investors CHRONICLE alpha

6 July 2018

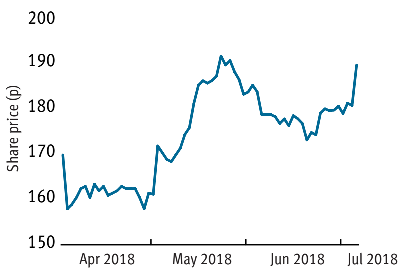
SimplyBiz: Profiting from regulation and compliance

The leading provider of compliance, business and technology services to over 3,400 financial intermediaries offers prospects for significant earnings growth, earnings-accretive bolt-on acquisitions and a progressive dividend policy

SimplyBiz (Aim:SBIZ)

Ticker	SBIZ
Current price (p)	190
Target price (p)	272
Market cap (£m)	145
52-week high (p)	196
52-week low (p)	155
Net cash (£m)	3.3
Shares in issue (m)	76.5
Financial year-end	31 Dec
Next event	2018 half-year pre-close trading update summer 2018
Company website	simplybizgroup.co.uk

SimplyBiz somewhat overlooked since listing in April



Source: Bloomberg

Analyst: Simon Thompson
simon.thompson@ft.com

Alpha Production Editor: Sameera Hai Baig

Simon Thompson's view:

SimplyBiz (SBIZ) listed its shares on London's junior market a few months ago and, with a market value of £145m, has slipped below the radar. It's worth exploiting, though, as there is a real opportunity to lock into an investment that has the potential to deliver a 50 per cent return over the next few years, in line with anticipated EPS growth. A shift in the IFA industry towards direct authorisation, and the need for financial intermediaries to comply with a raft of new legislation means that an increasing number are seeking the services of companies such as SimplyBiz, who provide compliance, business and technology services they need to carry out their business. The company makes money from product providers, too, so profits from both the 'demand' and 'supply' side. It's a win-win business model investors are likely to warm to.

Bull points

- New legislation driving growth.
- Market leader.
- High barriers to entry.
- Low attrition rate of clients.
- Non-cyclical revenue and profit streams.
- High recurring revenues.
- Operationally-geared.
- Highly cash-generative.
- Substantial boost to pre-tax profits from paying down borrowings.
- Progressive dividend policy.
- Low-cost bank facility to facilitate earnings-accretive bolt-on acquisitions.
- Senior management heavily invested.

Bear points

- UK economic uncertainty.
- Liquidity.
- Risk of housing market downturn.

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

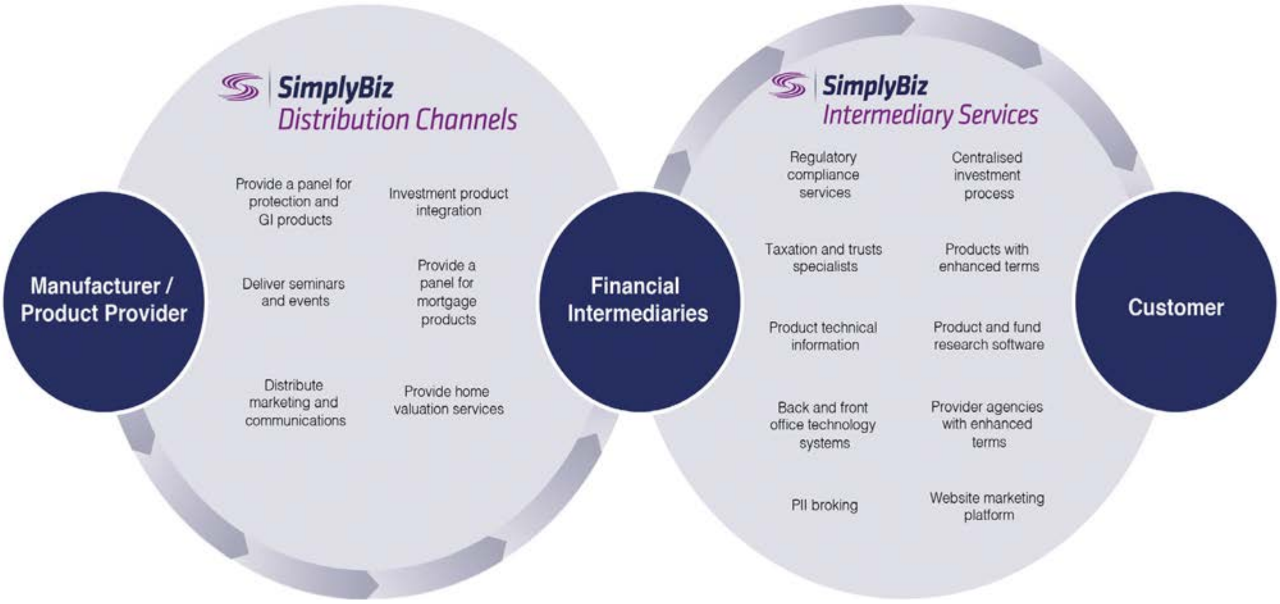
When **SimplyBiz (SBIZ)** listed its shares on the Alternative Investment Market (Aim) three months ago, the company attracted the interest of some heavyweight financial institutions, including **Liontrust Asset Management**, **Lombard Odier**, **Fidelity** and **Franklin Templeton Fund**. It's easy to see why.

Founded in 2002 by chairman and 39.9 per cent shareholder Ken Davy, the company generates half of its revenue by providing a range of compliance, business and technology services to over 3,400 firms, including wealth managers, Independent Financial Advisers (IFAs), mortgage and general insurance intermediaries, estate planners and credit brokers. The other half of the revenue is earned by providing a range of services to over 135 financial institutions, so that they can connect and sell their products through intermediaries in a highly efficient way. In effect, SimplyBiz makes money from both the 'demand side' (intermediaries) and 'supply side' (product providers).

SimplyBiz: Divisional structure

	Intermediary Services Division	Distribution Channels Division
Service and revenue lines	**Membership.** Comprehensive regulatory compliance services and business support for IFAs, mortgage advisers and consumer credit broker firms.	**Marketing services.** Enabling product providers to deliver intermediary training and communicate their products and services to the independent sector.
	Additional services. Field consultant support, file checking, estate planning & probate, and professional indemnity insurance broking.	**Mortgage panel & transaction services.** Enabling aggregated negotiation, efficient origination and property valuation services to mortgage lenders.
	Employee benefits software. Proprietary software used by workplace consultants and employers to provide automatic enrolment and flexible benefit services to employees. This business currently serves a separate customer group from the members.	**Protection insurance & general insurance panel.** Enabling aggregated negotiation and efficient origination of life insurance policies for product providers.
	Software. Back office CRM licenses.	**SimplyBiz's own investment products:** Verbatim Asset Management
Key facts	Over 3,400 directly authorised members.	135 product providers commercially engaged as distribution channel partners.
	Monthly subscription model with high recurring revenues.	Annual contracts with high recurring revenues.
	Average revenue per member of £4,623 in 2017.	£10bn of mortgage lending originated in 2017.
	Additional services up-selling and software cross-selling delivers recurring revenues and increases average income per member by 87 per cent.	49,000 general insurance policies originated in 2017.
	£40bn assets under administration.	£582m in assets under management in own investment products, representing growth of £148m in 2017.
Revenues (2017)	£22.1m	£21.9m

Source: Aim Admission Document



Source: SimplyBiz

The business offering is proving incredibly popular. For instance, intermediary membership has increased by more than half since 2013, a key driver of the company's revenues and profits. There are sound reasons for this, too.

That's because firms operate in one of two ways: under direct authorisation and regulation by the Financial Conduct Authority (FCA); or as an appointed representative of a principal authorised firm, whereby the principal takes responsibility for regulatory compliance of the appointed representative. In addition to the requirement to meet threshold conditions for authorisation and ensure ongoing compliance with regulation, directly authorised intermediary firms are subject to a range of commercial and operational pressures that are difficult to meet without a support services provider such as SimplyBiz. Importantly, the compliance support that SimplyBiz provides to its members does not constitute regulated advice, and the member is authorised and regulated by the FCA directly, so remains responsible for their advice and all matters of regulatory compliance.

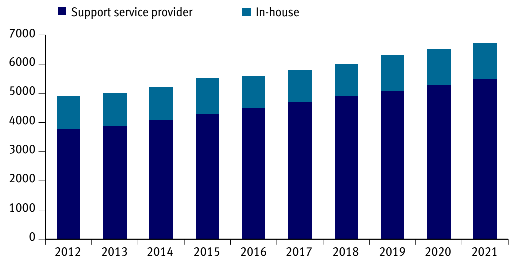
Shift towards direct authorisation

Bearing this in mind, there has been a definite shift in the industry towards direct authorisation.

"SimplyBiz has been taking advantage of the underlying trend towards direct authorisation"

It's understandable as poor network performance and inherent inefficiencies make the appointed representative model more expensive and inflexible for some financial advisers. For instance, networks may seek to restrict a firm's chosen advice model and many consolidator models seek to impinge on a firm's independence. As a result, SimplyBiz has been taking advantage of the underlying trend towards direct authorisation by offering a packaged

Number of directly authorised firms (target market)



Source: Aim Admission Document (CIL, 2017)

membership service that includes authorisation services to assist firms' transition from being an appointed representative to being directly authorised. Moreover, there is an increasing propensity for directly authorised firms to buy-in regulatory and compliance services as against managing all affairs in-house. Reasons for doing so include:

- Complex regulatory environment.
- Breadth and complexity of products.
- Complex tax regime.
- Documentation management.
- Continuing professional development (CPD) requirements.
- Software training and education requirements.

On a practical level, the company offers its members a vast range of helpdesk services such as specialist guidance on HMRC, Department of Work and Pensions and FCA aspects of pension-related regulations, including carry-forward rules, the Sipp/SSAS regime, pension switching and transfers. Specialist trust and taxation are proving popular, too. Key topics here include capital gains tax mitigation, inheritance and estate planning. SimplyBiz also provides members with a customised investment planning and research software application provided by Defaqto. Other business services include professional indemnity insurance broking, file-checking and a back-office production service that supports members in producing wills and undertaking estate planning and probate.

Members can also sign up for the sector's leading specialist practice management and customer relationship management (CRM) software application, Intelligent Office. Many do so because there are significant cost savings to be made. That's because the scale of SimplyBiz's operation means that it can offer its members attractive discounts on the retail price of Intelligent Office and earn a decent margin, too.

There is clearly a high level of customer satisfaction as member attrition rates were just 5 per cent last year, with the average member signing up for more than five years, thus providing a solid recurring income stream for SimplyBiz. It's not a chunky business either, as no member accounts for more than 1 per cent of the company's annual revenue, and more than 90 per cent of the members generate less than £10,000 per annum in revenue, so the spread of business is well diversified.

Importantly, SimplyBiz's 'one-stop shop' proposition to UK intermediaries continues to pull in new members who are charged a relatively modest average membership fee of £2,460 for its basic subscription. The subscription rate is set at 2.5 per cent of the member's turnover plus VAT, implying that the average firm has a turnover of £100,000 and the total turnover of the 3,433 member firms is around £340m. SimplyBiz then upsells the additional services mentioned above to boost the average annual income earned from its members to around £4,623. Moreover, as client businesses grow, so does SimplyBiz's subscription income.

Intermediary services (excluding employee benefits software)

Year ended 31 Dec	2015	2016	2017
Revenue	£13.1m	£14.1m	£15.9m
Ebitda	£2.3m	£2.8m	£3.3m
Ebitda margin	17.5%	19.8%	20.8%
Number of members	2,962	3,216	3,433
Average subscription per member	£2,505	£2,446	£2,460
Average additional revenue per member	£1,203	£1,143	£1,196
Average software revenue per member	£724	£815	£967
Total revenue per member	£4,432	£4,404	£4,623

Assuming single-digit revenue growth and modest margin expansion.....

Year ended 31 Dec	2018	2019	2020
Revenue	£17.4m	£19.1m	£21.0m
Ebitda	£3.8m	£4.4m	£5.0m
Ebitda margin	21.8%	22.8%	23.8%

.....cash profits could surge by almost half by 2020

Source: Aim Admission Document, Zeus Capital revenue estimates (2018-2020), Investors Chronicle financial models

The fact that cash profits from intermediary services increased by 43 per cent from £2.3m to £3.3m in the past two financial years, on revenues up by 21 per cent from £13.1m to £15.9m, highlights the attractive operating leverage in this business. Namely, an increasing proportion of incremental revenue drops straight down to the bottom line. I estimate that an eye-watering 45 per cent of new revenues is being converted into cash profit, which is why profit is likely to continue to rise strongly even based on modest revenue growth. As a leading provider of compliance and business services to directly authorised IFAs, SimplyBiz is ideally placed to capitalise on further growth in the market. It already has a 17 per cent market share for individuals employed by directly authorised IFAs and a 7.5 per cent share of the non-bank, non-insurer market.

It's a valuable source of income, accounting for a third of the £9.5m cash profits SimplyBiz reported last year. Please note that the there is only a £200,000 difference between the company's cash profit and underlying operating profit of £9.3m. Cash profits are also referred to as Ebitda (earnings before interest, taxation, depreciation and amortisation charges) and give a more accurate idea of the overall cash profitability of the business.

"An increasing proportion of incremental revenue drops straight down to the bottom line"

Intermediary Services fee structure

	2015	2016	2017	CAGR (%)
Core compliance fees	£7.4m	£7.8m	£8.5m	6.5
Additional fees	£3.6m	£3.7m	£4.1m	26.2
Software fees	£2.1m	£2.6m	£3.3m	26.1
Membership income	£13.1m	£14.1m	£15.9m	14.0

Prospects for strong growth from 2018 to 2020

	2018E	2019E	2020E	CAGR (%)
Core compliance fees	£9.0m	£9.6m	£10.3m	6.8
Additional fees	£4.7m	£5.4m	£6.0m	13.4
Software fees	£3.6m	£4.1m	£4.7m	12.2
Membership income	£17.4m	£19.1m	£21.0m	9.7

Source: Aim Admission Document, Zeus Capital

Employee benefits software

The balance of the intermediaries services division's revenue (£6.3m out of £22.1m in 2017) comes from providing its Zest technology 'software as a service' to over 300 employers. This helps set up benefit schemes to improve employee engagement, administration and maintenance. It also helps organisations to remain fully compliant with their duties under the General Data Protection Regulation (GDPR). The software is licensed to the UK's leading employee benefit consultants, including **Hargreaves Lansdown**, **Aviva** and **Mattioli Woods**.

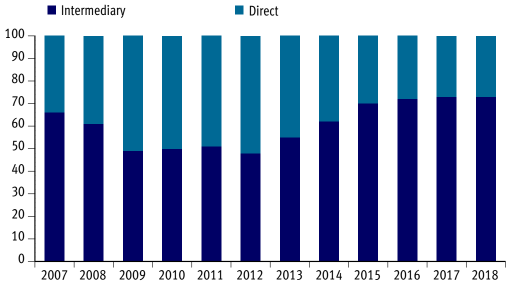
A multi-million investment (around £4.6m) has been made in new technology to position the Zest platform and create a scalable proposition to support around 4m potential clients, including employees who are obliged to auto-enrol into employer pension schemes. Last year, license fee income from this activity covered its operating costs and it turned into a modest cash profit of £100,000. However, the risk to earnings surprises from this segment looks skewed to the upside. That's because analysts have taken a conservative view on the future profit contribution here, even though there is clearly scope for product providers to sell into what could be a potentially lucrative new distribution channel.

Regulation drives growth

There is every reason to expect the positive trends benefiting the intermediary services business to continue given the increasing amount of new legislation that financial firms have to comply with. For instance, the introduction of Mifid II this year is expected to result in a greater use of technology and centralised research by the financial adviser. The legislative backdrop in the financial services industry is also highly supportive of SimplyBiz's role in enabling product providers to satisfy new regulatory requirements to demonstrate understanding of how products are intermediated, with emphasis on appropriateness

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

Intermediary share of the mortgage market by value (%)



Source: Aim Admission Document (CIL, 2017)

of their products for the consumers who buy them.

Mifid II is not the only new legislation that financial firms have to comply with as the requirements of GDPR has added another layer of compliance for them to contend with. In addition, the Mortgage Market Review – introduced in 2014 – has added complexity and greater responsibility to the activity of providing mortgage advice. Interestingly, independent professional intermediaries have benefited from this change in regulation, with 73 per cent of mortgage lending by value put through the intermediary channel in 2017, up from 55 per cent in 2013 when the Retail Distribution Review (RDR) was first introduced.

By positioning the business to help intermediaries meet the compliance and operational requirements of existing and new legislation, SimplyBiz has been able to take a dominant market share on the 'demand side'. For example, the company launched its 'Vision' service, delivering a complete operating model for firms to meet all the requirements of RDR. It also helped accelerate growth in software sales, providing an efficient practice management solution for independent firms.

A profitable distribution channel

It's not the only part of the business that's flying as SimplyBiz has been exploiting business opportunities on the 'supply side' by offering product providers an effective distribution channel to reach an otherwise fragmented independent intermediary sector. In total, 135 financial institutions have signed up, including 26 life and pensions companies, 43 asset managers, 46 lenders, 13 general insurers and seven credit lenders. It's big business, as every year member firms arrange 9,000 general insurance policies, process over £10bn of mortgages and advise on over £4bn of fund flows. In total, these firms have assets under administration (AUA) in excess of £40bn.

It's a lucrative business segment for SimplyBiz, which generates revenue from product providers when they successfully engage with its members. In fact, the distribution channel accounted for £6.1m of the company's cash profits of £9.5m, on revenues of £21.9m, in 2017.

"SimplyBiz has been exploiting business opportunities on the 'supply side' by offering product providers an effective distribution channel"

"Prospects for a surge in profits from the distribution channel works is a real possibility"

Distribution channel: Financial performance

Year ended 31 Dec	2015	2016	2017
Revenue	£18.2m	£19.7m	£21.9m
Ebitda	£4.1m	£4.6m	£6.1m
Ebitda margin (%)	22.5%	23.4%	27.9%
Number of members	2,962	3,216	3,433

If margins are just maintained then cash profits....

Year ended 31 Dec	2018E	2019E	2020E
Revenue	£28.2m	£30.8m	£33.2m
Ebitda	£7.9m	£8.6m	£9.3m
Ebitda margin (%)	28.0%	28.0%	28.0%
Number of members	3,605	3,785	3,974

....will surge by half by 2020

Source: Aim Admission Document, Zeus Capital revenue estimates

Prospects of a surge in profits from the distribution channel works is a real possibility when you consider the range of services offered and the drivers behind each one.

■ **Events and seminars:** SimplyBiz hosts over 400 events and seminars each year to provide product providers with the opportunity to deliver information that is relevant to their own markets, products and services that will enhance adviser knowledge and improve consumer outcomes.

Product providers are able to interact in person, thus offering them an efficient method to reach an otherwise fragmented independent sector. Events take a variety of formats suited to the particular needs of different members, including learning and development events, investment forums, mortgage events, mainstream product education and advice to process seminars. The main focus last year was on pension freedoms, understandable in light of the changes in legislation that came into effect in 2015. Events are well attended, with the audience size typically ranging from 30 to 100 plus per venue.

■ **Brand and product communications:** SimplyBiz delivers a range of electronic and printed materials from product providers to its members. This enables product providers to keep a regular communication plan in place with a large number of independent intermediaries. Content is delivered alongside technical and compliance materials produced for members, thus increasing the likelihood of members reading the communications.

Income from marketing services is well diversified across 65 product providers and no single one accounts for more than 5 per cent of SimplyBiz's revenue. Furthermore, ongoing engagement with product providers provides excellent revenue visibility. Indeed, revenue earned from marketing services was around £1,793 per eligible member in 2017, or £6.1m in total.

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

> *"SimplyBiz's mortgage club is now the third largest in the UK, having placed over £10bn of mortgages in 2017"*

Distribution channel: Marketing services

Marketing services	2015	2016	2017
Membership	2,962	3,216	3,433
Participation (%)	100	100	100
Revenue per eligible member	£1,958	£1,779	£1,793
Revenue (£m)	£5.7m	£5.9m	£6.1m

With a modest rise in membership and revenue per member...

Marketing services	2018E	2019E	2020E
Membership	3,605	3,785	3,974
Participation (%)	100	100	100
Revenue per eligible member	£1,853	£1,917	£1,982
Revenue (£m)	£6.7m	£7.3m	£7.9m

....revenues could rise by 30 per cent by 2020

Source: Aim Admission Document, Zeus Capital

■ **Mortgage panel and transaction services:** In recent years, there has been a rapid expansion in SimplyBiz's mortgage club and transaction services to mortgage lenders. In fact, it's now the third largest mortgage club in the UK having placed over £10bn of mortgages in 2017. SimplyBiz helps lenders connect with the mortgage advisers through their attendance at complimentary mortgage meetings and round-table events held across the UK.

The service includes a dedicated account manager for intermediaries to assist them with queries and case placement. SimplyBiz negotiates preferred products from key lenders and presents product information in an easy to access rate summary sheet to assist advisers. It then delivers parity with other major mortgage clubs on procuration fees payable, ensuring members are receiving a competitive commercial deal.

It's proving popular as over 1,600 members now use its mortgage panel service, and SimplyBiz's directors believe there is a significant future growth opportunity in this service from the other 1,800 of its eligible members. To increase market penetration, members have free access to two software applications: Mortgage Brain, subject to minimum case numbers; and subsidised access to the Trigold Crystal sourcing software.

It's a lucrative source of income as the Mortgage Panel segment has increased revenues from £4.9m in 2015 to £5.8m in 2017, buoyed by a 10 percentage point increase to 60 per cent in the number of eligible members using the service, with each one generating around £3,400 of revenue for the company.

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

Distribution channel: Mortgage panel

Mortgage panel	2015	2016	2017
Membership	2,962	3,216	3,433
Participation (%)	50	56	60
Revenue per eligible member	£3,372	£3,194	£3,421
Revenue (£m)	£4.9m	£5.2m	£5.8m

With higher penetration and modest rise in members...

Mortgage panel	2018E	2019E	2020E
Membership	3,605	3,785	3,974
Participation (%)	65	70	75
Revenue per eligible member	£3,421	£3,450	£3,600
Revenue (£m)	£6.0m	£6.4m	£7.0m

.....revenues could rise by 20 per cent by 2020

Source: Aim Admission Document, Zeus Capital

■ **Valuation services:** SimplyBiz acts as a panel manager through its Gateway subsidiary to 16 per cent of the UK building society sector and operates a survey and valuation panel of over 50 firms covering England, Scotland and Wales. Sonas Surveyors is its in-house employed workforce, comprising 54 employed surveyors operating in England and Wales.

Both businesses are appointed to the majority of major banks and building societies. The flexible model of using employed surveyors and an external panel has enabled the business to expand and contract as the market has fluctuated. The unit earns an average fee of £167 per survey and carried out 35,300 surveys in 2017, up from 28,700 the year before, to generate revenue of £6m in the 2017 financial year. This accounts for more than a quarter of the distribution channel's revenues.

The £4.8m acquisition of Landmark Surveyors in January 2018, a business complementary to Sonas Surveyors, should help valuation services exploit the ongoing structural shift in the market to the intermediary sector.

Distribution channel: Valuation services

Valuation services	2015	2016	2017
Number of surveys	28,700	32,900	35,300
Average fee per survey	£188	£167	£167
Revenue (£m)	£5.5m	£5.5m	£6.0m

With the benefit of the Landmark acquisition...

Valuation services	2018E	2019E	2020E
Number of surveys	64,100	67,300	70,600
Average fee per survey	£167	£167	£167
Revenue (£m)	£10.7m	£11.2m	£11.8m

....revenues could double by 2020

Source: Aim Admission Document, Zeus Capital

■ **Protection insurance and general insurance:** Members are offered access to a protection and a general insurance panel. They receive competitive product terms, negotiated centrally, while the product providers benefit from efficient distribution of products and support with training and origination of policies.

SimplyBiz provides specialist software and a range of training and business development services that are designed to increase productivity and efficiency for members advising on insurance products. Take-up by eligible members doubled from 30 per cent to 60 per cent in 2017, following a sustained marketing and sales campaign. In the short term, this has depressed the average revenue per member, but it's reasonable to expect strong revenue growth in this high-margin service this year and beyond as members increase their use of the panel.

Distribution channel: Insurance panel

Insurance panel	2015	2016	2017
Membership	2,962	3,216	3,433
Participation (%)	25	30	60
Revenue per eligible member	£1,822	£1,942	£1,219
Revenue (£m)	£1.3m	£2.0m	£2.1m

With new members using the panel more and greater participation...

Insurance panel	2018E	2019E	2020E
Membership	3,605	3,785	3,974
Participation (%)	65	70	75
Revenue per eligible member	£1,400	£1,500	£1,600
Revenue (£m)	£2.6m	£3.0m	£3.1m

....revenues could rise by half by 2020

Source: Aim Admission Document, Zeus Capital

■ **Verbatim investment products:** SimplyBiz launched Verbatim in 2010 to provide retail clients with packaged investments that meet clear risk-managed objectives over a medium- to longer-term time-frame. Verbatim initially launched with five growth portfolio funds and one income portfolio fund.

The portfolio funds are matched to an independent investment process so that advisers are able to understand the risk-managed investment mandate, have visibility of the fund holdings and independent attribution analysis. The funds are managed to bespoke mandates by outsourced investment managers Liontrust, Sarasin and Architas.

Verbatim's approach of delivering a client-focussed investment solution, with high levels of transparency for financial advisers, is proving attractive. By the end of 2017, more than 1,000 IFAs had placed an investment with Verbatim, leaving the opportunity to promote the products to the remaining 1,000 investment firms within the membership.

Interestingly, around 18 per cent of IFAs who have placed an investment with Verbatim have assets under management (AUM) in excess of £500,000. SimplyBiz's directors believe there is significant opportunity to increase AUM with the existing IFA users of Verbatim. The Verbatim Portfolio Funds are available on all major platforms and several insured product wrappers, providing new or existing clients with a wide range of opportunities to use the solutions, too.

The fund range holds Lipper Leaders' ratings of 4 or 5 for consistent returns compared with peers. They are also risk-rated as meeting a consistent advice process by leading adviser research companies Defaqto, Synaptics and Distribution Technology.

The fund range is proving popular with the clients of intermediaries. For instance, when Verbatim acquired a multi-index passive fund range, Total Clarity, it had £10m AUM in 2013. This has since grown to £130m. Two years later, Verbatim launched a discretionary model management service on a single purpose platform, which was subsequently extended to a range of third-party platforms. It now has AUM of £65m. In fact, Verbatim has increased its AUM from £349m in 2015, to £424m in 2016, rising to £582m in 2017.

Distribution channel: Verbatim Asset Management

Insurance panel	2015	2016	2017
Membership	2,962	3,216	3,433
Participation (%)	9	20	24
AUM	£349m	£424m	£582m
Revenue (£m)	£0.8m	£1.1m	£1.9m

With assets managed rising and greater participation....

Insurance panel	2018E	2019E	2020E
Membership	3,605	3,785	3,974
Participation (%)	27	29	30
Average AUM	£730m	£880m	£1,030m
Revenue (£m)	£2.2m	£2.9m	£3.4m

....revenues could rise by almost 80 per cent by 2020

Source: Aim Admission Document, Zeus Capital

Importantly, ongoing growth of the Verbatim products is delivering high-margin recurring revenues from a highly-diversified user base and a decent return on capital, too. SimplyBiz only holds a modest amount of regulatory capital, around 0.5 per cent of revenues, for its Verbatim Asset Management business and professional indemnity insurance broking.

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

Key strengths of the business

■ **Defensive non-cyclical recurring revenues.** Intermediaries signing up for compliance, governance and risk services provide SimplyBiz with defensive non-cyclical recurring revenues that are spread across a wide breadth of financial services sectors. So visibility of forward revenues is strong.

■ **High barriers to entry.** The breadth of the packaged service is difficult to replicate and the long-term close relationships with members makes it difficult for new entrants to prise them away. The scale of SimplyBiz's membership is key to securing product enhancements, reducing technology costs and providing the range of services to product providers through the company's distribution channel.

■ **Multiple market drivers for growth.** Significant new regulation for financial intermediary firms is increasing both the importance and range of services that they require. As the market share of financial product sales grows through the intermediary sector, existing and new entrant product providers will see greater benefits from the efficient access to the independent sector provided by SimplyBiz.

Also, Mifid II places additional responsibilities on product providers. This is likely to further encourage them to seek out providers such as SimplyBiz to assist in meeting regulatory responsibilities in a low-risk model.

■ **Regulation light.** The compliance support provided to its members does not constitute regulated advice. The members, who are authorised and regulated by the FCA directly, remain responsible for their advice and all matters of regulatory compliance. There is no requirement for SimplyBiz's intermediary services division to be regulated by the FCA, therefore there is no associated regulatory capital requirement for providing intermediary services. As a result, SimplyBiz operates within a "regulation-light" and "capital-light" business model. Also, it's reassuring to know that when the FCA last looked at the mortgage market there was no requirement for SimplyBiz's Mortgage Club to be regulated either.

■ **High cash-conversion rates.** The beauty of this business model is that it delivers strong and growing margins and over 90 per cent operating cash conversion. In fact, net cash generated from operating activities has marginally exceeded cumulative operating profit over the past three years.

High cash flow conversion

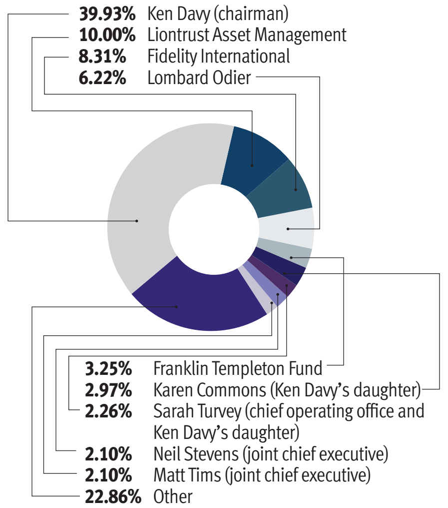
	2015	2016	2017
Underlying operating profit	£7.5m	£8.3m	£9.3m
Net cash generated from operating activities	£8.0m	£7.3m	£10.7m

Source: Aim Admission Document

■ **Track record of successful acquisitions.** In the past 16 years, the company has made seven successful bolt-on acquisitions. With the benefit of an ungeared balance sheet – SimplyBiz had pro forma net funds of £3m on listing (excluding the cost of the IPO) – and access to a low-cost revolving credit facility of £15m charged at 1.8 per cent above Libor, the company has the fire-power to acquire services that are complementary for existing customers. It can also take advantage of attractive market dynamics for consolidation of rivals. The directors are actively exploring these options. Even if the company decided to raise new equity for a larger bolt-on deal, it would still be earnings-accretive on the basis of exit multiples of around eight times cash profits, so would undoubtedly be well received by investors.

■ **High and sustainable margins.** SimplyBiz has an operating margin of 21 per cent and generates north of 46 per cent cash profit margin on incremental revenues. High profit margins enable the company to recycle cash back into product and software development, and reward its new shareholders with a progressive dividend policy.

SimplyBiz's shareholder base



Source: Aim Admission Document, London Stock Exchange filings

Strong shareholder base

SimplyBiz listed its shares on Aim to enhance the profile of the business, assist in incentivising management and employees, provide permanent capital from institutional investors to enable the board to take long-term investment decisions, including making further acquisitions, and to enable Ken Davy, chairman and majority owner, and other shareholders to sell down all or part of their respective holdings.

The company received £26.3m of net proceeds (£30m gross before fees) from a placing at 170p a share in early April, which was used to pay down debt and strengthen its balance sheet to support investment in organic growth and potential acquisition opportunities.

The board and senior management have substantial skin in the game, controlling 46.5 per cent of the share capital. Importantly, the non-management shareholder base now includes more than 40 shareholders below the 3 per cent disclosure limit and a further four large institutional investors, who between them control 27.8 per cent of the issued share capital. This means that the company has a far more diversified shareholder base.

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

True, this means that the top nine shareholders control 77 per cent of the 76.5m shares in issue, so the free float is lower than normal. However, the shares are easily tradable on a bid-offer spread of around 2.5p. The other point worth noting is that, if SimplyBiz delivers the level of profit growth predicted over the coming years, the lower free float is likely to accentuate share price moves on positive news flow. Clearly, it works both ways, but the risk to earnings looks very favourable which mitigates risk.

Major shareholders

Name of shareholder	% of share capital
Ken Davy (chairman)	39.93
Liontrust Asset Management	10.00
Fidelity International	8.31
Lombard Odier	6.22
Franklin Templeton Fund	3.25
Karen Commons (Ken Davy's daughter)	2.97
Sarah Turvey (chief operating officer and Ken Davy's daughter)	2.26
Neil Stevens (joint chief executive)	2.10
Matt Tims (joint chief executive)	2.10
Total	77.14

Source: Aim Admission Document, London Stock Exchange filings

Potential for earnings multiple expansion

Importantly, the potential for SimplyBiz to continue to grow both sides of the business is not being accurately priced in.

That's because, even without the benefit of earnings-accretive bolt-on acquisitions, the potential for the company to lift its underlying operating profit from £9.3m in 2017 to £14.3m in 2020, based on revenues increasing from £44.1m to £59m, is being undervalued by the market.

Please note that the operating profits are expected to rise from £9.3m to £10.8m in 2018, part of which is due to the contribution from the purchase of Landmark Surveyors in January 2018. However, pre-tax profits are forecast to surge from £6m to £10m this year. The difference between the growth in operating profit and pre-tax profit reflects the reduction in the finance charge from £3.3m in 2017 to £0.8m in 2018, as the company paid down substantial amounts of debt on listing. Furthermore, as the company moves into a net cash position there will be no interest to pay in 2019. This means that there is an in-built boost to pre-tax profits in 2019, something investors may not have fully cottoned on to.

"As the company moves into a net cash position, there will be no interest to pay. This means there is an in-built boost to pre-tax profits in 2019"

At the current offer price of 190p, the shares are rated on a modest 12.6 times 2020 earnings estimates, which is hardly exacting for a business that could double EPS from 8.3p to 15p over the next three financial years. Moreover, the ability of the company to convert a high proportion of its profits into cash flow underpins expectations that the board will declare a well-covered dividend per share of 4.3p in 2018, rising to 5p in 2020. The directors' hefty shareholdings mean there is every incentive to do so. On this basis, the prospective dividend yields are 2.3 per cent and 2.6 per cent.

The robust cash generation is set to bolster the company's cash pile, too. After accounting for the annual payout, expect net funds to increase by £13.2m over the 2019 and 2020 financial years to boost net cash to £16.8m, a sum worth 22p a share based on 76.5m shares in issue. This means that at the current price, the shares are being rated on a cash-adjusted PE ratio of 13.7 for 2019, falling to 11 for 2020.

Key financial projections

	2015	2016	2017
Revenue	£38.5m	£40.8m	£44.1m
Operating profit	£7.5m	£8.3m	£9.3m
Operating margin	19.5%	20.3%	21.0%
Finance charge	£1.9m	£3.3m	£3.3m
Pre-tax profit	£5.6m	£5.0m	£6.0m
EPS	na	na	8.2p
Dividend	na	na	na
Net cash position	na	na	na
	2018E	**2019E**	**2020E**
Revenue	£51.1m	£55.0m	£59.0m
Operating profit	£10.8m	£12.3m	£14.3m
Operating margin	21.1%	22.4%	24.2%
Finance charge	£0.8m	£0.0m	£0.0m
Pre-tax profit	£10.0m	£12.3m	£14.3m
EPS	10.5p	12.9p	15.0p
Dividend	2.6p	4.3p	5.0p
Net cash position	£3.6m	£9.5m	£16.8m

Source: Aim Admission Document, Zeus Capital forecasts

It's highly unlikely that the board will just let cash build and not exploit earnings-accretive bolt-on opportunities. For instance, if they were to deploy £17m on acquisitions over the next couple of years, based on an acquisition price of eight times operating profits, this would add more than £2m to forecast pre-tax profits in 2020. This would boost EPS by 2p to 17p and reduce the forward PE ratio to 11. It would still leave the company with an ungeared balance sheet, offering scope for the board to make further bolt-on purchases using the low-cost debt facility.

The point being that, assuming SimplyBiz's shares maintain their forward PE ratio of 16 based on the 170p IPO price and this year's EPS estimates of 10.5p, the share price is set to rise sharply as earnings ramp up and surplus cash flow is recycled into earnings-accretive acquisitions. To put this into some perspective, assuming the company makes £17m of acquisitions by 2020 and delivers

"The share price is set to rise sharply as earnings ramp up and surplus cash flow is recycled into earnings-accretive acquisitions"

EPS of 17p that year, then based on a forward PE ratio of 16 the shares would command a price of 272p, 43 per cent above the current level. And for good measure, shareholders are also in-line for cumulative dividends of almost 12p, to boost the total return to 50 per cent. This implies an annualised shareholder return of 17.6 per cent over the next 30 months.

It's worth flagging up that the shares are attractively-priced on a peer group basis, too.

Peer group comparison

There are four UK-listed financial service providers which have similar sources of revenues, operating margins and 'capital light' business models for a peer group comparison.

- **Curtis Banks (CBP)** administers self-invested personal pensions (Sipps) and small self-administered pension schemes.
- **Mortgage Advice Bureau (MAB1)** distributes mortgages and insurance products through appointed representative firms.
- **Mattioli Woods (MTW)** employs its own advisers and has AUM in excess of £6bn.
- **Tatton Asset Management (TAM)** provides support services to directly authorised firms, has a mortgage club, and in excess of £5bn of AUM.

Peer group comparison

	Curtis Bank	Mortgage Advice Bureau	Mattioli Woods	SimplyBiz	Tatton Asset Management
Share price	306p	624p	795p	190p	234p
Market value	£164m	£319m	£208m	£145m	£131m
2018 PE	17.7	24.1	20.1	18	24.4
2019 PE	15.3	20.7	17.9	14.7	20.7
2018 operating margin	26.4%	12.7%	21.5%	21.1%	44.1%
2019 EPS forecast growth	15.6%	16.8%	17.5%	22.7%	17.8%

Source: Bloomberg

SimplyBiz is by far the lowest-rated company amongst this peer group, trading on a PE ratio of 14.7 for 2019, despite the fact that it's predicted to post the highest (22.7 per cent) EPS growth in 2019. The company's operating margin of 21.1 per cent is similar to Mattioli Woods, but it has no exposure to regulatory risk whereas the latter employs its own advisers.

Tatton Asset Management has the highest operating margin, but as a wealth manager it has £5bn of AUM or nine times that of SimplyBiz's Verbatim asset management business. This means that Tatton's revenues are more highly correlated to financial markets, whereas SimplyBiz's income is mainly based on subscription and

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

licence fees, both of which are non-cyclical and more defensive in nature, thus offering a higher degree of revenue and earnings visibility.

Given the potential for SimplyBiz's faster EPS growth (and that's without factoring in potential for bolt-on acquisitions), a higher proportion of defensive and non-cyclical earnings, and scope to enhance operating margins, the shares are attractively priced on a peer group basis.

Management team

It's reassuring that joint chief executives Neil Stevens (responsible for group strategy) and Matt Timmins (sales and marketing activities) have each been with the company for more than 15 years. They each hold 2.1 per cent equity stakes, so are well-incentivised.

The same is true of Sarah Turvey, who joined SimplyBiz as finance director at its inception in 2002 and has been directly involved in all acquisitions and investments made by the company. She took the position as chief operating officer on admission of the shares to Aim and is now involved in setting and executing corporate strategy, as well as project-managing future acquisitions. Sarah Turvey is the daughter of founder and chairman Ken Davy and holds a 2.26 per cent shareholding. Mr Davy has over 35 years experience in the industry, having created the IFA network concept for financial advisers, taking DBS Financial Management from a start-up to a flotation on Aim, and then a full stock market listing before it was acquired in 2001. He retains a 39.9 per cent stake.

Finance director Gareth Hague has only been with the company for two years, but prior to this he was head of financial reporting at FTSE 250 constituent Pace Technology until it was acquired for £1.4bn in January 2016. With Sarah Turvey's experience in the role, there is significant in-house back-up in the finance department.

Given the nature of the company's activities, the fact that compliance officer Gary Kershaw has been with the business since launch in 2002 is another major positive.

Target price

Having taken into consideration the risk factors outlined below, the probability of SimplyBiz hitting profit forecasts over the next three years, the likelihood of earnings-enhancing acquisitions of complementary service businesses, and peer group comparisons, I feel that a target price of 272p, or 43 per cent above the current level, is achievable on an 18-month basis.

This is based on the company using its surplus cash to make total acquisitions worth £17m by the end of 2020 and on an exit multiple of eight times operating profit to lift EPS to around 17p in the 2020 financial year. I have valued these earnings on a multiple of 16 times, the same multiple the shares were priced at on admission.

In other words, the key driver of the share price over the next 18 months is likely to be an earnings growth story unfolding as profits hit forecasts and acquisitions are made, rather than earnings multiple expansion.

Trading on a bid-offer spread of 187.5p to 190p, I rate SimplyBiz's shares a **buy**.

Risk assessment

No business is without risk and there are several to consider:

■ **Brexit risk:** There are uncertainties surrounding the terms of an exit from the European Union, the time frame for doing so in the event that a transition period is agreed, and the ensuing fiscal, monetary and regulatory landscape in the UK, including regulation of the financial services industry. If there is an economic impact then this would affect levels of investor activity and confidence in the market. In this subdued environment investors are likely to become more cautious, and this could impact the level of business transacted by both financial product providers and intermediaries.

There is a case to be made that intermediaries and product providers will focus more on efficiency gains in an economic downturn, thus making the company's support service proposition even more attractive. SimplyBiz's revenues are largely uncorrelated to economic variables, although an economic slowdown is likely to dampen housing market activity and could impact SimplyBiz's mortgage club and residential surveying business segments.

■ **Material housing market slowdown:** SimplyBiz is less exposed than one would expect. That's because the company doesn't have any exposure to the south east of England housing market which would be the most exposed UK region in a housing market downturn in light of the rampant house price appreciation seen in the past decade. This mitigates risk of a loss of business for SimplyBiz's mortgage club and residential surveying business segments.

It's worth pointing out that in the 2008-09 downturn the company's mortgage club actually gained market share by increasing the market penetration rates, so was largely unaffected by the downturn. There is also a decent stream of remortgage applications for intermediaries to process for clients even if housing market transaction levels soften.

Moreover, the company's surveying business only takes on 75 per cent of the business it is offered, so has a natural buffer in place. It doesn't have any exposure to commercial properties held in SSAS pensions, thus offering another avenue to pick up business. These commercial properties have to be revalued more frequently now to comply with legislation.

■ **Regulatory risk:** The regulatory risk is relatively low as SimplyBiz's clients are directly authorised firms who are themselves responsible for the advice they give their own clients. Only SimplyBiz's Verbatim asset management activity and its general insurance business are regulated activities, and these account for less than 10 per cent of last year's revenues.

■ **Client relationships:** The fact that the attrition rate on the intermediary services division is only 5 per cent highlights a degree of customer satisfaction, as does the fact that the company continues to grow the number of members. Entering into ongoing communication and taking feedback from both the product providers and member firms helps to maintain customer service and satisfaction levels.

■ **Staff retention:** Senior management team and key members of staff have long-term incentives in place as part of their remuneration package in order to maintain staff loyalty and protect the business from a loss of key personnel. The main board has significant shareholdings in the business, thus aligning their interests with those of outside shareholders and acting as a strong incentive to continue to work for the company.

www.investorschronicle.co.uk
telephone: +44 (0)20 7873 3000 email: icalpha.editorial@ft.com

■ **Reputational damage:** If the advice given to members is not accurate and complete then their firms could inadvertently breach their legal or regulatory obligations, the FCA's rules and guidelines, and could be fined by the regulator for their actions. This could lead to a financial loss to their clients, who would seek redress from the intermediary who gave the inaccurate advice. In turn, the member could seek redress from SimplyBiz. To mitigate this risk, the company invests heavily in product development and training of its staff so that they are able to provide member firms with the most accurate advice.

It's possible that a member chooses not to follow the advice given and breaches obligations imposed by law, regulation or FCA rules and guidelines. The member may then be investigated and potentially sanctioned by the FCA. So, even if the company has provided correct and timely advice, the perceived failings may lead to a decline in the use of its services due to damage to its reputation. This could have an adverse effect on the business, results of operations and growth prospects.

■ **Recruitment of new members:** SimplyBiz's business model is based on the company continuing to attract new members and retaining a high proportion of existing ones based on its service offering. Failure to do so could have an adverse financial effect.

The two largest direct competitors for the provision of support services to directly authorised IFA firms are Threesixty, which is controlled by Standard Life Aberdeen and provides services to 822 client firms employing 8,200 advisers; and Bankhall, a subsidiary of Aviva. Combined these two business generated total revenue of less than £13m in their last financial year, highlighting the dominant market position of SimplyBiz and one that is supportive of the company continuing to use its strong market position to attract new members.

■ **Acquisition execution risk:** Making bolt-on acquisitions carries execution risk. The fact that the board of directors have considerable experience, having overseen seven acquisitions since the company was formed in 2002, mitigates this risk to some extent.

■ **Financial risk:** This is relatively low in light of the fact that SimplyBiz has high recurring revenue streams, the placing de-geared its balance sheet to leave it with pro-forma net cash of £3m on listing, and has access to a £15m low interest rate revolving credit facility.

■ **Verbatim operates in a highly competitive environment:** The UK investment management industry is highly competitive. Rivals of Verbatim include global, national and local specialist asset managers, as well as banks and financial services companies, some of which are substantially larger than Verbatim. Verbatim competes on the basis of investment performance, brand recognition, business reputation, range of products offered, quality of service and the level of fees for services.

Any failure by Verbatim to compete effectively in the UK market could lead to a loss of business and/or a failure to win new business, each of which could have an adverse effect on prospects for the business. That said, it has been growing well and the fact that acquisitions made have scaled up is indicative of the quality of the product offering.

■ **Shareholder lock-ins:** The directors have signed lock-in agreements not to dispose of any shares for a period of 12 months after admission. Given the board and parties connected with Mr Davy control around half the issued share capital, any material sale of shares after the lock-in period expires could be at a discount to the market price at the time. That said, if the company delivers as anticipated then it's reasonable to assume that the market price will be far higher in April 2019 when the lock-in expires, thus offering potential for new investors to soak up any stock overhang from director share sales, assuming of course they decide to sell.

■ **Liquidity:** Around 77 per cent of the issued share capital is controlled by only nine shareholders. This lower than average free float means that share price moves are likely to be accentuated. That's not an issue as long as SimplyBiz delivers on earnings forecasts as it's likely to lead to a re-rating in the shares. However, the share price reaction on any earnings miss is likely to be accentuated, too.

Investors Chronicle adheres to a self-regulation regime under the FT Editorial Code of Practice: A link to the FT Editorial Code of Practice can be found at www.ft.com/editorialcode. Many of the charts in the magazine are based on material supplied by Thomson Datastream and S&P Capital IQ.

Registered office: Number One, Southwark Bridge,
London SE1 9HL. ISSN 0261-3115.