ACG – Anchor Group Limited Full Year Results Initiation of Coverage

Valuation: Undervalued

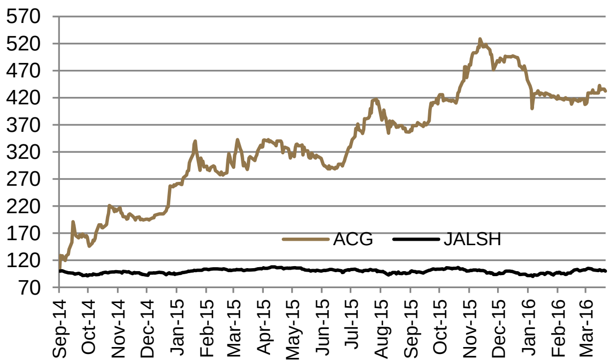
ACG released full year results on 17 March 2016 for the year ended 31 December 2015

Price (R)	**15.14**
PE Fair Value (R)	**18.53**
DCF Value (R)	**17.40**
Upside(Downside) to DCF (%)	14.9%
DY %	1.8%

Price Performance		**Relative**
	Absolute	**to JALSH**
1 month	4.4%	7.4%
3 month	-11.5%	-15.2%
12 month	39.5%	43.8%
12 month	**High**	**Low**
(SA Rands)	18.99	9.80

No. of share:	176	Price (R)	15.14
Ave. volume	173	Mkt cap (Rm)	2621

Financial Year	**2014**	**2015**	**2016F**	**2017F**
Turnover (Rm)	82	226	446	717
AUM (Rm)	5100	18100	36890	62713
AUM yield	1.62%	1.25%	1.21%	1.14%
EBITDA	35	120	217	375
EBIT	34	117	196	336
PAT	24	84	163	273
HEPS (cents)	28.3	55.0	92.4	155.6
P/E ratio	24.9	31.6	18.8	11.18
EV/EBITDA	6.7	19.3	13.4	7.4
EBITDA margin (%)	42.5%	53.1%	48.8%	52.3%
Net debt/equity	(0.85)	(0.39)	(0.13)	(0.26)
ROCE (%)		21.6%	24.1%	34.8%
ROE (%)		15.4%	20.1%	28.3%



RESULTS COMMENTARY

ACG produced an impressive set of results showing major growth in revenue, assets under management (AUM) and profitability.

- Revenue increased by 175% to R226m through a combination of strong organic growth bolstered by key acquisitions. Operating profit improved by 181% to R80.4m.
- The operating margin improved to 35.5% in FY15 from 34.7% in FY14. Margin improvements are expected to continue over the next 3 to 5 years as AUM increase on a fixed cost base.
- Assets under management and advice grew by 297% from R8.6bn in FY14 to R34.1bn in FY15.
- 90% of the growth in AUM was organic with 10% coming from acquisitions. The average organic growth of AUM was more than R500m per month in 2015.
- During the year the group made 2 significant acquisitions. A 66% stake in Robert Cowen Investments for R92m and a 50% stake in Portfolio Bureau for R125m.
- After the reporting period a 48% stake in Capricorn Fund Managers was acquired for R348m. The acquisition will take effect from 1 March 2016.
- HEPS increased by 95% to 55.1cps with share dilution accounting for the proportionately lower growth than at operating level.
- ACG declared a dividend of 16cps in H2:FY15 bringing the total dividend for the year to 27cps up from 15cps in FY14.

OUTLOOK FOR NEXT REPORTING PERIOD

The results for FY15 were impressive as the group grew assets under management, revenue and profitability significantly. The majority of the growth was organic, complimented by key acquisitions.

ACG will continue its focus of making key acquisitions to provide a complete asset management service offering, however this is expected to be completed during FY16 after which the focus will be on the organic growth of AUM.

The group aims to build distribution capacity and its capability to generate growth in AUM. According to management this will involve a two part strategy. The first “perform and wait” part involves marketing to traditional channels who outsource the asset management function to third party asset managers including financial advisors, institutional investors, multi-managers and fund-of-funds. The second “go and gather” step involves direct marketing to clients mainly in the private client space. This step is driven by the employment of individuals who attract assets as well as by the acquisition of businesses that have their own distribution capacity and client base such as financial advisory businesses.

The above strategy is already starting to show returns. FY16 began with R34.1bn in AUM and advice and by 1 March FY16 AUM and advice was in excess of R40bn as a result of new organic inflows as well as the acquisition of a 47.4% stake in Capricorn fund managers.

08 April 2016

Effective from 1 March ACG acquired a 47.4% stake in Capricorn Fund Managers (CFM) for a total consideration of R348m consisting of R256m cash and the issue of 7.7m ACG shares at R12 per share. CFM is a European hedge fund company that specialises in investing in emerging markets including Turkey, South America, Africa and Indonesia. This brings ACG's offshore proportion of earnings to 30% bringing the group closer to realising their goal of a 50% international profit contribution. We forecast the equity accounted contribution for 10 months in FY16 to be R27.5m increasing to R32.0m in FY17.

Capricorn is strategically important as it allows ACG to move away from their traditional long only investment market into hedge fund investing. Local and international markets are expected to be somewhat subdued over the next 3 years and hedge fund positions will allow ACG to generate returns when the markets aren't performing and will also allow them to invest in the volatility of emerging markets. The local hedge fund industry is on the verge of regulatory changes that will allow hedge funds to launch as collective investment schemes which will bring hedge funds into reach of the average investor.

During FY15 the group concluded the acquisition of 100% of Robert Cowen Investments (RCI). RCI is a niche asset management business targeting private client investments and has ~R4bn in assets under management. An initial cash consideration accounting for 66% of RCI was paid in FY15 for R92m and the additional 34% will be paid off in 4 annual tranches commencing 31 December FY16. The total consideration of these tranches cannot exceed R92m. We have included estimates for these repayments in our cash flow forecasts.

The group also acquired a 50% stake in Portfolio Bureau (PB) for R125m in FY15. PB is a financial services provider with a wide range of financial products. We expect the investment to further complement ACG's service offering.

The Investment in CFM, RCI and PB brings ACG closer to its aim of providing a complete service offering in the asset management space and should continue to boost growth in both AUM and margins across the group over the medium to long term.

In November FY15 Astoria completed an inward listing on the JSE raising R2bn, the biggest ever IPO capital raise for a new business on the JSE. Astoria is an offshore investment fund based in Mauritius and is managed by Anchor Capital Mauritius for a management fee of ~80bps. Astoria provides an asset mix of 60% direct listed equities, 20% private equity and 20% in niche funds and gives investors good exposure to offshore global equity markets. The company has significant potential for growth and should provide significant value for ACG.

Overall we forecast revenue to increase by 96.9% in FY16 and 60.9% in FY17 to R446m and R717m respectively. AUM are expected to grow by 104% to R36.9bn in FY16 with an AUM yield of 1.21% and by 70% to R62.7bn in FY17 with a yield of 1.14%. We forecast operating margins of 44.0% for FY16 and 46.9% for FY17. HEPS is forecast to increase by 67.8% to 92.4cps in FY16 and by 68.4% to 156cps in FY17. The lower HEPS growth forecast compared to operating profit is due to the effect of dilution as a result of new shares issued to cover acquisitions.

VALUATION

The share price performance will be influenced by a number of factors. These include, ACG's relative performance to local and global markets, the inclusion of RCI and Portfolio Bureau for a full year and Capricorn for 10 months, the impact on AUM from a significantly larger distribution force, the strength/weakness of the rand with a weaker rand marginally favouring the group.

Both our DCF valuation and relative PE valuation indicate the share is **undervalued.**

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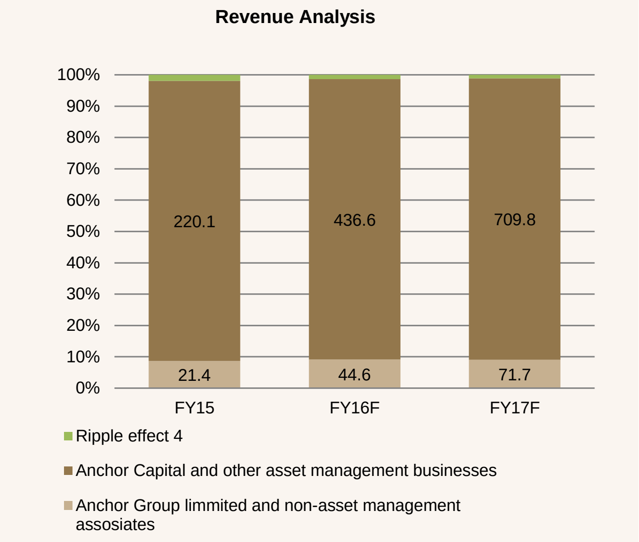

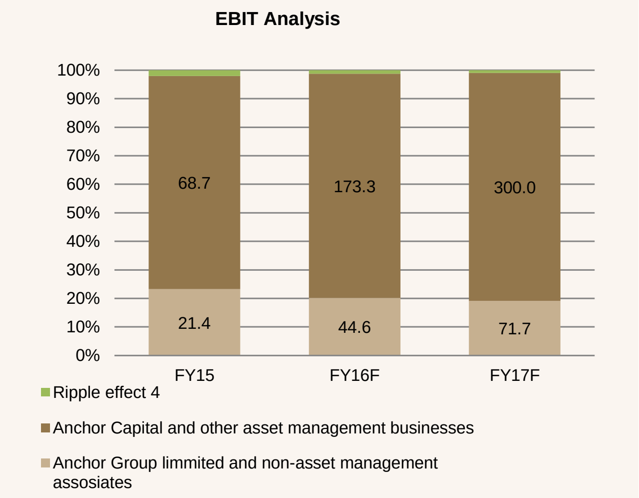

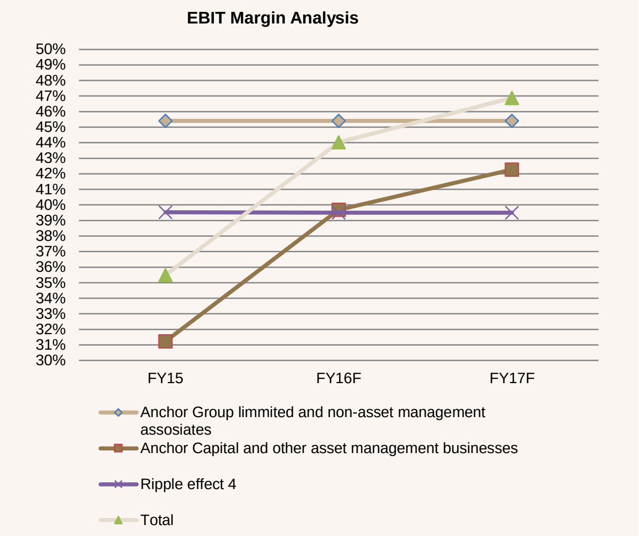

Overall we feel that the group's relatively small size compared to their larger competitors gives them an advantage in terms of flexibility and ability to quickly enter and exit investments. This will allow the group to continue to grow aggressively for at least the next 3 years as AUM increases significantly on a constant fixed cost base. We therefore feel the group still has runway for significant share price appreciation.

SEGMENTAL PERFORMANCES

Anchor Capital and other asset management businesses revenue increased 182% from R78.1m in FY14 to R220m in FY15 off the back of strong organic growth in AUM, a result of the Group's 2 stage strategy for driving new assets into their "asset management engine". The operating margin decreased from 36.9% to 31.2% as a result of the costs associated with acquisitions and the increase in the group's distributions base.

We expect revenue to continue growing aggressively albeit at a diminishing rate as scale increases. We forecast revenue growth of 98.4% in FY16 and 62.6% in FY17 to R437m and R710m respectively. Revenue is a direct function of AUM growth multiplied by the AUM yield. Operating margin is expected to increase to 39.7% in FY16 and 42.3% in FY17. AUM yield is expected to decrease gradually as AUM increases. An AUM yield of 1.21% is anticipated in FY16 falling to 1.14% in FY17. The group is close to achieving a comprehensive asset management service offering in local and international markets which should mean that further acquisition costs will remain low. ACG's larger competitors experience margins of ~50%, ACG's margins are expected to approach this point over the next 5 years as the AUM base grows significantly while fixed costs increase at a much lower rate.

Anchor Group Limited and non-asset management associates revenue increased 787% from R2.4m in FY14 to R21.4m in FY15 off the back of strong organic growth across the business. The operating margin increased from -20.6% to 45.4%.

We expect revenue to continue growing aggressively in line with the asset management division. We forecast revenue growth of 108% in FY16 and 60.9% in FY17 to R44.6m and R77.1m respectively. Operating margin is expected to remain at the FY15 level of 45.4% in FY16 and FY17.

Ripple Effect 4 is a small business that provides financial services education and research to Anchor Capital. Revenue increased by 31.6% from R3.6m in FY14 to R4.7m in FY15 off the back of strong organic growth across the business. The operating margin increased from 8.7% to 39.5%.

We expect revenue to continue growing strongly in line with the rest of the business however the division will continue to become a smaller proportion of overall revenue as the asset management division grows. We forecast revenue growth of 42.5% in FY16 and 34.1% in FY17 to R6.7m and R9.0m respectively. The operating margin is expected to remain at the FY15 level of 39.5% in FY16 and FY17.

VALUATION

With reference to the DCF table on the right, we have considered a discounted cash flow analysis with cash flows forecast to FY18. Utilising a terminal growth rate of 6% for which we used a discount rate of 18.0%, yielding a value of R17.40.

With reference to the relative PE table on the right, we believe it is appropriate to compare ACG to other asset management companies and apply no premium or discount to the peer group, the risk of being relatively small compared to competitors is offset by the ability to move swiftly in and out of investments. The implied forward PE valuation of 16.9 places ACG at a price of R18.53.

Growth rate	DCF Discount rate 14.0%	16.0%	18.0%	20.0%	25.0%
0%	16.29	14.07	12.35	10.98	8.54
2%	18.61	15.75	13.61	11.96	9.10
4%	21.85	17.99	15.24	13.18	9.78
6%	26.72	21.12	**17.40**	14.75	10.59
8%	34.81	25.82	20.43	16.84	11.59
10%	50.99	33.64	24.97	19.77	12.87
12%	99.29	49.26	32.53	24.16	14.53

Industrial	Price	Mkt cap (m)	1 year fwd PE
Sygnia	21.20	2929	33.3
Alexander Forbes	6.50	8719	11.0
Peregrine	29.10	6714	10.9
Coronation Asset Management	71.55	24759	15.7
Anchor Capital Group	15.14	2621	13.9
Average			**16.9**
*consensus forecasts used			-18%
Anchor Capital Group	**15.14**	**2621**	**13.85**
Premium (Discount) applied to average:			0%
Anchor Capital Group: Implied current g	18.53	22%	**16.9**

COMPANY PROFILE

Anchor Group is financial services holding company with investments in a number of financial services companies. The Group's primary focus is in asset management and has a number of asset management subsidiary companies that invest both locally and internationally across a wide range of financial products and services in a addition to a number of partners and associate companies.

The company is split into three main divisions;

Anchor Group limited and non-asset management associates which contains Anchor Financial Services which provides investment process advice and consulting rather than the physical asset management operation.

Anchor Capital and other asset management businesses, the primary division of the Group which holds Anchor Capital and the groups other asset management subsidiaries

Ripple Effect 4 which provides financial services education and research, primarily to Anchor Capital. This division contains the subsidiary Investor Campus.

Anchor Capital is the group's primary subsidiary and focuses predominantly on the management of client's assets. Anchor Capital provides a wide range of products across risk profiles ranging from high risk equity positions to lower risk cash alternatives. Some of the divisions products and services include;

- **Services to private clients** in the form of managed local and international portfolios as well as retirement portfolios including pension funds and retirement annuities and specialist investment advice and portfolio analysis. Anchor Capital has a highly skilled and experienced team of analysts and they manage over R15bn in assets.
- **Financial advisors** and their clients are given direct access to the Group's investment process and team.
- **Unit trusts** are offered with varying degrees of risk tolerance both locally and offshore.
- **Institutional asset management service** is offered to a number of clients in the institutional space.
- **Hedge fund investing** the group has a number of long short fund options available for high net worth investors that can tolerate a higher risk profile. The ability to invest in hedge fund positions allows the Group to generate returns even in a down market and allows bets to be taken on the volatility of emerging markets. Regulatory changes currently tabled should bring these funds into the reach of retail investors and the acquisition of 48% the European emerging markets hedge fund company Capricorn Capital Group will further enhance ACG's hedge fund offering.

Anchor Financial Services provides advice models, investment solutions and client service processes to individuals and businesses. This includes services to;

- **Employee Benefit Service Providers** whereby the group provides tools, support and investment knowledge.
- **Retirement fund Trustees** whereby the group provides member focused investment solutions that reduce risk and liability to the trustee.
- **Financial Advisors** by providing investment advice and up to date investment processes.

ANCHOR CAPITAL

ANCHOR FINANCIAL SERVICES

INVESTOR CAMPUS

CAPRICORN CAPITAL GROUP

PORTFOLIO | BUREAU PRIVATE WEALTH MANAGEMENT AUTHORISED FINANCIAL SERVICES PROVIDER

Robert Cowen Investments Growing families' wealth since 1982

DISCLAIMER