Sigma Capital Group

Results to end Dec 2012

Property services driving growth

Real estate

Sigma's property business is set to deliver large urban-regeneration projects, mainly in partnership with three public sector (Liverpool, Salford and Solihull) and one private client (Edinburgh). Each plans large-scale residential and commercial development over the next 10-15 years. The results confirmed the continued shift in favour of property services as VC Funds is wound down. H2 property revenues were 57% ahead of H1, 143% better y-o-y, reflecting acquisitions and new projects. We forecast further 39% y-o-y growth in FY13, which reflects the scale of the project pipeline and positive news on Edinburgh. The upside hinges on Sigma's ability to secure institutional finance for larger projects of thousands of new homes, none of which are included in our FY13 or FY14 forecasts. Management has worked on the development of new funding models over the last 18 months and sees these coming to fruition later this year.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/11	1.6	(0.8)	(1.74)	0.0	N/A	N/A
12/12	2.3	(1.1)	(2.33)	0.0	N/A	N/A
12/13e	2.6	0.1	0.31	0.0	81.5	N/A
12/14e	2.5	0.2	0.36	0.0	70.1	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Non-property investments in active wind-down

Remaining VC fund interests and non-property investments (Frontier IP) were valued at £1m at end-FY12 following £0.8m of write-downs. We forecast £0.5m of VC fees this year, which may be affected by the timing of portfolio sales (fees depend on holding the stakes for a full year). We expect full realisation of the portfolio this year end and no further divisional contribution from FY14.

Property division growth driven by new contracts

Forecast FY13 property division revenues are based on existing contracts. FY14 includes discussions with local authority partners and progress on planning consent in Edinburgh. Initiatives to secure new sources of institutional funding could unlock a much larger project portfolio and potentially transform revenues and profitability over the medium term. The statement expects positive news on this by the September interims. Sigma aims to facilitate its partners' needs for new housing stock by accessing medium and long-term finance from entities such as private equity houses, pension funds and insurers in a number of possible structures.

Valuation: Catalyst for re-rating approaching fruition

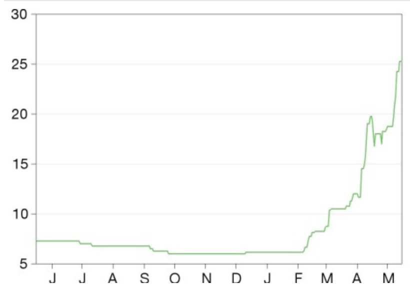
The investment case pivots on potential property division revenues, based on an estimated £3bn pipeline of urban regeneration work for its four joint-venture partners. At agreed fee rates for project management and arranging finance, revenues of £4-5m pa are possible. Development of the new institutional funding model will be the catalyst, especially if it provides a template to finance future residential projects. Recent share strength does not fully discount that potential.

16 May 2013

Price	**25.25p**
Market cap	**£12m**

Net cash (£m) as at end Dec 2012	1.0
Shares in issue	45.6m
Free float	52%
Code	SGM
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	27.9	210.8	242.2
Rel (local)	21.2	193.4	174.4
52-week high/low		25.25p	6.00p

Business description

Sigma provides urban regeneration, property development, financing and asset management services to a contracted private and public-sector client base, the latter in Liverpool, Salford and Solihull. A VC fund management arm is in wind-down.

Next events

AGM	June 2013
Interims	September 2013

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Edison profile page

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FY12 results: Property picking up as VC winds down

Sigma grew its core property operation in FY12. Property division revenue was 143% up y-o-y at £1.48m, VC funds 20% lower at £0.85m. Underlying group revenue (from services) was 40% up y-o-y in FY12 at £2.33m, excluding £0.83m of realised and unrealised losses (FY11: £0.12m realised loss less unrealised profit) on revaluation of VC investments.

The revaluation resulted in a £1.1m operating loss (FY11: £0.12m loss), while another £0.11m deficit related to its holding in Frontier IP (FY11: £1.31m loss and provision). As a result, Sigma's total FY12 pre-tax loss was £1.17m (FY11: £1.42m loss). Administrative costs included a write-back of £0.159m incurred on the North Solihull development. Adjusted for that, administrative costs were 14% higher y-o-y, mainly due to the inclusion of a full year of Sigma Inpartnership.

Exhibit 1: Results summary

	FY11	FY12
Property service revenue	606	1,479
VC funds revenue	1,862	847
Revenue from services	2,468	2,326
Loss on disposal of equity investments	(123)	(7)
Unrealised losses on revaluation of VC investments	3	(826)
Discontinued operations	59	0
Compensation receipt for Sigma Sustainable Energy Fund II	0	0
Total revenue	**2,407**	**1,493**
Administrative expenses	(2,407)	(2,575)
Goodwill impairment	(123)	0
Loss from operations	**(123)**	**(1,082)**
Net interest income	15	22
Loss on disposal of controlling interest in Frontier IP	(79)	0
Share of loss of associate	(228)	(111)
Provision against holding in Frontier IP	(1,000)	0
Loss before tax	**(1,415)**	**(1,171)**

Source: Sigma Capital group FY12 results

Exhibit 2 below sets out the progression of revenues on a half-yearly basis. This illustrates how steadily revenue from property services has grown into Sigma's largest division over the last four six-month periods. Divisional performance was boosted by the first full-year contribution from InPartnership, acquired in August 2011. Revenues from the venture capital funds fell as the division was wound-down and its investments sold.

Exhibit 2: Breakdown of divisional results over last four half-years

	H111	H211	H112	H212
Property service revenue	219	387	576	903
VC funds revenue	560	502	514	333
Revenue from services	**779**	**889**	**1,090**	**1,236**
Loss on disposal of equity investments	(117)	(6)	(7)	0
Unrealised losses on revaluation of VC investments	(106)	109	(277)	(549)
Discontinued operations	0	59	0	0
Compensation receipt for Sigma Sustainable Energy Fund II	800	0	0	0
Total revenue	1,356	1,051	806	687

Source: Sigma Capital Group FY12 results

Balance sheet: £1m of cash at end-FY12

Net assets fell to £2.6m at end-FY12 (FY11: £3.8m), or 5.7p/share (FY11: 8.2p), reflecting write-downs and losses on sales of VC investments. The investment in VC funds was valued at £0.69m (FY11: £1.48m), spread across four of the funds managed by Sigma, with investments in 16 companies (FY11:17). The group also held shares in AIM-listed Frontier IP Group, valued at £0.3m at end-FY12; the share price has since fallen from 14p to 8.25p (mid-market).

There was £1m of net cash at the year end (FY11: £1.3m). Cash outflows included a payment of £0.28m to the limited partners of the Venture Fund, which satisfied that commitment in full. Other changes in working capital resulted in a £0.17m cash inflow (FY11: £0.57m outflow), while net proceeds from investment sales generated £0.06m (FY11: £0.12m). Forecasts and cash projections are sensitive to the timing of property project development fees and VC fund investment realisations, as well as receipt of any profits from Sigma's partnerships with local authorities. Lead times for cash generation from newer property projects in FY12 are likely to result in net cash falling by c £0.4m in the first half, before recovering in H2.

Sigma Inpartnership did not generate any development profit during FY12. The terms of the acquisition included possible deferred payments to one of the vendors, West Coast Capital (Trading), calculated as a share of future development profit from existing contracted projects at the time of the acquisition, after minimum overhead recovery of £0.825m pa. There was nothing payable to WCCT in FY12, but a proportion of anticipated development profit from 2013 onwards will trigger deferred payments to WCC Trading and these are reflected in our forecasts. Sigma estimates that £0.3m is payable under these arrangements (on projects visible as at August 2012), and has provided for this within current creditors.

Revised forecasts

At this stage, we expect further, albeit less dramatic (in percentage terms) growth in property division revenues over the next two years, to £2.05m in FY13 and £2.49m in FY14. This reflects the growing maturity of the existing business and portfolio. Individual projects are also relatively short term, which provides limited revenue visibility beyond FY14. We have incorporated stronger contributions from existing and new projects in Edinburgh, Salford and Liverpool, with a small (£0.1m) aggregate fall in Solihull, as the North Arran Way project is completed next year. Progress made securing projects within local authority partnerships in Liverpool and Solihull improves revenue visibility for FY13, as has receipt of in principle planning consent in Edinburgh.

Our newly published FY14 forecasts include contributions from these new sources, plus further work from the project pipeline, which is well ahead of previous years at this stage. However, we expect a small fall in overall group revenues in FY14, as these include no contribution from VC funds after FY13. Property services growth will not entirely make up the difference, subject to the progress of new funding models discussed below.

We also assume that some central costs relating to and currently paid by the VC Fund division will continue after the latter division is closed (saving c £0.3m pa of direct costs) and its investment assets sold. The ongoing costs relate to office space and administrative expenses previously shared across the two divisions.

Exhibit 3: Changes to forecasts

	Revenue			PBT			EPS			Dividends		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
12/11	1.70	-	-	(0.70)	-	-	(1.60)	-	-	0.0	0.0	-
12/12	2.28	2.33	2%	(0.59)	(1.06)	79%	(1.30)	-2.33	79%	0.0	0.0	-
12/13e	2.69	2.57	-5%	0.20	0.14	-30%	0.40	0.31	-23%	0.0	0.0	-
12/14e	-	2.49	-	-	0.16	-	-	0.36	-	0.0	0.0	-

Source: Edison Investment Research forecasts

These figures do not include any contribution from larger residential contracts with local authority partners, which pivot on the success of new institutional funding models currently under negotiation. Our current P&L forecasts also assume the VC arm will be fully wound down by end-FY13, with all investments exited.

Property: Sole source of group revenues from FY14

The division provides Sigma with two ongoing revenue sources: fees for the management of development projects on behalf of private and public sector clients; and equity shares in the value it adds to its partners' assets. FY12 revenue growth reflected both the full contribution from the InPartnership acquisition, and a business still at a relatively early stage.

Sigma's acquisition of Inpartnership (renamed Sigma Inpartnership) in August 2011 for £0.35m brought it its three local authority partnerships in Liverpool, Salford and North Solihull, established to deliver large-scale residential and commercial urban developments. This was the key component of the group's strategic refocus on property finance, residential and commercial development, and urban regeneration.

Property division revenue growth in FY13 and FY14 reflects the new JVs established for residential and commercial property development in FY12 and early-FY13. These have secured more of the project pipeline and broadened the group's exposure across projects and property sectors.

The increase in expenses in FY12 reflects a full year of Sigma InPartnership, additional recruitment, work on the new funding model and a lower contribution to central costs from VC Funds from FY14.

Exhibit 4: Property division results and forecasts

	FY09	FY10	FY11	FY12	FY13e	FY14e
Adjusted revenues	0.78	0.32	0.61	1.48	2.05	2.49
Expenses	(0.96)	(0.69)	(1.27)	(1.52)	(1.87)	(2.14)
Trading profit	(0.18)	(0.37)	(0.66)	(0.04)	0.18	0.35

Source: Sigma Capital group reports, Edison Investment Research forecasts

Divisional performance could be materially affected by agreements on new contracts in its partnerships and by delivery of the new funding model discussed below, which is designed to enable the group to bring substantial residential developments to fruition.

Project progress across all partnerships

In Salford, Sigma agreed terms for further homes in Higher Broughton and obtained detailed planning consent in June 2012 for a £9m healthcare and retail scheme, which includes a 4,000sq ft food store pre-let to Tesco. The partnership sold six acres of land to Countryside Properties, which started construction of 80 new family homes in late-November 2012. The base fee for Sigma over the next three years is £0.35m, with potential for a further £0.15m as units are sold.

In May 2012, the group established a new joint venture with commercial property developer Neptune Developments to accelerate regeneration of commercial sites, and it is working on a proposed flagship regeneration project in Liverpool's city centre. In March 2013, it formed a second JV in Liverpool, Countryside Sigma, with house builder Countryside Properties (UK) to focus on delivery of the residential regeneration component. Sigma has so far completed 115 homes at the Norris Green site and the third phase of 63 homes (Countryside Sigma) moved onsite in March 2013. A detailed planning application was submitted for a fourth phase of 167 units in January 2013.

In Edinburgh, where Sigma is retained by a private, not a local authority client, planning permission in principle has been granted for the Winchburgh development. This is an important milestone, which starts a 15- to 20-year construction programme, and Sigma has been contracted for an initial five-year period to provide development management services. The development, on a 350 hectare site, is one of the UK's single largest residential and mixed use developments, worth an estimated £1bn in total. The development is expected to be phased over the next 15 to 20 years. Sigma has been retained as development manager for the project implementation stages, which should generate fees of £1.8m over the five years from 2012-16. There is also potential to generate additional carried interest incentive fees based on profit targets.

New funding models: Potential catalyst for strong growth

At this stage, we have not included any contribution from major new residential projects. Despite recent growth, the scale of the current project portfolio is still only a small proportion of the JV partners' total regeneration goals. The group is in place to be retained as project manager on a potential £2bn project pipeline over the next 10-15 years in three established local authority JVs in Liverpool, Solihull, Salford. In Edinburgh, Sigma has been retained by a private entity to project manage the Winchburgh development, one of the UK's largest residential and mixed use developments with an estimated c £1bn GDV. Via these four entities, Sigma potentially controls the delivery of over 10,000 new houses.

Sigma's role can, in addition to project management, include procuring development finance, so its success in this respect could both significantly increase the scale of the projects in which it is engaged and secure a valuable additional revenue stream. The established fee structure (3.5% of gross development cost and 2% of any funding secured) suggests a potential £4-5m pa revenue stream is feasible.

In order to access this larger portfolio, the group has actively pursued the development of new property finance funding models over the last two years. Sigma has devoted significant management resources to initiatives to generate new sources of property finance required to fund proposed developments of thousands of new homes in a relatively short time frame.

Exhibit 5: New institutional funding models under discussion

Basis	Outline structure
Secure long-term revenues	Long-term development loan, with debt service covered by secure long-term income streams, eg rents guaranteed by a housing association on a social housing development.
Capital growth	Where revenues are derived from private tenants, it would capitalise on UK residential rental market strength and enhance returns from medium-term capital value growth.

Source: Sigma Capital group, Edison Investment Research

These projects are principally residential developments for the private rental market, for which Sigma has sought institutional and private equity finance. Sigma Inpartnership is talking to alternative sources such as institutional (large insurers) and private equity providers to structure project revenues to suit their specific funding requirements. Management reports that discussions have been encouraging and that it hopes to see traction by its September interims.

The proposed funding structures seek to take advantage of the current strong UK rental market and outlook for capital value growth, assisted by base values with low entry costs; and the potential for long-term income, secured by housing association covenants. Delivery of these should enable it to materially scale up the value of the development work for which it is retained as project manager, with a positive impact on fee income and potential profit shares.

The group has also stated that it is working on opportunities to finance commercial and infrastructure projects. These similarly seek to unlock new sources of institutional and private equity funding, although no details have been disclosed. The first of these is a student accommodation scheme in Edinburgh, which needs £7m of construction finance.

VC division: Intention to exit in FY13

Six funds under management, 16 remaining investments

Sigma is actively seeking to dispose of its residual VC investments. It manages four VC funds, in which it has a limited partner interest and two university funds. The VC funds come to the end of their lives during the period to June 2015. The investment team's focus is to manage the process of realising value from 16 remaining investments held in these funds. It is working with investee company management teams and co-investors on these entities' business and exit strategies.

In FY12, the sale of portfolio company Extramed generated a small payment for the group and after the year end, i-design Group was sold to Cardtronics, Inc, which returned c £0.2m to Sigma. The group made a £0.8m provision in FY12 against the carrying values of its holdings in the equity funds it manages; the carrying value is now below its share of the NAV of the equity funds.

Further realisations are expected in FY13 and Sigma has engaged advisors in respect of the potential sale of two other investee companies. Any cash generated will be reinvested in the property division, but it is important to note that growth of the latter division is not predicated on the receipt of income from this source.

The venture capital fund management business is expected to generate further cash flows in FY13 from a mix of annual management fees, investee company retainers and corporate finance fees payable on investment sales. This division is potentially exposed to further falls in the value of its investment in its VC funds and its holding in Aim-listed Frontier IP, a small early-stage company. Sigma made a provision against its investment in FY11 to reflect the risks and the shares' illiquidity. At end-FY12, Frontier IP's shares stood at 12p/share (bid price); Sigma's holding in the group balance sheet is equivalent to 9p per share. The shares are currently 8p bid, which would reduce the value of the group holding from £0.31m to £0.28m, although we have not included any adjustment for this in our forecasts.

Our forecasts assume the group will have fully exited its VC funds business in FY13. However, we have included £0.2m of residual expenses in FY14 forecasts, which relate to its notional share of office and other costs.

Exhibit 6: VC Fund division results and forecasts

	FY11	FY12	FY13e	FY14e
Adjusted revenues	1,062	847	520	0
Expenses	(1,138)	(1,060)	(570)	(200)
Trading profit	(76)	(213)	(50)	(200)

Source: Sigma Capital group reports, Edison Investment Research forecasts

Valuation: Upside potential in £3bn of developments

Recent share price strength reflects the ongoing transformation of the group into a standalone property advisory business, with diminishing dependence on income from the VC funds and other investments to support its growth ambitions. We assume property will be the sole operation from FY14. The investment case pivots on management's ability to secure a consistent flow of new projects from the c £3bn estimated development pipeline in its four joint ventures, and complete these over the next 10-15 years. If it achieves this, it could generate c £4-5m pa of fee income and, if it secures funding for, say, 10% of that, possibly another £0.3-0.4m pa of commissions.

The property division requires little working capital, as all projects including preparatory work such as obtaining planning consent are funded by the individual partnerships. Recent growth in the project pipeline suggests this division will make a trading profit in each of the next two years. We have not built VC exits into our projections. Realisations at 50% of book value would generate c £0.35m, but exit timings would affect retainer fees. Even after recent share price growth, the current £12m market capitalisation does not fully reflect the potential. If there is positive news on the new sources of institutional finance over the next three to four months, we will revisit our forecasts in the light of the potential realisation of a steady stream of fee income from a substantial pipeline of urban regeneration projects for at least the next decade.

Exhibit 7: Financial summary

£'000s	2010	2011	2012	2013e	2014e
December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	1,836	1,607	2,326	2,570	2,490
Cost of Sales	(55)	0	0	0	0
Gross Profit	1,781	1,607	2,326	2,570	2,490
EBITDA	(563)	(781)	(226)	150	161
Operating Profit (before amort. and except.)	(563)	(800)	(249)	135	155
Goodwill & Intangible Amortisation	(1,366)	(123)	0	(18)	(18)
Provisions & other	0	800	0	0	0
Exceptionals	0	0	0	0	0
Operating Profit	(1,929)	(123)	(249)	117	137
Net Interest	31	15	22	6	8
Unrealised profit/(loss) on revaluation of investments	(417)	0	(833)	0	0
Provisions/other losses	(1,250)	(1,307)	(111)	0	0
Profit Before Tax (norm)	(949)	(785)	(1,060)	141	163
Profit Before Tax (FRS 3)	(3,565)	(1,415)	(1,171)	123	145
Tax	(10)	0	0	0	0
Profit After Tax (norm)	(959)	(785)	(1,060)	141	163
Profit After Tax (FRS 3)	(3,575)	(1,415)	(1,171)	123	145
Average Number of Shares Outstanding (m)	46.6	44.2	45.6	45.6	45.6
EPS - normalised (p)	(2.0)	(1.7)	(2.3)	0.3	0.4
EPS - normalised and fully diluted (p)	(2.0)	(1.7)	(2.3)	0.3	0.4
EPS - (IFRS) (p)	(7.6)	(3.2)	(2.6)	0.3	0.3
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	97.0	100.0	100.0	100.0	100.0
EBITDA Margin (%)	-30.7	-48.6	-9.7	5.8	6.5
Operating Margin (before GW and except.) (%)	-30.7	-49.8	-10.7	5.3	6.2
BALANCE SHEET					
Fixed Assets	4,281	2,251	1,645	1,412	583
Intangible Assets	2,209	322	614	596	578
Tangible Assets	15	41	26	11	5
Other - investments, financial assets etc	2,057	1,888	1,005	805	0
Current Assets	2,408	2,304	1,833	2,098	2,357
Trading investments	53	172	45	5	5
Debtors	389	606	688	1,000	1,100
Cash	1,821	1,265	1,024	1,093	1,252
Other	145	261	76	0	0
Current Liabilities	(1,007)	(802)	(881)	(800)	(900)
Creditors	(1,007)	(802)	(881)	(800)	(900)
Short term borrowings	0	0	0	0	0
Long Term Liabilities	0	0	0	0	0
Long term borrowings	0	0	0	0	0
Other long term liabilities	0	0	0	0	0
Net Assets	5,682	3,753	2,597	2,710	2,040
CASH FLOW					
Operating Cash Flow	(1,622)	(379)	(292)	(127)	161
Net Interest	33	15	22	6	8
Tax	0	0	0	0	0
Capex	0	0	0	(10)	(10)
Acquisitions/disposals	50	(142)	29	200	0
Financing	(158)	(50)	0	0	0
Dividends	(94)	0	0	0	0
Net Cash Flow	(1,791)	(556)	(241)	69	159
Opening net debt/(cash)	(3,612)	(1,821)	(1,265)	(1,024)	(1,093)
HP finance leases initiated	0	0	0	0	0
Other	0	0	0	(0)	0
Closing net debt/(cash)	(1,821)	(1,265)	(1,024)	(1,093)	(1,252)

Source: Edison Group forecasts

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