Cenkos Securities

FY20 results

Strong FY20 and positive outlook

Financial services

Cenkos delivered a good performance in 2020, with revenue growth of over 20% and reduced fixed costs contributing to a rebound in profitability. The reformed executive committee is focusing on developing the existing strengths in corporate finance and broking while ensuring increased collaboration between teams. Timing of delivery of the transaction pipeline is always uncertain, but the focus on service delivery for clients should help generate long-term returns.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/17	59.5	10.00	13.2	9.0	5.9	11.6
12/18	45.0	3.24	4.4	4.5	17.6	5.8
12/19	25.9	0.15	0.1	3.0	N/A	3.9
12/20	31.9	2.25	3.3	3.5	23.4	4.5

Note: *PBT and EPS are reported with EPS on a fully diluted basis. Uncertainty over the market outlook means we are not publishing forecasts.

Strong performance, challenging operational background

Cenkos's full-year 2020 results demonstrated its success in maintaining a high level of client service and the benefit of the recovery in equity markets activity following the initial impact of the pandemic. Cenkos completed 29 transactions and raised £0.9bn for clients (versus £0.7bn in 2019) including four IPOs. Revenue increased by 23% to £31.9m and underlying profit by 188% to £4.0m (£1.4m). Reported pre-tax profit was £2.3m versus £0.1m. Diluted EPS was 3.3p (0.1p). A final dividend of 2.5p was announced taking the full year total to 3.5p (3.0p).

Outlook: Healthy pipeline and strong balance sheet

While considerable uncertainties surround the economic consequences of the pandemic over the coming years, the recovery in equity markets and increased level of capital markets activity are providing a favourable environment for investment banks and brokers. Cenkos reports a healthy business pipeline, has a strong balance sheet and is completing its leadership succession plan with Julian Morse set to take up the CEO role from Jim Durkin following FCA approval.

Valuation

The shares are trading at a book multiple of around 1.4x, which compares with a 10-year average level of 2.2x. To set this in context the return on equity (ROE) based on reported FY20 earnings was 7% compared with a 10-year average of 23%. However, the underlying ROE for FY20 was 14% and a ROE/cost of equity (COE) model implies the market is assuming a return of 13.5%.

12 April 2021

Price	**77.5p**
Market cap	**£37m**

Net cash (£m) at end December 2020	32.7
Shares in issue (excluding treasury)	47.4m
Free float	64%
Code	CNKS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	6.2	26.0	64.9
Rel (local)	3.0	23.8	35.0
52-week high/low		78p	42p

Business description

Cenkos Securities 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 stood at 94 at the end of December. The business has an approach where fixed costs are contained and variable rewards are closely geared to revenues.

Next events

AGM	12 May

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FY20 results analysis

The year 2020 was one substantial fluctuation in the equity market background for Cenkos. Following the December 2019 general election, the year started with stronger corporate activity that was halted by the initial impact of COVID-19. A period of increased fund raising to support balance sheets then followed and strength in equity markets sustained capital markets activities through the balance of the year and into 2021. Exhibit 1 provides a summary of FY20 results compared with FY19 and shows the first half/second half split. We highlight the main features below, with comparisons against FY19 unless stated.

Revenue increased by 23%, mainly driven by corporate finance where revenue was 28% ahead. While some of the fundraisings were to support companies' balance sheets during the pandemic, more were to raise funds to take opportunities for acquisition and expansion. Although the number of stocks in which Cenkos made markets decreased from 237 to 197 reflecting risk appetite, net trading gains from Execution jumped by 77% to £3.5m. To put these figures in a longer-term context, the five-year average for corporate finance is £29.2m and for execution £4.1m. Nomad, broking and research revenue fell 6%, reflecting a lower client count.

Exhibit 1: 2020 results analysis

£000	H120	H220	FY19	FY20	% change
Revenue					
Corporate finance	9,216	13,034	17,364	22,250	28.1
Nomad, broking and research	3,244	2,931	6,582	6,175	-6.2
Execution - net trading gains	445	3,043	1,970	3,488	77.1
Total revenue	**12,905**	**19,008**	**25,916**	**31,913**	**23.1**
Staff costs	(7,392)	(13,912)	(15,805)	(21,304)	34.8
Administrative expenses before restructuring and STIP costs	(3,539)	(3,046)	(8,715)	(6,585)	-24.4
Underlying profit (loss)	**1,974**	**2,050**	**1,396**	**4,024**	**188.3**
Restructuring costs	(658)	(67)	(1,281)	(725)	-43.4
STIP	(500)	(400)		(900)	N/A
Operating profit	**816**	**1,583**	**115**	**2,399**	**N/A**
Investment income - interest income	23	7	106	30	-71.7
Finance costs	(86)	(90)	(76)	(176)	N/A
Profit before tax	**753**	**1,500**	**145**	**2,253**	**N/A**
Tax	(163)	(286)	(101)	(449)	344.6
Profit after tax	**590**	**1,214**	**44**	**1,804**	**N/A**
Earnings per share (p)	1.1	2.3	0.1	3.3	N/A
Dividend per share (p)	1.0	2.5	3.0	3.5	16.7

Source: Cenkos, Edison Investment Research

Staff costs, before restructuring and short-term incentive plan (STIP) costs, increased 35% reflecting higher variable costs on increased pre-bonus profit, partly offset by a lower fixed cost following headcount reductions. Staff numbers fell from 114 at the beginning of FY19 to 95 at the end of the year and 87 by the end of FY20, giving an FY20 average of 91 versus 111 (-18%).

Administrative costs, again before restructuring and STIP costs, fell by 24%, reflecting the review of fixed costs undertaken in 2019.

As a result, **underlying profit** reached just over £4m compared with £1.4m in FY19.

The **review of overheads** initiated in 2019 and further measures taken in H120 resulted in restructuring costs of £1.3m and £0.7m in FY19 and FY20, respectively. The measures were expected to reduce costs by £3.8m per year in total and, based on the group's measure of fixed costs to non-corporate finance revenue, fixed costs in FY20 were £3.9m lower than in the prior year.

Another element of one-off cost in FY20 was the **STIP**, which was put in place in April to retain and incentivise staff. This was funded by shares already held in the employee benefit trust (the net asset value of the company had already been reduced by the purchase of these shares with the cost taken straight to equity). The shares vest on the first and second anniversaries of the scheme (April 2021 and 2022). While the grant of the shares is one-off, the cost is accrued from the beginning of 2020 to April 2022, with a charge of £0.9m for FY20. Based on this charge and the accrual periods we estimate the total fair value of the scheme is circa £1.7m with about £0.6m in 2021 and the balance in H122.

After the restructuring and STIP costs and the relatively small investment income and finance cost items, **pre-tax profit** was £2.25m compared with £0.15m.

Following the interim dividend of 1p, the board declared a final payment of 2.5p giving a **total dividend** of 3.5p versus 3.0p for FY19, reflecting confidence in the group's strong capital position and strategic direction.

In Exhibit 2 we summarise **performance indicators** for Cenkos between 2015 and 2020. This shows significant recoveries in 2020 versus 2019 in the level of funds raised for clients, revenue per head, underlying profit, cash at bank and non-corporate finance revenue to fixed costs. The latter measure reflects a combination in increased non-corporate finance revenue and lower fixed costs (at £17.0m versus £20.9m) following the restructuring measures mentioned above.

The corporate client base saw a further but smaller decline than seen in 2019 with a net reduction of six to 94 reflecting a combination of client rotation, delistings and acquisitions in large part offset by 18 new client additions. Approximately half of clients have been with Cenkos for over five years.

The regulatory surplus over Pillar 1 capital requirements increased by £1m to £14.5m. The company notes that, while the exact details of the calculation of the new Investment Firm Prudential Regime (which will apply from January 2022) have yet to be settled, it is confident its significant financial resources and transitional arrangements will mean it remains comfortably capitally adequate.

Exhibit 2: Performance indicators

	2015	2016	2017	2018	2019	2020
Revenue per head (£m)	0.63	0.37	0.48	0.41	0.23	0.35
Corporate client base (number)	124	116	117	116	100	94
Funds raised for clients (£m)	3,068	1,325	2,533	1,193	664	944
Non-corporate finance revenue to fixed costs (%)	77	66	63	50	41	57
Cash at bank (£m)	33.1	23.8	36.8	33.6	18.3	32.7
Regulatory surplus over Pillar 1 capital requirements (£m)	15.0	9.8	9.6	11.2	13.5	14.5
Underlying profit (£m)	19.9	5.0	10.7	4.6	1.4	4.0
Dividend per share (p)	14.0	6.0	9.0	4.5	3.0	3.5

Source: Cenkos

Exhibit 3 sets out a list of selected transactions carried out during 2020 and 2021 to date. This includes four IPOs for FRP Advisory raising £70m, Calnex Solutions (£22.5m), Round Hill Music Royalty Fund ($282m) and HeiQ Materials (£60m). Placings included those for Saltlake Potash ($98.5m), Diversified Gas & Oil (£69.4m) and Venture Life (£45m).

Exhibit 3: Selected company transactions 2020/2021

Month	Company	Transaction	Consideration (£m unless shown)
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
May	Providence Resources	Placing and subscription	2.7
	Diversified Gas & Oil	Placing and subscription	69.4
	Rosslyn Data Technology	Placing	7.3
June	Diaceutics	Placing	20.5
July	Inspiration Healthcare	Placing	17.0
	Landore Resources	Placing	2.8
	Marlowe	Placing	40.0
	InfraStrata	Placing	9.0
August	Pelatro	Placing	2.1
September	Salt Lake Potash	Placing	US$98.5m
October	Calnex Solutions	IPO	22.5
November	SkinBio Therapeutics	Placing	4.5
	Marlowe	Placing	30.0
	Round Hill Music Royalty Fund	IPO	US$282.0
	88 Energy	Placing	US$10.0
December	HeiQ Materials	IPO	60.0
	Saltlake Potash	Placing	US$56.0
	Round Hill Music Royalty Fund	Placing	US$46.6
	Venture Life	Placing	45.0
	RUA Life Sciences	Placing	7.0
	Eddie Stobart	Placing	16.0
January 2021	Infrastrata	Placing	7.4
February	88 Energy	Placing	US$12.0
March	Kromek	Placing	13.0
	Plant Health Care	Placing	US$10.0

Source: Cenkos Securities

Management changes and strategic plan

In December 2020 **chief executive** and founder shareholder Jim Durkin announced his retirement. Julian Morse has been appointed as his successor, subject to FCA approval. Julian was appointed as a board member in May 2020, has led the Cenkos Growth Companies team since 2016 and joined the firm in 2006. He has over 25 years' experience in the City, including previous directorships at Beeson Gregory and Evolution Securities. Other changes to senior management included the appointment of Jeremy Osler, co-head of Corporate Finance and Sponsor Services & General Counsel, as an executive board director, subject to approval by the FCA.

The board approved a **strategic plan** put forward by the incoming management team. The plan provides continuity and evolution, building on existing dual strengths in corporate finance and broking while ensuring increased collaboration between sector teams. Two taskforces addressing capital markets and business development will seek to increase synergies across the business. A reformed executive committee is engaged with firm-wide development, governance and deployment of enhanced systems and processes to deliver increased performance and service levels. The group sets out four strategic objectives:

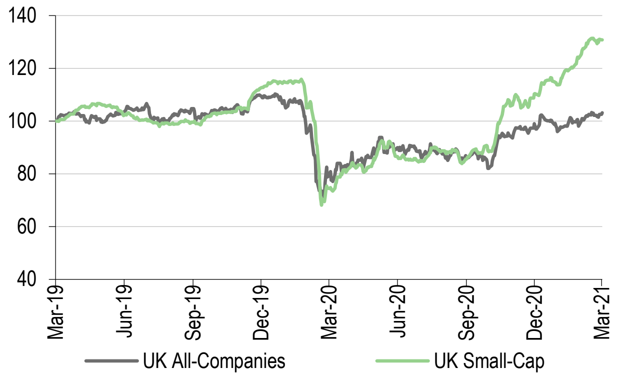
- Grow the revenue base by providing a consistent, focused market-leading service to retain existing and win new clients.
- Sustain a strong team culture to attract and develop talented staff.
- Disciplined approach to operational efficiency. Fixed costs are held at a low level to mitigate the effect of changes in the level of market activity.

- Use the strong balance sheet and capital position to grow the business and mitigate the effect of market swings.

Background and outlook

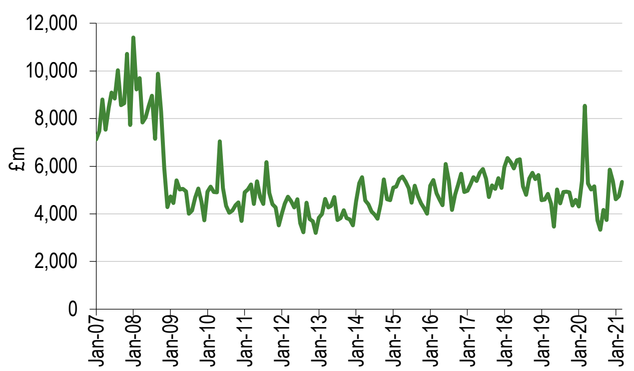
Exhibit 4 sets out the recent equity market trends highlighting the initial impact of COVID-19 last year and the significant recovery that has followed. Since the end of 2020, the bounce back in small-cap equities has been most pronounced as market sentiment rotated towards higher risk/more economically sensitive stocks. In total, 74% of Cenkos corporate clients were listed on AIM at end 2020. Exhibit 5 illustrates the trading activity level on the London Stock Exchange order book, showing there was a sharp but short spike in activity after the start of the pandemic. This was comparable with the levels seen during the global financial crisis but shorter lived. Subsequent activity subsided to earlier levels but has increased to some extent more recently.

Exhibit 4: UK equity indices



Source: Refinitiv, CBOE indices

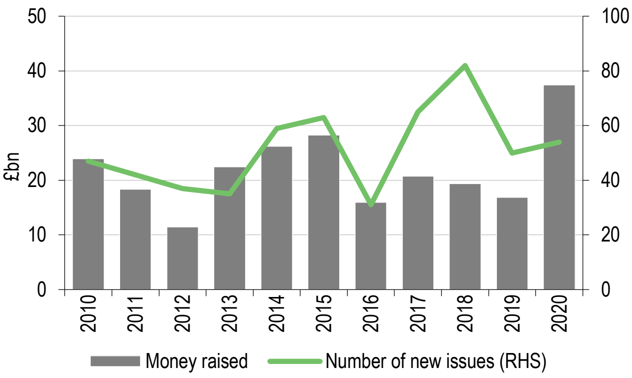
Exhibit 5: LSE order book, average daily value traded



Source: London Stock Exchange (Main Market)

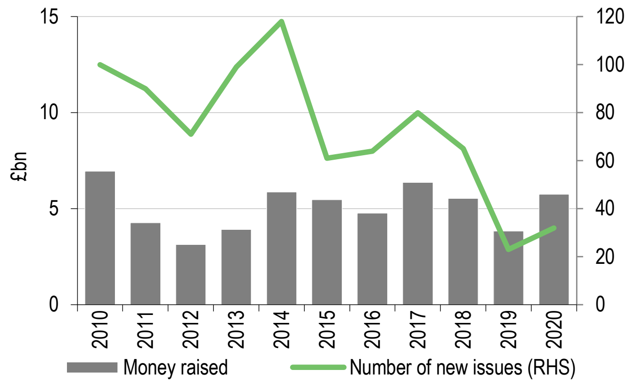
The next two charts look at trends in equity issuance on the London Stock Exchange Main and AIM markets. For both markets, activity strengthened in 2020, driven mainly by further issuance with IPO numbers restricted by the market background. Fund raising to support balance sheets played a prominent role after the onset of the pandemic but, starting in September, there was a bounce back in new issuance and fund raising was directed more towards financing M&A and growth. Total funds raised on the Main Market in 2020 increased by 122% and on AIM by 50%.

Exhibit 6: Main Market money raised and new issues



Source: London Stock Exchange

Exhibit 7: AIM money raised and new issues



Source: London Stock Exchange

Looking ahead, the strength in the equity market after the early impact of the pandemic, particularly for smaller-cap and AIM stocks, provides a helpful background for continued equity issuance. In its annual report Cenkos commented that its 2021 business pipeline is healthy.

Sensitivities for the business include changes in equity market conditions, the loss of key staff, reputational risk and regulatory change. Changes in risk mentioned by the company in its assessment include an increase in residual risk given the reduction in number of retained clients, increased threats to IT security following the pandemic, and global economic stress induced by COVID-19. Mitigating measures and the further strengthening of the financial position of the group in 2020 are positive factors.

Financials

Given the continuing uncertainty over prospective revenues, we do not include estimates in this note. However, it is useful to highlight the impact of the measures to contain fixed costs mentioned earlier (total underlying fixed costs in FY20 of £17m compared with £20.9m for FY19). Ignoring the accrual of STIP costs (we estimate £0.9m in 2020 and c £0.6m and £0.2m in FY21 and FY22, respectively) and any restructuring costs (£0.7m FY20), this would mean annual revenue would have to fall toward £17m before an underlying loss was incurred. Alternatively, on an underlying basis, Cenkos generated an operating profit of £4.0m and an ROE of 14% in FY20, which could rise to about £6.5m and 19% respectively if revenue reached the historical five-year average of £41.2m (making an assumption about the level of variable compensation and factoring in a 19% tax rate versus 12% for FY20).

Turning to cash flow, operating cash flow before working capital movements and tax in FY20 was £5.5m. Working capital movements are typically volatile between individual periods for stockbroking firms, reflecting the timing of fees, bonus payments and market-making positions. In FY20 there was a positive move of £11.5m compared with an outflow of £9.4m in the prior year. There were outflows of £1m for dividends and £2m for share buybacks and, with other small movements, there was an overall cash inflow of £14.4m, leaving net cash at £32.7m.

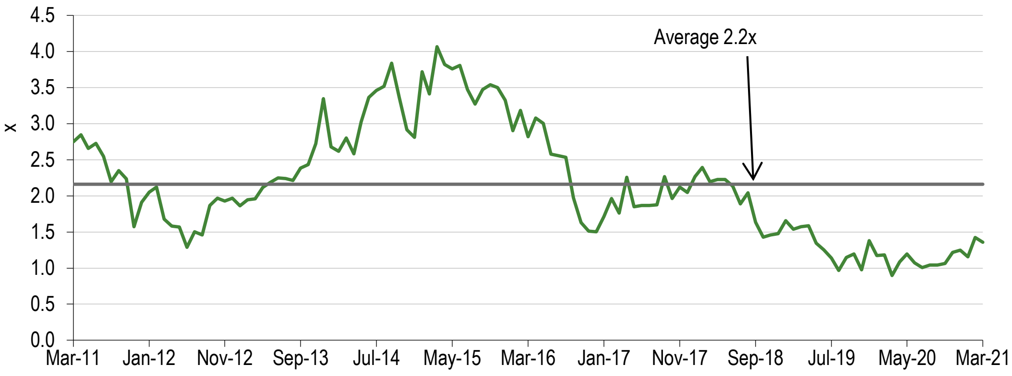
On capital, as shown in Exhibit 2, the FY21 year-end regulatory surplus over Pillar 1 capital requirements stood at £14.5m compared with £13.5m at end FY19.

Valuation

As we are not publishing forecasts for Cenkos, we focus on where the valuation stands in terms of the historical price to book multiple and look at the implied ROE based on an ROE/COE model.

The shares are trading at a book multiple of around 1.4x, which compares with a 10-year average level of 2.2x (see Exhibit 8). This relatively depressed level can be set in context by looking at the returns on equity that Cenkos has earned over a number of periods. Taking reported earnings, the FY20 return was 7%, significantly below the five- and 10-year averages of 10% and 23% respectively. Historically, Cenkos benefited from an ability to execute a number of large transactions, which may recur but are unpredictable, while regulatory costs and MiFID II impacts are permanent negative changes. Against this, Cenkos's flexible operating model and control over fixed costs should help protect profitability as set out in the Financials section. Using a ROE/COE model and assuming long-term growth of 2% and a COE of 10%, the share price suggests the market assumes a ROE of 13.5%, still below the 14% underlying FY20 ROE we calculated in our illustration in the Financials section.

Exhibit 8: 10-year price to book value history



Source: Refinitiv, Edison Investment Research

Exhibit 9: Financial summary

£000s	2015	2016	2017	2018	2019	2020
Year end 31 December						
PROFIT & LOSS						
Revenue	76,513	43,743	59,504	44,953	25,916	31,913
Administration expenses (ex depreciation)	(56,510)	(38,581)	(49,286)	(41,567)	(25,530)	(29,304)
EBITDA	20,003	5,162	10,218	3,386	386	2,609
Depreciation	(241)	(182)	(242)	(247)	(271)	(210)
Operating profit	19,762	4,980	9,976	3,139	115	2,399
Investment revenues	134	83	23	103	30	(146)
Profit before tax	19,896	5,063	9,999	3,242	145	2,253
Tax	(4,525)	(1,858)	(1,815)	(805)	(101)	(449)
Profit after tax, continuing operations	15,371	3,205	8,184	2,437	44	1,804
Discontinued operations	0	(661)	(973)	0	0	0
Profit after tax	15,371	2,544	7,211	2,437	44	1,804
Average number of shares outstanding (m)	56.5	54.7	54.7	51.8	51.2	49.2
EPS continuing operations (p)	27.2	5.9	15.0	4.4	0.1	3.7
Fully diluted EPS (p)	26.8	4.6	13.2	4.4	0.1	3.3
Dividend per share (p)	14.00	6.00	9.00	4.50	3.00	3.50
NAV per share (p)	53.0	49.8	56.2	54.0	49.4	54.0
ROE (%)	43%	10%	25%	9%	0%	7%
Cost/income ratio	74.2%	88.6%	83.2%	93.0%	99.6%	92.5%
Staff costs/Revenue	60.1%	68.3%	63.7%	64.4%	63.6%	70.8%
BALANCE SHEET						
Non-current assets	1,626	625	1,263	1,179	5,611	5,202
Property, plant and equipment	296	389	525	558	517	382
Other non-current assets	1,330	236	738	621	5,094	4,820
Current assets	64,725	62,692	68,492	65,333	40,821	51,040
Other current assets inc Investments - long positions	12,706	13,811	10,615	12,648	8,973	5,312
Cash	33,106	23,795	36,829	33,635	18,333	32,735
Debtors and other	18,913	25,086	21,048	19,050	13,515	12,993
Current liabilities	(37,432)	(35,254)	(39,641)	(38,658)	(16,555)	(25,531)
Other current liabilities inc short positions	(2,551)	(2,694)	(3,341)	(6,018)	(1,840)	(1,011)
Other current liabilities	(34,881)	(32,560)	(36,300)	(32,640)	(14,715)	(24,520)
Non-current liabilities	(351)	(880)	(366)	(263)	(5,219)	(5,086)
Net assets	28,568	27,183	29,748	27,591	24,658	25,625
CASH FLOW						
Operating cash flow	15,538	(465)	6,917	3,168	(1,818)	5,474
Working capital and other items	16,184	(1,387)	13,490	1,558	(9,051)	11,636
Tax paid	(5,049)	(2,533)	(1,334)	(1,664)	(351)	(99)
Net cash from operating items	26,673	(4,385)	19,073	3,062	(11,220)	17,011
Fixed asset investment	(174)	(272)	(378)	(280)	(197)	(41)
Acquisitions/disposals	0	0	0	0	(140)	0
Other investing activities	191	93	23	90	90	24
Share (purchase)/issuance	(16,823)	(438)	(549)	(2,353)	(1,277)	(1,960)
Ordinary dividends	(9,740)	(4,367)	(5,201)	(3,573)	(2,485)	(1,027)
Other financing	47	58	66	62	(73)	395
Net cash flow	174	(9,311)	13,034	(2,992)	(15,302)	14,402
Opening net (debt)/cash	32,932	33,106	23,795	36,627*	33,635	18,333
Closing net (debt)/cash	33,106	23,795	36,829*	33,635	18,333	32,735

Source: Cenkos Securities, Edison Investment Research. Note: *A change in accounting policy relating to EBT and SIP in 2019 was applied retrospectively to 2018 and results in a small mismatch between closing net cash in 2017 and opening net cash in 2018.

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