrows significantly to 18.2%.
- Portfolio valuation remains highly attractive – price to cash flow rating of 7.1x.

Investment Manager's Review

- The period saw a further improvement in net assets per share of 7.9%, taking the cumulative increase over the twelve months ended 31st March 2011 to 40.9%. The Company's NAV growth has outperformed the smaller companies index by 25.7% over this period and is now ahead of the smaller companies market over one, three and five years.
- Performance was driven by the continued strong performance of top portfolio holdings. Mecom, E2V and Lupus rallied 47%, 27% and 24% respectively following solid final results, positive outlook statements and continued upgrades to consensus earnings forecasts. These three holdings accounted for c.7.8% of the increase in NAV in the period. Performance of other holdings was also strong, especially RPC following the completion of the Superfos acquisition and a subsequently positive trading statement together with further upgrades.
- The only materially negative contribution came from Lavendon, which fell following the cessation of bid talks in mid January. The Manager was strongly opposed to the cash offer proposed by TVH and Ashtead, which we believe materially undervalued the business, and worked extensively with other shareholders to prevent it. Lavendon subsequently released final results in March, which demonstrated strong degearing and communicated several self help initiatives which should improve the operational and financial performance of the business.
- Our principle engagement activity in the period involved discussions with portfolio companies concerning their dividend policies and payout ratios. We continue to believe that dividend growth will be a significant contributor to re-rating of smaller companies. In addition we continued to lobby successfully for increased research coverage of a number of portfolio companies which "fell off the radar screen" of the sell-side during the market turbulence of the last two years.

Portfolio Review

- The portfolio remains highly focused with 18 holdings, a slight reduction from the prior period as toe-hold investments have been exited where we believe there is scope to deploy further capital or where we believe better risk rewarded returns exist elsewhere. The top 10 holdings accounted for 82.8% of net assets, broadly in line with our 80% target. At the end of the period the portfolio was 4.5% in cash.
- Purchases over the period included selective increases in existing portfolio holdings, predominately RPC's rights issue and Wilmington, as well as a new investment in Kewill Systems. Kewill is a business well known to SVGIM with a management team which has generated consistent returns for shareholders over the past eight years. Its valuation is undemanding and there are multiple opportunities for accelerating returns going forward.
- Sales over the period involved continued exits of mature holdings and recycling capital to more attractive risk-reward opportunities. The remaining stub holding in Redstone, an unsuccessful legacy investment, was fully exited. Following exceptionally strong performance the largest position, E2V, was reduced in order to maintain a sensible rebalance within the portfolio.
- Despite the strong NAV performance over the period, from a valuation perspective the portfolio remains very attractive. Our key financial metric (calculated as operating cash flow less maintenance capital expenditures to enterprise value), remains at c.15%, still materially above what we would consider the long term average. On more conventional measures the median consensus forecast PE of 10.4x, PE Growth ratio of 0.65x and price to cash flow of 7.1x also imply an attractive combination of attractively rated cash generative growth. The look-through gearing of the underlying portfolio remains modest at 1.2x debt to EBITDA, a slight reduction on prior period as the underlying portfolio companies degear.

Outlook

- Now some two years from the trough of the equity markets, earnings momentum is starting to decelerate and profit warnings have increased, particularly driven by high street retailers. Macro concerns remain to the fore and inflationary concerns are rising. As is always the case, the strong businesses with strong management teams will continue to prosper over the medium to long term and in some cases, the current market conditions can provide as many opportunities as risks.
- We remain wary of investing in companies which have already returned to peak operating margins or where the possibility of disappointing turnover growth may have increased. Our analysis of the portfolio suggests that none of our holdings are generating peak sales or margins, which bodes well for further gradual earnings recovery.
- The 15% earnings growth and 3% dividend yield offered by the FTSE Small Cap Index indicates potential forward returns of some 18%, excluding any change in ratings, which are at the low end of historic trends. We therefore remain confident that Smaller Companies will continue to offer attractive absolute and relative returns for the medium term.
- We continue to seek out those reasonably priced smaller companies, which offer niche products or services, are well managed and nimble, and can continue to create value for shareholders in excess of that achieved by the market. As an asset class, we continue to believe that smaller companies relative discount remains unsustainable given this point in the economic cycle. This combined with sporadic sell side research and a contracting base of Small Cap investors continue to allow us to find investment opportunities which we believe will offer compelling risk adjusted returns.
- The prospects for new investments remain good, although a recent dearth of secondary fundraisings has led to market purchases being our primary entry mechanism. Poor levels of liquidity require patience to build target weights without losing pricing discipline, and we are continually seeking block transactions. The attractive valuation characteristics of and potential returns from the existing portfolio continues to provide a high threshold for new investments and the focused nature of the portfolio and long investment horizon allows us to be highly selective in deploying capital in new opportunities.
- With corporate sector balance sheets forecast to be the least geared since 1996, and falling to a 20 year low by 2012, we continue to anticipate M&A activity to rise throughout 2011. The other three drivers of equity return: earnings growth, re-rating and degearing all remain favourable among our portfolio companies. The cash flow yield of the portfolio remains very high, implying continued scope for re-rating. We remain cautiously optimistic of further growth in the Company Net Asset Value.

Summary (as at 31 March 2011)	
Net assets	£74.96 million
NAV per share	97.64p
Net cash %	5.09%

Top 10 Investments

Company name (as at 31 March 2011)	**% of invested portfolio**
Strategic Recovery Fund II	15.55
E2V Technologies Ord GBP0.05	11.66
RPC Group Ord GBP0.05	11.00
Lupus Capital Ord GBP0.05	10.10
Kcom Group Ord GBP0.10	9.87
Mecom Group Ord GBP0.6085888	8.24
Lavendon Group Ord GBP0.01	7.45
4imprint Group Ord GBX38.461538	6.87
Allocate Software Ord GBP0.05	3.95
Wilmington Group Ord GBP0.05	3.58

Sector Analysis	**% of portfolio**
Unlisted	16.67
Manufacturing	20.47
Telecoms	9.37
Technology	18.82
Retail	2.67
Media	18.77
Support services	8.14
Financial general	–
Leisure	–
Net cash	5.09

Size Analysis (market cap)	**% of portfolio**
<£100 million	36.16
£100 – £300 million	31.12
£300 – £500 million	27.63
Greater than £500 million	–
Net cash	5.09

The Directors are not aware of any significant events or transactions which have occurred between 31 March 2011 and the date of publication of this statement which have had a material impact on the financial position of the Company.

Contact Details

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Strategic Equity Capital

Strategic Equity Capital plc

Investment Manager – SVG Investment Managers

SVG Investment Managers (SVGIM) was established in 2002 and applies private equity techniques to public markets. Investment decisions for Strategic Equity Capital are made by a Strategic Investment Committee consisting of Tony Dalwood, Adam Steiner, Stuart Widdowson and Jonathan Morgan.

Investment Process

The Manager seeks to identify investment opportunities by applying private equity appraisal techniques primarily in public markets.

After a potential investee company has been identified, initial due diligence is undertaken.

Before finalising an investment decision, the Manager will seek to engage directors, management and shareholders of potential investee companies in constructive dialogue directed towards the implementation of value creation strategies. Such strategies may include:

- capital raisings;
- financial restructurings;
- operational restructurings;
- trade sales; and
- public to private transactions.

The Company does not seek to involve itself in the day-to-day management of the companies in which it invests. The Manager seeks to maintain regular contact with the managers and directors of investee companies.

Fund Facts

- A London Stock Exchange listed, UK domiciled investment trust
- Independent board chaired by John Hodson
- The objective is to achieve absolute returns over a medium term period, principally through capital gains
- The majority of the portfolio to be invested in 10-15 companies
- An investment horizon of typically two to five years for each investment
- A flexible gearing policy of up to 25% of net assets

Principal Terms

- Management fee of 1% of (per annum) of company's market capitalisation
- Performance fee of 15% of excess above FTSE Smaller companies (Ex-IT) Index, measured on a 3 year rolling basis
- High water mark of 118.8p

The Industry Advisory Panel

The Investment Manager utilises an Industry Advisory Panel to assist in the analysis of company management and directors, business dynamics and investment opportunities. The Industry Advisory Panel also provides introductions to other industrialists for due diligence. Members of the Industry Advisory Panel include:

Stewart Binnie

- Has been involved in UK publishing, retail and financial services businesses since 1976.
- Presently Chairman of Aurora Fashions, whose retail brands include Karen Millen, Coast and Oasis, is a member of the Investment Committee of the Schroder Private Equity FoF business and has advised Schroders plc on private equity related issues since 2005.
- Former activities include Partner of Permira (formerly Schroder Ventures) and Schroder Finance Partners, and Chairman of Helicon Publishing Group, Elddis and Cassell plc.

Alan MacKay

- Chief Executive of Hermes GPE.
- 1994–2010 – 3i plc.
- Former Group Partner at 3i Group plc with strategic responsibilities including 3i holdings in public listed companies.
- Previously Development Director for Europe plc and Chief Executive of 3i Nordic plc

Ken Minton

- Has led successful turnarounds within a number of UK publicly listed companies.
- Currently Executive Chairman of 4imprint Group plc.
- Former Executive Chairman of Arjo Wiggins Appleton plc, former Chief Executive Officer of Laporte plc, former Non-Executive Director of Tomkins plc, Solvay SA, Elementis plc and former Non-Executive Chairman of Mowlem plc.

Sir Clive Thompson

- Deputy Chairman of Strategic Equity Capital plc.
- Served as Chairman of Rentokil Initial plc between 2002 and 2004, having been Chief Executive for 20 years to 2002.
- Former President of the CBI, member of the Committee on Corporate Governance and Deputy Chairman of the Financial Reporting Council. He is also a former Director of J Sainsbury plc, Wellcome plc, Seeboard plc, Caradon plc and BAT Industries plc.