Cenkos Securities

FY19 results

Uncertainty and opportunity

Financial services

Cenkos benefits from a flexible business model that rewards staff and shareholders in periods of strong activity and revenues but limits the downside when the level of transactions is depressed. Fixed costs have been further reduced, which will help sustain profitability prospectively, while the strong balance sheet and surplus regulatory capital are important supportive features for both clients and investors.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16	43.7	5.06	4.6	6.0	9.8	13.3
12/17	59.5	10.00	13.2	9.0	3.4	20.0
12/18	45.0	3.24	4.4	4.5	10.2	10.0
12/19	25.9	0.15	(0.2)	3.0	N/A	6.7

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

FY19 results

As indicated at the time of the FY19 update in February, Cenkos recorded a much stronger second half in 2019 reflecting a number of significant fund raisings. H2 revenues of £15.3m compared with £10.6m in the first half, illustrating how substantially corporate activity can vary between accounting periods. For the full year, revenue was nevertheless 42% down y-o-y as Brexit uncertainty weighed on market and business sentiment. Following a first-half loss, there was a modest full year profit (£0.15m) compared with £3.2m in FY18 demonstrating cost base flexibility. Earnings per share were marginally negative and, taking into account the group's strong balance sheet position, an uncertain outlook but with tempered optimism, a reduced final dividend of 1p (2.5p in FY18) was announced giving a total of 3p (4.5p in FY18) for the year.

Background and outlook

The pandemic has generated a rapidly changing market backdrop and considerable uncertainty; in these circumstances we have not included estimates in this report. While lower equity market levels and raised volatility are a deterrent to new issuance, the need for equity to support companies through exceptional circumstances has increased fund raising on both the Main and AIM markets of the London Stock Exchange in recent weeks. This is in tune with Cenkos's commentary that it has a strong pipeline while it has also won retained clients in the current period, showing the benefit of its client focus and established team with a wide network of relationships.

Valuation: Trading close to book

Given high levels of uncertainty on the outlook and in the absence of estimates, we focus on the price to book ratio as an indicator of value. Trading at just below book value, the rating certainly appears cautious in the context of a five-year average historical return on equity of 17% and a 10-year average price to book of 2.3x.

14 May 2020

Price	**45p**
Market cap	**£23m**

Net cash (£m) at 1 April 2020	23.8
Shares in issue	51m
Free float	66%
Code	CNKS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(1.1)	(25.0)	(26.8)
Rel (local)	(1.4)	(4.1)	(11.3)
52-week high/low		65p	32p

Business description

Cenkos is a leading UK securities business that acts as nominated adviser, sponsor, broker and financial adviser to companies across all sectors and stages of growth. Since inception in 2005 it has raised more than £20bn in equity capital for corporate clients, which currently number about 100. The business has an approach where fixed costs are contained and variable rewards are closely geared to revenues.

Next events

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FY19 results

Exhibit 1 provides a summary of the FY19 and H219 results with a number of features highlighted below. Comparisons are with FY18 unless stated.

- Revenue was 42% lower with corporate finance, which accounted for 67% of the total, down 47%.
- Corporate finance revenue bounced 78% in the second half compared with H119 and Cenkos carried out three of the 10 AIM IPOs that occurred in 2019.
- The corporate client base was lower at 100 companies and investment funds versus 116, reflecting the rotation of a number of investment trusts and some de-listings. Within this list 78 are AIM clients (81) and 45% have been clients for over five years.
- Within the nomad, broking and research segment, research fees and commission income fell 16% to £6.6m due to a difficult market background and the impact of MiFID II. Nomad and brokership retainer fees are the larger part of revenue within the segment, accounting for c £5m in 2018 and are more stable by nature.
- Execution services revenue increased in the second half compared with the first but was still down 55% for the year, reflecting the market background and risk appetite (markets made in 237 stocks versus 285).
- Administrative expenses were down 38%, primarily reflecting reduced variable compensation in line with lower revenues. A review of overheads has resulted in cost reductions that will lower fixed costs by £3m in 2020. See below for further detail on costs.
- As a result of the flexibility in the cost base and higher H219 revenue, operating and pre-tax profits were achieved in the second half and for the full year.
- Full-year EPS was marginally negative (following deduction of £0.138 of dividends in share incentive and deferred bonus plans) and the dividend for the full year was 3p versus 4.5p.
- Playing into the dividend decision was balance sheet strength, which remains a feature with year-end cash of £18.3m, cash of £23.8m at 1 April and surplus pillar 1 capital of £13.5m at the year-end (£11.2m).

Exhibit 1: FY19 and H219 results summary

£000 unless stated	2018	H119	H219	2019	% change H219/H119	% change FY19/FY18
Corporate finance	32,734	6,245	11,119	17,364	78%	-47%
Nomad and broking	5,070	2,521				
Research	2,754	938				
Nomad, broking and research	7,824	3,459	3,123	6,582	-10%	-16%
Execution	4,395	921	1,049	1,970	14%	-55%
Total revenue	**44,953**	**10,625**	**15,291**	**25,916**	**44%**	**-42%**
Administration expenses	(41,814)	(10,876)	(14,925)	(25,801)	37%	-38%
Operating profit / (loss)	**3,139**	**(251)**	**366**	**115**	**N/A**	**-96%**
Investment income	103	65	41	106	-37%	3%
Finance expense	0	(10)	(66)	(76)	560%	N/A
Pre-tax profit	**3,242**	**(196)**	**341**	**145**	**N/A**	**-96%**
Tax	(805)	(5)	(96)	(101)	N/A	-87%
Attributable profit	**2,437**	**(201)**	**245**	**44**	**-222%**	**-98%**
Basic EPS (p)	4.4	(0.6)	0.4	(0.2)	**N/A**	-104%
DPS (p)	4.5	2.0	1.0	3.0	-50%	-33%

Source: Cenkos, Edison Investment Research

Exhibit 2 sets out selected corporate transactions for Cenkos during 2019 and 2020 to date. Last year Cenkos was involved in three of the 10 IPOs on AIM as new issues on the market reached a 25-year low. It has also executed one AIM IPO so far in 2020 (£80m IPO of FRP Advisory). The market conditions and the normal lumpiness in the incidence of transactions meant the level of funds raised for clients fell (from £1,193m to £664m) giving Cenkos a market share of 8% versus 13% in FY18. Cenkos notes that while COVID-19-related uncertainty clouds the outlook, it nevertheless has a good pipeline and the requirement for otherwise strong businesses to bolster balance sheet liquidity is generating an alternative mix of actual and potential transactions.

Exhibit 2: Selected transactions 2019 and 2020

Month	Company	Transaction	Consideration (£m unless shown)
2019			
February	Kromek	Placing	21.0
March	Diaceutics	IPO	17.0
April	Seeing Machines	Placing	27.5
	Tasty	Placing	3.3
May	Landlore Resources	Placing	1.0
	Falcon Oil & Gas	Placing	USD9.0
June	GCP Asset Backed Income Fund	Placing	63.3
	Collagen Solutions	Placing	6.0
	Marlowe	Placing and acquisition	20.0
July	Dods	Placing	13.2
August	Brickability	IPO	56.7
	Intelligent Ultrasound	Placing	6.3
	Rotala	Placing	1.1
September	Inspiration Healthcare	Placing	4.3
	Equals	Placing	14.3
October	Duke Royalty	Placing	17.5
December	MJ Hudson	IPO	31.4
	Corero Network Security	Placing	3.3
	Creo Medical	Placing	51.9
2020			
February	Brickability	Placing for Promethean	c 20.0
	FRP Advisory	IPO	70.0
March	Eden Research	Placing, subscription and open offer	10.0
	Arena	Placing and subscription	9.5
April	Intelligent Ultrasound	Placing	5.2

Source: Cenkos, Edison Investment Research

Next we show the evolution of costs in more detail (Exhibit 3). The analysis shows the significant reduction in staff costs (42%, in line with revenue) and that the ratio of staff cost to revenue has been broadly stable over the period shown. Reorganisation costs of £1.3m in FY19 are related to the cost review mentioned above, which will result in a £3m saving in fixed staff, related IT and other costs in the current year.

Exhibit 3: Administrative cost analysis

£000 unless stated	2017	2018	2019
Staff costs	37,214	27,431	15,805
Other administrative costs	10,505	12,340	8,668
Reorganisation costs	715	1,507	1,281
Regulatory projects	1,094	536	47
Total administrative costs	**49,528**	**41,814**	**25,801**
Staff costs % of revenue	63	61	61
Other administrative costs % of revenue	18	27	33
Total admin costs % revenue	83	93	100

Source: Cenkos, Edison Investment Research

As noted above, the year-end cash of over £18m and surplus capital of £13.5m remain substantial. An analysis of the £15.3m cash outflow during the year is set out in the financial summary (Exhibit 9) but can be summarised as follows: after marginal earnings the deduction of nearly £4m of shares and options received in lieu of fees left an operating cash outflow of £1.8m; working capital movements (including payment of staff bonus in respect of 2018) and tax paid were a net negative of £9.4m; and dividends paid and share buybacks absorbed £3.7m. These items together with relatively small outflows in investing activities and lease payments resulted in the overall outflow. Large working capital fluctuations between years have been a regular feature of the cash flow statement reflecting the timing of transactions and lumpy cash receipts/payments, while fee payments in kind have also been a consistent and fluctuating element (the items are grouped together in our financial summary table).

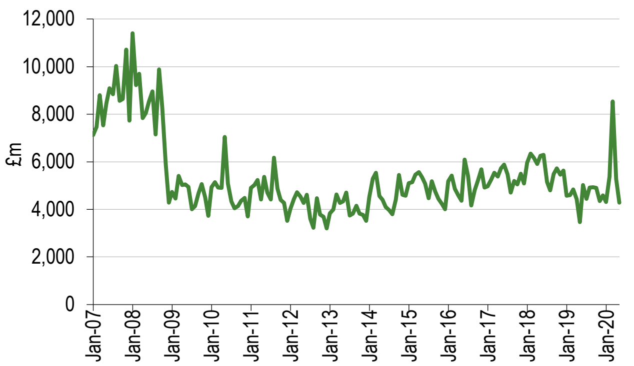
Background and outlook

In this section we briefly show the equity market background including the early impact of the pandemic. The exceptionally uncertain outlook means we have not included estimates in this report but we discuss the impact of reduced costs for Cenkos and summarise what the company has been able to say about prospects so far.

Exhibit 4 shows how London Stock Exchange trading activity spiked to levels seen in the global financial crisis as the impact of the pandemic began to become evident and governments reacted. This has subsided to an extent but given the uncertainty of the development of the epidemic and its economic ramifications further periods of elevated volatility and activity are possible.

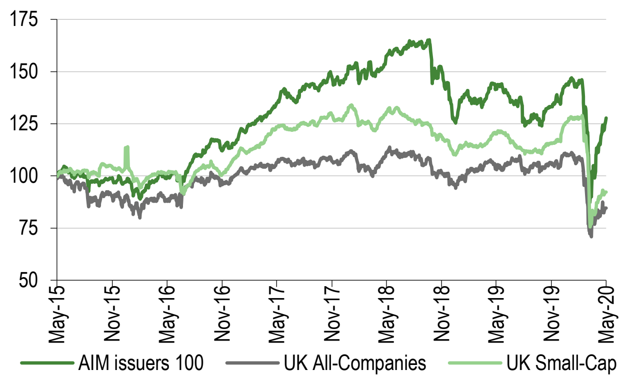
Exhibit 5 records the dramatic fall and bounce back in UK equity indices that has been seen in recent weeks. On a five-year view, AIM issuers (CBOE Alternative UK 100) and All-Companies indices are down c 25% from their peak levels while the small-cap index is down 32%.

Exhibit 4: LSE order book, average daily value traded



Source: London Stock Exchange (Main Market)

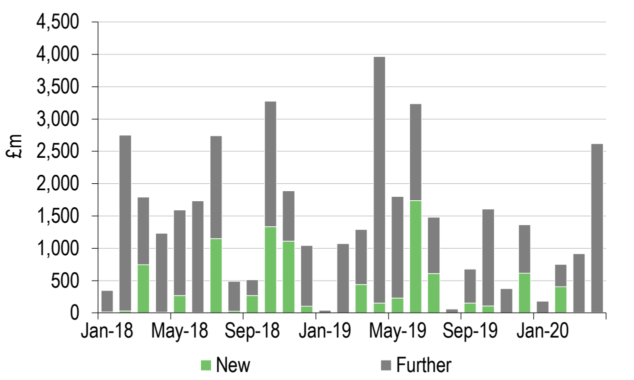
Exhibit 5: UK equity indices



Source: Refinitiv, CBOE indices

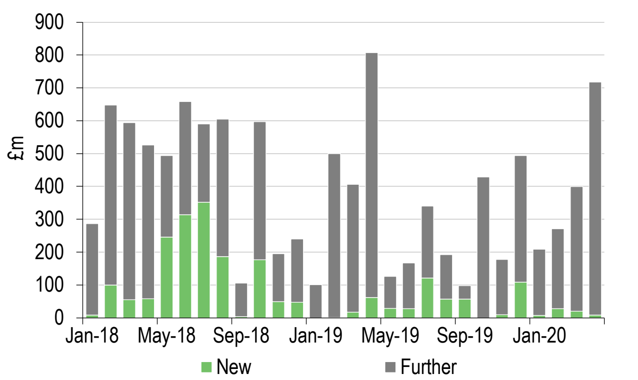
The next two charts look at trends in equity issuance on the London Stock Exchange Main and AIM markets. Money raised was relatively subdued last year, particularly on AIM.

Exhibit 6: Main Market money raised, new and further



Source: London Stock Exchange

Exhibit 7: AIM money raised, new and further



Source: London Stock Exchange

As the monthly data for April show, there has been a significant pick up in further issuance as companies react to the pandemic by strengthening their balance sheets, with the noticeable difference from the financial crisis being the broader sectoral exposure relative to the earlier period. The current month has seen additional issues to support companies in the current exceptional circumstances.

This is in tune with Cenkos comments that it has a good transaction pipeline (although the emphasis within this has changed, ie more towards companies seeking to support liquidity). It also notes it has continued to win new clients despite the absence of in-person meetings.

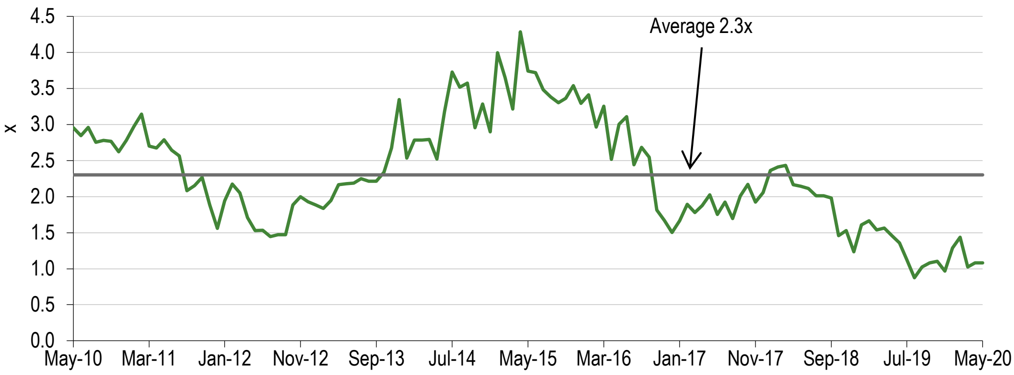
As set out above, Cenkos is characterised by a flexible business model where fixed costs are contained and variable staff costs provide incentives to staff while enabling the business to navigate even exceptional fluctuations in market activity such as those experienced currently. The reduction of fixed costs by £3m in the current year leaves the company potentially well placed to deal with a potential subdued period in activity but still with the capacity to serve clients. In this context, the fact that over 54% of staff have been with the firm for over five years provides continuity and a wide network of contacts that should prove helpful in current circumstances for both corporate and institutional clients.

As an illustration, reflecting the cost analysis shown in Exhibit 8 and allowing for the reduction in overheads, we estimate that fixed costs for the current year are likely to be running at around £18.5m, which suggests revenue could fall close to this level before a loss was incurred, while if we assume roughly unchanged revenues, pre-tax profit could be in the region of £0.8m.

Valuation

In the absence of estimates and with the immediate outlook so uncertain we tend to focus on the price to book ratio as a measure of valuation. This currently stands at just below 1x compared with a 10-year average of 2.3x (Exhibit 8).

Exhibit 8: 10-year history of price to book ratio



Source: Refinitiv, Edison Investment Research

While FY19 revenues were significantly below recent years and the return on equity is currently depressed, the five-year average ROE (including the marginal return for FY19) was 17% suggesting potential for significant upside in valuation once Cenkos is able to demonstrate its capabilities when market confidence begins to return in a sustained way. For balance it should be also be acknowledged that the background and confidence may yet weaken significantly but even in this circumstance, Cenkos's favourable cash and regulatory capital position is an important supportive factor.

Exhibit 9: Financial summary

£000s	2015	2016	2017	2018	2019
Year end 31 December					
PROFIT & LOSS					
Revenue	76,513	43,743	59,504	44,953	25,916
Admininstration expenses (ex depreciation)	(56,510)	(38,581)	(49,286)	(41,567)	(25,530)
EBITDA	20,003	5,162	10,218	3,386	386
Depreciation	(241)	(182)	(242)	(247)	(271)
Operating profit	19,762	4,980	9,976	3,139	115
Investment revenues	134	83	23	103	30
Profit before tax	19,896	5,063	9,999	3,242	145
Tax	(4,525)	(1,858)	(1,815)	(805)	(101)
Profit after tax, continuing operations	15,371	3,205	8,184	2,437	44
Discontinued operations	0	(661)	(973)	0	0
Profit after tax	15,371	2,544	7,211	2,437	44
Average number of shares outstanding (m)	56.5	54.7	54.7	51.8	51.2
EPS continuing operations (p)	27.2	5.9	15.0	4.4	(0.2)
Fully diluted EPS (p)	26.8	4.6	13.2	4.4	(0.2)
Dividend per share (p)	14.00	6.00	9.00	4.50	3.00
NAV per share (p)	53.0	49.8	56.2	54.0	49.4
ROE (%)	43%	10%	25%	9%	0%
Cost/income ratio	74.2%	88.6%	83.2%	93.0%	99.6%
Staff costs/Revenue	60.1%	68.3%	63.7%	64.4%	63.6%
BALANCE SHEET					
Non-current assets	1,626	625	1,263	1,179	5,611
Property, plant and equipment	296	389	525	558	517
Other non-current assets	1,330	236	738	621	5,094
Current assets	64,725	62,692	68,492	65,333	40,821
Other current assets inc Investments - long positions	12,706	13,811	10,615	12,648	8,973
Cash	33,106	23,795	36,829	33,635	18,333
Debtors and other	18,913	25,086	21,048	19,050	13,515
Current liabilities	(37,432)	(35,254)	(39,641)	(38,658)	(16,555)
Other current liabilities inc short positions	(2,551)	(2,694)	(3,341)	(6,018)	(1,840)
Other current liabilities	(34,881)	(32,560)	(36,300)	(32,640)	(14,715)
Non-current liabilities	(351)	(880)	(366)	(263)	(5,219)
Net assets	28,568	27,183	29,748	27,591	24,658
CASH FLOW					
Operating cash flow	15,538	(465)	6,917	3,168	(1,818)
Working capital and other items	16,184	(1,387)	13,490	1,558	(9,051)
Tax paid	(5,049)	(2,533)	(1,334)	(1,664)	(351)
Net cash from operating items	26,673	(4,385)	19,073	3,062	(11,220)
Fixed asset investment	(174)	(272)	(378)	(280)	(197)
Acquisitions/disposals	0	0	0	0	(140)
Other investing activities	191	93	23	90	90
Share (purchase)/issuance	(16,823)	(438)	(549)	(2,353)	(1,277)
Ordinary dividends	(9,740)	(4,367)	(5,201)	(3,573)	(2,485)
Other financing	47	58	66	62	(73)
Net cash flow	174	(9,311)	13,034	(2,992)	(15,302)
Opening net (debt)/cash	32,932	33,106	23,795	36,627	33,635
Closing net (debt)/cash	33,106	23,795	36,829	33,635	18,333

Source: Cenkos, Edison Investment Research. Note: An accounting change for Cenkos' Employee Benefit Trust, Deferred Bonus Scheme and Share Incentive Plan has resulted in a restatement for FY18 including a small change that means that opening cash does not equal closing cash for FY17. See page 55 of FY19 accounts for further detail.

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