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Investors MONTHLY

NOVEMBER 2015

Why **Naspers** is still a buy
Page 22-23

Ivan Glasenberg's comeback plan
Page 28-30

The cracks in **Bill Venter's empire**
Page 24-25

Neal Froneman on his plans **to take over the world**, one mine at a time
Page 14-15

FUND MANAGER FRENZY

Why investors are piling into Sygnia and Anchor Capital

Page 18-21

Magda Wierzycka, Sygnia Asset Managers

DISRUPTIVE IN CLASS – AND THAT'S GOOD

Have investors gone a bit mad about asset management stocks? Not if you look at the differences between them, writes **Marc Hasenfuss**

Older readers will remember the tech boom on the JSE in the late 1990s, a time when sentiment was so frothy that any geek with a laptop was tempted to float an "idea business" onto the JSE.

When the tech tide went out, of course, it exposed a slew of dishevelled companies sans cash flow and hard assets.

Are we witnessing a repeat now in the high-flying wealth management hub of the JSE?

That asset management sector is starting to feel dangerously exuberant. Some market ratings look surreal for a sector that has largely been soberly assessed for most of the past decade.

In the middle of September, asset manager Sygnia, run by Magda Wierzycka, listed on the JSE, sparking a mad rush for its stock.

When Sygnia offered stock to investors in the book-build before the listing at R8,40/share, the offer was oversubscribed by 20 times. That private placement of 31,2m shares aimed to raise R262m. And as soon as Wierzycka blew the horn at the JSE to signal the opening of trade, the stock roared up, gaining an astounding 80% on the day to finish at R16. (Cue "stags" doing merry jigs!)

Clearly, investors are hungry for asset management companies, thanks to the extraordinary success of Anchor Capital (up 320% from R3,50 when it listed in September 2014) and Coronation, up 500% in five years.

Wierzycka says the frenzy for Sygnia shares took her by surprise. "During our prelisting roadshows, the sentiment was lukewarm. My sense is that people came to those presentations, far more people than we expected, and left believing the story. But we never anticipated this," she says.

Magda Wierzycka and her husband Simon Peile at the listing of Sygnia on the JSE.

> Investors are hungry for asset management companies, thanks to the success of Anchor Capital and Coronation

No fewer than 61 institutions applied — hedge funds, asset managers and other wealth managers.

She says it's not that Sygnia underpriced the shares. "We priced it at a price-to-earnings ratio of a shade under 15, and that seemed to be the median. We thought it was fair, and it left a bit on the table, expecting it would appreciate a bit, but not like this," she says.

Is it just that investors have abandoned all reason in their fervour for asset management stocks?

"Well, Anchor was clearly undervalued when it listed. This meant that people who invested in it tripled their money in 12 months, and this created something of a frenzy, because the man-in-the-street investor is now hoping Sygnia can replicate that," she says.

But as the Coronation share price drop attests, it's not as if every asset manager is the flavour of the month.

Wierzycka, who worked at Coronation many years ago, says the investment appetite depends on where the asset manager is in its growth cycle.

"Investors are looking for growth, but Coronation already has strong market dominance. When you're small, R1bn is a lot of money, but when you've got R600bn, it's nothing. So its ability to grow is limited," she says.

This buzz around the sector must have tempted a few other fledgling asset management boutiques to patch together a "uniquely positioned" wealth management listing that can be "premium pitched" to excitable retail shareholders.

But this would be to unfairly diminish the competitive advantage that underpins the stock performance of both Sygnia and Anchor Capital.

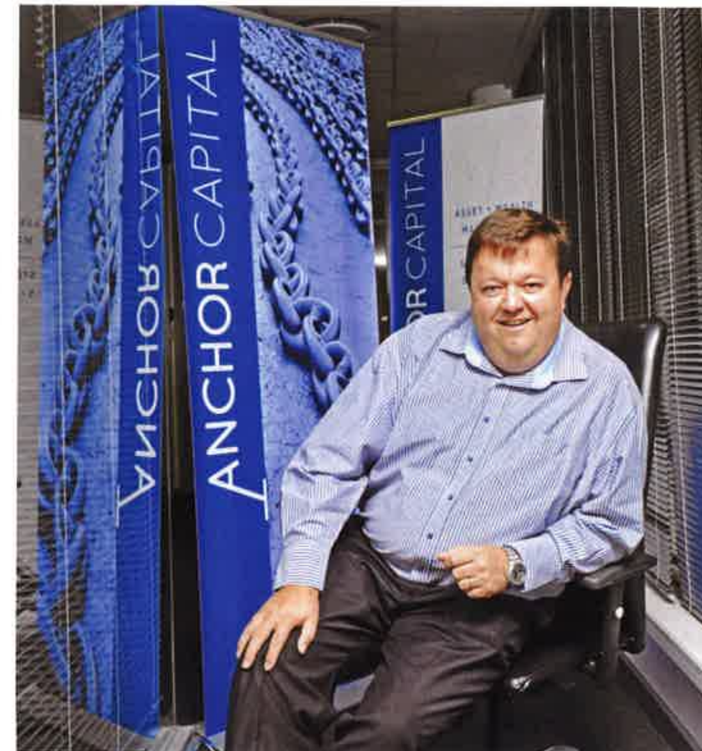
Both have broken with prevailing asset management trends and, as so-called industry disrupters, have attracted loads of investor attention, particularly from retail investors. Both also have the potential for large growth.

Anchor's share register shows a handful of holdings by boutique unit trusts, and Sygnia's private placement was devoured by its own clients and smaller investors.

But this does lead Anchor, headed by mercurial asset manager Peter Armitage, looking pretty pricey.

Armitage's company now trades on a trailing earnings multiple of over 40 times — three times more expensive than the sector "gorilla", Coronation Fund Managers (on a trailing earnings multiple of 13 times).

Even PSG Konsult's rich market rating of 26, which raised eyebrows when it listed on the JSE in June last year, is left in the dust by Anchor.



Peter Armitage ... determined to grow fast. Picture: FINANCIAL MAIL

> The alternative — acquisitions — is exciting but with potential pitfalls, considering each asset manager has its own corporate culture and investment style

Can such euphoria ever be justified?

What is often missed in this debate is that this sort of stock performance heaps pressure on the companies themselves.

Sygnia's shock rise on the JSE has put big pressure on Wierzycka's company — not exactly helpful when you're just feeling your way onto the market.

Wierzycka admits as much. "I don't want to be forced to live up to a ridiculous PE ratio. It's not the strategy of our business to acquire. We need time to grow earnings organically, as opposed to rushing to live up to a rating," she says.

To ease the pressure, it's likely that Sygnia may release more shares into the market soon, considering that only 22% of its stock is listed on the JSE.

Wierzycka says this would create a "healthier" situation, "which would provide more liquidity and perhaps a more representative valuation".

Emotions aside, a tightly operated fund management business should be fairly lucrative.

The business model is solid: established operators typically have sticky client bases, are highly cash generative, operate on sexy margins and are able to produce decent returns on equity thanks to recurring income.

However, there is consensus among industry players canvassed by IM that those asset managers operating under the ominous moniker "CIA" (Coronation, Investec and Allan Gray) probably hold too dominant a position.

This is promising for the second-tier operators, as it means there is scope for a handful of them to make inroads into the CIA's collective market share.

What is less certain, however, is how this market share is gained.

Building market share organically can take years, and requires successive strong performances for clients to really switch on big inflows.

The alternative — acquisitions — is exciting but with potential pitfalls, considering each asset manager has its own corporate culture and investment style. Critically, the "assets", for want of a better term, are the highly skilled staff, who can decide on a whim to walk out of the door (and some of whom do at fairly regular intervals).

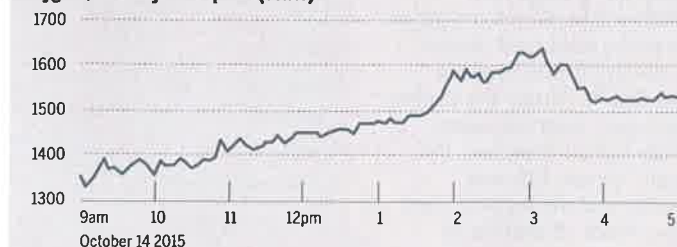
Of course, things can still go awry even at companies that adhere to a disciplined organic growth approach.

Chris Logan, a veteran fund manager who is now CEO of boutique asset manager Opportune Investment, says the local asset management industry can be divided into "players of the past" and "players of the future".

"Some asset managers stick around for long periods, but some companies that previously shook

DREAM DEBUT

Sygnia, intraday share price (cents)



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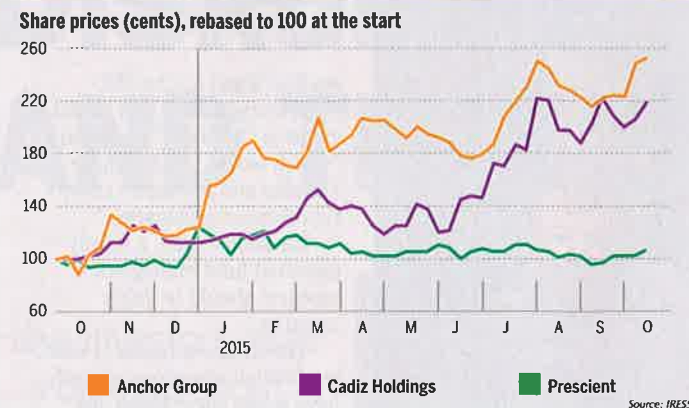

up the industry — like BoE, Syfrets and UAL — have simply faded away," he says.

Logan says that at the same time, some inventive asset managers have come to market with winning formulas that position their businesses well for years to come.

"But these formulas can get embedded so deeply in the culture and ethos that when circumstances shift in the market these companies can sometimes find it difficult to adapt or change."

Indeed, the performances of Anchor and Sygnia must be seen against the fast-changing backdrop of the asset management segment.

A number of niche players, especially those with a deep value bent, have been battling to cope with serious outflows of funds, as prolonged market momentum renders their meticulous stock-picking styles ineffectual.

Cadiz had perhaps the most public fall from grace. Its executives seemed unable to stop the steady leaking of funds under management as its performance dwindled.

Eventually, in April this year, Stellar Capital, an investment company aligned with retail tycoon Christo Wiese, stepped in with a buyout offer pitched below Cadiz's tangible net asset value.

Charles Pettit, CEO of Stellar Capital Partners, is confident that Cadiz can be resuscitated.

"We've bought into a turnaround. It's a tough business, but ultimately there is the chance to secure annuity type income flows, which is the Holy Grail."

Pettit argues that the chances of mega-mergers in the local asset management sector are remote, though a crowded market does mean some consolidation among smaller players is possible.

"At Cadiz, we think we have the right team in place to reverse outflows. We think organic growth is the way to go, and have plans to be disruptive in the market. I won't comment on these plans yet, but Cadiz has a lot of talent in its team that perhaps was not properly utilised before," he says.

> It's a tough business, but ultimately there is the chance to secure annuity type income flows

Sygnia and Anchor might be hogging the spotlight, but investors might do well to look at some of the less-hyped players, who quietly ply their trade in niches that lie outside the shadow of the bigger asset managers.

They include Prescient, PSG Konsult, Vunani, Efficient, Peregrine and the recently listed N-Vest, which all hold viable niches.

Prescient, which has a substantial R67bn of assets under management, trades at an earnings multiple of 12,5 times with a yield of over 5%.

Peregrine, which owns other financial services businesses aside from its asset management hub under Citadel, trades at a 19 times earnings multiple and also offers a yield of over 5%.

The ratings on Efficient and PSG Konsult are a little headier, probably as a result of the market factoring in corporate action.

Vunani has toughed out a prolonged turnaround, and CEO Ethan Dube is determined the company will go it alone.

"Our fund management business is getting close to R20bn, and we are making money off it. Our recently acquired Fairheads business, which is largely an administration business, is stable and capable of generating annual net profit of between R60m to R70m."

Dube, however, rightly warns that there is significant execution risk when undertaking corporate action in the asset management space, where people are key assets.

PSG Konsult, with Jannie Mouton's opportunistic PSG Group as a backer, might be regarded as a prime candidate to move and shake in the sector. But PSG CEO Piet Mouton says its organic growth plan is working just fine.

Mouton sats PSG Konsult's results for the six months to August showed assets under management up a sprightly 17% to R151bn, and assets under administration jumping 21% to R321bn.

But perhaps a more appropriate gauge of sentiment for JSE-listed wealth management stocks is the recent shift in the share price of Coronation, which has been the poster child for listed fund management endeavours.

After a near decade of consistent share price growth, driven by strong earnings and a generous dividend, Coronation this year suffered a sharp downward correction, dropping from a high of around R112 to around R69.

On fundamentals, this seems an unreasonable drop.

Aside from an embarrassing exposure to the collapsed African Bank, there's not much fundamentally unsound about Coronation's business model.

But the downbeat sentiment from Coronation's executives probably spooked investors.

Last November, Coronation CEO Anton Pillay reiterated a warning that investors should expect lower returns from markets.

Pillay reminded investors that Coronation was a cyclical business highly geared to market returns, and shareholders shouldn't expect earnings to grow every year off its high base.

Coronation has lost around 35% of its market value this year, yet its latest trading update suggests assets under management have grown 8% from R588bn from September last year to R636bn by June.

But crucially, Coronation already had R636bn of assets under management at the end of March, which means, for the first time in a long time, it has seen no quarterly growth.

Any suggestion that Coronation has stalled will reinforce the notion that new listings like Anchor and Sygnia are in strong positions to snatch market share away from the giants (including stalwarts like Allan Gray, Old Mutual, Sanlam, Stanlib and Investec Asset Management).

The critical difference between the giants and the new upstarts is that neither Anchor nor Sygnia is just another asset management specialist. Both have an unfettered ambition to grow big by disrupting traditional markets, a tactic that appeals to retail investors looking for high growth stories.

Logan says that Sygnia and Anchor offered new fund management stories when the market was receptive to bolder, game-changing initiatives.

"Certainly both companies are pressing ahead aggressively with plans at a time when some of the incumbents are looking a little jaded."

Nic Norman-Smith, chief investment officer for Lentus Asset Management, says both Sygnia and Anchor have huge operational gearing which allowed growth in assets to flow straight down to the bottom line.

Norman-Smith says Sygnia's low-cost passive investment style could be an enormous advantage in more bullish market conditions.

"The model is very scalable . . . they can grow assets under management without pushing up their costs markedly," he says.

However, critics have asked whether Sygnia might have to sacrifice margins to snag market share.

One senior executive at a large wealth management cluster admits that both Anchor and Sygnia appeal to a broader investment public by successfully dispensing with the carefully crafted stoicism associated with fund management.

"Sometimes we can be boring and management often prefer to stay out of the public eye. But Anchor and Sygnia are 'pure rock n roll' — and clearly reaching the public with their marketing campaigns," he says.

Logan lauds Anchor for its client website — "refreshing in its candour and transparency and a pleasure to engage with". Sygnia's corporate persona is also openly "client-centric".

In the case of Anchor, the steep gains have been underpinned by Armitage's determination to grow the business rapidly, both organically (securing client inflows by chalking up enviable investment performances) and by acquisition (slotting in top boutique fund managers that bring a receptive client base).

As this magazine went to print, Anchor announced it had bought 47,41% of Capricorn Fund Managers (CFM) and CFM Malta for R348m.

CFM brings R6bn in assets under management, adding to

Below: Vunani CEO Ethan Dube. Left: Coronation CEO Anton Pillay.

> Sygnia's appeal is that it cleverly avoids the well-set habits of large fund managers. It looks lean and mean

Anchor's third-quarter tally of R21,4bn.

Sygnia's appeal is that it cleverly avoids the well-set habits of large fund managers. It looks lean and mean, and because of its compelling cost-effective offering the company could gobble up just about anyone's lunch.

The difference between Anchor and Sygnia is essentially scale. Even though Anchor is growing at a rate of knots, it still has R30bn less in assets under management.

Sygnia, on the other hand, has an imposing R127bn of funds under management, ranking it among the biggest fund managers in SA.

There have been some eye-popping predictions for Sygnia and Anchor from some quarters.

Anthony Clark, the outspoken investment commentator from Vunani Securities, has forecast that by 2020 Anchor would hold assets under management of R100bn, earn 300c/share and pay a dividend of 200c/share.

Clark has pencilled in a R50 share price — far higher than its current R15/share.

The long-term prognosis for Sygnia looks equally compelling.

Says one industry insider: "Sygnia is a small, speedy ship measured against some of the large tankers in the asset management industry. Being nimble and able to cut through the wakes of bigger players could easily see Sygnia collecting R140bn assets under management in the short term.

"This would push Sygnia's assets under management to R300bn in the medium term and possibly over R400bn in the longer term, especially if Sygnia targets the private client market with a lower cost pitch."

Besides organic growth, expect Anchor and Sygnia to look for complementary businesses to buy in the next few years, which should keep their larger rivals on their toes. IM