

Shore Capital Group

Diversified business model

H118 results

Since its flotation in 2000, Shore Capital has navigated a number of market cycles, generating operating profits throughout this period. More recently, it has continued to grow its franchise, adding further corporate clients and increasing assets under management in the first half of the current year, helped by investment to support client service. Equity market conditions have become more difficult but this has already been reflected in a weaker share price, which now stands below book value, suggesting significant potential upside on a longer-term view.

Year end	Revenue (£m)	PBT (£m)	EPS** (p)	DPS (p)	P/E (x)	Yield (%)
12/15*	42.0	11.7	26.1	0.0***	8.6	0.0
12/16	39.4	2.4	5.8	5.0	39.0	2.2
12/17	41.9	4.6	12.8	10.0	17.6	4.4
12/18e	42.2	4.1	11.5	10.0	19.6	4.4

Note: *2015 figures include radio spectrum sale. **Fully diluted. ***There was a £10m share buyback in 2015.

Recent trading: Diversification a positive factor

Shore Capital reported interim figures in mid-September. Group revenue and pre-tax profits were up 6.5% and 2.8%, respectively. Capital Markets generated lower revenue and profit, however, corporate clients were added, research coverage increased and a high level of institutional take-up for the research and sales service achieved. Since the period end, Shore Capital's appointment as joint broker to FTSE 100 constituent, Marks & Spencer, is a notable client win. Growth in AUM, revenue and profit in Asset Management were sufficient to generate the overall increase at the group level. The next phase in the strategy for growth here is to leverage the track record established in private client tax-efficient products for institutional investors. A step in this direction has been reported this month with the commitment of £200m of institutional funding for property development finance.

Background and outlook

The recent fall in equity markets and increased volatility creates a more challenging background for Shore Capital and particularly for Capital Markets as corporate decisions on equity issuance and M&A activity may be delayed. Nevertheless, activity continues and a resolution of some of the macro uncertainties could prompt a sharp bounce-back in corporate activity. Asset Management appears well positioned to grow further and is itself diversified with both property and equity related streams of income.

Valuation: Below book

As noted, the share price currently trades below book. Our ROE/COE model suggests that, on one set of assumptions, the current share price is discounting a return on equity of c 7% (see page 7). While this is above the H118 level of 5.5%, it is not dissimilar to historical average levels and on a longer view could be surpassed, given a more favourable market background and further growth in Asset Management.

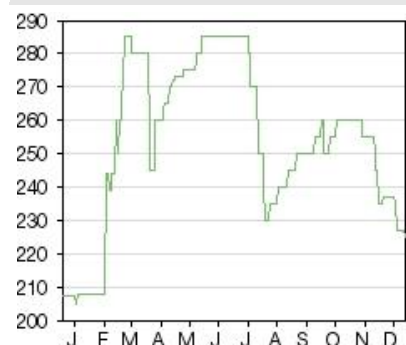
Financial services

14 December 2018

Price 225p
Market cap £49m

Net cash (£m) end-June 2018	18.7
Shares in issue	21.6m
Free float	40.8%
Code	SGR
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(8.2)	(11.8)	8.4
Rel (local)	(5.2)	(5.4)	18.8
52-week high/low	285p	205p	

Business description

Shore Capital Group is an independent investment group with three main areas of business: Capital Markets, Asset Management and Principal Finance (on-balance sheet investments). It has offices in Guernsey, London, Liverpool, Edinburgh and Berlin, and has over 160 staff serving 75 retained corporate broking and advisory clients.

Next events

AGM	December 2018
FY18 results	March 2019

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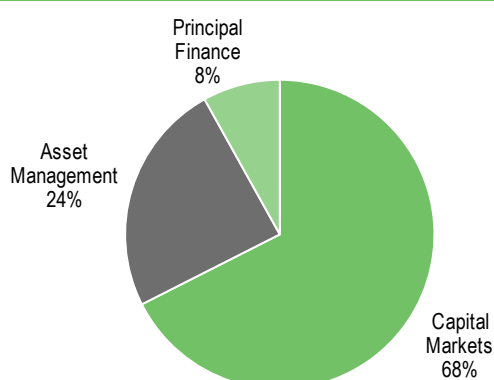
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Entrepreneurial investment group

Shore Capital describes itself as an independent investment group. Its two main operating activities are the Capital Markets and Asset Management businesses, while the Principal Finance activity makes opportunistic on-balance sheet investments on a highly selective basis. Over the five years to end-2017, the businesses have contributed 68%, 24% and 8% to revenues, respectively (Exhibit 1).

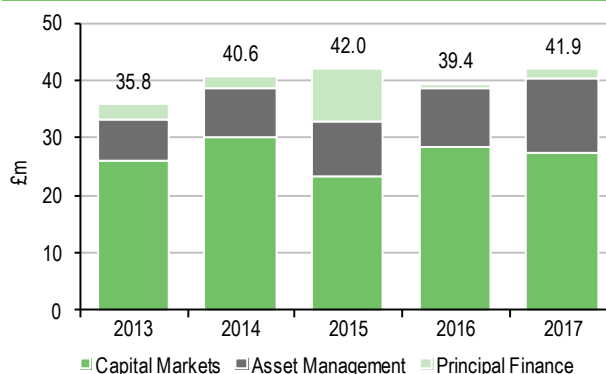
Exhibit 2 shows how the diversification of the group has supported the overall level of revenue generated, the strong growth in asset management revenues (from £7.3m to £12.9m) and the potential for Principal Finance to make a significant episodic contribution (over £9m in 2015 related to the profit on sale of radio spectrum licences by an investee company).

Exhibit 1: Revenue analysis – average 2013-17



Source: Shore Capital Group, Edison Investment Research

Exhibit 2: Five-year revenue evolution



Source: Shore Capital Group, Edison Investment Research

Background

- Founded by chairman, Howard Shore, in 1985.
- Management indicates the operating companies have been profitable since the group listed in 2000.
- The company has offices in Guernsey, London, Liverpool, Edinburgh and Berlin.
- In 2017, the average number of employees was 163, split roughly 60/40 between Capital Markets and Asset Management, with the latter seeing greater growth to support the expansion of the activity.
- Howard Shore and Graham Shore together own 54% of the company. In total, 59.2% of the ordinary shares are reported as not being in public hands. (All figures as at 28 September 2018.)
- Most members of the senior management team have been with the company for a significant period. Co-chief executives Simon Fine and David Kaye joined the group in 2002 and 2006, respectively, and assumed their roles in 2017, at which point Howard Shore, as chairman, stepped back from operational duties to focus on the group's strategy, developing new client relationships and investment opportunities.
- Senior executives have bought minority shareholdings in subsidiaries engaged in the capital markets and asset management activities, providing incentive and alignment with external shareholders in the group. In the years since 2013, excluding 2015 in which there was a large item relating to the radio-spectrum sale, the non-controlling interests' share of post-tax profits averaged 23%.

H118 results demonstrate diversification

The first-half results announced in mid-September highlighted the benefit of the diversity in the group's activities. Normal fluctuation in activity levels for Capital Markets, together with the initial effects of implementation of MiFID II, meant a lower revenue and profit contribution from this division. However, a strong performance from Asset Management (and lower central costs) more than made up the shortfall, allowing both revenues and profits to move ahead at the group level (see Exhibit 3). Key features of the results included the following points (comparisons are with H117 unless stated).

- Overall **revenues** increased by 6.5%, with Capital Markets down by 8.5%, but Asset Management 48.7% ahead as period-end assets under management increased from £810m to £915m (+13%).
- These revenue movements were reflected in the divisional **pre-tax profit** contributions with Capital Markets £0.66m lower and Asset Management £0.88m higher. While the loss for Principal Finance was £0.27m higher versus H117, it was markedly lower compared with H217, a period that included a significant impairment charge (c £1.9m). Central costs were nearly 12% lower and stable compared with H217.
- The **tax charge** was lower at 18% versus 23%, allowing growth of c 11% for basic and diluted earnings per share.
- The interim **dividend** payment of 5p was maintained.
- The **balance sheet** remained strong, with cash of £24.8m and investments in gilts, Puma funds, quoted equities and unquoted holdings totalling £15.1m. There is an undrawn £20m working capital facility. With debt of £6.1m, net cash stood at £18.7m.

Exhibit 3: H118 P&L summary with segmental analysis				
£000s except where stated	H117	H217	H118	% change H118/H117
Revenue				
Capital Markets	14,756	12,474	13,507	-8.5
Asset Management	4,904	8,002	7,290	48.7
Principal Finance	669	1,091	844	26.2
Group	20,329	21,567	21,641	6.5
Profit before tax				
Capital Markets	3,387	1,806	2,742	-19.0
Asset Management	408	2,593	1,292	216.7
Principal Finance	(424)	(1,542)	(698)	64.6
Central/other	(876)	(775)	(772)	-11.9
Group	2,495	2,082	2,564	2.8
Pre-tax profit margin (%)				
Capital Markets	23.0	14.5	20.3	
Asset Management	8.3	32.4	17.7	
Earnings per share				
EPS basic (p)	6.7	6.3	7.4	11.1
EPS diluted (p)	6.6	6.2	7.3	10.8
Source: Shore Capital Group				

Looking more closely at **Capital Markets**, the company reported that the retained corporate client base increased (in the 2017 annual report this was shown as over 70) with the addition of five new clients during the period (Sirius Minerals, Produce Investments, Savannah Petroleum, Cake Box and Echo Energy).

Since the results announcement, Shore Capital has been appointed as joint broker to Marks & Spencer. The first half saw the completion of a number of significant transactions including: joint bookrunner roles in a £198m placing of GVC shares on behalf of Playtech and a £70m placing for Dairy Crest; lead managing the readmission to AIM of Savannah Petroleum; acting as bookrunner,

nomad and broker to the IPO of Cake Box Holdings, raising £16.5m; and acting as nomad, global coordinator and bookrunner in Applegreen's acquisition of a majority stake in Welcome Break, including a placing raising €175m.

The group emphasises that it has continued to invest in servicing clients and has added to its corporate broking capabilities and research resources, including the addition of industrials to its core consumer and financial sector research coverage. Shore Capital is pleased with the take-up of institutional investors of its research services in the post-MiFID II period while noting, in line with other commentators, that all participants are still adjusting to the new environment for research and institutional sales services. Revenue in this area is not broken out separately but Cenkos in its half-year report covering the same period showed research revenue down 12% versus H117. The Shore Capital market-making activity continued to perform well in the first half, with revenues only slightly down on the prior-year period. It is one of the three largest market-makers on the London Stock Exchange.

For **Asset Management**, the 13% increase in AUM highlighted above arose from fund-raising in its private client business (Puma Investments) and valuation gains in the institutional portfolios. Assets under management have grown from £680m to £915m from the end of 2014 to the end of the first half, compound annual growth of 9%. The division provides a diversifying source of profits for the group and itself has a range of products with a range of asset class exposures; equity assets account for a minority of AUM.

Within the private client, tax-efficient investments area (Puma Investments) the Puma VCTs have raised cumulative funds of over £230m since 2005 and the latest fund, Puma VCT 13 remains open for investment. Puma enterprise investment scheme funds (managed by the same team as the VCTs) now have total assets of £70m, with the number of investments made standing at 13. The Puma Heritage company gives investors access to the property finance and construction team's expertise in the provision of secured, first charge, prudent LTV loans made across commercial, residential and specialist areas within the property sector. The fund seeks to counter long-term inflationary pressures and is intended to provide investors with 100% relief from inheritance tax after two years. The AIM IHT service, which reached its fourth anniversary at the end of the period, also seeks to mitigate inheritance tax through investment in selected AIM stocks.

Shore Capital has many years of experience in providing finance for social care property. This has provided a network of contacts in the area and enabled it to partner with external funds investing in supported living accommodation and to offer a full service sourcing, structuring and negotiating acquisitions. Last year, Shore Capital made an investment in a supported living property portfolio (Puma Social Care Investments) alongside two US family offices. The portfolio was sold opportunistically later in the year, generating an IRR of 27%. In the first half of this year, a 75% stake in a company (EA Capital) investing in supported living accommodation was purchased for a cash consideration of £0.892m, in line with the net assets acquired.

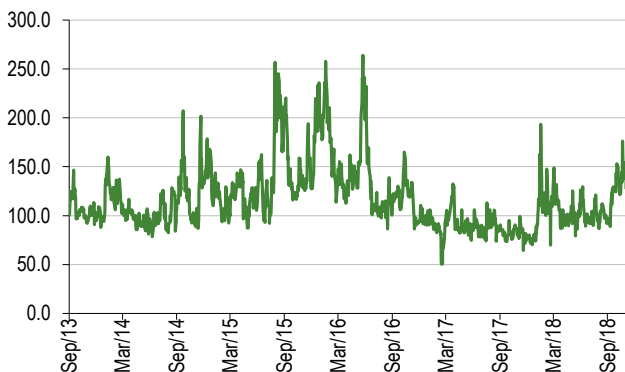
Institutional asset management includes the management of Brandenburg Realty (focused on high-quality property in Germany), Puma Brandenburg (a diversified portfolio of properties in Germany) and St Peter Port Capital (a pre-IPO fund now in the process of realising its remaining investments). Activity for Brandenburg Realty included steps to obtain condominium title for three assets acquired at the end of 2017 and investment with Puma Brandenburg in Mixer Global (operator of co-working spaces founded in Tel Aviv, which is expanding geographically). For Puma Brandenburg, additional actions included work to add restaurants at one hotel investment and apartment conversions to provide further furnished accommodation. At St Peter Port Capital, the manager reported that investee companies had a more positive outlook but, on a prudential basis, two investments were written down to reflect illiquidity. The company's life has been extended to July 2019 to allow further time to realise the remaining assets (net assets at end-March £12.1m).

The **Principal Finance** division reported that DBD, a company where it holds an investment and which holds 32 licences for radio spectrum in Germany, intends to challenge the German telecoms regulator's recent decision to withdraw the licences and offer licences for an alternative frequency band (albeit with fewer restrictions). The gross carrying value of the investment was unchanged at £2.2m.

Market background and outlook

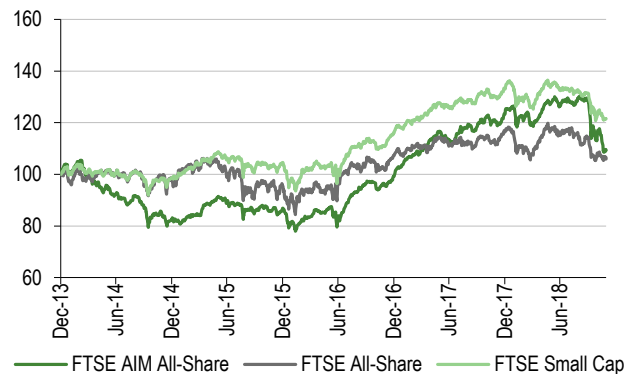
In response to an uncertain global geopolitical and macroeconomic background, equity markets have seen a rise in volatility and a marked correction during October (UK equity market indices shown in Exhibits 4 and 5). The FTSE All-Share and FTSE Small cap indices were down 10% and 9%, respectively, over six months (at 3 December) while the FTSE AIM All-Share was down 14%. This creates a more challenging background for capital markets activities, potentially dampening new and further issuance activity.

Exhibit 4: FTSE 100 volatility index



Source: Thomson Datastream

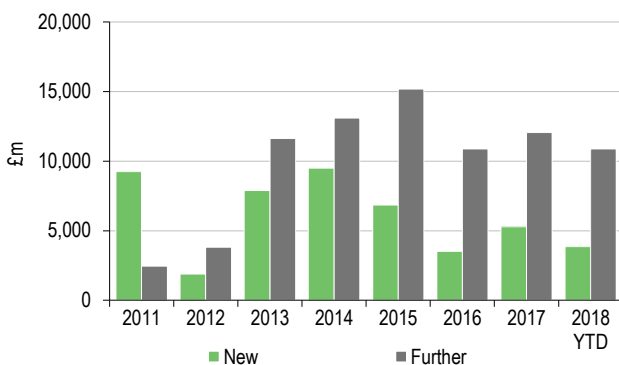
Exhibit 5: FTSE AIM, All-Share and Small Cap indices



Source: Thomson Datastream

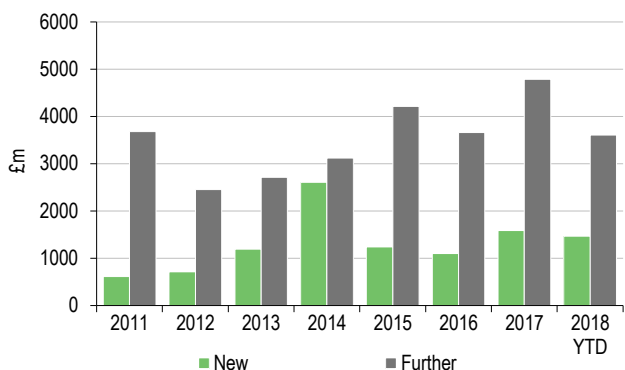
While this is likely to be having an impact, it has yet to become clear in overall London Stock Exchange issuance figures, given that significant monthly variations are a normal feature of the market. For the year-to-date to end-October, the value of Main Market issuance was ahead of the prior-year period by 14%, while AIM was up a more modest 4%. For the month of October alone, Main Market issuance was up 4%, while AIM issuance did experience a substantial 47% fall versus October 2017.

Exhibit 6: LSE Main Market issuance



Source: LSE

Exhibit 7: LSE AIM issuance



Source: LSE

More volatile markets could have a similar influence on the level and timing of M&A activity as corporates defer decisions on transactions. Conversely, an easing of uncertainty and stabilisation of

markets could generate a bounce-back in activity. In this context, the continued growth in Shore Capital's corporate client base and investment in servicing institutional clients should provide the basis for longer-term growth through market fluctuations.

On the Asset Management side of the group, the equity-exposed part of the business is clearly sensitive to market levels although this is only a small part of the business and the division has continued to accumulate assets under management, benefiting from strengthened distribution of tax efficient products in the IFA market. Looking ahead, the strategy is to make use of management expertise and the track record that has been established within the private client area to market to institutional investors, focusing initially on the property lending part of the business.

To this end, the group has announced (on 4 December) a new institutional funding commitment of up to £200m with funds advised by RoundShield Partners. Loans will be sourced and arranged by a newly incorporated company (Puma Property Finance), in which RoundShield is entitled to acquire a stake of up to 25% as funds are deployed. RoundShield may also be entitled to payments on exit. The funding will be used by the property finance teams to meet significant demand in existing areas of expertise, including residential developments, hotels, retirement living, student accommodation and care homes.

Financials

Our estimate for FY18 is detailed in the financial summary (page 8). We have assumed a marginal overall revenue increase (+0.8%) compared with FY17, with capital markets lower and asset management ahead, in line with the pattern seen in the first half. After a 5% increase in administrative costs, this results in a 9% reduction in pre-tax profits versus FY17 or 10% at the diluted earnings per share level (11.5p).

As noted above, the balance sheet remains strong with end-June net cash of £18.7m compared with £25.9m at the end of 2017, with the cash outflow primarily reflecting a £4m working capital outflow in the period (well within the historical range of half-yearly variation) and dividend payments to ordinary and minority shareholders.

Valuation

Our updated peer valuation is shown in Exhibit 8, which should be seen in the context of the significant differences between the companies as well as the potentially volatile and lumpy nature of earnings across the sector. While the Shore Capital P/E ratio is above the average, this is based on reported earnings and current market conditions are likely to put capital markets earnings under pressure. In these circumstances, Shore Capital is likely to benefit relative to peers from the earnings contribution from its asset management activity. The price to book ratio at 0.8x is below the peer average (1.4x) and its historical average level of 1.1x since end-2011.

Exhibit 8: Quoted UK broker comparison

	Price (p)	Market cap (£m)	Last reported P/E ratio (x)	Price to book (x)	Yield (%)	ROE (%)
Shore Capital	225	48.5	17.6	0.8	4.4	4.8
Arden	30.5	9.4	9.2	1.0	0.0	N/A
Cenkos	61.5	34.0	4.7	1.3	14.6	15.6
Numis	269	289.2	10.7	2.0	4.5	19.3
WH Ireland	62.5	19.9	Loss	1.7	0.0	N/A
Average			10.6	1.4	4.7	13.2

Source: Bloomberg, Edison Investment Research. Note: prices as at 13 December 2018.

The strength of Shore Capital's balance sheet has tended to depress the return on equity, which was 5.5% (annualised) at the interim stage. A catalyst for a move to a higher price-to-book valuation would be the expectation of a higher return on equity, potentially prompted by continued growth in the asset management business and more favourable conditions for capital markets activities. The output of a ROE/COE model shown in Exhibit 9 indicates the sensitivity of the valuation to different assumptions for cost of equity and return on equity. Other assumptions used here include growth of 3% and a book value per share of 270.5p. To match the current share price (225p at the time of writing) at a cost of equity of 8% would require an assumed return of equity of 7.2%, arguably a cautious assumption on a longer view and similar to the 2014–17 average (6.8%).

Exhibit 9: ROE/COE valuation output variations (value per share, p)

		Cost of equity				
		7.0%	7.5%	8.0%	8.5%	10.0%
Return on equity	6.0%	203	180	162	148	116
	7.0%	271	240	216	197	155
	8.0%	338	301	271	246	193
	9.0%	406	361	325	295	232
	10.0%	473	421	379	344	271

Source: Edison Investment Research

Finally, in this section we show the recent share price performance for Shore Capital and the comparator stocks. Here, Shore Capital has demonstrated significantly greater resilience than the average, albeit standing 24% below its 12-month high following recent market weakness.

Exhibit 10: Share price performance comparison (%)

	1 month	3 months	1 year	Year-to-date	From 12m high
Shore Capital	-8.2	-11.8	8.4	8.4	-23.7
Arden	0.0	-14.1	-43.0	-43.0	-46.0
Cenkos	-17.4	-36.9	-43.1	-42.8	-48.8
Numis	-8.8	-35.2	-13.6	-19.7	-40.1
WH Ireland	-18.3	-36.9	-49.0	-47.9	-59.4
Average	-10.5	-27.0	-28.0	-29.0	-43.6

Source: Bloomberg, Edison Investment Research. Note: prices as at 13 December 2018.

Exhibit 11: Financial summary

Year-end 31 December (£000s except where shown)	2012	2013	2014	2015	2016	2017	2018e
PROFIT & LOSS							
Year to 31-Dec							
Capital Markets	22,653	25,796	30,129	23,350	28,286	27,230	25,600
Asset Management	6,331	7,334	8,478	9,500	10,446	12,906	14,945
Principal Finance	3,837	2,635	1,968	9,102	676	1,760	1,690
Total revenue	32,821	35,765	40,575	41,952	39,408	41,896	42,235
Costs	(28,805)	(29,262)	(31,117)	(29,086)	(33,130)	(35,006)	(37,006)
EBITDA	4,016	6,503	9,458	12,866	6,278	6,890	5,228
Depreciation and amortisation	(1,114)	(1,102)	(1,064)	(1,039)	(1,046)	(892)	(814)
Share-based payments	(54)	0	(17)	(4)	(11)	(8)	(8)
Balance sheet impairments					(2,664)	(1,883)	0
Share of associates' results					0	805	0
Operating profit	2,848	5,401	8,377	11,823	2,557	4,912	4,406
Net interest	(321)	8	(68)	(126)	(152)	(335)	(260)
Other	0	0	0	0	0	0	0
Profit before tax	2,527	5,409	8,309	11,697	2,405	4,577	4,146
Tax	(494)	(1,100)	(1,804)	(1,002)	(554)	(912)	(761)
Non-controlling interests	(46)	(911)	(1,297)	(4,250)	(549)	(839)	(860)
Profit after tax (FRS 3)	1,987	3,398	5,208	6,445	1,302	2,826	2,525
Average number of shares outstanding (m)	24.2	24.2	24.2	23.8	21.8	21.7	21.6
Average, fully diluted no. of shares (m)	24.3	24.5	25.1	24.7	22.6	22.1	22.0
EPS (p)	8.2	14.1	21.6	27.1	6.0	13.0	11.7
EPS (p) fully diluted	8.2	13.9	20.8	26.1	5.8	12.8	11.5
Dividend per share (p)	5.0	8.0	10.0	0.0	5.0	10.0	10.0
EBITDA margin (%)	12.2	18.2	23.3	30.7	15.9	16.4	12.4
Operating margin (%)	8.7	15.1	20.6	28.2	6.5	11.7	10.4
NAV per share (p)	247.4	253.5	265.6	268.7	269.5	270.0	269.5
ROE (%)	3.4	5.6	8.3	9.2	2.2	4.8	4.4
BALANCE SHEET							
Non-current assets	20,210	19,901	19,100	19,555	23,045	16,933	20,138
Intangibles and goodwill	4,436	4,406	4,002	2,222	2,516	2,610	2,613
Property, plant and equipment	11,669	10,897	10,969	10,864	9,423	7,699	7,428
Investments and other	4,105	4,598	4,129	6,469	11,106	6,624	10,097
Current assets	100,435	111,185	95,406	103,250	88,124	96,626	105,624
Bull positions	4,058	4,557	4,636	9,344	12,290	8,154	8,326
Cash	30,443	41,395	30,658	22,113	23,937	35,673	27,228
Debtors and other	65,934	65,233	60,112	71,793	51,897	52,799	70,070
Current liabilities	(43,441)	(52,883)	(32,445)	(45,972)	(33,316)	(46,323)	(55,646)
Bear positions	(1,395)	(1,033)	(846)	(946)	(765)	(1,017)	(564)
Short-term borrowings	(327)	(321)	(341)	(360)	(431)	(9,726)	(4,191)
Other current liabilities	(41,719)	(51,529)	(31,258)	(44,666)	(32,120)	(35,580)	(50,891)
Long-term liabilities	(10,817)	(9,241)	(9,640)	(9,791)	(10,768)	(66)	(2,060)
Long-term borrowings	(10,549)	(8,892)	(9,105)	(9,256)	(10,649)	0	(1,862)
Other long-term liabilities	(268)	(349)	(535)	(535)	(119)	(66)	(198)
Net assets	66,387	68,962	72,421	67,042	67,085	67,170	68,056
CASH FLOW							
Net cash from operations	846	15,123	(7,181)	774	8,312	12,635	1,684
Fixed asset investment	(614)	(340)	(412)	(363)	(517)	(601)	(392)
Acquisitions/disposals	0	(1,731)	0	0	0	0	(826)
Other investing activities	93	297	211	7,121	(4,313)	4,099	(752)
Share issuance	0	0	0	0	0	1,530	0
Share purchases	0	0	0	(10,047)	0	(2,248)	0
Ordinary dividends	(604)	(2,175)	(2,175)	(1,208)	0	(2,167)	(2,158)
Other financing	(514)	230	(1,070)	(4,914)	(1,719)	(1,228)	(815)
Other	654	1,342	(574)	(530)	(1,894)	961	(1,958)
Net cash flow	(139)	12,746	(11,201)	(9,167)	(131)	12,981	(5,217)
Opening net (debt)/cash	19,696	19,567	32,182	21,212	12,497	12,857	25,947
FX	10	(131)	231	452	491	109	445
Closing net (debt)/cash	19,567	32,182	21,212	12,497	12,857	25,947	21,175

Source: Shore Capital accounts, Edison Investment Research

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