EDISON **Scale research report - Update**

# MPC Capital

Financial services

26 February 2018

## Investing in business development

**MPC Capital met its 2017 financial performance targets. The share price has suffered in the recent shake-out. P/NAV has slipped to a relatively undemanding 1.83x. The current phase of investment in business development will only begin to bear fruit fully next year and the possibility of a capital increase to support this strategy may weigh on the share price.**

### 2017 still 'transitional'

Underlying revenue growth of 11% in 2017 was in line with management's forecast. Pre-tax profit (EBT) margin also grew in line with forecasts. Pre-tax profit rose to €17.4m versus €15.7m in FY16. Key management services income declined by 9% from €40.2m to €36.5m over the course of the year, reversing the upward trend in H117 when it rose 1% to €18.7m. This was driven by a decline in fees from old business which outstripped fees from new business. According to management, FY17 may be viewed as a transitional year. Contrary to some analyst expectations, no dividend was paid.

### Flat AUM figure masks major shifts

Total assets under management (AUM) were unchanged at €5.1bn but this masks some significant shifts, in part reflecting the lumpiness of MPC's business. The company surpassed its goals by bringing in €1.1bn of gross new AUM. The structure of the AUM base improved with a shrinkage in discontinued product assets from €0.7bn to €0.5bn. The steady downward trend in the importance of legacy retail business continued. Institutional business accounted for 47% of AUM at end 2017 up from 44% at end 2016. MPC lost a large (€350m) asset management mandate. But for €0.3bn of revaluation effects reflecting improved conditions in the shipping markets total, AUM would actually have declined.

### Business continues to develop

For FY18 management expects 10% revenue growth and improved EBT margin. The sale of the micro-living apartment portfolio already announced will make a major contribution here. The equity ratio improved to 75% in 2017 but co-investment in new projects absorbed cash, which will continue in 2018. MPC may raise fresh equity to support the development of the business.

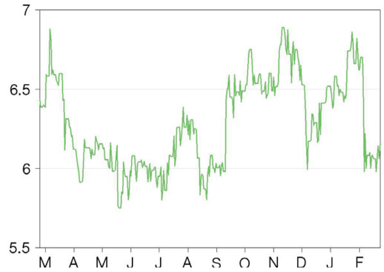
**Consensus estimates**

| Year end | Revenue (€m) | PBT (€m) | EPS (€) | DPS (€) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 12/16 | 53.8 | 15.7 | 0.33 | 0.00 | 18.7 | N/A |
| 12/17 | 47.3 | 17.4 | 0.41 | 0.00 | 15.0 | N/A |
| 12/18e | 64.9 | 20.7 | 0.50 | 0.24 | 12.3 | 3.9 |
| 12/19e | 73.7 | 26.2 | 0.64 | 0.31 | 9.6 | 5.0 |

Source: MPC (historical), Bloomberg (prospective) as at 20 February 2018. Note: 2017 revenue does not include 'The Cloud' income.

| | |
|---|---|
| **Price** | **€6.16** |
| **Market cap** | **€187m** |

**Share price graph**




**Share details**

| | |
|---|---|
| Code | MPC |
| Listing | Deutsche Börse Scale |
| Shares in issue | 30.4m |
| Net cash as at 31 December 2017 | €27.1m |

**Business description**

MPC is an independent asset and investment manager for real assets in the shipping, real estate, and infrastructure sectors. It initiates, structures, finances and manages real assets, targeted at institutional investors. It is a subsidiary of the MPC Group (c 50% shareholding), founded in 1994 and listed in 2000. AUM at 31 December 2017 were €5.1bn.

**Bull**

- Strong demand for real asset investment.
- Increased share of recurring revenues with margin growth potential.
- Scalable operating platform.

**Bear**

- Strong competition for assets and investors from large incumbents.
- Interest rate rises and/or economic weakness may slow investment in real assets.
- Regulatory risks, particularly legacy products.

**Analyst**


Adrian Phillips +44 (0)20 3077 5700

financials@edisongroup.com

Edison profile page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## FY17 in line with guidance

MPC's performance in FY17 met management's guidance of at least 10% revenue growth and an expansion of pre-tax profit (EBT) margin. Because of the transaction structure adopted for a major asset divestiture – 'The Cloud' in Amsterdam – MPC's share of the revenue was booked as "other operating income" and not headline turnover so the published total turnover declined to €47.3m from €53.8m. However, underlying revenue rose 11% including income of €12.3m from The Cloud transaction. This helped pre-tax profit rise 11% to €17.4m.

At the beginning of 2018, MPC announced the sale of 1,000 micro-living apartments, developed under its STAYTOO brand, to Harrison Street Capital, a well-established Chicago-based investor in student accommodation. The deal in fact went through in the last days of 2017, so the transaction contributed some €4m in fee income.

Management services income, which represents the dependable and recurring revenue stream of the business, declined 9% from €40.2m to €36.5m in the course of 2017. This reversed the upward trend in the first half when management services income rose 1% to € 18.7m. This was driven by a decline in fees from old business that outstripped fees from new business. It also offset the boost to average fees from the continuing shift to higher margin institutional business. According to management, FY17 may be viewed as a transitional year.

As a result of measures introduced to improve the quality of business including changes to project structures and renewing the base of investors and partners, it was possible to reverse previous writedowns on receivables generating (non-cash) income of €4.9m up from €1.4m in 2016.

As the group moves to a more normal mix of business, income from equity investments dropped to €1.7m from €3.4m in 2016. The FY16 figure had been inflated by terminal income from real estate investment vehicles in Japan and the US.

FY17 EPS showed a strong improvement from €0.33 to €0.41 but, contrary to the expectations of some analysts, MPC did not resume dividend payments for the year.

### AUM boosted by revaluation of shipping assets

The figure for total assets under management (AUM) was unchanged at €5.1bn but this masks some significant shifts, partly due to the lumpiness of MPC's business: total transactions (both sales and purchases) closed in FY17 were worth €2.5bn. MPC. 2017 saw an unusually high level of divestitures. MPC met its goal by bringing in €1.1bn in gross new AUM (of which shipping counted for €0.5bn, real estate for €0.5bn and infrastructure €0.1bn), but it lost a large (€350m) asset management mandate in The Netherlands. But for €0.3bn of revaluation effects the figure would actually have declined. The value of shipping assets was written up in line with improved conditions in the shipping markets which more than offset the adverse effect of the decline in the US dollar versus the euro which we estimate would have reduced AUM by some €250m.

The structure of the AUM base improved as discontinued product assets shrunk from €0.7bn to €0.5bn. The decline in infrastructure assets to €0.3bn from €0.5m was due to a single major planned divestiture: the Ancora windpark in Portugal. The infrastructure segment remains a major focus of secular growth for the company.

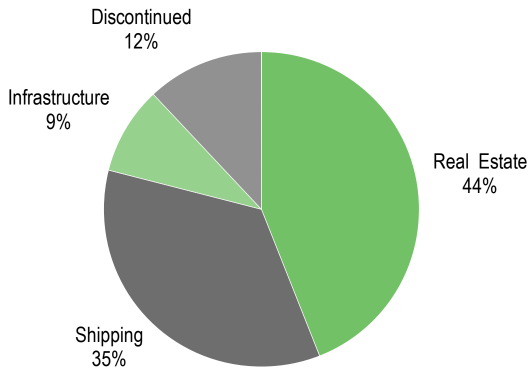
The steady downward trend in the importance of legacy business continued. 'Institutional' business accounted for 47% of AUM at the end of FY17 up from 44% at the end of FY16 and 45% at the end of June. Legacy business correspondingly declined to 53% of total AUM.

## Investments continue

The downward trend in cash and equivalents on the balance sheet observed during H117 was reversed somewhat in the second half as disposal proceeds from 'The Cloud' flowed through. Cash and equivalents were €28.9m at year end 2017 up from €27.5m at end June, albeit down from €65.6m at the end of 2016. Much of this can be attributed to the progressive normalisation in the figure for short-term trade receivables which jumped to €8.3m at the end of June 2017 from €3.1m at the end of 2016. At the end of 2017, this figure had dropped to €5.3m.

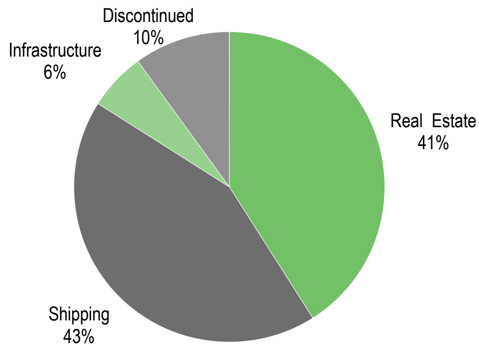
Bank borrowings dropped to €1.8m at the end of 2017 from €2.3m. MPC's financing ratios continued to improve. Equity as a percentage of total assets rose to 75% from 71% at the end of 2016. MPC continued to invest in the growth of its operations in the second half. Investments in financial assets hit €37.1m for the full year compared to €5.6m in 2016. This implies a small decline from the €20.0m invested in the first half. The bulk of this was accounted for by MPC's co-investment in new projects which totalled some €30m in 2017.

**Exhibit 1: Distribution of AUM by class, 31 December 2016**




Source: MPC Capital data

**Exhibit 2: Distribution of AUM by class, 31 December 2017**




Source: MPC Capital data

## Continuing growth in AUM will drive results

As a result of a series of capital measures, beginning with the stock market listing last year, MPC's holding in its Norwegian shipping company affiliate, MPC Container Ships dropped to 5%. These measures have given MPC Container Ships financial resources of US$625m. It now owns 44 ships which are managed by subsidiaries of MPC itself. This is expected to generate incremental management fees of €10-15m in 2018.

At the beginning of 2018, MPC sold 1,000 micro-living apartments, developed under its STAYTOO brand, to Harrison Street Capital, a well-established Chicago-based investor in student accommodation. There will be some €4m in fee income from the Harrison Street Capital transaction. Under the terms of the deal, MPC will continue to manage the assets and it remains firmly committed to the micro-living segment as a promising real estate asset class. Current micro-living projects will add €250-300m to AUM with annualised fee revenue of €2-3m.

Ground has been broken on MPC's major real estate investment project in the Netherlands, the Bajes Kwartier in Amsterdam on the former site of the Bijlmer prison. The total value of the project is €300m and debt finance is under arrangement.

AUM will also grow in the infrastructure segment. Paradise Park is a solar farm in Jamaica and is the lead investment in the CARICOM zone, where management sees potential for €500m in AUM. The Sainshand onshore windfarm in Mongolia is expected to go live in 2018.

The company forecasts a full year financial performance for 2018 similar to 2017's: 10% revenue growth with an expansion of profit margins. This is driven by the expected increase in AUM. Currently, committed projects should make for a further increase in new gross AUM of €1.2bn in 2018.

The company's business model embodies continuing growth in AUM. Management is targeting €1bn in new AUM per annum entirely in the institutional segment where it gives a margin range of 70-120bp. The steady run-off in legacy business is expected to continue with its share in total AUM dwindling to 10% on far lower margins, 40-60bp.

New investments in FY18 will continue to absorb funds and net liquidity will drop again. Co-investment will be around the FY17 level of €30m. €19m of this investment has already been firmly committed – 65% will go into the real estate sector, 25% into shipping and 10% into infrastructure. The company expects the equity ratio will remain at the very healthy level of over 70%. Notwithstanding, the company may raise fresh capital in order to exploit growth opportunities.

The unwinding of legacy business will absorb some €2m in cash annually for the next three to five years. Management is confident that this will be covered by the €7.2m provisions on the balance sheet at end 2017, although court cases launched by investors are still being pursued.

From FY19, MPC should begin to reap the full rewards of the reorientation of its business. As well as the progressive expansion in average management fees levels as the migration towards institutional business makes itself felt, a number of projects where MPC is a co-investor should become profitable and generate associate income.

**Exhibit 3: Income statement**

| Year to 31 December (€000's) | FY15 | H116 | H216 | FY16 | H117 | H217 | FY17 |
|---|---|---|---|---|---|---|---|
| Management services | 35,072 | 18,153 | 22,025 | 40,178 | 18,697 | 17,800 | 36,497 |
| Transaction services | 12,121 | 4,773 | 7,979 | 12,752 | 3,803 | 6,642 | 10,445 |
| Other | 570 | | 861 | 861 | 206 | 170 | 376 |
| **Revenue** | **47,763** | **22,926** | **30,865** | **53,791** | **22,706** | 24,612 | **47,318** |
| Other operating income | 8,604 | 6,906 | 4,969 | 11,875 | 3,972 | 18,744 | 22,716 |
| Cost of materials/purchased services | (1,066) | (535) | (1,083) | (1,618) | (592) | (2,518) | (3,110) |
| Personnel expenses | (20,693) | (11,539) | (14,480) | (26,019) | (12,038) | (15,099) | (27,137) |
| Depreciation & amortisation | (1,332) | (873) | (885) | (1,758) | (893) | (879) | (1,772) |
| Other operating expenses | (29,503) | (11,741) | (14,615) | (26,356) | (11,970) | (12,249) | (24,219) |
| **Operating profit** | **3,773** | **5,144** | **4,771** | **9,915** | **1,185** | **12,611** | **13,796** |
| Income from equity investments | 5,856 | 556 | 2,820 | 3,376 | 633 | 1,111 | 1,744 |
| Other interest & similar income | 1,924 | 656 | 417 | 1,073 | 252 | 998 | 1,250 |
| Write-downs on financial assets | (1,125) | (347) | (15) | (362) | 0 | (787) | (787) |
| Interest & similar expenses | (2,655) | (4,246) | (463) | (4,709) | (108) | (336) | (444) |
| Share of profit of associates | 3,606 | 5,567 | 843 | 6,410 | 1,494 | 300 | 1,794 |
| **Pre-tax profit** | **11,379** | **7,330** | **8,373** | **15,704** | **3,456** | **13,897** | **17,353** |
| Pre-tax margin | 23.8% | 32.0% | 27.1% | 29.2% | 15.2% | 56.5% | 36.7% |
| Extraordinary result | | | | | | | |
| Tax | (3,911) | (2,532) | (2,952) | (5,484) | 404 | (4,596) | (4,192) |
| Effective tax rate | 34.4% | 34.5% | 35.3% | 34.9% | n/a | 33.1% | 24.2% |
| **Consolidated net profit** | **7,468** | **4,798** | **5,421** | **10,220** | **3,860** | **9,301** | **13,161** |

Source: MPC Capital data

**Frankfurt** +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

**London** +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

**New York** +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

**Sydney** +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia