Tatton Asset Management

Growth, profitability, opportunity

18th November 2019

Tatton, the UK's largest provider of on-platform discretionary fund management services to IFAs, has released its interim results for the six months to 30 September 2019 and showed successful delivery against nearly all key metrics. We believe the prospects to rapidly scale up AUM and boost profits because of the (already proven) opportunity for operational leverage justify a fair value of 300p / share.

AUM grew 22.8% year-on-year to £7.0bn; revenue 15.2% to £9.7m; operating profit (adjusted) 23.2% to £4.1m; and EPS 19.1% to 5.9p. Adjusted operating margin continued to improve, rising from 39.7% in H1 19 to 42.4% in H1 20. Organic growth was the dominant story of the half, but the group did make its first acquisition since listing in 2017. **Sinfonia Asset Management** was acquired for up to £2.7m (£2.0m upfront payment), bringing with it £135m of AUM. Furthermore, AUM from the recent strategic partnership with Tenet Group (one of the UK's largest adviser support groups giving access to 474 IFA firms - a £1.2bn AUM opportunity) are accelerating.

Key Financials

	H118A	2018A	H119A	2019A	H120A	2020E	2021E
Revenue (£'000)	7,298	15,507	8,445	17,518	9,729	19,895	22,018
Revenue growth, y-o-y (%)	31%	31%	16%	13%	15%	14%	11%
Operating profit (adj)	3,094	6,526	3,350	7,308	4,126	8,716	9,987
Operating margin (adj) %	42.4	42.1	39.7	41.7	42.4	43.8	45.4
EPS basic adj (p)	4.4	9.3	5.0	11.0	5.9	13.2	15.1
DPS (p) - interim for half years	2.2	6.6	2.8	8.4	3.2	9.3	10.6
EV/EBIT (x)	106.0	33.8	20.1	20.1	16.9	15.8	13.3
P/E ratio (x)	26.9	25.1	23.6	21.4	19.8	17.8	15.6
Yield (%)	0.9%	2.8%	1.2%	3.6%	1.4%	3.9%	4.5%

Source: Company Historic Data, ED estimates

We believe the business is set to maintain its growth and profit trajectory because:

- **There is a powerful market trend of IFAs moving more and more of their client assets onto discretionary fund management (DFM) platforms** (a £48bn market[1], up from £5bn[2] in 2011), avoiding the regulatory and risk burden of selecting investments for end-clients themselves;
- **Tatton has carved out a market-leading proposition in this space**, especially with respect to the two most important criteria advisers use to select a DFM: fees and investment performance;
- **It has tried-and-tested methods of winning new clients and capturing a higher share of their AUM**;
- **Operational leverage should see margins improve further** as the business scales;
- The adviser support services business complements the asset management business well and provides **deep IFA market insights.**

[1] *Platforum, DFM Distribution Dynamics, July 2019*
[2] *FCA, Investment Platforms Market Study, March 2019*

Company Data

EPIC	TAM
Price (last close)	235p
52 week Hi/Lo	249p / 179p
Market cap	£131m

Share Price, p

Source: ADVFN

Description

Tatton Asset Management was founded in 2007 and serves smaller, UK-based Independent Financial Advisers via two distinct business units: investment management (discretionary fund management or DFM) delivered via WRAP platforms, and adviser support services (regulatory and compliance consulting and outsourcing, plus mortgage and protection insurance aggregation).

Aggregate AUM at end Sept. 2019 was £7.0bn.

Paul Bryant (Analyst)
0207 065 2690
paul.bryant@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

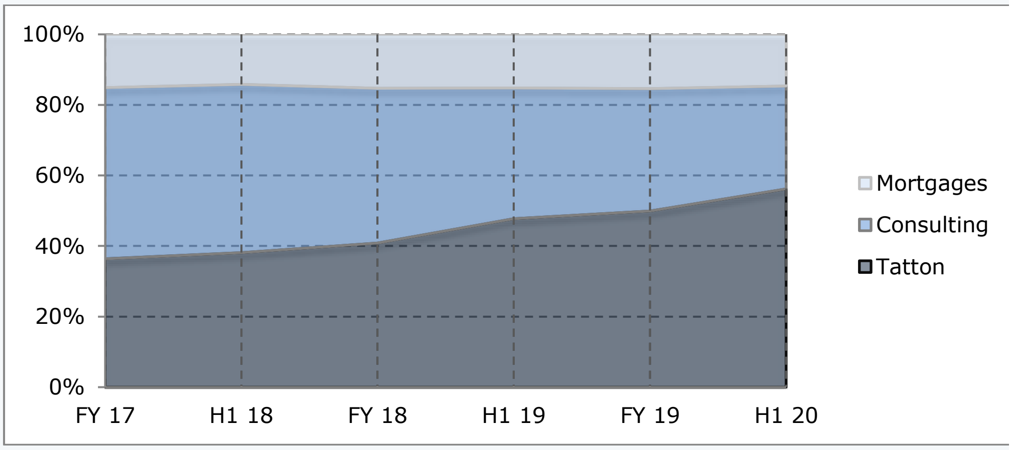
In our note of 17 October 2019, which initiated ED coverage, we outlined the strategic investment case and drilled down into the specific competitive advantages of the group. We now dive deeper into H1 performance, financial forecasts, and valuation.

Asset management leads an impressive H1

The group now operates two business units: Tatton Investment Management **(Tatton)**, and **Paradigm**, which consists of the IFA adviser support services businesses, Consulting and Mortgage Services. The evolving nature of the group, and in particular the growing dominance of the asset management business, has prompted a change of structure and segment reporting format.

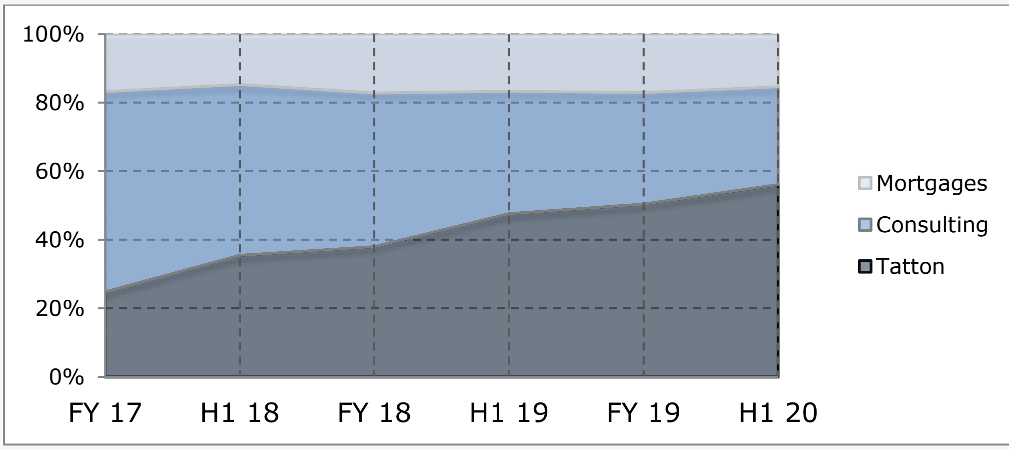
Over the last few years, asset management has grown to become the dominant business unit:

Share of revenue, by business unit



Source: Company historic data, ED analysis

Share of adjusted operating profit, by business unit



Note: 100% = sum of business unit adjusted operating profits i.e. excludes 'central' costs
Source: Company historic data, ED analysis

Tatton was the star performer in H1, continuing the recent trend of rapid AUM and revenue growth, coupled with robust profitability.

AUM grew to £7.0bn, up 22.8% year-on-year and 14.8% up on the 31 March 2019 year-end figure of £6.1bn. A small part of this growth (£135m) came from the Sinfonia Asset Management acquisition, leaving organic AUM growth at 21.1%.

Tatton continued to show an ability to add new clients with IFA numbers increasing 28.9% year-on-year from 405 to 522. **Just over 10%** of the UK's 5,500 directly authorised adviser firms now use Tatton.

As these new clients typically only move a small part of their AUM to Tatton immediately, this existing client base provides a rich source of opportunity for future AUM growth (i.e. Tatton is only partly dependent on growing AUM through adding new clients).

The scope of this 'share-of-client-assets' opportunity can be appreciated by considering that the average Tatton IFA has **£40m** of AUM placed through platforms, yet Tatton's average AUM per IFA is only **£13.4m**.

Revenue grew 18.6% year-on-year to £7.1m. This was down to the changing mix in business and the particularly strong growth in AUM that took the group to £7bn AUM in total.

Adjusted operating profit grew 22.7% to £4.27m, with margins increasing to 60.2% from 58.2% in H1 19.

Tatton summary data

	H1 19A	FY19A	H1 20A
AUM, £bn	5.7	6.1	7.0
AUM from acquisition			0.135
Growth, y-o-y	30%	24%	23%
Revenue, £m	6.0	12.5	7.1
Share of total firm rev	71%	72%	73%
Adj op profit, £m	3.5	7.4	4.3
Adj op profit margin	58.2%	58.9%	60.2%
Share of firm adj op profit*	81%	80%	82%

** Based on 100% = sum of business unit adjusted operating profits i.e. excludes 'central' costs*
Source: Company historic data

Importantly, Tatton is not restricted to adding new IFA clients 'one-by-one'. It also has an opportunity to do this en-masse through corporate mandates.

For example, in June 2019, it won a three-year mandate to provide a Managed Portfolio Service through Tenet Group (Tenet), one of the UK's largest adviser support groups, giving Tatton strategic access to 474 additional IFA firms, with the corresponding opportunity to rapidly boost AUM (total opportunity estimated at £1.2bn).

AUM flow from this opportunity is starting to accelerate. Between June and September, Tatton had won 40 new clients through this partnership, with £24.5m of AUM added. In October alone, £32.8m of AUM was added. In addition, Tenet is ending its in house portfolio service in March 2020. This should rapidly accelerate the pace that funds are migrated to Tatton.

Furthermore, the group has always been open to opportune acquisitions that are a good strategic fit and are earnings enhancing, despite the core focus remaining on organic growth. On 30 September 2019, Sinfonia Asset Management (SAM), a wholly owned subsidiary of Tenet, was opportunistically acquired. SAM runs five funds with a total AUM of £135m.

The entire issued share capital of SAM has been purchased for up to £2.7m (£2.0m payable on completion, the balance payable against AUM targets in two equal instalments at the end of years one and two post completion). The acquisition has been funded out of existing cash resources, with the group still maintaining a healthy cash position of £9.2m as at 30 September 2019 (after payment of the £2m acquisition price).

Notably, the initial acquisition-price-to-AUM ratio of SAM (1.5%) is roughly in line with the market-cap-to-AUM ratio of Tatton Asset Management plc (1.7%).

In summary, asset management is the growth engine of the group, is highly profitable, and is set to benefit from further economies of scale. It has an opportunity that could see its earnings dwarf that of the adviser support services business in a few years' time.

Paradigm - Solid performance

The half-year performance of the Paradigm business has been steady. There has been some consolidation in the IFA market, but with the recent amalgamation of the Consulting and Mortgage divisions, this business should grow modestly in the future. With the income generated, currently representing 27% of total group revenue – this business has the ability to cover the fixed costs of the Tatton Asset Management group as a whole, leaving all the profit from Tatton to drop straight to the bottom line. ,

Revenue grew 6.9% year-on-year to £2.6m, adjusted operating profit 10.6% to £0.91m, with margins increasing to 35.0% from 33.8% in H1 19.

Paradigm summary data

	H1 19A	FY19A	H1 20A
No of member firms (consulting)	382	390	385
No of member firms (mortgages)	1,290	1,389	1,466
Gross mortgage lending, £bn	4.0	8.4	4.8
Revenue, £m	2.4	4.9	2.6
Share of total firm rev	29%	28%	27%
Adj op profit, £m	0.8	1.8	0.9
Adj op profit margin	33.8%	36.7%	35.0%
Share of firm adj op profit*	19%	20%	18%

** Based on 100% = sum of business unit adjusted operating profits i.e. excludes 'central' costs*
Source: Company historic data

In **Consulting,** while member firms are holding broadly steady, average annual revenue per client fell to £14.7k from £16.0k in FY19 and £16.9k in H1 19. This resulted in business unit revenue falling 9.3% year-on-year to £2.83m, but costs were also reduced, and this resulted in adjusted operating profit falling only 3.8% to £1.48m (pre-reorganisation reporting metrics).

CFO Paul Edwards attributes the fall in revenue to a reduction in one-off projects, but with the bulk of the Consulting business being recurring revenues from on-going consulting and outsourcing contracts (with market conditions remaining robust for this part of the business), is confident of a return to growth in time.

While Consulting is a mature business, it remains financially and strategically important to the group. The deep relationships formed with IFAs are an important source of market insight, which helps with new service and product design across the group.

Moreover, it will form a larger and important part of the new adviser support services business unit (see below), with the amalgamation with Mortgage Services likely to be positive for the development of cross fertilisation opportunities.

Mortgage Services had an impressive H1, particularly given the weak UK housing market.

It grew the number of member firms to 1,466 (up 13.6% from 1,290 in H1 19) and gross mortgage lending to £4.8bn (up 20% year-on-year). Using pre-reorganisation reporting metrics, revenue grew to £1.42m (up 11.4%), and operating profit to £0.80m (up 11.3%).

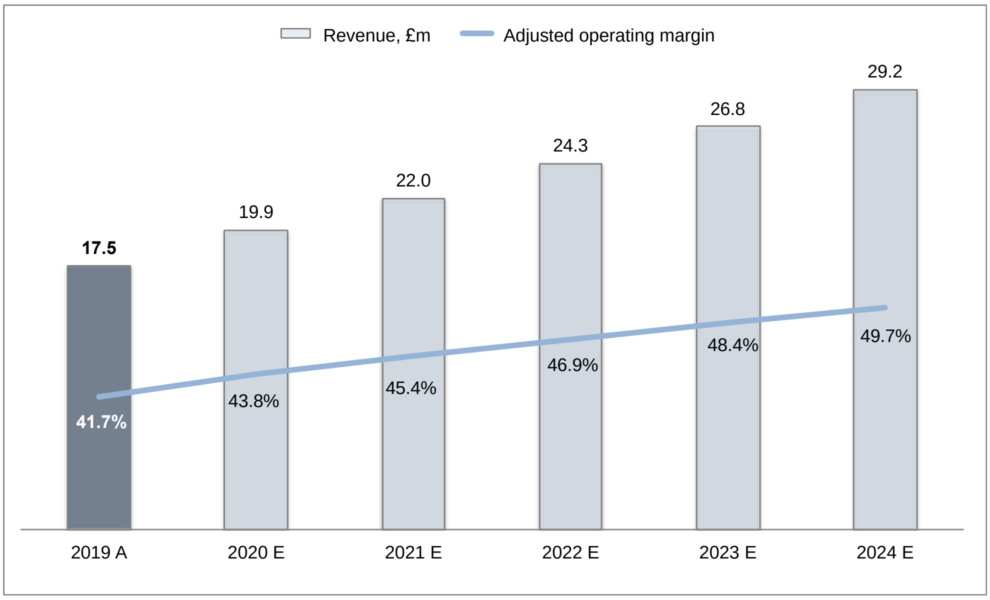
Operating margins remained robust at 56.1%, roughly in line with H1 19 (56.2%).

This business has further growth potential, driven primarily by adding new intermediary clients. The market itself was boosted in 2014 following the **Mortgage Market Review** that drove distribution towards intermediaries and intermediaries towards distributor businesses. Robert Hunt has enjoyed significant success driving the mortgage business and will now head up the Paradigm business unit.

Group prospects: revenues and profits could double in five years

On the basis of the opportunities outlined above, we believe that the group can grow revenues to nearly £30m in five years, and adjusted operating margin to nearly 50%.

Five year revenue and adjusted operating margin projections



Source: Company historic data and ED estimates

The opportunity to accelerate this growth also exists, such as winning further corporate mandates (similar to the Tenet deal or via an IFA industry 'consolidator'), and through further acquisitions.

Five-year forecasts						
Year-end 31 March	**2019 A**	**2020 E**	**2021 E**	**2022 E**	**2023 E**	**2024 E**
AUM (£bn)	**6.1**	**7.5**	**8.7**	**10.1**	**11.5**	**13.0**
Growth	24.5%	23.6%	15.9%	15.4%	13.9%	12.7%
Total revenue (£m)	**17.5**	**19.9**	**22.0**	**24.3**	**26.8**	**29.2**
Growth	13.0%	13.6%	10.7%	10.5%	10.0%	9.2%
Admin expenses (£m)	**10.2**	**11.2**	**12.0**	**12.9**	**13.8**	**14.7**
Growth	13.7%	9.5%	7.6%	7.4%	6.9%	6.4%
Operating profit, adj (£m)	**7.3**	**8.7**	**10.0**	**11.4**	**12.9**	**14.5**
Growth	12.0%	19.3%	14.6%	14.2%	13.5%	12.2%
Operating margin, adj	41.7%	43.8%	45.4%	46.9%	48.4%	49.7%
Profit after tax (£m)	**4.9**	**6.3**	**7.4**	**8.5**	**9.8**	**11.1**
Growth	113.4%	29.5%	17.2%	15.8%	14.8%	13.2%
EPS basic adj (p)	**11.0**	**13.2**	**15.1**	**17.2**	**19.5**	**21.8**
Growth	14.0%	20.3%	14.6%	13.8%	13.1%	11.8%
Dividend (p)	**8.4**	**9.3**	**10.6**	**12.1**	**13.6**	**15.3**
Yield	3.6%	3.9%	4.5%	5.1%	5.8%	6.5%
Net assets (£m)	**15.3**	**16.6**	**18.7**	**21.0**	**23.8**	**26.9**
Growth	10.2%	8.9%	12.1%	12.5%	13.1%	13.3%
Net cash (£m)	**12.2**	**10.8**	**12.8**	**14.8**	**17.3**	**20.4**
Growth	4.9%	-11.5%	18.7%	15.7%	16.4%	18.3%
Valuation benchmarks						
PE Ratio (on adj earnings)	21.4	17.8	15.6	13.6	12.1	10.8
EV/Sales	6.8	6.1	5.4	4.8	4.3	3.8
EV/EBIT	20.1	15.8	13.3	11.3	9.6	8.3
Share price (p)	**235**					

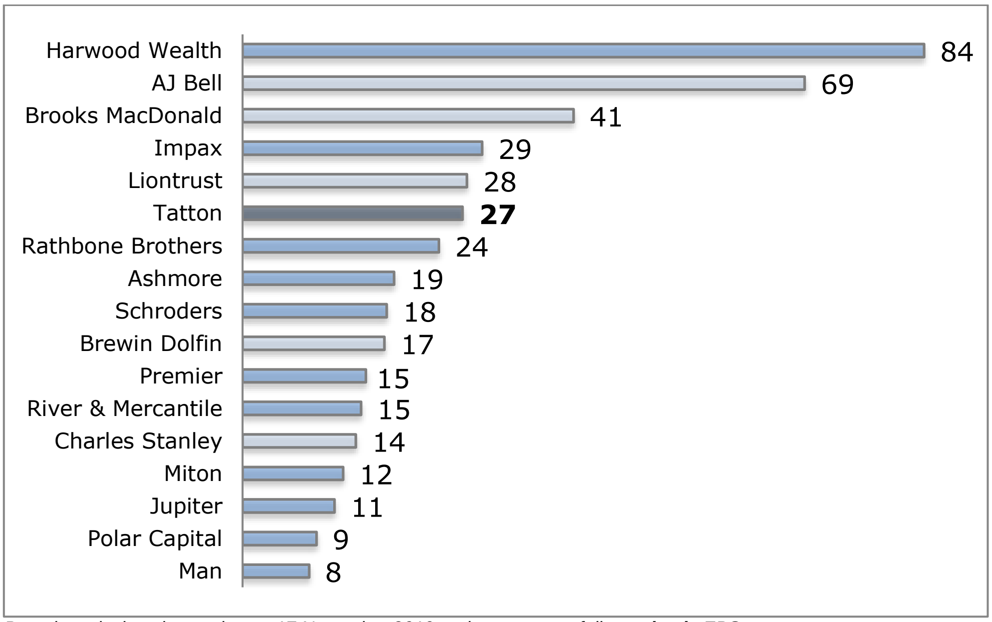
Source: Company historic data and ED estimates

Valuation upside

We believe Tatton's valuation has substantial upside, and see 300p/share as more appropriate when taking into account a peer analysis and discounted cash flow calculation.

Sixteen companies were selected for the peer group comparison, all listed entities. This includes businesses that compete directly with Tatton in the DFM on-platform space but, like Tatton, also have other business units (e.g. AJ Bell, Brewin Dolphin and Harwood Wealth), as well as 'pure-play' asset managers (e.g. Ashmore and Liontrust).

Peer group Price-Earnings-Ratio comparison



*Based on closing share price on 17 November 2019 and most recent full-year **basic** EPS.*
Note: PER ratio differs from ED calculation which uses adjusted basic EPS
Source: ADVFN, ED

Peer group comparison

Name	Market Cap, £m	AUM, £bn	PER	Div Yield	RoE	Rev Growth 1 year	Op Margin (non adj)	EPS Growth
Tatton	131	6.1	27.0	3.6%	31.8%	13%	33.8%	113.5%
Schroders	7,230	407.2	17.7	3.6%	13.9%	5%	24.0%	-15.0%
Ashmore	3,501	71.2	18.6	3.4%	21.2%	8%	65.9%	17.6%
Man Group	2,186	84.1	8.2	6.5%	17.1%	-10%	31.7%	11.6%
Jupiter	1,660	42.7	11.3	7.9%	22.9%	0%	38.9%	-7.8%
AJ Bell	1,647	46.1	69.1	0.9%	35.4%	19%	31.5%	29.0%
Rathbone Brothers	1,208	44.1	24.1	3.1%	10.0%	7%	19.7%	-4.3%
Brewin Dolphin	1,015	37.6	17.4	4.9%	19.5%	7%	20.8%	18.2%
Polar Capital	505	13.8	9.1	6.3%	47.8%	33%	36.1%	58.8%
Liontrust	458	12.7	27.6	3.0%	30.5%	14%	19.5%	89.9%
Impax	352	12.4	29.4	1.5%	21.7%	101%	23.0%	38.5%
Brooks MacDonald	251	13.2	40.7	2.6%	6.1%	7%	7.9%	8.8%
River & Mercantile	201	33.8	14.5	7.9%	22.9%	4%	21.1%	-13.9%
Premier	194	6.9	15.2	5.6%	27.7%	16%	29.8%	41.7%
Charles Stanley	125	24.1	13.9	3.5%	8.5%	3%	6.1%	3.0%
Harwood Wealth	105	6.5	83.8	2.2%	4.6%	26%	7.9%	60.5%
Miton	100	4.4	12.4	3.6%	11.3%	30%	24.4%	38.8%
Median			**17.7**	**3.6%**	**21.2%**	**7.7%**	**24.0%**	**18.2%**

Above peer group median

In 1st quartile of peer group

Based on closing share price on 17 November 2019 and most recent full-year basic EPS
Source: ED analysis, ADVFN

The above-median PER (using non-adjusted basic earnings from the most recent full-year results as the denominator to ensure consistency of comparison between peers) assigned to Tatton is unsurprising given its above-median or 1st quartile positioning on a range of metrics compared to peers.

Particularly impressive are Tatton's return on equity, operating margin and EPS growth that place it in the first quartile of the peer group.

Even though Tatton's most recent full-year basic non-adjusted EPS growth of 114% was particularly high and has reduced in the current half-year results to 22%, our growth forecasts for the next two years (23% 2-year CAGR) shows basic EPS growth to remain well above the peer group median of 18%.

We believe that if Tatton delivers on its targets, maintaining a PER in the 24-27 range for two years is reasonable, which would translate to a share price of 317p – 356p at the end of March 2021 (our basic EPS forecast for FY 2021 = 13.2p).

In addition, we conducted a DCF valuation based on our explicit five years' forecast detailed in the section 'Updated Forecasts'. For the terminal value of the calculation, we assumed the business was sold at the end of this five-year period at a PE multiple of 20. Using a discount rate of 8% to calculate the present value of future cash flows results in a net-present-value of 313p per share.

Hence, we think shares in Tatton Asset Management deserve to be 300p+

Appendix

Investment management unit – historical vs new	H1 19	FY 19	H1 20
Tatton (historical)			
Revenue, £'000	4,025	8,732	5,453
Adj operating profit	2,050	4,628	2,906
Adj operating margin	50.9%	53.0%	53.3%
Tatton (new)			
Revenue, £'000	5,987	12,521	7,102
Adj operating profit	3,482	7,371	4,273
Adj operating margin	58.2%	58.9%	60.2%

Source: Company interim results to 30 September 2019

Adviser support services unit – historical vs new	H1 19	FY 19	H1 20
PPC (historical)			
Revenue, £'000	3,118	6,049	2,828
Adj operating profit	1,537	2,996	1,478
Adj operating margin	49.3%	49.5%	52.3%
PMS (historical)			
Revenue, £'000	1,278	2,689	1,424
Adj operating profit	718	1,565	799
Adj operating margin	56.2%	58.2%	56.1%
Paradigm (new)			
Revenue, £'000	2,434	4,949	2,603
Adj operating profit	823	1,818	910
Adj operating margin	33.8%	36.7%	35.0%

Source: Company interim results to 30 September 2019

Investor Access

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

More information is available on our website

www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690