

Solid interims. War chest bolstered. Primed to scale.

18 November 2020

Tatton delivered solid interim results for the 6 months period ending 30 September 2020, showing double-digit growth on most key metrics, despite very challenging market conditions. It also announced that it has secured a £30m credit facility to pursue organic and acquisitive growth. That, in addition to its accumulated net cash pile of £13.3m, is a significant 'war chest'. In today's uncertain and volatile economic environment, finding reasonably valued or even under-priced opportunities to deploy some of this capital is a realistic expectation.

Over H1, AUM grew 17.4% to £7.8bn (31 March 2020: £6.7bn) and H1 revenue increased 12.6% year-on-year to £11.0m (prior year £9.7m). Adjusted operating profit grew 21.9% to £5.0m (£4.1m); adjusted fully diluted EPS 21.5% to 6.55p (5.39p); and the adjusted operating margin continued to expand to 45.9% from 42.4% in the previous half-year¹. Tatton ended the period with net cash of £13.3m, 45% up on 30 Sep 2019 (£9.2m). An interim dividend of 3.5p per share has been recommended, raised by 9.4% from 3.2p.

These impressive results were underpinned by Tatton's strong market positioning relative to competitors. It continued to attract AUM at a faster rate than most peers (over 12 months, it has the third highest net-inflow-to-AUM ratio amongst a group of 16 peers) and in a period of enormous uncertainty, continued to grow its client base of IFA firms across all business units. Asset management clients increased from 522 on 30 September 2019 to 624 on 30 September 2020 (+20%). Paradigm Mortgage Services member firms increased from 1,466 to 1,591 (+9%); and Paradigm Consulting member firms from 385 to 404 (+5%).

Tatton's share price of 284p remains below our fundamental valuation of 300p, which we believe is conservative and does not take into account any large, value-enhancing acquisitions. Additionally, its price-earnings ratio of 18.9 is only slightly above a peer group median of 18.2, while being far below its highest rated peers which have PE ratios in the 40s and 50s. If Tatton continues to build scale, enhance its margins, and successfully execute further acquisitions, there is potential for further significant re-rating of its share price.

Company Data

EPIC	TAM
Price (last close)	284p
52 weeks Hi/Lo	312p/170p
Market cap	£164m
ED Fair Value / share	300p
Proforma net cash	£13.3m

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 Sep 2020 was £7.8bn.

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Key Financials

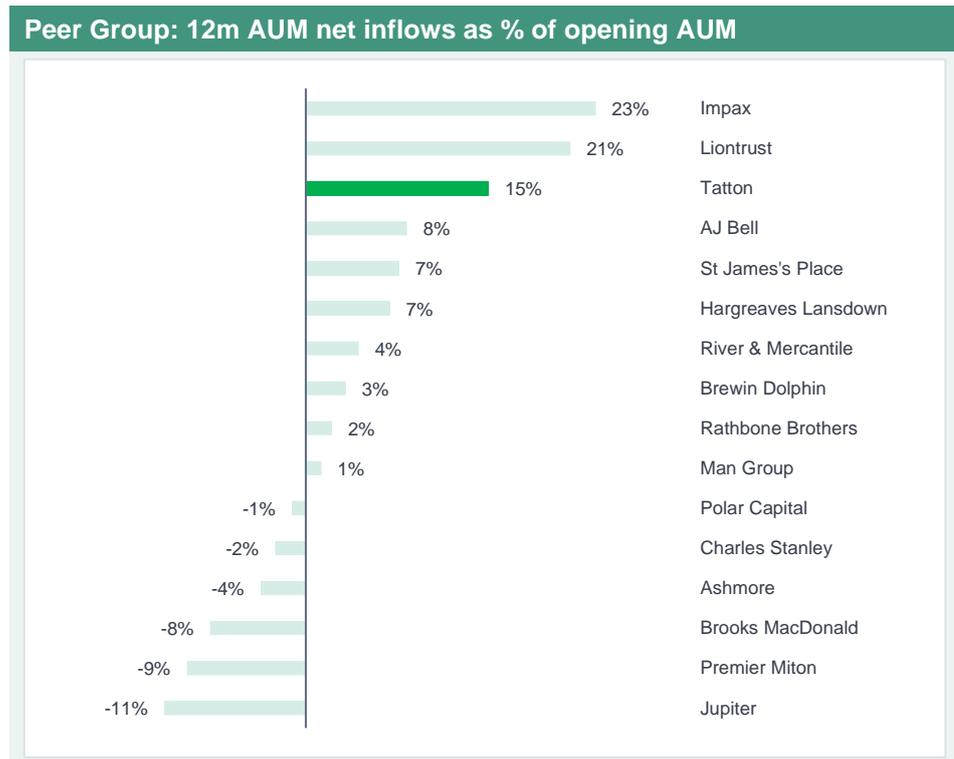
y/e end March 31	FY 19A	H1 20A	FY 20A	H1 21A	FY 21E	FY 22E
AUM end-of-period, £bn	6.1	7.0	6.7	7.8	8.1	9.0
Revenue, £m	17.5	9.7	21.4	11.0	22.5	24.5
Operating profit (adj), £m	7.3	4.1	9.1	5.0	10.0	11.0
Operating margin (adj)	41.7%	42.4%	42.5%	45.9%	44.5%	45.0%
EPS basic (adj), p	11.0	5.9	13.1	7.2	15.2	16.1
Div, p	8.4	3.2	9.6	3.5	10.7	11.3
Yield	3.0%	1.1%	3.4%	1.3%	3.8%	4.0%
PER	25.8	24.0	21.7	19.7	18.6	17.6
Net assets, £m	15.3	15.3	17.8	20.0	21.8	24.7
Net cash, £m	12.2	9.2	12.8	13.3	16.4	19.1

Source: Company Historic Data, ED estimates
 PER and Yield based on share price of 284p

¹ 'Adjusted' numbers exclude exceptional items, share-based payment costs and amortisation

Asset management: growth engine still firing

Tatton's asset management business maintained its strong growth trajectory. AUM in H1 jumped by £1.2bn (+17.4%) to £7.8bn (£6.7bn on 31 March 2020). Unsurprisingly, given the bounce-back in markets since March 2020, market movements were the largest contributor to this increase (£0.83bn). But significantly, £0.33bn came from **net inflows** – evidence that **financial advisers continue to see Tatton as a safe pair of hands with their clients' money**. Over 12 months, Tatton has the third highest net-inflow-to-AUM ratio amongst a group of 16 peers:



Source: Company reports and trading updates, ED analysis
 Covers 12m period from 1 Oct 2019 – 30 Sep 2020 except for Brewin Dolphin (1 July 2019 – 30 June 2020).
 Net inflows exclude AUMs added through acquisitions.

Advisers' confidence in Tatton is well justified. The investment performance of its suite of portfolios have comfortably outperformed industry peers with all core strategies producing higher returns against the relevant benchmarks over the longer term (green shading depicts outperformance versus benchmark).

Portfolio Performance (per cent.) - core product set
Annualised, after DFM charge and fund costs - since launch 1 January 2013

	TIML Active	TIML Tracker	TIML Hybrid	ARC Peers*
Defensive	4.4	4.7	4.6	3.1
Cautious	5.7	6.0	5.9	4.4
Balanced	6.2	6.9	6.6	5.9
Active	6.9	8.0	7.5	6.9
Aggressive	7.8	8.8	8.3	6.9
Global Equity	12.1	12.3	12.2	N/A

* ARC PCI –UK wealth management portfolio peer group with historically comparable asset allocation characteristics
 Source: Tatton Analysts Presentation November 2020

Revenue generated by this business unit grew 21.2% to £8.6 million (prior-year H1: £7.1m) and it now makes up 79% of total group revenue (prior year share of revenue 73%). Adjusted operating profit grew 23.6% to £5.3 million (£4.3 m). The adjusted operating margin increased from 60.2% to 61.4%.

Particularly pleasing is the continued growth in the number of IFA client firms using Tatton's discretionary fund management (DFM) services. Client numbers increased by 20% over the 12-month period ending 30 September 2020 from 522 to 624. This bodes well for continued AUM growth as these new firms tend to move only a small proportion of their assets under administration at the start of a relationship and build it up over a number of years. The scope of this opportunity can be appreciated by considering that the average IFA has **£40m** of AUM placed through platforms, while Tatton's average AUM per IFA is only £12.5m. **Tatton should therefore continue to see net inflows even without winning new IFA clients.**

Tatton is also not wholly dependent on winning new client firms 'one-by-one'. **In 2019, it won a long-term mandate to provide a managed portfolio service through Tenet Group**, 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). **Since inception in June 2019, this mandate has resulted in 93 new IFA clients placing £377m of AUM with Tatton.**

Paradigm: satisfactory performance in difficult times

The remainder of the group's business comes from the Paradigm business unit, which provides IFA support services – mortgage broking and protection insurance services; and regulatory and compliance consulting and outsourcing services (consulting).

The fundamental offering to clients of both of these businesses remains solid with client numbers increasing in both. **Paradigm Mortgage Services member firms increased from 1,466 to 1,591 (+9%) over the 12 months ending 30 September 2020, and Paradigm Consulting member firms grew from 385 to 404 (+5%).**

The financial performance of this business unit was however impacted by the mortgage market being heavily disrupted by the Covid-19 pandemic during H1. Housing surveys were not able to take place during the lockdown period which occurred earlier in 2020 and contributed to the residential mortgage market grinding to a halt. This had a negative impact on Paradigm mortgage income in Q1. Although Q2 has seen a recovery, the mortgage market is not yet at 'normal' levels.

Despite the market shock, gross lending through Paradigm Mortgage Services grew marginally from £4.8bn (30 Sep 2019) to £5.0bn (30 Sep 2020).

Paradigm Consulting has been largely unaffected by the pandemic.

Paradigm revenue (mortgages and consulting combined) fell 10% from £2.6m to £2.3 m in H1, making up 21% of group revenue. Adjusted operating profit fell 17% to £0.8m.

Financials: in line with expectations

Revenue increased 12.6% from £9.7m to £11.0m; adjusted operating profit 21.9% from £4.1m to £5.0m; and the adjusted operating profit margin increased from 42.4% to 45.9%. At a per share level, adjusted fully diluted EPS increased 21.5% from 5.39p to 6.55p. This includes the impact of potentially dilutive shares.

On a statutory accounting basis, profit before tax fell 14.9% from £3.6m to £3.1m, primarily due to abnormally high share-based payment charges of £1.6m. This was a slight anomaly, because a provision for these charges raised during the prior financial year was released at the 31 March 2020 year-end, owing to the increased level of uncertainty in the market due to the Covid-19 pandemic. Without that provision, and with a recovering market, share-based payment charges for H1 have therefore jumped (£1.6m vs £0.4m in the prior-year H1).

Also contributing to the decline in statutory profits was an exceptional cost of £0.2m incurred in pursuing a potential acquisition which did not materialise. This is to be expected from time to time in a group that is actively hunting for acquisitions. Basic EPS fell 9.3% from 5.26p to 4.77p.

The balance sheet of the group continued to strengthen with net assets increasing 31% from £15.3m on 30 September 2019 to £20.0m. **Net cash increased 45% from £9.2m to £13.3m. Tatton remains debt free.**

Tatton has proposed an interim dividend of 3.5p per share, 9.4% up on the prior year's interim dividend of 3.2p. This is consistent with the firm's policy of paying a total annual dividend of approximately 70% of adjusted earnings after tax, with one third of this being paid as an interim dividend.

Our forecast dividend for the full financial year is 10.7p per share which would result in a yield of 3.8% on today's share price.

Valuation upside remains

We believe that Tatton remains on a strong growth trajectory. The market trend of IFAs moving more and more of their client assets onto discretionary fund management (DFM) platforms is likely to continue. Especially as these firms look to avoid the regulatory and risk burden of selecting investments for end-clients themselves and focus more on financial planning and advice.

The platform DFM market has grown from £25bn in 2017 (when it made up 5.5% of the overall adviser platform market) to £55bn in 2020² and still only makes up 10% of the overall £554bn adviser platform market³, **so the growth trend of Tatton's segment is clear and there is also plenty of market opportunity.**

Given Tatton's proven ability to win new clients, both one-by-one and more rapidly through strategic deals such as that with Tenet, coupled with the opportunity to win a larger share of existing clients' assets under administration, **we think it is realistic for Tatton to achieve £12bn to £13bn AUM by 2025**, mostly through organic growth, which would see its revenue approach £30m. Additionally, as the business scales, operational leverage should see margins increase further.

Based on this growth trajectory (projections below), our DCF value is just north of 300p / share.

² Tatton Analysts Presentation, Nov 2020 (Original source Platform)

³ platform.co.uk/Blog/dJ/COVID-19-drags-on-platform-flows-in-Q3-2020

5 years forecasts						
Y/e 31 March	2020 A	2021 E	2022 E	2023 E	2024 E	2025 E
AUM, £bn	6.7	8.1	9.0	10.2	11.4	12.6
growth	9.6%	21.3%	11.3%	13.1%	11.8%	10.8%
Revenue (£m)	21.4	22.5	24.5	26.1	27.8	29.5
growth	22.0%	5.1%	9.0%	6.5%	6.6%	6.3%
Admin expenses* (£m)	12.3	12.5	13.5	14.3	15.2	16.1
growth	20.4%	1.5%	7.9%	6.0%	6.4%	6.0%
Op profit, adj (£m)	9.1	10.0	11.0	11.8	12.6	13.4
growth	24.2%	10.1%	10.5%	7.0%	6.9%	6.5%
Operating margin, adj	42.5%	44.5%	45.0%	45.3%	45.4%	45.5%
Profit after tax (£m)	8.4	5.2	6.9	7.5	8.2	8.8
growth	72.2%	-38.1%	33.1%	8.9%	8.7%	8.1%
EPS basic adj (p)	13.1	15.2	16.1	17.2	18.4	19.3
growth	19.3%	16.2%	5.8%	6.8%	6.8%	5.3%
Dividend (p)	9.6	10.7	11.3	12.1	12.9	13.5
yield	3.4%	3.8%	4.0%	4.2%	4.5%	4.8%
Net assets (£m)	17.8	21.8	24.7	27.7	31.0	34.5
growth	16.3%	22.8%	12.9%	12.4%	11.8%	11.3%
Net cash (£m)	12.8	16.4	19.1	22.3	25.7	29.3
growth	4.6%	28.4%	16.8%	16.7%	15.2%	14.0%

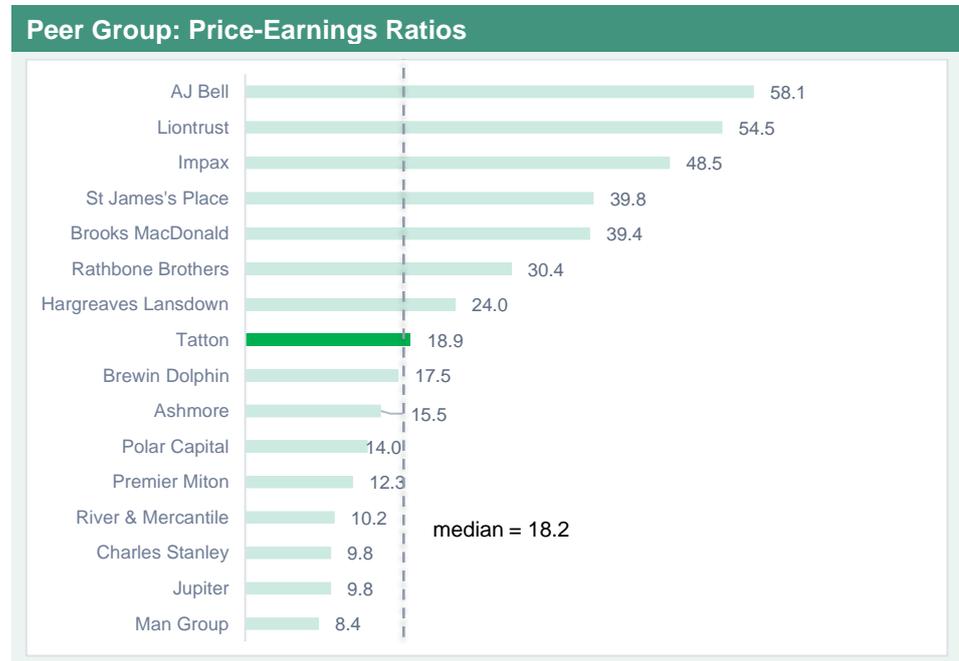
Source: Company Historic Data, ED estimates. Yield based on share price of 284p.

This growth trajectory could be further accelerated by acquisitions. Tatton's stated strategy has been to pursue strategic acquisitions in a disciplined manner, with the primary objective being to grow the scale of its AUM. Its first such acquisition was concluded in 2019 when it bought Sinfonia Asset Management for up to £2.7m (£2.0m upfront payment), adding £135m of AUM.

While that was a relatively small deal, **we expect larger opportunities to emerge. The group has secured a new lending facility which gives it access to £30m of credit. This, in addition to its net cash position of £13.3m provides Tatton with a substantial war chest to pursue larger deals.** Indeed, Tatton was a bidder for the Architas UK Investment Business (£5.7bn AUM) which was a good strategic fit for the group, but it was ultimately outbid by Liontrust. We expect acquisitions to entail acquiring blocks of fund business from other companies, or to be acquisitions of other DFM businesses.

Turning to Tatton's market valuation, in our June 2020 note, we highlighted that Tatton was a **1st quartile performer on a range of metrics:** AUM inflows, revenue growth, operating margin, EPS growth and ROE (financial metrics measured at last full financial year-end).

But Tatton's current PE ratio of 18.9 is only just above its peer group median of 18.2 and far below the highest-rated peers which have PE ratios in the 40s and 50s. As Tatton continues to scale and if it continues to deliver strong results, **we believe Tatton has the potential for a positive re-rating.**



Source: ADVFN (as at 16 November 2020)

Appendix 1

Consolidated Income Statement – Historical & Forecasts					
12 months to end Mar, £'000s	2018A	2019A	2020A	2021E	2022E
Revenue	15,507	17,518	21,369	22,465	24,496
Other exceptional revenue			1,588		
Administrative expenses (before separately disclosed items) ¹	(8,981)	(10,210)	(12,293)	(12,476)	(13,462)
Adjusted operating profit (before separately disclosed items)¹	6,526	7,308	9,076	9,989	11,034
Share based payment costs	(986)	(874)	(108)	(3,000)	(2,000)
Amortisation of intangibles - customer relationships			(60)	(120)	(120)
Exceptional items	(1,964)	(509)	1,394	(219)	-
Total administrative expenses	(11,931)	(11,593)	(12,655)	(15,815)	(15,582)
Operating profit	3,576	5,925	10,302	6,650	8,914
Finance income/(costs)	(26)	187	(6)	(180)	(300)
Profit before tax	3,550	6,112	10,296	6,470	8,614
Tax	(1,110)	(1,255)	(1,933)	(1,294)	(1,723)
Profit for the year on continuing operations	2,440	4,857	8,363	5,176	6,891
Loss related to disposal of discontinued operations	(164)	-	-	-	-
Profit for the year attributable to shareholders	2,276	4,857	8,363	5,176	6,891
Basic EPS, p	4.1	8.7	15.0	9.3	12.3
Diluted EPS, p	3.8	7.9	14.5	8.8	11.6
Basic adjusted EPS ² , p	9.3	11.0	13.1	15.2	16.1
Diluted adjusted EPS ² , p	8.8	10.0	12.0	13.8	14.4

¹ Adjusted for exceptional items and share-based payments

² Adjusted for exceptional items and share-based payments and the tax thereon

Source: Company Historic Data, ED estimates

Appendix 2

Consolidated Balance Sheet – Historical & Forecasts					
As at end Mar, £'000s	2018A	2019A	2020A	2021E	2022E
Non-current assets					
Goodwill	4,917	4,917	6,254	6,254	6,254
Intangible assets	-	223	1,495	1,500	1,525
Property, plant and equipment	104	349	1,034	1,030	1,025
Deferred income tax assets	-	104	-	-	-
Total non-current assets	5,021	5,593	8,783	8,784	8,804
Current assets					
Trade and other receivables	2,452	2,508	3,431	3,607	3,933
Cash and cash equivalents	10,630	12,192	12,757	16,386	19,132
Total current assets	13,082	14,700	16,188	19,993	23,065
TOTAL ASSETS	18,103	20,293	24,971	28,777	31,869
Current liabilities					
Trade and other payables	(3,922)	(4,521)	(6,186)	(6,442)	(6,964)
Corporation tax	(605)	(484)	(199)	(39)	(146)
Total current liabilities	(4,527)	(5,005)	(6,385)	(6,482)	(7,110)
Non-current liabilities					
Other payables	-	-	(702)	(351)	-
Deferred tax liabilities	(15)	-	(106)	(106)	(106)
Total non-current liabilities	(15)	-	(808)	(457)	(106)
TOTAL LIABILITIES	(4,542)	(5,005)	(7,193)	(6,939)	(7,216)
NET ASSETS	13,561	15,288	17,778	21,838	24,653
Equity attributable to equity holders of the Company					
Share capital	11,182	11,182	11,182	11,352	11,352
Share premium account	8,718	8,718	8,718	9,997	9,997
Other reserve	2,041	2,041	2,041	2,041	2,041
Merger reserve	(28,968)	(28,968)	(28,968)	(28,968)	(28,968)
Retained Earnings	20,588	22,315	25,801	27,416	30,231
Acquisition of own shares	-	-	(996)	-	-
TOTAL EQUITY	13,561	15,288	17,778	21,838	24,653

Source: Company Historic Data, ED estimates

Appendix 3

Consolidated Statement of Cash Flows – Historical & Forecasts					
12 months to end Mar, £'000s	2018A	2019A	2020A	2021E	2022E
Operating activities					
Profit for the year	2,276	4,857	8,363	5,176	6,891
Adjustments:					
Income tax expense	1,110	1,255	1,933	1,294	1,723
Finance (income)/costs	26	(187)	6	180	300
Depreciation of property, plant and equipment	53	91	298	313	342
Amortisation of intangible assets	-	43	195	195	195
Share-based payment expense	986	874	108	3,000	2,000
Share of profit from joint venture	(31)	-	-	-	-
Changes In:					
Trade and other receivables	(544)	78	(1,016)	(176)	(326)
Trade and other payables	(188)	491	1,338	317	583
Exceptional costs	1,964	509	(1,394)	219	-
Cash generated from operations before exceptional costs	5,652	8,011	9,831	10,519	11,707
Cash generated from operations	3,688	7,502	11,225	10,300	11,707
Income tax paid	(1,374)	(1,366)	(2,278)	(1,454)	(1,616)
Net cash from operating activities	2,314	6,136	8,947	8,846	10,092
Investing activities					
Acquisition payment, net of cash acquired	-	-	(2,002)	(351)	(351)
Purchase of intangible assets	-	(266)	(271)	(200)	(220)
Purchase of property, plant and equipment	(82)	(336)	(294)	(309)	(337)
Net cash used in investing activities	(82)	(602)	(2,567)	(860)	(908)
Financing activities					
Proceeds from the issue of shares	10,000	-	-	1,449	-
Stamp duty paid on share transfer	(10)	-	-	-	-
Interest received/(paid)	(26)	53	162	(180)	(300)
Payment of lease liabilities	-	-	(61)	(61)	(61)
Acquisition of own shares	-	-	(996)	-	-
Dividends paid	(1,556)	(4,025)	(4,920)	(5,565)	(6,076)
Net cash used in financing activities	8,408	(3,972)	(5,815)	(4,357)	(6,437)
Net increase in cash and cash equivalents	10,640	1,562	565	3,629	2,746
Cash and cash equivalents at the beginning of the period	(10)	10,630	12,192	12,757	16,386
Net cash and cash equivalents at the end of the period	10,630	12,192	12,757	16,386	19,132

Source: Company Historic Data, ED estimates



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