

Numis

Very strong result in exceptional circumstances

Investment in staff in recent years paid off for Numis in FY20 enabling it to serve clients successfully in a year marked by substantial market fluctuations and the operational challenges posed by COVID-19. It seems reasonable to expect some normalisation of activity levels prospectively, but the increase in the average deal fees and client market capitalisation together with further development of the private markets business (Growth Capital Solutions) appears promising on a longer view.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/18	136.0	31.6	23.0	12.0	14.6	3.6
09/19	111.6	12.4	8.1	12.0	41.4	3.6
09/20	154.9	37.1	26.7	12.0	12.6	3.6
09/21e	149.0	28.8	20.2	12.0	16.7	3.6

Note: *PBT and EPS are on a reported basis and EPS is fully diluted.

FY20 an active year with market share gains

As reported in the year-end update in September, Numis saw sustained second half strength in its capital markets activity, which recorded FY20 revenue up 59%, accounting for 50% of the group total. Net trading gains quadrupled from a depressed FY19 and institutional income was up 12% with market share gains and high activity levels more than offsetting slightly lower research income. Corporate retainers were stable while advisory revenues (-11%) were affected by COVID-19 disruption. Total group revenue was up 39%. Administrative costs increased by 21%, mainly reflecting higher variable compensation, and pre-tax profit tripled to £37.1m with diluted EPS increasing from 8.1p to 26.7p.

Strong start to FY21

Numis has seen a strong start to FY21 with the level of activity in equity markets being favourable for the equities business. On the investment banking side of the business, M&A activity is recovering and the IPO pipeline is promising. In our estimate we have assumed there will be some normalisation in capital markets and trading revenues, and have allowed for one-off non-staff costs of £2.3m associated with the office relocation, which should drop out in FY22. However, we still look for a strong result in FY21 given the start to the year and potential unlocking of activity as pandemic restrictions ease. Given the uncertainty of estimates we have included a scenario analysis in this note (Exhibit 8).

Valuation

Numis shares trade on a price to NAV of 2.2x, modestly above the 10-year average of 2.0x. Using an ROE/COE model we calculate the current share price (336p) would be consistent with the assumption of a return on equity (ROE) of 17.5%. This is above the 15% that would be earned in FY21 on our estimate but slightly below the historical five-year average. The longer-term potential for development of the group is encouraging for growth and prospective returns.

FY20 results and outlook

Financial services

8 December 2020

Price 336p

Market cap £352m

Net cash (£m) at end September 2020 125.2

Shares in issue 104.6m

Free float 75%

Code NUM

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 20.1 16.2 32.8

Rel (local) 8.1 4.6 44.6

52-week high/low 345p 167p

Business description

Numis is one of the UK's leading independent investment banking groups, offering a full range of research, execution, equity capital markets, corporate broking and advisory services. It employs c 290 staff in offices in London and New York, and at the end of September 2020 had 188 corporate clients.

Next events

AGM trading update Est February 2021

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FY20 results analysis

Exhibit 1 provides a summary of the figures including the revenue analysis with additional comments noted below. Figures are compared with FY19 unless stated.

Group **revenue** for FY20 increased by 39% or £43m compared with FY19. The largest increase was in **capital markets** (£29m in absolute terms). Numis reports that the increase in average deal fees rather than the number of the transactions was the driver of growth here. Growth was focused in the second half (capital markets revenues were down 8% in H120) when companies turned to the market to strengthen balance sheets in the face of COVID-19 and subsequently to finance growth opportunities. Private markets transactions also made a significant contribution to this segment, accounting for more than 20% of its revenue. As would be expected, **corporate retainer** fees were stable although the number of corporate clients at the year-end was lower at 188 versus 217 at end FY19. A large part of this reduction reflected the decision made in the second half to withdraw from the natural resources sector and in the process to resign from 18 clients (three further clients are expected to leave after the expiry of notice periods). The sector accounted for approximately £1.5m of retainer fee revenue. The context for this move is Numis's intention to build its client base in particular segments with companies with scope for growth and where it believes it can add value through high service levels. While size is not a factor in targeting clients, the average market capital of the client base has increased to £1.1bn (£0.9bn), a helpful trend in terms of potential deal sizes. **Advisory fees**, down 11%, were affected initially by political uncertainty and then, following the general election, by COVID-19 disruption. Taking these activities together, **investment banking** revenues increased 37%.

Within the **equities** business, **trading income** was sharply higher than in FY19 when the result had been depressed by a £3m loss on the Kier rights issue. The FY20 result was also ahead of earlier years reflecting market volumes and control over exposure levels during periods of heightened volatility. **Institutional** income benefited from market share gains, a new electronic trading product and, again, market volumes while slightly lower research fees reflected tightened institutional budgets mitigated by high ratings accorded to the research and sales teams.

Exhibit 1: Five-year profit and loss analysis

£m unless stated	FY16	FY17	FY18	FY19	FY20	Change FY20/FY19
Net trading gains	6.5	9.0	9.6	4.0	16.0	299%
Institutional income	31.9	35.8	37.9	33.3	37.2	12%
Equities	38.4	44.8	47.5	37.3	53.2	43%
Corporate retainers	9.6	11.6	12.4	13.4	13.5	1%
Advisory fees	16.3	14.4	17.3	12.6	11.1	(11%)
Capital markets	48.0	59.4	58.8	48.4	77.0	59%
Investment banking	73.9	85.3	88.6	74.3	101.7	37%
Total revenue	112.3	130.1	136.0	111.6	154.9	39%
Other operating income	3.8	3.4	1.7	(2.2)	0.3	(114%)
Total income	116.1	133.5	137.8	109.4	155.2	42%
Staff costs	(58.9)	(69.0)	(75.3)	(64.5)	(86.0)	33%
Non-staff costs	(24.7)	(26.4)	(31.0)	(33.0)	(32.4)	(2%)
Total administrative expenses	(83.6)	(95.4)	(106.3)	(97.5)	(118.4)	21%
Operating profit / loss	32.5	38.1	31.4	11.9	36.8	210%
Finance income/expense	0.0	0.2	0.2	0.6	0.3	(52%)
Pre-tax profit	32.5	38.3	31.6	12.4	37.1	198%
Tax	(6.1)	(7.9)	(5.0)	(3.1)	(5.7)	84%
Effective tax rate	18.8%	20.7%	15.7%	25.0%	15.4%	(38%)
Attributable profit	26.4	30.4	26.7	9.3	31.4	236%
Diluted EPS (p)	22.4	25.9	23.0	8.1	26.7	235%
Dividend (p)	12.0	12.0	12.0	12.0	12.0	0%

Source: Numis, Edison Investment Research

The **other operating income** line had shown a £1.9m loss on investment portfolio write-downs at the interim stage and also saw write-downs in FY19 (£2.2m), but swung to a £0.3m gain for the full year as market levels staged a substantial recovery and a gain on disposal was recorded. The portfolio, valued at £14.7m, now comprises only unquoted investments (60% operating companies and 40% diversified funds) with the intention being to liquidate remaining legacy investments and focus on investments that can benefit from Numis's network and experience.

Administrative expenses increased by 21% driven by a 33% increase in total staff costs (or 42% excluding share-based payments) mainly reflecting higher variable remuneration given the jump in pre-bonus profitability. The compensation ratio at 56% is close to the centre of the target range of 50–60%.

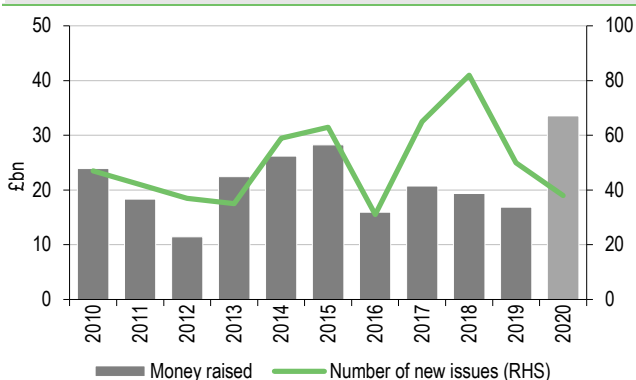
This left **operating profits** (excluding other income) more than double the FY19 level and the operating margin at 23.6% versus 12.6%. Including other income, **pre-tax profit** almost trebled and **EPS** more than trebled.

The full year **dividend** was unchanged at 12p/share. The group aims to pay a stable dividend while remaining committed to returning excess cash to shareholders and mitigating the dilutive impact of share awards; during the year £9.8m (£12.0m) was spent on buying back shares.

Background and outlook

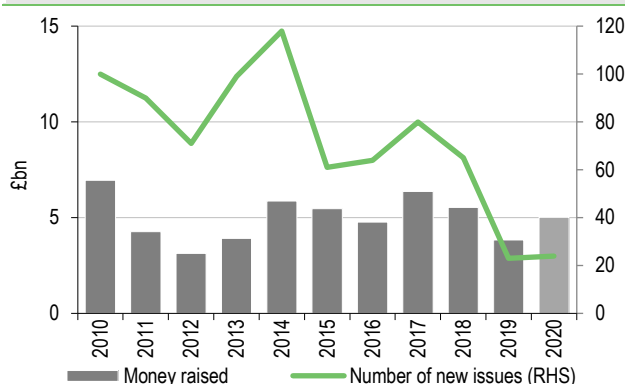
The two charts below show the value of new and further issuance for the London Stock Exchange Main and AIM markets since 2010: the last columns are the 11 months to end November. For the Main Market the IPO count has continued the downward trend seen in 2019 as political and then COVID-19 uncertainties deferred plans for listing. In contrast total money raised for both markets is noticeably above the prior year with one month to go. This reflects in part the secondary equity raisings undertaken to strengthen balance sheets. To provide context, money raised in each market is still running well below the peaks seen during the financial crisis when large financial institutions on the Main Market required recapitalisation; in the Main Market money raised was £77bn in 2009 and for AIM £16bn in 2007 compared with £34bn and £5bn respectively year-to-date.

Exhibit 2: LSE main market issuance and IPO count



Source: London Stock Exchange. Note: 2020 to end November.

Exhibit 3: LSE AIM issuance and new issue count

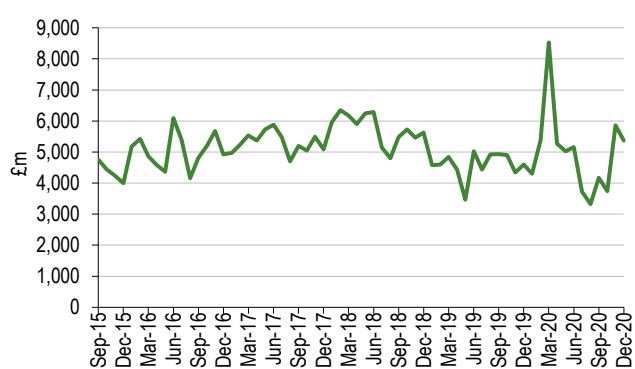


Source: London Stock Exchange. Note: 2020 to end November.

Exhibit 4 shows recent equity market performance with the severe initial impact of the onset of COVID-19 in March and subsequent recovery prominent features. The CBOE UK all-companies and UK small companies indices are down 14% and 6% respectively year-to-date, with the stronger recovery in the small companies index reflecting greater economic sensitivity and expectations of a vaccine-enabled recovery. Exhibit 5 shows recent levels of London Stock Exchange order book trading; the elevated trading levels associated with the pandemic are clear. Subsequently there was a return to more normal levels followed by another surge as positive news on vaccines emerged.

Exhibit 4: All-companies and small cap indices


Source: Refinitiv. Note: CBOE UK net-return indices.

Exhibit 5: LSE order book, average daily value traded


Source: London Stock Exchange (Main Market)

Looking ahead, the recent strength in market indices shown above suggests confidence in a progressive easing of the impact of the pandemic accompanied by economic improvement. However, the medium- and longer-term economic impact of the health crisis has yet to play out and could result in periods of weaker market sentiment and business confidence. At the time of writing the outcome of UK/EU trade negotiations remains in the balance with potentially significant economic effects depending on the outcome.

In its comments on trading since the year-end, Numis noted that revenues in the first two months of FY21 have been in line with the FY20 performance with strength in the equity market supporting buoyant execution commissions and trading gains. The flow of private market deals has continued and M&A activity has recovered including several M&A mandates from corporate clients, some which would require equity raising. Numis reports that its IPO pipeline is also looking healthier than it has for some time.

Financials

As indicated above, Numis has made a good start to the current financial year and there are grounds to feel confident that the pandemic will recede during calendar 2021. Nevertheless, there is still substantial macroeconomic and political uncertainty that could affect the trading background for Numis; our estimates should be viewed with this in mind and we have included an illustrative sensitivity analysis in this section.

Exhibit 6 shows the breakdown of our revenue estimate for FY21. We have assumed capital markets achieves a lower, but still high, level of revenue with IPOs, private transactions and growth funding replacing reduced balance-sheet strengthening transactions. We look for a significant pickup in advisory following the COVID-19 hiatus, while corporate retainers are expected to be lower reflecting the contraction in client numbers as signalled. Institutional income is assumed to be down slightly on some normalisation of volumes and lower research fees and, finally, we have allowed for a degree of normalisation for net trading gains.

Exhibit 6: Analysis of revenue estimate

£000	2019	2020	2021e	FY21e change
Net trading gains	4,008	16,003	12,000	-25%
Institutional income	33,317	37,192	36,500	-2%
Equities	37,325	53,195	48,500	-9%
Corporate retainers	13,357	13,536	12,000	-11%
Advisory fees	12,576	11,146	16,500	48%
Capital markets	48,352	77,022	72,000	-7%
Investment banking	74,285	101,704	100,500	-1%
Total revenue	111,610	154,899	149,000	-4%

Source: Edison Investment Research

Exhibit 7 shows the outcome for FY20 versus our estimate and key numbers from our FY21 estimate; further detail is given in the financial summary (Exhibit 11). The 4% decrease in assumed revenues for FY21 versus FY20 flows through to 22% and 26% decreases in pre-tax profit and earnings per share. In addition to normal operational gearing and the assumption of a 19% tax rate (15.4% FY20), this reflects additional costs related to the new London office of c £4m in total (see below for detail). FY22 should see approximately £1m of double rental and related costs and £1.3m of one-off expenses drop out of the cost base.

Exhibit 7: Estimate changes

	Revenue (£m)			PBT (£m)			EPS (p)			DPS (p)		
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
09/20	150.8	154.9	2.8%	34.8	37.1	6.6%	24.7	26.7	8.0%	12.0	12.0	0.0%
09/21e		149.0			28.8			20.2			12.0	

Source: Edison Investment Research. Notes: For FY20 new figures are actual and old our estimates. The FY21 estimate is introduced with this report. EPS is fully diluted.

As reported previously, the timing of the move to the company's **new London office** at 40 Gresham Street has been affected by COVID-19. The building is expected to be completed in early 2021 with the move taking place in the summer. The 50,000 square foot office will be c 60% larger than the existing one, providing capacity for growth over the term of the 15-year lease. Numis has recently reassessed its space requirements given likely changes in working practices and concluded that its current real estate strategy remains appropriate. Including the effect of implementation of IFRS 16, Numis expects this will increase ongoing costs from FY21 by £3m. In addition to this there will be fitout costs that we estimate could be in the region of £7–9m (based on a Cushman and Wakefield cost report). These costs will be amortised over the lease term and in cash terms would be broadly balanced by the benefit of a three-year rent-free period (we estimate c £9m in total). In addition, there are likely to be exceptional costs relating to moving out of the Paternoster Square office and Numis indicates that one-off expenses similar to the £1.3m in relocation expenses incurred in FY20 are likely.

Given the considerable uncertainty over revenue levels at this early stage in Numis's financial year we have prepared an estimated sensitivity analysis to show some possible outcomes at different revenue levels. Note that for the other operating income line we have assumed a neutral position (no positive or negative impact from the investment portfolio). Non-staff costs are held flat across the scenarios and include the estimated one-off move-related costs mentioned above. These would drop out in FY22. Staff costs are flexed to reflect movements in pre-bonus profitability with fixed costs unchanged between the scenarios. As shown, net profit varies between £14.5m and £33.4m on our assumptions.

Exhibit 8: Illustrative scenario analysis around 2021 estimate

£m unless stated	Low	Mid	High
Revenue	125.0	149.0	167.5
Other operating income (investment portfolio)	0.0	0.0	0.0
Total income	125.0	149.0	167.5
Non staff costs	(38.4)	(38.4)	(38.4)
Staff costs	(69.2)	(82.3)	(88.3)
Operating profit	17.4	28.3	40.8
Net finance income	0.5	0.5	0.5
Pre-tax profit	17.9	28.8	41.3
Tax	(3.4)	(5.5)	(7.8)
Net profit	14.5	23.3	33.4
EPS (p)	12.5	20.2	28.9
DPS (p)	12.0	12.0	12.0
Return on equity	9%	15%	20%
Total cost/revenue	86%	81%	76%
Total staff cost/revenue	55%	55%	53%

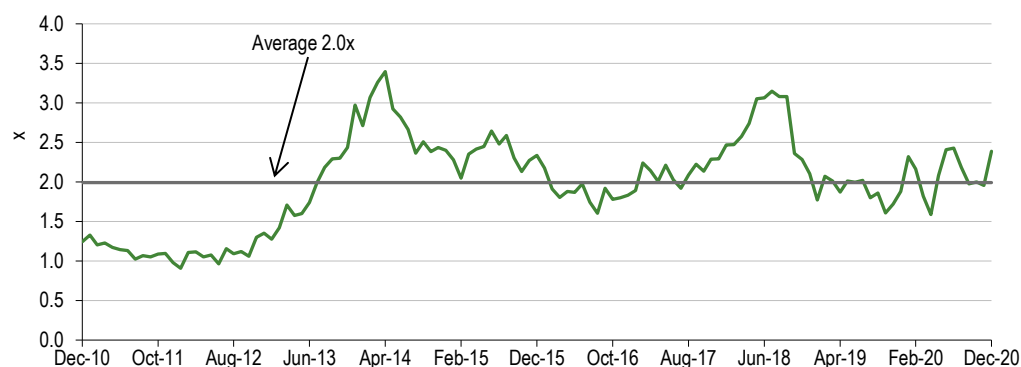
Source: Edison Investment Research. Note: EPS fully diluted.

Numis remains financially strong with no debt drawn and end-September cash and cash equivalents of £125.2m compared with £84.2m at the end of FY20. The group has additional liquidity available in the form of a £35m rolling credit facility. Numis notes that it is normal for its business to see large swings in liquidity with variance in daily cash positions during FY20 being £78m. The group also continues to have significant excess capital for regulatory purposes, which it regards as providing long-term stability and strategic flexibility.

Looking at cash flow there was a net cash inflow from operations of £66m of which £25.6m was provided by working capital movements. Share repurchases and the dividend payment absorbed £22.4m and, with other smaller items accounting for another £2.6m, in total there was a net cash inflow of £41m. Prospectively, FY21 is set to see sharply higher level of capital spending with the fit out of the new London office and increased share purchases to balance a higher than usual volume of share awards vesting during the year.

Valuation

Given the uncertainties surrounding estimates, we continue to concentrate on price to book value as a valuation measure. Exhibit 9 shows where this stands relative to the 10-year history with a current value of 2.2x compared with an average of c 2.0x.

Exhibit 9: 10-year history of the price to book value ratio for Numis


Source: Refinitiv, Edison Investment Research

Using an ROE/COE valuation model to infer the ROE assumption required to match the 336p share price at time of writing gives a value of 17.5% (based on the FY20 NAV of 150p and assuming a cost of equity of 10% and growth of 4%). This is above the 15% return implied by our estimate for

FY21 but below the five-year historical average of 18.4%. The potential for further benefits to be realised from the investment in staff and systems made in recent years, the development of the private markets business and the quality of the corporate client base provide encouragement for the medium-term prospects of the business and hence the valuation.

Exhibit 10: ROE/COE valuation output variations (value per share, p)					
Growth rate (right) Return on equity	2.0%	3.0%	4.0%	5.0%	6.0%
10.0%	150	150	150	150	150
12.0%	187	193	200	210	225
15.0%	243	257	275	300	337
18.0%	300	321	350	390	449
20.0%	337	364	399	449	524
Source: Edison Investment Research					

Exhibit 11: Financial summary

£'000s	2015	2016	2017	2018	2019	2020	2021e
Year end 30 September							
PROFIT & LOSS							
Revenue	97,985	112,335	130,095	136,047	111,610	154,899	149,000
Administrative expenses (excl. amortisation and depreciation)	(65,018)	(76,120)	(83,626)	(94,603)	(85,432)	(105,327)	(106,270)
Share based payment	(4,104)	(6,229)	(10,454)	(10,583)	(10,914)	(9,961)	(9,000)
EBITDA	28,863	29,986	36,015	30,861	15,264	39,611	33,730
Depreciation	(882)	(1,126)	(1,226)	(1,113)	(1,124)	(3,016)	(5,293)
Amortisation	(111)	(125)	(89)	(49)	(44)	(105)	(110)
Operating Profit (before other operating income)	27,870	28,735	34,700	29,699	14,096	36,490	28,327
Net finance income	190	37	188	212	550	263	470
Other operating income	(1,978)	3,759	3,431	1,733	(2,210)	310	0
Profit before tax	26,082	32,531	38,319	31,644	12,436	37,063	28,797
Tax	(4,533)	(6,132)	(7,942)	(4,967)	(3,110)	(5,713)	(5,471)
Profit after tax (FRS 3)	21,549	26,399	30,377	26,677	9,326	31,350	23,326
Average diluted number of shares outstanding (m)	117.6	118.0	117.2	115.8	114.9	117.3	115.6
EPS - basic (p)	19.5	23.5	27.4	25.1	8.8	29.9	22.0
EPS - diluted (p)	18.3	22.4	25.9	23.0	8.1	26.7	20.2
Dividend per share (p)	11.50	12.00	12.00	12.00	12.00	12.00	12.00
NAV per share (p)	102.0	113.5	125.0	135.0	131.3	149.8	144.6
ROE (%)	19%	22%	23%	19%	6.6%	21.2%	14.6%
EBITDA margin (%)	29.5%	26.7%	27.7%	22.7%	13.7%	25.6%	22.6%
Operating margin (before GW and except.) (%)	28.4%	25.6%	26.7%	21.8%	12.6%	23.6%	19.0%
BALANCE SHEET							
Fixed assets	6,724	5,522	6,147	8,215	6,832	12,639	43,986
Current assets	279,114	312,462	407,850	533,033	326,641	509,034	507,530
Total assets	285,838	317,984	413,997	541,248	333,473	521,673	551,516
Current liabilities	(170,319)	(188,895)	(280,371)	(398,112)	(195,319)	(361,397)	(362,747)
Long term liabilities	0	(12)	0	0	0	(2,643)	(27,523)
Net assets	115,519	129,077	133,626	143,136	138,154	157,633	161,246
CASH FLOW							
Operating cash flow	6,467	48,735	43,369	45,830	(2,748)	65,953	36,589
Net cash from investing activities	(3,632)	84	(198)	(1,014)	(77)	(474)	(7,260)
Net cash from (used in) financing	(17,510)	(19,580)	(36,359)	(29,035)	(24,646)	(24,451)	(30,833)
Net cash flow	(14,675)	29,239	6,812	15,781	(27,471)	41,028	(1,504)
Opening net (cash)/debt	(74,518)	(59,591)	(89,002)	(95,852)	(111,673)	(84,202)	(125,217)
FX effect	(252)	172	38	40	0	(13)	0
Closing net (cash)/debt	(59,591)	(89,002)	(95,852)	(111,673)	(84,202)	(125,217)	(123,713)

Source: Company data, Edison Investment Research

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