Impax Asset Management

AUM impresses, ESG stars continue to align

8 October 2019

Impax closed FY19 managing £15.1bn of assets, 20% up on the £12.5bn AUM of 30 Sep 2018, and beating our forecast of £14bn. Longer-term, we think the business remains well placed for strong revenue growth, capitalising on a global structural shift towards Environmental, Social and Governance (ESG) investing, and even stronger profit growth because of operational leverage.

AUM of London-managed listed equities (71% of total AUM, sourced mainly from institutional investors) ended the year on £11.7bn, 29% up year-on-year, an impressive performance considering the movement in major equity indices over the same period was mostly flat, typically varying between -1% and + 2%. London-managed Real assets AUM (3% of total AUM) closed the year on £445m, practically flat year-on-year with no capital raises or significant exits.

US operations (23% of total AUM) were not as strong, with AUM falling slightly by 3% to £3.0bn (adjusted to remove double-counting). Challenging market conditions prevailed as skittish retail investors, which make up the bulk of the US-managed book, exited equity markets, particularly during the turbulent months of December 2018, May 2019, and August 2019. Notably, in the last quarter of FY19, Impax's US operations recorded a small inflow of funds, bucking the trend of a continued broader move out of US equity mutual funds[1,2].

ESG boom underpins medium and long term potential

A shift of capital into ESG investments continues at pace around the world, and the outlook is for this trend to continue.

The Global Sustainable Investment Alliance (GSIA)[3], using a very broad definition of sustainable investing, estimates that sustainable investing assets in the five major markets of Europe; the United States; Japan; Canada; and Australia & New Zealand; reached US$30.7 trillion in 2018, 34% up on 2016, and making up just over one-third of total managed assets.

By 30 June 2019, signatories to the UN-backed *Principles for Responsible Investment* (PRI) reached 2,450 (roughly doubling over five years). Combined, these signatories manage assets of US$82 trillion[4].

Indeed, according to Morningstar: "*Over 170 ESG-related regulatory measures were proposed globally in 2018—more than in the prior six years combined. And more than 80% of the measures target institutional investors rather than companies or issuers*."[5]

Company Data

EPIC	IPX
Price (last close)	240p
52 week Hi/Lo	291p/180p
Market cap	£313m

Share Price, p

Source: ADVFN

Description

Impax AM is a specialist asset manager. Founded in 1998, it offers a range of thematic and unconstrained global equity strategies as well as real asset funds focused on the growth opportunity arising from a sustainable economy.

Aggregate AUM at end Sept 2019 was £15.1 bn.

Paul Bryant (Analyst)
0207 065 2690
paul.bryant@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

1 *https://ycharts.com/indicators/us_domestic_equity_mutual_fund_flows*
2 *Morningstar Direct Fund Flows Commentary: United States | August 2019*
3 *GSIA: 2018 Global Sustainable Investment Review*
4 *PRI Update, Q3 2019*
5 *Morningstar: The Evolving Approaches to Regulating ESG Investing, June 2019*

Global momentum

Europe is the region most advanced in terms of pushing the ESG agenda – 49% of all managed assets fall under the GSIA's 'sustainable' definition - and is currently Impax's largest market, with 64% of AUM sourced from EMEA (including UK & Ireland) domiciled clients. Across Europe, 305 new 'sustainable' funds launched in 2018 alone[6].

The EU's *Action Plan on Sustainable Finance* will be the development to watch. The plan has not yet come into law (an announcement is expected in 2019) but it will without doubt nudge more money to flow into the ESG space (advisers will have to ascertain clients' ESG investment objectives and preferences and take this into account when recommending investments). It is also likely to help the cream of ESG funds rise to the top (all managers of investment products will need to publish policies of how sustainability risks are integrated into investment decisions; and disclosures will need to be in accordance with a common taxonomy, to ensure consistency of ESG reporting and making investment products easier to compare).

In the UK (together with Ireland, making up 10% of Impax AUM), the government released its *Green Finance Strategy* in July 2019, outlining ambitions for all 'listed companies and large asset owners' to disclose in line with the recommendations of the Financial Stability Board's *Task Force on Climate-related Financial Disclosures* by 2022.

In the US (a priority growth market for Impax, with North America currently making up 32% of AUM), although lagging Europe in ESG adoption (26% of all managed assets fall under the GSIA's 'sustainable' definition), and despite the Trump administration's antipathy towards climate change, things are also moving. The GSIA reports sustainable investing assets reached US$12 trillion in 2018, up 38% since 2016.

Legislative changes at state level will probably be influential. For example, in 2018, the California legislature passed Senate Bill 964 requiring pension funds to assess the risk of climate change to their portfolios and act accordingly. In fact, Impax was selected in 2018 to execute part of the ESG investment strategy of the California State Teachers' Retirement System (CalSTRS), a US$ 225 bn pension plan[7]

And private sector initiatives are also prominent, such as the US Alliance for Sustainable Finance (USASF). This was founded in December 2018 by large financial institutions, and "aims to encourage more climate-friendly and sustainable finance innovation across the US capital markets … in line with the aim of meeting the United States' targets of the Paris Agreement" (this despite the Federal Government's announcement that the US will withdraw from the Paris Agreement).

Even in China, ESG momentum is building. The Chinese Government's 5-year plan released in 2016 contained a raft of 'green' development, social and governance proposals. The Peoples Bank of China has issued guidelines for establishing a 'green financial system', and has developed a regulatory framework for green bonds, green lending and a green-industry classification system. Indeed, the China Securities Regulatory Commission (CSRC) is said to be working on making ESG disclosures mandatory for A-listed shares. While China is still a very small market for Impax, it is an important long-term growth target with a credible distribution partner (BNP Paribas) already secured.

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[6] *Morningstar: European Sustainable Funds Landscape, August 2019*
[7] *https://www.calstrs.com/news-release/calstrs-selects-eight-esg-focused-asset-managers*

Impax well placed

Although Impax is clearly in a market sweet spot, competition is hotting up, with most asset managers now offering ESG investment products.

Yet hardly any have the 20-year track-record of Impax, nor the accumulated knowledge and proprietary IP that goes with it. In fact, Impax currently has 10 different ESG investment strategies that allow it to cater to a wide range of client investment priorities.

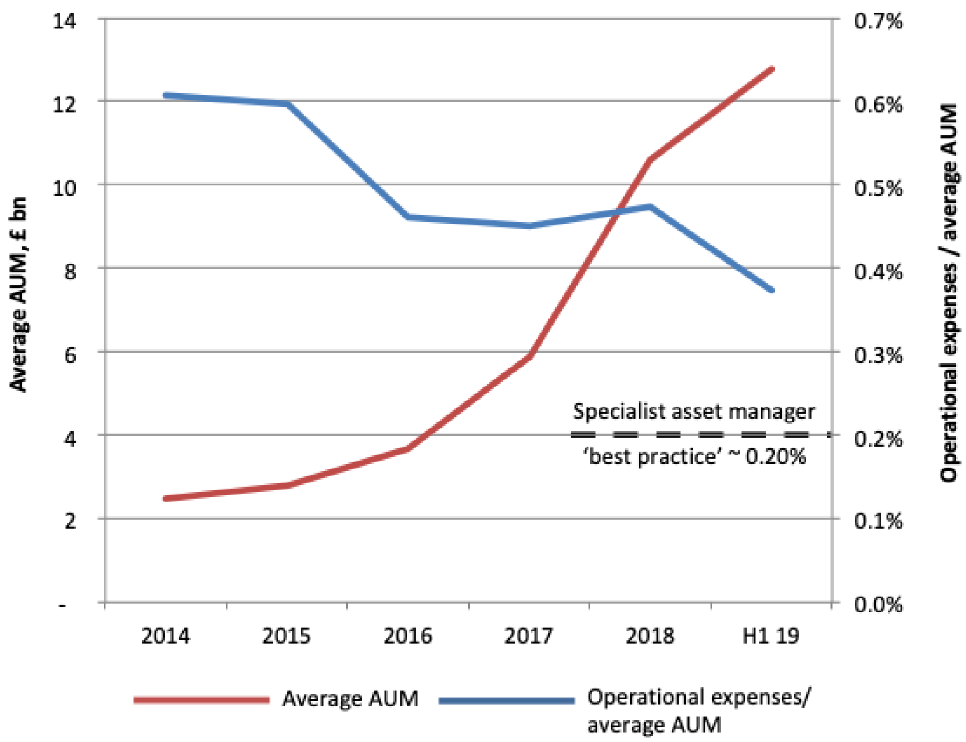
We view its key strengths as:

- Being well positioned to win substantial mandates from institutions and pension funds, particularly those wanting to allocate more assets to ESG investments (a powerful trend that will in all likelihood accelerate). ESG factors have been integrated into Impax's investment process for many years, along with a focus on Environmental markets.
- Its fund portfolio is differentiated, diversified by strategy and geography, and includes quoted and private equity infrastructure funds. This adds proven resilience in periods of market volatility.
- It has an established global distribution network and can capitalise on the shift to sustainability in underlying businesses and by investors around the world.
- Management and staff hold 30% of the equity, well aligned with external investors.
- Costs are closely controlled and recent investments in systems and processes should make the operation highly scalable. Further significant AUM growth should be able to be absorbed without a proportionate addition of expenses, so margins should build progressively.

This operational leverage has been clearly evident over the last few years, as shown in the chart below. Further margin enhancement should be possible. At the end of H1 19, Impax had reduced its *Operational Expenses to average AUM* ratio to 0.37%, from 0.61% in FY14. This makes it a leader among peers of a similar scale. Polar Capital (£13.8bn AUM) and Liontrust (£12.7bn AUM) have *Operational Expenses to average AUM* ratios of 0.89% and 0.68% respectively.

The lowest ratio among specialist asset management peers is approximately 0.20%, achieved by Ashmore, the emerging markets specialist. However, that level is on the back of a significantly higher AUM base than Impax (£72bn v £13bn), so a drop to that level would probably only be feasible for Impax in the mid to long term.

AUM vs. Expense ratio



Source: Company Annual Reports, ED analysis.

The strategic positioning of Impax, coupled with efficiently run operations, makes the investment case from a capital growth perspective look attractive. In addition, it is our view that its strategic advantages are highly likely to attract consolidation interest in the future.

From an income perspective, the investment case also has merits. The business is cash generative with a progressive dividend policy. FY18 dividend yield was 1.7%, and our previously forecast full-year dividend for FY19 of 5.0p (1.5p interim plus 3.5p final), would translate to a yield of 2.1%. If our forecast payment is correct, dividends will have more than doubled over the last three years.

Previous forecasts

Impax has exceeded our previous year-end AUM forecast of £14bn, and we now look forward to seeing the impact on revenue and profits when the full-year financial results are released later this year.

Summary forecasts

Year end 30 Sep	2016A	2017A	2018A	2019E	2020E
Revenue, £m	21.1	32.7	65.7	69.3	76.2
Adjusted Op. Profit, £m	4.2	9.3	20.0	17.9	21.0
Adjusted EPS, Basic p	3.7	6.2	12.5	10.4	13.4
PER	65.7	38.7	19.3	23.1	17.9
EV/NOPAT	83	34	25	18	18
Yield, %	0.9	1.2	1.7	2.1	2.4

Source: Group report & accounts and ED estimates (EV calc. includes net cash and seed investments) Adj. results eliminate non-recurring acquisition costs, ongoing amortisation of intangibles acquired, one-off tax credits and mark-to-market of NI on equity award schemes.
Note: All PER, EV/NOPAT and Yield calculations based on a share price of 240p.

Investor Access

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk