Impax Asset Management Group

Making one plus one equal three

15 March, 2018

Enhanced EPS and growth outlook

We have updated and added FY19e forecasts post completion of Impax's acquisition of US-based Pax World Management LLC. In addition to greater scale reflected in the £11.225bn end January AUM, that extended Impax's product portfolio, marketing reach and client base. We expect an immediate boost to adjusted EPS net of (a) the cost of servicing new debt secured to finance the acquisition and (b) an issue of 2.66m new shares at 170p.

Margins should progressively benefit from increased scale and a broader, more diversified AUM base. We estimate that as at end January 2018, Pax, since renamed **Impax Asset Management LLC (IAM LLC)**, represented c 32% of the enlarged group's AUM and generated just under 40% of its ongoing run-rate revenue. We have, however, assumed no benefit from cost savings or synergies, as neither was part of the rationale for the acquisition; but see potential for efficiency gains.

Impax plans to run independent investment teams, exchange ideas for best practice, progressively build collaboration and integrate some support functions.

Valuation: transformational acquisition, 2.7% FY19e yield

Potential EPS enhancement is better than we initially projected. Fewer consideration shares were issued and FY18 PER is 17x vs 20x at announcement. The acquisition terms were assisted by favourable GBP/USD, although this is a sensitivity for Impax's enlarged USD revenue base included in our forecasts. Current forecast end FY18 EV is 1.79% of AUM (£11.225bn at end January), falling to 1.68% based on our end FY18 AUM estimate.

Dividend growth is well covered by forecast EPS/cash generation. Projected FY18 cover is 3.2x vs 2.2x (FY17), net of cost of servicing new debt and scheduled amortisation. We assume 25% dividend growth for this year and FY19e, below the 38% increase in FY17. That is deliberately conservative. It reflects the potential for Impax to pay up to another US$37.5m by 2021 contingent on performance, funded by a mix of cash and debt.

Revenues may be affected by stock market volatility, but AUM growth momentum and the impending closure of the latest Private Equity fund drive fee income short term. Beyond that, we regard the combination as **a potential sea change in group prospects**, as Impax leverages its experience as an institutional fund manager to drive its acquired US institutional operation and offer new products to its existing client base.

Summary forecasts

Year end 31 Sep	2015A	2016A	2017A	2018E	2019E
Revenue, £m	19.7	21.1	32.7	62.4	70.4
Op. Profit, £m	3.1	4.2	7.9	18.0	19.9
EPS, p	3.1	3.7	6.2	11.5	12.7
PER x	53.2	44.6	26.6	14.3	13.0
EV/NOPAT	84	55	22	14	12
Yield, %	1.0	1.3	1.8	2.2	2.7

Source: Group report & accounts and ED estimates, (EV calc. includes net cash and seed investments).

Company Data

EPIC	IPX
Price (last close)	165p
52 week Hi/Lo	214p / 70p
Market cap	£216m
Net cash (Sep 2018e)	£4.9m

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 January 2018 was £11.225bn.

The group has won many prestigious awards including:

THE QUEEN'S AWARDS FOR ENTERPRISE: SUSTAINABLE DEVELOPMENT 2014

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Upgraded forecasts post completion

Impax completed the acquisition towards the end of January. That has materially extended the group's investment management, research and client service capabilities in the US, and improves access to a key market.

We recap the terms below and update forecasts for the deal and recent AUM updates. We expect the deal to enhance returns in both the short and progressively over the medium term, as the enlarged group capitalises on an increased profile and broader client base, extended marketing reach, product range, coverage and strategies.

EPS enhancing acquisition

Prospective EPS enhancement is slightly ahead of our calculation post the announcement last September. In addition to the contribution from the acquired entity, fee income includes one-off contributions related to backdated fees from latter investors in the new private equity fund (PE3) and carried interest distributions as all investments in PE2 are exited. EPS is also adjusted for the retained minority stake, lower US tax rates and assumed exercise of options.

Summary financial outlook

Year ended 30 September	2016	2017	2018e	2019e
AUM (£bn)	4,502	7,205	11,975	13,925
Net fee income (£m)	21.1	32.7	62.4	70.4
Adj. Pre-tax profit (£m)	5.2	5.9	18.0	19.9
Diluted EPS (p)	3.7	6.2	11.5	12.7
Dividend/share (p)	2.1	2.9	3.6	4.5

Source: Company/Equity Development forecasts

Post announcement adjustments include:

- Lower than expected consideration shares; 2.66m issued at 170p, vs the 4.29m at 110p we had initially assumed.
- Estimated c 5% growth in the acquired entity's AUM since the announcement underpins projected fee income.
- Recent GBP/USD strength cut the sterling cost of a US dollar denominated acquisition, although it will have a potentially offsetting negative impact on the projected contribution from what is now a significantly larger US-based operation.

Our forecasts are not affected by deferred consideration, which we assume will be settled in 2021. Impax expects to cover the cost from ongoing cash flow and/or the new 5-year revolving credit facility.

Our FY18 fee income projection is based on 16% growth in underlying aggregate AUM. That assumes Impax's listed AUM grows by 23%, IAM LLC's by 7.5% y-o-y at consistent underlying fee rates i.e. 0.13% EBITDA/AUM margin for the acquired entity vs 0.15% for Impax alone. The difference in the latter reflects the economies of scale post recent growth at Impax, and we see potential for IAM LLC to progressively move into line and grow by 25% if it achieves the target increase in AUM to US$8bn, and benefits from the enlarged group's higher profile and improved distribution. That does not specifically include cost savings or efficiencies post acquisition, as synergies were not part of the deal rationale.

Acquisition terms: brief recap

Impax acquired 83.3% for c US$44.2m (£34.2m) and will pay US$8.3m for the remaining 16.7%, plus deferred payments worth potentially another US$37.5m (£29.0m) over a multi-year period to 2021. The US$52.5m initial payment was equivalent to 9.0x the acquired business's run rate EBITDA and 1.17% of AUM, falling to 1.13% AUM (US$90m and US$8bn AUM) if all earn out targets are achieved.

- The initial US$44.2m was settled in cash (US$38.1m) and 2.66m shares (US$6.1m). The cash was funded from existing resources and two new US$13m debt facilities provided by RBS i.e. US$26m in total.
- The consideration shares were issued at 170p, the average over the prior 20 trading days. They are subject to a 12-month lock-up post completion, then an orderly market provision for another year.
- The remaining 16.7% held by IAM LLC management is covered by put and call option arrangements until 2021, at which time either management or Impax can exercise the option. Impax will pay US$8.3m (£6.4m) for that balance, either in new shares issued at the prevailing share price and/or cash, at its discretion.

The US$37.5m (£29.0m) deferred payment is contingent on average AUM at end June, September and December 2020. No further consideration is due if it is below US$5.5bn, and the full amount if it is US$8.0bn or above. If it is between those figures, the payment will be adjusted pro-rata. If the AUM target is achieved rapidly, up to US$10m of the contingent consideration may be paid in Q3 FY19.

Deal rationale, complementary UK and US based fund managers

The deal combined entities with aligned investment strategies and broadly complementary portfolios, product suites and geographic coverage. The integrated group can offer a broader range of investment solutions to both institutional and retail investors.

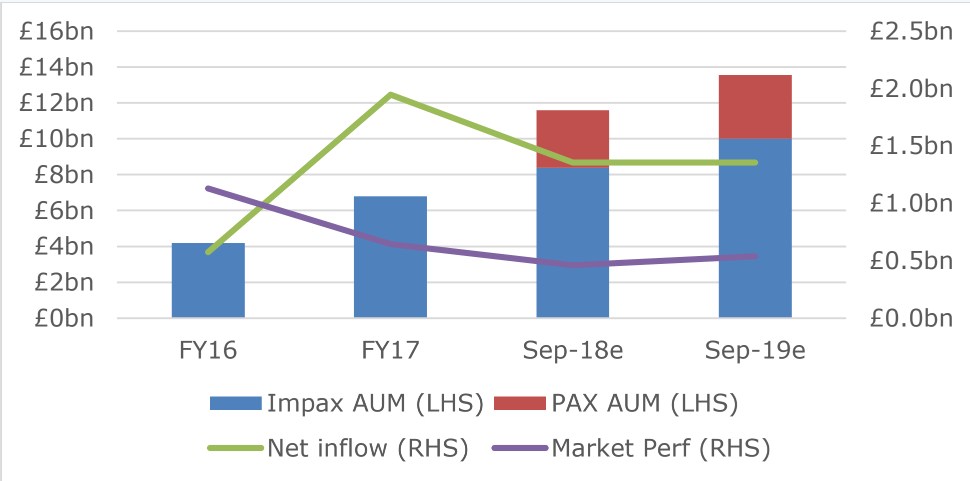
- Impax runs commingled funds and segregated accounts, primarily for institutions. Its core focus is actively managed small and mid-cap global public equity and private equity strategies. It has a mainly European client base and growing US institutional presence. The latter will now be enhanced by the addition of a well-developed mutual funds business directed mainly at US based financial advisors.
- IAM LLC's AUM comprises eleven US mutual funds, including actively managed, fixed income (75% of AUM) and passive equity strategies (25%), provided mainly for domestic retail investors. Its investment focus is equities and bonds issued by US companies.

Integration risks will be managed by retaining independently operating investment teams and the acquired entity's existing President & CEO remains in place. **Encouragingly, the two groups already had a ten-year plus relationship**, derived from their collaboration on the design and management of the US511m (end August 2017) Pax Global Environmental Markets Fund.

Financial Outlook and Valuation

We have adjusted FY18 forecasts for an eight-and-a-half-month contribution from IAM LLC, 2.66m new consideration shares issued, the cost of projected debt and the latest AUM update. Although recent stock market volatility may affect growth rates our AUM growth forecasts pivot primarily upon net inflows, rather than market performance.

Historic and forecast AUM growth, new investment and fund performance



Source: Company/Equity Development forecasts

The group's track record and composition of its AUM provides satisfactory revenue visibility. Although growth has accelerated recently, client investment in its listed equity funds has proven relatively resilient to stock market gyrations, while the addition of the new US funds and completion of the latest private equity fund raising, scheduled for May 2018 underpins the FY18e outlook.

For forecast purposes we have assumed underlying 5% pa market driven growth in AUM and further net inflows running at c 64% of that achieved during FY17.

Private Equity – Third fund to close by end May

We project that the third private equity fund (NEFIII) will close somewhere north of €400m. The marketing period has been extended beyond the originally projected, end February 2018 close date to accommodate potential additional investors. We also assume that all investments in NEFI and NEFII will be exited by end September 2018.

New debt: interest and amortisation well covered by cash flows

Impax secured two new facilities totalling US$26m from RBS to fund the acquisition. These are respectively a US$13m three-year term loan at LIBOR +2.9%, and a US$13m five-year revolving credit facility at LIBOR +3.3%.

We estimate maximum annual debt service of c £0.85m assuming all debt were fully drawn, plus an annual c £3.1m amortisation charge for the term loan over the next three years.

Our forecasts are however, adjusted for the acquisition timing, the expectation that the revolving credit will not be fully drawn and the reducing term loan balance. With respect to the revolving credit, our forecasts suggest that Impax could reduce the outstanding balance relatively quickly from internal cashflow, but this will to some extent depend upon whether it pays part of the contingent consideration earlier than we anticipate (i.e. the acquired business hits defined targets ahead of schedule).

Sensitivities

Stock market performance and sentiment is a key source of sensitivity for revenue forecasts. Our AUM projections assume:

- 5% pa market related growth in existing funds
- net inflows for the combined group of c £1.4bn in each year

To put these in perspective, market performance added 45% (FY16) and 15% (FY17) to Impax's own AUM (prior to the acquisition), and net inflows were respectively £575m and £1,948m.

Both entities have independently reported strong recent fund performance, but market related growth may be adversely affected by pressure on equity markets worldwide. We nonetheless see potential for continued momentum from net inflows, underpinned by investor interest in the sector and recent fund performance, and contributions from an enlarged portfolio and enhanced US marketing and distribution.

Although the net performance in January was flat, AUM for the enlarged group has grown by c 9% since end August 2017 (the last reported figure prior to the announcement), to £11.225bn at the end of January 2018 vs £10.3bn when the acquisition was announced.

AUM movement – Impax AM funds

Total AUM, £m	Listed Equity funds	Private Equity funds	Property funds	Total
30 June 2017	**6,235**	**424**	**22**	**6,681**
Net inflows	379	27		
Market movement and performance	173			
30 September 2017	**6,788**	**451**	**22**	**7,261**
Net inflows	672	3		
Market movement and performance	294			
31 December 2017	**7,754**	**454**	**22**	**8,230**
30 January 2018	**10,749**	**454**	**22**	**11,225**

Source: Impax RNS

Any material changes in GDP/USD will affect reported GBP revenues and earnings, as post acquisition, the group is likely to generate a much higher proportion of its income in North America.

From an operational perspective, the acquired business is hedged against forex shifts as it is largely a domestic US operation which earns fees and incurs expenses in USD.

Reported figures would however benefit from significant sterling weakness and conversely, be negatively affected by strong GBP/USD appreciation. For forecasting purposes, we have assumed steady exchange rates.

FINANCIALS

Income statement, key ratios					
To end Sept, £'000s	**2015**	**2016**	**2017**	**2018e**	**2019e**
Revenue	**19,726**	**21,067**	**32,694**	**62,414**	**70,379**
Operating costs excluding legacy LT incentive schemes	(16,616)	(16,915)	(24,809)	(43,998)	(50,438)
Operating profit	**3,110**	**4,152**	**7,885**	**18,023**	**19,941**
Operating margin	16%	20%	24%	27%	28%
Minority interest (16.7% held by management)				(795)	(1,252)
Credits/(charges) related to legacy LT incentive schemes	1,285	27	(653)	0	0
Exceptional acquisition costs	0	0	(999)	(500)	0
Amortisation of goodwill/intangibles				(1,905)	(1,905)
Fair value gain/(loss) on investments	615	989	(605)	0	0
Investment income	228	319	464	450	450
Finance cost				(576)	(718)
Change in 3rd party interest in consolidated funds	(101)	(288)	(239)	0	0
Profit before taxation	**5,137**	**5,199**	**5,853**	**14,697**	**16,517**
Adj. profit before tax	**5,137**	**5,199**	**5,853**	17,397	19,673
Taxation	(1,504)	(1,022)	1,814	(3,479)	(3,935)
Profit after tax	**3,633**	**4,177**	**7,667**	**13,917**	**15,739**
Other adjustments for EPS calc.					
Profit attributable to owners of the company			7,206	13,013	14,716
Adj. re profit attributable. to restricted shares			461	905	1,023
			7,667	**13,917**	**15,739**
Earnings per share					
Shares in issue (basic) k	115,133	111,794	111,251	120,000	123,000
Shares in issue (diluted) k	115,909	114,399	115,396	121,000	124,000
Basic EPS, p	**3.16**	**3.62**	**6.48**	**11.60**	**12.80**
Diluted EPS, p	**3.13**	**3.65**	**6.42**	**11.50**	**12.69**
Interim dividend	0.40	0.50	0.70	0.85	1.10
Final dividend	1.20	1.60	2.20	2.75	3.40
Total dividends per share, p	**1.60**	**2.10**	**2.90**	**3.60**	**4.50**
Dividend cover	**1.96x**	**1.74x**	**2.15x**	**3.17x**	**2.80x**

Source: Company historic data; ED estimates

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