EDISON

Cenkos Securities

Trading update

Costs adjusted to protect profitability

Financial services

2019 was a difficult year for UK equity capital markets activity, and Cenkos demonstrated the strength of its flexible business model and the client relationships sustained by its staff, achieving full year profitability despite one-off restructuring costs. Lower fixed costs will benefit future earnings and Cenkos reports a positive start to 2020 with a strong pipeline. Conservatively, we have reduced our revenue/earnings assumptions for this year, but improved market/investor confidence could generate significant upside.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/17	59.5	10.0	13.2	9.0	4.9	13.8
12/18	45.0	3.2	4.2	4.5	15.3	6.9
12/19e	27.0	0.2	(0.1)	4.0	N/A	6.2
12/20e	32.5	2.0	2.7	4.5	24.4	6.9

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

FY19 trading update

Cenkos noted the challenging equity market conditions that were a feature of 2019 with reduced equity issuance and institutional trading activity. Against this background, it took steps to reduce its cost base and indicates that the annual fixed cost base is expected to be more than £3m below the level of 2019. The restructuring will give rise to one-off costs of approximately £1.4m in H219. Despite this additional cost, an improvement in second half revenues, supported by a number of significant fund-raisings, has (subject to audit) allowed a return to profitability in the second half and for the full year following a £0.2m pre-tax loss in the first half.

Outlook: A good start to the year

Cenkos indicates that the stronger momentum seen in the second half of 2019 has continued into the current year and that the strength of its transaction pipeline is encouraging. Reflecting this, the board expects to announce a final dividend with its full year figures in late March. Taking into account the update comments, we have tempered our revenue and recurring cost assumptions for 2019, leaving PBT at £0.25m (£1m previously), including the £1.4m restructuring cost. Given macro uncertainties potentially affecting investor and corporate confidence, we have chosen to adopt a more conservative revenue assumption for 2020 (and sensitivity range – see Exhibit 3) but still look for a 20% recovery in revenues and a significant profit bounce to £2m, with the potential for positive surprises if equity market activity builds and sustains further strength.

Valuation

On our assumptions (page 3), the current share price implies that the market is assuming an ROE of c 12% for Cenkos, above our current year estimate of 6%. However, this would represent a still relatively depressed level and over 10 years the group has achieved an average ROE of 26%. Similarly, the current price to book ratio of 1.3x compares with a 10-year average of 2.3x.

21 February 2020

Price	**65p**
Market cap	**£37m**
Net cash (£m) at end June 2019	14.7
Shares in issue	56.7m
Free float	66%
Code	CNKS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	10.2	56.6	(4.4)
Rel (local)	12.7	51.6	(8.8)
52-week high/low		70p	38p

Business description

Cenkos is a leading UK securities business which acts as nominated advisor, sponsor, broker and financial adviser to companies across all sectors and stages of growth. Since inception in 2005 it has raised more than £19.6bn in equity capital for corporate clients, which currently number 110. The business has an approach where fixed costs are contained and variable rewards are closely geared to revenues.

Next events

FY19 results	March 2020

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Edison profile page

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Appointment of chairman

Jeff Hewitt, a non-executive director since 2008, has been acting non-executive chairman since November 2018. Following a search process, Cenkos has announced the appointment, subject to FCA approval, of Lisa Gordon as non-executive chairman. Jeff Hewitt is to retire from the board at the end of February and, if necessary, non-executive director Jeremy Miller will take the position of acting chairman for any interim period.

Lisa Gordon brings more than 25 years of board experience in executive and non-executive positions at both listed and private companies. She is a non-executive director of Alpha FX Group, an AIM-listed corporate foreign exchange specialist, and also the non-executive chairman of Albert Technologies, an AI technology business operating in the digital marketing sector. She was previously a founding director of Local World, which was acquired by Trinity Mirror in 2015, COO of Yattendon Group, a private conglomerate, and corporate development director of Chrysalis Group, a media group. Her early experience was as an analyst at Greig Middleton and County NatWest Securities.

Transactions

Exhibit 1 shows selected transactions in which Cenkos was involved during 2019. AIM total new issues touched a 25-year low last year and there were only 10 IPOs. These included three undertaken by Cenkos (Diaceutics, Brickability and MJ Hudson), underlining the value of its strong track record in raising funds (see our November initiation note for further detail). Since the year end, City AM has reported that Cenkos has been appointed as broker for the potential flotation of FRP Advisory, a provider of corporate restructuring and other corporate finance services, with a possible valuation of £200m. Cenkos's corporate client Share plc has announced that terms have been agreed for its acquisition by Interactive Investor, a transaction the companies expect to complete in Q320, subject to satisfaction of relevant conditions. Cenkos has highlighted the strength of its pipeline and the pace with which transactions flow through will depend on continued resilience of market levels, together with corporate confidence and institutional investor appetite.

Exhibit 1: Selected completed transactions during 2019 (£m unless shown)

Month	Company	Transaction	Consideration
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	US$9.0
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
	Total		**366.1**

Source: Cenkos Securities

Estimate changes and sensitivity analysis

Exhibit 2 shows changes in key figures from our estimates, with further detail given in the financial summary. As noted earlier, our more conservative assumption for revenues simply reflects the macro uncertainty that remains a factor in markets. Post-Brexit negotiations may weigh on confidence during the year, impinging on the number of transactions completed. Nevertheless, Cenkos itself is confident in the strength of its pipeline, and recent statements from Arden and Numis also reference higher current/prospective levels of activity. As an alternative indicator, RBG Holdings (legal and other professional services) reported in a January trading update that its corporate division, focused on commercial transactions, is beginning to see a significant increase in the number of transactions it is working on.

Exhibit 2: Estimate changes

	Revenue (£m)			PBT (£m)			EPS (p)			DPS (p)		
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
12/19e	29.5	27.0	-8%	1.0	0.2	-75%	1.0	(0.1)	N/A	4.0	4.0	0%
12/20e	37.5	32.5	-13%	3.5	2.0	-43%	5.0	2.7	-46%	4.5	4.5	0%

Source: Edison Investment Research

As in our initiation note, we underline the uncertainty of prospective revenues and the benefits of the group's flexible cost base by including an analysis illustrating two alternative scenarios above and below the revenue assumption we have used in our forecast for 2020 (Exhibit 3). As shown, on our estimates, a £2.5m revenue variation would feed through to a change of £0.5m and £0.75m in pre-tax profits on the low and high scenarios, respectively. For reference, adjusting our previous central revenue scenario (£37.5m) for the revised cost base and other assumptions would, we estimate, result in pre-tax profit of £4m and EPS of 5.8p (5.0p previously).

Exhibit 3: P&L scenario analysis

£000 unless stated	Low	Central	High
Revenues	**30,000**	**32,500**	**35,000**
Non-staff costs	(7,770)	(7,770)	(7,770)
Staff costs	(20,840)	(22,840)	(24,590)
Operating profit	1,390	1,890	2,640
Investment income	130	130	130
Finance income	(20)	(20)	(20)
Pre-tax profit	**1,500**	**2,000**	**2,750**
Tax	(285)	(380)	(523)
Net profit	**1,215**	**1,620**	**2,228**
Cost/income ratio	95.4%	94.2%	92.5%
Staff costs/revenue	69.5%	70.3%	70.3%
EPS (p)	1.9	2.7	3.9

Source: Edison Investment Research

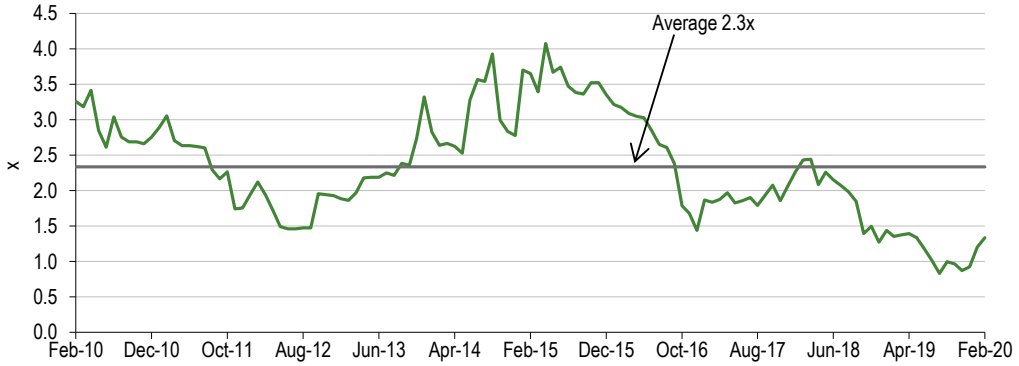
Finally in this section, it is worth recalling the strength of the Cenkos balance sheet, with end-H119 cash and cash equivalents of £14.7m, and regulatory capital resources £15.9m above the Pillar 1 requirement.

Valuation

On our revised central estimate, Cenkos would generate a return on equity of 6% in 2020, while if our previous assumption for revenues was achieved this would rise to 12%. Using an ROE/COE model and assuming a cost of equity of 10% and growth of 4% suggests the share price at the time of writing (65p) does imply that the market is assuming approximately 12% as the prospective sustainable return. While well ahead of our current year estimate, this has to be seen in the context of the long-term average returns delivered by Cenkos of 28% and 26% over five and 10 years, respectively.

Similarly, the history of the price to book ratio shows that the current multiple of 1.3x compares with a 10-year average of 2.3x (see Exhibit 4 below).

Exhibit 4: 10-year history of the price to book value ratio for Cenkos



Source: Refinitiv, Edison Investment Research

Exhibit 5: Financial summary

£000s	2015	2016	2017	2018	2019e	2020e
Year end 31 December						
PROFIT & LOSS						
Revenue	**76,513**	**43,743**	**59,504**	**44,953**	**27,000**	**32,500**
Admininstration expenses (ex depreciation)	(56,510)	(38,581)	(49,286)	(41,655)	(24,812)	(30,320)
EBITDA	**20,003**	**5,162**	**10,218**	**3,298**	**2,188**	**2,180**
Depreciation	(241)	(182)	(242)	(247)	(648)	(290)
Operating profit	**19,762**	**4,980**	**9,976**	**3,051**	**1,540**	**1,890**
Non-recurring items	0	0	0	0	(1,400)	0
Investment revenues	134	83	23	103	110	110
Profit before tax	**19,896**	**5,063**	**9,999**	**3,154**	**250**	**2,000**
Tax	(4,525)	(1,858)	(1,815)	(805)	(90)	(380)
Profit after tax, continuing operations	**15,371**	**3,205**	**8,184**	**2,349**	**160**	**1,620**
Discontinued operations	0	(661)	(973)	0	0	0
Profit after tax	**15,371**	**2,544**	**7,211**	**2,349**	**160**	**1,620**
Average number of shares outstanding (m)	56.5	54.7	54.7	51.8	51.0	51.0
EPS continuing operations (p)	27.2	5.9	15.0	4.2	(0.1)	2.7
Fully diluted EPS (p)	**26.8**	**4.6**	**13.2**	**4.2**	**(0.1)**	**2.7**
Dividend per share (p)	14.00	6.00	9.00	4.50	4.00	4.50
NAV per share (p)	53.0	49.8	56.2	54.0	51.1	53.4
ROE (%)	43%	10%	25%	8%	1%	6%
Cost/income ratio	74.2%	88.6%	83.2%	93.2%	94.3%	94.2%
Staff costs/Revenue	60.1%	68.3%	63.7%	64.4%	63.8%	70.3%
BALANCE SHEET						
Non-current assets	1,626	625	1,263	1,178	6,538	5,868
Property, plant and equipment	296	389	525	558	591	601
Other non-current assets	1,330	236	738	620	5,947	5,267
Current assets	64,725	62,692	68,492	65,334	54,185	55,355
Other current assets inc Investments - long positions	12,706	13,811	10,615	12,648	10,168	10,168
Cash	33,106	23,795	36,829	33,635	25,483	26,653
Debtors and other	18,913	25,086	21,048	19,051	18,534	18,534
Current liabilities	(37,432)	(35,254)	(39,641)	(38,658)	(34,507)	(33,827)
Other current liabilities inc short positions	(2,551)	(2,694)	(3,341)	(6,018)	(9,007)	(8,327)
Other current liabilities	(34,881)	(32,560)	(36,300)	(32,640)	(25,500)	(25,500)
Non-current liabilities	(351)	(880)	(366)	(263)	(171)	(171)
Net assets	**28,568**	**27,183**	**29,748**	**27,591**	**26,045**	**27,225**
CASH FLOW						
Operating cash flow	**15,538**	**(465)**	**6,917**	**3,180**	**2,250**	**4,460**
Working capital and other items	16,184	(1,387)	13,490	1,444	(6,134)	0
Tax paid	(5,049)	(2,533)	(1,334)	(1,664)	(285)	(380)
Net cash from operating items	**26,673**	**(4,385)**	**19,073**	**2,960**	**(4,169)**	**4,080**
Fixed asset investment	(174)	(272)	(378)	(280)	(307)	(300)
Acquisitions/disposals	0	0	0	(100)	0	0
Other investing activities	191	93	23	90	104	110
Share (purchase)/issuance	(16,823)	(438)	(549)	(2,353)	(678)	0
Ordinary dividends	(9,740)	(4,367)	(5,201)	(3,573)	(2,418)	(2,040)
Other financing	47	58	66	62	(684)	(680)
Other	0	0	0	0	0	0
Net cash flow	**174**	**(9,311)**	**13,034**	**(3,194)**	**(8,152)**	**1,170**
Opening net (debt)/cash	**32,932**	**33,106**	**23,795**	**36,829**	**33,635**	**25,483**
FX	0	0	0	0	0	0
Closing net (debt)/cash	**33,106**	**23,795**	**36,829**	**33,635**	**25,483**	**26,653**

Source: Cenkos Securities accounts, Edison Investment Research

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