

Cenkos Securities

Making hay when the sun shines

H117 results

Financial services

Cenkos Securities' H117 result was strong with a pre-tax profit increase of over 150% bolstered by the Eddie Stobart IPO, which provided further evidence of the company's ability to complete larger transactions as well as a flow of smaller deals. The second half has started well and, subject to market conditions, the pipeline is reported to be healthy. Our FY17 earnings estimate has been increased by nearly 11%. Revenue and profit are subject to market fluctuations but the business model of contained fixed costs and high variable compensation mitigates the impact of this. The valuation both in terms of P/E and yield appears cautious.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/14	88.5	27.0	35.2	17.0	3.3	14.5
12/15	76.5	19.9	27.2	14.0	4.3	12.0
12/16	43.7	4.4	4.7	6.0	24.9	5.1
12/17e	58.0	8.4	12.4	11.0	9.4	9.4

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

H117 results

Cenkos' first half revenues increased by more than 90% from H116 and were 3% ahead of the stronger H216, reflecting the contribution from fees generated by the £386m Eddie Stobart Logistics IPO and a generally improved market background that fed into strong market-making profits. Continuing pressure on commission rates meant that corporate broking, research and commission revenue was down 15%. Variable compensation contributed to an 82% increase in costs from H116, which still left pre-tax profits (£4.2m) 156% up on the prior year period and, with the benefit of a lower tax charge, earnings per share were five times last year's level at 6.1p. The interim dividend proposed is 4.5p compared with 1.0p.

Outlook

Equity market levels have risen substantially since June last year (FTSE All-Share total return index +19%) and sustained higher levels despite a range of uncertainties surrounding Brexit and global geopolitical developments. While this remains the case the environment for transactions is supportive and Cenkos has already undertaken a number of significant fund-raising in the second half and reports a good pipeline of potential transactions. In 2018 the implementation of MiFID II is generally expected to exert further downward pressure on commission income (part of the 15% of H117 revenues from corporate broking, research and commission). In the longer term, Cenkos' flexible cost base, its track record in completing transactions for both SME and larger companies and the breadth of its 120-strong client base are positive features.

Valuation

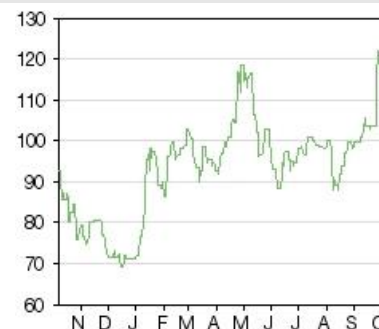
Both yield and P/E multiple appear attractive, even allowing for the equity market sensitivity of earnings and dividends. An ROE/COE based valuation (page 3) points to a valuation of 194p (previously 189p).

6 October 2017

Price 117p
Market cap £66m

Net cash (£m) at end June 2017	19.8
Shares in issue	56.7m
Free float	62%
Code	CNKS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	17.6	20.6	25.8
Rel (local)	15.5	18.0	16.9
52-week high/low	122.0p	69.0p	

Business description

Cenkos Securities is an independent, specialist institutional securities group, focused on growth companies and investment funds. Its principal activities are corporate broking and advisory and institutional equities.

Next events

FY17 results	March 2018
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H117 results review

Exhibit 1 gives a P&L analysis for the first half. Salient points are as follows, with percentage changes from H116 unless stated.

- Within the 91% revenue increase, corporate finance and placing fees together with market making were the positive drivers. As noted earlier, the Eddie Stobart IPO was a significant contributor (one client is identified as contributing £10.59m). Market-making revenue included benefits from gains on shares and warrants received in lieu of fees of £1.29m (H116 loss £1.63m).
- The cost increase of 82% was the result of higher variable compensation together with costs arising from an extensive exercise to strengthen systems and controls following regulatory breaches reported last year in relation to Cenkos' provision of sponsor services. Investment has also been made in preparation for MiFID II and the Senior Managers and Certification Regime.
- A reduction in tax charge amplified the 156% pre-tax profit increase to 406% at the EPS level.
- The dividend was increased by 350% to 4.5p and Cenkos notes that since flotation it has made cash returns to shareholders (dividends and share buybacks) of 160.8p (or 165.3p once the interim dividend has been paid).

Exhibit 1: H117 Profit and loss analysis					
£000s	H116	H216	H117	% change vs H116	% change sequentially
Corporate finance & placing fees	9,675	20,045	21,209	119%	6%
Corporate broking, research, and commission	5,106	5,399	4,351	-15%	-19%
Market making	563	2,957	3,689	555%	25%
Total revenue	15,344	28,401	29,249	91%	3%
Recurring Administration expenses	(13,726)	(25,700)	(25,032)	82%	-3%
Operating profit / loss	1,618	2,701	4,217	161%	56%
Investment income	32	51	8	-75%	-84%
Pre-tax profit	1,650	2,752	4,225	156%	54%
Tax	(997)	(861)	(904)	-9%	5%
Attributable profit	653	1,891	3,321	409%	76%
EPS (p)	1.2	3.4	6.1	406%	79%
DPS (p)	1.0	5.0	4.5	350%	-10%
Source: Cenkos Securities, Edison Investment Research					

Since the beginning of the year there have been several **board changes**. In May Nick Wells stood down from the board but remains with the company, focusing on developing the corporate finance operations. Jim Durkin, a founder shareholder in Cenkos, retired as chief executive and director at the beginning of August, with his role assumed by existing non-executive director Anthony Hotson. Hotson has substantial financial sector experience including roles at the Bank of England, SG Warburg and Henderson Group. He joined the board in May 2012, so has a good understanding of the culture of the business. Finance director Mike Chilton also resigned as a director in August and Philip Anderson, previously at Curo Financial Technologies and Virgin Money Holdings, has been appointed as finance director.

In the next table we have collated the placing and IPO transactions highlighted on the company's website (it excludes tap issues for investment companies, for example). This confirms the comments made about a good start to the second half, with the total raised for clients so far totalling £523m. This compares with the £702m shown here for the first half (the actual first half total raised including other transactions not recorded here was £982m).

Exhibit 2: Highlights of completed transactions for 2017 year to date

Month	Company	Transaction	Consideration
February	Kromek Group	Placing	£21m
	Mercia Technologies	Placing	£40m
	GCP	C share issue	£79m
	Cello Group	Placing	£15m
	UP Global Sourcing Hldgs	IPO	£53m
March	Collagen Solutions	Placing	£8m
	88 Energy Ltd	Placing	A\$17m
	Totally	Placing	£18m
	Frontier IP Group	Placing	£3m
April	Corero	Placing	£5.6m
	Salt Lake Potash	Fundraise	£7.5m
	Eddie Stobart	IPO	£386m
May	Rosslyn Data Technologies	Placing and acquisition	£5m
	UK Oil and Gas	Placing	£6.5m
June	Plastics Capital	Placing	£3.7m
	1PM	Placing	£13m
	Flow Group	Equity placing and loan note subscription	£26.6m
July	Angling Direct	IPO	£9m
	Hurricane Energy	CV bond placing	US\$230
	Hurricane Energy	Equity placing	US\$300
	Arena Intl Events	IPO	£60m
August	TP Group	Placing	£21.85m
	Marlowe	Placing	£10m
	Rotala	Placing	£3.5m
	FairFX	Placing	£27.7m

Source: Cenkos Securities website

Financials

Our FY17 estimate is increased to reflect the H117 performance and commentary on trading since the half-year end. Our revenue estimate is increased from £52m to £58m and this translates into pre-tax profits of £8.4m compared with £7.8m previously and EPS of 12.4p versus 11.2p. Our full year estimates are set out in more detail in the financial summary table (Exhibit 3).

There was a cash outflow of £4m in the first half, with an operating cash inflow of £1m before working capital items offset by working capital and tax outflows (£1.9m), and a dividend payment of £2.7m, while other items absorbed £0.4m. This left cash and cash equivalents (no debt) of £19.8m at the end of June.

Valuation

In our previous note we derived a valuation based on a simple ROE/COE model using an assumed sustainable ROE of 24% (in line with our current FY17 estimates) and a growth rate of 5%. On the same assumptions, applied to the slightly higher H117 NAV, the implied value is 194p (previously 189p). Alternatively, the current share price would imply an ROE of c 17%, which seems cautious given the average over the last five years has been 36%.

Exhibit 3: Financial summary

	£000s	2014	2015	2016	2017e
Year end 31 December					
PROFIT & LOSS					
Revenue		88,516	76,513	43,745	58,000
Cost of Sales (excl. amortisation and depreciation)		(61,318)	(56,510)	(39,244)	(49,439)
EBITDA		27,198	20,003	4,501	8,560
Depreciation		(386)	(241)	(182)	(200)
Amortisation		0	0	0	0
Operating Profit (before amort. and except.)		26,812	19,762	4,319	8,361
Exceptionals		0	0	0	0
Non-recurring items		0	0	0	0
Investment revenues		160	134	83	50
Profit Before Tax (norm)		26,972	19,896	4,402	8,410
Tax		(5,644)	(4,525)	(1,858)	(1,682)
Profit After Tax (norm)		21,328	15,371	2,544	6,728
Minority Interests		0	0	0	0
Average number of shares outstanding (m)		60.5	56.5	54.7	54.2
EPS - normalised fully diluted (p)		35.2	27.2	4.7	12.4
Fully diluted EPS (p)		33.5	26.8	4.6	12.4
Dividend per share (p)		17.00	14.00	6.00	11.00
NAV per share (p)		0.65	0.53	0.50	0.55
ROE (%)		60%	43%	10%	24%
Cost/income ratio		69.7%	74.2%	90.1%	85.6%
Staff costs/Revenue		64.8%	58.8%	60.1%	69.2%
BALANCE SHEET					
Non-current assets		2,463	1,626	625	675
Intangibles and goodwill		0	0	0	0
Property, plant and equipment		421	296	389	439
Other non-current assets		2,042	1,330	236	236
Current assets		63,392	64,725	62,692	64,424
Other current assets inc Investments - long positions		10,014	12,706	13,811	13,811
Cash		32,932	33,106	23,795	28,053
Debtors and other		20,446	18,913	25,086	22,560
Current liabilities		(26,294)	(37,432)	(35,254)	(35,254)
Other current liabilities inc short positions		(2,711)	(2,551)	(2,694)	(2,694)
Short-term borrowings		0	0	0	0
Other current liabilities		(23,583)	(34,881)	(32,560)	(32,560)
Non-current liabilities		0	(351)	(880)	(880)
Long-term borrowings		0	0	0	0
Other long-term liabilities		0	(351)	(880)	(880)
Net assets		39,561	28,568	27,183	28,965
CASH FLOW					
Operating Cash Flow		24,137	15,538	(465)	9,060
Working capital and other items		(7,344)	16,184	(1,387)	2,526
Tax paid		(4,815)	(5,049)	(2,533)	(1,682)
Net cash from operating items		11,978	26,673	(4,385)	9,904
Fixed asset investment		(420)	(174)	(272)	(250)
Acquisitions/disposals		0	0	0	0
Other investing activities		173	191	93	50
Share (purchase)/issuance		244	(16,823)	(438)	0
Ordinary dividends		(9,386)	(9,740)	(4,367)	(5,445)
Other financing		0	47	58	0
Other		0	0	0	0
Net cash flow		2,589	174	(9,311)	4,258
Opening net (debt)/cash		30,343	32,932	33,106	23,795
FX		0	0	0	0
Closing net (debt)/cash		32,932	33,106	23,795	28,053

Source: Edison Investment Research, Cenkos Securities accounts

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