Cenkos Securities

H114 results

AA super-charged

Financial services

As shown by the positive trading statement, and with the financial benefits of the AA IPO, Cenkos has delivered excellent H114 results. The relative operational gearing (revenue up 226%, cost up 143%) is better than the historic cost income of the group, showing good leverage and confirming that Cenkos's performance-related model not only limits downside risk, but gives investors upside gearing in favourable market conditions. The outlook comment is positive. The dividend was doubled and the possibility of other capital returns has been indicated.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/12	43.2	7.0	7.4	7.5	23.4	4.3
12/13	51.4	10.7	14.2	12.0	12.3	6.9
12/14e	92.2	27.8	36.5	13.0	4.8	7.5
12/15e	60.0	12.4	17.8	16.1	9.8	9.2

Note: *PBT and EPS are normalised.

H114 results

The key business messages from H114 included revenue up 226% to £65.2m. Excluding the large £1.4bn AA IPO (£31.5m of revenue), residual income was up 69%. Total IPO and secondary funds raised were £2.2bn (H113: £0.4bn) and there were four M&A transactions (H113: two). Corporate clients rose to 127 (from 122) and corporate finance income from £13.1m to £54.2m. Costs rose by 143% (£24.8m) including performance-related pay, an increase of 10% in headcount and a £0.9m increase in the dividend related CAP bonus (see below). Pre-tax profits rose 653% to £23.5m, and basic EPS by 700% to 31.2p. The dividend was doubled to 7p. The FY14 dividend is expected by Cenkos to be above the 12p paid in FY13. Other capital distributions including buy-backs are being considered.

Outlook

Staff attracted to Cenkos's performance-related model are incentivised to deliver good business in favourable market conditions, giving investors geared upside. The model has historically also limited downside risk in weaker markets. While the H114 AA deal was large, it is indicative of the former aspect of the business. Market uncertainty means that any near-term forecasts need to be treated with caution (with both upside and downside potential). We note that after a strong Q1 the market-wide volume of trading and new issues has been somewhat weaker in Q2.

Valuation: 30% upside

Cenkos's policy of high capital distribution of profits means it has a good yield (2014e 7.5%). Our future dividend payments have been increased slightly and we have built in a £10m other capital distribution this year. The DDM valuation approach is now at 218p. The Gordon's growth model indicates a value of 240p. Our forecasts are for business as usual and there is further upside if Cenkos generates further large transactions, which the AA deal has proved it can deliver.

13 October 2014

Price	**174p**
Market cap	**£105m**

Net cash (£m) at 30 June 2014	43
Shares in issue	60.4m
Free float	61%
Code	CNKS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(17.3)	(20.0)	93.2
Rel (local)	(11.1)	(15.8)	96.0
52-week high/low		244.0p	96.0p

Business description

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

Next event

Year-end results	March 2015

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Edison profile page

Cenkos Securities is a research client of Edison Investment Research Limited

Investment summary

Company description: Independent, specialist institutional securities group

Cenkos's core business is corporate broking and advice, specialising in growth companies and investment funds. These niches are too specialist for bulge bracket houses to be active and, with limited regulatory capital requirements, Cenkos's business model has generated excellent returns and has been profitable every year since it was founded. Investment funds should benefit from secular growth in savings associated with greater longevity, increased personal provision for retirement and a normalisation of the savings ratio. Cenkos also has a modest institutional equities business (5-10% of group revenue).

Each unit is run on its own P&L, meaning that the industry-wide practice of expecting secondary equities to be a loss leader is not acceptable to Cenkos. Across the company remuneration is transparent and based on meritocratic returns. Management believes this is a major differentiator, as is the high distribution policy, ensuring a focus on using capital optimally.

Valuation: Upside 30%

Forecasting Cenkos's earnings and its valuation is critically dependent on its success in attracting corporate deals. We have been conservative and assumed what may be described as business as usual, ie we have not assumed any material lumpy deals, with 2015 revenue of £60m against a five-year average of £55m. The AA transaction proved that Cenkos can attract large transactions but also deliver on them at good value to the client. The average of our valuation approaches indicates c 30% upside without any major AA-type of deals.

Financials: Client growth gives upside to base case

Investment banking results are highly volatile and the exceptional performance of H114 has not been carried forward at the same level. We have built in a slightly higher revenue stream, more costs from the increased headcount and higher dividend related bonus payments (see below). We have also increased the dividend and assumed that £10m of capital will be repatriated through share buy-backs in 2014 (helping 2015 EPS).

Exhibit 1: Key forecast changes

	Revenue (£m)			PBT* (£m)			EPS* (p)			DPS (p)		
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
12/14e	56.0	92.2	65%	11.3	27.8	146%	14.7	36.5	148%	13.0	13.0	0%
12/15e	59.0	60.0	2%	12.2	12.4	2%	16.1	17.8	11%	14.5	16.1	11%

Source: Edison Investment Research

Sensitivities: Business model has limited downside risk in the past and should do so in the future

While Cenkos's procedures should limit any potential downside (as they did in 2008, when it was still profitable), the company is exposed to equity markets and is so sensitive to market sentiment and macroeconomic factors. The strategic competitive environment is challenging, and could see some irrational competitor behaviour, but Cenkos's niche positioning in growth and selected sectors is strong. Cenkos is, like all similar businesses, dependent on key staff, but historically has had lower staff turnover because of the transparency of its remuneration. While Cenkos has issued more options than peers, their exercise has only a very modest dilutive effect as the bonuses that are linked to dividends (see CAP scheme, page 8) drop away.

Company description: A leading UK institutional broker to growth companies

Cenkos is managed and reported as an integrated UK institutional stockbroking business, but internally has a number of teams to ensure that remuneration is transparent and linked to the team's net contribution (after adjusting for risk factors). We believe the key features of the Cenkos model are: (i) flexible remuneration and other costs. Cenkos for example outsources its core trading and settlement systems. (ii) Each operating unit is run to be a profitable business in its own right with no cross subsidiation. (iii) Capital is kept as a scarce resource through a high distribution policy, ensuring focus on returns. (iv) The company's chosen niches mean it is not generally competing head on with bulge bracket investment banks, although the AA deal has shown it is capable of generating the large transactions normally associated with these competitors. (v) There is no over-dependence on any specific market. (vi) Remuneration policies and high staff ownership mean risk exposures have a real impact on the financial position of risk takers. These factors have generated revenue and profit diversification, with the group being profitable every year since its 2006 float.

Cenkos remains highly focused in its chosen niches, and as noted in Adviser Rankings' July 2014 'AIM Adviser Rankings Guide', was ranked second in terms of both nominated adviser (Nomad) and stockbroker for all AIM clients by number of clients, top Nomad for oil and gas and consumer companies, second Nomad for industrial companies and third for financials and technology (ranked by number of AIM clients).

Exhibit 2: Nomad/advisory/investment trust clients

	2006	2007	2008	2009	2010	2011	2012	2013	H114
Number	46	72	103	105	104	111	119	125	127

Source: Cenkos Securities

Cenkos generates income from:

- Fund-raising, which in recent years has been relatively widely spread over a range of deals with a focus on further capital raisings for already quoted companies, a market that has proved a much more resilient market than IPOs. Cenkos does not underwrite in its primary fund-raising business and so the capital requirements are relatively modest. In H114 Cenkos completed 18 transactions raising £2.2bn for clients (including £1.4bn in AA IPO; H113: £0.4bn). With the recent growth in client numbers, there is greater upside should markets be more positive. Cenkos completed four M&A transactions in H114 (H113: two). Fees from this business line, in any specific six-month period, are both lumpy and unpredictable and rose 315% to £54.2m in H114. Cenkos's diversity of customers by economic sector and type mean that at least a fifth of its clients have historically had fund-raising needs per year, generating a sustainable core element to this income.
- Retainers: Cenkos has one of the largest AIM and investment trust client lists with 127 retained clients paying aggregate annual retainers of c £6m. In a normal year this would account for c 10% of group revenue and cover nearly all of Cenkos's annual non-staff costs.
- Market making typically accounts for around £4-6m pa. Cenkos makes markets in all of its corporate and investment trust broking clients (127) together with 213 non-clients (around two-thirds of which are small-cap names and one-third non-client investment trusts). While unusual events can cause losses, Cenkos's risk procedures (outlined in the section on risk below) mean that is less likely than in some other houses (eg Collins Stewart Hawkpoint just ahead of it being taken over). We note that, even though in the extreme conditions of 2008 market making generated negative revenue of around 12% of the revenue that year, the group was still profitable; however, since then limits imposed on market positions have come down materially with net market making positions more than halving by end 2012 against end 2007. Market

making is to facilitate client transactions rather than take own-account risk positions, and the daily distribution of profit is encouraging.

- Commission from sales, sales trading and research activities have historically accounted for 5-10% of group revenue. In 2014 Cenkos has been hiring highly-rated analysts in sectors such as leisure, gaming, tobacco and general financial and, while management notes the structural market-wide pressures on this line (see section below), they have yet to be felt in scale by Cenkos itself.
- Other advice.

By business unit, we note the strong presence Cenkos has established in its selected group of growth companies. It has a dedicated natural resource companies team and a growth companies team with a focus on providing services to small and mid-cap UK companies across leisure, mining, property, technology, bio-tech, business services, insurance and environmental sectors. The institutional investment trusts business is well resourced (over 10 in the team). We believe the long-term outlook for this business is excellent, driven by demographic and economic factors together with increased self-provision for old age. Institutional equities have historically accounted for 5-10% of group revenue with a team of over 10, and have been a profitable business unit in their own right. Revenue is primarily from agency-only orders in large-cap stocks generated from the personal relationships of the sales/sales traders and research team, and only partially from broad voting pools from the largest institutions. Large-cap research is complemented by the mid- and small-cap research teams in the growth and natural resource units, which focus on corporate clients.

Peer performance comparisons

While we would not ascribe too much weight to any one reporting period, we have given a number of key operational parameters for Cenkos and peers below as reported in their most recent numbers. Even excluding the large AA transaction, we believe Cenkos has delivered faster revenue and profit growth than peers, confirming the upside from its business model.

Exhibit 3: Recent performance measures

	Period (6 months to)	Revenue £m H114 (H113)	Costs £m H114 (H113)	Cost income ratio% H114 (H113)	Statutory PBT £m H114 (H113)	Annualised ROE H114 (H113)	EPS diluted (p) H114 (H113)	Div H114 (H113) (p)	Retained clients H114 (H113)
Arden Partners	April 2014	3.5 (5.7)	4.0 (4.7)	114% (83%)	Loss 474 (1,004)	-7% (13%)	Loss 1.8 (3.3)	0 (1.25)	46 (35)
Cenkos Securities	June 2014	65.2 (20.0)	41.8 (17.0)	64% (85%)	23.5 (3.1)	116% (18%)	29.7 (3.9)	7.0 (3.5)	127 (122)
Numis	March 2014	51.3 (35.3)	34.9 (26.5)	68% (74%)	16.7 (9.0)	24% (16%)	11.5 (6.9)	5.0 (4.0)	165 (153)
Panmure Gordon	June 2014	16.2 (13.0)	13.8 (12.2)	88% (97)	1.9 (0.3)	9 %(2%)	9.8 (0.9)	0 (0)	>130 (119)
Shore Capital	June 2014	22.5 (17.8)	17.5 (14.5)	78% (81%)	5.0 (3.3)	9% (6%)	11.7 (9.2)	5.0 (4.0)	63 (65)

Source: Company announcements, Edison Investment Research. Note: *Excludes the CAP payment due to its timing and nature (see section on page 8 below).

The pay and revenue metrics in Exhibit 4 confirm the business messages outlined above. In particular: (i) Cenkos has a more flexible cost structure (eg in 2013 87% [2012: 85%] of directors' remuneration is non-salary) and (ii) staff remuneration is above average as it is geared to performance and staff generate significantly more revenue per head. Numis had an exceptional 2013 – Exhibit 11 shows that over the long term Cenkos has consistently delivered higher post-tax profits without Numis's volatility.

Exhibit 4: Selected key pay and revenue metrics in last full financial year (£000s)

	No staff	Total staff costs	Avg pay	Avg revenue	Avg net contribution
Arden Partners	39 (37)	4,752 (5,211)	122 (141)	259 (264)	137 (124)
Cenkos Securities	107 (98)	33,318 (27,753)	311 (283)	481 (440)	170 (157)
Numis	184 (173)	41,172 (30,583)	224 (177)	441 (290)	217 (129)
Panmure Gordon	124 (127)	16,569 (13,662)	134 (108)	220 (167)	87 (60)
Shore Capital	124 (121)	15,787 (14,322)	127 (118)	288 (271)	161 (153)

Source: Last company annual report and accounts, Edison Investment Research. Note: Prior year in brackets.

Management

Cenkos reinvigorated its board in 2012 with a new chairman, one new non-executive (two leaving) and the appointment of four new executive directors. While the balance is now three non-executive and five executive directors, we note the non-executives are unusually highly qualified for a company of this size. We also note that all directors are subject to annual election at the AGM.

Capital and risk management

The balance sheet is very strong. As at H114 Cenkos had:

- Significant cash deposits (cash £43.2m, borrowing facility £5m nil drawn; H113: £16.3m cash). Noting the £24m growth in total accruals and deferred income (note 10 interim release) we estimate that c £15-20m of the cash will be used to pay bonuses in H115 for revenue generated in H114, but the underlying cash position is strong.
- Net assets of £41.2m (H113: £21.7m) allowing considerable flexibility in making further capital distributions.
- Regulatory solvency ratio of 145% (all Pillar 1) before H114 profits are consolidated (they are only included in regulatory capital once audited).

The company's regulatory capital requirements are relatively modest. At end 2013 (the latest detailed disclosure), regulatory capital was £19m, all Tier 1, the regulatory solvency ratio of was 199% (all Pillar 1) with a capital surplus of £9.6m against Pillar 1 and Pillar 2 requirements (H113 205% and £6.4m respectively). The total Pillar 1 requirement was £9.7m of which £7.0m was due to operational risk (15% of the average revenue over the prior three years; 2013: £7.4m). Market risk was just £1.7m (up from £1.3m end 2013) and credit/counterparty risk £0.9m (including £0.5m on cash deposits). Cenkos does not incur the capital-heavy requirements from underwriting capital raises.

We believe the attitude to risk is also a key differentiator for the company. As noted above, the high staff ownership and meritocratic remuneration packages mean risk exposures are owned by the risk takers. Market making positions are managed by a (generally) real-time authorisation structure, which means that when positions reach a certain nominal level they need sanction from the CEO or FD. Daily profits and losses are investigated and unusual performance investigated. Investors can take great comfort from the continuing profile of daily trading profits at Cenkos, where we understand it has continued on average to see a distribution that is positive and appropriate in size (market making is generally under 10% Cenkos annual revenue).

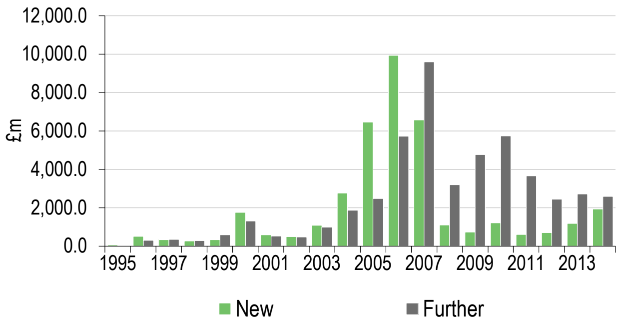
Outlook for small and medium-sized brokers

Challenging strategic outlook for the market

The market outlook for small and medium-sized brokers is strategically challenging but trading commissions are a small part of its business, and management notes that the financial impact on them to date is modest. Looking forward, there may be market-wide structural changes, the results of which are uncertain, but Cenkos would appear to have at least as many opportunities as threats from these developments. The key issues are: (i) Fund managers have been squeezing the rate paid as their own margins are falling. This is despite continued calls for independent research especially around IPOs. The unbundling of research from other services has received the attention of the regulators and potentially will squeeze smaller sell-side brokers (see Edison report The future of equity research). We note in section 5.66 of the FCA's July 2014 discussion paper (www.fca.org.uk/static/documents/discussion-papers/dp14-03.pdf) that the FCA sees that a move towards unbundling research may also help facilitate entry of independent research firms and enable them to exert a stronger competitive constraint on brokers' in-house research. (ii) The migration of larger investment houses to point-based allocation of commission rather than personally directed orders also favours larger investment banks with comprehensive coverage. (iii) Technology, market information and regulation incur elements of fixed cost. (iv) Political considerations have already seen market-wide increases in base salaries so that the bonus element appears smaller. This fixed-cost element is disproportionately painful for smaller brokers, which may not have the depth and breadth of revenues to cover them. (v) Smaller brokers are in competition with the large investment banks for the best talent. The smaller scale of business makes it hard for such brokers to generate the same returns as larger banks, but they still have to compete for the staff. (vi) There has been intermittent irrational pricing on retainer fees from smaller firms with business models under pressure.

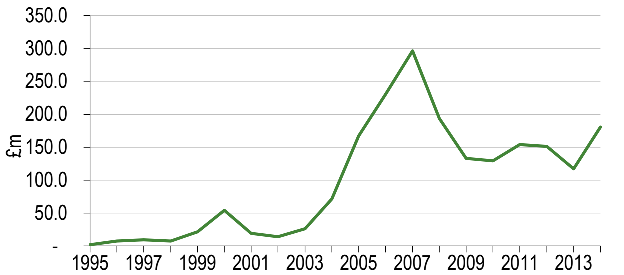
Underlying markets up on 2013, but Q2 weaker than Q1

Exhibit 5: Funds raised on AIM – new and further



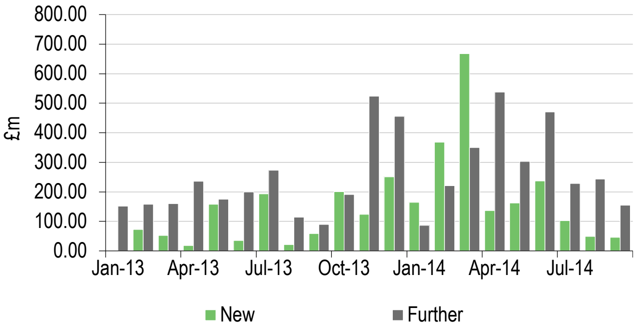
Source: London Stock Exchange

Exhibit 6: Average daily trading by value on AIM



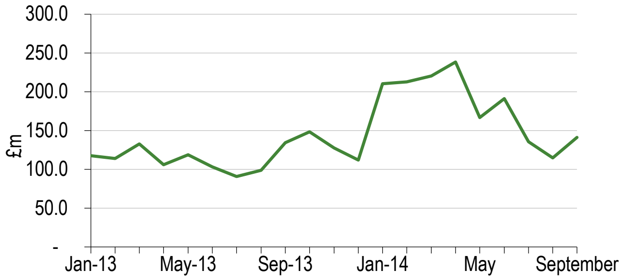
Source: London Stock Exchange

Exhibit 7: Funds raised on AIM – new and further (January 2013 to date)



Source: London Stock Exchange

Exhibit 8: Average daily trading by value on AIM (January 2013 to date)

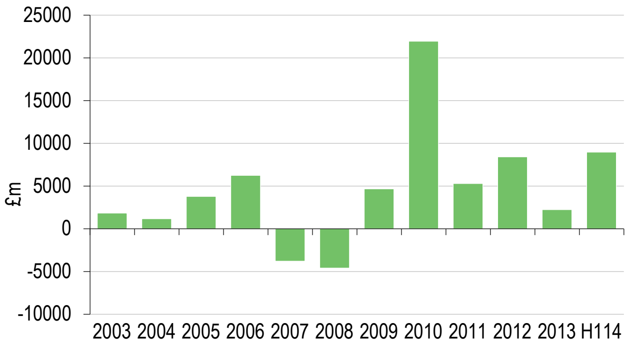


Source: London Stock Exchange

As shown in Exhibit 6, market-wide new-issue (IPO) funds raised fell by c 85% 2008 on 2007 and have not recovered materially since. 2014 year to date is already around the 2013 levels, but Q214 has been slower than Q114. Cenkos's focus on further issues by companies with existing listings has been a more stable market. In terms of daily trading on AIM, 2014 is ahead of 2013, but again Q2 has seen a sharp slowdown on Q114. Market uncertainties including global political risks as well as domestic issues such as Scottish independence have weighed.

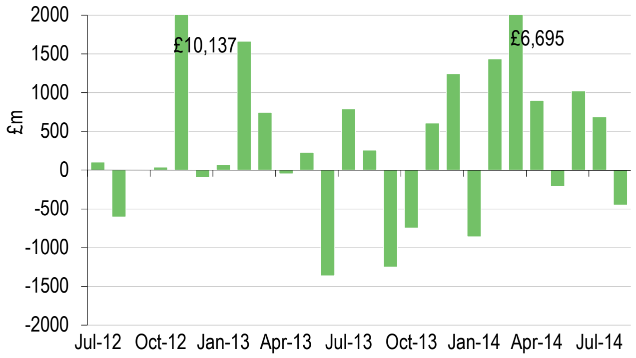
The sales of funds to the institutional market have been more positive, with H114 already exceeding any year except 2010. We believe that competition in the investment/company/trust space is increasing, but Cenkos has a market-leading number of clients in this space with nearly a sixth of all investment companies (by market capitalisation) as clients.

Exhibit 9: Annual institutional net sale of funds



Source: Investment Managers Association

Exhibit 10: Monthly institutional net sale of funds



Source: Investment Managers Association

Cenkos's model largely outperforms

Cenkos's profits demonstrate its resilience. While there has been some volatility in both statutory and normalised profits, there has not been the sharp decline that would be suggested by the market trends. We note annual post-tax losses have been reported by peers (eg Numis 2009-11, Panmure Gordon 2008-11, Shore Capital 2011, Arden Partners 2010 and H114 and Daniel Stewart 2013). Less competition should prove positive for Cenkos subject to factors mentioned above.

Exhibit 11: Selected brokers' post-tax profits (£000s)

	2008	2009	2010	2011	2012	2013	H114	2008-H114
Cenkos	3,366	7,420	6,876	3,578	5,151	8,569	18,793	53,733
Numis	10,561	(8,649)	(101)	(671)	3,301	18,064	13,602	36,107
Panmure Gordon	(7,771)	(109)	(532)	(5,817)	32	832	1,926	Loss

Source: Company report and accounts, Edison Investment Research. Note: Cenkos: Edison normalised profit excludes discontinued business for whole period; Panmure Gordon: UK + Swiss only; Numis in 2008 excludes gain on sale on associate and estimated tax effect.

By not being universal, there is a risk that Cenkos could miss a potential market hot spot (eg typically lower-margin retail bonds for Numis in H113), but these are likely to be temporary. The high-quality staff who out-performed in weak markets have also done well in good markets.

Incentivisation of staff aligned to shareholders

We have highlighted how Cenkos is managed to generate economic returns with performance-related pay, tight capital allocation and risk controls. We also note that around 40% of the staff own shares directly and their holdings (including those of the directors and the EBT) represent just over 40% of the company.

Flexible remuneration

The group's cost:income ratio has averaged 85% for the past five years and at its peak was only 90% (H114: 64%). The fixed element of remuneration is set at an unusually low level, meaning that profitability can be maintained in poor market conditions, which would see peers with higher fixed-cost bases suffering losses. We note that in 2013 the directors had fixed remuneration of £0.7m (13%) and variable of £4.5m (87%), after a similar proportional split in 2011 and 2012. Although distribution from the bonus pool to each team is discretionary, the target size of each pool is related to the net contribution made by that team. With team sizes typically between five and 20 people, the pods are small enough to ensure that each member of staff has great transparency on their likely remuneration and very importantly knows it is related to performance over which they have some input/control.

Compensatory award phantom (CAP) dividend scheme

Cenkos restructured its partly paid 'B' share scheme in 2009, allowing staff to either remain in the scheme (which has now been paid up in full and converted into ordinary shares) or alternatively opt to take a 10-year option over the shares instead. 10.6m CAP options are outstanding. On these options the relevant staff receive compensation per option equivalent to the dividend per share received by investors until the option is exercised, adjusted for tax. Staff get the dividend as a 'bonus in lieu of dividend' (BILD) as well as compensation for the tax differential between its being paid as income rather than as a dividend. Historically, 5.1m Long Term Incentive Plan options were also eligible to receive this BILD, but they have now received the last payment due and in future will no longer get this payment. The costs of this BILD are accrued in the period in which the interim or final dividend is declared (effectively postponing payment into the half year after the profits have been made), thus creating timing issues. Looking forward, we do not expect new options to carry BILD rights.

We believe that the accounting for the CAP options in the dilution calculation is not reflective of the economic impact. The share number is adjusted for options in the normal way, ie it reflects those options in the money and the degree to which they are in the money (driven by the average share price in the period). Given where the share price has been in 2014, there is likely to be a marked increase in the number of shares in the dilution calculation. However, the earnings number is not adjusted for the BILD (as it is paid with the dividend in the next accounting period). In reality this drops away on exercise so the real dilution will not be as great as the accounting number suggests.

While Cenkos has issued proportionately more options to staff than peers, investors should note that the CAP payments will cease, meaning that any earnings dilution is immaterial on their exercise.

Sensitivities

The company's key sensitivities are: i) it is a geared play on equity markets both positively and negatively; ii) the strategic competitive environment remains challenging; iii) regulation will see increased costs but creates opportunities; and iv) key personnel risk.

Geared to equity markets with downside managed

Cenkos's business is in equity markets and it is not immune from market sentiment and resultant customer activity. However, management aims to limit this sensitivity through its transparent remuneration policy, management of business units as separate profit and loss entities, limits on market making and employee ownership of half the company. Ultimately the evidence is in the earnings and Cenkos has been profitable every year since it was founded.

Competitive environment

We have noted the strategic and near-term challenges in Cenkos's market above. It is changing the competitive environment as peers consolidate and exit the market. Given Cenkos's business model there are opportunities as both customers and potential employees are unsettled by the changes.

Regulation

Cenkos faces both opportunities and threats from regulation. Cenkos is regulated by the FCA and so is subject to its Remuneration Code principles. Significant changes to capital requirements and operating guidelines would have an impact on both Cenkos and its peers. However, we note that the FCA consultation paper issued on 10 October 2013 means it is likely that Cenkos will, on the grounds of proportionality, continue to remain outside of European proposals on bankers' bonuses, keeping the model intact. We also note proposed regulatory changes in unbundling trading commissions.

Key personnel

Any company in this space is dependent on human capital and in particular the relationships of a few of its key staff. We note that Cenkos's management says it has only lost a handful staff it wished to retain since it was founded in 2006. The successful retention of staff is attributed to transparent remuneration based on staff taking a targeted proportion of the revenue they generate within visible and identifiable business units.

Personnel risk also includes potential claims. In 2012 Cenkos settled with a former employee in its Edinburgh office for an undisclosed sum. Given Cenkos's transparent remuneration policies, we believe such events are exceptional and have treated them as such.

Valuation

Our valuation approaches indicate an average fair value of 229p (previously 173p).

Peer comparisons

Exhibit 12: Key peer comparisons

	Price (p)	Market cap (£m)	2013 P/E (x)	2013 yield (%)
Arden Partners (Oct)	49	11	9.5	6.2
Cenkos Securities*	174	105	12.3	6.9
Numis (Sept)	231	260	12.0	3.9
Panmure Gordon	127.5	20	23.8	0.0
Shore Capital	422	102	28.1	1.9

Source: Company reports, Thomson Datastream, Edison Investment Research. Note: *Edison full-year forecast. Prices as at 10 October 2014.

The publicly available forecasts for brokers are limited and therefore we have included historic performance measures.

Capital return discount model (218p)

Given the high capital return we would expect Cenkos to be especially of interest to income investors. A dividend-only approach could, however, understate the value of the company should it choose to do buybacks. We therefore recommend a total capital return discount model. We use our explicit forecasts for dividends for 2013-15, and increase the 2015 dividend number by 5% pa for 10 years. We include £10m of buybacks in 2014. We then apply a 10x multiple for terminal value and apply an 11% discount rate (cost of equity) to the resultant cash flows. On these assumptions, the fair value is 218p (up from the previous 174p with the higher buy-back).

Gordon's growth model (240p)

As an advice-rich and regulatory capital-light business, Cenkos should have a sustainable return on equity well above its cost of capital. This is enhanced by its strategic appetite to pay away profits as they are earned. Accordingly, we have assumed a high 25% sustainable return and a cost of equity of 11% and growth of 5%. The near-term performance is significantly above this level (our model assumes ROE of 79% in 2014 and 32% in 2015), which leads us to include a premium of 25% for forecast outperformance against long-term assumptions. Buybacks should at least in theory see a higher ROE (on a lower equity base), a higher cost of equity (less capital cushion/more gearing) and higher growth (same capital generated, but growth from lower base). Given these are long-term assumptions, the effects should be modest unless a large buyback is undertaken. The impact on the book value per share will depend on the price paid (above book value implies the NAV per share for residual holders will go down). A buyback may change the near-term performance assumption, where it is likely to have the greatest impact.

Exhibit 13: Gordon's growth model and assumptions

	Base	+1% ROE	-1% COE	+1% growth
Return on equity (%)	25.00	26.00	25.00	25.00
Cost of equity (%)	11.00	11.00	10.00	11.00
Growth (%)	5.00	5.00	5.00	6.00
P/BV (x)	**3.33**	**3.50**	**4.00**	**3.80**
BVPS 2015 (p)	57.6	57.6	57.6	57.6
Implied value (p)	**192.0**	**201.6**	**230.4**	**218.9**
Near-term performance discount/premium	25%	25%	25%	25%
Implied value (p)	**240.0**	**252.0**	**288.0**	**273.6**
Variance from base (p)		12.0	48.0	33.6

Source: Edison Investment Research

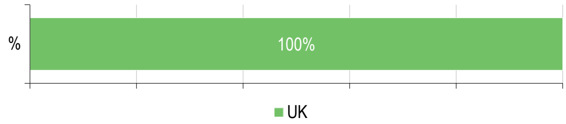
Financials

As noted above, 2014 has seen a material change in forecasts with the inclusion of the AA deal. For 2015, we have tweaked revenue and costs up slightly, but that year's EPS forecast sees the benefit of a buyback conducted in H214.

Exhibit 14: Financial summary

£000s	2008	2009	2010	2011	2012	2013	2014e	2015e
Year end 31 December								
PROFIT & LOSS								
Revenue	24,480	40,289	51,688	37,360	43,155	51,433	92,225	60,000
Cost of Sales (excl. amortisation and depreciation)	(20,535)	(30,749)	(46,406)	(32,194)	(36,339)	(40,545)	(64,233)	(47,361)
EBITDA	3,945	9,540	5,282	5,166	6,816	10,888	27,993	12,639
Depreciation	(341)	(327)	(346)	(362)	(331)	(311)	(326)	(341)
Amortisation	0	0	0	0	0	0	1	2
Op. profit (incl. share-based payouts pre-except.)	3,604	9,213	4,936	4,804	6,485	10,577	27,668	12,300
Exceptionals	0	0	0	0	0	0	0	0
Non recurring items	0	(3,848)	0	0	0	0	0	0
Investment revenues	1,166	506	453	311	351	134	149	149
Profit before tax (FRS 3)	4,770	6,125	5,095	5,115	7,006	10,711	27,817	12,449
Profit before tax (norm)	4,770	9,973	10,349	5,115	7,006	10,711	27,817	12,449
Tax	(1,404)	(2,469)	(2,318)	(1,537)	(1,855)	(2,122)	(6,120)	(2,614)
Profit after tax (FRS 3)	3,366	3,656	2,777	3,578	5,151	8,589	21,697	9,835
Profit after tax (norm)	3,366	7,420	6,876	3,578	5,151	8,589	21,697	9,835
Minority Interests	(175)	(537)	(1,098)	(300)	(88)	0	0	0
Average number of shares outstanding (m)	72.6	72.4	71.2	71.3	69.3	60.5	59.4	55.1
EPS – normalised (p)	4.64	10.24	10.90	5.02	7.43	14.19	36.50	17.84
EPS – FRS3 (p)	4.88	6.20	5.24	5.21	12.10	14.19	36.50	17.84
Dividend per share (p)	10.00	20.00	8.00	5.00	7.50	12.00	13.00	16.05
EBITDA margin (%)	16.1%	23.7%	10.2%	13.8%	15.8%	21.2%	30.4%	21.1%
Operating margin (before GW and except.) (%)	14.7%	22.9%	9.5%	12.9%	15.0%	20.6%	30.0%	20.5%
BALANCE SHEET								
Fixed assets	1,941	1,610	1,054	5,069	822	1,411	3,294	3,344
Current assets	59,222	64,504	71,020	46,073	48,591	64,478	70,439	64,980
Total assets	61,163	66,114	72,074	51,142	49,413	65,889	73,733	68,324
Current liabilities	(25,936)	(37,309)	(44,819)	(26,057)	(27,184)	(39,797)	(44,630)	(35,378)
Minority interests	(429)	(837)	(1,540)	(1,405)	0	0	0	0
Net assets	34,798	27,968	25,715	23,680	22,229	26,092	29,103	32,946
CASH FLOW								
Operating cash flow	1,240	28,234	13,422	(7,915)	16,232	13,271	22,744	3,322
Net cash from investing activities	840	757	(75)	(447)	2,235	(86)	(226)	(241)
Net cash from (used in) financing	(12,344)	(16,709)	(6,920)	(6,180)	(10,206)	(5,113)	(17,128)	(9,540)
Net cash flow	(10,264)	12,282	6,427	(14,458)	8,261	8,072	5,390	(6,458)
Opening cash	16,244	6,337	18,619	28,468	14,010	22,271	30,343	35,733
Closing net cash	6,337	18,619	25,046	14,010	22,271	30,343	35,733	29,274

Source: Cenkos Securities accounts, Edison Investment Research

Contact details	Revenue by geography
6.7.8 Tokenhouse Yard London EC2R 7AS UK +44 (0) 20 7397 8900 www.cenkos.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 2013-15e	12%	ROE 2014e	79%	Net cash 2014e £m	36	Litigation/regulatory	◖
Revenue 2013-15e	8%	ROE 2015e	32%	Net cash 2015e £m	29	Pensions	○
Costs 2013-2015e	8%	CIR 2014e	70%	Reg capital ratio (H114)	145%	Currency	○
PBT 2013-15e	8%	CIR 2015e	80%	Stock days	n/m	Stock overhang	◖
		Avg CIR 2010-13	85%	Debtor days	n/m	Interest rates	◖
				Creditor days	n/m	Oil/commodity/equity prices	●

Management team

CEO: Jim Durkin

Jim joined the group as head of the corporate broking team in March 2005 and was appointed executive director in October 2006 and to the position of chief executive officer in December 2011. He has over 20 years' experience in the UK securities industry. Prior to joining the group, Jim worked at Collins Stewart. He has worked extensively on the origination and execution of corporate finance transactions across a range of industries including insurance, property, financials and utilities.

Non-Executive Chairman: Gerry Aherne

Gerry was appointed a non-executive director of the company in April 2012, and chairman in May 2012. Gerry was an executive director of Schroder Investment Management Limited until 2002, managing both institutional segregated and pooled pension funds and unit trusts. He is currently non-executive chairman of Electric & General Investment Fund and a non-executive director of Iveagh Limited. Gerry was formerly a non-executive director of Henderson Group plc and Mecom Group plc and he was an executive director of Majedie Investments plc and chief executive and founder of Javelin Capital LLP until April 2011.

Finance Director: Mike Chilton

Mike was appointed to the board in June 2012. He has over 25 years of financial services experience and joined the company in April 2011 from NS&I (National Savings and Investments) where he was finance and risk director. Prior to this, Mike worked for 10 years at Standard Chartered PLC. After qualifying as a chartered accountant with PWC, Mike spent several years with the firm as a management consultant in its financial services practice.

Other directors

Non-executive: Jeff Hewitt, Anthony Hotson
Executive: Jeremy Warren Allen, Joe Nally, Paul Hodges

Principal shareholders (1 August 2014)	(%)
Invesco Ltd	15.1
Hargreaves Hale Ltd	12.0
Paul Hodges	9.2
James Durkin	9.0
JP Morgan Asset Managament	7.3
Cenkos Securities EBT	5.0
Nicholas Wells	4.0

Companies named in this report

Arden Partners (ARDN), Daniel Stewart (DAN), Panmure Gordon (PMR), Numis (NUM), Shore Capital (SGR)