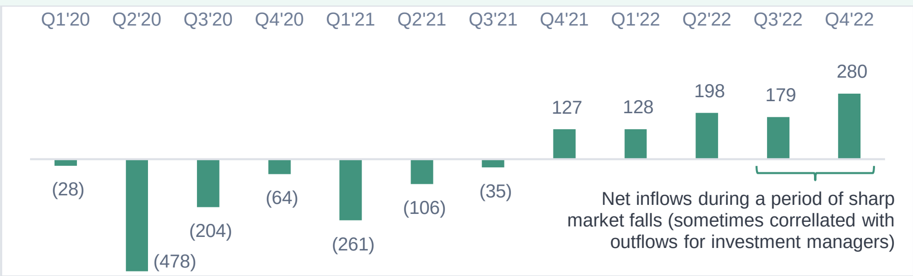
Brooks Macdonald Group plc

Net inflows strengthen again, but market falls reduce FUM

14 July 2022

Two themes jump out at us at the close of FY22 (to 30 Jun 22). First, in the first full FY of CEO Andrew Shepherd's tenure it has been a year of strategic strengthening, characterised by a return to consistent net inflows, following the 'restructuring' years of FY20 and FY21, which suffered net outflows. Most impressive now are the net inflows in Q3 and Q4, periods of sharp market falls, which can coincide with net outflows for investment managers.

FY22 marked a return to consistently positive net flows, £m



Source: Company reports, ED analysis. FY quarters shown (Q1 = Jul-Sep, Q2 = Oct-Dec, Q3= Jan-Mar, Q4= Apr-Jun).

Second, in absolute terms, investment performance saw gains in Q1 and Q2 (+£227m & +£317m), and sharp declines in Q3 and Q4 (-£850m & -£1,271m) as markets fell.

In summary, total FUM fell 4.8% over the year, from £16.5bn on 30 Jun 21 to £15.7bn on 30 Jun 22. Net flows contributed +£785m over the year (+4.8% of opening AUM) while investment performance resulted in a -£1,578m decline in FUM (-9.6% of opening FUM). [See page 2 for more detail]

Forecasts and valuation

Recent market falls have led us to revise our forecasts and valuation slightly downwards. Our FY22 revenue forecast is now £123.5m (previously £125.4m), growth of 4.5% over the £118.2m of FY21, and our underlying PBT* forecast is £31.0m (previously £32.9m), up 1.3% on the £30.6m of FY21.

Our fundamental value reduces from 3,200p per share to 2,900p (also impacted by a slight increase in the discount rate used in our DCF model due to the increase in the 10yr gilt yield). However, with the recent share price fall to 2,160p it stands at a discount to our fundamental value of 34%. With such a strong franchise, evidenced by consistent net inflows in turbulent markets, we think the medium to long term prospects of BM remain very strong and see potential for a re-rating.

Key Financials

Year-end 30 Jun	FY19A	FY20A	FY21A	FY 22E	FY 23E
AUM, £bn	13.2	13.7	16.5	15.7	17.3
Rev, £m	107.3	108.6	118.2	122.2	121.7
Underlying expenses*	86.6	85.6	87.6	88.5	89.1
Underlying PBT*	20.7	23.0	30.6	33.1	31.9
Underlying PBT margin	19.6%	21.2%	25.9%	27.1%	26.2%
Statutory PBT, £m	8.6	10.1	25.1	28.2	27.6
EPS basic, p	41.7	43.2	125.3	140.6	136.7
Underlying diuted EPS**, p	123.5	123.7	155.1	160.4	153.9
PER	51.8	50.0	17.2	15.4	15.8
Div, p	51.0	53.0	63.0	69.0	76.0
Yield	2.4%	2.5%	2.9%	3.2%	3.5%
Net assets, £m	87.6	123.5	134.0	145.9	156.3
Net cash, £m	34.6	50.2	54.9	64.3	79.8

Source: Company Historic Data, ED estimates. PER and Yield based on share price of: ***2,160p***
** 'Underlying' excludes one-off expenses, mostly acquisition-related, & goodwill amortisation, gains & losses. **After tax.*

Company Data

EPIC	BRK
Price (last close)	2160p
52 weeks Hi/Lo	2800p/1970p
Market cap	£350m
ED Fair Value/share	2900p
Net cash	£55m
Avg. daily volume	10.6k

Share Price, p

Source: ADVFN

Brooks Macdonald was founded in 1991 and listed on AIM in 2005.

It provides investment management services to financial advisers and private clients in the UK, and to international clients via its operations in Jersey, Guernsey, and Isle of Man. Its main product offerings include:

- Bespoke Portfolio Services (tailored for individual clients)
- Managed Portfolio Services (risk-profiled 'model' portfolios)
- Funds (mostly multi-asset funds for simpler or smaller portfolios)
- Financial Planning Services
- BM Investment Services (B2B white-labelled investment proposition for IFAs)

FUM at end Jun 2022: £15.7bn

Next Event: 15 Sep 22, FY22 results

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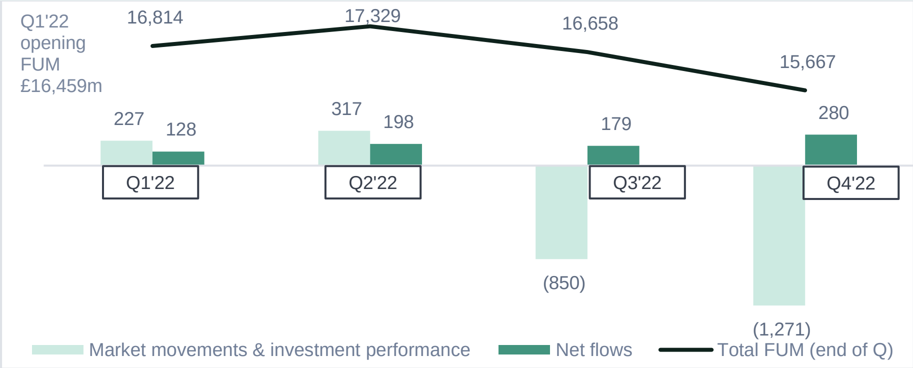
Falling markets in H2 erase net inflow and H1 investment gains

FY22 quarterly investment performance and total FUM, £m



Source: Company reports, ED analysis. FY quarters shown (Q1 = Jul-Sep, Q2 = Oct-Dec, Q3= Jan-Mar, Q4= Apr-Jun).

On a relative basis, BM had a mixed investment performance versus its primary benchmark, the *MSCI PIMFA balanced index*, with a strong Q1 performance (1.4% vs 0.2%), weaker Q2 and Q3 (1.9% vs 3.8% in Q2; -4.9% vs - 2.7% in Q3) and performance roughly in line with the index in Q4 (-7.6% vs -7.4%)

MPS continues to be fund flow growth engine

From a product perspective, BM's flagship Bespoke Portfolio Services, or 'BPS' (55% of FUM) saw annual inflows of £88m in FY22 (0.9% of opening FUM). BPS clients tend to skew towards wealthier market segments (the *High Net Worth* segment with >£750k FUM per client and the *Upper Affluent* segment with FUM per client between £350k and £750k).

Meanwhile, **its fast-growing Managed Portfolio Services, or '**MPS' (19% of FUM) saw annual inflows of £829m (34% of opening FUM). The typical profile of MPS clients tends to be **younger and in the wealth accumulation phase** of their investment life cycle (although these services are to an extent used across the wealth spectrum), and often in the *Upper Affluent* (FUM between £350k and £750k) and *Mass Affluent* (FUM between £30k and £350k) segments.

The stronger MPS growth is very much in line with broad market trends, with research house Platforum reporting that MPS services remained the fastest growing area for UK wealth management assets in 2021, with a recent annual growth rate of 25%. It also reports that its research of wealth managers and financial advisers indicates that this MPS growth is likely to continue: "*Assets are shifting from multi-asset funds and bespoke wealth management portfolios. An awful lot of advised business out there also remains in bespoke advisory portfolios. We'd expect a sizable proportion of this to gradually migrate towards models*."[1]

It is however worth highlighting the strategic relationship between BPS and MPS at BM. **BM is pursuing a deliberate strategy to target this younger client base and sees them as a 'pipeline of future over-55s'**, whose investment pots will grow more rapidly as their careers progress, whose investment needs will become more complex, **and who are likely to migrate to higher-yielding BPS services over time, fuelling future growth**.

BM's funds business (12% of FUM) – mostly risk-rated multi-asset funds which are suitable when needs and risk profiling are not complex and/or the portfolio is small – saw net outflows during FY22 of £113m (5.1% of opening FUM).

And lastly, its international business (14% of FUM) **–** a mix of specialised products and services including BPS, MPS, services for trustees, multi-currency products and specialist funds – saw a small net outflow of £25m or 1.0% of opening FUM).

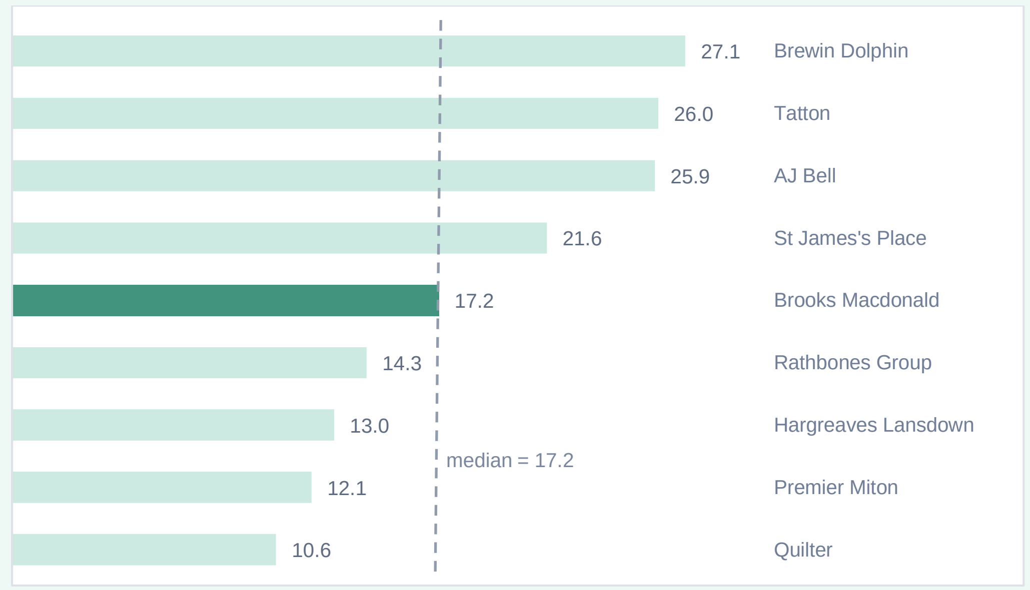
[1] *Platforum, 24 June 2022, Prospects for growth in platform MPS*

Valuation undemanding compared to peers

We also highlight that BM's valuation compared to peers looks undemanding, where it trades at the median peer group PER of 17.2.

Given the strength of its franchise and its ability to continue to attract assets in very challenging market conditions, we think it's PER rating compared to peers can increase.

PE Ratios: UK-listed investment/wealth managers and platforms



Source: ADVFN, as of 13 Jul 2022
Note: Mattioli Woods would normally be included in this peer group but its PER of 135 is severely distorted by 'one-off' expenses depressing statutory earnings in its last financial year – hence it has been omitted.

Scarcity appeal

It is particularly interesting to compare BM's current PER rating to that of competitor Brewin Dolphin in the context of recent M&A activity. When the proposed acquisition of Brewin Dolphin by RBC Wealth Management (Jersey), a wholly owned subsidiary of Royal Bank of Canada, was announced in March 2022, its PER jumped from 16.9 to 27.2, a premium of 62% to its share price the day before the deal was announced.

This suggests large foreign wealth managers are seeing substantial value in the UK wealth management sector.

This view seems to be supported by recent research by McKinsey which highlights a key reason why the economics of Western European wealth managers may make them attractive targets to North American counterparts[2]:

- Between 2007 and 2021, on average, North American wealth managers' revenue margin has reduced from 94bps to 56bps (-40%), while European wealth managers' revenue margin has only reduced from 96bps to 70bps (-27%).
- Over this same period, North American wealth managers' cost-to-income ratio has increased from 71bps to 79bps (+11%), while European wealth managers' cost-to-income ratio has remained static at 68bps.

We wouldn't be surprised to see further cross-border M&A activity in this sector.

[2] McKinsey & Company, Successful M&A in Wealth Management, 5 April 2022

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