

Jeremy Grime's Weekly Commentary

Exclusively for SharePad & ShareScope subscribers



With Recovery comes Refinance

13 April 2020

Markets

The market suddenly appears to anticipate an end to this crisis. With the FTSE up 4.7% and the FTSE Small Cap ex IT index up 9.3% last week it seems that, while many companies have withdrawn guidance on earnings, the market is anticipating something better. Perhaps it is a bear market rally or perhaps we have passed the bottom. The chart below suggests that markets historically have anticipated 9-10 months ahead. In 1917 the Spanish Flu pandemic started to hit in the spring of 1917 and the death rate accelerated over 18 months peaking in October 1918. Markets fell 33% from peak to trough in 1917 but then mysteriously started to recover in early 1918 despite the fact that the death rate didn't peak until 10 months later.



Source: Great Hill Capital

Who knows if it's the same this time, but on 23 March when the market bottomed (so far!) the FTSE 100 index was down 35% from its peak in February, which is very similar to the 1917 fall. If we look forward 10 months from now it is very possible that we have a smaller number of stronger, leaner, and better companies that are enjoying a less competitive environment. Some changes will be lasting changes. One CEO of a fund management company last week was worrying how he is going to get his fund managers back into the office again, and it is possible that working at home becomes more regular.

Other than a few such changes, life may resume and consumers may still have wants for which they are willing to pay 10 months ahead.

There is the economic gap to bridge. The government is offering staff assistance and companies get an interest free loan, but equity funding is likely.

One fund manager told me last week that some brokers have resorted to mailing their list of brokership clients asking fund managers which ones they would like to refinance. This is an opportunity for fund managers to increase their exposure at attractive prices. So the great refinancing started last week. Alpha FX raised £20m, ASOS raised £247m, followed on Thursday by placings from Bonhill, Essensys, IMImobile and Advanced Oncotherapy. There has been a big change in how these financings are executed over the years. When I started the large shareholders would get a call from the broker to attend a company presentation at the brokers' office. The company would present its case and then leave the room. The top shareholders would then discuss the merits of the offer and a collective decision was made whether to provide the funding or not. Usually it had to be unanimous support in the case of a rescue and if one person failed to support a rescue the broker was given the unfortunate job of explaining to the company they should consult an insolvency practitioner. It's not like that now.

River and Mercantile Asset Management and Hargreave Hale were fined by the FCA last year for price collusion on an IPO and so these collective meetings are no longer acceptable. Placings are now expected to be inclusive and fair to all. Hence, while the large cornerstone investors remain important, they will typically be taken inside beforehand and the placing covered over the few days before announcement and then at 7 am the placing is announced by accelerated book build. The "ABB", as it is referred to, leaves the books open for a few hours to enable retail investors to be involved, which is an opportunity.

Alpha FX share price rose 13% on the day the placing was announced last week as the added reassurance that the company is well financed to grow going forward is perhaps price sensitive. Similarly, ASOS shares shot up 29% on the day of the placing and 27% the following day as the company was able to reassure that it had adequate liquidity to manage through a period of continued disruption. Restaurant Group was next up, with a 40% rise on the news of a placing.

It seems with this period of sharp and sudden disruption that a land of opportunity is to be presented to long suffering investors. For those companies that have weaker balance sheets coming into the disruption they may well be inclined to tap the equity markets at a time when equity markets are discounted, a unique opportunity to help companies out of their balance sheet pain at attractive prices.

The problem is that it may well be the weaker companies that carry out the placings and in order to participate we may well be diluting portfolio quality, which traders may be happy with, but a long-term investor may not want to participate. We should, as always, be choosy about the company placings we invest in, but the easier way to benefit is by owning shares in a quoted broker.

Brokers

Institutional equity brokers are notoriously volatile. In the days before big-bang they were partnerships. In bear markets the partners would earn very little, if anything, and then would earn vast amounts in a recovery. After big bang they all incorporated, and the big banks entered the space which replaced the dividend culture of partnerships with the bonus culture of banks. Fixed commissions were abolished so the laws of supply and demand enticed high speed traders to take advantage of the new lower prices and the seeds of the global financial crisis were laid in 1986.

Today commissions are a small part of a brokers' revenue with corporate transaction revenue being their focus. Brokers that are sub scale will disappear, such as Arden Partners, Allenby, SP Angel etc, while the stronger companies, such as Numis and Cenkos, are likely to prosper.

Numis is the leading small and mid-cap institutional broker with c,220 corporate clients, while Cenkos is smaller and more volatile, but has the accolade of never having made a full year loss, something which Numis did in 2009.

Numis

Share Price 232p

Mkt Cap £246m



Source: SharePad

History

Numis was founded by Oliver Hemsley as Raphael Zorn Hemsley who sold off the private client business and hired teams from Panmure Gordon in 2001. With a background in insurance Oliver Hemsley was well connected in the insurance market and so prospered in bear markets post 9/11 when the insurance market was short of capital and also in the credit crunch when insurer balance sheets became stretched. The company epitomises the hallmark of successful firms that build their business in a downturn, emerging stronger and leaner. In the credit crunch the Hoare Govett index was acquired from a distressed ABN Amro and re named the Numis small companies index, for which fund managers were charged for the first time. Oliver Hemsley has now retired and handed over to joint chief executive Alex Ham and Ross Mitchinson and the company acts for 217 corporate clients with 270 staff.

Corporate Client List

The intellectual property of an institutional broker is its client list as they will typically receive an annual retainer from corporate clients and will be responsible for the equity placings. These placings may each carry a significant fee, which can often be 2%-5% which may equate to individual fees of £1m-£5m. So in order to own Numis we need to take a view as to how many of the stocks are likely to raise money. While Numis also has a private company business, the quoted client list they are broker to is included in the Appendix to this note.

Balance Sheet

Numis has £138m net assets, of which nearly all are tangible assets. At the last reported date, September 2019, cash was £84m, and trading investments was £38.5m. Of the £38.5m of trading investments £14.8m was held outside of the market making portfolio. These may be strategic investments, such as their stake in Crowdcube, which offers crowd investing in private companies.

Incentives

The two joint chief executives were awarded an LTIP in 2016 which awards up to 2.96m if a share price is reached for a 90 day period at any point within the 5 year period to 2021. At a share price of 209p 592k shares are awarded with a value of £1.2m and at 509p 2.96m shares are awarded at a value of £15m. We may therefore expect the CEO's to be very interested in getting the shares to 509p from the current 232p. A look at what the shares have done since 2016 shows they were well on their way in 2018 before Brexit uncertainty and virus disruption hit, and they have another year to make it back. I could imagine the CEO's are eyeing up the rescue fund raises with particularly beady eyes. The incentive scheme may also help explain why the company is using its cash to buy back shares as a lower number of shares will enhance EPS.

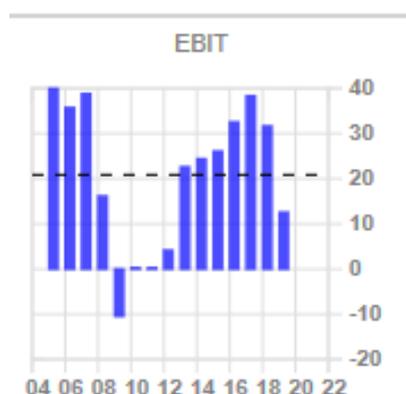


Source: SharePad

Valuation

With a cyclical business such as Numis I would see this as a play on earnings more than valuation. There are no market forecasts although on 30 March the company issued a pre-close update saying they

expected H1 revenue to be 10% ahead of the prior period. The cyclical nature of the earnings can be seen on this SharePad chart:



Source: SharePad

This would suggest that last year's earnings are not a typical level of earnings. The 15 year average is £20m of EBIT while in the good times the company has delivered £40m. £20m of EBIT corresponds to c.12p of EPS which happens to be the same level as the dividend, maintained for the past 3 years. That would put the shares on 19X with a 5.2% yield. If, however, the company reached £40m of EBIT, as it did in 2007, the shares would be trading on 9.5X. In 2007 Numis had 107 corporate clients, less than half the recently reported 217 corporate clients so it is conceivable that in the current funding shortage profits could be very much higher than the £40m reported in 2007.

Conclusion

The shares are down 20% since February and arguably the shares should have appreciated in the new world of funding shortages. It is hard to argue the company is massively cheap on a PE basis, but markets have a tendency to underestimate the volatility of the earnings. It could just be that the joint CEO's achieve their 509p share price.

Cenkos

Share Price 47p

Mkt Cap £27m



Source: SharePad

History

Cenkos was founded in 2004 by a number of teams, some of whom left Collins Stewart where Terry Smith was CEO. It was listed in 2006 and has never made a full year loss. There have, however, been bumps in the road, in particular in advising Quindell the company received a fine from the regulator, for due diligence failings.

Corporate Client List

At June 2019 Cenkos reported 110 corporate clients which vary in size. It is perhaps a fair rule of thumb that a broker needs 100 corporate clients to be assured of profitability in an industry where fixed costs of regulation and infrastructure are high. The list of quoted companies to which Cenkos is appointed broker is attached in the appendix.

Balance Sheet

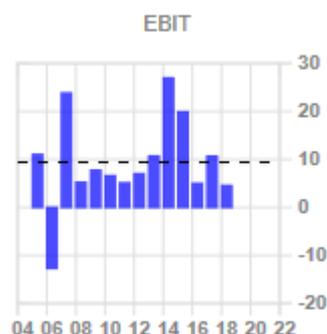
At June 2019, the most recent results, net assets were £30m of which cash was £14.7m and £10m was classified as “other financial assets” which will include the market making book. The company put a trading statement out on 3 April saying that it was delaying its results in line with FCA guidance, but cash was £23.8m at 1 April 2020. This will have been swelled by the IPO of MJ Hudson in December, the IPO of FRP advisory in January and a placing for Brickability. It seems likely the year has started well.

Incentives

Jim Durkin, one of the ex-Collins Stewart founders, was reappointed CEO in August 2019, having relinquished the position in July 2017. He has a 9% stake in the company alongside his colleague Paul Hodges.

Valuation

The business has lumpy revenues which alongside the regulatory difficulties of the past suggests a lowly valuation. The variability of the EBIT can be seen in this SharePad chart:



Source: SharePad

This chart would suggest that a level of profitability of £5m EBIT has historically been a reasonable expectation but in the good years the company has made £27m, when the company brought the AA to market. In EPS terms £5m would deliver c 6p EPS while in the year it delivered £27m EBIT that equated to 33p EPS putting the shares on a PER of 7X a reasonable year and 1.3X the good year.

The dividend has been variable over the years but a 4p dividend is expected for 2019 which is the lowest that has ever been paid since IPO and represents an 8.5% yield. The market cap of £27m is also below the £30m NAV of which £24m is cash.

Conclusion

This is cheap. For the braver investor there could be multi bagger upside in this one if 2020 turns out to be a good year. However, it is lumpy, has historically had some issues and is also likely to remain cheap for those reasons. A good play on the refinancing cycle.

Summary

There was a time for value, a time for recovery and now looks like the time for refinancing. This will produce opportunities for investors to participate in the accelerated book builds, though it may be easier just to own the quoted brokers, who will prosper by rebuilding company balance sheets. Numis is not cheap but the earnings could drive strong share price performance and deliver the 509p share price the joint CEO's are incentivised on, while Cenkos is extremely cheap and could also deliver strong earnings which would be likely to come to shareholders in dividends. That may be the higher risk/higher reward stock to play the refinancing cycle.

Forthcoming Events

Numis – H1 results to March – “In due course” pending FCA guidance

Cenkos- FY Results to December – “in due course” pending FCA guidance

Appendix:

Numis Client List

3i Group PLC (J)

Abcam PLC (J)

Aberdeen Frontier Markets Investment Company Ltd

Aberdeen New Thai Investment Trust PLC

accesso Technology Group PLC

Accsys Technologies PLC (J)

Acorn Income Fund Ltd

ADES International Holding PLC (J)

AJ Bell PLC

Alfa Financial Software Holdings PLC (J)

Alliance Pharma PLC (J)

Allied Minds PLC (J)

AO World PLC (J)

Aquila European Renewables Income Fund PLC

Arbuthnot Banking Group PLC (J)

Argentex Group PLC

Arrow Global Group PLC (J)

Ascential PLC (J)

ASOS PLC (J)

Aston Martin Lagonda Global Holdings PLC (J)

Auto Trader Group PLC (J)

AVEVA Group PLC (J)

B&M European Value Retail SA (J)

Baker Steel Resources Trust Ltd

Balfour Beatty PLC (J)

Bank of Georgia Group PLC

Base Resources Ltd (J)

Beazley PLC (J)

Bellway PLC (J)

Benchmark Holdings PLC

Better Capital PCC Ltd
Biffa PLC (J)
Bluefield Solar Income Fund Ltd
Boot (Henry) PLC (J)
Breedon Group PLC (J)
Burford Capital Ltd (J)
Capital & Regional PLC (J)
CATCo Reinsurance Opportunities Fund Ltd
Centaur Media PLC (J)
Chaarat Gold Holdings Ltd (J)
Circassia Pharmaceuticals PLC (J)
Clinigen Group PLC (J)
Clipper Logistics PLC (J)
Countryside Properties PLC (J)
Custodian REIT PLC
Danakali Ltd
Diploma PLC (J)
Domino's Pizza Group PLC (J)
Draper Esprit PLC (J)
e-Therapeutics PLC
Ebiquity PLC
Edinburgh Worldwide Investment Trust PLC
EJF Investments Ltd
Electra Private Equity PLC (J)
Electrocomponents PLC (J)
Elementis PLC (J)
EMIS Group PLC
EPE Special Opportunities Ltd
Ergomed PLC
Euromoney Institutional Investor PLC (J)
Fair Oaks Income Ltd
Fevertree Drinks PLC (J)
Forterra PLC (J)
Foxtons Group PLC (J)
French Connection Group PLC
Fuller, Smith & Turner PLC
Funding Circle Holdings PLC (J)
Future PLC (J)
Genel Energy PLC (J)
Georgia Capital PLC (J)

Georgia Healthcare Group PLC (J)
Grafton Group PLC (J)
Grainger PLC (J)
Greatland Gold PLC (J)
Griffin Mining Ltd
Gym Group (The) PLC (J)
H&T Group PLC
Hargreaves Lansdown PLC (J)
Hastings Group Holdings PLC (J)
Helical PLC (J)
Henderson Smaller Companies Investment Trust PLC
HgCapital Trust PLC
Highland Gold Mining Ltd (J)
Hilton Food Group PLC (J)
Horizon Discovery Group PLC
Horizonte Minerals PLC (J)
Hostelworld Group PLC (J)
Howden Joinery Group PLC (J)
HSS Hire Group PLC
Huntsworth PLC (J)
Hyve Group PLC
ICG Enterprise Trust PLC
IG Group Holdings PLC (J)
Induction Healthcare Group PLC
Intermediate Capital Group PLC (J)
International Biotechnology Trust PLC
International Personal Finance PLC (J)
International Public Partnerships Ltd
IP Group PLC (J)
JPMorgan Brazil Investment Trust PLC
JPMorgan Claverhouse Investment Trust PLC
JPMorgan Indian Investment Trust PLC
JPMorgan Russian Securities PLC
JPMorgan US Smaller Companies IT PLC
JTC PLC (J)
Jupiter Fund Management PLC (J)
Jupiter UK Growth Investment Trust PLC
Just Group PLC (J)
Keystone Investment Trust PLC
Keywords Studios PLC

Kier Group PLC (J)
Kin and Carta PLC
Knights Group Holdings PLC
Lancashire Holdings Ltd (J)
Learning Technologies Group PLC (J)
Lekoil Ltd (J)
Liontrust Asset Management PLC (J)
Lookers PLC (J)
LoopUp Group PLC (J)
LSL Property Services PLC (J)
Luceco PLC (J)
M&C Saatchi PLC
Marshalls PLC (J)
Marston's PLC (J)
MaxCyte, Inc. (J)
McColl's Retail Group PLC
Menhaden PLC
Micro Focus International PLC
Miton Global Opportunities PLC
Morgan Sindall Group PLC (J)
Mortgage Advice Bureau (Holdings) PLC
Mothercare PLC (J)
Motorpoint Group PLC (J)
MyCelx Technologies Corporation
NB Global Floating Rate Income Fund Ltd
Next Fifteen Communications Group PLC
Nexus Infrastructure PLC
Norcross PLC
Nostrum Oil & Gas PLC (J)
Numis Corporation PLC
Ocado Group PLC (J)
Ocean Outdoor Ltd (J)
On the Beach Group PLC (J)
Origin Enterprises PLC
Orosur Mining Inc (J)
Palace Capital PLC (J)
Pan African Resources PLC (J)
PetroTal Corp. (J)
Pets at Home Group PLC (J)
Phoenix Spree Deutschland Ltd

Polar Capital Holdings PLC (J)
Polypipe Group PLC (J)
Premier Miton Group PLC (J)
Primary Health Properties PLC (J)
Princess Private Equity Holding Ltd (J)
PureCircle Ltd (J)
Randall & Quilter Investment Holdings Ltd (J)
Raven Property Group Ltd (J)
Reach PLC (J)
Redde Northgate PLC (J)
Renew Holdings PLC
Restaurant Group (The) PLC (J)
Rightmove PLC (J)
RIT Capital Partners PLC (J)
River and Mercantile Group PLC (J)
Riverstone Energy Ltd (J)
RPS Group PLC (J)
RWS Holdings PLC (J)
Sabre Insurance Group PLC (J)
Safe Harbour Holdings PLC (J)
Saga PLC (J)
Savannah Petroleum PLC (J)
Savills PLC (J)
Scapa Group PLC (J)
Schroder AsiaPacific Fund PLC
Schroder European Real Estate Investment Trust PLC (J)
Schroder Oriental Income Fund Ltd
Scottish Mortgage Investment Trust PLC (J)
Shanta Gold Ltd
Sherborne Investors (Guernsey) B Ltd
Sherborne Investors (Guernsey) C Ltd
SME Credit Realisation Fund Ltd
Softcat PLC (J)
Spire Healthcare Group PLC (J)
St Modwen Properties PLC (J)
Stenprop Ltd
Stock Spirits Group PLC (J)
Superdry PLC (J)
Symphony International Holdings Ltd
Syncona Ltd (J)

Synthomer PLC (J)
Ten Entertainment Group PLC (J)
Third Point Offshore Investors Ltd
TP ICAP PLC (J)
Triam Investors 1 Ltd (J)
Troy Income & Growth Trust PLC
TT Electronics PLC
TwentyFour Income Fund Ltd
TwentyFour Select Monthly Income Fund Ltd
Tyman PLC
UK Mortgages Ltd
ULS Technology PLC
UNITE Group PLC (J)
Vectura Group PLC (J)
Velocys PLC (J)
VinaCapital Vietnam Opportunity Fund Ltd
Vistry Group PLC
Vivo Energy PLC (J)
Wilmcote Holdings PLC
Wilmington PLC (J)
Wincanton PLC (J)
Yellow Cake PLC (J)
YouGov PLC

*Source: Adviser Rankings
(J) – Joint appointment*

Cenkos Client List

1pm PLC
88 Energy Ltd (J)
Aberdeen Diversified Income and Growth Trust PLC
Alternative Income REIT PLC
Arena Events Group PLC
Argos Resources Ltd
BlackRock Greater Europe Investment Trust PLC
BlackRock Latin American Investment Trust PLC
BlackRock North American Income Trust PLC
BMO Capital & Income Investment Trust PLC
Breedon Group PLC (J)

Brickability Group PLC
Caribbean Investment Holdings Ltd
Cello Health PLC
Cenkos Securities PLC
Chamberlin PLC
Circle Property PLC
City of London Investment Trust (The) PLC (J)
Clarke (T.) PLC
Collagen Solutions PLC
Concurrent Technologies PLC
Corero Network Security PLC
Creo Medical Group PLC
Diaceutics PLC
Duke Royalty Ltd
Eddie Stobart Logistics PLC (J)
Eden Research PLC
Empyrean Energy PLC
Equals Group PLC (J)
European Opportunities Trust PLC
Falcon Oil & Gas Ltd
Filta Group Holdings PLC
Finsbury Food Group PLC
FRP Advisory Group PLC
Fulcrum Utility Services Ltd (J)
Henderson Far East Income Ltd (J)
ICG-Longbow Senior Secured UK Property Debt Investments Ltd
Infrastrata PLC
Infrastructure India PLC (J)
Ingenta PLC
Inspiration Healthcare Group PLC
Intelligent Ultrasound Group PLC
IXICO PLC
Jaywing PLC
John Lewis of Hungerford PLC
JPMorgan Asian Growth & Income PLC
JPMorgan European Smaller Companies Trust PLC
Kromek Group PLC
Landore Resources Ltd
Marechale Capital PLC
Marlowe PLC (J)

Mercantile Investment Trust (The) PLC (J)
Mercantile Ports and Logistics Ltd
MJ Hudson Group PLC
Montanaro European Smaller Companies Trust PLC
Montanaro UK Smaller Companies Investment Trust PLC
NextEnergy Solar Fund Ltd (J)
One Media iP Group PLC
OPG Power Ventures PLC
Personal Group Holdings PLC
Plexus Holdings PLC
Prime People PLC
Property Franchise Group (The) PLC
Providence Resources PLC (J)
RA International Group PLC
Record PLC
Regional REIT Ltd (J)
Rosslyn Data Technologies PLC
Rotala PLC (J)
Safe Harbour Holdings PLC (J)
Salt Lake Potash Ltd (J)
Seeing Machines Ltd (J)
Share PLC (J)
Shearwater Group PLC (J)
Smart Metering Systems PLC (J)
Tasty PLC
TP Group PLC
Trinity Exploration & Production PLC
UK Oil & Gas PLC (J)
United Oil & Gas PLC (J)
UP Global Sourcing Holdings PLC (J)
US Solar Fund PLC (J)
Velocity Composites PLC
Venture Life Group PLC
Vianet Group PLC
Volta Finance Ltd
Westmount Energy Ltd
XLMedia PLC (J)
Xpediator PLC (J)

Source: Adviser Rankings

(J) – Joint appointment