Polar Capital Holdings

26 June 2023

Tough FY23, outlook improving for flows & returns

In FY23 (to 31 Mar 23), market conditions created strong headwinds for asset managers, especially those with a growth equities bias like Polar. AUM declined 13% from £22.1bn to £19.2bn, with net outflows of - £1.6bn (FY22: + £0.4bn), investment performance of - £0.9bn (FY22: +£0.9bn); and fund closures of - £0.5bn. However, the story of the year was certainly not entirely negative, but mixed, with an improving picture towards year-end and also post-year-end (although we caution that economic and market conditions remain uncertain).

Indeed, **Polar's Q4 was strong**, with AUM up £0.8bn (+4%), driven by investment performance. Many strategies recorded net inflows during this quarter, with the overall net outflow of -£0.4bn driven almost entirely by profit taking from the Global Insurance fund which had delivered significant outperformance during the interest rate hiking cycle. Also encouraging was the rate of outflows from Technology strategies continuing to decline through the year (£0.42bn in Q1 v £0.24bn in Q4).

There are also early signs of capital allocations being re-directed back to active managers, following a period of heavy outflows (this is typical during sharp market falls, see pages 8-10). And post year-end, **the key benchmark indices of Polar's largest strategies posted gains**, most significantly, the Dow Jones Global Technology Index was up c 12% between 1 Apr 23 and 15 Jun 23 (technology strategies make up c 38% of AUM).

No surprises in results, fundamental value unchanged at 625p, yield 9.3%

The strength of FY22, buoyed by the bull market of calender-2021, makes FY23 results look comparatively weak. Gross income fell 18% from £226m to £186m. However, performance-tilted variable pay structures resulted in operating costs reducing by 16% from £141m to £119m, which limited margin impact. So, while core operating profit* fell 31% y-o-y from £69m to £45m, core margin fell from 37% to 31%. Statutory PBT fell from £62m to £48m, and PBT margin fell from 28% to 24%.

Polar maintains a strong balance sheet, with cash of £107m (down from £121m), and no debt. This strength has given the board **confidence to maintain a full-year dividend of 46p, a yield of 9.3%**.

We forecast AUM growth in FY24 based on an improving outlook, although revenues are expected to fall in FY24 (lower ave. AUM), before recovering in FY25. Our fundamental value is 625p per share, 26% above the share price, **and we see potential for a company and sector re-rating** (page 15).

Key Financials

Year-end 31 Mar	FY20A	FY21A	FY 22A	FY 23A	FY24E	FY 25E
AUM, £bn	12.2	20.9	22.1	19.2	20.7	22.7
Rev, £m	151.7	201.5	224.1	182.9	178.4	193.8
Management fees, £m	130.8	157.3	210.0	176.2	171.6	184.4
Performance fees, £m	22.3	43.6	14.1	6.7	6.9	9.4
PBT, £m	50.9	75.9	62.1	45.2	48.2	54.3
Core op profit*, £m	41.6	51.5	69.4	47.9	44.1	49.1
Performance fee profit	8.8	19.5	4.1	1.7	3.0	4.1
EPS basic, p	43.5	67.2	50.8	36.8	36.8	40.9
EPS adjusted diluted, p	40.7	62.3	56.0	44.3	38.1	42.0
PER	11.4	7.4	9.7	13.4	13.4	12.1
Div, p	33.0	40.0	46.0	46.0	46.0	46.0
Yield	6.7%	8.1%	9.3%	9.3%	9.3%	9.3%
Net assets, £m	116.1	151.4	156.2	142.9	140.6	142.7
Net cash, £m	107.8	136.7	121.1	107.0	104.2	111.1

Source: Company Historic Data, ED estimates. PER and Yield based on share price of: ***495p***
** excluding performance fees and performance-related costs, other income, exceptional items and tax*
*** Seed inv, securities, fund units held against deferred remuneration, other fin assets & liabilities*

Company Data

EPIC	POLR
Price (last close)	495p
52 weeks Hi/Lo	559p/381p
Market cap	£500m
ED Fair Value/share	625p
Net assets	£143m
Avg. daily volume	172k

Share Price, p

Source: ADVFN

Description

Polar Capital (Polar) is an active fund manager, established in 2001. It has 14 autonomous investment teams managing specialist portfolios with a thematic, sector, geographic, or financial instrument focus, including:

- Global Technology
- Global Healthcare
- Global Insurance
- UK Value
- North America
- Global Convertible
- Emerging Markets & Asia
- Sustainable Equity

AUM 31 Mar 2023: £19.2bn

Next Event: Q1 AUM update, 13 Jul

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

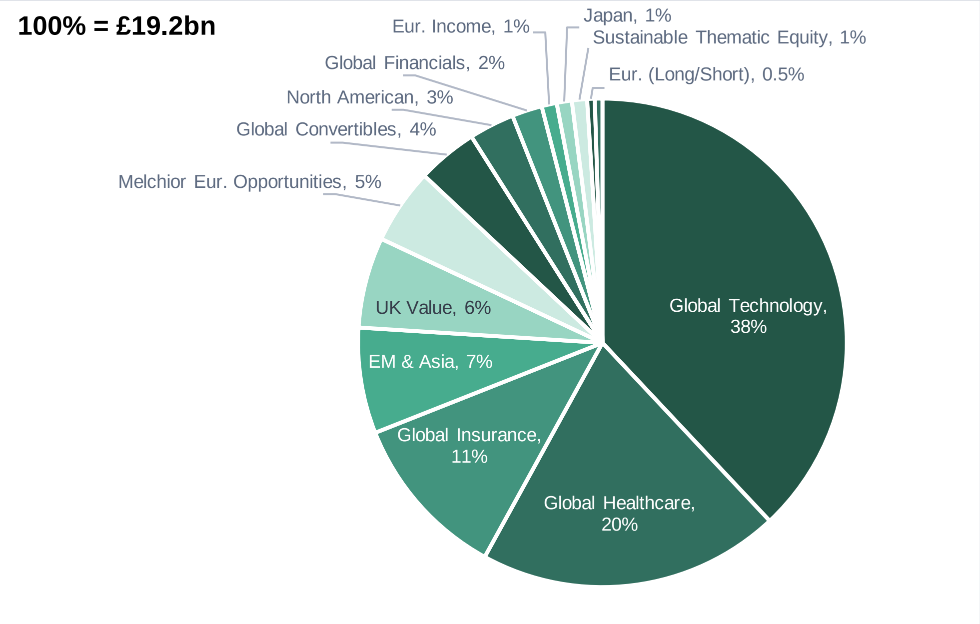
Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

Polar Capital at a glance

Polar is an active fund manager with 14 autonomous investment teams and a presence in 9 countries around the world (UK, USA, Germany, Switzerland, France, Spain, Denmark, China, and Singapore). Teams manage specialist portfolios and operate as semi-autonomous business units, heavily incentivised on investment performance. 'Centralised' operations support these teams, providing back-office services (IT, compliance, administration), centralised dealing, and marketing, distribution, and client services functions.

Technology funds have always been core to Polar although over the years, additional investment strategies have been added as part of a 'growth with diversification' strategy, with technology funds' share of AUM declining from 49% at the end of FY21 to 38% at the end of FY23.

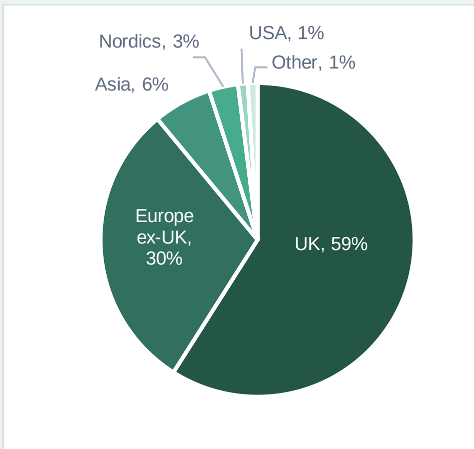
Split in AUM by strategies*



*Source: Company, as at 31 Mar 23. *Strategies with <0.5% of AUM not shown.*

Polar manages investments primarily for institutional clients, mostly based in Europe although it is also successfully diversifying its client base from a geographical perspective (at the end of FY20, UK & European clients accounted for 98% of AUM compared to 89% at the end of FY23).

Split in AUM by client geography and client type



Bank	23%
Polar investment Trusts	20%
Private Wealth Manager	18%
Platform	16%
Asset Manager	10%
Fund of Funds	5%
Pension Fund/Foundation	3%
Other	3%
Family Office	2%
Insurance Company	1%
Consultants	0.5%

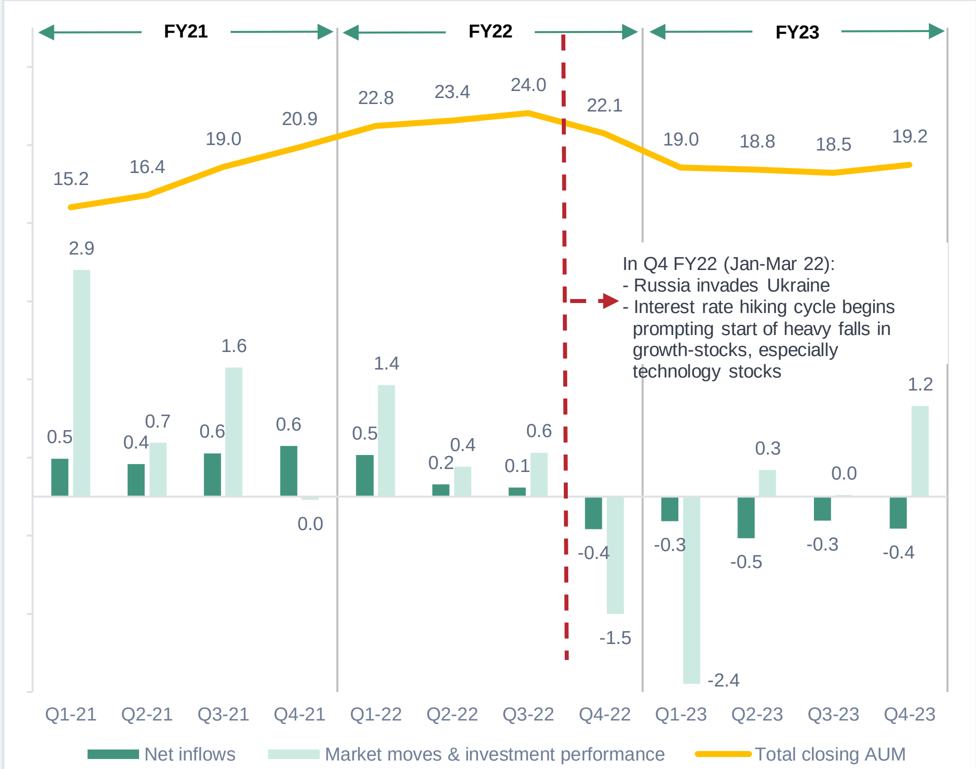
Source: Company, as at 31 Mar 23.

Bear market hits AUM in FY23, signs of green shoots

AUM was hit by multiple headwinds in FY23. Covid-19 disruptions (especially in China in the earlier part of FY23); the war in Ukraine; rising interest rates; and growing inflation; drove a general investment trend away from 'risk-on' growth-oriented equity funds (the bulk of Polar's AUM) towards areas such as government bond funds, defensive sector equity funds, funds investing in precious metals, and cash. There was also an element of investors shunning UK equities amidst heightened political and economic uncertainty.

In the chart below, the effect of these factors can clearly be seen to start impacting Polar's AUM metrics from the Jan-Mar 22 quarter (Q4-22), marking a sharp contrast to the strong performances of FY21 and FY22. Indeed, over FY23, AUM declined 13% from £22.1bn on 31 Mar 22 to £19.2bn on 31 Mar 23, with the decline made up of net outflows of -£1.56bn (FY22: +£0.39bn); market movements and investment performance of -£0.87bn (FY22: +£0.87bn); and -£0.47bn from fund closures (FY22: nil).

AUM movements by quarter FY21 – FY23, £bn



Source: Company, ED analysis

However, Polar's final quarter of FY23 was a strong one, with AUM up by £0.75bn (+4%), driven mostly by an investment performance contribution of +£1.2bn (+6% of opening AUM) as risk-on sentiment returned. Net flows of -£410m were recorded but these were almost all down to profit taking from the Global Insurance fund (-£373m) which delivered significant outperformance during the interest rate hiking cycle. Encouragingly, many strategies reported net inflows during Q4 and the rate of outflows from Technology funds again continued to decline (more detail below).

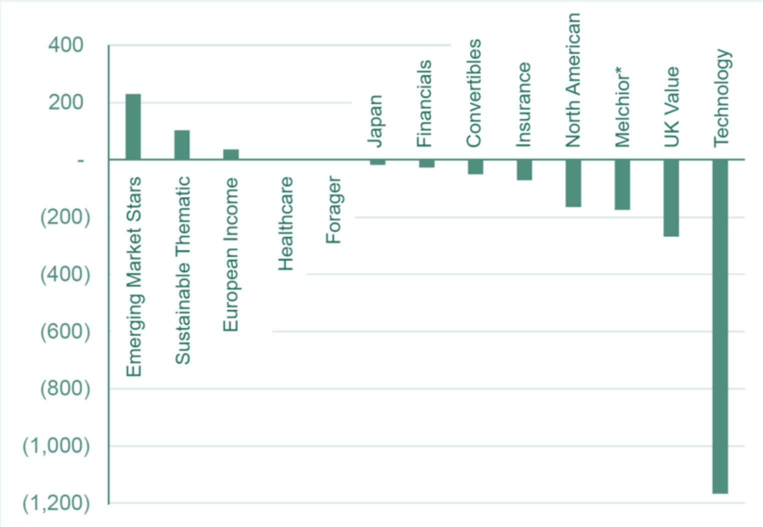
There are also signs of interest picking up in active management more generally, following a bruising 2022 which saw heavy outflows (see pages 8-10 for more detail).

And post year-end, there have been further gains in the key benchmark indices of Polar's largest strategies, especially technology: The Dow Jones Global Technology Index was up c12% between 1 Apr 23 and 23 Jun 23, while the MSCI World Healthcare Index and MSCI Daily TR World Net Insurance Index were both up around 2%.

Net flow picture improves during year, outlook cautiously optimistic

While investor rotation out of technology and UK equities has certainly had the biggest impact on overall FY23 net flows, closer examination reveals a more nuanced picture across the portfolio, and moreover, an improving situation during the year.

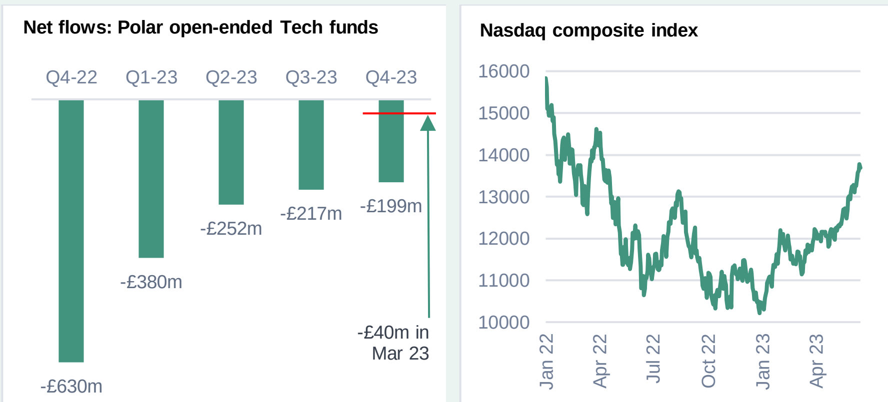
FY-23 net flows by strategy (Apr 22 – Mar 23). £m



Source: Company.
Sustainable Thematic strategies launched in Sep 21.
** Includes MST European Opportunities, MST European Absolute Return and MST Global Equity.*

For Polar's ***technology* strategies,** the year kicked off with investors continuing to rotate out of high-growth technology equities as interest rate rises accumulated (a trend which ramped up in late-FY22, particularly in the Jan-Mar 22 quarter). But this eased during the year, and **in recent months (from around the start of calender-2023), sentiment towards technology equities turned postive, particularly for mega-caps and AI-related stocks**.

Rotation out of tech eases during FY23, positive momentum builds



Source: Company, Nasdaq

In ***healthcare*** (seven strategies making up c20% of AUM), total net flows were neutral, with the Polar Capital Biotechnology Fund and Polar Capital Blue Chip Fund attracting £223m of net flows while the other funds had net outflows of roughly the same quantum.

For ***insurance* strategies** (c 11% of AUM), it was a year of two halves. In H1, investors piled into insurance looking for gains in a sector which is a beneficiary of higher interest rates, and Polar's strategies chalked up inflows of around £250m. Positive flows prevailed at a lower level in Q3 but in Q4 investors took profits from their insurance holdings with outflows from Polar's Global Insurance fund totalling £373m.

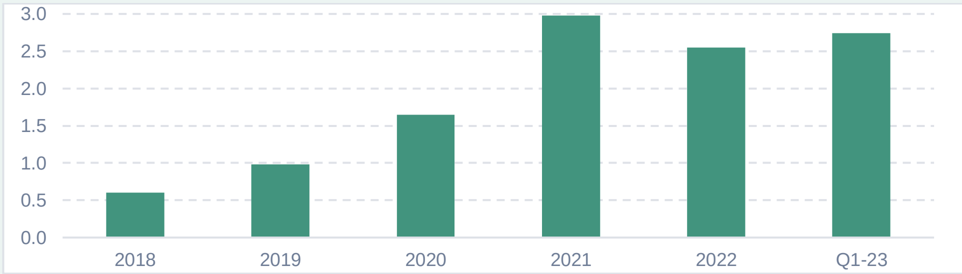
Emerging Market Stars had another strong year with £236m of net inflows as it continues to attract investors (it recorded the highest inflows of all Polar strategies in both FY22 and FY23). Key attractions are its well-defined process around ESG, and it is proving attractive to US investors for diversification purposes away from the US.

Sustainable-Thematic Equities (*Smart Energy* and *Smart Mobility*) also had a very strong year, with inflows of £103 and total AUM reaching around £250m since launching in Sep 21.

We believe EM Stars and Sustainable-Thematic Equities strategies are especially well positioned in a growing and resilient ESG/sustainable investing market[1], which has significant headroom for further growth.

In terms of market growth, the sustainable investment market has expanded rapidly in recent years because of significant capital flows into funds, market appreciation, and many funds being 're-packaged' as 'ESG' or 'sustainable'. Following a dip in assets during 2022 (due to widespread market falls, not negative net flows – see below), Q1-23 saw a return to growth.

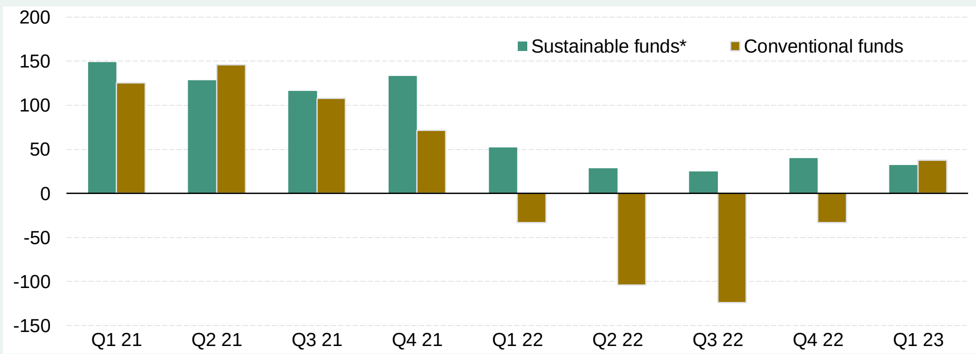
Global Sustainable Fund Assets, US$trn



Source: Morningstar: Global Sustainable Fund Flows: Q1 2023 in Review (and prior reports)

In terms of resilience, in Europe, which makes up around 84% of the global sustainable investing market, flows into sustainable funds were far stronger than those into conventional funds during the turmoil of 2022 and remained positive during every quarter, while conventional funds saw outflows during every quarter. Morningstar wrote: "*sustainability-focused investors—who are typically values-driven and long-term-oriented—are slower to pull money from funds they are invested in*".

European sustainable* and conventional fund flows, US$bn



Source: Morningstar: Global Sustainable Fund Flows: Q1 2023 in Review (and prior reports)
** Open-end funds & ETFs domiciled in Europe that claim to have a sustainability objective and/or use binding ESG criteria for investment selection. Excludes funds that employ only limited exclusionary screens, such as controversial weapons, tobacco, and thermal coal. Excludes money market funds, feeder funds, and funds of funds.*

And, considering that the market share[2] of sustainable funds In Europe stood at 22% at the end of Q1-23, (up from 18% 6-months prior), **there is ample headroom for further growth**.

[1] All market data in this section taken from Morningstar's *Global Sustainable Fund Flows: Q1 2023 in Review* (and prior reports)
[2] *Using the Morningstar definition of a sustainable fund as noted in the above charts*

The Polar Capital UK Value Opportunities Fund saw outflows of £265m driven by investors allocating away from UK equities, but Polar has reported that **sentiment for UK companies has improved, and that the UK value fund has started to see net inflows**.

Similarly, the Melchior European Opportunities Fund had net outflows of £172m, driven by negative sentiment and asset allocation away from European equities. However, the **Polar Capital European Income ex-UK Fund recorded net inflows** as performance improved and sentiment for European companies improved, with Polar reporting net inflow momentum building towards the end of FY23.

One year investment returns impress on relative basis in difficult markets

Polar has summarised the investment environment during the period below (emphasis added by Equity Development), and we have highlighted key 12-month investment performance metrics by strategy or fund in the table below this commentary.

"During this period, there has been a significant pick-up in the performance of value styles versus growth, and episodes where the outperformance of large companies versus small has been particularly marked. The rapid and sizeable moves in interest rates during calendar year 2022 played a role in style preference, while investor caution goes some way to explaining the strong performance of large capitalisation companies.

Polar Capital's strategies are reasonably evenly distributed in terms of directional sensitivity (i.e. whether they outperform on up days or down days in the market), and there is also representation in both value and growth styles, although a greater percentage of AuM is in growth styles. ***Many Polar Capital strategies generate outperformance on days when smaller companies outperform larger ones****.*

This is expected, given the bottom-up research orientation of Polar Capital's investment teams, and the likelihood therefore of finding the most attractive opportunities in the less well researched areas of the market. It is also in part a response to passive competition; clients want us to do something other than own the largest names in the investment universe*.*

Nevertheless, this has been a headwind for the performance for Polar Capital's Technology and North America strategies in the past year, due to the extended period of outperformance of the world's largest companies. Further, in down markets, investors often retreat to the perceived safety and resilience of larger companies."

One-year performance against benchmark (to 31 Mar 23)

Underperformers

- Global Technology Fund underperformed by 450bps
- North America Fund underperformed by 120bps
- MST European Opportunities strategy underperformed by 830 bps (suffering from the dominance of larger names and oil co's in Europe)
- Emerging Market and Asia Stars strategies marginally behind benchmark (gained ground during H2 as headwind from higher energy prices abated)
- UK Value strategy underperformed (UK market performance dominated by large oil and mining companies, which Polar has little exposure to, typically finding value further down the market cap scale – Polar highlights rock-bottom valuations in this part of the market are beginning to attract investors, and long term potential is significant)
- Closed-ended Financials funds slightly behind benchmark

Outperformers

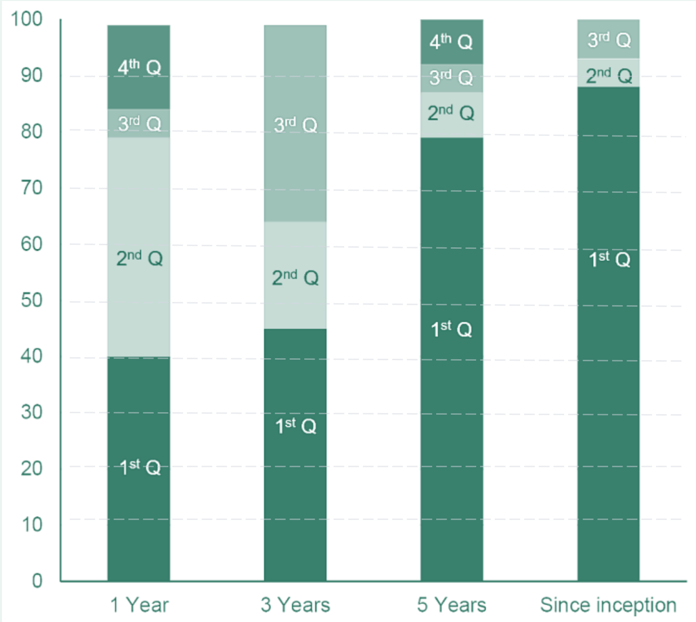
- European ex-UK Income Fund outperformed by 610 bps (benefited by value-orientation)
- Japan Value Fund outperformed by 1100bps (benefited by value-orientation)
- Global Insurance Fund outperformed by over 500bps (benefited by increasing short term interest rates - companies reinvest their 'float' at higher yields)
- Healthcare Opportunities Fund outperformed by 280bps
- Biotechnology Fund outperformend by 200bps
- Healthcare Discovery Fund (small and mid-cap) outperformed by 400bps
- China strategy outperformed by 610 bps
- Smart Energy Fund outperformed by 1070bps
- Smart Mobility Fund outperformed by 880bps
- Global Convertibles strategy outperformed by 110bps
- Open-ended financials funds slightly ahead of benchmark

Source: Company

Substantial longer-term investment outperformance

But looking beyond the short-term, Polar has a hugely impressive track record of delivering outstanding investment returns compared to peers. When measured **since fund inception, 93% of UCITS AUM (approximately 73% of total Polar AUM) had performed in the top two quartiles compared to a Lipper[3] peer group (88% in the first quartile)** with 87% in the top two quartiles over five years, 65% over three years, and **79% over one year.**

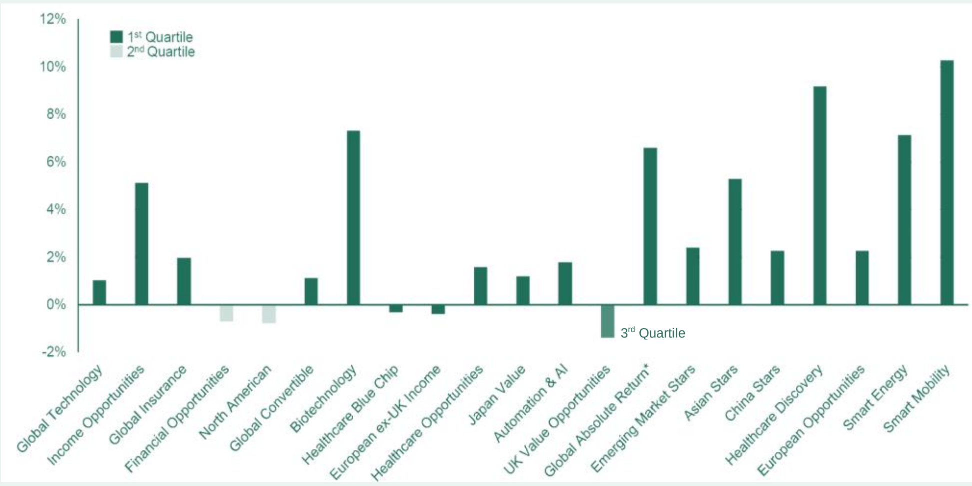
Proportion of UCITS AUM* by quartile (Q) compared to peer group



Source: Company, as at 31 Mar 23. **c73% of total Polar AUM. SI = Since Inception*

At an investment fund level, **18 out of 21 UCITS strategies have delivered 1st quartile returns since inception, with 2 delivering 2nd quartile returns and one in the third quartile.** This breakdown is shown below, which is a split of the far-right bar in the chart above (SI) by investment fund.

Annualised fund performance against benchmark (since inception)



Source: Company, Original source: Lipper.
Lipper quartile rankings as at 31 March 2023.
*UCITS performance illustrative of Polar CapitalFunds plc Irish UCITS and Melchior Selected Trust European Opportunities Luxembourg SICAV fund. Geometric performance shown for all periods greater than 1yr. *The Global Absolute Return Fund does not have a benchmark, therefore figures shown reflect absolute performance. Funds ordered according to Polar Capital launch date. All data is based on the Fund's base currency.*

[3] *Lipper provides performance data for homogeneous groups of funds with comparable investment objectives: lipperleaders.com*

Positioned to capitalise on ‘active’ bounce-back

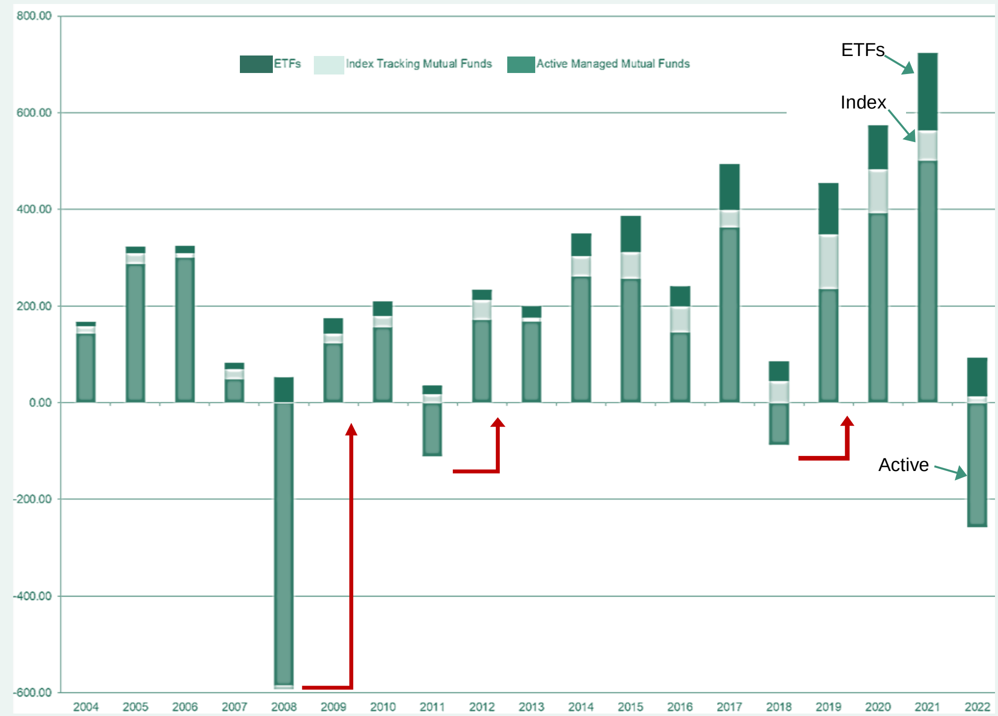
In addition to the investment-strategy-specific points outlined above, we believe it is also important for investors to understand the historical trends and outlook for actively managed funds more generally.

And while there certainly is an element of cyclicality in the active management space (which has worked against Polar over the last year or so but which could soon work in Polar’s favour); over the longer term, the case for active management is still very solid and **there should be ample growth opportunities for high-performing managers.**

The bear market of 2022 took a heavier toll on active funds compared to passive funds or ETFs, with active funds experiencing heavy outlows.

We do not downplay the impact of this but we highlight that historically**, flows out of active funds tend to be more severe during market downturns, and that flows tend to quickly bounce back and revert to the positive longer-term trend**. This can be clearly seen in the chart below with flow recoveries after: 2008 (financial crisis), 2011 (sovereign debt crisis), and 2018 (multiple factors) – highlighted in red.

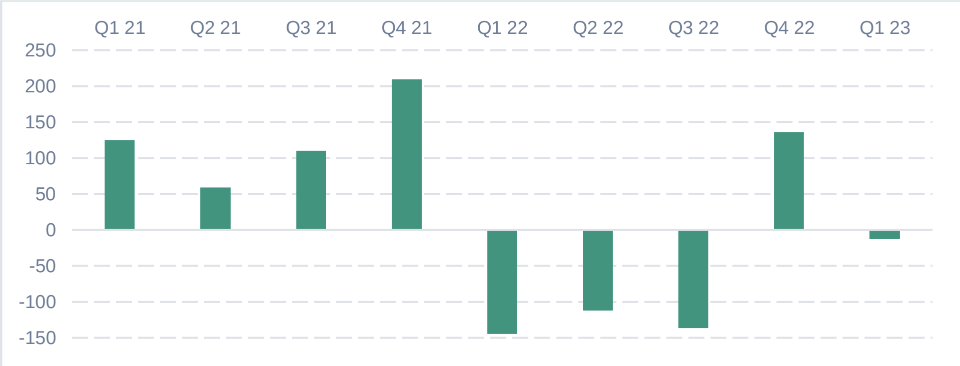
Annual estimated European net fund flows, €bn



Source: Refinitiv Lipper: European Fund Market Trends: 2022. Chart reproduced with permission

Indeed, there are already **some early signs of a recovery in flows into active funds**, with positive flows in Q4-22 and very small outflows in Q1-23, although we caution that market and economic conditions remain uncertain and it would be premature to say active funds have returned to an environment of positive flows.

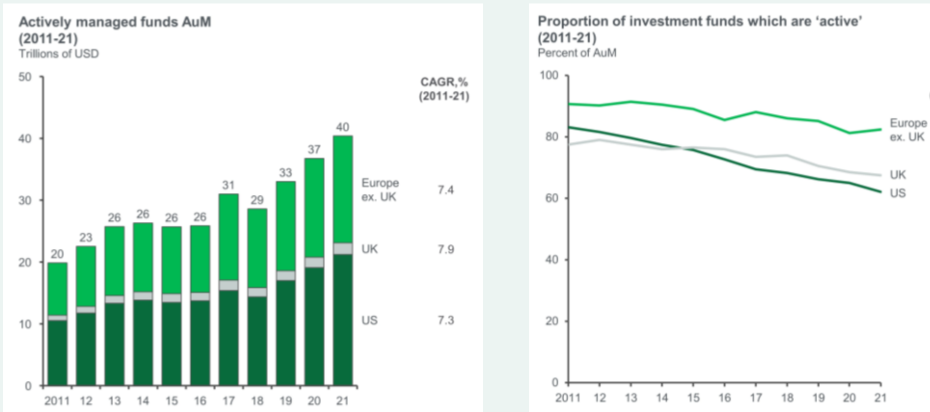
Quarterly estimated European net fund flows (active funds), €bn



Source: Refinitiv Lipper: European Fund Market Review Q1 2023 (and previous reports), ED analysis

Turning to the longer term outlook for active managers, a point we would stress is that while a 'shift to passive' has tended to capture many headlines, **active funds still make up the bulk of the funds industry (by far) and are still in a longer term growth trend**, even though passive funds have captured market share (mostly in the US and UK, less so in Europe ex-UK).

Active funds growth and market share



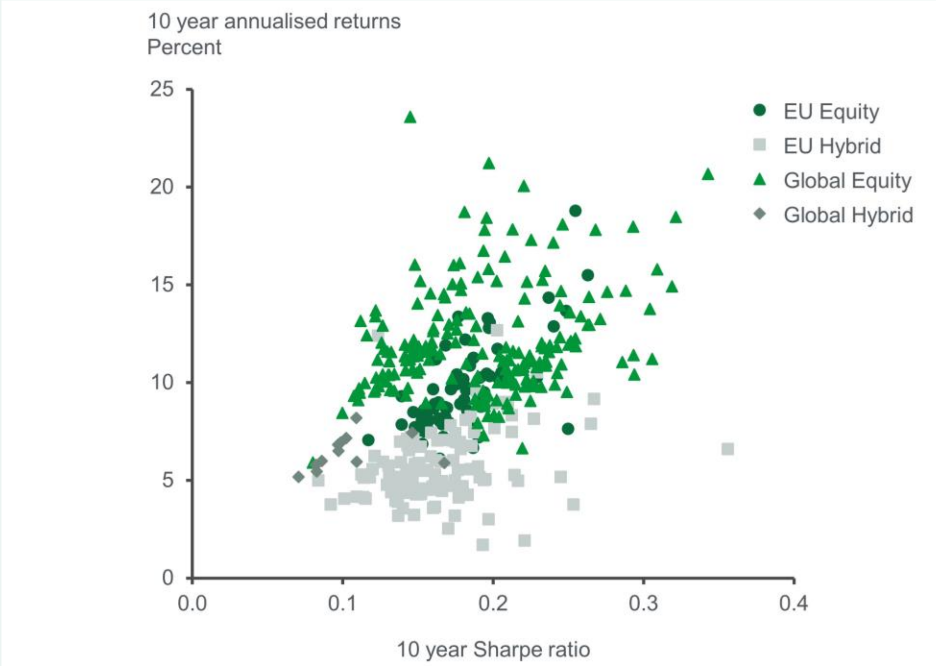
Source: L.E.K. Consulting, charts reproduced with permission. Data from ICI, Refinitiv Eikon, The Investment Association

We remain bullish on the prospects for high-performing active managers, as asset owners (Polar Capital's clients) will continue to seek market outperformance. And we believe Polar's highly specialist investment teams are ideally situated to meet this market need. There is no doubt that the most sophisticated clients are fully aware that there are cohorts of active managers which consistently outperform the market and will look to allocate capital to these managers.

In fact, a recent study conducted by L.E.K. consulting (reported on in the article '*Active funds are here to stay*'), found that: "*…**there is a cadre of active fund managers who are able to consistently generate alpha by focusing on niche strategies**. The chart below identifies about c.700 EU-domiciled funds which have remained consistently in the top-decile over a 10-, 5-year and 3-year period. A similar number exists in the US as well*." (emphasis added by Equity Development)

The chart plots returns versus Sharpe ratio for the top quartile cohort of European funds referred to above (Sharpe ratio measures risk-adjusted relative returns - it compares a fund's returns relative to a benchmark with the variability of returns). And it should be clear that specialist equity funds (data points in green), mostly produce higher returns than more generalised hybrid funds (data points in grey) for similar degrees of risk (there are significantly more green funds with Sharpe ratios above 0.2 than grey funds).

Consistently top quartile* European funds**



Source: L.E.K. consulting, chart reproduced with permission
**Top quartile risk-adjusted returns performance over the last three- five- and ten-year periods (as at Nov 22)*
***Domiciled in either Ireland or Luxembourg*

Polar, with its impressive track record of delivering superior returns across its multiple niches, is in our view very likely to capture at least its fair share of asset owners' capital relative to its size.

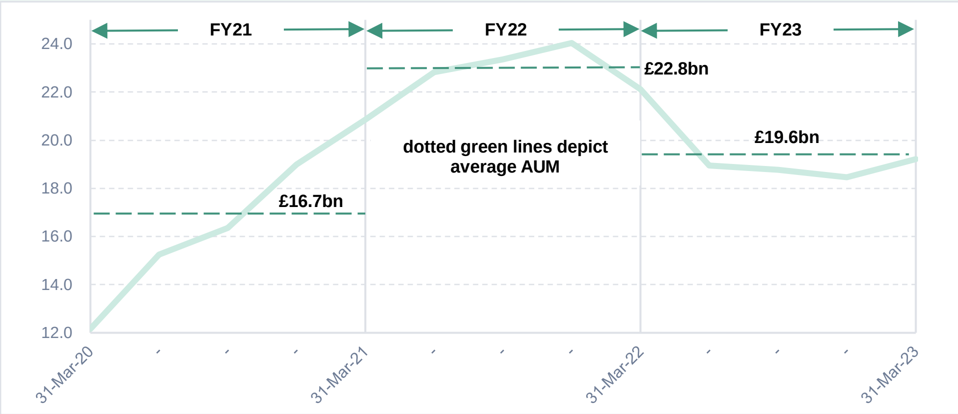
FY23 financial results

Average AUM falls, depressing revenue

Because average AUM is the main driver of Polar's largest source of revenue, *investment management and research fees* (IM fees), it is useful to have an understanding of AUM development and AUM averages for the period under review and for comparative periods. This is presented in the chart below. [Note that product mix and fee margins also impact IM fees to a degree, but not to the same extent as average AUM.]

It should be apparent that Polar's rapid growth up until the end of calender-2021 resulted in a sharp jump in average AUM between FY21 (£16.7bn) and FY22 (£22.8bn), and that the market falls and weak investor sentiment of calender-2022 subsequently depressed average AUM by in FY23 (by 14% to £19.6bn).

AUM profile last three years, £bn

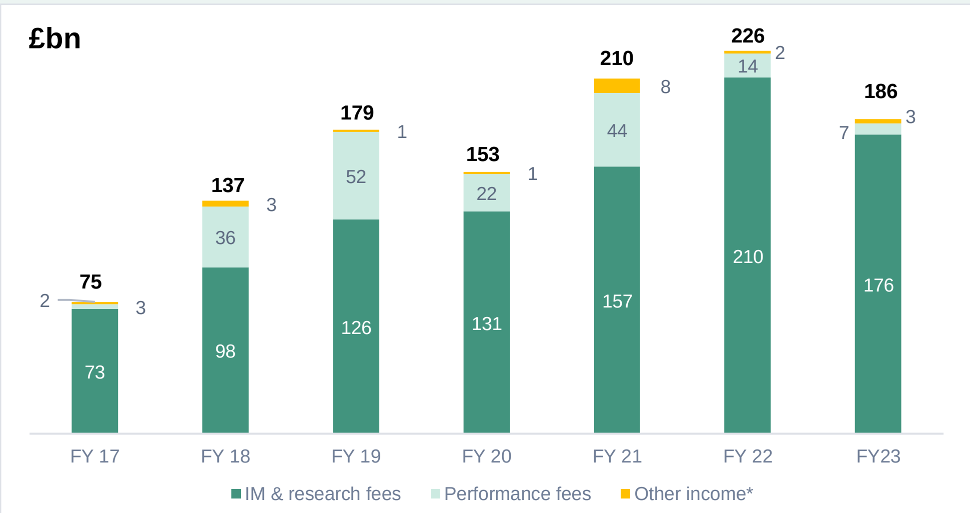


Source: Company, ED analysis

As such, IM fees fell 16% from £209.9m in FY22 to £176.2m (but still remained 12% higher than FY21). Performance fees, which are more volatile, fell from £14.1m to £6.7m, while 'other income' (mark-to-market gains or losses on the value of seed investments and interest income) increased from £1.6m to £2.6m.

Overall, this translated to a **gross income of £185.5, down 18% from £225.7m in FY22.** Net income (gross income less commissions and fees payable), fell 19% from £203.0m to £164.1m.

Gross income breakdown over time

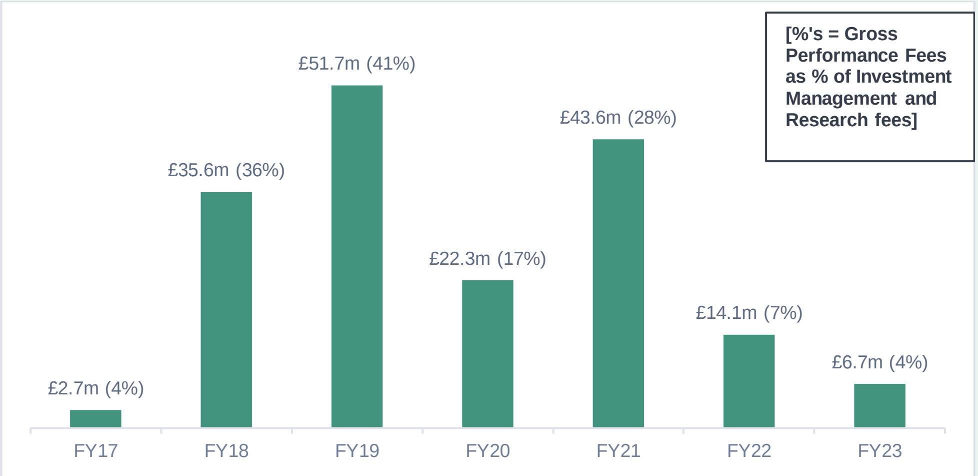


Source: Company reports, ED analysis
**Other income = interest income; gains/losses on seed capital investments, financial assets and liabilities; gains/losses on forward currency contracts; and investment income.*

Net management fee yield (investment management fees less rebates and commissions payable as a proportion of average AUM) reduced a little more than expected from 82bps to 79bps as a result of a changing product mix – more specifically that net outflows from higher margin Technology and Healthcare strategies were replaced by early stage net inflows into more recently launched strategies with lower margins.

While gross performance fees (before deduction of performance fee expenses (primarily fund managers' 'profit share') of £6.7m is significantly less than historical comparators, it is important to stress again that performance fees are by nature 'lumpy' income, and are typically depressed in weak markets and elevated in stronger markets, as illustrated in the chart below. While not a source of predictable income in any single year, looking forward, we would absolutely expect average performance fees over a multi-year period to be significantly higher than FY23 levels.

Gross performance fees



Source: Company reports, ED analysis

Core profits fall with AUM, but lower core costs cushion impact on margin

Core operating profit - *profit before performance fee profits, other income, exceptional items and tax –* which presents a measure of the Group's profitability excluding investment-performance-related profits and other components which may be volatile, non-recurring or non-cash in nature (therefore it is mostly a function of growth and operating efficiency) **fell 31% y-o-y from £69.4m to £47.9m.**

This was mostly as a result of lower IM fees which was driven by lower average AUM (net core income decreased 17% from £187.3m to £154.8m) and costs not reducing at the same rate as revenue.

Core operating costs fell 9% from £117.9m to £106.7m [these costs are made up of core distributions (variable compensation payable to investment teams from management fee revenue) and other core operating costs (other staff costs, office and administrative costs etc – see below)].

This resulted in **core operating margin falling to a lesser degree than average AUM or revenue from 37.1% to 31.0%**

Variable cost structures, cost control limit operational cost increase

With a significant part of Polar's costs being variable (variable compensation of investment teams related to the growth and profitability of each team's investment strategy), by implementing strict cost control, and as a result of lower exceptional charges, **Polar's IFRS operating costs reduced by 16%, from £140.9m in FY22 to £118.9m in FY23**, with further detail of y-o-y changes shown in the table overleaf:

Breakdown of operating costs with y-o-y comparison

	FY23	FY22	% change
Staff compensation costs			
Salaries, bonuses & other staff costs[1]	36.1	36.7	-2%
Core distributions	44.0	54.0	-19%
Share-based payments[2]	2.7	5.7	-53%
Performance fee interests	5.0	10.0	-50%
Total	**87.8**	**106.4**	**-17%**
Other operating costs			
IT	7.0	7.4	-5%
Rent & rates	3.2	3.0	7%
Professional fees	2.6	2.4	8%
Research & Corporate access	4.3	3.7	16%
Travel & entertainment	2.2	1.2	83%
Other	5.6	5.4	4%
Total	**24.9**	**23.1**	**8%**
Exceptional items			
Termination & reorganisation costs[3]	5.0	3.5	43%
Amortisation of intangibles - Dalton	1.2	1.9	-37%
Impairment of intangibles - Phaeacian	-	6.0	-100%
Total	**6.2**	**11.4**	**-46%**
Total operating costs	**118.9**	**140.9**	**-16%**

Source: Company
1. Including share awards under deferment plan of £0.8m (2022: £0.9m)
2. Share-based payments on preference shares of £0.3m (2022: £1.1m), LTIPs of £1.8m (2022: £3.8m) and equity incentive plan of £0.6m (2022: £0.7m).
3.In May 2023, the Group's legal action against First Pacific Advisors (FPA), the vendor of the funds in the Phaeacian transaction, and FPA's counterclaim was settled out of court. All such associated legal costs are included in termination and reorganisation costs. A further £0.6m has been recorded at 31 March 2023 for costs related to the closure of the Phaeacian entities, and £0.3m for the closure of subscale Dalton funds

IFRS profits and per share profit metrics

The results of the revenue and cost moves described above result in profit before tax reducing 27% from £62.1m to £45.2m and profit after tax also reducing 27% from £48.9m to £35.6m.

Basic EPS decreased by 28% to 36.8p (FY22: 50.8p), diluted basic EPS by 26% to 36.1 (FY22: 48.7p), while adjusted diluted core EPS fell 26% y-o-y to 39.7p (FY22: 53.8p).

Strong balance sheet and cash position

Despite FY23 being a tough year from a markets and growth perspective, Polar maintains its exceptionally strong balance sheet, with net assets of £142.9m (down 9% y-o-y from £156.2m). Cash and equivalents were £107.0m (down 12% y-o-y from £121.1m), with significant items being the £44.5m paid in dividends during the year, a £16.8m net cash inflow from third party subscriptions into and out of consolidated funds, a £11.7m net negative cashflow from the deconsolidation of seed investments, and £10.7m spent purchasing own shares. **Polar has no borrowings.**

On 31 Mar 23 £44.1m of the Group's balance sheet (FY22 £48.3m) was invested to seed fledgling funds.

The Group produces a 'surplus capital' report which takes account of capital commitments and minimum levels of regulatory capital to illustrate the capital available to pursue growth opportunities, such as seeding new investment products or acquisitions. This **surplus capital amounted to £57.7.m** (FY22: £69.7m) above its regulatory capital requirement of £26m (FY22: £26m) and Jul 23 dividend commitment of £30.9m.

Surplus capital calculation

Regulatory Capital	Year to Mar-23 £m	Year to Mar-22 £m
Capital after regulatory deductions	**114.7**	**126.7**
Less: dividend provision	-31.0	-31.0
	83.7	**95.7**
Regulatory capital	-26.0	-26.0
Surplus capital	**57.7**	**69.7**

Source: Company

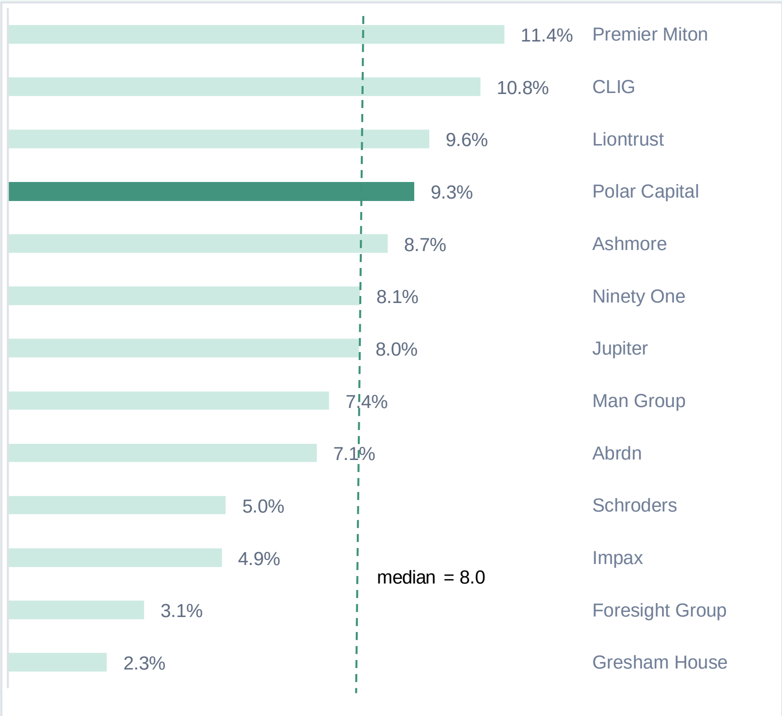
Dividend unchanged with a yield of 9.3%

Total dividends for the year have remained unchanged at 46.0p, although it is worth noting that dividends have grown at a CAGR of 10% over the last five years.

The Group's dividend policy is to pay an annual dividend within a range of 55% and 85% of adjusted total earnings, dependent on the scale of performance fees in the relevant year and the anticipated trading conditions for the following year. Keeping the dividend unchanged in FY23 has resulted in this payout ratio being exceeded (102% payout ratio in FY23, 79% in FY22), but the **strength of the group's balance sheet** and Board confidence in Polar's prospects have made an unchanged dividend possible.

As at 23 Jun 23, the FY23 dividend translated to an **extremely attractive dividend yield of 9.3%** (the fourth highest among a 13-strong London-listed asset manager peer group).

Dividend yield: UK-listed asset & wealth managers and platforms



Source: ADVFN, ED analysis. Data as at 23 June 2023

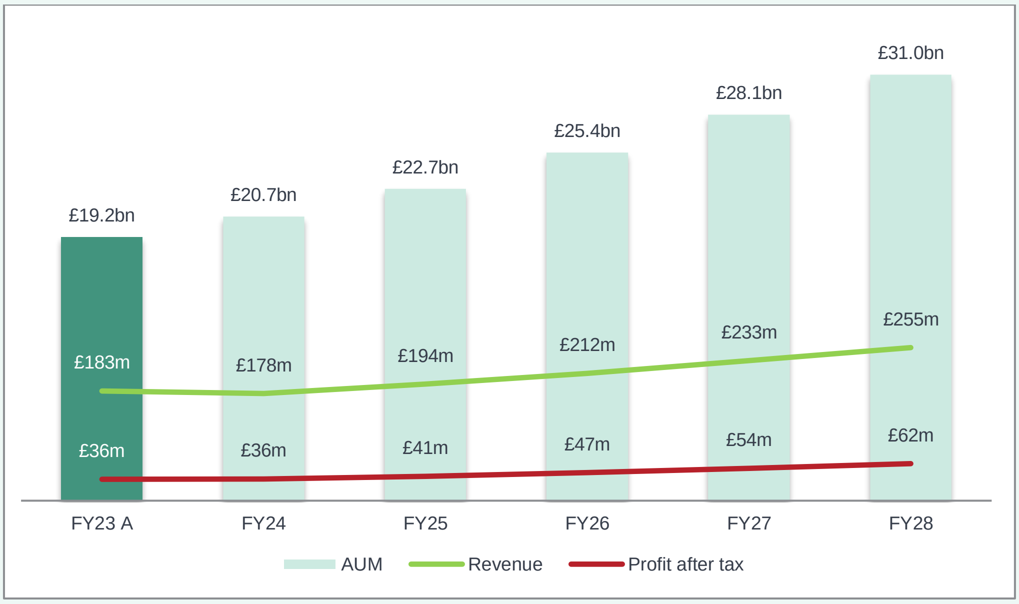
Valuation: fundamental and peer comparison

For our fundamental valuation, we have used a discounted cashflow methodology with the following main assumptions:

- Polar returns to positive inflows in FY24 (around £500m), which we believe is reasonable given the positive flows of many strategies in FY23, the return of investors' interest in the technology sector, and the early signs of a recovery in investor interest in actively managed funds.
- Net inflows then build over the following years to around £1.5bn per year (we remind readers that Polar recorded just over £2bn of infows in FY21 and just under £2bn in FY18).
- AUM gains from market movements and investment performance average 5% per year.
- Polar's investment management fee experiences some gradual erosion each year.
- Performance fees average aound 5% of IM fees (lower in FY24 due to current weak market conditions), which looks highly conservative given that over the last eight years, the average of this ratio has been 18%.
- Core operating margin falls to around 29% in FY24 (as average AUM will be depressed by the lower opening AUM level due to the falls in FY23) and then gradually increases to around 35% in five years.
- A terminal value based on the business being acquired in year five at a PE multiple of 15 (which we believe is conservative – see further commentary below).

The combined effect of the above assumptions is summarised in the chart below.

Forecast key metrics



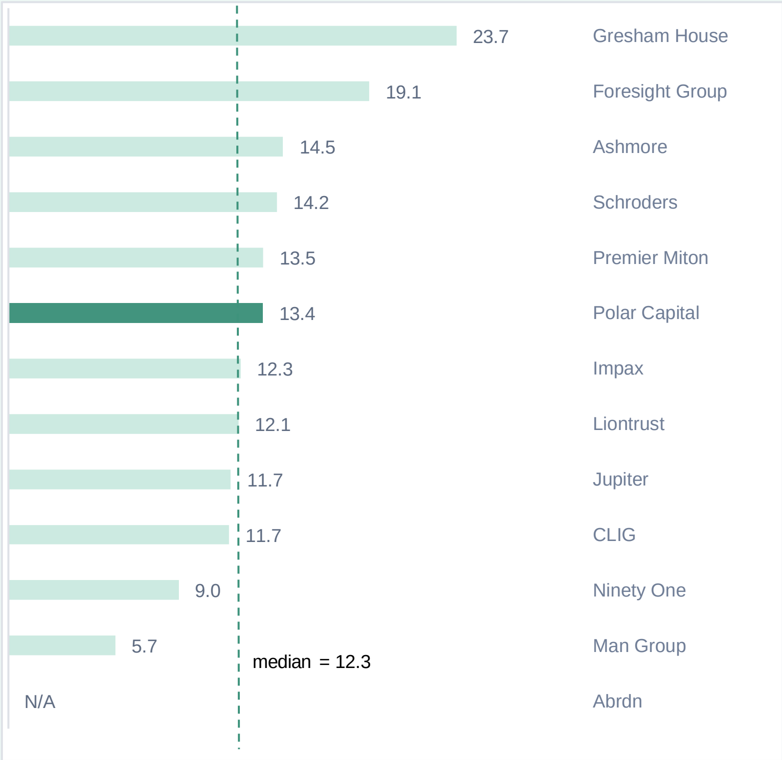
Source: Company Historic Data, ED Estimates
The dip in profit between FY23 and FY24 is impacted by the increase in UK corporation tax rate from 19% to 25% (from Apr 23).

Our DCF results in a fundamental valuation of 625p, 26% above the current share price of 495p.

We have also compared the relative valuation of Polar to other UK-listed asset managers (see chart overleaf), and highlight that Polar's PER is within a cluster of asset managers' PERs in the 12-15 range. We also highlight that asset managers' PERs have fallen quite dramatically since the end of the bull market in early-2022. In January 2022, we recorded an asset manager peer group median PER of 31.3 (now just 12.3). **We suspect that asset managers' PERs may recover quite sharply should markets stage a recovery**.

We see potential for a significant re-rating.

PE Ratios: UK-listed asset managers



Source: ADVFN, company reports, ED analysis, as of 23 June 2023

Historical and forecast financials

Consolidated Income Statement + Forecasts					
12 months to end Mar, £'m	**FY21A**	**FY 22A**	**FY 23A**	**FY 24E**	**FY 25E**
Revenue	201.5	224.1	182.9	178.4	193.8
Other Income	8.3	1.6	2.6	1.4	1.4
Gross Income	**209.8**	**225.7**	**185.5**	**179.8**	**195.2**
Commissions and fees payable	(15.4)	(22.6)	(21.4)	(18.5)	(19.9)
Net Income	194.4	203.0	164.1	161.3	175.3
Operating Costs	(118.5)	(140.9)	(118.7)	(112.9)	(120.8)
Profit for the year before tax	**75.9**	**62.1**	**45.2**	**48.2**	**54.3**
Taxation	(13.2)	(13.2)	(9.6)	(12.1)	(13.6)
Profit attributable to ordinary shareholders	**62.7**	**48.9**	**35.6**	**36.2**	**40.7**
Adjusted Profit, £'000					
The Group believes that aligning staff remuneration and profits generated in the same period will allow users of the financial statements to gain a better understanding of the Group's results and their comparability year on year.					
(post tax)					
Add ex. items, acquisition related costs	1.9	2.9	5.0	-	-
Add ex. items, amort. of intangible assets	0.4	1.9	1.2	-	-
Add ex. items, impairment of intangible assets		6.0	-	-	-
Add back cost of share-based pmts on prefs	(0.3)	1.1	0.3	0.3	0.3
Add back ex. items - FV charge on def cons on acq.		*(3.7)*	-	-	-
Less net amount of deferred staff rem	(3.7)	(0.8)	1.7	1.7	1.7
Adjusted Profit After Tax	**61.0**	**56.2**	**43.7**	**38.2**	**42.7**
Earnings per share, p					
Basic	67.2	50.8	36.8	36.8	40.9
Diluted	64.0	48.7	36.1	36.1	40.1
Adjusted basic	65.3	58.4	45.2	38.9	42.9
Adjusted diluted	62.3	56.0	44.3	38.1	42.0
Core operating profit (non-GAAP), £m					
Profit before performance fee profits, other income and tax. This presents a clear view of what the Group considers to be the results of its underlying operations before items which may either be volatile, non-recurring or non-cash in nature, and taxation.					
Management fees	157.4	210.0	176.2	171.6	184.4
Commissions and fees payable	(15.4)	(22.6)	(21.4)	(18.5)	(19.9)
Net management fees	142.0	187.3	154.8	153.0	164.5
Profit/(loss) on foreign currency contracts	0.6	-	-	-	-
Core operating costs	(91.1)	(117.9)	(106.7)	(108.7)	(115.2)
Finance costs			(0.2)	(0.2)	(0.2)
Core operating profits (before tax)	**51.5**	**69.4**	**47.9**	**44.1**	**49.1**

Source: Company Historic Data, ED estimates.

Consolidated Balance Sheet + Forecasts

As at end Mar, £'m	FY21A	FY 22A	FY 23A	FY 24E	FY 25E
Non-current assets					
Goodwill and intangible assets	25.0	17.1	15.9	14.8	13.6
Property & equipment	5.1	4.1	10.5	11.0	11.2
Deferred tax assets	5.8	3.5	0.1	0.1	0.1
	35.9	**24.7**	**26.6**	**25.9**	**24.9**
Current assets					
Assets at fair value through P&L	57.2	77.8	83.0	83.0	83.0
Trade & other receivables	23.9	25.4	19.5	19.0	20.7
Other financial assets	0.1	2.7	5.2	5.2	5.2
Cash & cash equivalents	136.7	121.1	107.0	104.2	111.1
Current tax assets	2.0	1.6	0.3	0.3	0.3
	219.8	**228.6**	**215.1**	**211.9**	**220.4**
Total assets	**255.7**	**253.3**	**241.7**	**237.8**	**245.6**
Non-current liabilities					
Provisions & other liabilities	4.1	2.9	8.9	8.9	8.9
Liabilities at fair value through P&L	4.3	0.6	0.5	0.5	0.5
Deferred tax liabilities	4.1	3.4	0.5	0.5	0.5
	12.5	**6.9**	**9.9**	**9.9**	**9.9**
Current liabilities					
Liabilities at fair value through P&L	16.1	10.0	16.4	16.4	16.4
Trade & other payables	71.6	80.1	68.7	67.0	72.8
Provisions			3.2	3.2	3.2
Other financial liabilities	4.1	0.0	0.0	0.0	0.0
Current tax liabilities	-	-	0.7	0.7	0.7
	91.8	**90.1**	**88.9**	**87.3**	**93.1**
Total liabilities	**104.3**	**97.0**	**98.8**	**97.2**	**102.9**
NET ASSETS	**151.4**	**156.2**	**142.9**	**140.6**	**142.7**
Capital & Reserves					
Issued share capital	2.5	2.5	2.5	2.5	2.5
Share premium	19.4	19.4	19.4	19.4	19.4
Investment in own shares	(26.6)	(24.9)	(31.6)	(31.6)	(31.6)
Capital & other reserves	11.0	12.4	12.3	12.3	12.3
Retained Earnings	145.2	146.9	140.3	138.1	140.1
TOTAL EQUITY	**151.4**	**156.2**	**142.9**	**140.6**	**142.7**

Source: Company Historic Data, ED estimates

Consolidated Cash Flow Statement + Forecasts (page 1 of 2)					
12 months to end Mar, £'m	**FY21A**	**FY 22A**	**FY 23A**	**FY 24E**	**FY 24E**
OPERATING ACTIVITIES					
Profit before taxation	**75.9**	**62.1**	**45.2**	**48.2**	**54.3**
Interest receivable and similar income	(0.1)	(0.1)	(0.7)	(0.9)	(0.9)
Investment income	(0.2)	(0.2)	(0.6)	(0.5)	(0.5)
Interest on lease	0.1	0.1	0.2	0.2	0.2
Depreciation on property & equipment	1.4	1.4	2.2	1.5	1.5
Revaluation of liability at FVTPL	(0.4)	-	-	-	-
Amortisation & impairment of intantible assets	0.4	7.9	1.2	1.2	1.2
Decr/(Incr) in fair value of inv securities	-	-	-	-	-
Decr/(incr) in fair value of assets at FVTPL	(14.3)	7.7	(4.2)	-	-
(Decr)/incr in other financial liabilities	5.1	(10.4)	(0.5)	-	-
incr in other financial assets	-	-	-	-	-
Decr/(incr) in receivables	(9.1)	(1.5)	5.9	0.5	(1.6)
(Decr)/incr in trade and other payables	26.5	8.4	(8.7)	(1.7)	5.8
Decr in provisions and other liabilities	-	-	-	-	-
Share-based payment charges	5.6	7.4	4.4	6.3	6.7
Incr/(decr) in liabilities at FVTPL	(6.1)	(3.9)	0.3	-	-
Release of fund units deferred rem	5.6	6.5	7.4	-	-
Other non-cash items	0.4	-	-	-	-
Cash generated from operations	**90.9**	**85.3**	**52.0**	**54.8**	**66.6**
Corporation tax paid	(13.6)	(10.9)	(7.7)	(12.1)	(13.6)
Interest on lease	(0.1)	(0.1)	-	-	-
Interest received			0.9	0.9	0.9
Net cash from operating activities	**77.1**	**74.4**	**45.1**	**43.6**	**53.9**

Source: Company Historic Data, ED estimates.

Consolidated Cash Flow Statement + Forecasts (page 2 of 2)

12 months to end Mar, £'m	FY21A	FY 22A	FY 23A	FY 24E	FY 25E
INVESTING ACTIVITIES					
Interest received	0.1	0.3	-	-	-
Investment income received	0.2	0.2	0.4	0.5	0.5
Sale of investment securities	-	-	-	-	-
Purchase of investment securities	-	-	-	-	-
Sale of assets at FV through P&L	33.3	41.2	55.3	-	-
Purchase of assets at FV through P&L	(45.2)	(70.3)	(62.8)	-	-
Purchase of property and equipment	(0.2)	(0.6)	(0.5)	(0.5)	(0.6)
Cash introduced via business combination	1.1	-	-	-	-
Payments in respect of business combination	(8.5)	(8.1)	-	-	-
Payments in respect of asset acquisition	(0.3)	(1.3)	(0.2)	-	-
Cash from disposal of cons seed inv	(0.3)	-	(11.7)	-	-
Net cash used in investing activities	**(19.8)**	**(38.5)**	**(19.5)**	**(0.0)**	**(0.1)**
FINANCING ACTIVITIES					
Dividends paid to shareholders	(31.9)	(43.4)	(44.5)	(44.7)	(45.4)
Lease payments	(1.3)	(1.3)	(1.4)	(1.4)	(1.4)
Interest on lease			(0.2)	(0.2)	(0.2)
Issue of shares	0.3	0.0	-	-	-
Purchase of own shares	(6.1)	(12.4)	(10.7)	-	-
3rd party subs into cons funds	12.0	9.9	20.7	-	-
3rd party redemptions from cons funds	(1.3)	(4.6)	(3.9)	-	-
Dividends paid to 3rd party interests	-	-	-	-	-
Net cash from /(used in) financing	**(28.3)**	**(51.8)**	**(39.9)**	**(46.3)**	**(47.0)**
Net (decr)/incr in cash & equivalents	**29.0**	**(15.9)**	**(14.3)**	**(2.7)**	**6.8**
Cash & equivalents beginning of year	107.8	136.7	121.1	107.0	104.2
Effect of forex rate changes	(0.1)	0.3	0.1	-	-
Cash & equivalents at end of year	**136.7**	**121.1**	**107.0**	**104.2**	**111.1**

Source: Company Historic Data, ED estimates.

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

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

Equity Development Limited is regulated by the Financial Conduct Authority

Disclaimer

More information is available on our website www.equitydevelopment.co.uk

Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London, EC2M 7EB

Contact: info@equitydevelopment.co.uk | 020 7065 2690