Impax Asset Management Group

Non-independent Research – Marketing Communication

Environmental trends drive proposition

9 December, 2016

We published a detailed initiation on Impax on 28 November 2016 before it released FY15/16 results. This follow-up note adds forecasts and views on growth prospects.

To recap, Impax is a market leading asset manager in a specialist, but substantial and fast-growing investment area. It manages funds designed to capitalise on trends driving demand for environmentally sustainable delivery of products and services to the global economy e.g. alternative energy, water and transportation. It manages a portfolio of distinct products and strategies which invest in listed and private entities. The three largest listed equity strategies outperformed their individual benchmarks in the last financial year.

Results: 12 months to end September 2016

As momentum behind these trends gathers pace Impax has seen significant growth in assets under management and advice (AUM), fund performance and inflows from new and existing clients/geographical markets. It reported **59%** y-o-y growth in (AUM) to £4.5bn at end September 2016 (since rising to **£4.9bn** by end November). That will generate parallel increases in fee income revenue and an inherently scalable, operationally geared business model push up EPS and net cash.

Growth in AUM incorporated record £496m net inflows reflecting strong growth in its North American business and expansion of product offerings for UK clients. The outlook is supported by an 'encouraging' mandate pipeline. Revenue was £21.1m (FY15: £19.7m), with a £23.7m full year run rate by the year-end, reflecting H2 AUM growth. Pre-tax profit 2% up y-o-y at £5.2m reflected prior year one-offs, relatively faster growth in operating earnings to £4.2m (FY15: £3.1m) illustrates operational gearing and scalability. The 2.1p/share full year dividend (final 1.6p/share, up 33%) is comfortably covered by 3.62p EPS (FY15: 3.13p).

Valuation: launch pad for strong growth over next two years

The outlook for growth in AUM/fees is underpinned by prospects for further net investment into the group's outperforming fund portfolio, strong global distribution and contributions from the latest private equity fund, which had attracted €149m commitments at first close on 30 November 2016 and will continue to raise money during 2017. That supports the case for a rating above generalist and less specialised peers.

Summary forecasts

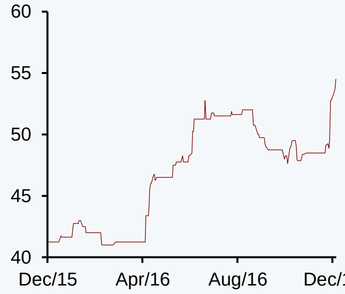
Year to 30 Sept	2014A	2015A	2016A	2017E	2018E
Revenue, £m	20.4	19.7	21.1	27.8	28.8
Op. Profit, £m	5.3	3.1	4.2	6.1	6.6
EPS, p	2.8	3.1	3.6	4.5	4.9
PER	19.0	16.8	14.4	12.0	11.1
EV/NOPAT	10.5	22.4	14.3	9.0	7.8
Div, p	1.4	1.6	2.1	2.8	3.1
Yield, %	2.6	2.9	3.9	5.1	5.7

Source: Group Report & Accounts and ED estimates

Company Data

EPIC	IPX
Price	54.5p
52 week Hi/Lo	54.5p / 40p
Market cap	£69m
Cash (Sept 2016)	£15.7m

Share Price, p



Source: ADVFN

Description

Impax is a market leading manager of both listed and private equity funds, which invest in ways that take advantage of more environmentally sustainable corporate and economic growth globally. Aggregate AUM at end September 2016 was £4.5bn.

The group has won many prestigious awards including:

THE QUEEN'S AWARDS FOR ENTERPRISE: SUSTAINABLE DEVELOPMENT 2014

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FY15/16: record net inflows and fund outperformance

FY15/16 revenue was 6% up y-o-y at £21.1m. That reflected growth in asset management fees on the back of record net inflows and strong performances by listed equity funds, net of reduced private equity AUM. The aggregate 59% y-o-y increase in AUM to £4.5bn included £0.5bn of net inflows and market effects (including investment performance) of £1.18bn, and the group reported further growth in AUM to £4.9bn as at end November.

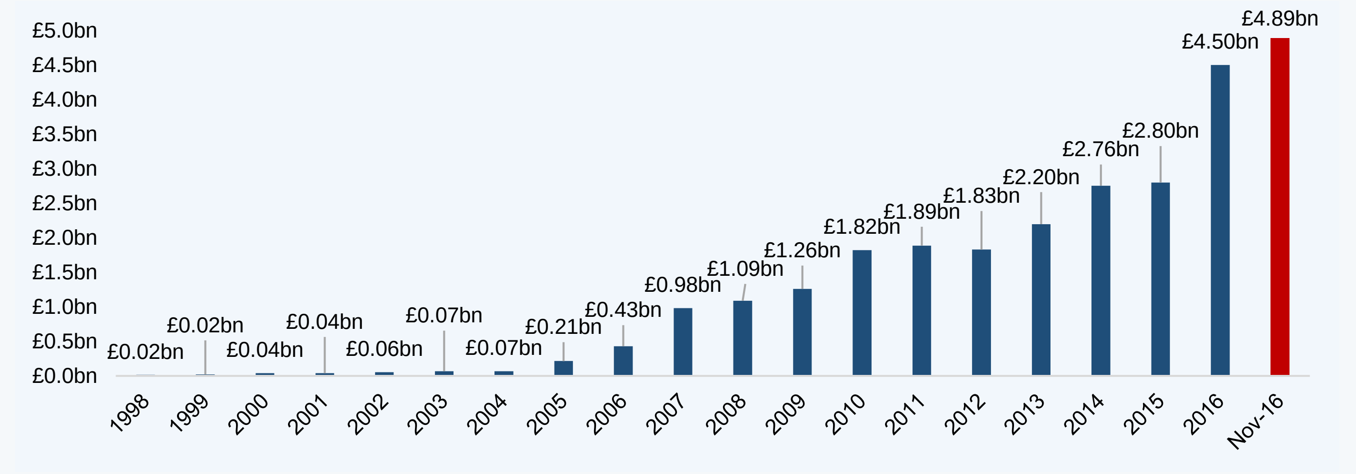
Results - 2015 / 16

12 months to end Sept, £m	2014	2015	2016
Assets under management/advice	2.8	2.8	4.5
Revenue	20.4	19.7	21.1
Operating earnings	5.3	3.1	4.2
Profit before tax	3.5	5.1	5.2
Shareholders' equity	24.9	25.9	26.7
Cash reserves	17.2	19.3	15.4
Seed investments	10.2	7.4	11.0
Dividends per share, p	1.4	1.6	2.1
Special dividend	0.0	0.5	0.0

Source: Company

The £79m fall in private equity AUM related mainly to exits from Impax New Energy Investors II in line with its business plan. This is positive, notwithstanding a fall in fee income. **Exits are a key component of each private equity fund's 8 to 10-year lifecycle**, and an influence on the group's ability to secure future investment in new funds.

Aggregate funds under management



Source: Company

The evolving business mix explained the fall in the aggregate revenue margin (revenues/£4.5bn year-end AUM) to 0.53% vs 0.62% a year earlier. Private equity fees are typically higher than for listed funds and timing is important as the figures do not include a full 12 months' impact of £4.5bn year-end AUM. The potential is illustrated by the £23.7m year-end revenue run-rate (based on the 53% blended margin), not including fees from the latest private equity fund launch (discussed below). Revenue margins are expected to stabilise this year.

Operational gearing apparent in an inherently scalable business

A better 20% aggregate operating margin (FY14/15: 16%) reflects inherent operational gearing. Revenues grew faster than underlying costs, a relationship which should continue beyond the forecast period as Impax capitalises on capacity and readily scalable operations.

It will incur expenses as it grows including IT investment and office relocation cost due to forthcoming lease expiry at existing premises. Staff hires are however, likely to be weighted towards the mid/junior, rather than senior level. Our forecasts also incorporate potential placement fees associated with money raised for the newly launched private equity fund.

The year-end balance sheet was debt free; £15.7m net cash and £10.5m of seed investments in Impax funds.

Divisional performances on track

Listed Equity

All group listed equity strategies **out-performed their global benchmark -** the MSCI All Country World Index (ACWI) which produced a 30.6% total sterling return in the period – **and their respective environmental benchmarks**.

Real Assets - private equity and property funds

Impax sold five assets or portfolios in FY15/16. It has now exited over 70% of the assets held by its second fund PE and returned over 1.15x cash drawn from investors. It intends to make further distributions as its exits the remainder of the portfolio.

That successful exit process contributed to the launch of NEFIII, which had €149m of commitments at its first close on 30 November 2016. Due diligence is already underway on potential investments and Impax continues to market this fund to pre-qualified investors in multiple countries. It expects to announce a final close of NEFIII with significantly higher commitments in late 2017 or early 2018, and Impax has committed €4m to be paid to the fund as new investments are made.

The group’s PE funds target construction of onshore wind and solar power generation projects, principally in Europe. In a fragmented market its strategy is designed to generate material capital gains by aggregating assets into larger portfolios for sale to utilities or institutional investors which seek long-term income streams.

Impax did comment on more challenging UK commercial property markets post the referendum in June. It remains optimistic that its property fund will conclude the sale of its one remaining asset over the next few months, and is developing plans to raise new capital in 2017. This division’s performance is not currently material to our forecasts.

Positive outlook: market momentum, extended reach and scalability

Impax sees FY15/16 as the start of a new phase of growth as it continues to leverage competitive advantages within markets gathering momentum. Demand is driven by products that satisfy investors’ search for consistent returns, contribute to portfolio diversification and provide strategies which hedge climate risk.

The immediate impact of higher AUM on fees/margins, EPS and cash flow growth is accentuated by a scalable, operationally geared business model.

And, although headline AUM is a key metric, other useful measures of earnings quality and reproducibility include individual product/strategy performance (AUM and investment returns), access to target geographical and client markets and follow-on investment from existing clients, typically higher margin than achieved from marketing initiatives.

FY15/16 saw significant inflows from segregated accounts and third-party distributors and geographically, material growth **from both North America and Continental Europe**. North American investors accounted for over 60% of net inflows in FY15/16 and generated an increase in AUM well above prior years. In April 2016, it was appointed to manage a US$250m segregated account on behalf of a US pension plan, and there was continued investment in the Impax-labelled private fund and the mutual fund sub-advised on behalf of Pax World. It also established its first commercial relationships in Canada via sub-advisory mandates at the launch of new funds with NEI Investments and Desjardins.

The group plans to build on improving traction in new geographies and has plans to continue to refine and optimise its distribution channels, with sales partners under review in parts of Europe and Asia. Its principal distribution partner across Continental Europe is BNP Paribas Investment Partners (BNPP) which reported sustained high demand for group sub-managed products from private wealth sector clients, particularly in France and the Benelux.

The BNPP water fund (launched in January 2009) had grown to €1.3bn by end October 2016 and the BNPP sustainable food fund (‘SMaRT’), which commenced investment in April 2015, €208m.

Investment themes growing profile, trends gathering momentum

The group’s marketing initiatives have identified a growing bank of new and existing investors which seeks better returns, attracted by the potential to capitalise upon an experienced team’s understanding of complex issues and its proven ability to identify mispriced winners in specific environmental categories. Impax has invested in these markets since the late 1990s; over the past 12 months the underlying drivers have continued to gather pace.

Investors also, increasingly, recognise the need to understand threats posed to incumbent providers by for example, stricter controls on greenhouse gas emissions. These may mean that a material proportion of fossil fuel reserves **currently factored into company valuations may never actually be extracted or consumed**. Impax’s scenario analysis assesses the potential impact on cash flow and factors such risks into valuations.

Valuation

Forecasts

Our forecasts for the next two years are based upon a range of assumptions which we regard as conservative:

Assumptions		
Listed equity	£250m pa net inflow 5% pa market/asset management driven growth in AUM	This is below the average £300m for the last two years and is underpinned by the mandate pipeline, extended marketing reach, enlarged fund portfolio and strong track record. Fees accrue on AUM value. We assume new money will be raised steadily across the period, so year-end run rate will be above the figure generated during each period.
Private equity	AUM are boosted by the €149m secured for NEF III, with further fundraising by Q1 2018. AUM growth offset by exits from existing PE funds. We assume €65m and €90m falls in AUM for NEF I/II for the next two years.	Impax has announced €149m total commitments for its latest PE infrastructure fund and will continue to raise money for the next 12-15 months. We have assumed for forecasting purposes that it will double that initial commitment by fund close. That would still be below the £330m raised for the previous fund and the target. Fees will be calculated on all committed and future investment from 30 November 2016. Fees fall during the final phase of each fund, as completed exits reduce AUM.
Property	Disposal of remaining fund asset. No fundraisings during the forecast period.	This division’s result is not currently material to our forecasts. There are plans to raise a new fund during 2017 and we will review our forecast as further details are available.

Source: ED

We have assumed (for forecasting purposes) that forex rates are unchanged vs the year end. FY15/16 benefited from recent sterling devaluation as a material proportion of AUM is denominated in foreign currency i.e. the GBP value of both that and associated management fees rose inversely. The group only hedges revenues which it can predict with high certainty, typically just Euro denominated private equity management fees. Over 85% of group costs are Sterling, which limits the impact of currency fluctuations.

Strong start to FY16/17

After unprecedented growth in AUM in FY15/16 **the current year has got off to a good start**, with a further increase in aggregate AUM to £4.89bn by end November and a reported encouraging pipeline of listed equity mandates. On 30 November, Impax announced first close of its **3rd private equity renewable energy infrastructure fund** at €149m and, although details of investors are not disclosed, this launch was contingent on successful performance of earlier PE funds.

Comparative valuation statistics

Quoted asset managers								
Company	**Price**	**Market Cap (£m)**	**PER 2016**	**PER 2017E**	**EV/NOPAT 2016 (X)**	**EV/NOPAT 2017 (X)**	**Dividend Yield (%) 2016**	**Dividend Yield (%) 2017e**
Specialist								
Ashmore	290p	£2,051m	17.3	16.8	14.8	12.8	5.7%	5.7%
Impax	55p	£69m	14.9	12.0	14.3	9.0	5.0%	5.4%
Jupiter	429p	£1,964m	15.0	13.4	13.7	12.4	5.5%	6.1%
Liontrust	354p	£161m	13.8	12.1	14.8	14.8	3.7%	4.3%
Miton Group	29p	£50m	13.8	12.1	8.2	7.3	2.6%	2.9%
Man Group	114p	£2,018m	7.3	6.6	5.9	5.4	5.6%	5.9%
Polar Capital	289p	£259m	15.3	14.2	11.9	10.8	8.6%	8.6%
Diversified								
Aberdeen	272p	£4,014m	13.2	11.2	11.4	9.6	7.2%	7.3%
Henderson	230p	£2,473m	16.0	14.4	13.7	12.5	4.4%	4.9%
Schroders	2,888p	£6,263m	17.3	16.5	14.1	13.5	3.1%	3.2%

Source: Companies, various websites, ED estimates y/e variables

The above table sets out the rating against generalist and specialist quoted fund managers. We don't necessarily believe that these entities replicate **Impax's competitive positioning, or potential for AUM growth.** There are no quoted peers which precisely match Impax's combination of sector focus and active conviction-based investment strategy which has generated consistent outperformance of benchmarks, general and specific.

The latter should benefit from (a) growing demand for both solutions to environmental challenges and more efficient use of natural resources which frame its strategies and products and (b) progressively higher penetration within major client groups/territories.

We believe Impax's strong positioning and strategy support arguments for a premium rating, but the rating is currently below sector peers at 9.0x FY16/17 EV/NOPAT and 0.92% EV/AUM, backed by a 5.1% prospective yield. The group has a stated commitment to progressive dividends and considerable alignment of the interests of employees and external shareholders.

Sensitivities

The key source of uncertainty relates to the US election result. Impax does not anticipate new US environmental regulation under a Trump presidency and sees potential for reversal of some recently enacted regulations. That adds an element of uncertainty, but we will comment on the implications in future updates as more detail becomes available from the new administration.

Consolidated income statement, £000's					
Year to 30 September	**2014**	**2015**	**2016**	**2017e**	**2018e**
Revenue	**20,359**	**19,726**	**21,067**	**27,817**	**28,782**
Operating costs excluding legacy LT incentive schemes	(15,039)	(16,616)	(16,915)	(21,697)	(22,162)
Operating profit	**5,320**	**3,110**	**4,152**	**6,120**	**6,620**
Operating margin	0	0	0	0	0
Credits/(charges) related to legacy LT incentive schemes	(539)	1,285	27	0	0
Fair value gain/(loss) on investments	(1,460)	615	989	0	0
Investment income	207	228	319	300	320
Change in third-party interest in consolidated funds	7	(101)	(288)	0	0
Profits before taxation	**3,535**	**5,137**	**5,199**	**6,420**	**6,940**
Taxation	(279)	(1,504)	(1,022)	(1,220)	(1,319)
Profit after tax	**3,256**	**3,633**	**4,177**	**5,200**	**5,621**
Earnings per share, p					
Basic	2.78	3.16	3.74	4.65	5.03
Diluted	2.77	3.13	3.65	4.55	4.91
Dividends per share, p	1.4	1.6	2.1	2.8	3.1
Dividend cover	2.0x	2.0x	1.7x	1.6x	1.6x
Special dividends per share	0.0	0.50	0.0	0.0	0.0

Source: Company historic and ED estimates

Balance sheet/statement of financial position, £000's					
Year to 30 September	**2014**	**2015**	**2016**	**2017e**	**2018e**
Assets					
Goodwill	1,666	1,681	1,681	1,681	1,681
Intangible assets	107	73	61	61	61
Property, plant and equipment	246	185	108	208	258
Investments	16	16	14	14	14
Total non-current assets	**2,035**	**1,955**	**1,864**	**1,964**	**2,014**
Trade and other receivables	3,097	4,754	6,931	7,000	7,000
Derivative asset	178	49	0	0	0
Investments	11,640	7,419	12,811	12,310	11,800
Margin account	293	177	378	378	378
Cash invested in money market funds and long-term deposit accounts	10,615	17,153	12,891	13,000	13,200
Cash and cash equivalents	6,634	2,364	2,804	5,451	8,176
Total current assets	**32,457**	**31,916**	**35,815**	**38,139**	**40,554**
Total assets	**34,492**	**33,871**	**37,679**	**40,103**	**42,568**
Equity and liabilities					
Ordinary shares	1,277	1,277	1,277	1,277	1,277
Share premium	4,093	4,093	4,093	4,093	4,093
Exchange translation reserve	(206)	(241)	(154)	(154)	(154)
Hedging reserve	172	39	(116)	(116)	(116)
Retained earnings	19,523	20,759	21,645	23,745	25,870
Total equity	**24,859**	**25,927**	**26,745**	**28,815**	**30,970**
Trade and other payables	6,536	4,987	5,473	5,500	5,500
Third-party interest in consolidated funds	1,119	144	2,125	2,125	2,125
Derivative liability	0	74	265	265	265
Current tax liability	73	305	2,135	2,120	2,250
Total current liabilities	**7,728**	**5,510**	**9,998**	**10,010**	**10,140**
Accruals	207	197	180	180	180
Deferred tax liability	1,697	2,237	756	1,100	1,277
Total non-current liabilities	**1,904**	**2,434**	**936**	**1,280**	**1,458**
Total equity and liabilities	**34,491**	**33,871**	**37,679**	**40,103**	**42,568**

Source: Company historic and ED estimates

Consolidated cash flow statement, £000's					
Year to 30 September	**2014**	**2015**	**2016**	**2017e**	**2018e**
Operating activities					
Profit before taxation	3,535	5,137	5,199	6,420	6,940
Adjustment for:	0	0	0	0	0
Investment income	(207)	(228)	(319)	(300)	(320)
Depreciation and amortisation	326	273	198	150	100
Fair value (gains)/losses	1,460	(615)	(1,180)	0	0
Share-based payments	377	437	512	500	500
(Credit)/charges related to legacy long-term incentive schemes	539	(1,285)	(27)	0	0
Change in third-party interest in consolidated funds	(7)	101	288	0	0
Operating cash flows before movement in working capital	**6,023**	**3,820**	**4,671**	**6,770**	**7,220**
(Increase)/decrease in receivables	48	(1,850)	(2,139)	(69)	0
Decrease/(increase) in margin account	(107)	117	(203)	0	0
(Decrease)/increase in payables	(178)	(280)	802	27	0
Cash generated from operations	**5,786**	**1,807**	**3,131**	**6,728**	**7,220**
Corporation tax paid	(96)	(570)	(815)	(1,000)	(1,200)
Net cash generated from operating activities	**5,690**	**1,237**	**2,316**	**5,728**	**6,020**
Investing activities					
Investment income received	207	228	329	300	320
Settlement of investment related hedges	(1,244)	(359)	(1,990)	0	0
Net redemptions made to Impax by unconsolidated Impax managed funds	1,171	2,469	2,329	0	0
Net investment disposals made by/(investments made by) consolidated funds	(3,710)	2,749	(4,549)	0	0
(Increase)/decrease in cash held in money market accounts and long-term deposit accounts	2,257	(6,538)	4,262	0	0
Acquisition of property, plant and equipment and intangible assets	(61)	(156)	(109)	(250)	(150)
Net cash used in investing activities	**(1,380)**	**(1,607)**	**272**	**50**	**170**
Financing activities					
Dividends paid	(1,338)	(1,676)	(2,462)	(3,130)	(3,466)
Acquisition of own shares	(619)	(1,158)	(1,547)	0	0
Cash received on exercise of Impax share options	47	0	166	0	0
(Distributions made to)/investments made by 3rd party investors in consolidated funds	554	(1,067)	1,693	0	0
Net cash generated from /(used in) financing activities	**(1,356)**	**(3,901)**	**(2,150)**	**(3,130)**	**(3,466)**
Net (decrease)/increase in cash and cash equivalents	2,954	(4,271)	438	2,647	2,274
Cash and cash equivalents at beginning of year	**3,680**	**6,634**	**2,364**	**2,804**	**5,451**
Effect of foreign exchange rate changes	0	1	2	0	0
Cash and cash equivalents	6,634	2,364	2,804	5,451	8,176
Plus cash invested in money market funds and long term deposit	10,615	17,153	12,891	13,000	13,200
Total	**17,249**	**19,517**	**15,695**	**18,451**	**21,376**

Source: Company historic and ED estimates

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